

Potential Increase in City of Los Angeles Documentary Transfer Tax

November 2012

In California, a County documentary transfer tax is imposed on every sale or transfer of real property (with certain exceptions and exemptions, largely related to inter-family transfers, transfers to an owner's trust, and transfers made without consideration, such as gifts and donations). In addition, each City is authorized to impose an additional transfer tax, with the amount of the tax being set by each City.

The current City of Los Angeles transfer tax is \$4.50 per \$1,000 of purchase price and the current Los Angeles County transfer tax is \$1.10 per \$1,000 of purchase price, with purchase price meaning the amount paid less the balance of any mortgage assumed by the buyer. City and County transfer taxes are payable at the time of recordation of the transfer.

In light of its continuing economic difficulties, the Los Angeles City Council, at its October 31, 2012 meeting, directed the City Attorney to draft an Ordinance that establishes a tiered-rate transfer tax increase to be put on the March 5, 2013 ballot. If the proposed Ordinance is approved by the City Council in November, 2012, voters will be asked at the March 2013 election to approve an increase in the City's transfer tax that increases by 50% the amount of the transfer tax for properties sold for more than \$335,000 and doubles the transfer tax for properties sold for more than \$568,000.

The City Council is considering various other tax increases, and it may elect to put a sales tax increase on the ballot instead of (or in addition to) an increase in the documentary transfer tax. The City Council is expected to make a decision on which tax increases will appear on the March 2013 ballot by mid-November. If the City Council approves placing the transfer tax on the ballot, and it passes, the increased transfer tax will affect the sale of most homes in the City of Los Angeles since, according to zillow.com, the average price of a home in Los Angeles is \$380,000. In many areas, the average price of a home in the city is well over \$600,000.

In addition to affecting most home sales, the increased tax will increase the transfer tax on the sale of essentially all commercial property. If the proposed tiered increase in transfer taxes is approved by the City Council and the voters, the transfer tax on the sale of a moderately priced commercial building that sells for \$6 million would be \$60,600, calculated at \$10.10 per \$1,000 of purchase price for the combined City (at \$9.00 per \$1,000 of purchase price) and County (at \$1.10 per \$1,000) transfer tax. In comparison, the current combined City and County transfer tax liability on the sale of the \$6 million building is \$33,600.

The potential increase in transfer tax rates will affect both sellers and buyers of property in the City of Los Angeles. A seller will almost certainly want the buyer to share in the cost of the increased transfer tax and, even if the entire burden of the City tax is borne by the seller, there will presumably be at least a partial increase in the purchase price to offset the increased tax.

Buyers and sellers of property in the City of Los Angeles should watch the progress of this proposal carefully, so they can take whatever steps are possible to protect themselves from substantially increased transfer taxes.

If a transaction is imminent, the parties should try to close promptly. It's not certain when the new tax, if passed, will take effect, but presumably shortly after the March election.

During the negotiation of a purchase agreement, expect to have increased focus on the issue of which party is obligated to pay the transfer taxes. Typically, in the City of Los Angeles, a seller pays the County transfer tax. The City transfer tax is often paid by the seller as well. However, a strong seller, with good leverage, may require that the tax be paid by the buyer, or split between buyer and seller. If the higher transfer tax rate is approved, buyers and sellers will be taking into account the new cost. Expect sellers to be more proactive and aggressive in

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trying to get the buyer to share in the cost of the City transfer tax. That discussion should take place sooner rather than later in the process (certainly at the letter of intent stage in a commercial transaction) because it could affect the purchase price or other aspects of the transaction.