



Potential tax pitfalls

June 30, 2008 - Front Section

Real estate attorneys are familiar with the typical real estate tax "pass-through" provisions found in most commercial leases. These typically define "taxes," broadly, to include many different types of taxes, describe how those taxes are to be paid, and usually determine which party may contest those taxes and how the reduction benefits will be apportioned.

When the tenant is responsible only for "tax increases" over a defined base tax year, it is crucial to understand what the base year taxes include and how they were determined. Overlooking this critical area of due diligence can lead to a dramatic and unexpected increase in taxes.

For example, if the base year taxes are calculated on property which is not fully assessed or not fully taxed, as a result of a tax abatement, the future escalations of taxes over the base tax year will substantially increase at the point at which the building is fully assessed or the abatement is reduced.

Tax abatements are often found where a landlord has obtained financing through an industrial development agency (IDA financing) and entered into a PILOT agreement with the municipality, or where owners are granted an exemption as permitted by certain statutes whereby the real estate taxes are "phased in" over a period of years. In both circumstances, the payments will be less than the taxes which would otherwise be paid on a fully assessed and fully taxed property.

At the inception of negotiations, the status of real estate taxes on the subject property must be determined and legal counsel must craft appropriate language to protect the client's interest in this atypical real estate tax situation, so that unforeseen pitfalls do not occur.

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New York Real Estate Journal - 17 Accord Park Drive #207, Norwell MA 02061 - (781) 878-4540