Revisiting the Rhode Island Acquired Real Estate Company Conveyance Tax

E. Hans Lundsten, Esq.
Adler Pollock & Sheehan P.C.
Providence

Kathryn S. Windsor, Esq.
Adler Pollock & Sheehan P.C.
Providence

The Rhode Island legislature enacted the statute to close a loophole that allowed an individual to transfer real estate to an entity for little or no consideration …

The Rhode Island Division of Taxation has issued minimal guidance and no regulations since the Acquired Real Estate Company Conveyance Tax[1] went into effect in July of 2015. No administrative or court decisions have been published regarding the interpretation of key provisions of the statute leaving it up to the Division to internally interpret those provisions, which may be to the disadvantage of taxpayers. Further complicating matters, the reporting and enforcement of the Acquired Real Estate Company Conveyance Tax are often hidden from public view because, based on our understanding, disputes with the Division involving the statute are usually resolved either during audit or prior to a formal hearing.

This article addresses the application of key provisions of the statute, recent legislative changes, and practical issues related to reporting and enforcement.

Background

Rhode Island enacted the Acquired Real Estate Company Conveyance Tax as part of the fiscal year-end 2016 budget.[2] The text of the statute is based on the Pennsylvania Realty Transfer Tax Act with few alterations.[3] The Rhode Island legislature enacted the statute to close a loophole that allowed an individual to transfer real estate to an entity for little or no consideration and then sell the interest in the entity to a buyer thereby transferring the underlying real estate. Using this structure, the seller avoided the Rhode Island real estate conveyance tax because the buyer and seller did not have to record a deed transferring title at the local level.

The Acquired Real Estate Company Conveyance Tax has two main elements. First, there must be a realty company, and second, the realty company must be an acquired real estate company for the tax to apply. The tax is $2.30 for each $500, and fractional part thereof, of the purchase price for the interest in the acquired real estate company. As discussed below, in some instances if the tax is applied to the transfer of an interest in an acquired realty company, the tax should be calculated based on the assessed value of the property rather than the purchase price which we understand is contrary to the Division's current practice.

Per the statute, the tax is paid by the grantor and is reported on Form CVYT-2, Acquired Real Estate Company Conveyance Tax Return. The grantor must provide written notice of the conveyance to the Division at least five (5) days prior to the transfer; however, the instructions for the Form CVYT-2 instruct the grantor to allow 8-10 business days for processing. A copy of the purchase and sale agreement and the tax payment must accompany the Form CVYT-2. While the statute assigns liability for the tax to the grantor, the acquired real estate company is the taxpayer on the Form CVYT-2 as discussed below. This begs the question, who is liable for the tax on an unfiled or incorrectly filed Form CVYT-2?

Real Estate Company

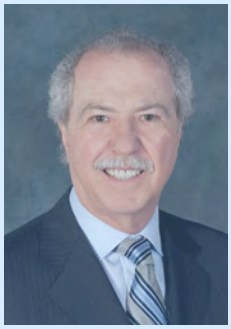
The definition of an "acquired real estate company" is relatively straightforward. An acquired real estate company is a real estate company that has undergone a change in ownership interest if (i) the change does not affect the continuity of operations of the company; **and** (ii) the change, whether alone or together with prior changes has the effect of transferring, directly or indirectly, 50% or more of the total ownership of the company within a period of three (3) years.[4] The definition of "real estate company" is more complicated.

Both the Rhode Island and Pennsylvania statutes define "real estate company" as an entity that:

(i) Is primarily engaged in the business of holding, selling, or leasing real estate where 90% or more of the ownership of the real estate is held by 35 or fewer persons **and** which company either: (a) derives 60% of its annual gross receipts from the ownership or disposition of real estate; or (b) owns real estate the value of which comprises 90% or more of the value of the entity's entire tangible asset holdings exclusive of tangible assets that are fairly transferrable and actively traded on an established market; **or**

(ii) Ninety percent or more of the ownership interest in such entity is held by 35 or fewer persons and the entity owns 90% or more of

MIGNANELLI & ASSOCIATES, LTD.
Attorneys At Law



Anthony R. Mignanelli
Attorney At Law

Wills & Trusts
Estate Tax Planning
Estate Settlements
Trusts for Disabled Persons
Personal Injury Settlement Trusts
All Probate Matters

Attorney to Attorney Consultations / Referrals

10 Weybosset Street
Suite 400
Providence, RI 02903
T 401-455-3500
F 401-455-0648

56 Wells Street
Westerly, RI 02891
T 401-315-2733
F 401-455-0648

www.mignanelli.com

The R.I. Supreme Court Licenses all lawyers in the general practice of law.
The court does not license or certify any lawyer as an expert or specialist in any field of practice.

CONDOMINIUM LAW

- Condo Collections – No Cost to the Association
- Condo Assoc. Representation
- Condo Document Drafting

PALUMBO LAW

535 Atwood Ave., Suite 4, Cranston, RI 02920
401-PALUMBO info@richardpalumbolaw.com
Offices in RI, MA & CT

the fair market value of its assets a direct or indirect interest in a real estate company. An indirect ownership interest is an interest in an entity 90% or more of which is held by 35 or fewer persons and the purpose of the entity is the ownership of a real estate company (emphasis added).[5]

Section (ii) is a circular way of including any entity which directly or indirectly owns 90% of an entity described in Section (i).

It is our understanding that the Division's current position is that if a company meets either Section (i)(a) or Section (i)(b) then the entity is primary engaged in real estate and is considered a "real estate company."[6] The Division's interpretation of the definition of "real estate company" fails to address the plain language of the statute. In effect, the Division is ignoring the "and" requirement of the statute. The Division's interpretation disregards the first prong of the test: Is the entity primarily engaged in the business of holding, selling, or leasing real estate? If not, the analysis should end there. The entity does not meet the definition of a real estate company.

The Pennsylvania Department of Revenue weighed in on the definition of "primary engaged in real estate" in a private letter ruling involving a cemetery company.[7] The question presented was whether a company owning a cemetery was a "real estate company" for purposes of the realty transfer tax. The Department of Revenue succinctly determined that a cemetery is not a real estate company because it is primarily a service business like a hotel rather than a business that holds, sells, or leases real estate. It also noted that "[a] cemetery company is similar to the operation of a hotel with a longer stay. The cemetery company provides a service on the real estate, and while the real estate is an integral part of the service, it is the service that is the primary business of the cemetery company. Therefore, a cemetery company is not a real estate company for Pennsylvania Realty Transfer Tax purposes."[8]

As used in legislation, the word "primarily" means of first importance or principally.[9] Other businesses that provide services on real estate but are not primarily engaged in holding, selling, or leasing real estate should include hotels, parking facilities, nursing homes, extended care facilities, hospitals, manufacturers, sports venues, entertainment facilities, and marinas among others. For example, a hotel's revenue is primarily derived from services rather than real estate. A company should not be deemed a real estate company solely because it owns real estate and satisfies either the 60% or 90% test in the statute.

Use of Assessed Value

It is our understanding that the Division's current interpretation of the statute is that the tax is based on the consideration paid for the property or the interest in the acquired real estate company. Form CVYT-2 includes a line for consideration paid; however, the form does not address a situation in which the sale includes consideration paid for personal or intangible property. The form also does not address R.I. Gen. Laws § 44-25-1(g) which calculates the tax based on the assessed value of the property. Specifically, the provision provides that "where the real estate company has assets other than interests in real estate located in Rhode Island, the tax shall be based upon the assessed value of each parcel of property located in each municipality in the state of Rhode Island."

This provision was ostensibly included to resolve apportion-

ment problems for multi-jurisdictional transactions that contain real estate in more than one municipality and transactions that include personal property. Apportionment issues arise when each asset is not assigned a value in the transaction documents. It's our understanding that the Division, however, has chosen to ignore the statute as written based on the Form CVYT-2 and Notice 2015-13. Statutes are to be interpreted and construed in accordance with their plain and ordinary meaning.[10] Furthermore, taxing statutes should be strictly construed with doubts resolved in favor of the taxpayer.[11] In this case, the statute is clear that in multi-locality transactions or transactions that include personal property, the assessed value of the real estate should be used to calculate the tax.

It is interesting though that the Division uses the assessed value of the real estate on Form CVYT-2 to determine the allocation of the tax between municipalities if the acquired real estate company owns real property in multiple Rhode Island municipalities. This mismatch between the assessed value and consideration paid can lead to inconsistencies in the allocation of the tax between the municipalities.

Increase in Tax

The Rhode Island Legislature increased the tax on real estate conveyances effective January 1, 2022 as part of the 2022 fiscal year budget.[12] The recently enacted legislation, House Bill 6122, Substitute A, as amended, imposes an additional $2.30 per $500, or fractional part thereof, on consideration paid above $800,000. Specifically, the enacted legislation states:

> [T]here is imposed, on each deed, instrument, or writing by which any ***residential*** real property sold is granted, assigned, transferred, or conveyed to, or vested in, the purchase or purchasers, or any other person or persons, by his or her or their direction, or on any grant, assignment, transfer, or conveyance or such vesting, by such persons which has the effect of making any real estate company an acquired real estate company, when the consideration paid exceeds eight hundred thousand dollars ($800,000), a tax at the rate of two dollars and thirty cents ($2.30) for each five hundred dollars ($500), or fractional part of it, of the consideration in excess of eight hundred thousand dollars ($800,000) that is paid for the purchase of property or the interest in an acquired real estate company … (emphasis added)![13]

The additional tax will be allocated to the Housing Production Fund, a new dedicated account administered by the Rhode Island Housing and Mortgage Finance Corporation to support affordable housing initiatives.

The term "residential real estate" is not defined in the statute. The IRS defines residential real estate in the context of depreciation of residential rental property in the Internal Revenue Code § 168(e)(2)(A). The term "residential rental property" is defined as any building or structure if eighty percent (80%) or more of the gross rental income from such building or structure for the taxable year is rental income from dwelling units.[14] "Dwelling unit" means a house or apartment used to provide living accommodations in a building or structure.[15] The definition excludes units in hotels, motels, and other establishments where more than fifty percent (50%) of the units are used in a transient basis.[16]

Residential real estate is also defined in the Rhode Island Department of Business Regulation banking regulations regard-

Injured at Work?

Accepting referrals for matters of

Workers' Compensation

Call Stephen J. Dennis Today!

1-888-634-1543 or 1-401-453-1355

MARK A. PFEIFFER
Alternative Dispute Resolution Services
www.mapfeiffer.com

Bringing over four decades of experience as a Superior Court judge, financial services industry regulator, senior banking officer, private attorney, arbitrator, mediator, receiver, and court appointed special master to facilitate resolution of legal disputes.

ARBITRATION MEDIATION PRIVATE TRIAL

(401) 253-3430 / adr@mapfeiffer.com
86 State St., Bristol, RI 02809

RICHARD S.
HUMPHREY
LAW OFFICES

Richard S. Humphrey
Christina Dzierzek

DUI / Refusal
DUI / Serious Bodily Injury
DUI / Death Resulting
Social Host Liability
Admiralty
Personal Injury
Construction
Municipal

401-624-6152 (OFFICE) 401-641-9187 (CELL)
richardhumphreylaw.com
3852 Main Road, Tiverton, RI 02878

1031 Exchange Services, Inc.
EXCHANGE WITH CONFIDENCE
401.331.0083 | cja@1031ri.com | www.1031ri.com
Providence, RI • Alexandria, NH

Structuring tax-deferred exchanges
throughout the U.S.
with Integrity and Experience

Charles J. Ajootian, Esq.
President and Counsel

Rhode Island's leading intermediary since 1997.

ing mortgage foreclosure disclosures.[17] The regulation defines "residential real estate" as "real property located in Rhode Island having between one (1) and four (4) dwelling units of which at least one is occupied by the Mortgagor. An individual owner-occupied residential condominium unit is included within this definition."

Similarly, R.I. Gen. Laws § 34-49-2 in defining "commercial real estate" excludes residential real estate which is defined as: "(i) Real estate containing one (1) to four (4) residential units; (ii) Real estate on which: (A) No buildings or structures are located; and (B) Which is zoned for single-family residential use; or (iii) Single-family residential units such as condominiums, townhouses, or homes singly or in a subdivision when sold, leased, or otherwise conveyed on a unit by unit basis, even though these units may be a part of a larger building or parcel of real estate containing more than four (4) residential units." Seemingly, based on the Rhode Island statutes, apartment buildings do not appear to be residential real estate unless they contain less than four (4) units; thereby, excluding large apartment buildings from the additional conveyance tax. Conversely, adoption of a definition similar to that of the IRS definition of residential rental property would subject large apartment buildings to the additional real estate conveyance tax.

Curiously, the Division does not specify that the additional conveyance tax is limited to residential real estate in the Division's Notice 2021-04 dated July 7, 2021 or in its Summary of Legislative Changes dated July 26, 2021.[18] The application of the additional tax specifically to "residential real estate" is a modification of the general rate of tax on "any lands, tenements, or other realty."[19] It will be interesting to see if the Division applies the newly imposed additional tax only to residential real estate (and if so, how the Division defines "residential") or to all real estate despite the plain language of the statute.

Enforceability

Unlike other sections of the Rhode Island General Laws, the Acquired Real Estate Company Conveyance Tax statute does not impose a lien on the real estate. For example, R.I. Gen. Laws § 44-30-71.3 imposes a lien upon the real property subject to sale by a nonresident. R.I. Gen. Laws § 44-11-8 of the business corporation tax provides that any tax imposed upon any corporation under the provisions of the chapter shall constitute a lien upon the corporation's real estate. Similarly, the employment tax contribution provisions of R.I. Gen. Laws § 28-43-20 include a statutory lien.

Arguably, R.I. Gen. Laws § 44-25-7 grants the tax administrator the power to collect any tax imposed by Title 44, Chapter 25 using the same collection powers of the towns and cities. R.I. Gen. Laws § 44-25-7 provides that "[t]he tax administrator receives and collects any tax imposed under this chapter in the manner and with the powers prescribed for, and given to collectors of taxes by chapters 7-9 of this title." R.I. Gen. Laws § 44-9-1 states that tax assessed against a person for real or personal property tax constitutes a lien on the person's real estate arising as of the date of the tax assessment. However, in the case of the Acquired Real Estate Company Conveyance Tax, a Form CVYT-2 presumably has to be filed alerting the Division to the transfer before any tax assessment can be made.

The Acquired Real Estate Company Conveyance Tax statute does provide that a transaction will be fraudulent and void

against the state unless appropriate notice is given and the tax is paid. However, what does fraudulent and void against the state mean in practical terms when there is no statutory lien? Arguably, it means the realty company could still be treated by the state as an asset of the seller; however, there is no automatic lien on the interest in the realty company or its assets under the statute. Unlike typical real estate sales, title insurers are not reviewing these types of transactions as there are no liens involved. The title to the real estate is not transferred, so the buyer does not need to purchase title insurance.

Based on the Form CVYT-2 itself, the acquired real estate company is required to file the Form CVYT-2 and remit the appropriate tax for the acquisition of the real estate company. However, under the statute, the tax is imposed on upon "the grantor, assignor, transferor, or person making (giving) the conveyance or vesting."[20] Buyer's counsel and lender's counsel need to be aware of the tax and reporting requirements even though there is no statutory lien because of the uncertainty of who is liable for the tax, i.e., the grantor or the acquired real estate company, and because the state could declare the transaction fraudulent and void at a later date. This could sour future transactions especially when a certificate of tax good standing is required. It also may be hard to convince the original grantor to pay the tax years down the road without adequate protections in the transaction documents.

Conclusion

Without a court or administrative decision, it is unlikely that the Rhode Island Division of Taxation will modify its internal interpretation of the Acquired Real Estate Company Conveyance Tax. This could prove costly for sellers in multijurisdictional transactions or sellers in transactions that involve multiple assets when the Division assesses tax on consideration paid rather than the assessed value of the real estate. It could also prove costly for businesses that may not be primarily engaged in holding, selling, or leasing real estate but still own real estate as part of the services they provide. Practitioners should be aware of these issues when counseling clients on the tax and preparing the Form CVYT-2. Practitioners should also be vigilant that the upcoming increase in tax is only applied to transactions involving residential real estate per the provisions of the statute.

ENDNOTES

1 *The Acquired Real Estate Company Conveyance Tax was incorporated into Title 44, Chapter 25 "Real Estate Conveyance Tax" at R.I. Gen. Laws § 44-25-1 et seq., as amended. All references herein to R.I. Gen. Laws § 44-25-1, as amended, refer to R.I. Gen. Laws § 44-25-1 as amended by 2021 Rhode Island Public Laws Ch. 21-162 (21-H 6122Aaa).*

2 *2015 Rhode Island Public Laws Ch. 141 (2015 - H 5900 Sub. A, as amended).*

3 *72 Pa. Stat. §§ 8101-C – 8114-C.* ***See*** Clark Calhoun & Kathleen Cornett, Controlling Interest Transfer Taxes: A Mostly Critical Review, *26-JAN J. MULTISTATE TAX'N 16, 8 (Jan. 2017) ("The [Rhode Island] Division of Taxation likely will issue more guidance as time passes and disputes arise, but, until then, it may be best to consult Pennsylvania's [realty transfer tax] guidance because the Division acknowledges that Rhode Island copied its statute from Pennsylvania.").*

4 *R.I. Gen. Laws § 44-25-1(e), as amended.*

5 *R.I. Gen. Laws § 44-25-1(f), as amended.*

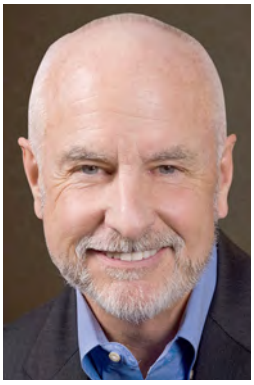
6 *Rhode Island Department of Revenue, Division of Taxation Notice 2015-13 (Sept. 2015).*

7 *Pennsylvania Letter Ruling No. RTT-04-008 (March 17, 2004).*

8 ***Id.***

JIM PURCELL ADR

Arbitration - Mediation
Facilitation - Fact Finding



– Highly experienced arbitrator and mediator.

– Former trial lawyer, Rhode Island and Massachusetts.

– Former CEO of major health insurer.

– Member of AAA and AHLA national rosters of arbitrators and mediators.

– Dedicated to the prompt and fair resolution of your matters consistent with your schedule.

James E. Purcell
JimPurcellADR@gmail.com
401-258-1262

Tell Your Insurance Company "[redacted]"
401-PALUMBO

No FEE unless successful!
DENIED, DELAYED, UNDER-PAID

Fire	Water	Ice Dams
Back-ups	Collapse	Mold
Storm Damage	Theft	Vandalism

401-PALUMBO
propertydamageinsuranceclaimsattorneys.com
Offices in RI, MA & CT

Combine Profit & Public Service in 2022 with LRS

The Bar Association's **Lawyer Referral Service** (LRS) offers you a major opportunity to obtain new clients while you provide a public service. For only $8 a month we can help market your practice and increase your client base. New members may join now for the special price of only **$50 until September 2022** at which time you can choose to renew for the annual membership fee of only $100.

Last year alone 6,000 referrals were made through the full fee LRS program with additional referrals through the optional reduced-fee and referral service for the elderly. Referrals are made in almost all areas of civil and criminal law. ***Please note, we have recently added Limited Scope panels as well as COVID issues based on the public's inquiries.***

Please contact us today to get started. Joining is an easy process! Applications are available for completion on the Bar Association website at ribar.com. You may also contact the LRS directly at 401-421-7799 or email cpoland@ribar.com or eking@ribar.com to receive an application. If you have any questions about the referral process, please call or email us. We look forward to having you as an LRS member.

Join today and kick start the New Year with new clients!

9 *Devine v. Comm'r of Revenue*, 558 F.2d 807, 813-14 (5th Cir. 1977); *20th Century Mfg'ing Co. v. U.S.*, 444 F.2d 1109, 1113 (Ct. Claims 1971).
10 *Ellis v. Rhode Island Public Transit Authority*, 586 A.2d 1055, 1057 (R.I. 1991); *Stone v. Goulet*, 522 A.2d 216, 218 (R.I. 1987).
11 *Balmuth v. Dolce for Town of Portsmouth*, 182 A.3d 576, 585 (R.I. 2018) (quoting *Maggiacomo v. DiVincenzo*, 122 R.I. 615, 618, 410 A.2d 1332, 1333 (1980)).
12 2021 Rhode Island Laws Ch. 21-162 (21-H 6122Aaa).
13 R.I. Gen. Laws § 44-25-1(b), as amended.
14 I.R.C § 168(e)(2)(A)(i).
15 I.R.C § 168(e)(2)(A)(ii)(I).
16 *Id.*
17 230-RICR- 40-10-4.4
18 The State of Rhode Island General Assembly also did not refer to residential real estate in the press release regarding the approved 2022 state budget dated July 1, 2021. The press release does refer to "high end" real estate but does not distinguish between residential and commercial real estate. http://www.rilin.state.ri.us/pressrelease/_layouts/RIL.PressRelease.ListStructure/Forms/DisplayForm.aspx?List=c8baae31-3c10-431c-8dcd-9dbbe21ce3e9&ID=371945.
19 R.I. Gen. Laws § 44-25-1(a), as amended.
20 Rhode Island Department of Revenue, Division of Taxation Notice 2015-13 (Sept. 2015). **See also** R.I. Gen. Laws § 44-25-1(a). R.I. Gen. Laws § 44-25-8 provides that "[a]ny tax imposed under the provisions of this chapter, together with all penalties and interest also become, from the time they are due and payable, a debt due to the state from the person liable for the payment of the tax." The instructions for the Form CVYT-2 also indicate that the grantor should file the form and pay the tax; contrary to the form itself. ◊

VALUE APPRAISALS on Antique, Collector, Custom and Special Interest Vehicles for:

RHODE ISLAND SALES TAX REFUNDS AND PROPERTY TAX INSURANCE •• CLAIM SETTLEMENT •• SELLING A VEHICLE BUYING A VEHICLE •• COLLATERAL •• ESTATE SETTLEMENT DIVORCE SETTLEMENT •• DONATION OR GIFT VALUATION

GREEN HILL VEHICLE APPRAISALS

Website: WWW.CLASSICCARAPPRAISALGH.com

Dennis P. DeGrave
I-VAN Certified Vehicle Appraiser
AACA- Vehicle Judge
12 White Parkway
North Smithfield, Rhode Island 02896
Cell Phone: 401-345-5891
Local Phone: 401-766-3299

CERTIFIED BY THE INTERNATIONAL VEHICLE APPRAISERS NETWORK

E- Mail: **Degravedennis@yahoo.com**
Serving Rhode Island, Connecticut and SE Mass to Cape Cod
WWW.I-Van.org

Representing Residents Injured in Nursing Homes

- Abuse and neglect
- Pressure and bed sores
- Resident falls
- Bed rail strangulation
- Dehydration and malnutrition related injuries
- Medication errors

Anthony Leone
Past President of the Rhode Island Association for Justice

LEONE LAW, LLC

1345 Jefferson Boulevard, Warwick, Rhode Island 02886
Tel (401) 921-6684 info@leonelawllc.com