

# DON'T LOSE OUT ON CONSTRUCTION TAX EXEMPTIONS

Tax exemptions can apply to income-producing real estate from apartments to manufacturing facilities.

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The construction cranes that punctuate our city skylines confirm that economic recovery is again driving commercial real estate development. Property tax considerations should not be the tail that wags the dog when

it comes to timing construction or leasing. However, the savvy investor and tax manager may want to make sure they are not leaving money on the table by overlooking potential tax savings. Most should also be aware that, in many states, property under construction is exempt from property taxes.

Most states encourage the development of commercial and industrial facilities by sheltering construction projects from the payment of property taxes until the property is in use or occupied, and therefore producing income to pay the taxes. As with most property tax exemptions, however, taxpayers must follow statutory procedures and meet specific conditions to qualify. Frankly, many taxpayers inadvertently fail to meet the criteria for receiving the full benefit of the tax exemption.

A tax exemption typically will apply to a commercial or industrial building under construction, including ramps, loading docks, and paved areas used for parking or storage built in conjunction with the project. In most states, the key to receive the exemption is that the property must be constructed to produce an income.

Exemptions most often apply to hotels, apartments, office buildings, retail stores and manufacturing plants. Even a condominium project may be entitled to the exemption because it is built to produce an income. A qualifying income may be from a one-time sale of the property, as with a condominium project, or an ongoing income stream from a lease or use of the property in business.

The tax exemption may also apply to construction of an addition in an existing building or structure, such as a new wing for a building already on a site. In most cases, the modification must change the nature of the building, perhaps increasing manufacturing space or adding a new wing onto a shopping mall, thus increasing the property's income-producing potential.

In many states, the construction exemption also applies to machinery

added to the space. This is usually limited to machinery and equipment installed or affixed to the new building, structure or addition. Unfortunately, most states disallow equipment installed subsequent to construction to qualify for this construction-in-progress exemption.

The exemption seldom applies to preparing the land for construction. That means that site development such as excavation or grading the property to prepare for construction will not qualify as property under construction for a tax exemption.

An exemption will be denied if the applicant fails to meet one of the conditions. For example, in Oregon the property must be under construction on Jan. 1 of the assessment year. As discussed earlier, site preparation is not considered part of the construction, nor is demolition of an existing building; construction commences when work begins on the foundation.

Timing can be critical to securing the tax exemption. In Oregon, if the user occupies any part of the property before Jan. 1 of the year following the year for which the exemption is claimed, the property is disqualified for a construction-based tax exemption.

Partial occupancy is one of the fatal stumbles that many taxpayers make, losing their tax exemption. For example, user occupancy of the first floor retail space in a multi-story commercial or apartment building would disqualify the entire building from exemption, even if floors 10-15 are still under construction on Jan. 1. Thus, the occupancy of the retail space, in advance of the apartment complex completion, may result in hundreds of thousands of dollars in lost property tax exemption.

Additionally, many jurisdictions require a full year of construction, from Jan. 1 to Jan. 1, to qualify for a property tax exemption. If the building is first occupied on day 363 of the tax year, then the property owner could lose the entire year of property tax exemption.

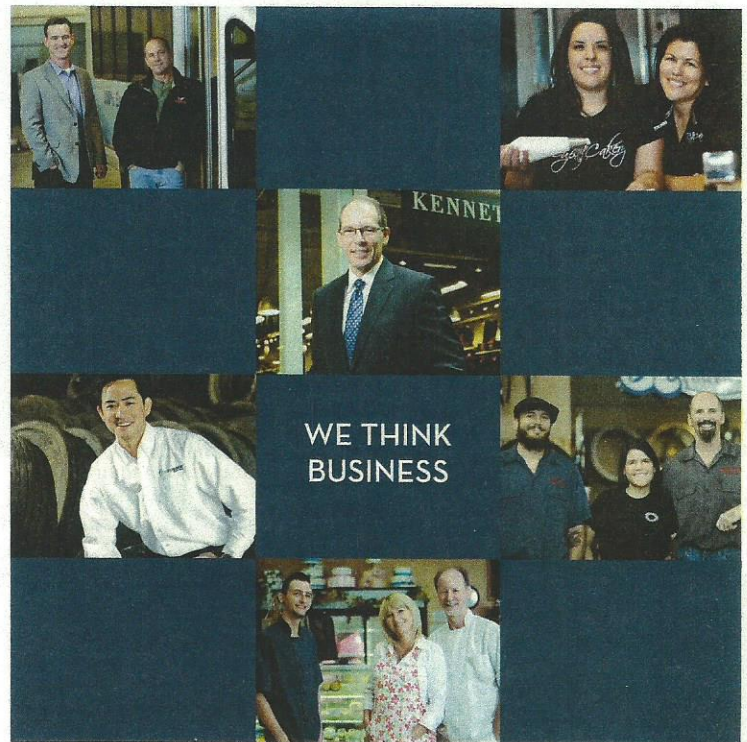
Finally, most states require that the taxpayer apply for an exemption before starting construction. Oregon's statute requires the applicant to file the application on or before April 1 of the assessment year for which the exemption is claimed.

Most states limit how long a taxpayer may benefit from the tax exempt status for property under construction. Usually, this exemption is no more than two consecutive years.

The taxpayer must carefully review

their statutes to determine the criteria and conditions for a construction-in-progress tax exemption. The under-construction provision is one of many exemptions that can yield significant tax savings for property owners who take the initiative to learn effective tax strategies for their markets. This is particularly true of the commercial projects taking shape under those construction cranes gracing our skylines today.

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