CASE LAW DEVELOPMENTS INTERPRETING REAL ESTATE TRANSFER TAX

by

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Since 2003 the New Hampshire Department of Revenue Administration ("NH DRA") has been fully authorized by statute to aggressively apply and collect the real estate transfer tax upon a transfer any interest in a limited liability company that hold New Hampshire real estate. Whether a business owner is a developer of real estate or merely the owner of the condominium unit in which the business operates, the tax is an additional expense that has to be considered in any sale or transfer of a New Hampshire real estate asset. This includes transfers merely to facilitate financing.

Two recent cases decided by the NH Supreme Court regarding property owners making transfers to new entities as a condition of obtaining financing illustrate both the broad reach of the tax and NH DRA's aggressive efforts to collect it, as well as the very limited circumstances in which it can be avoided.

In First Berkshire Business Trust v. Commissioner, NH DRA, 161 NH 176, the taxpayer which was audited by NH DRA was

unsuccessful in challenging a Notice of Assessment seeking over $200,000 in transfer tax based on the following facts:

First Berkshire owned a commercial property in Manchester and was in financial difficulty. To avoid bankruptcy it obtained a commitment from Wells Fargo Bank for refinancing. The Bank as a condition of making the loan required First Berkshire to create a single purpose entity; First Berkshire Properties, LLC to: 1) take title to the property from First Berkshire by deed and 2) be the borrower under the loan. First Berkshire made the conveyance and subsequently refinanced again with another lender which required that a second LLC be created to take title from the first LLC and to borrow the funds for the second loan. NH DRA claimed both transactions were subject to the tax calculated at the fair market value of the property. First Berkshire claimed there were no bargained-for-exchanges subject to the tax and, even if there was a taxable transfer, the value of the transfer was $10.00 and other valuable consideration as stated in each of the deeds.

The NH Supreme Court agreed with NH DRA's position. The Court held that because money and other consideration was exchanged there was a taxable transfer and that NH DRA in its role as auditor, charged with enforcing the tax, could look behind the stated price in the deed and determine the actual

price or consideration based upon the fair market value of the real estate.

In Say Pease IV, LLC v. NH DRA, (decided March 23, 2012), a taxpayer in a similar financing transaction, was successful in qualifying the scope and reach of the First Berkshire decision, thereby avoiding an assessment of the tax by NH DRA on its 47.5% interest in a property at the Pease Tradeport with a value in excess of 10 million dollars.

Say Pease IV was an entity created by Two International Group, LLC ("TIG") and its managing member Say Pease, LLC, so as to meet the requirement of a lender of $10.5 million mortgage loan that all of the members of TIG be "single purpose bankruptcy remote entities" to protect the lender from other potential creditors of TIG or Say Pease, LLC. Say Pease IV ("SPIV") was formed by the members of Say Pease, LLC for the sole purpose of being a Managing Member and Member of TIG and couldn't engage in any other business activity as long as the loan was outstanding. Say Pease's 47.5% interest in TIG was transferred to SPIV under these conditions.

The NH Supreme Court considered NH DRA's appeal of a decision of the Superior Court holding that the real estate transfer tax didn't apply because it was not a contractual transfer and additionally that the transfer met the statutory requirement for a non-contractual transfer and therefor was

exempt from the tax, notwithstanding the decision in First Berkshire.

The Supreme Court stated that the only issue was whether unlike the transfer in First Berkshire, there was a contractual transfer, i.e., a bargained-for-exchange of an interest in real estate. The Court held that Say Pease, LLC received no consideration for the transfer to SPIV. While the members of each entity who were its members may have exchanged consideration with each other to form SPIV, none of it was paid to Say Pease, LLC. The Court held that the members were merely attempting to maintain TIG's original ownership, while placing it in a suitable financing vehicle. The Court further held that the promise not to engage in any other business activity made by SPIV was nothing more than an accommodation to TIG's lender and wasn't consideration for the transfer by Say Pease, LLC. The Supreme Court explicitly distinguished its decision in First Berkshire finding any benefit received by the transferee SPIV was too attenuated to support a finding of consideration under the statute. The Court stated:

> We are not inclined to extend First Berkshire Business Trust's reach to permit DRA to trace the benefits through multiple layers of ownership back to an original transferor. When a complete identity of interest between a beneficiary and the transferor exists, imputing the

benefits one receives to the other, as we did in First Berkshire Business Trust, is supportable. But here, given the attenuated relationship between the beneficiary, TIG, and the transferor, Say Pease, there is no reason to assign the benefits that one entity received to the other.

Where does this leave the business owner? In most situations the tax is going to apply to the transfer of real estate or interests in a real estate holding company even if the beneficial ownership remains identical after the transfer and the only purpose is to obtain financing. However, the Say Pease decision shows the value of anticipating the issue and with the assistance of counsel and your tax advisor drafting transfer documents that position you to avoid or resist the tax. This is an aggressive strategy, with considerable risk, recognizing that NH DRA can seek to impose a 100% penalty for intentional failure to pay the tax (the penalty was sought in First Berkshire but the Superior Court found it was not warranted based on the then unclear state of the law). In some unique cases like Say Pease, where there is a layered LLC approach and a very substantial tax is at stake, an effort to analyze all aspects of how a contemplated transaction can be structured to meet the "no consideration" standards laid out in Say Pease can be justified.

Additionally, business owners in making financing decisions need to consider some of the NH specific tax implications of

dealing with securitized commercial lenders who routinely require such transfers to meet the bankruptcy remote entity requirement of the underwriters for the bundled securities sold that are collateralized by the mortgages. Those rates are attractive, but especially in a low rate environment, dealing with your local commercial lender may save you misery.

Finally, because the State is so revenue starved it is also likely that NH DRA will pursue legislative action to further clarify the definition of consideration in the statute so as to effectively render the distinction drawn in Say Pease by the Supreme Court moot, and therefore reverse the outcome to make such layered transfers subject to the tax. This is another reason to stay in touch with your counsel and tax advisor who monitor such developments.

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