

CHAPTER 16A

CONTROLLING INTEREST TRANSFER TAX

Authority

N.J.S.A. 54:50-1 and P.L. 2006, c. 33, §3e(4) (N.J.S.A. 54:15C-1e(4)).

Source and Effective Date

R.2008 d.180, effective July 7, 2008.
See: 39 N.J.R. 4556(a), 40 N.J.R. 4222(a).

Chapter Expiration Date

Chapter 16A, Controlling Interest Transfer Tax, expires on July 7, 2013.

Chapter Historical Note

Chapter 16A, Controlling Interest Transfer Tax, was adopted as new rules by R.2008 d.180, effective July 7, 2008. See: Source and Effective Date.

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SUBCHAPTER 1. CONTROLLING INTEREST TRANSFER TAX

18:16A-1.1 Definitions of words and terms

The following words and terms, when used in this subchapter, shall have the following meanings, unless the context clearly indicates otherwise:

“Beneficial ownership” means ownership of tangible or intangible property by a person or entity that does not have legal title to the property but has ultimate control of the property.

“Classified real property” means commercial property as defined in N.J.A.C. 18:12-2.2(e) that is income-producing real property other than property classified as vacant land, residential property, farm property, industrial properties and apartments designed for the use of five or more families including residential cooperatives and mutual housing corporations.

“Consideration” means the actual amount of money and the monetary value of any other thing of value constituting the entire compensation paid or to be paid for the transfer including the remaining amount of any prior mortgage to which the transfer is subject or which is to be assumed and agreed to be paid by the purchaser.

“Controlling interest” means, with respect to entities:

1. In the case of a corporation, more than 50 percent of the total combined voting power of all classes of stock of that corporation; or
2. In the case of an entity that is a partnership, association, trust or other organization, more than 50 percent of the beneficial ownership of that partnership, association, trust or other organization.

With respect to classified real property, “controlling interest” means more than 50 percent of the fee simple ownership of the classified real property.

“Equalized assessed value” means the assessed value of the property in the year that the transfer is made divided by the Director’s equalization ratio, which changes each year based on a sales study. The resulting amount is the equalized assessed value. The Director’s equalization ratio is published annually on or before October 1 by the Director, Division of Taxation pursuant to N.J.S.A. 54:1-35.1. Since assessed value, which is the value on the tax rolls, does not change often, the calculation is needed to approximate the current fair market value of the property.

“Related parties” means parties that have the relationship necessary for attribution of constructive ownership of stock pursuant to IRC §318 and members of an affiliated group or a controlled group pursuant to IRC §1504 or IRC §1563.

18:16A-1.2 Calculation of the tax

(a) On and after August 1, 2006, a tax is imposed on the transfer of certain controlling interests. There are two different methods for calculating the tax that are used under differing circumstances. Under both methods the tax is paid by the purchaser.

1. The first method is used if consideration in excess of \$1,000,000 is paid for controlling interest in an entity, and the entity possessing, directly or indirectly, the controlling interest in classified real property owns only the classified real property. In this case the tax is calculated by multiplying the consideration paid by one percent.
2. The second method is used if a controlling interest in an entity is sold or transferred and the entity possesses, directly or indirectly, a controlling interest in classified real property and also an interest in other property, real or personal. In this second method, the equalized assessed value of the classified property, not the amount of consideration paid for the controlling interest itself, is used in the calculation of tax. In this situation, the tax is paid only if the equalized assessed value of the classified real property exceeds \$1,000,000. The tax is calculated by multiplying the equalized assessed value of the classified real property by one percent times the ownership percentage transferred. Thus, the tax is measured by the portion of

the equalized assessed value that is proportional to the percentage of the total interest in the property transferred.

18:16A-1.3 Exceptions to tax

(a) No tax shall apply to any sale or transfer:

1. By or to the United States of America, the State of New Jersey, or any instrumentality, agency or subdivision thereof;

2. To a purchaser that is recognized as qualified under IRC §501(c)3;

3. Having the characteristics of transactions listed in N.J.S.A. 46:15-10, which concerns deeds excluded from the additional recording fee;

4. That is subject to the fee imposed tax pursuant to N.J.S.A. 46:15-7.2; or

5. That is incidental to a corporate merger or acquisition if the equalized assessed value of the classified real property transferred is less than 20 percent of the total value of all assets exchanged in the merger or acquisition.

18:16A-1.4 Filing and recordkeeping

(a) On or before the last day of the month following the month when the sale or transfer of a controlling interest was completed, the purchaser/transferee must file a return (Form CITT-1) with the Director, Division of Taxation. Payment of the tax shall accompany the return. A copy of the return shall be filed as a supporting attachment and accompany the purchaser/transferee's business tax return filed with New Jersey.

(b) The purchaser/transferee shall supply a copy of the CITT-1 to the seller/transferor and a copy of such return shall be filed as a supporting attachment and accompany the seller/transferor's business tax return for the entity filed with New Jersey.

(c) If sale or transfer of a controlling interest in an entity, which owns classified real property occurs, the entity shall keep a record of each transfer of, or connected with, a controlling interest in its stock or in its capital, profits, or beneficial interests as the case may be.

(d) If an exemption from tax is claimed and an exemption box is checked on form CITT-1, Part 6 or Part 7, a properly executed CITT-1E "Statement of Waiver" must be attached to Form CITT-1, and both forms must be filed. The completed CITT-1E documents why no tax is paid. If an exemption is claimed, calculations must nevertheless be shown on Part 6 and/or Part 7 of the CITT-1.

(e) Administration of the controlling interest transfer tax is governed by the provisions of The State Uniform Tax Procedure Law, N.J.S.A. 54:48-1 et seq.

18:16A-1.5 Application of the tax; examples

(a) The tax may apply to the transfer of control of an upper tier entity of a chain where a lower tier entity owns classified real property, as well as to a transfer of control of the direct owner of real property. N.J.S.A. 54:15C-1a(1) refers to possession "directly or indirectly" of a controlling interest. However, in the event that the transfer of control of a partnership, association, trust or other organization that directly owns classified real property does not effectuate a change in more than 50 percent of the beneficial ownership of that partnership, association, trust or other organization, then the tax will not apply to such transfer of control.

(b) In a transaction where a corporation is going private, the value of the stock acquired may include assets not on books such as going concern value or intangible good will, for example, and not just the book value of the assets that are depreciable. If the value of the real property transferred is less than 20 percent of the total value of all assets exchanged in the acquisition, no tax would apply.

(c) The following examples illustrate the calculation and application of the tax.

Example 1: Individuals J and K each own 50 percent of the shares in Corporation A. Corporation B is a 100 percent owned subsidiary of Corporation A. Corporation B is the sole member of an LLC that owns classified property with an equalized assessed value is \$1.2 million and common stock worth \$2 million.

If J sells his stock to L, for \$2 million, no tax is due. He has not sold a controlling interest since the percentage of shares sold is not greater than 50 percent of the total combined voting power of all classes of stock of A.

Example 2: J owns 60 percent and K owns 40 percent of the shares in Corporation A. Corporation B is a 100 percent owned subsidiary of Corporation A. Corporation B is the sole member of an LLC that owns classified property with an equalized assessed value is \$1.2 million and common stock worth \$2 million.

If J sells his stock to L for \$1.4 million, tax is due. He has sold a controlling interest in the classified property because the percentage of shares sold is greater than 50 percent of the total combined voting power of all classes of stock of A. Since J transferred controlling interest of an entity owning classified property and other property, the tax due is calculated using the second method as follows: 1 percent x \$1.2 million x 60 percent = or \$7,200. The first method is not used since the entity owning the classified property also owns other property. Since the value of the consideration includes consideration for assets other than the classified real property, the tax due is not \$14,000 (calculated as one percent of \$1.4 million).

Example 3: Same facts as Example 2, except that the subject Class 4A commercial property is encumbered by a mortgage of \$1.2 million.

If J sells his stock to L for \$200,000, tax is due. Even though the consideration paid by L is under \$1 million, \$7,200 tax is due since tax is calculated using the same methodology as in Example 2. When controlling interest in an entity is sold and the entity owns directly or indirectly classified property whose equalized assessed value is greater than \$1,000,000 and also other assets, then the tax calculation is based upon the percentage of the ownership interest transferred multiplied by one percent times the equalized assessed value of the classified property.

Example 4: J owns 60 percent and K owns 40 percent of the shares in Corporation A. Corporation B is a wholly owned subsidiary of A. Corporation B is the sole member of an LLC whose only asset is classified property with an equalized assessed value of \$1.2 million. If J sells his stock to L for \$200,000, no tax is due. The consideration paid by L is under \$1 million, therefore no tax is due. The alternate methodology is not used because the entity owning the real estate does not own an interest in any other assets.

Example 5: A binding agreement that fully executed before July 1, 2006, but the agreement is subject to regulatory approval by the Securities and Exchange Commission after July 1, 2006. Since the contract was fully executed before July 1, such transaction is considered to be not subject to tax if approval is given after July 1 by the regulating agency. However, if there are aspects of the agreement that are still subject to appraisal or if the amount of tax liability cannot be calculated without appraisals being made after July 1, the contract is not considered to be fully executed. If all terms and values are not known before July 1, tax would be applicable on the transaction.

Example 6: A limited partnership, which owns a 100 percent interest in classified real property and is owned by partners G1, L1, L2 and L3, is dissolved, and the ownership interest of the partners are collectively transferred to one newly created LLC. The equalized assessed value of the

property is \$10 million. Each former partner's membership interest in the LLC is equal to her share in the dissolved partnership. G1 owned 51 percent of the partnership and owns a 51 percent interest in the LLC. Because the transfer of G1's interest in the partnership to the LLC is a mere change in identity of the controlling interest in the property and there was no change in beneficial ownership, the transfer is not subject to the tax.

Example 7: Corporation B transfers a building to a single member LLC (SMLLC) and pays the New Jersey realty transfer fee on the transfer. Corporation B then transfers its membership interest in the SMLLC to Corporation C for \$2,000,000. The transfer of control of the membership interest to C is subject to the controlling interest transfer tax because the consideration is in excess of \$1,000,000. If the consideration had been \$1,000,000 or less, then no tax would be due.

Example 8: Corporation A directly owns 100 percent of both Corporation B and Corporation C. Corporation B is the member of SMLLC, which owns a class 4A Commercial Property. Corporation B transfers the ownership interest in SMLLC to Corporation C for \$5,000,000. This transfer is not subject to tax. While ultimate control (beneficial control) of the property remains in Corporation A, direct control of the property has changed from Corporation B to Corporation C. The purchaser, Corporation C, does not pay a one percent tax on the consideration because it has acquired direct control of SMLLC and its commercial property.

This change is a mere change in the identity of lower tier owners of a non-corporate entity with no change in the beneficial ownership.

Example 9: LLC 1 owns 51 percent of the fee simple interest in a parcel of classified real property. LLC2 owns the remaining 49 percent of the fee simple interest in the same parcel and no other property. H Inc. owns 100 percent of LLC2 and sells this interest to a third party in an arms' length transaction for \$2 million. The transfer of H Inc.'s controlling interest in LLC2 is not subject to the tax because LLC2 does not possess a controlling interest in classified real property.