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How property taxes can help the sale of commercial property - by Brad and Sean Cronin

September 10, 2024 - Long Island

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The lack of transactions in the commercial market has been well documented. Even if rate cuts are in the near future, buyers and sellers must explore every avenue that will facilitate a transaction. While property taxes are typically seen as a negative aspect of owning commercial buildings, they are unavoidable. To navigate property taxes in the current environment, below are a few ways sellers and buyers can prepare for the property tax aspect of commercial transactions.

How Sellers Can Prepare Property Taxes for Sale.

1. File a grievance to preserve all rights to an assessment reduction. By starting the process, buyers will feel comfortable they can continue the appeal and do not have to wait until the next grievance period. Simply stating, “Tax certiorari appeal pending,” can provide a buyer with a greater level of comfort knowing they have an opportunity to reduce the taxes.

2. Communicate regarding the current tax burden. If a seller has already been diligent and availed themselves of the certiorari process, this should be communicated. Not only to emphasize lower taxes, but to show that the lower tax burden has been agreed upon and there is stability in the years to come. All too often and lower tax burden is seen as something that is going to give way to greater exposure. Demonstrating consistent and predictable taxes for the future will reduce these concerns.

3. Provide financial information to the assessor via counsel. If a grievance has been filed, supply your counsel with financial and lease information. Just as the market for sales has changed, so have

operations at commercial properties. Rising inflation, higher insurance prices, and labor costs are just a few of the many operational changes owners have endured recently. The assessor will not be aware of these changes unless they are brought to his or her attention.

How Buyers Should Handle Property Taxes in a Sale.

1. Research the tax history and evaluate tax rates. If the property is located in a high tax rate jurisdiction, this must be factored into any future budgeting for operations. If in a low tax rate jurisdiction, the history should be reviewed to make sure there are not any increases on the horizon. School taxes comprise 60% to 70% of the tax burden, therefore a particular focus on the school district in which the property is located is important.

2. Allocate real estate versus business value, personal property, etc. If the purchase includes personal property, an allocation should be made as to how much of the price is dedicated to the real estate as compared to other items. Under New York law, the assessor may only tax the real estate, and if the purchase price makes no allocation between those items, there is no way to identify the difference. The RP-5217 filed with the transaction has different boxes where such an allocation can be noted. This will allow the assessor to analyze the purchase price knowing that it entailed more than just the bricks and mortar.

Similarly, if there was a going concern or an actual book business that is part of the transaction, this should be identified, and an allocation should be made. The value of the business is not taxable, but the assessor needs to be made aware that consideration was given for items other than the real estate in order for the sale to be properly factored into the assessment.

1031 transactions, compulsion to purchase, conversion to different use. New York courts have said if a sale is not truly of arm’s length nature, it should not be relied upon for tax purposes. If a purchase price is inflated, a buyer will want to document why in order to have that sale disregarded by the assessor. A 1031 exchange is a transaction that can lead to a much higher sales price since the buyer has only a certain amount of time to purchase a property or be subject to capital gains tax. These are typically noted on closing statements and should be relayed to the assessor.

There are other, more nuanced reasons why a sale may not be relied upon. If a business is expanding and the building adjacent to the existing operations becomes available, a buyer may be inclined to pay a higher price given the location. Likewise, if a purchaser is acquiring a property to convert to a different use, that purchase price reflects an inflated value for the future use, not the value as it exists at the time of purchase.

These circumstances influence the purchase price beyond the typical market supply and demand and therefore are not indicative of value for tax purposes.

By being mindful of property taxes during a commercial property transaction, sellers can obtain the maximum return on their investment and buyers can better assess the full financial implications of the purchase, plan for future expenses, and make more informed investment decisions.

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