

Manipulating Real Property Purchase/Sales Price: A Risky Venture

Renewed Interest in Adjusting Sales Prices in 2023. After the passage of Initiative Ordinance ULA in the City of Los Angeles which imposed additional transfer taxes on all commercial and residential real property sales exceeding \$5 million, some sellers of these high-value properties have attempted to avoid the consequence of the ordinance by altering the sales price. (Attempts to adjust sales prices to achieve tax savings or other benefits are not new. Before the passage of Proposition 19 in 2020, some buyers attempted to manipulate purchase prices to enable them to keep a previous low property tax and apply it to a replacement residence.) Whether a seller or buyer is attempting to manipulate a sales price to reduce taxes owed or for some other reason, brokers and salespeople should not be involved in advising or assisting their clients in such efforts and should instead refer the buyer or seller client to seek the advice of legal counsel or other appropriate professional.

Full Value: Transfer taxes on real property sales are authorized pursuant to the Revenue and Taxation Code (RTC), and property taxes pursuant to the California Constitution. Both types of taxes are based on the full cash value of the property, which is generally considered to be the amount of cash or its equivalent that property would bring if exposed for sale in the open market. RTC 110 states the purchase price shall be rebuttably presumed to be the "full cash value" unless it is established by a preponderance of the evidence to the contrary. Real property includes all buildings, structures, and fixtures. Nontaxable tangible personal property includes household goods and personal effects (Publication 29, p. 6, CA Board of Equalization).

Examples of attempts to manipulate purchase price:

Personal property items: A seller may attempt to alter a sales price by allocating part of the price to nontaxable personal property, and a buyer may agree. Two big issues are whether: (i) personal property is otherwise considered part of the real property; and (ii) overvaluation of personal property, not reflecting its true value. On the first issue, built-in appliances are classified as improvements and are part of the real property. (BOE Tax Rule 134). As for the second issue, a seller cannot properly transfer to a buyer a lower cost item and reduce the sales price by a higher cost item. A black velvet picture of dogs playing poker does not have the same value as a signed, limited edition Leroy Nieman "The Gaming Table." Legitimate sales of personal property, such as free-standing furniture, should be accompanied by a bill of sale and, if available, a copy of the original sales receipt.

Transfer of legal entity: If the real property is held in a legal entity, transfer of the entity itself, rather than the deed to the property, would ordinarily not avoid property taxes or sales tax.

Commissions: Another typical effort at reducing the purchase price is to have the commissions "waived" or paid separately from the purchase price. The BOE looks skeptically at any such juggling of fees since it considers commissions as part of the property's value. (BOE Assessor's Handbook Section 503). Note that the buyer will be asked at closing to fill out and sign a Preliminary Change of Ownership form in which the assessor asks for an explanation of any "special terms" such as broker fees waived.

Items not paid out of escrow: Pass-throughs out of escrow, in addition to being risky, are likely to be equally ineffective if discovered.

How should a licensee address a seller or buyer's concern about minimizing taxes on sale of real property? Simple. Remind the client that you are a real estate professional and will attempt to obtain the desired sales or purchase price for your client but that any attempts to adjust a price to achieve a certain financial or tax outcome should be discussed with an appropriate professional such as CPA or tax attorney of the principal's choosing. Even a mutually agreed alteration of the price could not only fail to achieve its desired result but could also lead to expensive penalties and attorney fees.