

May 6, 2016

[Taxpayer Representative]
[Address]
[Address]
[Address]

Re: Formal Ruling 16-05

Dear [Taxpayer Representative]:

This is a formal ruling for your client, [Taxpayer], regarding the applicability of property transfer tax to its proposed acquisition of real property. This ruling is based upon representations in your letter dated [Date], and our telephone conversation of [Date].

FACTS

Your client, [Taxpayer], is a multi-member limited liability company. Funds were provided to [Taxpayer] by its members at some time in, or prior to, [Date]. After [Taxpayer] received those funds, it purchased a property in [Date], using those funds as the down payment. No other significant assets have been transferred to [Taxpayer]. The members now intend to transfer property which they currently own to [Taxpayer]. The property which they intend to transfer to [Taxpayer] will then constitute “the significant majority of the LLC’s total assets.”

You have asked whether the intended transfer of property from the members to [Taxpayer] will be subject to the property transfer tax, or will be exempt under 32 V.S.A. § 9603(24), as a transfer to a limited liability company at the time of formation.

DISCUSSION

The statute

Vermont's property transfer tax does not apply to a transfer of real property to a limited liability company if the transfer is made at the time of formation of the LLC, and the transfer qualifies for nonrecognition of gain under the Internal Revenue Code:

(24) Transfers made to a limited liability company at the time of its formation pursuant to which no gain or loss is recognized under the Internal Revenue Code, except where the Commissioner finds that a major purpose of such transaction is to avoid the property transfer tax;

32 V.S.A. § 9603(24).

A transfer must meet both the Federal nonrecognition test and the "time of formation" test to qualify as exempt from property transfer tax.

The Federal nonrecognition test

Under Federal income tax law, the owners of a partnership or corporation may transfer real property to their business entity solely in exchange for ownership interests in the partnership or corporation, with no recognition of gain on that transaction if the individuals who own the property before the transfer own at least 80 percent of the entity after the transfer. 26 U.S.C. § 351, 721. A nonrecognition transfer under Section 351 (corporations) or 721 (partnerships) may be made at any time throughout the life of the partnership or corporation. Any gain on such a transfer which is not recognized at the time of transfer is actually deferred until such later time as the corporation or partnership might sell the property and realize the gain.

A multi-member limited liability company may choose whether to be treated for Federal income tax purposes as a partnership or a corporation. It will be treated as a partnership by default, unless it elects to be treated as a corporation. Treasury Regulation § 301.7701-3(b)(1)(I), *Proced. & Admin. Regs.* You did not indicate how [Taxpayer] is treated for Federal income tax purposes. It does not matter which [Taxpayer] chose, however, because, as noted above, Federal

income nonrecognition treatment is available for a qualifying transfer to either a partnership or to a corporation. If the proposed transfer to [Taxpayer] would be a transfer in exchange for ownership in accordance with the Federal rules, the Federal nonrecognition test would be met.

Time of formation test

The Supreme Court has defined “the time of formation” for purposes of the property transfer tax LLC exemption. Polly’s Properties, LLC v. Department of Taxes, 2010 VT 41. In that case, the “time of formation” was defined as “the time of the initial transfer of capital” to the entity. In *Polly’s*, the LLC’s articles of organization were filed with the Secretary of State in July of 2006, and ten months later, in May of 2007, the LLC members transferred two condominium units to the LLC. *Id.* at FN4. The Department had determined that the transfer was not made “at the time of formation.”

At the time of the *Polly’s* transfer, the Department had an informal rule which provided that the time of formation was the date on which the articles of organization were filed with the Secretary of State as required under Title 11, but to allow sufficient time for start-up of the entity, the Department would consider any otherwise-qualified transfers as “at the time of formation” if the transfers occurred within 90 days of the filing of the articles of organization. The Court found the Department’s 90-day rule arbitrary and without a basis in the statute. The Court instead held that “time of formation” meant the time of “the formative event,” which is “the initial transfer of capital” to the entity. *Id.* at ¶ 9. It was undisputed that the transfer of the two parcels constituted “the LLC’s initial capital,” and so the Court held that the transfer qualified as being “at the time of formation.” *Id.* at ¶ 2.

You have suggested the “initial capitalization” might mean not merely the first transfer of capital to the entity, but “probably requires transfer of sufficient assets for an entity to operate its business.” The test, however, is whether the transfer of capital is the “formative event,” which the

Court said is “the initial transfer of capital [which] occurs at some point in time after the filing of the articles of organization, the execution of an operating agreement, and other steps in the process of getting an LLC up and running.” *Id.* at ¶ 9.

In your case, the initial transfer of capital was the transfer of funds from the members to [Taxpayer] in [Date], and [Taxpayer] was up and running when it used those funds to purchase real estate. As a result, if the members were to transfer real property to [Taxpayer] now, that transfer would not qualify as the initial capitalization, and therefore would not qualify as made at the time of formation under 32 V.S.A. § 9603(24).

GENERAL PROVISIONS

Issuance of this ruling is conditioned upon the understanding that neither the taxpayer nor a related taxpayer is currently under audit or involved in an administrative appeal or litigation concerning the subject matters of the ruling. This ruling is issued solely to the taxpayer and is limited to the facts presented, as affected by current statutes and regulations.

Other taxpayers may refer to this ruling, when redacted to protect confidentiality, to see the Department's general approach, but the Department will not be bound by this ruling in the case of any other taxpayer or in the case of any change in the relevant statutes or regulations.

This ruling will be made public after deletion of the parties' names and any information which may identify the parties. A copy of this ruling showing the proposed deletions is attached, and you may request within 30 days that the Commissioner delete any further information that might identify the parties. The final discretion as to deletions rests with the Commissioner.

You have the right to appeal this ruling within 30 days. 3 V.S.A. §§ 808, 815.

Emily Bergquist

Date

Approved:

Mary N. Peterson
Commissioner of Taxes

Date