

Pennsylvania Department of Revenue Clarifies Changes to New Realty Transfer Tax Law

Article By:

David Shechtman

Stephen D. D. Hamilton

Kaitlin A. McKenzie-Fiumara

The Pennsylvania Department of Revenue recently released an Information Notice^[1] explaining the implications of Act 52 of 2013, which enacted some significant changes to the Pennsylvania realty transfer tax, effective January 1, 2014.

Basics of Act 52

With respect to realty transfer tax, Act 52 made three significant changes:

1. Pennsylvania imposes realty transfer tax not only on transfers of fee title to real estate but also upon transfers of 90 percent or more of the interests in a “real estate company” within a three-year period. For purposes of determining whether an entity is a “real estate company,” the definition of “real estate” was expanded to include property outside Pennsylvania; it previously included only Pennsylvania real estate. The base for computing the tax remains the value of Pennsylvania real estate only, however.
2. The granting of an option is treated as an actual transfer for determining whether the “90 percent test” is met. Thus, a transfer of an 89 percent interest in a real estate company, coupled with an option for buyer to acquire the remaining 11 percent interest outside the three-year period (an 89-11 structure), no longer escapes imposition of realty transfer tax.
3. For purposes of determining whether a taxable acquisition of a real estate company has occurred, the definition of “real estate company” was expanded to include entities that own interests in other real estate companies that, together with directly owned real estate, amounts to 90 percent or more of its assets.

For further explanation of the basics of Act 52, please see our July 2013 Client Alert, available [here](#).

Additional Explanations Provided by the Information Notice

1. Each real estate company in a multi-tier structure must be analyzed independently to determine if there has been an acquisition (i.e., transfer of 90 percent or more of the entity within a three-year period); the analysis does not require one to “look through” transfers at an upper-tier level to determine whether there has been an acquisition of a lower-tier entity.
2. For purposes of the three-year look-back to determine whether a 90 percent acquisition has occurred, only years during which an entity met the definition of a “real estate company” are taken into account. Further, because under Act 52 certain entities with indirect ownership in real estate will become “real estate companies” as of January 1, 2014, merely because of the definition change, the Department has confirmed that it will not retroactively apply this definition change prior to January 1, 2014, for purposes of the three-year look-back.
3. The realty transfer tax imposed upon real estate company acquisitions is computed based on the property’s assessed value for local property tax purposes, divided by the common level ratio. Realty transfer tax due as a result of real estate company acquisitions where Pennsylvania real property is owned indirectly will be computed by multiplying this computed value by the real estate company’s ownership percentage in the title owning entity.
4. For purposes of “89-11 structures,” the Department has confirmed that the transfer is deemed to occur upon the grant of the option to acquire the remaining 11 percent (even if the option is never exercised).
5. For “89-11 structures,” the Information Notice also confirms that “a non-binding agreement to negotiate a future transfer of an interest in a real estate company” would not be a deemed transfer of an interest in a real estate company and therefore would not trigger realty transfer tax. In order for an arrangement to purchase the remaining 11 percent to be non-binding, the parties must be free to negotiate for the transfer in the future and the terms of such transfer may not be established in advance. In another context, the Department takes the position that the use of any type of agreed-upon formula for determining fair market value at the time of transfer, takes an arrangement outside the scope of a “free to negotiate” arrangement.

The Information Notice provides numerous examples with explanations and diagrams and may be accessed [here](#).

For more information on Act 52 or Pennsylvania taxes in general, please contact the authors listed above, or the Drinker Biddle lawyer with whom you regularly work.

[1] Information Notice – Realty Transfer Tax 2014-01, October 17, 2014.