COMMERCIAL REAL ESTATE

Will L.A.'s mansion tax take root in OC?

Measure ULA, commonly known as the mansion tax, is imposing a new Homelessness and Housing Solutions Tax on transfers of residential and commercial real property in the city of Los Angeles valued in excess of $5 million.

Let me tell you a little ditty about a deal cut 62 miles from home and how it educated me on the ever-changing tax rules in Southern California.

Recently, we sold two buildings in Los Angeles county, in Chatsworth to be exact. The deal was lengthy, spanning the horrors of the changing finance market and Jerome Powell's ratcheting up of bank borrowing rates.

But alas, we got it done, satisfying the buyer's 1031 exchange and providing the seller with a long-term lease from which to operate his business.

Chatsworth, as well as most of the San Fernando Valley, is considered part of the city of Los Angeles. For context, imagine if the north Orange County cities of Anaheim, Buena Park, Orange, Placentia, Brea, La Habra and Fullerton were under the purview of, say, Santa Ana. Yeah. That's the situation in Chatsworth.

Consequently, Los Angeles wields tremendous clout when determining taxation — especially in the transfer of real property.

One line item in our estimated closing statement caused the county recorder to pull our file.

It seemed the transfer tax was improperly computed, or so they thought. When our title officer pointed out the correct calculation — which appeared on the deed — the county capitulated and allowed the recording. Never had I spent so much time understanding how such taxes are determined.

My education, I believe, is column-worthy. But recently, another development in Los Angeles known as Measure ULA, or the mansion tax — which was passed by voters — encouraged a deeper dive. So here we go.

From the website deedclaim.com (a wonderful resource, by the way), you can find this: "California's Documentary Transfer Tax Act allows counties and cities to collect tax on documents that transfer real estate. The Documentary Transfer Tax Act is broadly worded, imposing a tax on:

"Each deed, instrument or writing by which any lands, tenements, or other realty sold within the county shall be granted, assigned, transferred or otherwise conveyed to, or vested in, the purchaser or purchasers, or any other person or persons, by his or their direction, when the consideration or value of the interest or property conveyed (exclusive of the value of any lien or encumbrance remaining thereon at the time of sale) exceeds one hundred dollars …"

In reading further, "this language covers almost every interest in property that can be created or transferred under California law." It includes:

• Outright property transfers.

• Tenancy in common interest.

• Joint tenancy interests.

• Community property interests.

• Life estates and remainder interests.

- Long-term leases.
- Non-temporary easements.
- Mobile homes installed on permanent foundations.

A transfer of any of these interests is subject to documentary transfer taxes. The documentary transfer tax is due even if the instrument is not recorded in the county real estate records. The creation and delivery of the deed cause the documentary transfer tax to become due.

Most counties in California impose a transfer tax equal to $1.10 per thousand dollars of value. In addition to the county rate, cities may impose additional documentary transfer taxes.

Again from deedclaim.com: “The amount that the city may impose depends on whether the city is a charter city or a general law city.”

The website gives a breakdown of all the counties and cities in California, which are charter and general law, and the respective transfer taxes. But to save you some reading, Anaheim, Buena Park, Cypress, Huntington Beach, Irvine, Los Alamitos, Newport Beach, Placentia, Santa Ana and Seal Beach all are charter cities. The balance of OC is general law. You can find more on this at californiacityfinance.com

Now to Measure ULA, which recently passed in Los Angeles city.

“Measure ULA, commonly known as the ‘mansion tax,’ would impose a new ‘Homelessness and Housing Solutions Tax’ on transfers of residential and commercial real property in the city of Los Angeles valued in excess of $5 million,” according to the law firm gibsondunn.com.

According to the firm, and I’m paraphrasing its words here, revenue raised by the new tax, expected to be between $600 million and $1.1 billion annually, “is intended to be used to fund affordable housing and tenant assistance programs.”

Under the measure, sales of residential and commercial real property valued at more than $5 million but less than $10 million would be subject to an additional tax at the rate of 4%, while sales of properties valued at $10 million or more would be subject to an additional tax at the rate of 5.5%.

The new tax would apply to the entirety of the sale value, not solely excess threshold amounts, and regardless of whether the property is sold at a gain or a loss. The tax, which can be adjusted for inflation, would apply to property sales occurring on or after April 1, 2023.

Also, the new tax is in addition to the existing documentary transfer tax imposed on property sales in the city of Los Angeles, which is imposed at a combined city and county rate of 0.56%.

So what does all of this mean? Selling a property greater than $5 million in Los Angeles just got a lot more expensive.

A $10 million property used to cost $56,000 to transfer. Starting April 1 next year, that same $10 million transfer will be taxed at $606,000, more than a tenfold increase. And by the way, a $5 million residence typically is a big deal, as in large home. A commercial deal in L,A. will trigger the tax on a very small square footage, affecting many occupants who own their building and choose to sell.

But so what? We're in OC.

Just this: Will unfunded pension liabilities straining city budgets cause city governments to search for revenues to bridge the gap? Ten of the 34 cities within Orange County have charters that allow such an increase in transfer taxes — with voter approval. We will see.

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