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## Tax strategies for selling real estate owned by corporations

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Asset Preservation

While most investors own real estate today in the name of an LLC, partnership or S Corporation, there are still those who own property in a C Corporation. Selling real estate owned by a C Corporation poses special challenges not faced by the other types of entities as discussed below.

There are primarily two situations that result in C Corporation's owning real estate today. The first situation arises from the fact that prior to 1986 corporate tax rates were lower than the personal tax rates. Thus, C Corporation ownership was preferred by many investors seeking to minimize their tax liabilities. It is not uncommon for an investor who has owned property for decades to still hold title in the name of a C Corporation. Although under the 1986 Tax Act, personal rates were reduced and C Corporations were permitted to convert to an S Corporations (a pass-through entity similar to a partnership), thereby avoiding the double tax that can now reach approximately 50%. Some C Corporation shareholders never took the opportunity to convert and therefore remain subject to double taxation.

The second and most prevalent situation arises due to the tax treatment of foreigners owning property in the U.S. In many countries including the U.S., foreign investors are advised to acquire title to real estate through a

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local corporation owned by a foreign holding company often established in a favorable tax jurisdiction. In the event of the subsequent sale of the real estate, foreign investors prefer to sell by selling their foreign entity, as opposed to selling their U.S. corporation or having the local corporation transfer title by deed. This is because the Foreign Investment in Real Property Tax Act ("FIRPTA") taxes foreign investors in U.S. real estate as if they were U.S. residents on the sale of real estate. By selling the shares of the foreign entity, investors can avoid the FIRPTA tax.

Likewise, even non-foreign investors who own real estate in a C Corporation will prefer to sell their shares in the C Corporation, as opposed to having the C Corporation transfer title to the property by deed due to the fact that double tax will be incurred if the real estate is transferred by the C Corporation by deed.

One way to avoid this adverse tax consequence for both foreign and domestic investors is for the C Corporation to perform a tax deferred exchange. Though the C Corporation transfers title to the property through a deed, all taxes at all levels are deferred under IRC 1031. However, the problem cannot be solved by a tax deferred exchange if the C Corporation wishes to liquidate its real estate holdings and deploy proceeds from the liquidation into other non real estate investments.

In such cases, the investors of the selling C Corporation will prefer to accomplish the sale by a transferring their shares. However, for many reasons, this is generally not acceptable to buyers. Buyers are seldom interested in buying shares of a corporation owning real estate as by doing so they inherit a lower tax basis with imbedded tax liability and all of the liabilities of the C Corporation. Furthermore, the buyer's ability to depreciate the asset significantly reduced. Finally, if the buyer is itself performing a tax deferred exchange, the purchase of shares of stock will not qualify as replacement property under IRC 1031.

In many cases, the conflicts between the interests of sellers and buyers of C Corporation real estate have resulted in deals going astray. However, investors should be aware that a creative structure may be employed which addresses each party's concerns and interests, avoids the buyer acquiring unnecessary liabilities, imbedded taxes and depreciation disadvantages and the seller incurring unwanted taxes, but which still results in a sale of the real estate.

There are private investment firms that may be interested in acquiring real estate owned by corporations in the U.S. and abroad across a broad range of property types (office buildings, single and multi-family housing, raw land, mineral rights, etc.) and geographic regions.

These firms will consider acquiring stock of any corporation (or its parent) holding real estate where doing so would increase the after-tax proceeds to the seller.

While the price offered by these firms discounts the fair market value of the underlying real estate, the net after-tax sale proceeds to the seller substantially

exceed that which would be derived by the shareholders if the C Corporation sold the real estate directly.

For example, on a recent transaction, the selling shareholders of a corporation owning a \$50 million asset realized an after-tax (before personal taxes) benefit of \$40 million rather than the \$30 million they would have received from selling the asset – an increase of \$10 million or 33%.

In many instances, the investment firm itself may seek to perform a tax deferred exchange with respect to the real estate owned by the C Corporation.

In these cases, once the investment firm has purchased the shares of the selling corporation, the corporation then completes the sale of the property pursuant to the contract and purchases replacement property in a tax deferred exchange using a Qualified Intermediary to facilitate the transaction in the period specified by IRC 1031, thus deferring all imbedded income taxes. In other instances, the investment firm may simply seek to retain the property for investment purposes.

The above scenarios can also be accomplished if the C Corporation has a contract in place to sell its real estate at the time the investment firm is engaged and provides a viable way for investors selling real estate owned by a C corporation to receive the benefits of a highly appreciated asset without incurring double taxation.

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