



May 9, 2008
Pennsylvania Realty Transfer Tax
No. RTT-08-004
Corrective Deed
Conversion of GP to LP

ISSUES:

1. Will a deed that conveys title to real estate from Taxpayer No. 1 and Taxpayer No. 2 to a general partnership consisting of Taxpayer No. 1 and Taxpayer No. 2 qualify as a non-taxable corrective deed for Pennsylvania Realty Transfer Tax purposes?
2. Will a deed for real estate from a general partnership to a limited partnership pursuant to an alleged conversion of the general partnership's business form to a limited partnership form qualify as a non-taxable confirmatory deed?

CONCLUSIONS:

1. The deed will qualify as a non-taxable corrective deed for the reasons provided below.
2. The deed will not qualify as a non-taxable confirmatory deed for the reasons provided below.

FACTS:

On April 19, 1993, Taxpayer No. 1 entered into an Agreement of Sale ("Agreement") with LP No. 1, and LP No. 2, to purchase three parcels of real estate and a ground lease. The Agreement designated the parcels as Parcel 1, Parcel 2 and Parcel 3. LP No. 1 owned Parcel 1 and Parcel 3. LP No. 2 owned Parcel 2.

Parcel 2 is the real estate that is subject to this letter ruling. Hereinafter it shall be referred to as the "Real Estate." Parcel 2 is also the parcel of real estate that was subject to the ground lease that Taxpayer No. 1 purchased under the Agreement.[1] The Agreement indicates that ground lease was originally executed on December 8, 1983 between LP No. 2, as lessor, and Lessee, as lessee. The terms and duration of the ground lease were not provided to this Office. Lessee made improvements to Parcel No. 2 in the nature of a building.

The total purchase price for all three parcels and the ground lease was \$1,550,000. Agreement provided an allocation of the total purchase price between all three parcels and the ground lease. The purchase price allocated to Parcel 2 was \$125,000. The purchase price allocated to the ground lease was \$1,090,000.

The Agreement allowed Taxpayer No. 1 to assign his rights in the Agreement without the consent of LP No. 2. It further provided that Taxpayer No. 1 had to notify LP No. 2 in writing of any assignment and that any assignee had to acknowledge in writing to LP No. 2 that the assignee accepted the assignment and agreed to be bound by all the terms and conditions of the Agreement. However, the Agreement also provided that any assignment would not relieve Taxpayer No. 1 of his obligations under the Agreement.

Prior to closing on the purchase of the Real Estate, Taxpayer No. 1 and Taxpayer No. 2 entered into a Partnership Agreement dated July 15, 1993 (the "Partnership Agreement") for the express purpose of creating a general partnership (the "Partnership") to acquire and hold title to property, including the Real Estate. Under the Partnership Agreement, Taxpayer No. 1 agreed to provide day-to-day oversight and management of the Partnership's property. The net income/loss from the Partnership was to be allocated and distributed two-thirds to Taxpayer No. 1 and one-third to Taxpayer No. 2. Within the Partnership, Taxpayer No. 1 held a two-thirds partnership interest and Taxpayer No. 2 had a one-third partnership interest.

Contemporaneously with establishing the Partnership, Taxpayer No. 1 assigned his rights in the Agreement to the Partnership by way of a written assignment dated July 15, 1993 (the "Assignment"). Taxpayer No. 1 provided notice of the Assignment to LP No. 2 pursuant to the Agreement. The Assignment specifically identifies the Partnership as the assignee of the Agreement.

Taxpayer No. 1 and Taxpayer No. 2 secured financing from Bank in the amount of \$1,100,000 to cover a portion of the total Agreement purchase price. Taxpayer No. 1 and Taxpayer No. 2 executed a Mortgage and Security Agreement in favor of Bank. The Security Agreement only indicates that Taxpayer No. 1 and Taxpayer No. 2, as individuals, were the mortgagors. There is no indication that the Partnership was the mortgagor. Taxpayer only provided the first page and signature page of the Mortgage and Security Agreement. Because the complete agreement was not provided, the real estate that was subject to the mortgage was not clear. For purposes of this ruling, it is assumed that the Real Estate was subject to and encumbered by the mortgage.

Settlement on the Real Estate occurred on or about August 20, 1993. The settlement sheet that Taxpayers provided indicates that the purchaser was Taxpayer No. 1 and Taxpayer No. 2. There is no reference on the settlement sheet to the Partnership.

A deed for the Real Estate from LP No. 2 was executed and delivered at settlement. The deed was filed on August 23, 1993. The deed only references Taxpayer No. 1 and Taxpayer No. 2 as the grantees. The deed did not designate the Partnership as the grantee.

Taxpayers allege that the Partnership has made annual tax filings as a "Domestic General Partnership" since its creation in 1993 and has provided the name of the Partnership on the returns as "Taxpayer No. 1 and Taxpayer No. 2" without a designation as a partnership.

Further, Taxpayers allege that the Partnership has maintained and operated the Real Estate as its own.

Given the fact that the Real Estate has been maintained and operated by the Partnership, Taxpayers consider the deed of conveyance from LP No. 2 to Taxpayer No. 1 and Taxpayer No. 2 as a conveyance to the Partnership rather than to Taxpayer No. 1 and Taxpayer No. 2 in their individual capacities. Taxpayers argue that the failure to list the Partnership as the grantee on the deed or omission of a reference to Taxpayer No. 1 and Taxpayer No. 2 as partners to be a scrivener's error, and that title to the Real Estate has always been in the Partnership. Consequently, Taxpayers intend to execute a deed from themselves to the Partnership to correct the record title to the Real Estate.

Once the deed from Taxpayers to the Partnership is recorded, Taxpayers intend to merge the Partnership into a Pennsylvania limited partnership known as LP No. 3. Taxpayers did not submit any documentation to this Office regarding LP No. 3. Nevertheless, Taxpayers assert that Taxpayer No. 1 and Taxpayer No. 2 are limited partners in LP No. 3. LP No. 3's general partner is LLC No. 1. LLC No. 1 is owned entirely by Taxpayer No. 1. Department of State filings for LP No. 3 indicate that the limited partnership was formed on January 3, 2007. LLC No. 1 was created on November 21, 2006. For purposes of this letter ruling, it is assumed that LLC No. 1's sole asset is its general partnership interest in LP No. 3. It is also assumed that LP No. 3 is a shell entity; that is, it does not currently own any assets and has not conducted any business since its creation.

Articles of Merger will be filed with the Pennsylvania Department of State. Thereafter, the Partnership will execute a deed for the Real Estate to LP No. 3.

Taxpayers allege that the merger is designed to effectuate a conversion of the Partnership business form from a general partnership to a limited partnership. Further, Taxpayers assert that the deed from the Partnership to LP No. 3 following the merger should be viewed as a non-taxable confirmatory deed that merely evidences the conversion of the Partnership into a limited partnership.

DISCUSSION:

Although there are two issues presented in this ruling, the main issue to be addressed is whether Taxpayers' proposed merger of the Partnership into LP No. 3 will effectuate a conversion of the Partnership into a limited partnership, and whether Taxpayers can execute and file a non-taxable confirmatory deed for the Real Estate that will merely evidence the conversion.

Before the merger is effectuated, Taxpayers desire to execute a deed from Taxpayer No. 1 and Taxpayer No. 2 to the Partnership. The purposes of executing that deed is to get title to the Real Estate in the name of the Partnership that is attempting to convert its business form. Having title in the name of the converting entity is a requirement that must exist in order for Taxpayers to claim the confirmatory deed exclusion for the deed that will evidence the conversion. See 61 Pa. Code § 91.152(b)(1).

In this case, title to the Real Estate is in the name of Taxpayer No. 1 and Taxpayer No. 2, not the Partnership. Taxpayers argue that title to the Real Estate should have been in the name of the Partnership from inception rather than in the individual names of the partners, Taxpayer No. 1 and Taxpayer No. 2. Taxpayers argue that this "mistake" in title is purely the result of a scrivener error that can be corrected through the filing of a corrective deed.

A non-taxable corrective deed can be executed and filed for Pennsylvania Realty Transfer Tax purposes, but only if the following criteria are met:

A deed made without consideration for the sole purpose of correcting an error in the description of the parties or of the premises conveyed is not taxable. This exclusion only applies if:

(1) The property interest in the correctional deed is identical to the property intended to pass with the original deed.

(2) The parties treated the property interest described in the correctional deed as that of the grantee from the time of the original transaction.

(3) The parties have not treated the property interest described in the original deed as the property of the grantee from the time of the original transaction.

91 Pa. Code § 91.151.

This Office has addressed situations in which it has been alleged that real estate has erroneously been titled in the individual names of partners rather than the partnership itself. In Private Letter Ruling RTT-07-004, this Office addressed this specific issue in terms of a general partnership. In that ruling, this Office stated the following:

[T]he Department historically has allowed taxpayers to file non-taxable corrective deeds in situations where a business entity has entered into an agreement of sale and purchased real estate, but through a scrivener error, the deed of conveyance accidentally and erroneously shows the business entity owners as the grantees rather than the business entity itself. However, in order for the corrective deed exclusion to be applicable, there must be evidence to demonstrate an actual scrivener error rather than an error of judgment. If the evidence indicates that title to the real estate was purposefully conveyed to the owners of the business entity rather than to the business entity itself, the exclusion is not applicable. The fact that the parties later discover or determine that it is not advantageous to have title in the name of the owners is irrelevant.

The issue of real estate ownership can be particularly problematic in partnership situations. Although real estate may be titled in the name of a partnership, Pennsylvania's Partnership Code, 15 Pa.C.S. §§ 8101, et seq., permits an individual to contribute an interest in real estate to the use of a partnership in which he is a partner while still remaining the legal owner and titleholder to the real estate interest. [Footnote omitted.] Consequently, real estate can become "partnership property" for purposes of the Partnership Code even though actual ownership remains with the partners in their individual capacities. For realty transfer tax purposes, the actual ownership of real estate is the dispositive factor. In this case, there is conflicting evidence as to whether the title to the Real Estate was placed in Taxpayer No. 1 and Taxpayer No. 2's individual names because of a scrivener error.

Some of the documentation suggests that title was properly in the individual names of Taxpayer No. 1 and Taxpayer No. 2. Taxpayer No. 1 executed the Agreement in his individual capacity. Taxpayer No. 1 and Taxpayer No. 2 are listed as the mortgagors in the Mortgage and Security Agreement, which instrument secured the purchase money for the Real Estate. Further, the deed of conveyance for the Real Estate from LP No. 2 designates Taxpayer No. 1 and Taxpayer No. 2 as the grantees.

Other documentation suggests that title should have been in the name of the Partnership. The Agreement provided that Taxpayer No. 1 could assign the Agreement, and Taxpayer No. 1 did assign the Agreement. The Assignment itself specifically designates the Partnership as the assignee. Therefore, the Partnership obtained the right to receive title to the Real Estate from LP No. 2.[2] Further, the Partnership was established

contemporaneously with, yet still before, the transfer of title to the Real Estate; and it was established for the purpose of acquiring title to the Real Estate.

The fact that Taxpayers filed income tax returns for the Partnership from its inception and the fact that the Partnership may have treated the Real Estate as partnership property and reported income from the Real Estate is not a dispositive fact in this analysis. As stated above, a partnership may treat real estate as partnership property even though it does not actually own and hold title to the real estate.

Despite this conflicting evidence, the most compelling facts are the Assignment for the Real Estate to the Partnership itself and the Partnership Agreement. Those documents provide that the Partnership was to acquire and hold title to the Real Estate. Based upon those facts, it is accepted that the Real Estate was always intended to be titled in the name of the Partnership and not in the name of Taxpayer No. 1 and Taxpayer No. 2 individually. Therefore, Taxpayers may file a non-taxable deed from Taxpayer No. 1 and Taxpayer No. 2 to the Partnership to correct the record titleholder of the Real Estate.

Following the execution and filing of the corrective deed, Taxpayers intend to merge the Partnership into LP No. 3 in order to convert the Partnership into a limited partnership. Thereafter, Taxpayers want to execute and file a deed from the Partnership to LP No. 3 to confirm the Partnership's existing ownership of the Real Estate in its new limited partnership form.

This Office has issued numerous letter rulings that explain the criteria that must be met and the situations under which a document will be considered a non-taxable confirmatory deed that evidences a mere conversion of a business entity's business form. Further, the Department has recently codified those criteria and situations by regulation. See 61 Pa. Code §§ 91.152(b) and 91.193(b)(4). Therefore, there is no need to reiterate these criteria here. For purposes of this letter ruling, it is sufficient to note that one of the criteria that must be met is that the ownership interest of the business entity owners must be identical before and after the conversion. 61 Pa. Code § 91.152(b)(4).

In this case, Taxpayer No. 1 has a two-thirds ownership interest in the Partnership and Taxpayer No. 2 has a one-third interest. In the context of a general partnership, all partners have an equal interest in the management and control of the partnership. 15 Pa.C.S. § 8331(5). The fact that Taxpayer No. 1 agreed to oversee the day-to-day operations and management of the Partnership does not mean that Taxpayer No. 1 had complete management and control of the Partnership. It merely meant that he was the business manager. Taxpayer No. 2 was not delegated to the status of a partner with mere income rights in the Partnership (akin to a limited partner in a limited partnership) just because Taxpayer No. 1 agreed to perform the services of the day-to-day manager of the Partnership.

Following the proposed conversion, Taxpayer No. 1 will be vested with all the management and control of LP No. 3 through his ownership of LLC No. 1, the general partner of LP No. 3. Taxpayer No. 2 will lose all rights to manage and control the Partnership after the conversion because he will only have a limited partnership interest in LP No. 3. This situation is specifically described in the Department's regulation under 61 Pa. Code § 91.152(b), Example No. 3. In that example, it explains that when a general partnership converts into a limited partnership, the partners in the general partnership must have both

general and limited partnership interests equal to their proportionate interest in the general partnership following the conversion. That condition is not met in the proposed conversion. Therefore, the deed for the Real Estate from the Partnership to LP No. 3 following the merger will not be deemed to be a non-taxable confirmatory deed.

[1] The tax consequences associated with the ground lease are not the subject of this letter ruling. Nevertheless, it should be noted that for Pennsylvania Realty Transfer Tax purposes, the conveyance of a leasehold interest, including a ground lease, where the term of the lease at the time of the conveyance is thirty years or more is subject to tax. 72 P.S. §§ 8101-C (definition of "title to real estate") and 8102-C.

[2] Although not a specific issue addressed under this ruling, current regulations and Department guidance would hold that this assignment is subject to tax, and the tax should have been paid as part of tax due on the deed from LP No. 2 to Taxpayer No. 1 and Taxpayer No. 2. See 61 Pa. Code § 91.170 and Realty Transfer Tax Bulletin 2008-01.