



Sep 21, 2020

Categories:

[Blogs](#)

[Tax Law Defined™ Blog](#)

Authors:

[Martin E. Mooney](#)

Ohio Tax Talk: Structuring And Defending Drop-Down LLCs

This article was originally published in [Law360 Tax Authority](#).

The drop-down LLC transaction has become a commonly used technique in real property transfers and commonly disputed issue in Ohio real property tax cases.

The recent decision in Cleveland Metropolitan Schools Board of Education v. Cuyahoga County Board of Revision,^[1] is the latest Ohio Board of Tax Appeals case providing insight into the factors that courts will utilize in evaluating these sorts of transactions for real property tax purposes.

Cleveland Metropolitan Schools also offers valuable lessons to taxing authorities regarding the burden of proof required to demonstrate that a drop-down LLC transaction was done for the sole purpose of transferring real property between two parties.

The Drop-Down LLC Transaction

Ohio counties are entitled to collect a transfer tax on each deed conveying real property within their boundaries.^[2] The tax is levied on the party named as grantor in the subject deed and must be paid before the deed is recorded. The real property transfer tax, also known as a conveyance fee, is limited to 4 mills, i.e., \$4 per \$1,000 of the value of the property sold or transferred.

For example, when a parcel of real property sells for \$1 million, the seller would be responsible for \$4,000 in transfer tax. The actual amount of tax will vary depending on the county and the tax is in addition to any county auditor's or recorder's fees.

There are certain key exemptions to the real property transfer tax. One critical exemption that applies to transfers "[t]o or from a person when no money or other valuable and tangible consideration readily convertible into money is paid or to be paid for the real estate or manufactured or mobile home and the transaction is not a gift."^[3]

Simply put, this exemption provides that real property transfer tax will not apply when the property is transferred between parties when no money or consideration is exchanged — for example, in an exchange between related parties.

It is also important to note that there is no real property transfer tax on transfers of corporate stock or LLC membership interests, even when the entity primarily holds real property.

This framework enables the drop-down LLC transaction in three basic steps. After a buyer and seller of real property have established a price for the property, the seller would:

- Form a limited liability company as its sole member.
- Transfer the real property to the newly created LLC in exchange for \$0 — i.e., no valuable consideration — which would be reflected on a conveyance fee statement justifying the aforementioned exemption to the real property transfer tax.
- The seller would transfer the seller's membership interest in the newly created LLC to the buyer at the agreed upon price. Because there is no real property transfer tax on the sale of LLC interests, no transfer tax would theoretically apply to any step in this series of transactions. Also, the transfer of the LLC interest does not need to be reported to the county auditor or recorder at all.

Real Property Tax Consequences

Beyond the exemption from the real property transfer tax, most taxpayers would find the more significant benefit of the drop-down LLC transaction to arise from the ongoing real property tax savings.

In Ohio, real property is generally valued based on the most recent arm's-length sale.^[4] This valuation method allows county auditors to determine the value of real property based on the purchase price reflected on a recorded deed.

However, as outlined above, in a drop-down LLC transaction, the transfer of the real estate to the LLC is treated as exempt from the conveyance fee and no value for the property is reported. The

subsequent sale of the LLC membership interest is not reported to the county auditor or recorder.

Therefore, there is a lower risk that the auditor would detect the property transfer and, more importantly, there is no reporting of the purchase price for the sale of the LLC membership interest that would reflect a change in the value of the property.

Even if an auditor or other interested party, such as a municipality or local school district, did become aware of the transfer, there is an issue of how to value the property after the transfer.

Taxpayers often argue that the value of an LLC interest does not necessarily equal the value of the underlying real property. After all, the buyer is purchasing an LLC interest; the purchaser is not acquiring the real property free and clear of all encumbrances.

Cleveland Metropolitan Schools

Cleveland Metropolitan Schools was initiated by the Cleveland Metro Board of Education when it filed a complaint against valuation with the Cuyahoga County Board of Revision. The BOE requested that the subject property's value be increased from \$1,568,300 to \$2.8 million.

At its hearing before the Revision Board, the BOE presented a number of documents in support of its requested valuation, including: (1) a limited warranty deed transferring the property to the present owner along with an exemption transfer certificate, (2) information about the real estate from Co-Star, a real estate database, and (3) evidence of a recently recorded \$2.1 million mortgage encumbering the property.

Following the hearing, the Board of Revision determined that the BOE did not meet its burden in demonstrating that the value should be increased to \$2.8 million.

On appeal to the Ohio Board of Tax Appeals, the BOE argued that the documents shown at the Board of Revenue hearing were evidence of a drop-down LLC transaction for which the sole purpose was to transfer real estate.

In its written decision, the board recognized that it will regard a transfer of an entity interest to be an actual sale of property when the purchase agreement and other contracts between the parties “make clear no other going concern value or assets were owned by the newly formed entity.”

However, the board wrote that it

has not considered the sale of membership interest to be a real property sale when the record lacks specific evidence of the transaction, which make clear the newly formed entity’s sole purpose was to facilitate the transfer of real property only ... [i]mportantly, a party must present evidence that the entity transfer was not a transfer of nonrealty.

The decision made clear it is critical to consider whether the purchase contracts between buyer and seller contemplated the transfer of the underlying real estate.

The Board of Tax Appeals cited the recent 2020 Ohio Supreme Court case in Columbus City Schools Board of Education v. Franklin County Board of Revision,[\[5\]](#) also known as the Palmer House case, as an example of a party presenting sufficient evidence that the entity transfer was simply a means to transfer real estate.

In Palmer House, the property transfer at issue involved a contract that identified itself as a purchase agreement for the subject property. The contract included a provision setting forth an option to consummate the deal as a transfer of corporate ownership rather than conveyance of real estate from seller to buyer.

These factors made it sufficiently clear to the Ohio Supreme Court that the transfer of an interest in an entity was used to accomplish the sale of commercial real estate.

In contrast to the Palmer House case, the board did not find sufficient evidence that the LLC transfer was solely a technique to accomplish the sale of real estate in Cleveland Metropolitan Schools. The board noted that the purchase agreement included a provision that nonrealty items would be transferred as part of the transaction.

Ultimately, the Board of Tax Appeals found that the BOE did not satisfy its burden in presenting sufficient evidence that the entity transfer was not a transfer of nonrealty. As such, it upheld the original valuation of the real estate at \$1,568,300.

Takeaways From Cleveland Metropolitan Schools

Cleveland Metropolitan Schools has some important lessons for taxpayers who are buying and selling business entity interests that hold real estate. For one, parties should realize that the purchase agreement could become the subject of a discovery request in a real property valuation case.

Therefore, it would benefit the parties to craft the agreements in such a way as to highlight the rights and responsibilities that are included in the LLC interest transferred to the purchaser, as well as other property, tangible as well as intangible, besides real estate that will be held by the LLC along with any liabilities that may encumber the property.

Also, unlike the taxpayers in the Palmer House case, the parties should not include a provision in the purchase agreement that grants any party the option to transfer the real estate by deed or by an LLC interest transfer. This type of provision would be evidence that the newly formed entity's sole purpose was to facilitate the transfer of real property.

Further, from a public sector perspective, Cleveland Metropolitan Schools should serve as a lesson as to the type and amount of evidence needed to support a complaint against valuation involving a drop-down LLC transaction.

Deeds, exemption forms, information about the property from third party websites and mortgage information may not be sufficient to determine that the entity transfer was solely accomplished to transfer real estate and was not a transfer of nonrealty.

Instead, it appears that the Board of Tax Appeals and various boards of revision will focus on what is written in the contracts entered into by the parties.

Conclusion

Cleveland Metropolitan Schools is a good example of how courts will scrutinize entity interest transfers used in a drop-down LLC transaction.

Taxpayers should be mindful of the considerations emphasized by the BTA when they are structuring an entity interest transfer, particularly when significant rights, encumbrances, personal property and other ancillary items accompany real property.

Also, taxing authorities should take note of their relatively high burden in proving that an entity interest transfer is merely and solely a transfer of real property in disguise.

Martin E. Mooney is a member at Frost Brown Todd LLC. The author is a contributor to the Frost Brown Todd [Tax Law Defined blog](#).

The opinions expressed are those of the author(s) and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

[1] Cleveland Metropolitan Schools Board of Education v. Cuyahoga County Board of

Revision, BTA Case No. 2019-497.

[2] Ohio Revised Code Section 322.02(A).

[3] O.R.C. 319.54(G)(3)(m).

[4] O.R.C. 5717.03; see also Terraza 8, L.L.C. v. Franklin Cty. Bd. Or Revision, 150 Ohio St.3d 527, 2017.

[5] Columbus City Schools Board of Education v. Franklin County Board of Revision, 150 N.E.3d 877, 2020.

© 2026 FBT Gibbons LLP. May be considered attorney advertising in some jurisdictions.