



Controlling-Interest Real Estate Transfer Taxes: The Potential State Tax Trap in Mergers and Acquisitions

MICHELE RANDALL AND JOSEPH GURNEY

Analysis & Perspective

Tax Base

With the upswing in merger and acquisition activity comes concern about the obligation to pay state and local real estate transfer taxes, often overlooked during the complex M&A process. Authors Michele Randall and Joseph Gurney of Deloitte Tax LLP provide an overview of the state taxing regimes applied to controlling-interest real estate transfers, highlight nuances of each state's rules, point out pitfalls, and describe emerging trends in controlling-interest transfer taxes.

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BY MICHELE RANDALL AND JOSEPH GURNEY

I. Introduction

As merger and acquisition activity appears once again on the upswing in the United States, the imposition of state and local real estate transfer taxes on these transactions remains a significant yet potentially overlooked cost. Because corporate mergers and acquisitions generally do not involve direct, deed-

effected transfers of real property, there is often a misconception that real estate transfer taxes do not apply. However, depending on the law of the applicable taxing jurisdiction, a merger or other change in control of a legal entity can result in imposition of these taxes in the same way as the outright sale of a company's real estate assets.

Generally, a transfer tax is imposed on documents that convey an interest in real property from one person or legal entity to another person or legal entity. The federal government imposed a documentary stamp tax on transfers of real property deeds until the tax was repealed in 1967. After the federal documentary stamp tax was repealed, states began to enact their own laws to impose transfer taxes on real estate transfers.

Michele Randall and Joseph Gurney are Directors with Deloitte Tax LLP's Multistate Practice, resident in Chicago. Randall, a CPA, holds a B.S. degree in accounting from the University of Illinois-Urbana, Champaign, and a M.S.T. from DePaul University. Gurney holds a B.S. degree in accounting from the University of Illinois-Urbana, Champaign. The authors can be contacted at micrandall@deloitte.com and jogurney@deloitte.com. The authors would like to acknowledge Mike Santoro, Senior Manager, and Fred Paladino, Director, both with Deloitte Tax LLP, Washington National Tax-Multistate, for their technical and editorial assistance in the preparation of this article.

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Many states have patterned their taxes after the federal documentary stamp tax. Historically, state transfer taxes generally have been imposed on the recordation of a deed and are based on the consideration paid or fair market value of the property. However, the state laws and tax rates can vary greatly across taxing jurisdictions.

In recent years, some states have expanded their transfer tax laws to impose tax on transfers of an ownership interest in an entity that directly or indirectly owns real estate (rather than imposing tax only when

the real estate itself is transferred). Such taxes are commonly known as “controlling-interest transfer taxes.”

In contrast to the relative simplicity and uniformity of a traditional transfer tax regime, controlling-interest transfer taxes can be more complex, with each state that imposes such a tax taking a different approach to determining the types of transfers subject to tax. Because the characteristics of controlling-interest transfer tax laws can vary from state to state, unwary taxpayers may find themselves unexpectedly paying significant tax on transfers that they never imagined would be subject to taxation, such as mergers or acquisitions involving publicly traded companies.

This article provides an overview of the various state taxing regimes that impose controlling-interest transfer taxes, highlights some of the nuances of each state’s rules, provides some common pitfalls associated with such taxes, and describes emerging trends.

II. Overview of Real Estate Transfer Taxes

To give perspective and context to emerging controlling-interest transfer taxes, it is helpful to compare their fundamental elements with those of traditional, deed-triggered real estate transfer taxes. As states have added controlling-interest transfer tax provisions to existing real estate transfer tax regimes, the change has not always been accompanied by sufficient guidance or interpretation to account for the unique facts of a controlling interest transfer.

A. Similarities in Administration

Some form of real estate transfer tax is imposed in 39 states at a state, county, or city level.¹ Many states that have a transfer tax impose the tax at the state level and have the county recorder of deeds collect the tax and remit it to the state when a deed is recorded. Other states mandate a statewide rate but permit the counties to retain the taxes collected. Some local jurisdictions have the authority to enact their own transfer tax rules that can apply even where no such tax is imposed at the state level.² Typically, the local rules conform to the state rules (where applicable), but certain local jurisdictions are authorized to enact their own rules that can be broader than those of the state and sometimes are imposed at a significantly higher rate.

In some cases, a controlling-interest transfer tax is administered in the same or similar manner as the jurisdiction’s real estate transfer tax. However, often there are differences in the way the controlling-interest tax is reported to the state since a deed will not be filed to report the purchase of real estate to the county recorder. Controlling-interest transfers typically require a tax return to be filed with the appropriate jurisdiction to report the change in control and remit the tax.

B. Transfer Tax Base

Most jurisdictions base the real estate transfer tax on the consideration paid for the conveyed real estate.

¹ See Appendix A.

² For example, California permits cities and counties to impose a transfer tax, but does not itself impose such a tax. Cal. Rev. & Tax Code §11911.

However, some jurisdictions base the tax on the property value, including conveyances where there is no or nominal consideration. Typically, the value of a property is the price the buyer is willing to pay. This would be the purchase price of the real property as agreed upon in a purchase contract.

Most states that impose a transfer tax on controlling-interest transactions do so based upon the “fair market value” of the real estate within the transferred entity. However, unlike the sale of a real property asset, when an entity is acquired there may not be a specific identification of real property values in the purchase contract.

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Few states address this issue specifically, which can create ambiguity regarding how to determine fair market value of the acquired entity’s real property (particularly when the entity owns other assets such as tangible personal property or intangible property). Washington state provides that when “the total consideration for the sale cannot be ascertained or the true and fair value of the property to be valued at the time of sale cannot reasonably be determined, the market value assessment for the property maintained on the county property tax rolls at the time of the sale shall be used as the selling price.”³ In contrast, the tax base in Delaware is generally the greater of consideration or appraised value, unless it is established that the fair market value is less than the appraised value in which case it is the greater of fair market value or consideration.⁴ Unfortunately, most states are silent regarding how to determine the tax base for controlled-interest transfers.

Other variations on the question of how the tax base is to be determined arise in New Jersey and Pennsylvania. Generally, both states impose their real property transfer tax on deeds measured by actual consideration.⁵ However, in the case of an entity transfer, Pennsylvania imposes its tax on the actual monetary worth of the real estate determined by adjusting the property’s assessed value by the common level ratio used for local property tax purposes.⁶ When a transferred entity owns certain classified real property and property other than

³ Wash. Rev. Code §82.45.030(4).

⁴ Del. Code Ann. tit. 30, §5401(3). (“ ‘Value’ means . . . the amount of the actual consideration . . . provided, that in the case of a transfer for an amount less than the highest appraised full value of said property for local real property tax purposes, ‘value’ shall mean the highest such appraised value unless the parties or one of them can demonstrate that fair market value is less than the highest appraised value, in which case ‘value’ shall mean fair market value, or actual consideration, whichever is greater. A demonstration that the transaction was at arm’s length between unrelated parties shall be sufficient to demonstrate that the transaction was at fair market value.”)

⁵ Pa. Cons. Stat. §8101-C; Pa. Cons. Stat. §8102-C; N.J. Rev. Stat. §46:15-7.

⁶ Pa. Cons. Stat. §8101-C; Pa. Regs. §§91.135(2), 91.131 (defining “computed value”).

real property, New Jersey imposes its controlling-interest tax on the equalized assessed value of the classified real property, which is the assessed value of the property determined by a state assessor for property tax purposes times a multiplier based on where the property is located.⁷ In times of significant real estate market fluctuations, the property tax assessed value base can be considerably different from fair market value, resulting in a surprising result if a property has drastically decreased in fair market value.

C. Tax Rates

Transfer tax rates vary from jurisdiction to jurisdiction. Further, rates applicable to real property transfers can differ from those applicable to controlling-interest transfers.

Six states have rates as low as 0.1 percent, while some state rates range as high as 5 percent. These numbers include local and county taxes as well, where applicable. Among the highest tax jurisdictions are Maryland, where recordation and transfer tax rates vary from 1.16 percent to 3 percent;⁸ Pennsylvania, with rates that vary by location from 2 percent to 5 percent by location;⁹ Washington, D.C., with a 2.9 percent economic interest transfer tax rate;¹⁰ Delaware, with a 3 percent rate in certain jurisdictions;¹¹ and New York City, with a maximum combined state and local rate of 3.025 percent.¹²

Additionally, rates can vary within a state if the state imposes a tax on deeds at a different rate from that imposed on a controlling-interest transfers. For example, New Jersey imposes a 1 percent tax on controlling-interest transfers of entities that own more than \$1 million of classified real property.¹³ However, New Jersey's realty transfer fee on deed transfers is imposed at a graduated rate of up to 1.21 percent.¹⁴ Connecticut also imposes a different tax rate for deed transfers, which can vary depending on location from 1.25 per-

⁷ N.J. Rev. Stat. §§54:15C-1 (for transfers involving consideration over \$1,000,000), 54:1-35.1

⁸ The total rate consists of a 0.33 percent state recordation tax, Md. Code Ann. Tax-Prop. §12-103(d), a 0.5 percent state "transfer tax," Md. Code Ann. Tax-Prop. §13-203(a)(1), county recordation tax rates ranging between 0.5 percent and 1.2 percent depending on the county, and county transfer tax rates ranging from zero to 1.5 percent.

⁹ Although the total rate consists of a 1 percent state rate, Pa. Cons. Stat. §8102-C, and local rates that may not exceed 1 percent, 53 Pa. Cons. Stat. §6924.311(5), a property may be subject to tax by overlapping tax jurisdictions (e.g., township, city, and school district), which can generate total rates as high as 5 percent in some localities.

¹⁰ D.C. Code Ann. §42-1103(a)(2). Washington, D.C., also imposes a real estate transfer tax at the rate of 1.45 percent and a deed recordation tax at a rate of 1.45 percent. D.C. Code Ann. §§42-1103(a)(1) and (a-4) and D.C. Code Ann. §§42-903(a)(1) and (a-4).

¹¹ Del. Code Ann. §5402.

¹² The total rate consists of a state tax of 0.4 percent (N.Y. Tax Law §1402(a)), and the New York City rate of 2.625 percent (N.Y. City Admin. Code §11-2102(10)(i)).

¹³ N.J. Rev. Stat. §54:15C-1.

¹⁴ N.J. Rev. Stat. §§46:15-7 - 46:15-7.1. New Jersey also imposes an additional 1 percent "mansion tax" on deeds of classified real property with a value of \$1 million or more. N.J. Rev. Stat. §15-7.2.

cent to 1.75 percent;¹⁵ by contrast, the rate on entity transfers is 1.11 percent for all locations.¹⁶

D. Exemptions

Certain deed or controlling-interest transfers may be exempt from the transfer tax. For example, exemptions may include deeds in lieu of foreclosure, confirmatory deeds, transfers to the federal government, and transfers that result in a mere change in identity or form of ownership. However, exemptions vary among the states and often do not keep up with the changing business landscape. There also may be variations in the state rules when applying exemptions to deed transfers versus controlling-interest transfers.

Several states provide exemptions for transfers of property between a parent and subsidiary corporation or for mergers between corporations. However, exemptions may not specifically include all entity types such as limited partnerships, business trusts, or limited liability companies (LLCs). This can result in tax being imposed on a transaction that involves an LLC but not imposed where that same transaction involves a corporation.

Related-party transfers may be subject to tax even though ultimate ownership of the property remains unchanged.

Additionally, some states provide broad exemptions for transfers that result in a mere change in identity or form of ownership if the ultimate ownership of the property remains the same (see, e.g., Connecticut, New York, and Washington state).¹⁷ For states that do not provide such an exemption, related-party transfers may be subject to tax even though ultimate ownership of the property remains unchanged. This can produce an unexpected result in the context of an internal reorganization.

Care also needs to be taken in determining the exemptions for states that impose tax on both deed transfers and controlling-interest transactions. On July 1, 2008, Maryland enacted a controlling-interest tax on entity transfers in addition to its recordation and transfer tax on deeds. The controlling-interest rules include a broad, mere-change-of-identity exemption for transfers if the ownership interest in the entity transferred is held by the same persons and in the same proportions as before the transfer.¹⁸ However, that same broad exemption is not provided for the transfer of a deed be-

¹⁵ The total rate generally consists of a 1.25 percent state tax for nonresidential properties (Conn. Gen. Stat. §12-494(b)) plus a local rate of 0.25 percent that is doubled in some communities at their option (Conn. Gen. Stat. §12-494(c)). The rates were recently changed, increasing the tax by 0.25 percent in most cases (2011 Pub. Acts 11-6, effective July 1, 2011).

¹⁶ Conn. Gen. Stat. §§12-494; 12-638b.

¹⁷ Conn. Gen. Stat. §12-498(a)(17); N.Y. Tax Law §1405(b)(6); Wash. Rev. Code §82.45.010(3)(o).

¹⁸ Md. Code Ann. Tax-Prop. §12-117(c)(3); Md. Code Ann. Tax-Prop. §13-103(c)(2).

tween related parties in Maryland.¹⁹ As a result, a significant cost can be incurred by directly transferring the title to a real estate asset among related parties, while the transfer of an entity that owns the property may be exempt, provided the ownership interests in the transferee entity are held by the same persons and in the same proportion as in the real property entity the controlling interest of which was transferred.²⁰

III. Unique Elements of a Controlling-interest Tax

Sixteen states have some form of controlling-interest tax. As previously mentioned, controlling-interest taxes are generally intended to capture tax on the sale of an entity that directly or indirectly owns real estate.

Several unique issues arise when analyzing the applicability of a controlling-interest tax, including:

- the meaning of a “controlling interest” in a transferred entity,
- whether the tax reaches all entity transfers or only those transfers involving entities established to hold real property,
- how the tax applies to transactions involving tiered structures, and
- the applicability of the tax to publicly traded companies.

A. Transfer of Control

What constitutes a transfer of a controlling interest varies among the states. Generally, most states provide that a certain percentage of the voting stock or voting power of a corporation, capital or profits interest in a partnership or unincorporated entity, or the beneficial interest in a trust constitutes a transfer of a controlling interest.

There is some variation in the threshold for a change in control. The threshold for a change of control is 50 percent or more in New York and is more than 50 percent in several jurisdictions, including Connecticut, Illinois, and Washington state.²¹ In other states, the threshold for a change in control of certain types of entities can be 80 percent (e.g., Maryland) or 90 percent (e.g., Pennsylvania).²² New Hampshire does not specify a threshold for change in control on entity transfers.²³

States that impose a controlling-interest tax typically provide a rule that aggregates transfers of interests among persons acting in concert or that occur within a specific period of time for purposes of determining whether a transfer of a controlling interest has occurred. For example, if a company sells half the stock of its subsidiary at one point in time and 13 months later sells the remaining half, the controlling-interest tax rules in some states would aggregate the transfers with the result that a transfer of a controlling interest would be deemed to occur. Among the states that pro-

vide an aggregation rule, the time periods include six months, 12 months, 24 months, 36 months, and an unlimited look-back period.²⁴

B. Scope of Tax

Some of the first states to adopt controlling-interest transfer tax rules impose their tax on transfers of ownership in any legal entity, regardless of whether the entity has an ongoing business other than investing in real estate. If an entity owns an interest in real property directly or indirectly and there is a change in control of that entity, the tax is imposed.

These rules do not exclude transfers of ownership in an entity that is engaged in a business that does not derive income from real estate, such as manufacturing, or that may involve providing goods or services to customers at locations consisting of real property, such as retailing, banking, or hotel operations. Additionally, these rules typically look through to indirectly owned real estate that may be held in a subsidiary or tiered structure of entities to determine whether a tax is triggered. Connecticut, Maine, and New York impose this type of broad controlling-interest transfer tax.²⁵

While some states may tax any exchange of an interest in real estate via entity transfer, others limit the scope of the tax to transfers of entities engaged in a real estate business. This is typically accomplished by applying the tax to transfers of a controlling interest in a “real estate entity.” The concept of a “real estate entity” appears in the controlling-interest tax rules of Delaware, the District of Columbia, Illinois, Maryland, Michigan, New Hampshire, and Pennsylvania.²⁶ The real estate entity concept is generally used as a limitation on the imposition of the tax, i.e., the tax will be imposed only on an entity that meets the state’s definition of a real estate entity.

The definition of what constitutes a taxable “real estate entity” varies from state to state. In general, most definitions involve a minimum percentage threshold of total company assets consisting of real estate or total company income derived from real estate. These tests may be viewed as a bright-line or safe harbor in some jurisdictions, but are viewed as a rebuttable presumption that the entity is a “real estate entity” in others (e.g., Illinois).²⁷ Some jurisdictions will employ only an asset test, while others provide either an asset test or an income test.

¹⁹ Md. Code Ann. Tax-Prop. § 12-108; Md. Code Ann. Tax-Prop. § 13-207.

²⁰ Md. Code Ann. Tax-Prop. § 12-117(c)(3).

²¹ N.Y. Tax Law § 1401(b); Conn. Gen. Stat. § 12-638a.(2); 35 ILCS 200/31-5; Wash. Rev. Code § 82.45.033(1).

²² Md. Code Ann. Tax-Prop. § 12-117; Pa. Cons. Stat. § 8102-C.5.

²³ N.H. Rev. Stat. Ann. § 78-B:1-a(V).

²⁴ Connecticut, Minnesota, and New Jersey have six-month aggregation periods: Conn. Gen. Stat. § 12-638b(a)(2); Minn. Stat. § 287.21(1)(c); N.J. Stat. Ann. § 54:15C-1(a)(2). Washington, D.C., Maine, Maryland, and Washington state are one year: D.C. Code Ann. § 42-1102.02(a); D.C. Regs. § 518.3; Me. Rev. Stat. Ann. § 36-4641-A(2); Md. Code Ann. Tax-Prop. § 12-117(c)(2)(i); Wash. Rev. Code § 82.45.010(2)(a). Illinois is two years: Ill. Regs. § 120.20(d)(2)(A). Delaware, Florida, New York, and Pennsylvania are three years: Del. Code Ann. § 5401(1)(n); Fla. Stat. § 201.02(1)(b)(2); N.Y. Regs. § 575.6(d); NY Adv Op Comm T & F TSB-A-92-(2)R; Pa. Cons. Stat. § 8102-C.5. Michigan, New Hampshire, and Virginia have no limit.

²⁵ Conn. Gen. Stat. § 12-638b(a)(1), Me. Rev. Stat. Ann. § 36-4641-A(2); N.Y. Tax Law § 1401(e).

²⁶ Del. Tech. Info. Memo. 86-9 (Dec. 18, 1986); D.C. Code Ann. § 42-1102.02; 35 ILCS § 200/31-5 “Real Estate Entity”; Md. Code Ann. Tax-Prop. § 12-117(a)(6); Mich. Comp. Laws § 207.523(c); N.H. Rev. Stat. Ann. § 78-B:1-a(V), (VI); Pa. Cons. Stat. § 8101-C, (“REAL ESTATE COMPANY”).

²⁷ 35 ILCS 200/31-5.

Often, the asset test involves measuring the value of the entity's real estate assets as a percentage of the value of its total assets immediately prior to the transfer of a controlling interest. However, the District of Columbia only compares the entity's real estate assets with its total *tangible* assets.²⁸ Similarly, Pennsylvania only considers asset holdings exclusive of tangible assets that are freely transferable and actively traded on an established market.²⁹ Other states that use an asset test include Delaware, Illinois, Maryland, and Michigan.³⁰

The asset tests typically measure the value of the entity's entire real estate holdings, but certain jurisdictions have further limited the scope of the controlling-interest transfer tax to entities that are holding real estate assets located within their jurisdictional borders sufficient to meet the test. For example, a Maryland "real property entity" is an entity that owns real property located in Maryland that constitutes at least 80 percent of the value of the entity's assets and has an aggregate value of at least \$ 1,000,000.³¹ Similarly, the District of Columbia limits its asset test, and for that matter its income test, based on property location. The D.C. controlling-interest tax rules apply only to the transfer of an entity that:

- holds on the date of transfer real estate located in the District with a value equal to at least 80 percent of its tangible asset holdings, or
- derives more than 50 percent of its gross receipts from real property in the District.³²

In addition to the bright-line asset and income tests, some states employ more qualitative measures that take into consideration what the principal activity of the entity is, such as Illinois and New Hampshire.³³ Other states inquire as to whether a transaction is more properly classified as a sale of the underlying assets. In Delaware, for example, the characterization depends on a four-factor test that considers:

- the timing of the transfer,
- the percentage change in interest,
- the transitory ownership status of the entity, and
- the business purpose of the transaction.³⁴

C. Other Considerations – Tiered Structures

One area of uncertainty involves how to apply the real estate entity tests to tiered structures. If the entity that is being sold owns only one real estate asset in a taxing jurisdiction, it is easy to apply the rules. However, if an acquired parent entity owns several tiers of entities that in turn own real estate in multiple jurisdictions, it is not always clear whether the real estate entity test should be applied at the property owner entity level or at the parent level. The Maryland rules provide an example indicating that the test is applied at the parent level by aggregating all of the parent's indirect in-

²⁸ D.C. Code Ann. § 42-1102.02(a)(2).

²⁹ Pa. Cons. Stat. § 8101-C.

³⁰ Del. Tech. Info. Memo. 86-9 (Dec. 18, 1986); 35 ILCS § 200/31-5 "Real Estate Entity"; Md. Code Ann. Tax-Prop. § 12-117(a)(6); Mich. Comp. Laws § 207.523(c).

³¹ Md. Code Ann. Tax-Prop. §§ 12-117(a)(5), (a)(6).

³² D.C. Code Ann. § 42-1102.02.

³³ 35 ILCS § 200/31-5 "Real Estate Entity"; N.H. Rev. Stat. Ann. § 78-B:1-a(V), (VI).

³⁴ Del. Tech. Info. Memo. 86-9 (Dec. 18, 1986).

terests in real estate held by its lower-tier entities.³⁵ In other jurisdictions there is little or no guidance on this issue.

D. Other Considerations – Publicly Traded Entities

Several states provide exclusions for publicly traded companies. Specifically, Delaware excludes transfers of publicly traded stock from taxation under its controlling-interest statute.³⁶ Maryland also excludes the sale of publicly traded shares from taxation.³⁷ Finally, Pennsylvania effectively excludes publicly traded companies by defining "real estate companies" as companies where 35 or fewer owners hold 90 percent or more of the ownership interest.³⁸ Consequently, a widely held or publicly traded company may be unlikely to satisfy Pennsylvania's definition of real estate entity. However, caution should be exercised regarding how to apply these rules, since the exclusion is only with respect to the public company itself. Thus, a public company's sale of a subsidiary entity that meets the real estate entity test may be taxable.

IV. Trends

In order to broaden the application of their real estate transfer taxes, states continue to enact controlling-interest transfer taxes. Michigan and Maryland are the most recent states to have enacted controlling-interest transfer tax rules, while other states have considered but did not enact such legislation, including a Hawaii proposals in 2009³⁹ and 2011.⁴⁰ Also, certain California local jurisdictions have recently adopted their own controlling-interest transfer tax rules including San Francisco⁴¹ in 2008 and Oakland⁴² in 2009.

The most recent states to enact controlling-interest rules limited their statutes to companies involved in real estate investment.

The most recent states to enact controlling-interest transfer tax rules, Maryland and Michigan, limited the scope of their respective tax statutes to companies substantially involved in real estate investment rather than to any business that owns an interest in real estate.⁴³ It is also important to note that Maryland further limited

³⁵ Md. Regs. § 13.02.11.

³⁶ Del. Code Ann. § 5401(7)(b).

³⁷ Md. Code Ann. Tax-Prop. § 12-117(a)(4)(ii).

³⁸ Pa. Cons. Stat. § 8101-C.

³⁹ 2009 Hawaii S.B. 1230.

⁴⁰ 2011 Hawaii H.B. 1180, 2011 Hawaii H.B. 1408.

⁴¹ San Francisco Business and Tax Regulations Code, Art. 12-C, Sec. 1114, available at: <http://library.municode.com/index.aspx?clientId=14132&stateId=5&stateName=California>.

⁴² Oakland Code of Ordinances, Ch. 4.20.020, available on the internet at: <http://library.municode.com/index.aspx?clientId=16308&stateId=5&stateName=California>.

⁴³ Md. Code Ann. Tax-Prop. § 12-117(a)(6)(i)(1); Mich. Comp. Laws § 207.523(c).

the scope of its controlling-interest transfer tax rules to transfers of entities that own most of their real estate within the state, rather than to companies with a national or international portfolio of real estate holdings.⁴⁴ By comparison, the states that were the earliest to adopt controlling-interest transfer tax rules, such as New York,⁴⁵ generally did not limit the scope of their rules to companies that were substantially involved in real estate investment.

Additionally, in order to prevent taxpayers from transferring property to a new entity and then subsequently attempting to transfer that entity free of tax, some states have enacted rules to impose tax on a deed transfer to a new wholly owned entity if that transfer is in anticipation of a change of control of the entity (*see* applicable provisions in Florida, Minnesota, and Virginia).⁴⁶ For example, Florida recently modified its documentary stamp tax rules to impose tax when “real property is conveyed to a conduit entity and all or a portion of the grantor’s direct or indirect ownership interest in the conduit entity is subsequently transferred for consideration within three years of such conveyance.”⁴⁷ A “conduit entity” means a legal entity to which real property is conveyed without full consideration by a grantor who owns a direct or indirect interest in the entity, or a successor entity.⁴⁸

Minnesota imposes a tax on “designated transfers” if a subsequent transfer would have been taxable if it occurred directly.⁴⁹ A designated transfer is generally a related-party transfer, such as one that qualifies as an Internal Revenue Code §368(a) reorganization or an I.R.C. §708 transfer.⁵⁰ Essentially, designated transfers are normally subject to a minimum tax, but become fully taxable if the property is reconveyed in another tax-free transaction shortly after the original designated transaction. The period during which a subsequent transaction will trigger taxation is six months fol-

lowing the original conveyance.⁵¹ Tax is imposed on the net consideration.⁵² Finally, Minnesota provides that, for purposes of a designated transfer, an interest in an entity indirectly owned by or for another entity is considered to be owned proportionately by or for the owners of the other entity under rules similar to I.R.C. §§267(c)(1) and (5).⁵³

Virginia imposes a tax on certain transfers to partnerships that are made for the purpose of avoiding the state’s real estate transfer tax.⁵⁴ Transfer tax is not applicable when a transfer is made to a partnership when the grantors are entitled to receive not less than 50 percent of the profits and surplus of the partnership, provided that the transfer is not made to avoid the tax.⁵⁵ There is no time limit on aggregating separate transfers for purposes of determining whether the 50 percent threshold has been met. The tax base is the greater of the consideration paid or “actual value” of the property conveyed.⁵⁶

V. Conclusion

As more jurisdictions expand the application of their real property transfer taxes from deed transfers to transfers of controlling interests in an entity holding an interest in real estate, taxpayers are posed with even greater challenges in determining taxability and the proper tax base. The significant variation among the states in how they tax transfers of controlling interests in entities that own real estate can produce some surprising results.

The existing ownership of the acquired entity, as well as the nature of its asset holdings and business operations, can determine whether the acquisition triggers a transfer tax in a particular jurisdiction. The legal organizational structure of the target company can also have an effect on the overall exposure to transfer taxes. Finally, the form and timing of the transaction can influence the ultimate result. Taxpayers should proceed with caution as they attempt to navigate the complex and varied state statutes and rules in this area.

⁴⁴ Md. Code Ann. Tax-Prop. §12-117(a)(5)(i).

⁴⁵ New York adopted its controlling-interest provisions in 1989 (N.Y. Session Law L. 1989, Ch. 61).

⁴⁶ Fla. Stat. §201.02(1)(b)(2); Minn. Stat. §287.21(1)(c); Va. Code Ann. §58.1-811 (A)(10), (11).

⁴⁷ Fla. Stat. §201.02(1)(b)2.

⁴⁸ Fla. Stat. §201.02(1)(b)1.a.

⁴⁹ Minn. Stat. §287.21(1)(c).

⁵⁰ Minn. Stat. §287.20(3a)(5); Minn. Stat. §287.20(9).

⁵¹ Minn. Stat. §287.21(1)(c).

⁵² *Id.*

⁵³ Minn. Stat. §287.20(3a).

⁵⁴ Va. Code Ann. §58.1-811 (A)(10).

⁵⁵ *Id.*

⁵⁶ Va. Code Ann. §58.1-801(A).

Appendix A		
List of States Imposing Real Estate Transfer Taxes		
As of January 1, 2011		
State	Impose state realty transfer tax [1]	Citation
Alabama	Yes	Ala. Code §40-22-2
Alaska	No	
Arizona	Yes [2]	Ariz. Rev. Stat. Ann. §11-1132
Arkansas	Yes	Ark. Code Ann. §26-60-105
California	No [3]	Cal. Rev. & Tax. Code §11911
Colorado	Yes	Colo. Rev. Stat. §39-13-102
Connecticut	Yes	Conn. Gen. Stat. §12-494
Delaware	Yes	Del. Code Ann. §5402
District of Columbia	Yes	D.C. Code Ann. §§42-1103, 47-903
Florida	Yes	Fla. Stat. §201.02
Georgia	Yes	Ga. Code Ann. §48-6-1
Hawaii	Yes	Haw. Rev. Stat. §247-1
Idaho	No	
Illinois	Yes	35 ILCS 200/31-10
Indiana	No	
Iowa	Yes	Iowa Code Ann. §428A.1
Kansas	No [4]	
Kentucky	Yes	Ky. Rev. Stat. Ann. §142.050
Louisiana	No [5]	
Maine	Yes	Me. Rev. Stat. Ann. §36-4641-A
Maryland	Yes	Md. Code Ann. Tax-Prop. §§12-102, 13-202
Massachusetts	Yes	Mass. Gen. L. ch. 64D, §1
Michigan	Yes	Mich. Comp. Laws §207.523
Minnesota	Yes	Minn. Stat. §287.21
Mississippi	No	
Missouri	No	
Montana	No	
Nebraska	Yes	Neb. Rev. Stat. §76-901
Nevada	Yes	Nev. Rev. Stat. §375.020
New Hampshire	Yes	N.H. Rev. Stat. Ann. §78-B:1
New Jersey	Yes	N.J. Rev. Stat. §§46:15-7, 46:15-7.1, 46:15-7.2
New Mexico	No	
New York	Yes	N.Y. Tax Law §§1402, 1402-a
North Carolina	Yes	N.C. Gen. Stat. §105-228.30
North Dakota	No	
Ohio	Yes	Ohio Rev. Code Ann. §319.202
Oklahoma	Yes	Okla. Stat. Ann. tit. 68, §3201
Oregon	No [6]	Or. Rev. Stat. §306.815
Pennsylvania	Yes	Pa. Cons. Stat. §8102-C
Rhode Island	Yes	R.I. Gen. Laws §44-25-1
South Carolina	Yes	S.C. Code Ann. §12-24-10
South Dakota	Yes	S.D. Codified Laws Ann. §43-4-21
Tennessee	Yes	Tenn. Code Ann. §67-4-409
Texas	No	
Utah	No	
Vermont	Yes	Vt. Stat. Ann. tit. 32, §9602
Virginia	Yes	Va. Code Ann. §58.1-801
Washington	Yes	Wash. Rev. Code §82.45.060
West Virginia	Yes	W. Va. Code §11-22-2
Wisconsin	Yes	Wisc. Stat. §77.22
Wyoming	No	

Footnotes:

[1] Other local jurisdictions may impose taxes.

[2] The tax is a flat fee of \$2 per deed.

[3] - There is no state realty transfer tax, but counties and cities may impose a tax.

[4] - Kansas imposes a recordation tax on mortgages, but not on conveyances of real estate.

[5] - There is no state realty transfer tax, but parishes may impose a tax.

[6] - There is no state realty transfer tax, but a county or city that had a tax in effect on March 31, 1997 may continue to impose a tax.