New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB-A-91 (8) R
Real Property
Transfer Gains Tax
August 6, 1991

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. M910517A

On May 17, 1991, a Petition for Advisory Opinion was received from 40 Schenck Owners, Inc., 40 Schenck Avenue, Great Neck, New York 11021.

The issues raised by Petitioner, 40 Schenck Owners, Inc., are whether for purposes of the Real Property Transfer Gains Tax (hereinafter the "gains tax"):

(1) Will the sales of unsold cooperative units by Petitioner be subject to gains tax.

(2) Will the Petitioner's original purchase price be $1,215,000.

On February 28, 1980 Arax Exerjian and Eldad Realty Corp. (hereinafter "First Mortgagee") made a loan to David Shichman ("Shichman") in the original principal amount of $499,420.50 as evidenced by a promissory note dated February 28, 1980 made by Shichman in favor of First Mortgagee in the principal amount of $499,420.50. The note was secured by a first mortgage dated February 28, 1980, made by Shichman to First Mortgagee in the principal amount of $499,420.50, which first mortgage encumbered the premises known as 40 Schenck Avenue, Great Neck, New York (the "Premises").

On May 12, 1987, the Bank of Great Neck ("Bank") made a loan to Shichman in the original principal amount of $500,000, as evidenced by a promissory note dated May 12, 1987 made by Shichman in favor of Bank in the principal amount of $500,000. The note was secured pursuant to a security agreement dated May 12, 1987 made by Shichman, Michael A. Shichman, Karen M. Shichman, and Janet Shichman doing, business as 40 Schenck Realty Company (collectively, "Assignor") to Bank, by the pledge of a first security in and collateral assignment of a $1,000,000 note dated March 25, 1987 made by the Petitioner to assignor and secured by a second mortgage dated March 25, 1987 made by Petitioner to assignor in the original principal amount of $1,000,000. The second mortgage also encumbered the premises.

On April 3, 1990 Shichman, Assignor, 40 Schenck Realty Co. and Bank entered into a modification and extension agreement (the "Extension Agreement") which provided for, inter alia, the extension of the $500,000 loan and the pledge to Bank, as further and additional collateral security, of certain unsold shares (the "Shares") in Petitioner, allocated to the cooperative units of the premises and the proprietary leases appurtenant thereto (the "Leases").

The $499,420.50 loan was in default, and as a result First Mortgagee filed a lis pendens against the premises and commenced a foreclosure action.

Moreover, since the $500,000 Loan was in default, Bank notified the various parties that it intended to sell at a public auction sale pursuant to the Uniform Commercial Code, the second mortgage, the shares and the leases.

The Supreme Court of the State of New York, County of Nassau, issued a temporary restraining order, dated June 5, 1990, which temporarily enjoined Bank from proceeding with its auction of the second mortgage, the shares and the leases.

During discussions between the parties, Bank and the Petitioner agreed to bring about a settlement to encompass all of the open issues, including but not limited to, the $499,420.50 loan, the first mortgage, the $499,420.50 foreclosure action, the $500,000 loan, the second mortgage, the shares and leases, the priority of Petitioner's lien for unpaid maintenance and Bank's action.

On December 14, 1990, Bank loaned to Petitioner, the total sum of $1,215,000.00. Said loan was made pursuant to the settlement agreement between Bank, Petitioner, and the First Mortgagee.

The closing followed a successful bid of $675,000.00 made by Bank at an auction sale. At the sale the bank purchased all the shares of Petitioner owned by 40 Schenck Realty Co. and the $1,000,000.00 second mortgage made by Petitioner to 40 Schenck Realty Co. all of which were pledged to Bank as security for a $500,000.00 loan made by Bank to Shichman upon which there were numerous defaults.

Once Bank owned the first mortgage in the face amount of $499,420.50, the second mortgage in the face amount of $1,000,000.00 and all the shares of stock allocated to the 8 vacant and 22 occupied apartments owned by 40 Schenck Realty Co., as unsold shares, Bank conveyed the same to Petitioner for the sum of $1,215,000.00, simultaneously lending that amount to Petitioner. As collateral for, said loan, Petitioner made and/or pledged the following:

1. A first mortgage to Bank in the sum of $1,215,000.00 as evidenced by a First Mortgage Consolidation and Security Agreement.

2. All the unsold shares in Petitioner allocated to the cooperative units at the premises known as 40 Schenck Avenue, Great Neck, New York, together with the proprietary leases appurtenant thereto.

In effect, Bank first took by assignment and then consolidated, extended and reduced notes and mortgages totalling the original principal amount of $1,499,420.50 to new debt of $1,215,000.00.

The restructured mortgage debt provided for payment as follows:

1. Interest only monthly at the rate of 12% on the first $540,000.00 of indebtedness, until December 13, 1994 when the principal balance becomes due;

2. A payment on December 13, 1992 of all accrued interest over the first $540,000.00 to date together with a principal payment of $675,000.00;

3. Payment in full of all remaining principal and continuing accrued interest on December 13, 1994.

4. The mortgage and pledge agreement contained a release clause. All payments made pursuant to this clause are applied to and reduce the $675,000.00 principal payment due on December 13, 1992 after all unpaid accrued interest is paid.

Pursuant to Sections 1441 and 1443.1 of the Tax Law and Section 590.1 of the Gains Tax Regulations a ten percent tax is imposed on the gain derived from the transfer of real property where the property is located in New York State and where the consideration for the transfer is $1,000,000 or more.

Section 590.35 of the Gains Tax Regulations provides, in part, as follows:

590.35 Transfers of shares which require payment of tax.

Question: Which transfers of cooperative shares by the person who transfers an interest in real property to the cooperative housing corporation (the realty transferor), or by the owners of the realty transferor, or by the cooperative corporation itself, require payment of tax?

(a) Transfers to tenant stockholders?

Answer: Yes, gains tax must be paid when the shares are transferred to persons who buy shares and are granted proprietary leases with respect to units.

Moreover, Section 590.40 of the Gains Tax Regulations provides, in part, as follows:

590.40 Million-dollar exemption.

Question: In the case of transfers pursuant to a cooperative plan, how does the aggregation clause of section 1440(7) of the Tax Law, and accordingly, the $1 million exemption apply to the following transfers?

(a) The transfer of shares by the realty transferor and the owners of the realty transferor?

Answer: All transfers by the realty transferor are aggregated with all the transfers by any transferor who received his shares in a transaction that did not require payment of tax, as described in section 590.35 of this Part, because the transferee was an owner of the realty

transferor. This total aggregation will determine the application of the $1 million exemption to all transfers by the realty transferor and to all such owners.

Section 1440.5(a) of the Tax Law provides that:

> "Original purchase price" means the consideration paid or required to be paid by the transferor; (i) to acquire the interest in real property, and (ii) for any capital improvements made or required to be made to such real property, including solely those costs which are customary, reasonable, and necessary, as determined under rules and regulations prescribed by the tax commission, incurred for the construction of such improvements. Original purchase price shall also include the amounts paid by the transferor for any customary, reasonable and necessary legal, engineering and architectural fees incurred to sell the property and those customary, reasonable and necessary expenses incurred to create ownership interests in property in cooperative or condominium form, as such fees and expenses are determined under the rules and regulations prescribed by the tax commission.

Accordingly, pursuant to Sections 1441 and 1441.3 of the Tax Law and Sections 590.1, 590.35 and 590.40 of the Gains Tax Regulations the transfer of unsold cooperative units by Petitioner will be subject to gains tax if the aggregate consideration received for such transfers is $1,000,000 or more. Pursuant to Section 1440.5(a) of the Tax Law the original purchase price to be used by Petitioner in determining its gain is the price it paid for the cooperative shares which was $1,215,000.

It is noted that this opinion does not address the gains tax consequences of the transfer of cooperative shares by 40 Schenck Realty Co. and the Bank of Great Neck for which a gains tax filing may be required.

DATED: August 6, 1991

s/PAUL B. COBURN
Deputy Director
Taxpayer Services Division

NOTE: The opinions expressed in Advisory Opinions are limited to the facts set forth therein.