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The Department of Revenue Imposes Additional Real Estate Transfer Tax on Electric Generation Facilities

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SUMMARY

The Pennsylvania Department of Revenue has recently initiated a program recalculating real estate transfer tax liabilities for the sale of many electric generation facilities that have occurred since the adoption of the Electric Generation Customer Choice & Competition Act in December of 1996 which provided for deregulation of the electric generating industry in Pennsylvania. In instances in which power plants have been subject to substantial reassessments for local tax purposes, the Department of Revenue is demanding the payment of transfer taxes based on the market value finally determined pursuant to assessment appeals, regardless of whether the property was exchanged in a bona fide arms-length transaction for a different amount or whether the reassessment applied to the tax year in which the ownership of generating facilities were transferred.

Because Pennsylvania laws and regulations have historically been construed to impose transfer taxes on actual compensation paid (or determined) in arms-length bona fide sales and limit reliance on assessed values in other cases to values determined for the year of the transfer, taxpayers affected by any such "notice of determination" may wish to consider whether to seek relief by petitioning the Department of Revenue's Board of Appeals for a redetermination of tax liability and pursuing subsequent appeals, if necessary, to the Pennsylvania Board of Finance and Revenue and to the Commonwealth Court.

ANALYSIS

As a result of the deregulation of the electric industry in Pennsylvania, since the adoption of the Electric Generation Customer Choice & Competition Act in December of 1996, there have been numerous purchases and sales of power plants. In Pennsylvania, generally when an interest in real estate is transferred, transfer tax on that transfer must be paid at the time that a document recording the transfer is filed with the local county recorder of deeds. Typically, the transfer tax is two percent of the value of the real estate. One percent is paid to the Commonwealth of Pennsylvania and one percent to the local municipality or school district in which the real estate is located.

Article XI-C of the Pennsylvania Tax Reform Code of 1971 imposes a one percent state real estate transfer tax upon "the value of real estate represented by [a] document" accepted or presented for recording. 72 P.S. § 8102-C. In addition, municipalities and school districts may impose a transfer tax upon transactions "to the extent the transactions are subject to [the state transfer tax]." 72 P.S. § 8101-D. Under the Local Tax Enabling Act, total local transfer taxes may not exceed an additional one percent, but home-rule municipalities, including Philadelphia and Allegheny County, impose higher transfer tax rates.[1]

"Real estate" subject to state and local transfer tax is defined to include land, buildings, structures, fixtures,

1 The City of Philadelphia imposes a 3% realty transfer tax. Philadelphia Code, § 19-1403. The City of Pittsburgh imposes a transfer tax of 2% and the Pittsburgh School District imposes a transfer tax of .5% for a total of 2.5%. Pittsburgh Code of City Ordinances, Title 2, Article VII, Ch. 255 and 256.

mines, minerals, timber and other improvements, but excludes "permanently attached machinery and equipment in an industrial plant." 72 P.S. § 8101-C. The Tax Reform Code provides that "value" of real estate in any bona fide sale of real estate at arms-length for actual monetary worth is the "actual consideration paid or to be paid." 72 P.S. § 8101-C. Regulations adopted by the Department define a "bona fide sale" as a "transfer between a buyer, willing but not obligated to buy, and a seller, willing but not obligated to sell, each acting with adverse economic interests at arms-length in its own interest and with knowledge of the value of the real estate transferred." 61 Pa. Code § 91.131.

In contrast, when property is not transferred pursuant to a bona fide arms-length transaction, transfer taxes are based upon the "computed value" of real property. 72 P.S. § 8101-C. Computed value is the locally determined assessed value of the property for the year of the conveyance, divided by the ratio of assessed values to amounts paid in arms-length transactions as determined by the Pennsylvania State Tax Equalization Board for the year of the transfer. 62 Pa. Code § 91.131.

In most transactions involving arms-length sales of power plants, the total purchase price included both real property, personal property and other assets. To determine the value of consideration paid for real property, parties to these transactions typically agreed upon a valuation schedule allocating the purchase price to various assets and paid transfer taxes based upon the allocated value. In other instances, taxes were paid based upon separate appraisals or were calculated using computed values. All three options are recognized as permissible pursuant to Pennsylvania laws and regulations.

When the power plants were transferred, in many instances, the current assessed value was the subject of a tax assessment appeal. These assessment appeals were initiated either by owners of electric generating facilities or by local taxing jurisdictions. After the transaction was finalized and the transfer tax was paid, through resolution of the tax assessment appeal, the actual market value of the real estate, as recorded by the local tax assessment office, may have increased or decreased.[2]

Recently, the Department of Revenue has begun issuing notices of determination to those entities that recorded a document evidencing a transfer of a power plant within the past three years and who have subsequently settled a tax assessment appeal regarding that real estate. According to the Bureau of Individual Taxes (the bureau responsible for transfer tax issues) at the Department of Revenue, those notices were deliberately held until the tax appeals were resolved. The Department of Revenue appears to be taking the position that the values established through the resolved tax assessment appeal are the sole evidence of value to be considered for purposes of transfer tax, regardless of whether the property was transferred pursuant to a bona fide arms-length transaction or whether the value of the real estate as reported was nominal.

In addition, the Department of Revenue appears to be taking the position that the value established through the effective date of the market value, as established through the tax assessment appeal, predates or postdates the transfer. According to the Department of Revenue, the values in effect prior to such challenges, and when the power plant was subject to state public utility realty tax, are of no moment because the counties largely ignored those values because prior to 1999 (the year that the Public Utility Realty Tax Act ("PURTA") was amended), and the assessed value did not affect actual tax liabilities paid pursuant to PURTA. According to the Department of Revenue, there were insufficient incentives for parties to appeal and properly update assessments prior to the PURTA amendments, so those assessments did not provide a satisfactory basis for determining value for transfer tax purposes.

The legal basis for the Department of Revenue's position is not clear. Until the amendment of PURTA in 1999, the utility realty's state taxable value, upon which the PURTA tax was imposed, was defined as the depreciated book value of all property that was included within the definition of utility realty. Section

2 Where the transfer tax was paid on the computed value and the resolution of the pending tax assessment appeal decreased the assessed value of the property, the taxpayer may file a petition for refund from the Department of Revenue. The refund petition must be filed within three years from the date of payment of the tax.

2 of Act 66 of 1970, *as amended*, 72 P.S. § 8101(4). The tax was not imposed on the assessed value of utility realty. Thus, the assessed value of such realty, as determined by the local assessors, did not have any relevance to the determination of the amount of PURTA tax owed by the utility.

The PURTA taxation scheme was and continues to be administered by the Department of Revenue. Pursuant to PURTA, the public utilities have paid utility realty tax to the Department of Revenue each year (based upon the value of utility realty at the end of the preceding year). The revenue so collected by the Department of Revenue is, in turn, distributed to the political subdivisions of the Commonwealth. Other realty continued to be governed by the local tax assessment laws. In 1999, the General Assembly stated that as of January 1, 2000, electric generation realty would no longer be governed by the PURTA taxation scheme and would, instead, be governed subject to local taxation and the laws governing that taxation scheme.

Even though exempt from local taxation, under Act 66 of 1970, utility realty was also assessed by local tax assessors. Act 66 of 1970 provided that it was the duty of appointed assessors to "assess and value all utility realty in the same manner *as is provided by law for the assessment and valuation of real estate*." Consequently, although PURTA exempted all utility realty from local property tax, the local taxing authorities were, nevertheless, required to assess the realty in accordance with tax assessment law (*e.g.*, General County Assessment Law, 72 P.S. § 5020.101, *et seq.*; Second Class County Assessment Law, 72 P.S. § 5452.1 *et seq.*, Second Class A and Third Class County Assessment Law, 72 P.S. § 5342, *et seq.*, Fourth to Eighth Class County Assessment Law, 72 P.S. § 5453.101, *et seq.*). 72 P.S. § 8105-A(a). While this assessed value was not relevant to the tax paid by utilities, it was relevant to the finances of the respective taxing entity and was used in determining computed values for transfer tax purposes.

Moreover, after the 1999 amendments to PURTA, a taxpayer could retroactively appeal the effective assessed value; however, the local taxing authorities could not. 72 P.S. § 8105-A(d). Accordingly, where a tax assessment appeal had been filed by the local taxing authorities, and not by the taxpayer, the revised market value could not have been effective prior to the date of the transfer.

While the issue is subject to dispute and has not been the addressed in rulings of courts of competent jurisdiction as of this date, the Department of Revenue's position is subject to challenge. Under the Department's regulations, computed values are only to be used in instances in which the value of property is not determined in bona fide arms-length transactions. *See* 61 Pa. Code §§ 91.131 – 91.137. In addition, in instances in which computed values are used to determine transfer taxes, computed values are calculated using assessed values for the year of the transaction. 61 Pa. Code § 91.131. Accordingly, while the issue is subject to dispute and has not been advised in relevant judical rulings, it may be appropriate for persons affected by the Department of Revenue's policies to seek the advice of counsel regarding whether to pursue appropriate appeals.

Property owners receiving a notice of determination from the Department of Revenue have 90 days from the date of mailing to file a Petition for Redetermination with the Department of Revenue, Board of Appeals. A decision from that Board of Appeals may be appealed to the Board of Finance and Revenue within 90 days from the mailing date of the Board's decision.

FOR FURTHER INFORMATION

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