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When a sale is not truly market value, it can help reduce your property taxes - by Brad Cronin and Sean Cronin

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A sale transaction does not always reflect the true market value of a property. The circumstances surrounding a sale transaction, when properly relayed to an assessor, can result in a significant reduction in property taxes.

Owners may assume that because they bought a property at a value higher than its assessment that they cannot obtain a tax reduction. This is incorrect; frequently owners can still get significant savings depending on why they bought their property. Numbers alone rarely tell the whole story, and there is no section on a deed to note a buyer's underlying motivations. It is critical in tax certiorari law to understand the reason why a buyer paid the amount they did as this could reduce the tax burden. Some examples are explained below.

1031's Lead to Significant Overpayment

One of the most prevalent reasons for inflated sales prices are 1031 transactions. Real estate professionals take advantage of 1031 opportunities regularly. Essentially, 1031 allows a buyer who recently sold a property to put off any capital gains from that sale if he identifies a property of "like kind" within 45 days of selling their own property. Buyers with "1031 money" are extremely motivated by a "use it or lose it" mentality. Owners will declare "I overpaid, but my 1031 was about to expire." Potential purchasers often find out they have been aggressively outbid by a 1031 buyer, as buyers will sometimes pay double what a property is worth if a 1031 is involved. This mechanism has become so widespread that there are companies that exist solely to facilitate 1031 exchanges.

Inflation/Rate Increases are Pushing Buyers to Act

Inflation has impacted sales prices recently as well. There was a flurry of acquisitions by purchasers looking to buy before interest rates were hiked to curb inflation. When 80% of most purchase prices are predicated on borrowing, a forecast of increasing interest rates serves as an incredible motivation to get the deal done even if the price is above market.

The rush to lock in a rate or willingness to move forward with a low rate while current rates are skyrocketing drives up prices. Savvy buyers remember that it wasn't too long ago when rates were double today's rates and locking in lower rates is of tremendous value. This kind of gamble means sale prices are correlated to interest rates, not the actual market value of the property.

Prices Based on Change of Uses Do Not Reflect the Market

A prospective change in use is a scenario where a buyer pays not for what the property is currently worth, but rather what they believe the property can become. While the buyer may execute that plan, the property is not worth that amount in its current condition. The courts have ruled definitively on this issue. If a property was purchased for a different use, the sale price cannot be relied upon for tax purposes. This situation is becoming more frequent with mass closings of banks and, more recently, drugstores. Buyers are purchasing these properties with entirely new uses in mind. However, until the property's use is actually changed, the property must be taxed as the outmoded bank, obsolete drugstore, etc.

User Purchases Result in Inflated Values

Another obvious over-payer is the user purchasing the property for their own business. When a company is looking to relocate and considering buying versus renting, this is an extreme motivator. The prospect of no longer paying rent is attractive for obvious reasons, but often it's a multitude of factors that lead a user to pay more. When an owner is considering buying a building that they will spend more time at than their own home, they will overpay for convenience. A layout that matches their exact specifications or size corresponding to their need may incentivize a user to overpay for the property rather than pay more than the difference to update another property less well-suited. Other considerations impacting convenience may even come into play such as commuting time. A user, when they find a match, is incentivized to overpay as they are making a long-term business and quality of life investment, not a purely financial real estate transaction with the goal of an immediate return.

Many Sale Prices are Higher than Market Value

It cannot be overlooked that these different players are bidding against each other. The 1031 investor, the investor trying to lock in his low rate, the speculative use developer, and the user purchaser may be bidding on the same site and driving up the price even above an already artificially inflated price. For these reasons, the typical investor frequently does win the bid. Therefore, each sale price must be closely examined and, if influenced by these factors, it should not be used for tax purposes. Without consideration of these motivations, purchasers will be unfairly and inequitably taxed as compared to similar properties.

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