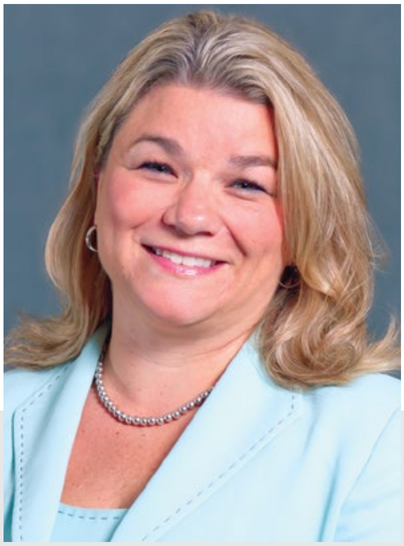
Transfer tax tutorial

What you don't know about realty transfer tax could cost you



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Anyone who has purchased real property in Pennsylvania knows that one of the highest costs paid at "closing" is realty transfer tax. In Pennsylvania, this tax is imposed by the Commonwealth and the counties upon the transfer of ownership of title to real estate located in the state, unless certain exceptions apply.

"What many people may not know is that the tax can also apply to the purchase of all or a significant portion of the ownership interests in a corporation, partnership or limited liability company that owns real estate," says Catherine Marriott, a member of Semanoff Ormsby Greenberg & Torchia, LLC.

Smart Business spoke with Marriott about how realty transfer tax works, how it might apply to other real estate-related transactions, and the importance of hiring professionals to structure the most favorable terms.

How does realty transfer tax work?

The usual scenario is when a property is sold from a buyer to a seller in an arm's length transaction. Upon the recording of the deed conveying the property, Pennsylvania and the county where the property is located collect a realty transfer tax based on the purchase price for the property. In that scenario, the realty transfer tax paid is equal to 2 percent of the purchase price, with 1 percent paid to the state and 1 percent paid to the county. The exception is Philadelphia, where the county tax is 3.1 percent. Buyers and sellers usually each pay half of the realty transfer tax assessed on the transaction.

Does the realty transfer tax apply to other real estate-related transactions?

Realty transfer tax can apply to certain transactions that involve the sale of all or a significant portion of a company that directly or indirectly owns title to real estate, even though a deed is not recorded in the transaction. Essentially, if the company meets the definition of a 'real estate company' — a company that is primarily engaged in the business of holding, selling or leasing real estate and has real estate as a significant part of its assets — when all or a significant portion of the ownership interests in the company are sold, realty transfer tax may be imposed.

The rules for determining whether a company is a real estate company are complicated and vary in Pennsylvania and Philadelphia. If the company meets the definition and the transfer of enough of the company is completed, even over a period of years, the company is deemed an 'acquired real estate company' and the tax will be due.

How is the tax calculated when a real estate company becomes an acquired real estate company?

In Pennsylvania, the realty transfer tax assessed when a real estate company becomes an acquired real estate company is based on the computed value of the property. The computed value is the assessed value of the property multiplied by a factor issued by the Pennsylvania Department of Revenue for the county in which the property is located.

In Philadelphia, the realty transfer tax on such a transaction, assuming the sale is made at arm's length, is based on the consideration paid for the interests in the company. This isn't always simple to determine as the company may own other assets, and the buyer may pay cash, but may also assume debt of the company or purchase the interests subject to existing debt.

Can realty transfer tax be avoided or minimized?

The provisions of Pennsylvania and Philadelphia law relating to the transfers of interests in real estate companies are complicated. Transactions can be structured to legally avoid or minimize the realty transfer tax implications.

Potential sellers of real property or interests in companies that own real estate should consult with their legal and tax professionals before they commit to any terms in a transaction. Ideally, these professionals will be involved at the earliest possible stage of the transaction to structure the most favorable terms, from a business and tax perspective, before any verbal or written commitments are made. ●