PENNSYLVANIA DEPARTMENT OF REVENUE
ISSUED: January 3, 2008
REVISED: April 18, 2008

Realty Transfer Tax Bulletin 2008–01

QUESTIONS AND ANSWERS:
THE RULE IN BAEHR BROS. (61 PA. CODE § 91.170)

The Department of Revenue received questions from the public regarding the application of its Realty Transfer Tax regulation under 61 Pa. Code § 91.170. In response, the Department is providing guidance through a series of hypothetical scenarios and an explanation of the tax results for each scenario. The scenarios include transactions involving: direct deeds in the context of a gift, assignments of sale agreements, and Internal Revenue Code § 1031 like-kind exchanges. The tax results for each scenario are fact sensitive. Therefore, the following should be understood as general guidance.

Section 91.170 of the regulation implements the rule that the Pennsylvania Supreme Court set out in Baehr Bros. v. Com., 409 A.2d 326 (Pa. 1979)—"[f]orm over substance is not the law of this Commonwealth, and quite to the contrary, tax cases must be decided on realities. Especially in tax cases, substance controls over form." Baehr Bros., 409 A.2d at 329 (Pa. 1979). In essence, the Baehr Bros. Court instructed that the Department must look to the substance of a transaction rather than its technical form in order to determine the tax consequences of the transaction.

Scenario 1

Scenario #1a. Albert has an uncle, John, who wants to buy him real estate and a house ("real estate") that Albert will use as his personal residence. Uncle John enters into a sale agreement with Sam, the owner of the real estate, to buy the real estate for $300,000. At closing, Uncle John pays the $300,000 purchase price to Sam and receives a deed for the real estate. The next day Uncle John conveys the real estate to Albert as a gift for $1. At the time of these transactions, the fair market value of the house is $350,000 and its computed value is $250,000.

Result #1a. The deed for the real estate from Sam to Uncle John is subject to tax. The taxable value is the $300,000 purchase price. The subsequent deed from Uncle John to Albert is also subject to tax. Because Uncle John conveyed the real estate to Albert as a gift, the $250,000 computed value of the real estate is the taxable value.

Scenario #1b. Assume the same facts as in scenario #1a except that Uncle John gives Albert $300,000 as a gift to buy the real estate. Then, Albert enters into a sale agreement with Sam to buy the real estate for $300,000. At closing, Albert pays Sam the $300,000 purchase price and receives the deed for the real estate.

Result #1b. In this case Uncle John gives Albert a $300,000 gift of cash. There is no realty transfer tax consequences associated with this transaction. Albert subsequently purchases the real estate from Sam. The deed from Sam to Albert is taxable on the $300,000 purchase price.

Scenario #1c. Assume the same facts as in Scenario #1a except at the closing Uncle John instructs Sam to convey the real estate directly to Albert. Sam conveys the deed to Albert.

Result #1c. The purpose for and the end result of the transactions in Scenario #1a-c is the same. Uncle John wants to buy the real estate for Albert. In all three Scenarios, Uncle John uses his money to buy the real estate, and Albert gets the real estate. Yet there is a different tax result for Scenario #1a and #1b.

The reason the result is different is because the substance of each transaction is different. In Scenario #1a, Uncle John intends to purchase the real estate and then make a gift of the real estate to Albert. In Scenario #1b, Uncle John gives Albert a gift of cash, and Albert directly purchases and obtains title to the real estate. The substance of the transactions in Scenarios #1a and #1b is revealed through the form of the transactions.

In Scenario #1c, the form of the transaction does not clearly reveal the substance of the transaction. Are the facts in Scenario #1c more like Scenario #1a or #1b? The holding in Baehr Bros. instructs that the tax result should follow the substance of the transactions. If the substance of the transaction is that Uncle John is making a gift of cash to Albert to purchase the real estate, and Albert is the actual purchaser of the real estate, then the transactions will be seen as identical to the facts in Scenario #1b with an identical tax result, regardless whether Uncle John directs Sam to convey the real estate directly to Albert or assigns the sale agreement to Albert. Sam and Albert will be jointly and severally liable for transfer tax on the $300,000 purchase price.

To reach this result, the facts and documents must demonstrate that Albert is the intended purchaser of the real estate and Uncle John is merely acting as a “go-between” or “middle-man.” For example, the sale agreement should indicate that Uncle John is not the intended purchaser and that he is acting on Albert’s behalf. Further, Albert should report the gift of cash from Uncle John for Federal gift tax purposes.

If the facts and documents demonstrate a different substance to the transaction, then the tax result could be different. If the sale agreement does not disclose that Uncle John is acting on Albert’s behalf and intends to either assign the sale agreement or have the deed executed in favor of Albert as his nominee, then the facts suggest that Uncle John is the actual purchaser of the real estate. Further, if Albert reports the real estate as a gift for Federal gift tax purposes rather than a cash gift, then there is further evidence that Uncle John is the actual purchaser of the real estate and intends to make a gift of the real estate to Albert. In that case, under § 91.170(b) (1) the deed from Sam to Albert will be viewed as two taxable transactions as in Scenario #1a—a sale of the real estate from Sam to Uncle John, and a subsequent gift of the real estate from Uncle John to Albert—that have been combined into one document for purposes of avoiding tax. In that case, the single deed will be subject to tax based upon the combined taxable value of both transactions in the amount of $550,000. Sam and Uncle John will be jointly and severally liable for tax on the $300,000 real estate purchase price, and Uncle John and Albert will be jointly and severally liable for tax on the tax on the $250,000 computed value of the real estate for the gift from Uncle John to Albert.[1]

Scenario #2

Scenario #2a. David owns real estate. Gina wants to purchase David's real estate for use in a business venture. Gina enters into a sale agreement with David to purchase the real estate for $600,000. Gina intends to take title to the real estate in her individual name. Gina has enough liquid assets to purchase the real estate without obtaining financing. At closing, Gina pays David $600,000 for the real estate, and David conveys the real estate to Gina in her individual name. One month later Gina seeks advice from her attorney about using the real estate as part of a business venture. The attorney advises Gina to operate the business through a single member, wholly-owned limited liability company (LLC) in order to insulate Gina from liability. Gina's attorney files the documents necessary to form the LLC. Gina conveys the real estate to the LLC in exchange for all the membership interest in the LLC. The computed value of the real estate at all times is $500,000.

Results #2a. This Scenario describes two transfers of title to the real estate and two taxable documents. The deed from David to Gina is subject to tax on the $600,000 purchase price. When Gina conveys the real estate to her newly formed LLC, the deed is subject to tax on the real estate's $500,000 computed value.

Scenario #2b. Assume the same facts as in Scenario #2a except that Gina seeks advice from her attorney before she enters into the sale agreement to purchase the real estate. After the LLC is formed, Gina contributes $600,000 cash to the LLC in exchange for all of the membership interest in the LLC. Gina has the LLC enter into a sale agreement with David for the purchase of the real estate for $600,000. At closing, the LLC pays David $600,000 for the real estate and David executes a deed to the LLC for the real estate.

Result #2b. In this Scenario, there is only one transfer of title to real estate and therefore only one taxable document. The deed from David to the LLC is subject to tax, and the taxable value is the $600,000 purchase price. Compare this to the result in Scenario #2a. In both scenarios, the end result is the same—the LLC ends up holding title to the real estate. However, in Scenario #2a, there are two taxable events and documents with respective taxable values of $600,000 and $500,000. In Scenario #2b, there is only one taxable event and document with a taxable value of $600,000.

---

[1] Scenario #1c is one of the fact patterns that the public submitted to the Department for consideration. If the true nature of the transactions is that the uncle wants to buy a house for his nephew, it is unclear from the Department's perspective why the taxpayers would choose such a complicated structure for the transaction. The best way to avoid confusion as to the actual substance of the transaction would be for the uncle to give his nephew the cash to buy the real estate and let the nephew enter into the sale agreement with the seller and receive the deed from the seller. In that case, for Realty Transfer Tax purposes there is one real estate transaction, one deed, one taxable event and one tax liability on the $300,000 purchase price. Structuring the transaction in a more complicated manner, begs the question "what is the purpose for the complicated structure and does the complicated structure suggest a different transaction and different tax result?"

Scenario #2c. Assume the same facts as Scenario #2b, except that after the LLC is formed, Gina enters into an agreement with the LLC to purchase the real estate on the LLC's behalf. The agreement provides that Gina will pay the $600,000 purchase price for the real estate using her own funds in lieu of making a cash contribution to the LLC. Gina will be credited on the LLC's books as making a cash contribution of $600,000 in exchange for all of the membership interest in the LLC. Gina enters into a sale agreement with David to purchase the real estate on behalf of the LLC for $600,000. The sale agreement discloses that Gina is acting on behalf of the LLC. At closing, Gina pays David $600,000 and David conveys the real estate to Gina on behalf of the LLC. Subsequently, Gina conveys the real estate to the LLC for no or nominal consideration. The computed value of the real estate at all times is $500,000.

Result #2c. When Gina purchases and obtains title to the real estate on behalf of the LLC, the deed is taxable, and the taxable value is the $600,000 purchase price.

Gina was acting on the LLC's behalf when she obtained title to the real estate. That relationship is disclosed in all the documentation. Therefore, Gina is considered the LLC's agent or straw-party for purposes of the transaction. The Realty Transfer Tax law provides that when a person acquires title to real estate on behalf of another as an agent or straw-party, the document by which the agent or straw-party receives title to the real estate is subject to tax. A subsequent conveyance of title to the real estate from the agent or straw party to the principle is not subject to tax. 72 P.S. § 8102-C.3(11). Consequently, when Gina conveys the real estate to the LLC for no or nominal consideration, the deed of conveyance is excluded from tax.

Scenario #2d. Assume the same facts as Scenario #2c except that Gina enters into the agreement of sale for the real estate with David before Gina's attorney files the documents to form the LLC and never enters into a written agreement with the LLC to purchase the real estate on its behalf although that is her intent. Further, neither the agreement of sale nor the deed from David to Gina discloses that Gina is acting on behalf of the LLC.

Result #2d. When Gina purchases and obtains title to the real estate on behalf of the LLC, the deed is taxable, and the taxable value is the $600,000 purchase price.

In this Scenario, as compared to Scenario #2c, there is not a clear agent or straw-party relationship. A principal and agent or straw-party relationship is a contractual relationship. All contractual relationships are legally binding agreements between two or more parties that have capacity to enter into the contract. It is axiomatic that a party to a contract must exist in order to have capacity to enter into the contract. At the time Gina executed the sale agreement, the LLC had not been formed, and therefore, it did not legally exist. Therefore, Gina could not have been an agent or straw-party for the LLC for purposes of entering into the sale agreement. As a result, Gina was the intended purchaser and grantee under the sale agreement.

Even if it were possible for an agent or straw-party relationship to exist, there is no evidence of the relationship. There was no written agent or straw-party agreement. Further, the fact that Gina was acting on the LLC's behalf was not disclosed in the sale agreement or the deed, which creates a rebuttable presumption that an agent or straw-party relationship did not exist. See 72 P.S. § 8102-C.3(11). Therefore, Gina is deemed to be acting in her individual capacity and not behalf of the LLC's when she purchased the real estate. Consequently, when Gina conveys title to the real estate to the LLC, the deed will be subject to tax. Because no consideration is paid (or even if it is construed that the membership interest in the LLC is the consideration for the transfer) the taxable value is the $500,000 computed value. See 72 P.S. § 8102-C (definition (2) of "value).

Scenario #2e. David owns real estate. Gina wants to purchase David's real estate for use in a business venture. Gina enters into a sale agreement with David to purchase the real estate for $600,000. The sale agreement provides that Gina or her nominee will be the grantee. Further, the sale agreement does not prohibit Gina from assigning her right in the sale agreement. Gina goes to her attorney after she signs the contract. Her attorney advises her not to own the real estate in her own name. The attorney advises Gina to operate the business through a single member, wholly-owned limited liability company (LLC) in order to insulate Gina from liability. Gina's attorney files the documents necessary to form the LLC. Gina contributes $600,000 to the LLC. At the closing, Gina directs David to convey the real estate to the LLC as Gina's nominee and the LLC pays David $600,000 for the deed. David conveys the real estate to the LLC. The computed value of the real estate at closing is $500,000.

Scenario #2f. Assume the same facts as Scenario #2e, except at closing Gina assigns the sale agreement to the LLC. The LLC buys the real estate for $600,000 and David conveys the deed to the real estate to the LLC.

Results #2e and #2f. The end result of the transactions in Scenarios #2e and #2f are the same as the end result in Scenarios #2a–#2d. Title to the real estate ends up in the name of the LLC. The only difference between the Scenarios is the manner or form by which the end result was accomplished.

In Scenarios #2a–#2d, the substance of the transactions is clear from the form of the transactions. It is clear whether there are one or two transactions and whether each transaction and the documents effectuating each transaction are taxable. In Scenarios #2e and #2f, the end result is the same as in Scenarios #2a–#2d, but the substance of the transactions is clouded by the use of an assignment or a nominee, which avoids essential steps of the transactions that occurred in Scenarios #2a–#2d.

In Scenarios #2e and #2f, only one document of transfer is executed—the deed from David to the LLC. The purchase price for the deed under sale agreement and the amount that the LLC pays for the deed is $600,000. Therefore, on its face, it appears that there is only one taxable document, and the taxable value of the document is the $600,000 purchase price.

The issue to be addressed under these facts is whether the intervening nomination or assignment that occurred between the signing of the sale agreement and the delivery of the deed are in substance transactions that should be subject to tax.

It is difficult to determine if there have been multiple transfers of the real estate because the sale agreement does not definitively identify the ultimate purchaser or grantee of the real estate. All that is known from the sale agreement is that Gina is executing the agreement of sale and the sale price for the conveyance of the real estate will be $600,000. Either Gina or some other person at Gina's nomination or by assignment will be the purchaser and grantee.

Because there is only one deed, Scenarios #2e and #2f appear to be similar to Scenario #2b. Arguably the tax result should be the same as well—one taxable document and a taxable value of $600,000. However, the holding in Baehr Bros. clearly provides that the fact that there is only one deed is not necessarily determinative of the proper tax result.

Nonetheless, Scenarios #2e and #2f also appear similar to Scenarios #2a and #2d, in which there are two transactions and two taxable documents. If that is the case, the tax result for Scenarios #2e and #2f should be the same as the result for Scenarios #2a and #2d—two taxable transactions and documents with taxable values of $600,000 and $500,000. Because there are multiple transactions associated with Scenarios #2e and #2f, it will be deemed that there are multiple transactions for purposes of determining the tax liability. The only question is whether the multiple transactions create multiple tax liabilities.

Scenarios #2e and #2f are similar to Scenario #2c in which Gina is merely acting as agent or straw-party for the LLC and is merely brokering the purchase of the real estate for the LLC. If that is the substance of the transaction then the tax result of the multiple transactions should be the same as the result in Scenario #2c—two transactions and documents, with the first document subject to tax on the $600,000 sale price, and the second document is excluded because it effectuates a transfer from and agent or straw-party to its principal.

The facts as presented in Scenarios #2e and #2f suggest the possibility of a principal and agent or straw-party transaction. The sale agreement states that Gina is either purchasing the real estate on her own behalf or on behalf of her nominee. If a nominee exists at the time the sale agreement was executed, the "nominee" can be viewed as the principal and Gina as an agent or straw party. But, like Scenario #2d, at the time Gina executed the sale agreement, the LLC had not been formed, and therefore, it did not legally exist. Therefore, Gina could not have been an agent or principal for the LLC for purposes of entering into the sale agreement. As a result, Gina was the intended purchaser and grantee under the sale agreement and should have received the deed. Gina could then have contributed the real estate to the LLC by executing a deed for the real estate to the LLC. Because the substance of the transaction is actually two conveyances of title to the real estate the proper taxable value is $1,100,000. David and Gina are jointly and severally liable for tax on the $600,000 purchase price, and Gina and the LLC are jointly and severally liable for tax on the $500,000 computed value.

If the LLC had been created prior to Gina executing the sale agreement Gina could have entered into a principal and agent or straw-party agreement with the LLC to execute the sale agreement on the LLC's behalf. In that case, the series of transactions would be viewed as a sale to an agent and a subsequent transfer to the principal, and the tax liability would be identical to the liability in Scenario #2c. Gina and David would be jointly and severally liable for tax on the $600,000 purchase price. The subsequent transfer from Gina to the LLC would be excluded from tax.

Scenario #2g. Assume the same facts as in Scenarios #2e and #2f, except that after Gina enters into the agreement of sale, she obtains approval to subdivide the real estate into 32 building lots. The fair market value of each lot is $100,000 based upon a bona fide real estate appraisal. However, the real estate is not immediately reassessed after the subdivision is completed and the computed value for the real estate is still $500,000.

Result #2g. The tax application is the same as Result #2e and #2f as described above. However, because the real estate has been subdivided and has not been reassessed, each lot does not have a determinable computed value. Therefore, computed value cannot be used. When the taxable value cannot be based upon a bona fide sale price or the computed value, the proper taxable value is the actual monetary worth of the real estate as determined by an appraisal. Thus, where the computed value was used in Result #2e and #2f, such value should be replaced by the actual monetary worth of $100,000 per lot.

However, if each lot is reassessed before its conveyance, then the computed value of each lot based upon its local tax assessed value is the proper taxable value.

Scenario #2h. Assume the same facts as in Scenarios #2e and #2f, except that prior to closing Gina finds an investor, Tom, who will invest $300,000 for a 50% interest in the LLC. At the closing, Gina and Tom each contribute $300,000 to the LLC, and the LLC buys real estate for $600,000.

Result #2h. The tax result for this Scenario is the same result as Result #2e and #2f. It is immaterial that part of the purchase price is obtained from an outside investor who is merely buying an interest in the LLC.

Scenario #2i. Assume the same facts as Scenario #2g except that Gina contributes the agreement of sale to the LLC for a 50% membership interest in the LLC and is credited on the books of the LLC as making a capital contribution worth $2,600,000[2]. Tom contributes $2,600,000 in cash to the LLC in exchange for the remaining 50% membership interest in the LLC. At the closing, the LLC uses $600,000 of the cash contributed by Tom, and purchases the real estate for $600,000. The LLC uses the remaining $2,000,000 to fund the construction of houses on the lots for sale to customers in the ordinary course of its business.

Result #2i. The tax result for this Scenario is the same result as Result #2g. This transaction will be deemed to be a purchase of the real estate by Gina from David for $600,000 and a subsequent contribution of the real estate by Gina to the newly formed LLC. Gina and David will be subject to tax on the $600,000 purchase price, and Gina and the LLC will be subject to tax on the total appraised value of each lot (total of $3,200,000) that Gina contributed to the LLC. The fact that the LLC credits Gina for a capital contribution of $2,600,000 and Tom's decision to invest in the LLC and contribute $2,600,000 to the LLC for his membership interest has no effect on the Realty Transfer Tax consequences of this transaction.

Scenario #3

Scenario #3a. A real estate investment trust (REIT) owns real estate through indirectly held single purpose entities (SPEs). Each SPE is owned by a limited partnership (the Operating Partnership) controlled by REIT and in which REIT is the majority owner. REITs regular practice is to cause one of its subsidiaries (the Contract Sub) to enter into all of its contracts to

[2] The fair market value of the real estate at the time Gina contributes the sale agreement to the LLC is $3,200,000. However, Gina's capital contribution is only $2,600,000 because the LLC will have to pay $600,000 to purchase the real estate from David.

acquire real estate. Prior to the closing under any particular agreement of sale, REIT will cause the Operating Partnership to form a new SPE, typically a limited liability company or a partnership, and will cause the Contract Sub to assign the agreement of sale for no or nominal consideration to the newly formed SPE owned by the Operating Partnership. Although it is always intended that each parcel of real estate will be purchased through a separate SPE, the exact SPE that will acquire any particular piece of real estate typically is not formed until shortly before closing. Consistent with this practice, Contract Sub enters into a sale agreement to buy real estate from David for $20,000,000. The contract is assignable either by its express terms (through an assignment clause or the grantee is described as "the Contract Sub, or its nominee") or because it is silent as to assignability and there are no other legal impediments to the assignability of the contract. The Contract Sub maintains a bank account from which funds are drawn to purchase the real estate. Subsequent to entering into the sale agreement: (i) REIT causes the Operating Partnership to form a new SPE as a wholly owned limited liability company, (ii) REIT causes Contract Sub to assign the agreement of sale to the new SPE and (iii) the Contract Sub pays David $20,000,000 (using debt and equity arranged for by the REIT). At the time of closing, the computed value of the real estate is $15,000,000.

<u>Result #3a.</u> The facts in this Scenario are practically identical to the facts contained throughout Scenario #2 except that the parties involved are related entities in a large business structure and the sale price and computed value for the real estate is higher. It is irrelevant that all the business entities are part of a business structure that is owned by the same parent entity. All of the entities in the business structure are separate and distinct from one another for Realty Transfer Tax purposes. Although the parties in this scenario have a common business practice of assigning sale contracts for real estate, that fact, in and of itself does not create enough of a distinction to result in a different legal analysis or conclusion from the analysis and tax result contained throughout Result #2a–#2i.

<u>Scenario #3b.</u> Assume the same facts as in Scenario #3a, except that the sale agreement between Contract Sub and David expressly provides that Contract Sub is entering into the agreement for the benefit of a nominee, a yet-to-be-formed SPE ("new SPE"), that will be created and disclosed to David prior to closing. Further, the sale agreement discloses that the Contract Sub has no intent to obtain legal or equitable title to the real estate. The assignment of the sale agreement from Contract Sub to the new SPE results in a repudiation of Contract Sub's duties to David and a novation on the part of the new SPE to the Contract Sub's duties. If financing is to be obtained to purchase the real estate, the lender is notified that the new SPE is the actual applicant for the financing and will acquire title to the real estate. Further, the new SPE purchases the real estate from David at closing either with the funds obtained from the financing or with its own assets.

<u>Result #3b.</u> Under this Scenario, all the facts and documentation indicate that the actual purchaser of the real estate will be the new SPE and that the Contract Sub is merely acting as a facilitator of the sale. The Contract sub is entering into the sale agreement for the benefit of the new SPE and will not take legal or equitable title to the real estate. When the Contract Sub assigns the sale agreement to the new SPE, the Contract Sub no longer has any obligation under the sale agreement. The new SPE takes its place and assumes all of the Contract Sub's obligations. Therefore, it is as if the original sale agreement was revoked and a new sale agreement was executed by David as the seller and the new SPE as the buyer. Further, all the funds used to purchase the real estate come from the new SPE. Therefore, the assignment of the sale agreement will not be considered a taxable transaction. The sole taxable transaction is the

conveyance of the real estate from David to the new SPE, and the taxable value of the deed from David to the new SPE is the $20,000,000 purchase price.

Scenario #4

Scenario #4a. Joe owns real estate. Joe enters into a contract to sell the real estate to Adam for $1,000,000. Adam pays Joe $1,000,000 for the real estate and Joe conveys the real estate to Adam. Joe has $1,000,000 in hand as a result of this transaction.

Adam is a speculator and developer. He believes that he can make a profit by selling the real estate. Adam gets certain approvals that increase the fair market value of the real estate to $3,000,000. Adam then enters into a contract to sell the real estate to Bruce for $3,000,000. Bruce pays Adam $3,000,000 for the real estate and Adam conveys the real estate to Bruce. At the end of this transaction Adam has made $2,000,000 ($3,000,000 sale price less his $1,000,000 acquisition cost) as a result of his speculation.

Bruce is also a speculator and developer. He gets further approvals that increase the fair market value of the real estate to $6,000,000. Bruce enters into a contract to sell the real estate to Carl for $6,000,000. Carl pays Bruce $6,000,000 for the real estate and Bruce conveys the real estate to Carl. At the end of this transaction Bruce has made in hand $3,000,000 ($6,000,000 sale price less his $3,000,000 acquisition cost) as a result of his speculation.

Result #4a. In this Scenario there are three transactions in which title to the real estate is conveyed and three taxable documents. The deed from Joe to Adam is subject to tax and the taxable value is the $1,000,000 sale price. Joe and Adam are jointly and severally liable for the tax liability. The deed from Adam to Bruce is subject to tax and the taxable value is the $3,000,000 sale price. Adam and Bruce are jointly and severally liable for the tax liability. The deed from Bruce to Carl is subject to tax and the taxable value is the $6,000,000 sale price. Bruce and Carl are jointly and severally liable for the tax liability.

Scenario #4b. Assume the same facts in Scenario #4a except that the transactions are accomplished by assignments of the contracts rather than by separate sale agreements and deeds for the real estate. Further, the full consideration for each transaction is not paid to each grantor. Rather, each grantee is paid only the net amount of money he expects to receive after purchasing and selling his interest in the real estate. The facts in Scenario #4a are thus revised as follows:

Joe enters into a contract to sell the real estate to Adam for $1,000,000. Adam gets certain approvals, which increase the fair market value of real estate to $3,000,000. Adam sells his rights under the contract to Bruce in exchange for Bruce’s agreement to pay Adam $2,000,000. Bruce gets further approvals which increase the fair market value of the real estate to $6,000,000. Bruce then sells the agreement of sale to Carl for $5,000,000 and Carl’s agreement to pay Joe $1,000,000 (a total of $6,000,000). At closing, (i) Carl pays Joe the $1,000,000 purchase price provided in the contract originally executed by Joe and Adam, and Joe conveys the real estate to Carl, (ii) Carl pays Bruce $5,000,000 and (iii) Bruce pays $2,000,000 of the cash he just received to Adam. Accordingly, of the total $6,000,000 paid by Carl, Joe received $1,000,000, Bruce initially received $5,000,000 but ended up with $3,000,000, and Adam received $2,000,000.

Result #4b. The facts in this Scenario describe, in substance, the same events that happened in Scenario #4a, albeit by a different transactional form. In this Scenario, the interest in the real estate was not conveyed by multiple sales contracts and deeds, but rather by one sale contract that was assigned multiple times for consideration ("flipping" the sales contract) and one deed. In substance, this is no different than multiple sales and conveyances of the real estate itself where each party intends make a profit on the subsequent transfer of the real estate. The holding in Baehr Bros. instructs that because the substance of the transactions is the same, the form must be overlooked to determine the tax consequences. Therefore, the Department views this transaction as identical to the transactions in Scenario #4a, as follows:

Grantor	Grantee	Purchase Price	Net
Joe	Adam	$1,000,000	$1,000,000 (Joe)
Adam	Bruce	$3,000,000	$2,000,000 (Adam)
Bruce	Carl	$6,000,000	$3,000,000 (Bruce)

The total purchase price for all three transactions is $10,000,000. Consequently, the tax liability for the single deed from Joe to Carl is $10,000,000. Each grantor and grantee will be jointly and severally liable for the tax on their proportionate share of the total purchase price attributable to their respective transfer. It is irrelevant who pays whom. If this transaction had been accomplished as a series of sales with a corresponding deed (1) Carl would have paid Bruce $6,000,000 for his deed, (2) Bruce would have paid Adam $3,000,000 for his deed and kept the remaining $3,000,000 for himself as profit, and (3) Adam would have paid Joe $1,000,000 for his deed and kept the remaining $2,000,000 for himself as profit.

The fact pattern in this Scenario is identical to the fact pattern in Allebach v. Com., 683 A.2d 625 (Pa. 1996). The Department has interpreted the Court's decision in Allebach to mean that the proper tax liability of someone who sells and conveys real estate is the amount paid to the seller for the conveyance. This is the proper value even if the contract for the sale of the real estate is subsequently assigned for additional consideration.

In this Scenario, the Department follows the Court's holding in Allebach by concluding that Joe's tax liability is limited to the $1,000,000 sale price he received for the real estate. However, Joe's sale of the real estate was not the only transaction. There were two other sales of the real estate by way of the assignments. The Court in Allebach did not specifically address how to treat the additional transactions.

The Department uses the Court's holding in Baehr Bros. as guidance for how the remaining transactions should be handled. Because there are substantively three transfers of the real estate for consideration, Baehr Bros. authorizes the Department to look to the substance of the transaction and impose tax on the value of each transfer.

This tax result demonstrates how the Department will implement the Supreme Court's holding in Baehr Bros. to this Scenario while still maintaining consistency with the Supreme Court's holding in Allebach.

Scenario #4c. Assume the same facts as Scenario #4b except instead of agreeing to pay Bruce $5,000,000 for the assignment of the agreement of sale, Carl agrees that he will assume Bruce's obligation to pay $2,000,000 to Adam and agrees to pay Bruce an additional $3,000,000. Thus, at closing, Carl directly pays Joe $1,000,000, Adam $2,000,000 and Bruce $3,000,000.

<u>Result #4c.</u> The tax result for this Scenario is the same as Result #4b. It is immaterial who ultimately decides to pay whom or how the funds will change hands.

<u>Scenario #4d.</u> David enters into a sale agreement to convey real estate to Jim for $10,000,000. The computed value of the real estate is $8,000,000. Jim obtains various approvals to subdivide and/or develop the real estate. Thereafter, Jim enters into an agreement with the REIT's Contract Sub as described in Scenario #3 to assign his sale agreement with David to the REIT's Contract Sub. The terms of the assignment agreement are identical to the terms of the sale agreement as described in Scenario #3b in that the Contract Sub is executing the agreement on behalf of its nominee, a new, yet-to-be-formed new SPE. It further provides that the Contract Sub will assign the contract to the new SPE, after it is formed, before or at the time of settlement. The new SPE is obligated under the assignment to pay Jim $5,000,000 for the assignment and is obligated to pay David the $10,000,000 purchase price at closing. At closing, David presents the new SPE with a deed to the real estate.

<u>Result #4d.</u> This scenario is a combination of Scenario #4c and #3b. Therefore, the deed from David to the new SPE is deemed to be two taxable conveyances—a conveyance from David to Jim and a subsequent conveyance from Jim to the new SPE. However, the assignment from the Contract Sub to the new SPE will not be deemed to be a taxable transaction as explained in the result to Scenario #3b. The taxable value of the conveyance from David to Jim is the $10,000,000 purchase price. The taxable value of the conveyance from Jim to the new SPE is $15,000,000, the total amount that the SPE paid for the assignment of the sale contract and the real estate. Therefore, the total taxable value of the deed from David to the new SPE is $25,000,000. David and Jim are jointly and severally liable for the tax on the $10,000,000 purchase price and Jim and the SPE are jointly and severally liable for the tax on the subsequent $15,000,000 purchase price.

<u>Scenario #5</u>

<u>Scenario #5a.</u> Tom owns real estate ("Property A") and enters into a sale agreement to sell the real estate to Adam for $1,000,000. The agreement provides that if Tom elects to structure the transfer of the real estate to Adam as part of a like-kind exchange of real estate under Internal Revenue Code § 1031, Tom will have the right to assign his rights under the agreement of sale to a "qualified intermediary" (or "QI") as described in the Treasury Regulations issued under section 1031 of the Code.

Tom then enters into an agreement with Bruce to buy a parcel of real estate ("Property B") from Bruce for $1,000,000. The agreement of sale gives Tom the right to assign his rights under the agreement to a QI. Tom intends to use Property B as the replacement property for Property A, the relinquished property, in his like-kind exchange.

After entering into the two agreements of sale, Tom enters into an exchange agreement with QI, who is not related to Tom, Adam or Bruce. The exchange agreement provides, among other things, that (i) Tom is to pay the QI a fixed fee of $500 for its services, (ii) the QI will act as a qualified intermediary for the purpose of effecting Tom's exchange of Property A for Property B, (iii) under no conditions will QI take title to either Property A or Property B, and (iv) the QI will not assume liability for any obligations under the agreement of sale for Property A or Property B, will not have any benefits or burdens of ownership of Property A or Property B, and will be fully indemnified from any losses by Tom.

Immediately prior to the closing, Tom assigns to QI, for no consideration, Tom's right to sell Property A to Adam and Tom's right to buy Property B from Bruce. At the closing, (i) Adam pays $1,000,000 to QI, (ii) QI directs Tom to transfer title to Property A directly to Adam, (iii) QI pays $1,000,000 to Bruce and (iv) QI directs Bruce to transfer title to Property B directly to Tom.

<u>Result #5a.</u> Regulation § 91.153(d) provides that a QI is not an agent or straw party for purposes of realty transfer tax. However, in this Scenario, it is immaterial whether the QI is an agent or straw-party because the QI never takes title to or has dominion over Property A or B. Further, Tom received no consideration in this case for either the assignment to QI of Tom's right to sell Property A or for the assignment to QI of Tom's right to purchase Property B. Similarly, QI received no consideration for either Property A or Property B or for assignment of either contract. QI's only compensation is its $500 fee for acting as a facilitator for the exchange. Moreover, QI does not have any benefits or burdens of owning either Property A or Property B. Accordingly, in this scenario, the QI is viewed as a mere facilitator of the conveyances of Property A and Property B. The resulting tax liability is as follows:

- The taxable value of the deed for Property A from Tom to Adam is the price in the agreement of sale ($1,000,000). Tom and Adam are jointly and severally liable for the tax liability.

- The taxable value of the deed for Property B from Bruce to Tom is the price in the agreement of sale ($1,000,000). Bruce and Tom are jointly and severally liable for the tax liability.

<u>Scenario #5b.</u> Assume the same facts as Scenario #5a, except that at closing Tom transfers title to Property A to QI for no consideration. The QI then transfers title to Property A to Adam for the $1,000,000 sale price. Further, Bruce transfers title to Property B to QI for no consideration. The QI then transfers title to Property B to Tom for the $1,000,000 sale price. At all relevant times, the computed value of Property A is $975,000 and $990,000 for Property B.

<u>Result #5b.</u> In this case the QI actually takes title to Property A and B. Because QI is not considered an agent or straw party under regulation § 91.153(d), there are four taxable documents.

- Because no consideration was given for the deed for Property A from Tom to QI, the taxable value is Property A's computed value of $975,000. Tom and QI are jointly and severally liable for this tax.

- The taxable value of the deed for Property A from QI to Adam is the $1,000,000 sale price. QI and Adam are jointly and severally liable for this tax.

- Because no consideration was given for the deed for Property B from Bruce to QI, the taxable value of the deed is Property B's computed value of $990,000. Bruce and QI and jointly and severally liable for this tax.

- The taxable value of the deed for Property B from QI to Tom is the $1,000,000 sale price. QI and Tom are jointly and severally liable for this tax.

<u>Scenario #6</u>

Tom owns real estate ("Property A") and wants to acquire real estate owned by Bruce ("Property B") as the replacement property for Property A as part of a like-kind exchange of real estate under Internal Revenue Code § 1031.

Tom enters into a sale agreement with Bruce to purchase Property B for $2,000,000. Unfortunately for Tom, Bruce insists that the closing of the sale of Property B must occur within 30 days, and Tom has not yet found a buyer for Property A. Accordingly, Tom hires an unrelated third party to act as an "exchange accommodation titleholder" ("EAT") as described in IRS Revenue Procedure 2000-37. The agreement between Tom and EAT provides, among other things, that (i) Tom will assign the agreement to purchase Property B to EAT for no consideration, (ii) EAT will acquire Property B and hold legal title for Tom's benefit pending the completion of a like-kind exchange for Property A, (iii) Tom will make nonrecourse loans to EAT and/or guaranty nonrecourse third party debt sufficient to enable EAT to pay the entire $2,000,000 purchase price, (iv) Tom and EAT will enter into a lease (for less than 30 years) or management agreement giving Tom the sole and exclusive right to manage and control how Property B is used, making Tom solely responsible for all operating costs and expenses of Property B and giving Tom the right to all income, revenues and rents generated by Property B, (v) Tom will fully indemnify EAT against any losses, costs and expenses arising out of EAT's ownership of Property B, (vi) Tom has the right to purchase Property B from EAT for $2,000,000 and Tom agrees to consummate such purchase through a QI within 180 days of EAT's acquisition of Property B (the EAT will not actually receive $2,000,000 for the purchase; rather the $2,000,000 purchase price will offset EAT's $2,000,000 liability for the nonrecourse loan), (vii) after the expiration of 180 days if Tom has not competed his exchange, EAT may force Tom to buy and take title to Property B (a "put") for $2,000,000, (viii) Tom will pay EAT a $1,000 fee for its services and (ix) to comply with Rev. Proc. 2000-37, for federal income tax purposes, EAT will be treated as the tax owner of Property B pending completion of Tom's exchange and Tom will not claim depreciation deductions for Property B for the period that EAT holds legal title.

Tom subsequently enters into an agreement to sell Property A to Adam for $2,000,000. Tom enters into an exchange agreement with QI and assigns to the QI, for no consideration, both the right to sell Property A to Adam and the right to buy Property B from EAT. At closing on August 1 (i) Adam pays $2,000,000 to QI, (ii) QI directs Tom to deed Property A directly to

Adam, (iii) QI pays $2,000,000 to EAT, which uses the cash to repay the loans incurred to buy Property B, and (iv) QI directs EAT to deed Property B directly to Tom.

Result #6. When the EAT takes title to Property B, the deed is subject to tax. The deed's taxable value is the $2,000,000 purchase price. The EAT and Bruce are jointly and severally liable for the tax liability.

Under regulation § 91.153(d), the EAT is not Tom's agent or straw party.

The remaining transactions are identical to the transactions in Scenario #5a, and the tax results are the same as Result #5a, as follows:

- The taxable value of the deed for Property A from Tom to Adam is the price in the agreement of sale ($2,000,000). Tom and Adam are jointly and severally liable for the tax liability.

- The taxable value of the deed for Property B from the EAT to Tom is the price in the agreement of sale ($2,000,000). The EAT and Tom are jointly and severally liable for the tax liability.

For additional information please visit The Department's website www.revenue.pa.gov.