

June 12, 2008

In Re: **8 Penn Center Owner, L.P.**

Docket No: **36RTMERZZ9902**

STATEMENT OF RECORD:

1. A Petition for Appeal was filed with the Tax Review Board on February 15, 2006 by 8 Penn Center Owner LP (hereafter "Petitioner") requesting review of a Realty Transfer Tax assessment with accrual of interest and penalty for the transfer of certain partnership interests in a partnership that owns the property at 1628 John F. Kennedy Boulevard Philadelphia, Pa. The tax principal assessed is \$325,440. As of the Tax Review Board hearing date, the accrued interest was \$87,055 and accrued penalty was \$174,110.
2. A public hearing was held before the Tax Review Board on October 24, 2006 following which the matter was taken under advisement and a briefing schedule set for the parties.
3. On January 29, 2008, the Tax Review Board announced its decision to abate the penalty accrued against the assessment. .
4. Petitioner has appealed to the Philadelphia Court of Common Pleas.

FINDINGS OF FACT:

1. The property at 1628 John F. Kennedy Boulevard, also known as 8 Penn Center, was acquired by Petitioner, a partnership, in 1998.
2. On April 23, 2004, the partners entered into an Agreement of Sale to sell certain partnership interests.
3. The Partnership Agreement was amended to admit the new general partner and a new limited partner. The buyers purchased partnership interests for the price of \$17,995,000.00. Of the selling partners, 2 retained small portions of their ownership interests. Of these remaining partners, 8 Penwit Partners ("PWP") retained a 5.5% interest, and 8 PC Wolgroup LP ("WG") retained a 5.5003% interest in the partnership.
4. The parties closed on the transaction on June 16, 2004.
5. At the Tax Review Board hearing, Petitioner provided the City and the Board with a revised Schedule "A" as part of the Amended and Restated Agreement of Limited Partnership. This Schedule "A" provided the partners and their equity interests in the partnership, listed on this schedule as their Beginning Capital Account.
6. The Schedule "A" provided at the hearing was actually a fully completed Schedule "A". The Schedule "A" provided to the City at the audit was not fully completed with all pertinent figures. Therefore it was referred to as "revised".
7. Petitioner filed a form 1065 U.S. Return of Partnership Income that covered the period January 1, 2004 through June 17, 2004. The Seller -Partners listed their percentage of interest in the partnership and their capital contributions to the partnership as reflective of their ownership interest. This return reflected that the partnership distributed \$16,866,529 and each partner received its full percentage interest from the distribution thus reducing all of the sellers capital accounts to \$0, including the remaining partners, PWP and WG. The Buyer's capital account reflected 100% of capital.
8. The capital account figures on the 1065 return did not match the figures on the revised Schedule "A".
9. The Partnership tax return filed for the period June 17 through December 31, 2004 reported negative capital accounts for each of the remaining partners based on a starting capital contribution of \$0 and an allocation of losses to each partner.

10. Under the Partnership Agreement, a partner with a negative capital account is not entitled to any distribution of profits and is not entitled to a distribution of capital at liquidation.
11. Petitioner also filed a federal tax return for the second half of 2004 which again listed the remaining sellers/partners as having made \$0 capital contribution and as having negative capital accounts to reflect partnership losses.
12. The revised Schedule "A" reclassified a portion of the Buyer's capital contribution to be a loan.
13. Petitioner's 2005 tax return showed capital account figures different from those on the 2004 return but consistent with the revised Schedule "A". It showed a capital contribution of \$125,000 by each remaining selling partner, rather than the \$0 contributions showing on the 2004 return.
14. Petitioner did not file an amended 2004 return and allowed the filed return showing the remaining partners with \$0 capital contributions.

CONCLUSIONS OF LAW:

This case involves an assessment of Realty Transfer Tax in the amount of \$325,400 in connection with the transfer/sale of a partnership that owns the property located at 1628 JFK Boulevard Philadelphia, Pa., also known as 8 Penn Center.

The Realty Transfer Tax (RTT) is imposed on the transfer of real estate and other real estate transactions where transfer or sales of shares in a corporation or partnership interests result in the de facto transfer of real estate owned by the corporation or partnership. To remedy the situation where the parties could avoid the RTT by transferring the corporate shares or partnership interests rather than by property deed, the City Council amended The Philadelphia Code by adding Chapter 19-1407. RTT is now required when more than 89% of the ownership interest in a partnership, corporation, or other entity which is considered a "real estate company" is transferred. A real estate company is a company primarily engaged in the business of holding, selling, or leasing real estate. The Philadelphia Code Chapter 19-1402(11).

The property 8 Penn Center was acquired by the Petitioner Partnership in 1998. On June 17, 2004, there was a transfer of an ownership interest in the Partnership. Petitioner's position is that 89% of the partnership was transferred and therefore no RTT is due. It is the City's position that more than 89% of the partnership was transferred to new ownership thus triggering RTT.

The issue before the Tax Review Board was whether the transfer of partnership interests in June 2004 exceeded 89% of the partnership interests.

The City is relying on Petitioner's June 2004 original federal tax return, form 1065 U.S. Return of Partnership Income, which shows the remaining partners' capital account at \$0 and the new partners', or the buyer's, contribution to the new Partnership at 100% of capital.

These capital account figures did not match the Schedule A for the Partnership Agreement that was entered into evidence at the TRB hearing. The purpose of this Schedule A is to list the partners and their equity interests in the partnership, listed on this schedule as their Beginning Capital Account. The Schedule A provided to the City at the audit did not contain the capital account figures. The "revised" schedule at the hearing had this column completed.

The City agreed that the sale documents directly transfer 89% of the partnership. However, the June 2004 tax returns show the remaining Partners retained no capital investment in the partnership. The City contended the TRB should accept the original tax returns which show that the buyer contributed 100% of the Partnership capital, disregard the revised Schedule A as self serving and therefore conclude that the Buyers contributed 100% of the capital for the new partnership i.e. more than the 89% threshold.

The Tax Review Board considered whether these original/continuing partners retained an 11% interest in the partnership such as would allow the partnership to avoid the RTT assessment, or whether Petitioner became an “acquired real estate company” which under The Philadelphia Code Chapter 19-1407 would subject Petitioner to RTT because more than 89% of the ownership interest was transferred within a period of 3 years.

When 90% or more of ownership interest in an entity is transferred to new ownership, this entity becomes known as an “acquired real estate company” under The Philadelphia Code and regulations. One of the requirements for becoming an acquired real estate company is that “directly or indirectly, 90% or more of the total capital *and* (emphasis added) profits interest in the company” has been transferred. RTT Regulations Section 602(a)(2).

The parties agreed that the test to determine whether this tax is due on the transfer of a partnership interest is whether the ownership change “has the effect of transferring, directly or indirectly, 90% or more of the total capital and profits ownership interest in the company” as required by the Code.

Petitioner relied on the Partnership Agreement, which provided that the remaining partners retained an 11% profits interest in the partnership, as well as 11% of the capital and distribution interests. Petitioner argued that this Partnership Agreement and not the tax return should be controlling, and pointed out the 2005 tax return corrects any “misclassification” showing that the continuing partners retained a share in capital distributions and a corrected capital account calculation. The Schedule A, which Petitioner says was not “revised” but rather the only signed Schedule A for the Partnership Agreement, showed beginning capital of \$125,000 for each of the two remaining partners and that \$250,000 represented 11% of the partnership equity.

Petitioner explained the 2005 tax return as showing a capital distribution to all partners, including an 11% distribution to the continuing partners.

Petitioner argued that by way of its Partnership Agreement and the actions detailed in its 2005 tax return it met its burden of showing that the continuing partners retained capital and profits interest of 11%. And even if the Board was persuaded that the capital accounts were at \$0 based on the 2004 return, the profits interest was not challenged, and under the regulations, to meet the test of becoming an acquired real estate company both capital and profits interests must be transferred at 90% or more. However, under the Partnership Agreement, a partner with a negative capital account is not entitled a share of the profits. So the 2004 tax return when taken in conjunction with the Partnership Agreement result in the conclusion that the sellers transferred both capital and profits interests at 100%, thus triggering the RTT.

In addition, Petitioner argued that relying on the 2004 tax returns, as the City does, is misleading since the tax basis for the continuing partnership is not necessarily the same as the book value for purposes of determining distribution interests or a partner’s capital account.

It was the determination of the Tax Review Board that Petitioner was an acquired real estate company as defined in The Philadelphia Code Chapter 19-1407 as a result of a transfer of greater than 89% of the partnership interest that occurred on June 16, 2004. While the Partnership Agreement expressly transfers 89% of the partnership interest to the new partners, the Board found that a review of the total transaction with all documents, including the 2004 and 2005 tax returns, indicated that in actuality more than 89% was transferred thus resulting in Realty Transfer Tax liability.

Petitioner provided both the City and the Tax Review Board with inconsistent documents and insists that the Board accept only the documents that support its position. During the audit, the City was provided with a Schedule A to the Partnership Agreement that did not have all of the pertinent information filled in, and a 2004 tax return that did not support Petitioner's scenario of the transfer. At the hearing a completed Schedule A was finally provided that still did not match the 2004 tax return. Petitioner did not explain why its 2004 tax return was not amended or corrected and offered no compelling reason for the Board to discard it, other than it did not support Petitioner's position before the Board. The June 2004 tax return reported that the buying partners contributed 100% of the partnership capital. The 2005 tax return reported capital contributions in line with the Schedule A provided at the hearing with a request by Petitioner to accept these as correct but with no explanation for the 2004 tax return reporting. It reclassifies the capital contribution of buyer-partner ASMM as a loan but provides no supporting documentation to establish that there was, in fact, a loan made to the partnership. The Tax Review Board was not persuaded that the 2004 tax return figures should be ignored as there was no substantive basis provided to do so.

Petitioner bears the burden of proof to establish by substantial evidence that the tax assessment is incorrect. Ernest Renda Construction Co., v. Commonwealth, 94 Pa. Commonwealth Court. 608, 504 A.2d 1349 (1986). Petitioner failed to do so. The Board was not persuaded that the remaining partners had retained the required 11% interest in the partnership that would result in avoidance of the RTT.

The Philadelphia Code Chapter 19-1702(5) provides that (t)he filing of a Petition for Review shall be deemed to include therein... a request for the waiver of interest and penalties." It was the decision of the Board in this matter to abate the penalty as there was no showing of bad faith, negligence or intent to defraud. The Philadelphia Code Chapter 19-1705(2).

Concurred:

Derrick Johnson, Chair
Una Vee Bruce
Joseph Ferla