

Tax Update Special Edition

NUMBER 131 • DEC 2007



THE TAX UPDATE IS A
BI-MONTHLY E-NEWSLETTER
PUBLISHED BY THE
PENNSYLVANIA
DEPARTMENT
OF REVENUE
THOMAS W. WOLF
SECRETARY OF REVENUE
EDWARD G. RENDELL
GOVERNOR



IN THIS ISSUE:

SPECIAL EDITION:

- REVENUE DEPARTMENT
UPDATES REALTY TRANSFER
TAX REGULATIONS *pages 1 & 2*

FAST FACT:

The Realty Transfer Tax amendments are not intended to create a greater tax burden for Pennsylvanians or enhance revenues.

VISIT OUR WEB SITE AT:
www.revenue.state.pa.us

REVENUE DEPARTMENT UPDATES REALTY TRANSFER TAX REGULATIONS

Amendments to the Realty Transfer Tax regulations (61 Pa. Code, Chapter 91) will be published in the *Pennsylvania Bulletin* on Dec 15, 2007. A copy can be obtained from the Pennsylvania Bulletin Web site www.pabulletin.com, and a link will be added to www.revenue.state.pa.us.

The regulations were last amended in 1988. The new regulations contain comprehensive amendments accounting for legislative changes to the Realty Transfer Tax law (Article XI-C of the Tax Reform Code of 1971) and codifying the department's long-standing tax policy on numerous issues.

The amendments provide essential guidance to the public and tax practitioners on the department's administration of the law and its tax policy. **The amendments are not intended to create a greater tax burden for Pennsylvanians or enhance revenues.**

The department has included new definitions and amendments to existing definitions such as: association, child, conversion, corporation, financing transaction and living, ordinary and testamentary trusts. The amendments address the 1994, 1997 and 1998 statutory changes to the act that relate to family farm corporations and partnerships and living and ordinary trusts. The department has also prescribed rules explaining when a document that merely evidences the change in a business entity's name or form is considered a confirmatory deed and is excluded from the imposition of tax. These rules incorporate the department's application of the Pennsylvania Commonwealth Court's holding in *Exton Plaza Associates v. Com.*, 763 A.2d 521 (Pa. Cmwlth. 2000).

Other topics the amendments address are: timber sales, documents that evidence the transfer of real estate by operation of law, the treatment of qualified intermediaries and exchange accommodation titleholders in Internal Revenue Code § 1031 like-kind exchanges, sale and leaseback transactions, transfers in bankruptcy proceedings and the department's application of the Pennsylvania Supreme Court's holding in *Baehr Bros. v. Com.*, 409 A.2d 326 (Pa. 1979).

In addition to the amendments, the department has added various examples to explain and clarify the application of the existing regulations and new amendments to specific fact patterns.

During the regulatory process, the department received a number of questions from tax practitioners and the business community regarding the application of some of the regulatory amendments. Those questions and the corresponding responses are as follows:

Question #1 - The regulations codify the department's position that a qualified intermediary or exchange accommodation titleholder acting as "parking entity" in Internal Revenue Code § 1031 like-kind exchange is not considered an agent or straw-party. Will this position result in multiple taxable events in such an exchange?

Response – Yes. Multiple taxable events can result in a like-kind exchange involving a parking entity that takes and holds title to real estate. Unfortunately, the current law does not provide an exclusion for transfers from such exchange facilitators. The department recognizes that this can result in a tax burden for parties involved in such transactions and is sensitive to this concern. Therefore, the department intends to pursue a legislative change to the Realty Transfer Tax law to alleviate the current statutory tax burden on such exchanges.

Question #2 – Why do the amendments to the regulations indicate that in a sale and leaseback transaction, the lease will be subject to tax if the lease is for 30 years or more? This is a change to the existing regulations.

Response - The department amended the regulation regarding sale and leaseback transactions to make the regulation conform to current law, which taxes all leases with a term of 30 years or more. The law does not allow a special exclusion for a lease in a sale and leaseback transaction. The department cannot create such exclusions absent a statutory basis for doing so.

The department does not believe the regulatory amendment will create an undue burden on the public. The regulation provides that neither the sale nor the lease, regardless of the term, is taxable in a sale and leaseback transaction designed as a "financing transaction." In the department's experience, most sale and leaseback transactions are structured as financing transactions. Therefore, few sale and leaseback transactions will be subject to tax.

Continued from page 1

The department will monitor the fiscal effect of this regulatory amendment. If the regulation creates a significant tax burden on the public, the department will consider pursuing a legislative change to the law to address the issue.

Question #3 – Will the regulation subject an assignment of a real estate sale contract to tax, such as an intra-company assignment of a sale contract (i.e., a transfer of an agreement between 100 percent directly or indirectly commonly owned entities?)

Response – No. The department has never sought to impose tax on an “intra-company assignment of a sale contract” when one business entity in a corporate structure acts as a facilitator or intermediary for the benefit of another business entity in the corporate structure in a real estate acquisition, assigning a sale contract for no or nominal consideration. The amended regulations do not seek to impose tax on such transactions. The regulations do seek to impose tax on the full value of multiple transfers of real estate for consideration that are disguised as a single transaction through the assignment of sale contracts (“flipping transactions”). The department will publish further guidance on the application of the regulations in relation to the assignment of sale contracts in the near future.

The department has not published transitional rules for the implementation of the amended regulations because the regulations implement existing tax policy. The department recognizes that the regulations provide greater tax guidance regarding tax policy in certain tax areas that were not readily available to the public prior to the publication of the regulation. The department will take that fact into consideration when reviewing transactions that were initiated prior to the published amended regulations.