

November 22, 2017
Pennsylvania Realty Transfer Tax
No. RTT-17-001
Termination of Condominium and Creation of Tenancy in Common; Transfer of Leases
Subsequent to Termination of Condominium

ISSUES:

- (1) Is the termination of a condominium pursuant to Section 3320(d) of the Pennsylvania Condominium Act (the “Act”), 68 Pa.C.S. §§ 3101 - 3414, subject to the Pennsylvania Realty Transfer Tax?
- (2) Is the assignment of interests in leases, subsequent to the termination of a condominium, subject to the Pennsylvania Realty Transfer Tax?

CONCLUSIONS:

- (1) Under the facts described below, the termination of a condominium pursuant to Section 3320(d) of the Act is subject to Pennsylvania Realty Transfer Tax.
- (2) The Taxpayer has provided insufficient information for the Department to make a determination regarding this issue.

FACTS:

The Condominium was formed pursuant to the Act. The Condominium consists of two properties with improvements, Property #1 and Property #2. Building #1 is located on Property #1, and Building #2 is located on Property #2.

There are two units in the Condominium. Unit 1 consists of the basement and first five floors of both Buildings #1 and 2. Unit 2 of the condominium consists of all interior floors above the fifth floor of both Buildings #1 and 2. According to the Declaration of Condominium, Unit 1 holds a 29.01% interest in the condominium, while Unit 2 holds a 70.99% interest in the condominium.

All of Unit 1 is leased to a single tenant pursuant to a single lease. Unit 2 is leased to multiple tenants pursuant to multiple leases.

Unit 1 is currently owned by an unrelated third party. It is anticipated that Taxpayer #1 will acquire title to Unit 1 in January 2018, and will pay any required Pennsylvania Realty Transfer Tax at that time. Unit 2 has been owned by Taxpayer #2 since March 2008.

After Taxpayer #1 acquires title to Unit 1 in January 2018, the Taxpayers will execute and record a Termination of Condominium terminating the Condominium.

Following the termination of the Condominium, title to the property will be vested in the Taxpayers as tenants in common pursuant to Section 3220(d) of the Act, and each Taxpayer's respective tenant in common interest will be determined in accordance with Section 3220(f) of the Act. Further, Taxpayer #1 will assign its interest as landlord in and to the single lease of the former Unit 1 to Taxpayers #1 and 2 as tenants in common. Likewise, Taxpayer #2 will assign its interest as landlord in and to the multiple leases of the former Unit 2 to Taxpayers #1 and 2 as tenants in common.

DISCUSSION:

In this case, Taxpayers intend to terminate a two unit condominium. Immediately prior to the termination, Taxpayer #1 is the owner of Unit #1 and the landlord under the lease encumbering Unit 1. Taxpayer #2 is the owner of Unit #2 and the landlord under the leases encumbering Unit 2.

The Act provides that "each unit together with its common element interest constitutes *for all purposes* a separate parcel of real estate." 68 Pa.C.S. § 3105(a) (emphasis added). Consequently, immediately before the termination Taxpayer #1 is the sole owner of Unit #1 and Taxpayer #2 is the sole owner of Unit #2.

The Act further provides that upon the termination of a condominium where the underlying real estate of the condominium is not sold "title to the real estate [constituting the condominium]...vests in the unit owners as tenants in common in proportion to their respective interests." 68 Pa.C.S. § 3220(d). In other words, the condominium reverts back to a single parcel of real estate owned by all of the unit owners as tenants in common according to their prior, respective unit interests in the condominium. Consequently, after the termination of the Condominium, Taxpayers will become tenants in common of the entire real estate of the Condominium according to their interests. The Act further provides that "[w]hile the tenancy in common exists, each unit owner and his successors in interest have an exclusive right to occupancy of the portion of the real estate that formerly constituted his unit." *Id.*

After the termination, Taxpayers will hold title to the entire property as tenants in common with Taxpayer #1 owning a 29.01% interest and Taxpayer #2 owning a 70.99% interest. What was originally two separate parcels will now become one parcel. As a result Taxpayer #1 will gain an interest in Unit 2 that it did not previously own, and Taxpayer #2 will gain an interest in Unit 1 that it did not previously own. Any document that effectuates or evidences a transfer of title to real estate is subject to the Pennsylvania Realty Transfer Tax. 72 P.S. § 8102-C. Therefore, this change in ownership of the real estate is taxable for Pennsylvania Realty Transfer Tax.

This result is supported by the Pennsylvania Commonwealth Court's decision in *Cunius v. Board of Assessment Appeals of Chester County*, 976 A.2d 635 (Pa. Commw. Ct. 2009). In *Cunius*, a taxpayer and his son owned a 68-unit apartment building as tenants in common and created a two unit condominium with the father taking one unit (consisting of 44 units and 62% of the common area) and the son taking the other unit (consisting of 24 units and 38% of the common area). 976 A.2d at 636. The county performed a reassessment of the two units, which resulted in an increase from the tax paid on the property compared to how it was taxed as a single parcel. *Id.* The taxpayer appealed, claiming that the reassessment was an illegal "spot reassessment." *Id.* at 637. In holding that the reassessment was not a spot reassessment, the Commonwealth Court noted that:

... more than just a change in the form of ownership occurred when the condominium was created and the units were conveyed to John and Edward individually. Following conveyance of the units, Cunius no longer possessed an

ownership interest in the entire property; his interest is limited to his unit only and its proportionate share of the common area. Therefore, John's unit is technically not owned by the same declarants because Edward does not have any ownership interest in that unit.

Id. at 640.

The instant matter is the reverse of the *Cunius* case. In that case, owners of a property as tenants in common created a condominium and splitting one parcel of property into two parcels of property, thus relinquishing ownership in a portion of the property as a whole.¹ Here, Taxpayers will separately own each unit, then, upon termination of the Condominium will become cotenants of the entire Condominium property. Therefore, each Taxpayer will gain property rights over the other unit, while at the same time relinquishing property rights over their previously owned unit.

Finally, since the termination of condominium must be executed and recorded in the same manner as a deed, 68 Pa.C.S. § 3220(b), the tax stamps must be affixed to the termination agreement upon recordation.

In regard to the transfer of leases, Taxpayers did not provide any information regarding the terms of the leases for either the Unit 1 or Unit 2 properties. Generally, the assignment of a lease is only taxable if the lessee is transferring his or her interest to another lessee and 30 or more years remain on the lease. The assignment of a lessor's interest in a lease in conjunction with the conveyance of title to the real estate upon which the lease is an encumbrance is not taxable because the interest in the lease is generally conveyed with the transfer of title and tax will be paid accordingly.² This will almost always be the case because a person cannot separate the lease from the real estate and cannot transfer it separately from the real estate. There are instances where someone may assign their interest in the rents, but this is an assignment of income and not a severance of the lease interest from the real estate.

¹ Taxpayers noted in their request for a letter ruling that a comment to Section 3220 of the Act suggests that no realty transfer tax is owed when a condominium is terminated. Specifically, the comment states:

Since the termination of a condominium does not involve any type of "conveyance" to "any person," the recording of the termination agreement is not subject to either The Realty Transfer Tax Act or any local realty transfer tax. See Pennsylvania Comment to Section 3201.

68 Pa.C.S § 3220 (Pennsylvania Comment – 1978). The Department notes that in *Cunius*, the Commonwealth Court referenced similar language in Section 3201 of the Act regarding the creation of a condominium, yet seemingly disregarded this comment in its analysis finding that a taxable event had occurred. Likewise, although this comment may suggest that its author did not feel a taxable event occurs when a condominium is terminated, under the facts presented in this matter it is the Department's position that a taxable event has occurred as a beneficial interest in real estate was transferred and a document must be recorded effectuating this transfer.

² See *National Forge Co. v. Carlson*, 307 A.2d 902, 904 (stating, "[w]hen land is sold by the original lessor, the purchaser of the land steps into the shoes of the original lessor and can enforce such restrictions as against an assignee of the original lessee.").