pennsylvania
DEPARTMENT OF REVENUE

September 20, 2007
Pennsylvania Realty Transfer Tax
No. RTT-07-007
Trust to Trust Transfer
Rule in Baehr Bros.
Living and Ordinary Trusts

ISSUES:

1. Is a document that is executed for consideration and that conveys title to real estate from the trustees of a trust to the trustees of another trust subject to Pennsylvania Realty Transfer Tax?

2. Must Taxpayer A and B provide a copy of any trust documents to the Recorder of Deeds when the document is recorded?

CONCLUSIONS:

1. On its face, the document is taxable. There is no tax exclusion for documents that are made for consideration that convey title to real estate from the trustee of one trust to the trustee of another trust.

However, if the document, in substance, represents a series of otherwise excluded transactions that have been reduced to one document for the convenience of the parties, then the Department will consider the document to be excluded from tax as well.

2. Taxpayer A and B will be claiming an exclusion from tax based upon the conveyance of real estate from and to an ordinary trust. Therefore, a copy of the trust instruments must be presented to the Recorder to claim the exclusion.

FACTS:

Taxpayer A and B are spouses and are joint trustees under a trust agreement known as Trust 1. Taxpayer A and B amended Trust 1 by a subsequent instrument.

Among other provisions, Trust 1 provides for a division of trust property into three shares—a joint share, husband's share and wife's share. Taxpayer A and B have the right to allocate any property to any trust share at the time of contribution to the trust or after the contribution. Specifically, both Taxpayer A and B have the right to reallocate property from their own individual trust share to the share of the other spouse or to the joint share. Taxpayer A and B are the lifetime beneficiaries of the trust income derived from each Taxpayers' trust share. Also, Taxpayer A and B each have the right as beneficiaries to demand and receive a distribution in whole or in part of trust principal and interest contained in their individual share or their proportionate share of the joint share. Upon death of Taxpayer A or B, such deceased Taxpayer's share of the trust is to be divided into two portions—a "Marital Deduction Portion" and a "Supplemental Portion." The Marital Deduction portion is to be distributed to a separate trust known as the "Continuing Trust." The Supplemental Portion is to be distributed to a separate trust known as the "Credit Shelter Trust." The Continuing Trust and its assets are to be managed and distributed according to the same terms as the management of Trust 1. The surviving Taxpayer is the lifetime net income beneficiary of the “Credit Shelter Trust” and has the right to receive $5,000 of trust principal, at a minimum, and up to an additional five percent (5%) of the trust principal per year. The surviving Taxpayer also has the right to receive trust principal for Taxpayer’s health, maintenance, support or education. Upon the death of the surviving Taxpayer, the assets of the Continuing Trust and the Credit Shelter Trust are to be distributed to another trust known as the “Family Trust” or to Taxpayers’ surviving children. Taxpayer A and B’s children and their heirs are the beneficiaries of the Family Trust.

X and Y are spouses. Taxpayer A and B are X’s natural parents.

X and Y are trustees under a trust agreement known as
Trust 2. Trust 2 is in all pertinent respects identical to Trust 1 except that it applies to X and Y.

One of Trust 1’s assets is a one acre (approximately) parcel of real estate located in Pennsylvania(“Real Estate”). Taxpayer A and B, as trustees of Trust 1, contemplate conveying the Real Estate to X and Y, as trustees of Trust 2, for consideration. For purposes of brevity, further references to a transfer from the trustees of a trust may simply be referred to as a transfer from the trust rather than the trustees.

DISCUSSION:

On its face, this transaction involves the conveyance of title to real estate from one trust, Trust 1, to another trust, Trust 2, for actual consideration.

Documents that convey title to real estate are subject to Pennsylvania Realty Transfer Tax absent an applicable exclusion. 72 P.S. § 8102-C. There is no exclusion for a conveyance from one trust or trustee to another that is applicable to this transaction. The only exclusion that exists for a document that conveys title to real estate from one trustee to another is the exclusion for a “transfer which merely confirms the appointment of a successor trustee to fill a vacancy or an additional trustee or the removal or resignation of a trustee.” 61 Pa. Code § 91.193(b)(10). That exclusion is not applicable to this transaction because this transaction does not involve a substitution of a trustee. Rather, it involves the conveyance of real estate from one distinct trust to another.

Because there is no applicable exclusion for this transaction, the document that effectuates the transaction is, on its face, subject to Pennsylvania Realty Transfer Tax. That is, unless the true substance of the transaction is something other than a mere conveyance of title to real estate between two trusts.

Based upon the Pennsylvania Supreme Court’s decision in Baehr Bros. v. Com., 409 A.2d 326 (Pa. 1979), it is the policy of the Department not to impose realty transfer tax on a document, which on its face is taxable, if the document actually represents a series of excluded transactions/documents that have been reduced to one transaction/document for the mere convenience of the parties. Because the true nature, or substance, of the transaction would be a series of excluded transactions/documents, the Department will not penalize the taxpayers for choosing to complete the transactions via one transaction and document for the mere convenience of the parties instead of executing the multiple excluded documents.

The following criteria must be met to qualify for the favorable tax treatment described above:

> A document shall be excludible from tax if each of the following requirements is satisfied -
> (1) The document stands in the place of two or more other writings.
> (2) Each of the writings for which the document stands would be -
> (i) Excludible from tax; and
> (ii) Effective notwithstanding the insolvency, bankruptcy or other legal disability of the signatories thereto.
> (3) Title to the affected real estate would not revert or be in any way impaired or encumbered by reason of the recordation of the writings described in paragraphs (1) and (2).

Stated another way, when a single document represents, in substance, two or more transfers of title to real estate, the document will be viewed as a series of separate transfers and documents. The tax due on the single document will be the same as the sum of the tax that would be due had each transfer been effectuated by a document. Therefore, if each separate transfer in the series is excluded from tax, then the single document is excluded from tax. This favorable tax treatment is only available if:

> (1) Each transfer and document in the series could have been accomplished and executed individually under the laws of the Commonwealth or the United States.
> (2) Completing the series of transfers and documents would result in the same transfer accomplished by the single document.
> (3) The series of transfers and documents have not been reduced to one transfer and document in order to avoid a legal, contractual, economic or personal detriment associated with completing the series of transfers and documents.
> (4) The series of transfers and documents would have been completed without the benefit of the favorable tax treatment.

It is arguable that this transaction is not a conveyance of title to real estate from one trust to another, but is rather a sale and transfer of title to real estate from a father and mother, Taxpayer A and B, to their child and the child's spouse, X and Y. The real estate just happens to be held in the father and mother's trust and the child and spouse want to transfer the real estate into their own trust after they obtain ownership of the real estate. Consequently, some additional transfers in addition to the sale and transfer from the parents to the child and spouse are necessary to effectuate the intent of the parties. Those additional transfers are the transfer from Trust 1 to Taxpayer A and B before Taxpayer A and B sell and transfer the Real Estate to X and Y, and a subsequent transfer from X and Y to Trust 2. If the true substance of the transaction is the series of transactions rather than only a transfer from Trust 1 to Trust 2 and each transaction in the series is excluded from tax, then the above favorable tax treatment will be applicable.

Any document that effectuates the sale and transfer of the Real Estate from Taxpayer A and B to X and Y is excluded from tax as a family transfer from parents to a child and the child's spouse. 72 P.S. § 8102-C.3(6) and 61 Pa.Code § 91.193(b)(6)(i)(B) and (D). Therefore, if the transfer from Trust 1 to Taxpayer A and B and the transfer from X and Y to Trust 2 would be excluded from tax, then the transfer of the Real Estate from the trustees of Trust 1 to the trustees of Trust 2 will be excluded from tax.

There are specific realty transfer tax exclusions for transfers to and from a trust, specifically "living" and "ordinary" trusts. The applicable statutory exclusions are as follows:

> (8) A transfer for no or nominal actual consideration to a trustee of an ordinary trust where the transfer of the same property would be exempt if the transfer was made directly from the grantor to all of the possible beneficiaries that are entitled to receive the property or proceeds from the sale of the property under the trust, whether or not such beneficiaries are contingent or specifically named. A trust clause which identifies the contingent beneficiaries by reference to the heirs of the trust settlor as determined by the laws of the intestate succession shall not disqualify a transfer from the exclusion provided by this clause. No such exemption shall be granted unless the recorder of deeds is presented with a copy of the trust instrument that clearly identifies the grantor and all possible beneficiaries.
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> (8.1) A transfer for no or nominal actual consideration to a trustee of a living trust from the settlor of the living trust. No such exemption shall be granted unless the recorder of deeds is presented with a copy of the living trust instrument.
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> (9) A transfer for no or nominal actual consideration from a trustee of an ordinary trust to a specifically named beneficiary that is entitled to receive the property under the recorded trust instrument or to a contingent beneficiary where the transfer of the same property would be exempt if the transfer was made by the grantor of the property into the trust to that beneficiary. However, any transfer of real estate from a living trust during the settlor's lifetime shall be considered for the purposes of this article as if such transfer were made directly from the settlor to the grantee.
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> (9.1) A transfer for no or nominal actual consideration from a trustee of a living trust after the death of the settlor of the trust or from a trustee of a trust created pursuant to the will of a decedent to a beneficiary to whom the property is devised or bequeathed.
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> (9.2) A transfer for no or nominal actual consideration from the trustee of a living trust to the settlor of the living trust if such property was originally conveyed to the trustee by the settlor.

72 P.S. § 8102-C.3(8), (8.1), (9), (9.1) and (9.2).

The Code defines a "living trust" as "Any trust, other than a business trust, intended as a will substitute by the settlor which becomes effective during the lifetime of the settlor, but for which trust distributions cannot be made to any beneficiaries other than the settlor prior to the death of the settlor."
72 P.S. § 8101-C.

Historically, the concept of a living trust did not exist under Article XI-C of the Code until the statutory amendments made in 1997. See the Act of May 7, 1997, P.L. 85, No. 7, § 17. Prior to those amendments, the only exclusion for a transfer of real estate to a trust was the exclusion for a transfer to an ordinary trust that is currently provided under 72 P.S. § 8102-C.3(8).

Wills, on the other hand, always have been excluded documents. 72 P.S. § 8101-C (see definition of "document"). The reason that a will is not taxable is because it provides no current transfer of ownership in property. It only provides a revocable direction on the part of the testator for the proper disposition of his probate assets after his death.

Although the statutory definition of a living trust does not use the term "revocable" it does state that a living trust is intended as a "will substitute." The Legislature did not define what it means to be a "will substitute." The Department believes the Legislature intended that a living trust must act and function like a "will" in order to be a "will substitute." It is a well-accepted principle of law that a "will" must be freely revocable during the testator's lifetime.[1] If a will were not revocable it would create a current disposition of a future interest in the testator's property. In contrast, a will's true function is to provide instructions for the testamentary disposition of the testator's property. Because a "will" must be freely revocable during a testator's lifetime, a living trust that is designed and intended to be a "will substitute" must also act like a "will" and be freely revocable by the settlor during the settlor's lifetime.

In current years, trusts have been used as a tool to replace wills for purposes of avoiding the probate process. Because of that trend, the Department believes that the Legislature wanted to give the same tax exclusion that applies to wills to trusts to the extent that the trust merely serves as a substitute for the will. However, the types of trusts and their provisions are practically limitless, bounded only by state law. The Department does not believe that the Legislature intended to create a completely new exclusion separate and apart from the exclusion for wills and testamentary transfers, hence the statutory language that a living trust must act as a will substitute. Consequently, it is reasonable that a living trust should be revocable so that it acts like a will and provides no current transfer of an interest in property, including real estate, to any future beneficiary. Rather, it provides only for a revocable direction for the proper disposition of a settlor's property after his death.

Based upon the statutory definition, it is the Department's policy that a living trust is an ordinary trust:

> (1) Which, throughout the settlor's lifetime, is wholly revocable by the settlor without the consent of an adverse party.
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> (2) Which vests no present interest in any of the trust corpus or income in any person other than the settlor or trustee until the settlor dies.
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> (3) All the corpus and income of which can be reached or materially affected by the settlor without revocation of the trust or the consent of an adverse party.
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> (4) From which no transfer of corpus or income may be made by the trustee at any time prior to the death of the settlor to any person in the capacity of a beneficiary other than the settlor.
>
> (5) Under which the trustee exercises no discretion as to the disposition of the trust corpus or income during the settlor's lifetime to any

person other than the settler without the express direction of the settler to make the specific disposition.

(6) Which the trustee or, if the settlor was the trustee, the successor trustee is required under the governing instrument to distribute the corpus and retained income upon the death of the settlor.

It should be noted that even if a trust does not qualify as a living trust, it may still qualify as an ordinary trust. In fact, living trusts are merely a subset class of ordinary trusts.

The statutory definition of an ordinary trust is "Any trust, other than a business trust or a living trust, which takes effect during the lifetime of the settlor and for which the trustees of the trust take title to property primarily for the purpose of protecting, managing or conserving it until distribution to the named beneficiaries of the trust. An ordinary trust does not include a trust that has an objective to carry on business and divide gains, nor does it either expressly or impliedly have any of the following features: the treatment of beneficiaries as associates, the treatment of the interests in the trust as personal property, the free transferability of beneficial interests in the trust, centralized management by the trustee or the beneficiaries, or continuity of life." 72 P.S. § 8101-C.

The Department has interpreted this definition to mean that an ordinary trust is an inter vivos, private trust of the settlor for which the trustees of the trust take title to property primarily for the purpose of protecting, managing or conserving trust assets, under the ordinary rules applied in the orphan's court division of the court of common pleas or in other chancery or probate courts, until distribution to the beneficiaries of the trust. The term does not include:

(1) Business trusts organized under Pennsylvania law or the law of any state or foreign jurisdiction, or any form of trust that has either of the following features:
  (a) The treatment of beneficiaries as associates.
  (b) Beneficial interests in the trust estate or profits that are evidenced by transferable shares, similar to corporate shares, or are otherwise treated as personal property.
(2) Minors' estates.
(3) Incompetents' estates.
(4) A resulting or constructive trust created by operation of law.
(5) A testamentary trust.

An ordinary trust may be revocable or irrevocable. A transfer of property, including real estate, to an irrevocable ordinary trust creates a current transfer of an interest in the property. That is why the exclusion for transfers of real estate to an ordinary trust treats the transfer as if it had been made directly to the trust beneficiaries and requires the Department to determine if the transfer would be excluded had the property been transferred directly to all the beneficiaries of the trust.

In this case, Trust 1 and Trust 2 are not trusts of single individuals. Rather, they are each "joint trusts." That is, they have multiple settlors.

The Act does not specifically address how to handle joint trusts. The statutory definition of both a living trust and an ordinary trust use the term "settlor" when referencing the creator of such a trust. This term is used in its singular form, which implies a singular creator or owner. However, the statutory language does not specifically or clearly exclude the possibility of joint settlors of a trust. In the absence of a legislative intent to limit the term settlor to its singular form, rules of statutory construction dictate that the singular form of any word is to include the plural. 1 Pa.C.S. § 1902. Therefore, the Department has taken the position that a joint trust may qualify as a living or ordinary trust and transfers of real estate to such a trust can qualify for the tax exclusions for transfers to or from a living or ordinary trust. For purposes of the trust exclusions, the Department treats a joint trust as two or more distinct trusts of each individual settlor. When viewed in this manner, each distinct, individual trust must meet the statutory criteria of a living or ordinary trust and the corresponding statutory elements for a tax exclusion in order for a transfer of real estate to or from the entire joint trust to be excluded from tax.

Trust 1 and 2 are revocable trusts. Therefore, they have the potential to be living trusts. However, both trusts provide for the reallocation of trust property between the three trust shares (joint, husband and wife share). Therefore, property including real estate that has been contributed to either trust by one spouse can be allocated to the share of the other spouse who can then benefit from the property by using, enjoying or withdrawing the property from the trust without consent of the other spouse. Consequently, it is possible for someone other than the settlor to benefit from property placed into the trusts by the settlor before the death of the settlor. Because someone else can benefit from property placed into the trusts by the settlor prior to the settlor's death, Trust 1 and 2 cannot be living trusts.

Nevertheless, Trust 1 and 2 appear to be ordinary trusts. They are inter vivos, private trusts that are designed to preserve, protect and distribute the assets of the settlors. Consequently, the realty transfer tax exclusions for transfers to and from ordinary trusts can apply to Trust 1 and 2.

Taxpayer A and B are lifetime principal and income beneficiaries of Trust 1. Therefore, Taxpayer A and B can receive a distribution of the Real Estate from the Trust without the imposition of realty transfer tax. For purposes of this letter ruling; it is assumed that the Real Estate is held in the joint share of Trust 1 and would be distributed to Taxpayer A and B as joint owners.

After the distribution of the Real Estate from Trust 1, Taxpayer A and B could convey the Real Estate to X and Y without the imposition of realty transfer tax as explained above.

After X and Y acquire the Real Estate from Taxpayer A and B, they could convey the Real Estate to Trust 2. For purposes of the ordinary trust exclusion, any transfer of the Real Estate from X and Y to Trust 2 would be viewed as a direct transfer to all of Trust 2's beneficiaries. Because the beneficiaries of Trust 2 are X and Y themselves, husband and wife, or their children and their heirs, or trusts whose beneficiaries are X and Y or their children and their heirs, any transfer from X and Y directly to those beneficiaries would be excluded family transfers under 72 P.S. § 8102-C.3(6) and 61 Pa. Code § 91.193(b)(6). Consequently, the transfer from X and Y to Trust 2 would also be excluded from tax.

Because it is assumed that the conveyance of the Real Estate from Trust 1 to Trust 2 actually represents a series of excluded transactions—(1) a distribution of the Real Estate from Trust 1 to Taxpayer A and B, (2) a sale and transfer of the Real Estate from Taxpayer A and B to X and Y and (3) a transfer of the Real Estate from X and Y to Trust 2—the

Department will recognize the single transfer of the Real Estate from Trust 1 to Trust 2 as the series of excluded transactions and will exclude the document effectuating the transfer of the Real Estate from Trust 1 to Trust 2 from the imposition of Pennsylvania Realty Transfer Tax.

It should be noted that because the single document of transfer from Trust 1 to Trust 2 represents a series of excluded transactions, a statement of value should be filed with the document explaining the series of transactions as well as the exemptions claimed for each transaction. Further, because Taxpayer will have to claim exclusions related to transfers from and to Trust 1 and 2, respectively, Taxpayers will have to present a copy of Trust 1 and 2 to the Recorder of Deeds at the time the document is recorded.

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[1] "Wills are by nature, revocable. The Probate, Estates and Fiduciary Code, 20 Pa. C.S. § 2505 expressly provides for the revocation of a will: 'by some other will or codicil in writing.'" Hatbob v. Brown, 394 Pa.Super. 234, 244; 575 A.2d 607, 612 (1990). Pennsylvania courts have recognized and enforced instruments that have been referred to as "mutual wills" or "reciprocal wills" that are irrevocable. However, Pennsylvania courts have never held that a will can be irrevocable. Rather, the courts have determined that two people may contractually agree to executed reciprocal wills and that such wills cannot be changed without the consent of the other party. In effect then the parties enter into a contractual obligation not to change the wills and the reciprocal execution of the wills serves as sufficient consideration to support the contract. Nonetheless, the agreement does not make the wills irrevocable or change Pennsylvania law that a will must be revocable. The agreement is merely an enforceable contract for which a party can seek legal redress if the contractual obligations are breeched. "An agreement, supported by consideration, to make a will or not to make a will, or to devise property in a stipulated manner, is binding and irrevocable. However, the existence of such a contract, which itself could be proven to be irrevocable, does not make any will written in conformity with it 'an irrevocable will.'" Baron Estate, 35 Pa. D. & C.2d 571, 573 (1965) (citations omitted). See also, Winters' Estate, 57 Pa. D. & C. 433, in which the Court, quoting from a California District Court opinion (Carpentier's Estate, 104 Cal. App. 33, 285 Pac. 348), stated "'A will, though it may be irrevocable as a contract is none the less revocable as a will, and in case such a will is revoked, the injured party cannot contest the later will in the probate court on that ground or insist on the probate of the earlier will, but is remitted to an independent action at law or in equity to enforce whatever rights he may have.'"