Phila. closes transfer loopholes

Buyers and sellers now cannot pay taxes based only on assessed values. Revenues could rise by millions.

By Jacob Adelman STAFF WRITER

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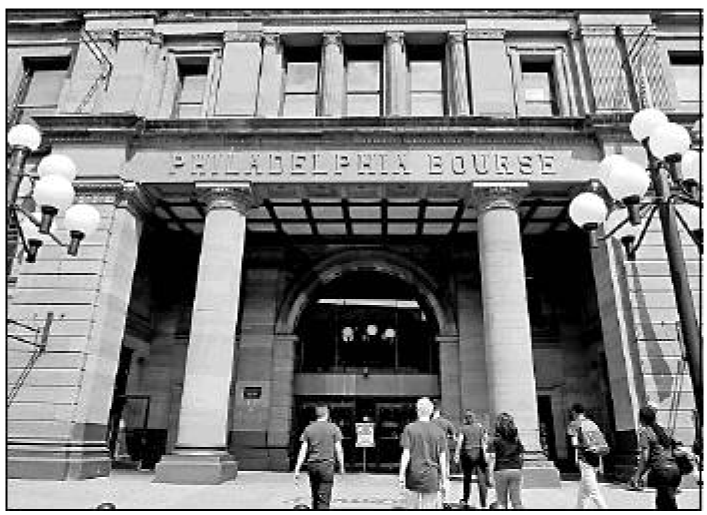

City Council has approved changes to Philadelphia's real estate transfer tax law that could add millions to public coffers, while possibly tamping down prices being paid in some of the city's biggest commercial property deals.

Council voted unanimously Thursday to pass legislation with the changes, which aim to close loopholes that have allowed buyers and sellers of real estate to pay the tax against sums far less than actual purchase prices, or avoid paying it entirely.

The vote comes after an Inquirer analysis found those loopholes being exploited more often than not in the city's biggest real estate deals, where the tax savings can be most pronounced.

Of the nine commercial real estate deals valued at more than $100 million between the start of 2015 and late August of this year, taxes were paid on full purchase prices only twice, the analysis found. The seven times it was not paid on the full purchase price allowed buyers and sellers to avoid a total of as much as $28.4 million in city and state transfer taxes.

Revenue Department Commissioner Frank Breslin told a Council committee last month that it is not possible to predict exactly how much new revenue closing the loopholes would generate.

But he said full transfer taxes paid in just one additional commercial real estate deal could “have a multimillion-dollar impact on the city’s finances.”

Commercial real estate observers said they expect the changes’ impact on the marketplace to be limited, with the lost tax savings of a few million dollars playing a marginal role in the city’s biggest deals.

Negotiations between buyers and sellers may become more complicated and drawn out, as the newly more-difficult-to-avoid tax burden makes it trickier to agree on a price, said Jason Kramer, asenior vice president at real estate services firm Binswanger Management Corp.

Bill Luff, founder of the commercial real estate consultancy CRE Visions, said he expects any deals currently in the works will likely be accelerated to conclude before the tax-law changes go into effect at the July 1 start of the next fiscal year.

Once the changes do occur, some compression in pricing may be expected, as sellers accept slightly lower offers to make up for the tax savings, Luff said.

The savings are “just one of the components in how people narrow the gap between what the seller wants a property to be sold for and what the buyer wants to pay,” he said. “It’s avehicle to help close that gap.”

One part of the bill passed Thursday takes aim at the practice of structuring deals so the transfer tax is paid against a property’s assessed value, which is often much lower than its actual purchase price.

Big commercial property owners can do this because they generally don't directly own their real estate, instead setting up special subsidiary companies to hold it for them.

By buying and selling those property-owning subsidiaries, rather than the properties themselves, they have been able to avoid filing deeds that document actual purchase prices, leaving tax collectors to rely on assessed values.

The new rules end this practice by having the city assess the transfer tax on the actual amount paid for the corporate entity, rather than the assessed value of the real estate.

The changes also crack down on so-called 89-11 transactions, in which the transfer tax is avoided by having sellers retain a stake of 11 percent or more in a property for four years or longer, so no deed is recorded at the time of sale and no tax is paid.

Sellers now have to retain a stake of more than 25 percent in a property, and hold it for more than six years.

City Councilman Al Taubenberger, the legislation's lead sponsor, said in an interview after the bill's passage that the tax loopholes needed to be closed.

"Over the years, I think it will help the city immensely," he said. " 'John Smith' in Mayfair has to pay the tax. So should the biggest investors." jadelman@phillynews.com

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