

Government of the District of Columbia
Office of the Chief Financial Officer
Office of Tax and Revenue



May 17, 2024

OTR TAX NOTICE 2024-02

**NOTICE REGARDING THE TAXATION OF
LEASEHOLD ASSIGNMENTS**

This notice will summarize the District of Columbia recordation and transfer tax treatment of an assignment of a lease. The District of Columbia Court of Appeals has ruled that the assignment of a lease is taxable in the same manner as a newly created lease. MEPT St. Matthews, LLC v. District of Columbia, 297 A.3d 1094, 1099-1100 (DC 2023). Moreover, the Court of Appeals has also ruled that a lease assignment may also transfer other real property interests, such as buildings or other leasehold improvements, and that such other interests are separately taxable from the lease assignment, even if the conveyance of all of these interests is accomplished by a single deed. Id. This notice is intended to provide guidance on the tax treatment of transactions involving lease assignments under the governing statutes and case law.

Taxation of Leases-In General

Both transfer and recordation taxes are imposed on the transfer of a lease or ground rent with a term of at least 30 years (including renewals). DC Official Code § 47-903(a), 42-1103(a)(1)(B). The taxes are imposed on each transfer of such a lease. Recordation of such leases is required by law within 30 days of execution. DC Official Code § 47-1431. In order to accurately capture the taxable value associated with a lease, District law looks to the rent due under the lease (which is the consideration for the lease), plus any other consideration paid besides the rent (which is called “additional consideration”).

The method for computation of the taxes on a lease transfer is prescribed by statute. If the average annual rent under the lease is ascertainable, the transfer and recordation taxes are imposed upon the average annual rent over the term of the lease, including renewals, capitalized at a rate of 10%, plus any additional consideration payable; provided that the amount to which the rate is applied shall not exceed the fair market value of the real property covered by the leasehold interest transferred. DC Official Code §§ 47-903(a)(2), 42-1103(a)(1)(B)(i). If the average annual rent is not ascertainable, then the taxes are based on the greater of (1) 105% of the of the minimum average annual rent ascertainable from the terms of the lease, capitalized at a rate of 10%, plus any additional consideration payable; or (2) 150% of the assessed value of the real property covered by the leasehold interest transferred. DC Official Code §§ 47-903(a)(3),

42-1103(a)(1)(B)(ii). If the consideration for the lease is zero or nominal, then the tax is applied to the fair market value of the real property covered by the lease. DC Official Code §§ 47-903(a)(1)(B), 42-1103(a)(1)(B)(iii).

For purposes of applying the tax computations using the capitalized average annual rent formulas, “additional consideration” includes any consideration paid or to be paid for the lease, whether in cash or other property, in any amount, other than the capitalized average annual rent. Such “additional consideration” is taken into account in full regardless of whether it is more or less than the amount of the capitalized average annual rent. For purposes of applying the 150% formula, the “real property covered by the interest transferred” is the real property that is being leased, such as land or buildings, and not a possessory interest in such real property.

Taxation of Lease Assignments

As noted above, a lease or ground rent with a term of at least 30 years (including extensions) is taxable when it is initially created as well as each time that it is subsequently assigned or transferred. Moreover, an extension of a lease where the term of the lease, as extended, is at least 30 years, is also taxable.

Where no other real property interests are transferred when a lease is assigned, the lease assignment is taxed on the capitalized average annual rent and additional consideration for the lease assignment as discussed above. If the taxes are based on 150% of the assessed value of the real property covered by the lease, only such assessed value is considered, and capitalized average annual rent or additional consideration are not counted in computing the tax.

Where other real property interests are conveyed in connection with the lease assignment, the deed of lease assignment is treated as conveying all such real property interests in addition to the leasehold. In such a case, a deed of lease assignment is taxable with respect to all of the interests conveyed. The Court of Appeals has ruled that a deed, including a lease assignment, can transfer more than one type of taxable interest in real property, and that, in such cases, each real property interest transferred is subject to tax in the manner provided by law for such interest. MEPT St. Matthews, LLC, 297 A.3d at 1099-1100 (stating that “[b]ased on the statutes, the transfer and recordation taxes must be applied to the individual interests contained within each deed”). Accordingly, each real property interest transferred is taxable, regardless of the way the transaction is structured, or the transfer is effected.

The transfer and recordation tax imposed on the assignment of the lease as well as the tax imposed on the conveyance of other real property interests are both reported on the tax return (Form FP7/C) filed with respect to the deed reflecting the lease assignment.

A separate deed of title from the assignor of the lease to the assignee purporting to convey interests in real property other than the lease, such as leasehold improvements, will not be accepted for record unless the assignor is the record owner of the real property interest being conveyed. As a result, generally only the deed of lease assignment will be accepted for record, and it will be treated as conveying all of the interests in real property transferred by the assignor of the lease to the assignee.

The tax on the transfer of real property interests other than the leasehold, such as buildings or leasehold improvements, is based on the consideration paid for such interests, or, if the consideration is zero or nominal, on the fair market value of such interests. D.C. Official Code §§ 47-903(a)(1), 47-904, 42-1103(a)(1)(A), 42-1104. The transfer of such real property interests is taxable even if the transfer occurs in connection with the assignment of a lease that is not taxable because it has a remaining term of less than 30 years.

Because rent generally constitutes the consideration for a lease, it will be presumed that any consideration (whether in cash or other property) paid or payable, other than the obligation to pay rent, is fully allocable to any real property interests transferred other than the assignment of the leasehold interest. The parties to the transfer shall have the obligation to establish that a lesser amount of such consideration is allocable to such other interests. Such other consideration paid or to be paid that is not allocable to such other interests shall be allocable to the lease assignment as “additional consideration.” Capitalized average annual rent is allocable only to the leasehold interest and not to other real property interests transferred.

While the parties may make an allocation of the consideration paid to each real property interest transferred in their agreements or contracts, the Recorder of Deeds is not bound by any such allocation of consideration. The Recorder may request appropriate substantiation of the allocation, including purchase and sale agreements, or accounting, income tax, regulatory and financial reporting records, to support any allocation made. Allocations which do not have a non-tax business purpose, including allocations made only for recordation and transfer tax purposes, will not be given effect.

Example

The following example illustrates the application of these principles:

Landlord and Tenant enter into a ground lease of land with a term (including renewals) of at least 30 years for a rent which is not nominal. The ground lease provides that Tenant shall own any building constructed on the leased land during the term of the lease. The ground lease is recorded and transfer and recordation tax are paid. Tenant constructs on the leased land a building that it owns pursuant to the terms of the ground lease. Subsequently, when the ground lease still has a remaining term (including renewals) of at least 30 years, tenant assigns and transfers its interests in the ground lease and the building to a third party for a lump sum that is not nominal. A document entitled “Assignment of Lease” is recorded to reflect the transfer.

The Assignment of Lease transfers both the assignor’s interest in the ground lease and its interest in the building it has constructed on the leased land, and each interest transferred is separately taxable. The leasehold interest assigned and transferred is taxed as provided above based on the capitalized average annual rent, if ascertainable, or, if not ascertainable, on the greater of 105% of the minimum ascertainable capitalized average annual rent or 150% of the assessed value of the land leased. The interest in the building transferred is taxable on the consideration paid for such building, which is presumed to be the lump sum paid, unless the parties can establish that a lesser amount is allocable to the building. Any portion of the lump sum paid that is not allocable

to the building will be treated as additional consideration for the assignment or transfer of the ground lease and taxed as such.

The transfer and recordation taxes imposed on the assignment of the lease as well as the conveyance of all other interests in real property are reported on the tax return (Form FP7/C) filed with respect to the document entitled "Assignment of Lease."

Please direct all questions or comments related to this Notice to the Office of the Recorder of Deeds, at 1101 4th Street, SW, 5th Floor, Washington, DC 20024, or call (202) 727-5734.