



January 23, 2009
Pennsylvania Realty Transfer Tax
No. RTT- 09-001
Financing Transaction

ISSUE:

Is the proposed conveyance of real estate to Taxpayer exempt from the imposition of the Pennsylvania Realty Transfer Tax as a financing transaction under 61 Pa. Code § 91.193(b)(23)?

CONCLUSION:

As explained more fully below, only a portion of the proposed conveyance of real estate to Taxpayer is exempt from the imposition of the Pennsylvania Realty Transfer Tax as a financing transaction under 61 Pa. Code § 91.193(b)(23).

FACTS:

In the 1960's, Taxpayer initiated a project to construct on-campus housing for approximately 5,100 students, including graduate and undergraduate dormitories and related facilities for student parking and dining services ("the Project").

Taxpayer sought to construct the Project on two large parcels of real estate ("Area 1" and "Area 2"). Area 1 and Area 2 are each composed of an assemblage of multiple smaller parcels. Area 1 and Area 2 are hereinafter referred to collectively as the "Project Area".

Prior to commencement of the Project, Taxpayer owned many of the parcels in the Project Area ("Taxpayer Parcels"). However, Taxpayer had a Redevelopment Authority ("RDA") acquire numerous other parcels in the Project Area pursuant to the terms of a Redevelopment Agreement (the "Redevelopment Agreement"). Hereinafter, the additional parcels are referred to as the "RDA Parcels." The Redevelopment Agreement provided, among other things, for the RDA to acquire title to the additional parcels located within the Project Area that Taxpayer did not own and, at its sole cost, to demolish all buildings and structures on the parcels and to transfer such properties to Taxpayer or its nominee for redevelopment. The RDA was required to pay consideration to Taxpayer or its nominee for the conveyance of the parcels. [1]

In order to finance the construction of the Project, the "Authority" issued tax exempt bonds pursuant to an Indenture dated August 1, 1968 (the "Indenture"). The Indenture provided that the bonds were issued for the purpose of constructing the Project for lease to Taxpayer. The Indenture required that fee title to the Project Area be held by the Authority. Accordingly, Taxpayer conveyed fee title to the Taxpayer Parcels to the Authority. Further, Taxpayer assigned its rights under the Redevelopment Agreement to the Authority, as Taxpayer's nominee. Taxpayer, the Authority and the RDA entered into an agreement (the "Tri-Party Agreement") which provided for the RDA, to transfer the RDA Parcels to the Authority, as successor to Taxpayer under the Redevelopment agreement. The Authority then purchased the RDA Parcels, and the RDA conveyed title to the RDA Parcels to the Authority.

In accordance with the terms of the Indenture, the Authority and Taxpayer entered into a lease, which provided for Taxpayer to lease the Project (the "Lease"). The repayment of the bonds was secured by an assignment to the bond trustee of the Lease and rentals payable by Taxpayer. The amount of the semi-annual rentals payable under the Lease were sufficient to pay the debt service on the bonds.

The obligations evidenced by the bonds have now been fully satisfied and pursuant to Article 10 of the Lease, following the expiration of the Lease term and full payment of all rent and other obligations thereunder, the Authority is required to convey to Taxpayer fee simple title to the Project Area. Taxpayer is requesting a ruling as to whether the conveyance of the fee simple interest in the Project from the Authority to Taxpayer is subject to Realty Transfer Tax.

DISCUSSION:

Documents that effectuate or evidence the conveyance of title to real estate located in Pennsylvania are subject to Realty Transfer Tax, unless the document is excluded or exempt from tax by statute. 72 P.S. § 8102-C.

For Realty Transfer Tax purposes, a taxable document does not include "mortgages, deeds of trust or other instruments of like character given as security for a debt and deeds of release thereof to the debtor." 72 P.S. § 8101-C (definition of "document"). Department regulations provide that a "conventional mortgage or assignment, extension, release or satisfaction thereof" is not a taxable document. 61 Pa. Code § 91.101.

The Department has interpreted the statutory exclusion applicable to mortgages to include any instrument that is akin to a mortgage if the instrument is given as security for a debt as part of a "financing transaction." 61 Pa. Code § 91.193(b)(23). A financing transaction is an "arrangement in which the following apply:"

- (i) Realty is transferred by the debtor solely for the purpose of serving as security for the payment of a debt.
- (ii) No sale or gift is intended.
- (iii) The debtor retains possession and beneficial ownership of the real estate transferred before default.
- (iv) The transferee obtains title or ownership to the real estate only so far as is necessary to render the instrument of transfer effective as security for the debt.
- (v) The transferee or the transferee's successor is obligated to return the transferred real estate at no or only nominal consideration to the debtor upon payment of the debt before default.

61 Pa. Code § 91.101 (definition of "financing transaction"). A "sale and leaseback" is an example of a transaction that may qualify as a financing transaction under certain circumstances. 61 Pa. Code §§ 91.168 and 91.193(b)(23); *see also* Hahnemann, 416 A.2d 604 (Pa. Cmwlth. 1980).

In this case, the Authority issued bonds to fund a loan to Taxpayer for the Project. As a requirement for the issuance of the bonds and the loan, the Authority required the Project

real estate, consisting of the Taxpayer Parcels and the RDA Parcels, to be conveyed to it. In turn, the Authority agreed to lease the Project real estate back to Taxpayer. The rental payments under the lease were designed to repay the debt service on the bond loan. At the end of the lease, the Authority was required to convey the Project real estate to Taxpayer. In essence the financing of the Project was structured as a loan and leaseback transaction rather than a typical mortgage arrangement. This is akin to a sale and leaseback transaction. To that extent, the transaction has the potential to qualify as an exempt financing transaction.

One of the essential requirements of a non-taxable, financing transaction is that the borrower must be the owner of the real estate serving as security for the loan and must convey title to the real estate to the lender. In turn, the lender must reconvey the real estate to the borrower when the loan has been satisfied.

In this case, Taxpayer owned and held title to the Taxpayer Parcels. In exchange for the loan from the Authority, Taxpayer conveyed title to the Taxpayer Parcels to the Authority.

Unlike the Taxpayer parcels, Taxpayer never owned or acquired title to the RDA Parcels. Rather, the RDA acquired title to the RDA Parcels in its own name. Further, the RDA did not acquire title to the RDA Parcels for Taxpayer's benefit as an agent or straw-party. In fact, Taxpayer would have been required to purchase the RDA Parcels from the RDA for valuable consideration after the RDA demolished all the buildings and structures on the real estate.

Even though Taxpayer could have purchased and taken title to the RDA Parcels under the Redevelopment Agreement after the RDA demolished the buildings and structures, Taxpayer made a conscious choice not to do so. Rather, it assigned its rights in the Redevelopment Agreement to the Authority, which in turn, purchased and took title to the RDA Parcels.

Because the RDA obtained title to the RDA Parcels and conveyed title to them to the Authority, the conveyance of the RDA Parcels to Taxpayer at the end of the lease term does not qualify as an exempt financing transaction. Only the conveyance of the Taxpayer Parcels from the Authority to Taxpayer, which Taxpayer originally conveyed to the Authority as security for the loan, qualifies as an exempt financing transaction.

[1] It is clear from the facts that the RDA, although acting pursuant to a contractual obligation, was not acting as Taxpayer's agent or straw-party for purposes of acquiring the additional parcels because the RDA was required to demolish the buildings and structures on the parcels at its own costs and because it required the payment of consideration for the subsequent conveyance of the parcels to Taxpayer or its nominee.