



June 29, 2006
Pennsylvania Realty Transfer Tax
No. RTT-06-005
Method of Converting GP to LLC

ISSUE

Will the manner in which Taxpayer proposes to change its business entity form allow for the filing of a non-taxable deed confirming the change in Taxpayer's business form?

CONCLUSION

No. The manner in which Taxpayer proposes to change its business entity form will not allow for the filing of a non-taxable deed confirming the change in Taxpayer's business form.

FACTS

Taxpayer is a Pennsylvania general partnership with a principal place of business in Pennsylvania. Currently, the partners are subject to a written partnership agreement.

Taxpayer's sole material asset is real estate, with improvements thereon, more fully set forth and described in the deed for the real estate filed in the applicable recorder of deeds office.

Taxpayer desires to change its business entity form from a Pennsylvania general partnership to a Pennsylvania limited liability company ("LLC"). The LLC will be a newly formed Pennsylvania entity. All of the partners of the Partnership will become members of the LLC. Each member's percentage interest in the LLC will be identical to his percentage interest that he held in the Partnership. A Certificate of Organization will be filed for the LLC. The interests of the LLC's members will not be certified, but the members will enter into a written operating agreement.

After the LLC is formed, Taxpayer will convey its real estate to the LLC by a special warranty deed.

The real estate is currently subject to various leases. Therefore, the leases will be amended to reflect that the LLC will assume all of the obligations of the landlord under each of the leases.

Taxpayer will then dissolve and will cease conducting business. The fictitious name for Taxpayer that has been filed with the Pennsylvania Department of State will be terminated of record.

Taxpayer will document the above series of transactions by Partnership resolutions duly adopted at a meeting called specifically therefore or by unanimous written consent.

DISCUSSION

A document that provides for the transfer of title to real estate from one distinct business entity (corporation, association, business trust, etc.) to another is subject to realty transfer tax. For example, if ABC Limited Partnership executes a deed conveying title to real estate to XYZ Corporation, the deed is subject to realty transfer tax. The deed is subject to tax even if the owners of both business entities are identical.^[1]

A document can appear to transfer title between two distinct business entities when in actuality the document does not effectuate such a transfer. This can occur when a business entity merely changes its business form and files a document to confirm its ownership of real estate under its previous business form. In such a case, the document is excluded from tax as a confirmatory deed. See 72 P.S. § 8102-C.3(4) and 61 Pa. Code §§ 91.152 and 91.193(b)(4).

For example, for purposes of obtaining liability protection, the partners of ABC General Partnership decide to change the form of the general partnership to a limited partnership. When a business entity changes its business form, it is often desirable to file a document to memorialize its change in form and to confirm its existing ownership in real estate. Therefore, in this example, after ABC General Partnership changes its form from a general partnership to a limited partnership, a document will be filed from ABC General Partnership, as grantor, to ABC Limited Partnership, as grantee, for any real estate owned by ABC General Partnership. The document memorializes ABC General Partnership's change in business form to the limited partnership and confirms its prior ownership of its real estate. On its face, the document from ABC General Partnership to ABC Limited Partnership appears to be a transfer between two distinct entities, when in actuality it is merely a confirmatory deed.

In Exton Plaza Associates v. Commonwealth, 763 A.2d 521 (Pa. Cmwlth. 2000), the Commonwealth Court held that realty transfer tax cannot be imposed upon a document that merely memorializes (or confirms) a business entity's real estate ownership following a change in the business entity's change of its business form. The Court described a business entity's change of its business form as a "conversion." Unfortunately, the Court did not define a "conversion" or describe how a conversion is to be effectuated in order to obtain the confirmatory deed exclusion from realty transfer tax.

It is the Department's position that the term "conversion" as used by the Exton Court is not a legal term of art in that the Department has been unable to identify any Pennsylvania statute that defines or provides for the conversion of a business entity. The term conversion as used by the Court was merely another way of describing a change in a business entity's business form.

Despite the fact that the Exton Court did not provide for the manner in which a business entity may convert its business form and still be able to file a non-taxable, confirmatory deed, the manner in which a conversion is accomplished is important in determining whether a document that is filed in conjunction with a conversion may be excluded from tax.

Although the Department has not established specific procedures that must be followed to convert a business entity, the Department has established by policy standards that must be met in order for a business entity to file a non-taxable confirmatory deed in conjunction with a business entity conversion. Those standards have been published in prior letter rulings

issued by this Office (copies of which are available on the Department's website at www.revenue.state.pa.us). The standards were also published as part of a proposed realty transfer tax regulatory package in the *Pennsylvania Bulletin* at 35 Pa.B. 6096 (November 5, 2005) (*see* proposed rulemaking for Realty Transfer Tax Amendments at § 91.152(b)).

Those standards provide that a document that is made without consideration and solely for the purpose of confirming a change in the form or identity, or merger or consolidation, of a corporation or association is a confirmatory deed and is not subject to realty transfer tax as long as the following conditions are met:

(1) if without the making of any document,

(i) the resultant entity is vested with all the property, real, personal and mixed, and franchises of, and the debts due, the original association or, in the case of a merger or consolidation, each party thereto;

(ii) the resultant entity is subject to all the obligations of the original association or, in the case of a merger or consolidation, each party thereto;

(iii) liens upon the property of the original association or, in the case of a merger or consolidation, each party thereto, are not impaired by the change in form; and

(iv) any claim existing or action or proceeding pending by or against the original association or, in the case of a merger or consolidation, each party thereto, may be prosecuted to judgment against the resultant entity;

(2) if the original association or, in the case of a merger or consolidation, each party thereto, is not required to wind up its affairs or pay its liabilities and distribute its assets either because there is no break in the continuity of its existence or because its separate existence ceases with the reformation; and

(3) considering all the ownership interests in the original association or, in the case of a merger or consolidation, each party thereto, there is no change in proportionate ownership interests resulting from the change in form.

The converting entity must also possess record legal title to the real estate being transferred. If the members of the converting entity possess record legal title rather than the converting entity[2], the deed will not confirm the transfer from the entity to itself upon conversion. Rather, it will evidence a transfer from the individual members to the new entity. Transfers from owners of an entity to the entity are fully subject to tax. 72 P.S. § 8102-C.4.

The Department has established the above conditions so that a conversion will not implicate provisions of the realty transfer tax law that would result in the imposition of tax on documents executed pursuant to the conversion. For example, if in the course of converting a business entity the converting entity winds up its affairs and distributes its real estate to its owners so that they can convey the real estate to a newly formed entity that is to take the place of the converting entity, the transfer from the converting entity to its owners is potentially subject to tax and the conveyance from the members to the new entity is subject to tax. *See* 72 P.S. §§ 8102-C.3(13) and 8102-C.4. Hence, one of the Department's

requirements is that there cannot be a break in the continuity of the converting entity that would require the dissolution of the converting entity and the distribution of the entities real estate. See condition (2) above.

In this case, Taxpayer proposes to convert from a general partnership to a limited liability company by forming a “shell”^[3] limited liability company, transferring the real estate from the general partnership to the limited liability company and dissolving the general partnership. The proposed transaction contemplates the execution of a special warranty deed followed by the dissolution of the general partnership. This transaction does not effectuate a conversion followed by a confirmatory deed. It effectuates a direct transfer of the real estate between two distinct entities followed by the termination of the original owner of the real estate. Two distinct business entities exist at the time the deed will be executed. Therefore, there is a direct transfer of real estate between two distinct business entities. Further, the dissolution of the general partnership breaks the continuity of life of the partnership and thus violates condition (2) above. Because the dissolution of the general partnership violates condition (2) and because there is a direct transfer of the real estate from one distinct entity to another, the deed does not qualify for the confirmatory deed exclusion.

Compare the proposed transaction to a transaction in which a general partnership, in an attempt to convert its business entity form, establishes a shell limited liability corporation in which the corporation members are the partners of the general partnership who each own identical membership interests in the limited liability company to their interests in the general partnership. The general partnership then merges into the limited liability company. In that transaction, the general partnership is absorbed into the limited liability company, which takes its place without the dissolution of the general partnership. Thus, there is no break in the continuity of the general partnership. Further, the general partnership’s real estate remains with the general partnership and flows to the limited liability company as a result of the merger. Consequently, there is no deed of transfer from the general partnership to the limited liability company. All the liabilities and other assets of the general partnership flow to the limited liability company as a result of the merger. Following the merger, the limited liability company files a document to confirm its ownership of the real estate that it previously owned in the form of the general partnership. In this transaction all of the above conditions are met and the confirmatory deed exclusion is applicable.^[4]

For the above reasons, the manner in which Taxpayer proposes to change its business entity form will not result in a conversion that will allow for the filing of non-taxable deed confirming the change in Taxpayer’s business form.

[1] See 72 P.S. § 8102-C.4, which provides that “corporations and associations are entities separate from their members, partners, stockholders or shareholders.”

[2] This is most often the case in partnership situations. The Partnership Code, 15 Pa.C.S. §§ 8101 – 8998, allows real estate that has been contributed to a partnership to remain titled in the name of the individual partners. (See 15 Pa.C.S. § 8313(c), which provides that real estate may be held in the name of a partnership. Compare 15 Pa.C.S. § 8322, which indicates that partnership real estate may be titled in the name of the individual partners.)

[3] The term “shell” is used to describe a newly formed business entity that has no assets or liabilities, that has not previously conducted any business activity and which is formed solely for the purpose of taking the place of and providing the new business form for an existing business entity.

[4] The transaction in this paragraph describes one way in which a business entity may change its form and meet all of the Department’s conditions for claiming the confirmatory deed exclusion. It is not intended to describe the sole method by which a conversion may be accomplished.