

LEGISLATURE TARGETS REAL ESTATE TAX LOOPHOLE

JANUARY 2020

Real estate transfers in Ohio are subject to a conveyance fee due upon recording the deed and payable to the county based upon the consideration given for the property. Additionally, the recording of a deed and related DTE 100 ([Real Property Conveyance Fee Statement of Value and Receipt](#)) puts the county on notice of the transfer and the consideration given, which in turn may trigger an increase or decrease in taxable value as of the current tax lien date.

For years, buyers and sellers of real estate in Ohio have avoided the conveyance fee and deferred the change in taxable value by restructuring their real estate transactions as *entity purchases*. Essentially, if the seller of the real estate is a single-purpose entity that owns only one asset (the real estate) the purchaser would purchase all of the ownership interest (i.e., membership interest (LLC), partnership interests (partnership), stock (corporation)) of the seller. If the seller is not a single-purpose entity with only one asset, the seller creates a single-purpose entity and contributes the property to that entity. The purchaser then buys the ownership interest in the newly created entity. Because the purchase of an interest in an entity is not one that triggers a conveyance fee, the seller and buyer avoid the conveyance fee and the county is not on notice of the consideration given for the “property.” By owning the entity that owns the property, the buyer indirectly owns the property.

Until recently, Ohio was one of a few remaining states where a party could effect this type of transaction and avoid the conveyance fee and the immediate change in taxable valuation. Those days may be coming to an end. New legislation, [H.B. 449](#), introduced by Representatives Green and Skindell on December 17, 2019, seeks to close Ohio’s loophole in certain circumstances.

TRIGGERING EVENT

The proposed legislation mandates disclosure and taxation of a transfer of more than 50% of the ownership interest in a pass-through entity – i.e., a sole proprietorship, limited liability company, partnership, or S corporation – that, directly or indirectly, owns real property in Ohio.

“Directly” and “indirectly” remain open to interpretation and guidance. No definition appears in H.B. 449 or the Ohio Revised Code sections being amended. A transfer of shares or membership interests in a holding company that owns various special purpose entities holding real property may qualify as an indirect ownership of real property, and therefore be subject to the new disclosure and taxation issues.

This transfer of ownership interests can occur in one transaction or in a series of transactions that occur within one year of each other, preventing shrewd buyers and sellers from slicing and dicing up the transfer over time so that it is not subject to taxation and disclosure.

DISCLOSURE DOCUMENTATION

H.B. 449 requires the transferor of the ownership interest to execute a statement declaring:

1. The total amount paid to the transferor as consideration for the ownership interest.
2. The portion of that total amount that is attributable to real property owned, directly or indirectly, by the entity.
3. The percentage of the ownership interest in the entity being transferred.
4. With respect to real property owned **indirectly** by the entity in which the ownership interest is being transferred, that entity’s percentage of ownership interest in the person that directly owns the property.

This statement is due to the auditor within 30 days of the transfer of the ownership interests. The auditor also reserves the right to seek additional information.

The information contained in the statement can be used to reassess the value of the real property and provides school boards with leverage to seek increased property valuations with the county boards of revision.

The fact that the disclosure relates to the *total amount* of consideration paid for the ownership interest is also problematic. The purchase price, an extremely coveted and confidential term, of an otherwise private deal could become a public record.

TAXATION

H.B. 449 proposes both a real estate transfer tax and a conveyance fee for qualifying transactions. The proposed real estate tax on the transfer of the ownership interests is 30 cents for every \$100 of the value of the real property (as determined by the price paid for the ownership interests as attributable to the real property). The proposed conveyance fee is 10 cents for every \$100 determined by:

- With respect to real property owned **directly** by the pass-through entity in which the ownership interest is being transferred, the product of the value of the real property owned directly by the pass-through entity and the percentage of the ownership interest in that entity being transferred;
- With respect to real property owned **indirectly** by the pass-through entity in which the ownership interest is being transferred, the product of the value of the real property owned indirectly by the pass-through entity, the percentage of the ownership interest in that entity being transferred, and the percentage of the ownership interest held by that entity in the person that directly owns the real property.

For example, if a purchaser buys 100% of the membership interests in a limited liability company that directly owns real estate for a total price tag of \$1 million, \$900,000 of which is attributable to the real estate, then the purchaser would file the required statement with the auditor stating that it paid these amounts and pay a transfer tax of \$2,700 ($0.3 \times 9,000$) and a conveyance fee of \$900 ($0.1 \times 9,000$).

PENALTY

H.B. 449 has teeth. If the transferor fails to pay the transfer tax or the conveyance fee, the county auditor will charge a penalty on any real property in the county owned, directly or indirectly, by the pass-through entity equal to the true value in money of that property multiplied by the aggregate rate of those unpaid fees or taxes applicable to the property. This penalty will become a lien upon the property, as of the first day of the tax year in which the penalty is charged.

Many states, such as Florida and Pennsylvania, have passed laws that impose a fee on indirect and direct transfers of ownership interests. Ohio's proposed law does not follow the often well-tested models of other states, and is a significant departure from those states' statutory schemes.

This isn't the first time the Ohio legislature has drafted legislation to attempt to capture (and tax) these kinds of transactions. In 2018, there was a similar bill. Will HB 449 have enough juice to get over the finish line?

ADDITIONAL INFORMATION

For more information, please contact:

- [Keith Raker](mailto:keith.raker@tuckerellis.com) | 216.696.2468 | keith.raker@tuckerellis.com
- [Ashley Gault](mailto:ashley.gault@tuckerellis.com) | 216.696.5648 | ashley.gault@tuckerellis.com

This Client Alert has been prepared by Tucker Ellis LLP for the use of our clients. Although prepared by professionals, it should not be used as a substitute for legal counseling in specific situations. Readers should not act upon the information contained herein without professional guidance.