

Real Estate Transfer Tax Incident to Divorce

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In October of this year, the Chicago City Council Finance Committee voted preliminarily to approve an ordinance that would prevent the City of Chicago from collecting real estate transfer taxes when a residence changes hands in a divorce or legal separation. Alderman Edward Burke of the 14th Ward introduced the proposed ordinance. The City's Department of Revenue opposes it on the basis that the City and Chicago Transit Authority ("C.T.A.") need the revenue. According to the Department of Revenue, the City and C.T.A. collect more than \$2 million a year from real estate transfers that occur between spouses incident to a divorce or legal separation.

The real estate transfer tax is a one-time tax on the transfer, sale, or granting of title to, or beneficial interest in, real property. Fifteen tax-exempt transfers are specified in Ordinance 3-33-060, but a transfer between spouses incident to a divorce or legal separation is not one of them.

"This overzealous enforcement of the Code has placed a harsh and unfair burden on couples and should be reversed," Alderman Burke said in a press release. He called the tax double-jeopardy by forcing couples to pay the transfer tax twice, once when they buy their home and then again when they divorce and transfer ownership of their home by quit-claim deed to their former spouse.

In the process of transferring title to the marital residence incident to divorce, often the real estate transfer tax cost is overlooked. Depending on the transfer price of the property, it can be a significant amount. As a lawyer, litigant, or judge making the ruling, you should consider what the transfer tax will be and who pays it before awarding property to one spouse over the other.

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The current combined total tax rate in the City of Chicago is \$5.25 per \$500 of the transfer price, or fraction thereof, of the real property or beneficial interest in the real property. Where property is transferred from one spouse to another in a divorce or legal separation, it is presumed the consideration is the fair market value of the interest in the property conveyed. Thus, a couple who has a home in Chicago with a fair market value of \$1,000,000 could pay a combined transfer tax of up to \$10,500 to transfer it by quit-claim deed, depending on how title is held prior to the transfer. Imagine that same couple also owns a business and the building and underlying real property in Chicago is valued at \$10,000,000. They could owe up to another \$105,000 in transfer tax if title to the business real estate was transferred as part of the divorce, depending on the interest conveyed.

At a combined rate of \$5.25 for every \$500 of a property's sale price, Chicago has the highest real estate transfer tax in Illinois—and one of the highest in the country—generating hundreds of millions of dollars of revenue for the City and C.T.A. About a dozen states do not have a real estate transfer tax at all.

Of the \$5.25, \$3.75 is the “City portion” of the transfer tax paid by the buyer; \$1.50 is the “C.T.A. portion” paid by the seller. The supplemental \$1.50 tax took effect on April 1, 2008 as part of the C.T.A. bailout, and is one of the reasons that prompted the proposed change in the ordinance. Another cause came about in 2005, when the City began cracking down on enforcement of the transfer tax incident to divorce and declared that the transfer price was presumed to be the fair market value in transfers from one spouse to another.

Although transfers of property between spouses incident to a divorce are tax-free transactions under the Internal Revenue Code, this transfer tax has nothing to do with I.R.S. regulations, but is justified as a tax upon the “privilege” of transferring real estate located in Chicago. Should the proposed ordinance pass, homes transferred between divorcing or separating spouses would be exempted from this tax. If proponents have their way, previously paid taxes might also be refunded for couples who made transfers dating back to 2002. Commercial or business property transferred between spouses would not be exempt, and it remains to be seen whether second homes would qualify.

As of the date this article was written, the Finance Committee had not finally approved the proposed ordinance and was waiting for more information on exactly how much revenue the City and C.T.A. would lose. For now, if you or your client has not filed with the Department of Revenue a real property transfer declaration or a supplemental transfer declaration in connection

with the transfer of title to, or beneficial interest in, real property, a penalty equal to the amount of the applicable tax may be charged. This penalty is in addition to any tax and interest due, and any negligence or willfulness penalty provided by law. Additionally, if the tax imposed is not paid when due, the City shall have a lien against the related real property in an amount equal to the tax, together with all applicable interest and penalties.

You may access more information on the City Clerk of Chicago web site at www.chicityclerk.com or by looking at Chapter 3-33 of the Municipal Code of Chicago.