

April 4, 2008
Pennsylvania Realty Transfer Tax
No. RTT-08-002
Agent-Principal
Rule in *Baehr Brothers*

ISSUE:

When an agent enters into a contract for the purchase of real estate for a principal and subsequently assigns the contract to the principal, will the deed for real estate from the seller to the principal be considered two taxable transfers of the real estate for Pennsylvania Realty Transfer Tax purposes?

CONCLUSION:

The deed will be viewed as one transfer of the real estate from the seller to the principal. The taxable value of the deed is the bona fide sale price for the real estate.

FACTS:

Taxpayer desired to purchase real estate in Pennsylvania and make improvements[1] thereon.

Before Taxpayer acquired any real estate in Pennsylvania, Taxpayer entered into negotiations and subsequently a contract with Contractor for the construction of the improvements.

On May 22, 2006, Taxpayer entered into an Agreement with Contractor's affiliate ("Affiliate"). Relevant provisions of the Agreement include[2]:

1. Affiliate shall act under Taxpayer's direction and approval as Taxpayer's exclusive agent for purposes of:
 - a. identifying suitable real estate upon which the improvements will be constructed,
 - b. conducting due diligence activities related to the identification and acquisition of the real estate, and
 - c. constructing/developing the improvements to the real estate.
2. Taxpayer is liable for any agreements that Affiliate enters into on Taxpayer's behalf.
3. Taxpayer is obligated to reimburse Affiliate for expenses incurred as a result of its services.
4. Taxpayer shall pay Affiliate a fee as described in the Agreement for its services.

Subsequently, Affiliate located real estate in Pennsylvania, owned by Seller, that was suitable for Taxpayer's purposes. Seller is not affiliated with Contractor or Affiliate. On June 15, 2007, Affiliate entered into an agreement ("Contract") to purchase the real estate from Seller for one million three hundred and sixty thousand dollars (\$1,360,000), with a \$50,000 down payment to be made towards the purchase price.[3] Taxpayer issued a check in the amount of \$50,000 to cover the down payment.

The Contract did not disclose that Affiliate was acting as Taxpayer's agent for purposes of acquiring the real estate. The Contract merely provided that Affiliate or its assigns was the purchaser and the party entitled to receive the deed for the real estate. It also contained an "Assignment" clause that provided that Affiliate could assign the Contract to a financial institution with which it had a contractual relationship to act as a consultant.

Affiliate assigned the Contract. Affiliate did not receive any consideration for the assignment

Improvements have not been made to the real estate. Construction of the improvements will not be made until after settlement. Settlement for the real estate is scheduled to be held within a few weeks.

DISCUSSION:

The issue presented in this ruling arises largely as the result of the Department's recent amendments to its Realty Transfer Tax regulations. Specifically, the issue focuses on the applicability of the new regulatory provisions found at 61 Pa. Code § 91.170, which explain the Department's interpretation of the Pennsylvania Supreme Court's holding in Baehr Bros. v. Com., 409 A.2d 326 (Pa. 1979).

The Department has issued guidance as to the applicability of the new regulation. See RTT Tax Bulletin 2008-1. However, questions still exist among the public regarding the regulation and its applicability to assignments of real estate sale contracts.

In its simplest terms, the regulation codifies the *Baehr Bros.* rule that in reviewing a transaction for tax purposes, the substance of the transaction is controlling rather than the form of the transaction. The Department has interpreted the Court's rule to mean that the form of a real estate transaction can be overlooked for purposes of determining the Real Estate Transfer Tax consequences of the transaction.

This rule can be particularly difficult to implement for a tax like the Realty Transfer Tax. The Pennsylvania Courts have held that "[t]he realty transfer tax is a tax upon the transaction, the transfer of title to real estate as evidenced by a document that is to be recorded." Wilson Partners, L.P. v. Com., 723 A.2d 1079 (Pa. Cmwlth. 1999). On the other hand, the Realty Transfer Tax statute contemplates the existence of a taxable document in that it provides for the affixing of documentary stamps. 72 P.S. §§ 8105-C. Further, the statute provides that the documentary stamps must be placed on the taxable document in order for the document to be offered as evidence of a transfer of real estate. 72 P.S. § 8108-C. Consequently, even though there is but one tax, the tax is a combination of a transfer and a document tax.

Because the Statute of Frauds requires a writing for the legal transfer of title to real estate and because Realty Transfer Tax stamps must be placed on a document, the Department has largely been constrained to determining tax liability by focusing on the form of real estate transactions through the documents used to effectuate or evidence the transactions. In other words, the intent of the parties or essence of a real estate transaction is largely irrelevant without a taxable document. Therefore, the Department generally looks to the documents that actually convey or evidence the conveyance of title to real estate.

Nevertheless, Pennsylvania Courts have held that the Realty Transfer Tax is a tax upon a transaction. Therefore, the Department may and arguably is required to look to both documents and transactions to determine tax liability.

Subsection 91.170(b) of the new regulation provides that even when there is only one document, as defined by the statute^[4], upon which stamps are to be affixed, the document can represent, in substance, one or more taxable or non-taxable transactions.

Subsection 91.170(b) provides several examples of the application of the *Baehr Bros.* rule. The first example applies the rule in the context of an assignment of a real estate contract for valuable consideration.^[5] Although the fact pattern in the Example involves an assignment of a real estate contract, the Example does not provide that the assignment document itself is taxable. Documents of assignments are not, in and of themselves, taxable documents under the Realty Transfer Tax statute. Rather, the Example attempts to demonstrate that the ultimate deed of conveyance from the seller to the assignee/buyer can be treated as two taxable transactions—a taxable transfer from the seller to the assignor and a subsequent transfer from the assignor to the assignee/buyer. Thus, the total taxable value of the one document is the sum of the taxable values had both transactions been effectuated by a taxable document. The regulatory provision and Example are not intended to imply that there will always be multiple taxable events in all real estate transactions involving an assignment of a real estate contract. It is only intended to demonstrate that certain documents can represent two or more taxable or non-taxable transactions for Realty Transfer Tax purposes.

This case involves a real estate transaction in which there is an assignment of a real estate contract. The question is whether the assignment, when viewed in connection with the original sale agreement and deed of conveyance evidences multiple taxable transactions.

Under the above facts, Affiliate entered into the Agreement with Taxpayer. The Agreement by its clear terms establishes an agency-principal relationship between Affiliate and Taxpayer. The relationship was established for purposes of identifying and procuring real estate for the Taxpayer. Affiliate was at all times subject to Taxpayer's direction and control. Further, Taxpayer was at all times liable for the agreements entered into by the Affiliate. Further, Taxpayer paid for the down payment on the real estate. The only consideration that Affiliate received was remuneration for its services. Affiliate did not receive any consideration from Taxpayer or make any profit for the assignment of the Contract to Taxpayer. Further, Affiliate did not derive any profit or benefit from the Contract or the real estate.

Based upon those facts, it is clear that Affiliate is acting as an agent for Taxpayer, the ultimate principal. As a result, when Affiliate executed the Contract, Affiliate did so for the benefit of Taxpayer. Therefore, the Contract is Taxpayer's contract and not Affiliate's contract. Further, the right to receive a deed to the real estate under the Contract ultimately belongs to Taxpayer. Affiliate has no inherent right to, ownership of or liability for the real estate except as agent of Taxpayer. Even if Affiliate had taken title to the real estate, it would have done so as agent for Taxpayer. There is no way that Affiliate can claim ownership of the real estate. Further, Taxpayer can not refuse to take title to the real estate or disclaim its ownership of the real estate. In other words, as a matter of equity,

Affiliate can require Taxpayer to take title to the real estate at the end of the agency relationship.

Because of the agency-principal relationship between Affiliate and Taxpayer, Affiliate's assignment of the Contract to Taxpayer merely memorialized or confirmed that which already existed—Taxpayer's ownership of the Contract and right to receive the deed to the real estate.

In substance, then, the deed from Seller to Taxpayer represents only one taxable transaction—a single sale and transfer of the real estate from Seller to Taxpayer through Affiliate acting as an agent for Taxpayer. The taxable value of the deed is the \$1,360,000 bona fide sale price for the conveyance of the real estate. 72 P.S. § 8102-C (definition (1) of "value").

[1] Specifically, the improvements are a new branch office for Taxpayer's operations.

[2] These provisions are paraphrased from the actual provisions of the Agreement.

[3] The purchase price is solely for the land itself and does not include the cost for any improvements that Affiliate is obligated to make on the real estate under the Agreement.

[4] **"Document."** Any deed, instrument or writing which conveys, transfers, devises, vests, confirms or evidences any transfer or devise of title to real estate, but does not include wills, mortgages, deeds of trust or other instruments of like character given as security for a debt and deeds of release thereof to the debtor, land contracts whereby the legal title does not pass to the grantee until the total consideration specified in the contract has been paid or any cancellation thereof unless the consideration is payable over a period of time exceeding thirty years or instruments which solely grant, vest or confirm a public utility easement. "Document" shall also include a declaration of acquisition required to be presented for recording under section 1102-C.5 of this article. 72 P.S. § 8102-C.

[5] *Example 1.* X enters into an agreement of sale with Y for the conveyance of real estate for \$100,000. Y subsequently assigns the sales agreement to Z for \$1 million. X executes a deed for the conveyance of the real estate to Z and receives \$100,000. Y receives \$1 million from Z for the assignment. The taxable value of the deed from X to Z is \$1,100,000. X and Y are jointly and severally liable for the tax on \$100,000 (See § 91.132(c)). Y and Z are liable for the remaining tax on \$1 million. 61 Pa. Code § 91.170(b)(Example #1).