

OHIO'S MISGUIDED TAX FIX

A proposed law to close 'LLC loophole' from real estate transfer taxes is a solution in search of a problem.

By Cecilia Hyun

Ohio legislators are drafting a measure to apply the state's real estate transfer tax to the transfer of any ownership interest in a pass-through entity that owns real property. This proposal will cause more problems than it solves.



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Ohio assesses its transfer tax, called a conveyance fee, on each real estate transaction based on the purchase amount reported on a conveyance fee statement and filed with the deed. If a pass-through entity owns the property, a sale of interest in that entity is exempt from transfer tax. The proposed changes would apply the conveyance fee to those transfers, however.

Also, if the property purchase price exceeds currently assessed value, recording the conveyance fee statement and deed with the county will usually trigger a lawsuit by the school district to increase the assessment and tax bill.

Transfers exempt from transfer tax include gifts between spouses or to children; sales to or from the U.S. government, the State of Ohio or any of its political subdivisions; transfers to provide or release security for a debt or obligation; and sales to or from a non-profit agency that is exempt from federal income tax, when the transfer is without consideration and furthers the agency's charitable or public purpose. Generally, the policy is to impose the transfer tax on a market transaction with market consideration.

What's the problem?

Lawmakers consider the proposal on transfer tax and pass-through entities a tool to fix the problem of real estate value escaping taxation, both at the time of transfer and, more importantly, as part of the assessment. The two supposed loopholes that the proposal aims to close are:

1. The transfer tax loophole argument assumes that some buyers may structure their purchase as an entity transfer, in part, to avoid the transfer tax, which can be significant for a highly valuable property.

2. The property tax loophole describes the more likely "problem" the proposed law purports to address. This argument suggests that some buyers attempt to avoid real estate tax increases when the purchase price is higher than the current tax assessment by structuring the deal as an entity transfer.

Ohio assumes that a recent, arm's length sale price is the best evidence of property value for real estate taxa-

tion. Filing the deed and conveyance fee statement prompts the school district to file a lawsuit to increase the taxes. The conveyance fee statement indicates the purchase price, carries evidentiary weight and is presumed to be completed under oath, even though as a practical matter it is more like a clerical function and seldom completed by any party to the sale.

When interest in the ownership entity transfers without direct conveyance of the real estate, the transfer tax is inapplicable under current law and no purchase price is recorded. Some sales may be structured this way, trying to avoid exposure to an increase in property taxes by filing a conveyance fee statement.

Everyone should bear their share of the tax burden based on fair property valuation, but this proposed bill does not solve the problem of people skirting their responsibility. It also can lead to unintended consequences including the loss of privacy, increased transaction costs, implementation and enforcement costs, and less real estate investment.

A multilayered dilemma

There is no indication that using a pass-through entity is an effective way for investors to avoid triggering an increased assessment. Ohio school districts file increase complaints not only when deeds and conveyance fee statements are recorded, but also in response to mortgages, LLC transfers, SEC filings, and sometimes the opinion of outside consultants. There is little evidence that significant numbers of sales are missed because they are the transfer of ownership interests. Thus, there is no loophole that needs to be closed.

The proposal disrupts uniformity, because using a recent purchase to set the assessment midway through Ohio's three-year valuation cycle treats taxpayers who've recently bought their properties differently than others. This is non-uniform treatment, which the Ohio Constitution prohibits.

The conveyance fee statement is often completed and filed by someone not a party to the sale. Common errors occur, usually in allocating the total asset purchase price. Historically, these incorrectly reported purchase prices were being applied to set real estate tax values with increasing rigidity, leading to assessments that did not accurately reflect the value of the real estate.

Assessments should only value real estate, but assessments based on these total asset prices would include the value of non-real estate items as well. To the extent that the value of these other items — for example, an ongoing, successful business operation — were also being taxed through sales taxes or a commercial activity

tax, these taxpayers were subjected to double taxation.

The solution exists

A recent amendment to the tax law mandates that a real estate assessment reflect the unencumbered fee simple interest. The Ohio Supreme Court recently confirmed in its *Terraza 8 LLC vs. Franklin City Board of Revision* decision that the amendment requires assessors and tribunals to evaluate all circumstances of a sale, and not blindly apply the number reported on the conveyance fee statement.

The appraisal of the unencumbered fee simple interest provides uniform assessment for all taxpayers, while acknowledging the circumstances of real world transactions. It limits double taxation by making sure real estate tax is based on real estate value only, and yields consistent results whether a sale price is higher or lower than the current assessment.

It ensures uniform measurement and taxation for everyone, just as you would not impose taxes based on gross profits for one taxpayer and net profits for another. It also ensures that the tax is ap-

plied consistently, whether the owner just bought the property, has owned it for decades, leases it, occupies it, owns it individually or owns it through interests in a pass-through entity. Valuing the unencumbered interest also results in predictability, aids budgeting and alleviates deal-killing uncertainty.

There are legitimate reasons to convey property through the transfer of ownership interests in an LLC or other pass-through entity, including privacy or other tax planning. The proposed bill undercuts those legitimate concerns without addressing the perceived problem of real estate value escaping taxation. Consistently valuing the unencumbered fee simple interest of real property through uniform assessment and uniform application ensures that no real estate value escapes taxation, and that no taxpayer bears more than their fair share of the burden. ■

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