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AMENDMENTS TO PHILADELPHIA'S REALTY TRANSFER TAX WILL HAVE A SIGNIFICANT IMPACT

By Jonathan R. Flora and Kevin S. Blanton

Recent amendments to Philadelphia's realty transfer tax will likely change the way commercial real estate is bought and sold. Rather than sell the real estate directly and record a traditional deed to evidence the transaction, it is common practice to sell ownership interests in the company that holds title to the real estate. This approach often significantly reduces the realty transfer tax due as a result of the transaction because the value used to compute the tax is based on the property's assessed value, which is often lower than the purchase price for the company. Moreover, selling less than 90% of the equity in the company does not trigger any tax at all, provided the seller holds the remaining equity for at least three years.

The amendments, which go into effect on July 1, 2017, change both of these frequently relied upon transfer tax rules.

"Value" for an Acquired Real Estate Company

Previously, if a buyer paid $20 million to purchase all of the equity in a company that owned real estate, but the property's computed value (a value derived from the property's assessed value) was $12 million, Philadelphia realty transfer tax was based on $12 million, which resulted in a significant savings to the parties.

As a result of the amendments, the transfer tax value due on the sale of equity in a real estate company is now the "monetary value" of the real estate. And, there is a rebuttable presumption that monetary value is the actual consideration paid for the company. A taxpayer may rebut the presumption by alternate proof of actual value.

Thus, the Philadelphia transfer tax in the previous example would now presumptively be based on the $20 million purchase price for the company.

89-11 Transactions

Previously, if a buyer acquired less than 90% of a real estate company, it would not result in the imposition of realty transfer tax because the sale does not meet the definition of an "acquired real estate company." These transactions were commonly referred to as "89-11" because the seller would sell 89% of the company and retain 11% for at least three years.

Based on the amendments, the Philadelphia realty transfer tax is now triggered if there is a sale of 75% or more of a real estate company. In addition, the period for determining the sale of interests is extended from three years to six years. As a result, an 89-11 transaction will now trigger the transfer tax because there is a sale of more than 75% of the interests in the company. And even if the seller retains 26% of the company, it must do so for six years rather than three in order to avoid the transfer tax, potentially making structuring a transaction in this manner a less attractive alternative.

Finally, it is worth noting that included in the amendments is also an increase in the rate of realty transfer tax charged in Philadelphia from 3.0% to 3.10%, making the combined City and Commonwealth realty transfer tax rate 4.10%.

The amendments pertain to common transactions arising in the Philadelphia commercial real estate market, and they are likely to have an impact on the structure and pricing deals upon their implementation.◆

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