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Pennsylvania Realty Transfer Tax
No. RTT-06-001
Conversion
Real Estate Company Acquisition

ISSUE

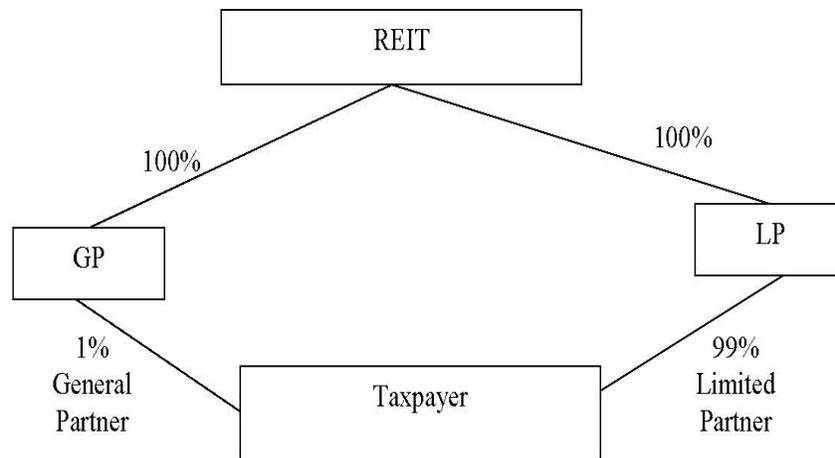
Does a change in form of entities that own interests in a real estate company effectuate an acquisition of the real estate company?

CONCLUSION

No. A mere change in an entity's form, which entity owns an interest in a real estate company, does not result in a change in the real estate company's ownership, and therefore, cannot in itself effectuate the acquisition of a real estate company.

FACTS

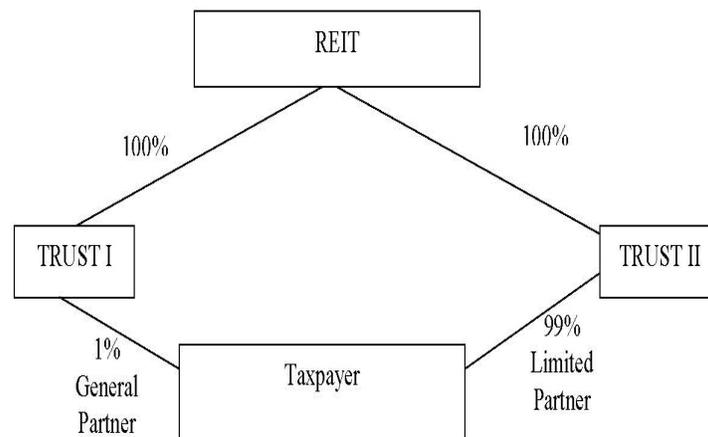
Taxpayer, an out-of-state limited partnership, is a real estate company as defined under Article XI-C of the Tax Reform Code of 1971. Taxpayer's sole asset is real estate located in Pennsylvania (herein, the "Property"). Taxpayer's one percent general partner is "GP" and Taxpayer's ninety-nine percent limited partner is "LP". Neither GP nor LP own real estate located in Pennsylvania. The sole shareholder of both GP and LP is a real estate investment trust (herein, "REIT"). The ownership structure is illustrated below:



REIT plans to change GP and LP's business forms from out-of-state corporations to out-of-state real estate investment trusts. To accomplish the restructuring, the following series of steps will be undertaken:

1. The REIT will organize and own 100 percent of the beneficial interests of two new out-of-state real estate investment trusts, (respectively, "Trust I and Trust II").
2. GP will merge with and into Trust I ("Merger I").
3. As a result of Merger I, Trust I will be wholly owned by the REIT. Trust I will hold title to all of the property of GP. Trust I will succeed to all of the debts and obligations of GP. Any liens existing on GP's assets will be unaffected by Merger I. Any claim existing or action or proceeding pending by or against GP may be prosecuted to judgment against Trust I. GP is not required to wind up its affairs or pay its liabilities and distribute its assets because its separate existence ceases by virtue of Merger I.
4. LP will merge with and into Trust II ("Merger II").
5. As a result of Merger II, Trust II will be wholly owned by the REIT. Trust II will hold title to all of the property of LP. Trust II will succeed to all of the debts and obligations of LP. Any liens existing on the LP's assets will be unaffected by Merger II. Any claim existing or action or proceeding pending by or against LP may be prosecuted to judgment against Trust II. LP is not required to wind up its affairs or pay its liabilities and distribute its assets because its separate existence ceases by virtue of Merger II.

Immediately after these steps, Trust I as a one percent general partner, and Trust II, as a 99 percent limited partner, will own Taxpayer. Both before and after the transactions described above, REIT (through its ownership of Taxpayer's general and limited partners) will indirectly own 100 percent of Taxpayer as illustrated in the chart below:



DISCUSSION

This case involves the change in form, or "conversion", of entities that own a real estate company.

Under Article XI-C of the Tax Reform of 1971, a real estate company becomes an acquired company and realty transfer tax is due on the value of the real estate that the company owns if there is a change in ownership in the company that does not affect the continuity of the company within a three year period and has the effect of transferring, directly or indirectly, ninety percent (90%) or more of the ownership in the company.
72 P.S. § 8102-C.5.

Because Taxpayer is a real estate company, if GP and LP convey their interests in Taxpayer to other entities or people, Taxpayer will become an acquired company and the acquisition would be subject to realty transfer tax.

In this case GP and LP intend to change their business forms from corporations to real estate investment trusts. This will be effectuated by merging GP and LP into two separate real estate investment trusts, Trust I and Trust II, respectively. The trusts will be created as "shell" business entities solely for the purpose of merging with GP and LP and changing GP and LP's business forms. Following the mergers, Taxpayer's ownership will change from GP and LP to Trust I and Trust II. As a result, the mergers ostensibly effectuate a taxable acquisition of Taxpayer.

However, in Exton Plaza Associates v. Commonwealth, 763 A.2d 521 (Pa. Cmwlth. 2000), the Commonwealth Court refused to hold that realty transfer tax could be imposed upon a document that evidenced the transfer of real estate from a general partnership to a limited partnership as part of the conversion of the general partnership to the limited partnership where the property rights of the principals in the general partnership remained unchanged after the conversion.

Based upon the holding in Exton Plaza, it is the policy of the Department that deeds that are made without consideration and solely for the purpose of confirming a change in the form or identity, or merger or consolidation, of an association are excluded from realty transfer tax under the following conditions:

- (1) if without the making of any document:
 - (i) the resultant entity is vested with all the property, real, personal and mixed, and franchises of, and the debts due, the original association or, in the case of a merger or consolidation, each party thereto;
 - (ii) the resultant entity is subject to all the obligations of the original association or, in the case of a merger or consolidation, each party thereto;
 - (iii) liens upon the property of the original associations or, in the case of a merger or consolidation, each party thereto, are not impaired by the change in form; and
 - (iv) any claim existing or action or proceeding pending by or against the original association or, in the case of a merger or consolidation, each party thereto, may be prosecuted to judgment against the resultant entity;

(2) the original association or, in the case of a merger or consolidation, each party thereto, is not required to wind up its affairs or pay its liabilities and distribute its assets either because there is no break in the continuity of its existence or because its separate existence ceases with the reformation; and,

(3) considering all the ownership interests in the original association or, in the case of a merger or consolidation, each party thereto, there is no change in proportionate ownership interests resulting from the change in form.

The reasoning of the Court was that an entity which merely changes its form has not changed in substance. Although the holding in Exton Plaza specifically applies to confirmatory deeds that change record legal title to real estate from one entity that has converted, or changed its form, to another entity and not specifically to changes in ownership in real estate companies, the Department sees no reason why the legal reasoning in Exton Plaza should not extend to conversions of entities that are owners of a real estate company. So long as the above conditions are met, the Department will not consider a conversion of an entity that holds an ownership interest in a real estate company as a change in ownership of the real estate company.

In this case, GP and LP's conversion to Trust I and Trust II meet the above requirements. Immediately after the merger, the ownership structure of Trust I and Trust II will be identical to the ownership structure of GP and LP. Further, all of the assets and liabilities of GP and LP will be transferred to Trust I and Trust II as part of the mergers. Therefore, GP and LP's merger into Trust I and Trust II, respectively, will merely result in a change in GP and LP's business forms. In all respects but business form, Trust I and Trust II are the same entities as GP and LP. Consequently, there will not be a change in Taxpayer's ownership and there will not be a taxable acquisition.