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What issues should a LLC consider when selling a property that it has under contract?

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There are many issues to consider for a limited liability company (LLC) that is planning to sell a parcel of property it has under contract. The facts are relatively straight-forward.

A N.Y. LLC has an agreement as purchaser to acquire a 15-acre parcel of real estate. The parcel of real estate is a single tax lot with a rundown residence. The LLC has agreed to pay $12 million for the parcel with the dilapidated residence and has deposited $1 million as a down payment with the balance due at closing. The LLC is purchasing the property to obtain subdivision approval with a view to selling the property at a profit. The LLC will commence the subdivision process and seeks environmental approval, subdivision and site plan approval. Several considerations arise.

The first consideration is the LLC must contact a tax attorney (which I am not). The second consideration is to make sure a law firm, well grounded in transactional real estate, is retained. An ordinary residential, or even commercial, real estate attorney may not be enough. An investment in lawyering may save the LLC substantial savings with regard to the state transfer taxes, mansion tax and both state and federal capital gains tax. The state and federal capital gains tax, as opposed to ordinary income tax, by itself, could provide a tax difference of 20%. Let's consider a few of the issues.

Minimally, the subdivision process will encounter municipal review pursuant to Article 8 of the Environmental Conservation Law and the State Environmental Quality Review Act, its implementing regulations (6NYCRR Part 617), the preliminary and final subdivision process (NYS City Law Sections 32 and 33; NYS Town Law Sections 276 and 277; and, Village Law Sections 7-728 and 7-730). The client should safely assume that the subdivision of the 15-acre parcel will take at least twelve months. In fact, the County Health Department review of the preliminary plat will probably take six months by itself!

During the municipal review process, the LLC should start looking for a buyer, not after it closes on the parcel. Rather, the LLC should seek an assignee of the LLC's real estate purchase agreement before the scheduled closing date. Why? If the LLC would sell the parcel immediately after municipal approvals and after its scheduled closing date for, let's say, $4 million more than it paid, the profit will be taxed at 40% or $1.6 million. On the other hand if the purchasing LLC sells, or assigns, its real estate purchase agreement twelve months after the purchase agreement had been executed, but, before the scheduled closing date in the base purchase agreement, the sale will generally be eligible for capital gains tax treatment. The selling price of the assignment of the underlying contract will be the same increased value of $4 million but the profit could be taxed at 20% or $800,000 - a savings to the LLC of $800,000.

Another issue a transactional real estate attorney would recognize is that property transfer taxes should be negotiated as part of the original contract negotiation. Generally, the seller pays the NYS transfer tax but it is negotiable and should be addressed. The NYS transfer tax is .4% of the selling price or $2 per $500.

As mentioned, another tax consideration in N.Y. is the mansion tax. Pursuant to NYS tax law section 1402-a, N.Y. collects a 1% tax on homes that sell for more than $1 million. This tax -- called the mansion tax -- is generally paid by the purchaser, but is properly a subject of negotiation.

In our example, the parcel was a single 15-acre tax lot with a residence for a purchase price of $12 million. The intention of the LLC was to subdivide the parcel. The purchaser's real estate attorney should make provision in the real estate purchase agreement for an appraisal process where the residence on its own subdivided lot is one part of the total $12 million purchase price and the remaining vacant land, the balance. Why?

In the absence of an appraisal and bifurcation procedure in the purchase agreement, the mansion tax will be on the entire $12 million purchase price. If the dilapidated residence on its newly subdivided lot is appraised at, let's say, $3 million, the mansion tax would only be based on that amount because the mansion tax does not apply to vacant land. If the 15-acre property with a residence was purchased for $12 million in one contract, the tax would be $110,000. With the use of an appraisal process, and a division of the land into a vacant parcel contract and a separate contract for the dilapidated residence on its own lot, a substantial tax savings is realized. In our example, the mansion tax on the $3 million acquisition of the residence on its own lot is $30,000, a savings of $80,000.

There are many other factors which the tax attorney will have to take into consideration. The above are several of the issues. Explain to your attorney in detail and in advance of contract execution what the plan is so he or she may adequately protect your interest and give you the most flexibility. Let your attorney prove to you that law school is not where creative minds go to die!

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