



November 10, 2010
Pennsylvania Realty Transfer Tax
No. RTT-10-003
Purchase of Real Estate and Appurtenant Leasehold Interests

ISSUE

1. What is the taxable value associated with Taxpayer's purchase of real estate, improvements and appurtenant leasehold interests thereto?
2. If Taxpayer assigns its right to purchase the real estate, improvements and appurtenant leasehold interest to an affiliated company, will such assignment result in additional Realty Transfer Tax?

CONCLUSION

1. The taxable value is the full purchase price for both the real estate and appurtenant leasehold interests.
2. The Realty Transfer Tax consequences associated with assignments of sale agreements are addressed in Realty Transfer Tax Bulletin 2008-01.

FACTS

Taxpayer desires to purchase real estate located in Pennsylvania and improvements thereon.

The real estate and improvements are subject to an existing 20 year lease (hereinafter "Master Lease").

The owners/lessors of the real estate and improvements are A and B (hereinafter "Lessor(s)").¹

The lessee is a limited liability company (hereinafter "Lessee").

The owners of the Lessee are the Lessors, C (the Lessors' son), and D, a business associate.

The Master Lease was executed on April 24, 2003.² Its term continues until December 31, 2020. The provisions of the Master Lease related to its term make reference to the possibility that the lease term can be extended, but the Master Lease itself does not contain any express provisions providing for extensions.

Realty Transfer Tax was not paid on the lease.³

The Master Lease was amended on January 29, 2010, to confirm the continuation of the lease and to amend the rent. The amendment provided that the rent for the remaining term of the Master Lease would be \$1.00 per year. No other amendments were made to the terms of the Master Lease.

¹ The owners/lessors owned the real estate and improvements as tenants by the entireties. A died on November 24, 2008. B became the sole owner/lessor of the real estate and improvements after her husband's death.

² The Master Lease contains a creation date of October 25, 2000. Taxpayer has asserted, however, that the Master Lease was not executed until April 24, 2003.

³ For purposes of this ruling, it is assumed that the lease is not a long-term lease (i.e., a lease with a term of 30 years or more). Because a lease is only subject to Realty Transfer Tax if it is a long-term lease, it is assumed that is the reason tax was not paid on the Master Lease.



Under the Master Lease, the Lessee has a right of first refusal to purchase the real estate and improvements in the event of a bona fide sale offer from a third party. It also provides Lessee with an option to purchase the real estate and improvements at any time during the term of the Master Lease for \$500,000.00 plus all rent or additional rent then due or previously deferred and any late fees.

The real estate, improvements and the Master Lease are currently subject to two unwritten subleases and one written sublease (hereinafter "subleases"). The existence of the subleases is provided in this ruling for informational purposes only. It does not appear that the existence of the subleases have any affect on the conclusions of this ruling.

On August 29, 2010, Taxpayer executed an agreement of sale with the Lessor and the Lessee to purchase the real estate and improvements thereon. The stated purchase price in the agreement is \$2,276,000. The agreement allocates the purchase price as follows: \$500,000 to the Lessor pursuant to the purchase price under the option in the Master Lease and \$1,776,000 to the Lessee for its relinquishment of its right of first refusal and option to purchase under the Master Lease.

When Taxpayer closes on the sale, it will own title to the real estate and improvements free and clear of the Master Lease, the option and the right of first refusal.

Even though Taxpayer executed the agreement of sale, it is possible that Taxpayer might decide to assign its interest in the sale agreement to an affiliated company and have the affiliated company purchase the real estate and improvement and take title thereto.

DISCUSSION

It is the position of the Department that the Taxpayer is attempting to purchase a fee simple interest in the real estate and improvements thereon. In order to do that, the Taxpayer has to consolidate the existing interests in the real estate currently held by the Lessor and Lessee.

Although the parties have allocated the purchase price, the Department views the purchase as a single transaction for the purchase of real estate with a single purchase price of \$2,276,000. The Lessor is selling the real estate and improvements and the Lessee is joining in the transaction to relinquish any interest it may have in the real estate under the Master Lease.

For Realty Transfer Tax purposes, in a bona fide sale, the taxable value of any document that conveys title to real estate is the amount of the actual consideration paid or to be paid including liens or other encumbrances thereon. 72 P.S. § 8101-C (definition 1 of "value").

The sale price allocated for the real estate and improvements is \$500,000. That amount is part of the taxable sale price.

A lease is an encumbrance on real estate. *Berger v. Weinstein*, 63 Pa. Super 153 (Pa. Super. Ct. 1916). Because a lease is an encumbrance, its value is included in the taxable value. The value allocated for the Lessee's rights under the Master Lease is \$1,776,000.

Because the Department views this transaction as a single transaction for the purchase of an unencumbered interest in the real estate and improvements, the entire sale price is subject to tax.

Complicating this matter is the fact that the real estate and improvements are encumbered by the Master Lease and there are two "sellers" who are releasing their interests in the real estate and improvements for



allocated sums. Certainly, if the Master Lease did not exist to encumber the real estate and improvements, there would only be one seller. Further, the purchase price for the real estate and improvements would not be limited to either the \$500,000 option price allocated to the Lessor or the remaining purchase price allocated to the Lessee. The purchase price would be the entire sale price of \$2,276,000. Consequently, the full purchase price is the correct taxable amount.

Although the purchase may appear to be two separate purchases, in substance, there is only one purchase. Department regulations address how single transactions are to be taxed when the form of the transaction is split into multiple parts. In such cases, the multiple transactions are treated as a single transaction. The Department regulation in pertinent part provides as follows:

§ 91.170. Rule in Baehr Bros. v. Commonwealth, 487 Pa. 233, 409 A.2d 326 (1979).

(a) General rules.

* * *

(2) Separate transfers of a greater estate and a lesser estate in real property will be taxed as a single transfer of both estates if the transactions are entered into in contemplation of a merger thereof.

* * *

(c) Splitting transactions. If a series of two or more transactions and associated writings, one or more of which would not be subject to tax if considered separately, are completed instead of a single transaction and taxable document, the series of transactions and writings will be considered as if completed by the single transaction and document. Therefore, each individual writing in the series of transactions and writings will be subject to tax upon a portion of the value of the title to real estate conveyed in respect of the transactions and writings. If it is not possible to determine how to apportion all or part of the taxable value between two or more of the writings, the value for which apportionment cannot be determined shall be divided equally among all writings that do not have an apportioned value. This rule only applies if:

(1) The parties to the single transaction and document are identical to the parties to the series of transactions and writings. For purposes of this section, parties are identical if they are the same person or the person's affiliate. The term "affiliate" in this section has the same meaning as the term "grantor's affiliate" in § 91.131 (relating to definitions).

(2) Completing the series of transactions and writings results in the same outcome that would have resulted from completing the single transaction and document.

(3) The primary purpose for completing the series of transactions and writings rather than completing the single transaction and document is the avoidance of tax.

* * *

Example 2. X is a land developer and is the sole owner of business entity 1 and 2.

X has business entity 1 purchase vacant real estate. Realty Transfer Tax is paid on the document of transfer for the real estate. X then has business entity 1 lease the real estate under a short term lease (less than 30 years) to business entity 2. Business entity 2 makes \$10 million worth of



improvements to the real estate. Business entity 1 remains the owner of the underlying real estate and business entity 2 remains the owner of the improvements.

X then enters into an agreement with Y for the sale of the real estate and improvements for \$15 million. The agreement provides that X will have business entity 1 convey its ownership in the underlying real estate to Y for a sale price of \$2 million. Business entity 1 and Y effectuate the transfer of the underlying real estate and pay realty transfer tax on the deed of conveyance based upon the \$2 million sale value.

The agreement also provides that X will have business entity 2 assign its lessee interest in the short term lease to Y for the remaining \$13 million sale price. No tax is paid on the assignment of the lessee interest. Y then terminates the lease resulting in a merger of the real estate and improvements in Y. Y has, in substance, purchased both the underlying real estate and improvements. By breaking the simple sale of the underlying real estate and improvements into multiple transactions, X and Y have attempted to avoid paying tax on the full sale price of \$15 million. In this case, the multiple transactions will be viewed as a single transaction. Therefore, the total taxable value of the single transaction is the \$15 million sale price.

Example #2 above, although not exactly identical, is in all relevant respects similar to the current facts. The real estate and improvements are subject to a lease. There are two different affiliated parties who have interests in the real estate and improvements. A third party enters into a contract to purchase the real estate and improvements and allocates the purchase price between the two parties. Realty Transfer Tax cannot be avoided because the sale is bifurcated and the purchase price is allocated to two different parties. In such cases, the full purchase price is subject to tax.

In the event that Taxpayer decides to assign its interest in the sale agreement to an affiliated company and have the affiliated company purchase the real estate and improvement and take title thereto, then additional Realty Transfer Tax rules can be implicated. The Department has already addressed how Realty Transfer Tax applies to the assignment of sale agreements between affiliated entities under Realty Transfer Tax Bulletin 2008-01. The assignment of a sale agreement can result in additional Realty Transfer Tax unless the assignor is released from performance under the original sale agreement. See Realty Transfer Tax Bulletin 2008-01, Scenario #3. As described in the Bulletin, the assignment of the sale agreement needs to result in a repudiation of assignor's duties and obligations and a novation on the part of the assignee to those duties and obligations. In such a case, it will be deemed that the original sale agreement was revoked and a new sale agreement is executed between the seller and the assignee.