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Notes from the Editor

Welcome to our spring issue of **Build On This**. As the weather gets warmer, we hope to see construction projects and real estate sales blossom after several years of hibernation. To help prepare you, we are presenting an article from **Steven Dimengo** on how to address Ohio sales and use tax in a construction contract. Additionally, **Anthony Vacanti** discusses real property tax valuation issues, and I offer insight into the growing problem of residential properties being used for the production of methamphetamine.

We hope you find these articles informative and, as always, we welcome your opinions and feedback.

David J. Lindner
Editor

FEATURE ARTICLES

Contractors: Are you Correctly Addressing Ohio Sales/Use Tax Pertaining to your Construction Contract?

By: **Steven A. Dimengo**



In a construction contract, the contractor is deemed the consumer of any tangible personal property purchased that it incorporates into real property and, thus, must pay tax on the purchase of such property. The construction contractor is the consumer even though he may subcontract the actual labor to incorporate the materials into the real property. However, subcontractors who purchase materials for incorporation into a job must pay tax upon the purchase of the materials.

A contractor cannot use tax erroneously paid on the purchase of its materials as an offset against tax that should have been collected. For example, a contractor may erroneously believe property to be constructed is real property and remit the sales tax due on the materials as they are purchased while failing to collect tax upon completion of the project. Under such circumstances, the contractor can only obtain a refund of tax it erroneously paid on its materials.

To avoid the foregoing problem, a contractor is allowed to request certification from the owner as to the classification of the property – real or personal property – before the contract is executed. The owner must respond to the request, and the contractor can rely thereon so that the risk of erroneous classification is transferred to the owner.

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If in doubt, claim the resale exemption

Since a contractor cannot always be certain as to whether property being purchased will be incorporated into real property or sold as tangible personal property, he or she should claim the resale exemption for any uncertain purchases. Use tax must then be paid on those materials subsequently incorporated into Ohio real property by the contractor, other than as part of an exempt construction contract .

Claim an exemption for materials used on Exempt Construction Contracts

A contractor may claim exemption upon the purchase of materials to be incorporated into:

1. Real property under a construction contract with the U.S. government or its agencies, the State of Ohio, or an Ohio political subdivision;
2. Real property which is owned or will be accepted for ownership at the time of completion by the U.S. government or its agencies, the State of Ohio or its political subdivisions;
3. A house of public worship or religious education, or a building used exclusively for charitable purposes by a nonprofit organization operated exclusively for charitable purposes;
4. The original construction of a sports facility under §307.696 of the Ohio Revised Code; or
5. A hospital facility entitled to exemption under §140.08 of the Ohio Revised Code.

A contractee claiming one of the above exemptions must execute the Construction Contract Exemption Certificate available on the Ohio Department of Taxation's website. A contractor is then protected from liability if it is later determined that the contract did not qualify for exemption; the contractee assumes liability for any unpaid taxes.

Rather than using copies of the Construction Contract Exemption Certificate when making purchases of materials, the contractor or subcontractor may use a Contractor's Exemption Certificate when purchasing materials to be used for an exempt contract. However, this certificate only protects the vendor/seller of the materials.

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Real Property Values are Declining. Is your Tax Bill?

Deadline to challenge tax bill is March 31

By: Anthony R. Vacanti



Rock bottom real property values are taking center-stage in the today's headlines, both nationally and in Northeast Ohio. Have you ever thought about your or your company's real property tax liability

in such a context? Have your or your company's real property taxes gone down with property value? Understanding the process may help in determining if you should challenge the value attributed to personal or company's real property.

The procedure by which property is valued for tax purposes is set forth in Ohio Revised Code Chapter 5713. Real property is taxed at 35% of its true value, which is referred to as the assessed value for property. The county auditor is charged with adjusting the assessed value of each parcel within a county every three years. There are two different evaluations that occur: "Reappraisal Year" and "Update Year." The Reappraisal Year occurs every six years, and during the Reappraisal Year each parcel is viewed and evaluated based on market conditions. The Update Year occurs three years after the Appraisal Year, and involves re-valuing property without physical inspection. This is often done using computer-assisted modeling of value changes by neighborhood and type of property within the county. The value of property is based on its condition on January 1st of each year. Each County has a different Reappraisal Year and Appraisal Year.

The county auditor's valuation of property may be challenged. Pursuant to Section 2, Article XII of the Ohio Constitution, real property is to be taxed "according to value." Ohio Revised Code Section 5713.03 also requires that each separate tract of property be valued according to its "true value." Section 5713.03 states, in relevant part,

that "[t]he county auditor, from the best sources of information available, shall determine, as nearly as practicable, the true value of each separate tract, lot, or parcel of real property and of buildings, structures, and improvements located thereon."

This begs the question: How is "true value" of property determined? True value is equivalent to fair market value, which the Ohio Supreme Court in *State ex rel. Park Investment Co. (1964)*, 175 Ohio St. 410, has defined as follows:

"The best method of determining value, when such information is available, is an actual sale of such property between one who is willing to sell but not compelled to do so and one who is willing to buy but not compelled to do so. In Re Estate of Sears (1961), 172 Ohio St. 443, paragraph 2 of syllabus. This, without question, will usually determine the monetary value of the property. However, such information is not usually available, and thus an appraisal becomes necessary. It is in this appraisal that the various methods of evaluation, such as income yield or reproduction cost, come into action. Yet, no matter what method of evaluation is used, the ultimate result of such an appraisal must be to determine the amount which such property should bring if sold on the open market. "

In sum, when property is recently the subject of an arm's length transaction between a willing seller and willing buyer, the sale price of the property will constitute the value for taxation purposes. The determination of how "recent" a real property transaction has to be is determined on a case-by-case basis. Generally one year or less is a good rule of thumb, but the purchase price of property in a transaction occurring later may still be relevant. It is important to note that only the value of real property, not the value

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of personal property, is considered when determining real property value. It should be noted that an arm's length sale may not be considered evidence of true value if the sale was not arm's length, for example sales involving bankruptcy or lease-backs.

When real property was not subject to a recent sale or such sale was not conducted at arm's length, then an appraisal or other evidence may be necessary to challenge the county's real property value applied to the subject property, especially when the market has drastically declined, as in today's current economy.

Generally, when a recent arm's length sale is not available, there are three other property valuation approaches used in determining true value:

1. Cost Approach to Value – determines value by estimating the costs to reproduce the improvements to the property based on current prices of labor and materials;
2. Market Approach to Value – the value of the property is determined by analyzing recent sales of similar properties; and
3. Income Approach to Value – the value of the property is based on the net cash flow that can be produced by the property, capitalized at the rate of return that would be required based on the risk associated with holding the property.

Given the drastic decline in the real estate market and corresponding real property values, it may be beneficial to review your own industrial, commercial, retail, business, and/or residential real property tax liabilities to see if they have also declined. If you disagree with the assessed value of your real property, you may file a complaint with your local county board of revision.

A complaint must be filed with the board of revision by March 31, 2011. The complaint form is straightforward, and the county provides a form with instructions. A counter-complaint may be filed, and many times is filed, by the Board of Education where the property is located. This counter-complaint must be filed within 30 days after the Board of Education receives notice of the filing of a complaint. If a tax assessment complaint is filed and unsuccessful, the property owner has the right to file an appeal to either the Court of Common Pleas or the Ohio Board of Tax Appeals.

In considering if you will challenge the valuation of your or your company's real property, you must keep in mind that March 31 will be an absolute deadline to file a complaint and failure to file by this date will result in a loss of your rights to challenge the 2010 valuation. The standard complaint form is referred to as Form DTE 1, Complaint against the Valuation of Real Property. Although the instructions accompanying the complaint indicate that certain non-attorneys may prepare the complaint and file it on behalf of a company, it is important to note that the Ohio Supreme Court has questioned the constitutionality of that provision, and has determined that in many circumstances having a non-attorney prepare the complaint may constitute the unauthorized practice of law, especially if the matter involves legal issues and would involve the questioning of witnesses, such as appraisers. *See, e.g., Dayton Supply & Tool Company, Inc. v. Montgomery County Board of Revision (2006), 111 Ohio St.3d 926, 927. Consequently, it is advisable to consult an attorney when filing a complaint.*

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Ohio May Require Disclosure of Methamphetamine Contamination

By: David J. Lindner



Methamphetamine, known on the street by the names "crank," "crystal meth," "speed" and others, has taken a devastating toll on individuals and communities across the country. Meth is a highly addictive drug that causes severe physical reactions in the user, including violent behavior, loss of teeth, strokes and heart attacks. Nevertheless, it has grown in popularity, spreading from rural areas in the South and Midwest to nearly every part of the country.

One of the reasons meth use has grown so rapidly is that production of the drug is relatively simple and a production facility, or "meth lab," can be located almost anywhere. Meth is synthesized or "cooked" using ingredients found in common medications and household products. Though the process is simple, it is also extremely dangerous due to the toxic and highly flammable ingredients used. In fact, meth labs are often discovered because they have exploded or caught fire, often injuring and sometimes killing the producer or others.

Though much of the methamphetamine used in the United States now comes from large drug smuggling operations in Mexico, there are still many small meth labs throughout the U.S., including Ohio. The U.S. Drug Enforcement Agency's website lists 308 "clandestine laboratory incidents" in Ohio in 2009. Though this list includes mobile labs, hotel rooms, and dumpsites, a substantial number are residential properties that will eventually be put up for sale. Even though the production of meth may have ceased at the property, the property is usually contaminated by the toxic chemicals and fumes that were present. These toxic substances can be harmful to the health of the property's new occupants, who may be unaware of the property's troubled past.

Is the seller required to disclose that the home was used for meth production? Laws vary from state to state, but few expressly require such a disclosure. Ohio has a mandatory disclosure form that must be completed by residential property sellers pursuant to R.C. 5302.30. While the form requires the seller to disclose the presence of toxic or hazardous substances, it only asks specifically about lead-based paint, asbestos, urea-formaldehyde foam insulation and radon gas. Thus, a seller might fail to disclose the presence of methamphetamine or the variety of toxic substances used in its production.

To address the disclosure issue, Ohio legislators have introduced Substitute House Bill No. 33, the Methamphetamine Awareness and Notification Act, which would establish an online database administered by the Ohio Attorney General to track properties used for meth production. The intent is that the database would be referenced in connection with a title search and thereby alert the prospective purchasers of the home's history. The bill would also require the property disclosure form to be revised to include an express disclosure requirement for methamphetamine manufacturing on the property. Such a disclosure would naturally make the property difficult, if not impossible, to sell. Thus, the legislation further provides that the property may be removed from the database, and the disclosure requirement would no longer apply, once a contractor has given an affidavit that the methamphetamine residue has been removed in accordance with guidelines to be prescribed by the director of health. The bill was passed by the House on May 19, 2010 and now awaits action by the Senate.

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Until this legislation is enacted, or in states lacking similar legislation, prospective purchasers can consult the U.S. DEA's National Clandestine Laboratory Register (<http://www.justice.gov/dea/seizures/index.html>) to see if the property is listed. If the property is located in Summit County, the Summit County Sheriff also maintains a database of known methamphetamine labs (http://www.co.summit.oh.us/sheriff/Meth_Sites/Meth_Sites.asp).

Speaking to neighbors or the local police department is another way to determine if the home has been used for drug production. If there is any concern, a buyer's safest course of action may be to hire a qualified contractor who can determine whether meth has been present in the home, since an ordinary home inspection does not include looking for evidence of methamphetamine production.

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