

Transfer tax uncertainty haunts property transfers



COLE



VARTANIAN

BY JASON E. COLE AND
JUSTIN T. VARTANIAN

New Hampshire's real estate transfer tax is pretty straightforward for arm's-length transfers of real estate, imposing a 1.5 percent aggregate tax (0.75 percent paid by buyer and seller) on the consideration paid for the property.

The tax is imposed on the sale price for arm's-length transfers because the real estate transfer tax — known as the RETT — assumes that, given the adverse interests of the buyer and seller, the agreed-upon sale price accurately reflects the value of the property being sold.

What happens when property is transferred between related parties for a discounted price or for no price at all? Two confusing and somewhat conflicting rulings from the New Hampshire Supreme Court in a span of three years have resulted in continued uncertainty for taxpayers.

Under the RETT, every sale, grant or transfer of an interest in real estate is presumed taxable, unless specifically exempted by statute. The statutory exceptions are fairly limited, which has led some related parties to rely on the argument that a related party transfer is not a "contractual transfer" as defined in the RETT statute, and thus is not subject to the tax.

The taxpayers in First Berkshire relied on this argument to their detriment when they transferred a large portion of property out of a real estate holding entity and then back into a different holding entity for financing purposes, incurring the RETT twice in the process.

The court found Berkshire derived benefits from completing the refinancing transaction, despite no money changing hands. Setting aside a painstakingly detailed and somewhat tortured review of the RETT statute definitions, the transfers at issue in First Berkshire involved little more than the property's owner transferring assets from its left pocket to its right pocket at the request of its lender.

Many interpreted the First Berkshire decision to mean that all related party transactions, even those for no monetary consideration — such as an individual transferring his real property into a real estate holding entity for liability purposes — were subject to the RETT. That was until the court's decision in Say Pease which, in a convoluted manner, reopened the door to the argument that a related party transfer is not a "contractual transfer" as defined in the RETT.

The court in Say Pease ruled that no contractual transfer occurred when the owners of an LLC transferred property with no monetary consideration to a newly formed LLC with the exact same ownership as the transferring LLC. It said the transfer was not made "in exchange for" the contributions to the new LLC or the benefit of limited liability protection, which accrued independent of the real estate transfer.

These cases leave related party transfers in limbo.

Careful planning and documentation of the transaction may help you steer clear of the RETT by relying on Say Pease, but this approach has risk and the assistance of a pro-

fessional tax adviser is recommended before completing such a transaction.

For now, the conservative and recommended approach is to assume that most related party transactions that differ from the circumstances found in Say Pease are taxable under the RETT until further guidance is issued or the Legislature chooses to amend the statute to provide clarification.

To the Department of Revenue Administration's credit, in anticipation of the existing administrative rules interpreting the RETT that are set to expire this winter, it has been proactive in reaching out to tax practitioners to get feedback on guidance that would be helpful to taxpayers. We encourage you to get involved with this process by sharing your concerns with the department early and often and reviewing draft rules when they become available. Given the constraints on the rulemaking process, however, we are less than hopeful that the new administrative rules will provide any definitive answers for taxpayers, although they may provide limited relief.

But the real solution likely involves legislative action to bring the RETT into the 21st century.

Sound tax policy is equitable, fair, certain, economical, simple, neutral, transparent and does not hinder economic growth and efficiency. The RETT statute has a long way to go given the chilling effect it has had on investment activity and the message it sends to property owners who want to transfer their property to a real estate holding entity without incurring an additional tax on the property they own and will continue to own. **NHR**

Jason Cole, CPA, is a member of Devine Millimet's Tax, Non-Profit and Merger and Acquisitions practice groups. Attorney Justin Vartanian is a member of Devine Millimet's Corporate Department.