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DEPARTMENT OF REVENUE
REGULATORY
REVIEW COMMISSION

December 1, 2005

Ms. Mary R. Sprunk
Office of Chief Counsel
Department of Revenue
Dept. 281061
Harrisburg, PA 17128-1061

Dear Ms. Sprunk:

I am enclosing some comments on the proposed regulations which will be used as one of my columns in the Philadelphia Legal Intelligencer. I would appreciate any comments you may have. Kindly acknowledge receipt.

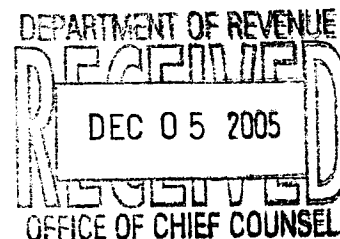
Yours truly,

Harris Ominsky 

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HO/mj

Enclosure



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NEW TRANSFER TAX RULES PROPOSED

By: Harris Ominsky*

The Pennsylvania Department of Revenue has promulgated proposed realty transfer tax regulations to supplement the existing ones. As required, the proposals were published in the Pennsylvania Bulletin (www.pabulletin.com/secure/data/vol35/35-45/2019.html). The Department posted these proposals on November 8th, and public comment is invited within thirty days of that date. The proposals cover a broad range of issues and extend over 24 pages. Some interested parties will undoubtedly have difficulty absorbing the changes and submitting responsible comments within that deadline.

Some of the changes have been inspired by appellate court decisions rendered over the past few years. For example, Section 91.132 conforms to the *Allebach* case which dealt with the computation of the taxable purchase price at deed closing when an assignee of any agreement of sale pays the assignor a flip price for the assignment. Also, Section 91.156 is substantially amended to address transfers involving trusts, as set forth in two Pennsylvania Supreme Court cases, *Leigh v. Commonwealth* and *Holmes v. Commonwealth*. A more esoteric change is set forth in Section 91.193, which involves an exclusion from transfer tax of a deed made pursuant to a confirmed bankruptcy plan, as discussed in *Baltimore County v. Hechinger Liquidation Trust*.

Many of the new regulations could have been predicted by those who follow recent rulings on the realty transfer tax. Perhaps the ones that will attract the most attention are those that involve ownership conversions of real estate owned by corporations, partnerships

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and other associations; and those involving transfers to and from ordinary trusts and living trusts.

Change in Form of a Corporation or Association

Section 91.152 of the new regs permits a confirmatory deed to be exempt from transfer tax if it is made “without consideration for the sole purpose of confirming real estate ownership following a merger, consolidation or change in the form or identity of a corporation or an association.” However, that exemption is available only if all of the listed criteria for the merger or change are met. For example, as was expected in the case of a merger or consolidation, there can be no change in proportionate ownership interests resulting from the change in form. Therefore, a general partnership with two equal partners may be converted to a limited partnership if the partners retain their same equal interests in the limited partnership.

In addition, the exemption still will apply even if the partners add an LLC, which they both own, as the general partner. This is a common device used to protect the limited partners from third-party liability.

A deed may then be used to convey the real estate from the general partnership to the newly-created limited partnership, but to succeed with this exemption, the regulations make it clear that the general partnership must cease to exist as a result of the conversion.

The regulations also specify that the exemption would not apply if the property had been titled in the two equal partners as “co-tenants,” and not as partners. A transfer from two individuals to a partnership, or any other entity, is taxable because the exemption does

not extend to a transfer from individuals to an association, even if the individuals retain the same percentage interests in the association as they had in their individual capacities.

These regulations were to be expected because they followed a series of private rulings involving these types of transfers. One concept introduced in the new regs will surprise many. An example in the regs would tax a transfer from a general partnership to a limited partnership of the same partners when only one of the partners is designated as the general partner of the transferee/limited partnership. Therefore, even though each of two partners retains the same 50% interest in the partnership's income, if one partner has assumed sole control over the partnership as a general partner, that is considered a "change in ownership interests" and, therefore, the deed is taxable.

The regulations do not discuss what would happen if the conversion starts off with an exempt transaction where both partners share in the interest of the LLC which is set up as a general partner, and then later transfer a 100% interest in the LLC to the one partner that will manage the partnership. Other questions will occur to thoughtful planners. For example, will the exemption be lost when the partners start out with equal shares in the LLC general partner, but later decide to amend the LLC documents to clarify that one of the partners has full management rights in the LLC.

Trusts

Another set of regulations (Section 91.156) attempts to clarify transfers to and from both ordinary trusts and living trusts. Essentially, a transfer to an ordinary trust is exempt if the transfer would have been wholly-exempt if it had been made directly from the grantor to "all of the possible beneficiaries . . . whether or not the beneficiaries are contingent or

specifically named.” This rule had been applied in a way that sometimes trapped estate planners into precipitating an unexpected transfer tax. For example, a transfer to an ordinary trust where a contingent or remainder interest might go to the grantor’s church could be fully taxable, even though all the other beneficiaries are exempt children or grandchildren, and even though the contingency is not likely to happen. That occurs because the transfer laws do not exempt a direct transfer to a religious organization.

The regulations do provide help to the estate planner under certain circumstances. Section 91.156(a) seems to make an exception for a trust which is set up so that the non-exempt party, i.e. the church, has a right to get other property from the trust under certain circumstances, but not the real estate or the proceeds from the real estate. Therefore, a church could be set up as a beneficiary, so long as it is made clear that the church would not be able to participate in any distribution of the real estate or the proceeds from real estate.

That section of the proposed regulations is written in a somewhat convoluted way and it should be clarified. However, this interpretation of the exemption is in accord with the Pennsylvania Supreme Court cases which were cited earlier.

The new regulations define a “living trust” and “ordinary trust.” These are important definitions because they may determine in some cases whether a transfer is exempt or not. Practitioners may have quarrels with these definitions, but they should be careful to follow them carefully in setting up trusts.

Overview

On final analysis, the proposed regulations cover a wide scope of issues ranging from taxation of transfers involving family-farm partnerships and conservancies to those involving

timber and crops and state-related universities and public charities. They are an attempt to address judicial developments, legislative changes and to “improve the clarity” of the existing regulations. Some practitioners will not like all of the changes, particularly those that define living trusts, and those that limit some of the standard exemptions to the transfer of real estate, instead of a broader interpretation that would include transfers of interests in real estate companies.

However, there do not seem to be many changes to the conventional positions of the Department. That is one reason why the Department is comfortable in stating that “the proposed rule making will have no significant fiscal impact on the Commonwealth.”

November 18, 2005