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Taxes Are Owed For Real Estate Transfer to Partnership

Alan Nochumson

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Prior to purchasing real estate in Pennsylvania, an individual must decide how he intends to own the property. Will he own the property individually, or will he form a corporate entity to hold ownership of the property? The decision should not be taken lightly, as illustrated by a recent ruling handed down by the Commonwealth Court of Pennsylvania.

In *Kline v. Commonwealth*, the Commonwealth Court found that a husband and wife were obligated to pay realty transfer taxes when they conveyed real property owned by them to their limited liability partnership.

In late 2003, Randal and Carol Kline transferred legal title to 27 properties they personally owned to Randcar LLP, a Pennsylvania limited liability partnership. The Klimes were the sole partners of and owned a combined 100 percent interest in Randcar. The Klimes formed Randcar for the sole purpose of transferring the property to the partnership.

For each of the recorded deeds, the Klimes claimed a 100 percent exclusion from realty transfer taxes and no transfer taxes were paid. "The statements of value that were filed with each deed claimed exemption from transfer tax as a 'corrective or confirmatory deed' and included the explanation: 'Grantors and the principals are one and the same, therefore no meaningful transfer of title has occurred and the transfer is therefore exempt under 72 P.S. Section 8102-C.3(4)' (see also *Commonwealth v. Exton Plaza*)."

The Pennsylvania Department of Revenue subsequently determined that none of the recorded deeds were exempt from transfer tax liability and imposed the 1 percent state transfer tax, plus appropriate interest, on the value of each of the transferred properties.

After a series of unsuccessful administrative challenges, the Klimes filed an appeal with the Commonwealth Court.

APPELLATE REVIEW

On appeal, the Klimes contended that, in light of *Exton Plaza*, a conveyance from a husband and wife to a limited liability partnership is not subject to a realty transfer tax where the husband and wife are the sole owners of the partnership.

In denying the appeal, the Commonwealth Court found the Klimes' reliance on *Exton Plaza* as misguided.

In *Exton Plaza*, the Commonwealth Court found that a transfer of real estate from a general partnership to a limited partnership was exempt from transfer tax liability.

The general partnership in *Exton Plaza*, "for the purposes of becoming a single-purpose and bankruptcy-remote entity, converted itself into a limited partnership." In *Exton Plaza*, the court in *Kline* noted that "[t]he conveyance was from an association which had decided to change its business form to a newly formed association of another kind which continued to carry out the very same activities."

The court in *Exton Plaza* found the transfer was "merely the 'memorialization' of the conversion from a general

partnership to a limited partnership" and concluded that the transfer was "analogous to the exclusion for correctional or confirmatory deed that does not change the beneficial interest in the property."

The court in *Kline* was unconvinced that the realty transfer taxes were excluded as a result of the court's ruling in *Exton Plaza*. Rather, the court believed that its subsequent decisions in *Farda v. Commonwealth* and *Penn Towers Associates LP v. Commonwealth* were controlling.

In *Farda*, the court explicitly limited the scope of *Exton Plaza*. Similar to the Klines, Joseph and Ann Farda were husband and wife who transferred their interest in real estate to a partnership that they completely owned and controlled.

The court rejected the Fardas' belief that, under "*Exton Plaza* ... the transfer tax does not apply ... because the deed did not transfer a beneficial interest to land to anyone other than to themselves, the grantors."

In *Farda*, the court reasoned that "unlike *Exton Plaza*, ... the Fardas, as grantors, were individuals, and not a business partnership wishing to change its business form under Pennsylvania law. The deed ... conveyed legal title to 'someone other than the grantors' because the Fardas, as tenants in the entirety, are not Farda Realty, the partnership, an entity governed by the laws for foreign registered limited liability partnerships."

The court in *Farda* thus held that a transfer from a husband and wife to a partnership, which they were sole partners, was a taxable event under the Realty Transfer Tax Act.

In *Penn Towers Associates*, the Commonwealth Court revisited its decision in *Farda*. In *Penn Towers Associates*, Joseph Soffer had conveyed real estate to a limited partnership. He individually was the sole limited partner with a 99 percent interest and a limited-liability company, owned entirely by him, was the general partner with a 1 percent interest. Soffer then recorded the deed claiming a 100 percent exemption from the realty transfer tax because he owned a 100 percent interest in the partnership and because "the deed in this transaction does not affect a transfer of a beneficial interest in the property to someone other than the grantor."

"On appeal, Soffer also cited *Exton Plaza* in support of his argument that the conveyance was not subject to the realty transfer tax because as the sole owner ... he effectively transferred the property to himself."

In rejecting that argument, the court explained that "[i]n *Farda*, we distinguished the situation in *Exton Plaza* from that where the Fardas, a husband and wife as grantors, were individuals conveying certain real estate to a limited partnership of which they were the sole partners, not a business partnership wishing to change its business form under Pennsylvania law. Thus, the deed in *Farda* conveyed legal title to someone other than the grantors because the Fardas were not the same as the partnership to which they transferred the property. ... The situation in *Farda* is repeated here. Soffer, as grantor, is an individual and is different from *Penn Towers*, a limited partnership governed by the laws for foreign registered limited liability partnerships. Because the deed in this case, which transferred property from Soffer to *Penn Towers*, is a conveyance between a partnership and a partner, the transfer is subject to realty transfer tax."

Relying on *Farda* and *Penn Towers Associates*, the court in *Kline* pointed out that the Klines were obligated to pay transfer taxes because legal title to the properties passed to an entity other than the Klines themselves.

LESSON LEARNED

In *Kline*, the court reiterated that an individual conveying real estate to a partnership is a taxable document even if the partners consist of the grantors themselves. The court's holding is just another example of its insistence on looking at the form rather than the substance of the transfer. In doing so, the court has thus decided that a previously unsophisticated individual may not change the form of ownership without being penalized for his originally imprudent decision. **ALAN NOCHUMSON** is the sole shareholder of *Nochumson P.C.*, where he specializes in real estate, litigation, employment and labor, and land use and zoning. *Nochumson* regularly speaks at and writes for trade and professional associations, local universities and adult education programs on issues commonly confronted by businesses, individuals and professionals. *Nochumson* is also president of *Bear Abstract Services*, where he offers comprehensive title insurance, title examination and closing services for transactions ranging from simple residential agreements of sale to complex commercial projects. He may be reached by telephone at 215-399-1346 or by e-mail at anochumson@nochumson.com.