NEW YORK CITY REAL PROPERTY TRANSFER TAX: CONTINUING LIEN EXCLUSION

BY: Thomas D. Kearns and
Kelly A. Molloy*

An unfamiliar and little understood change in New York City Real Property Transfer Tax ("RPT") which has been in effect since August 1997 assists sellers of homes, cooperatives and condominiums to substantially reduce their transfer taxes and, if done correctly, also helps purchasers reduce their mortgage recording taxes. The complexity of rules (and increased legal fees) generally limit these tax savings to sales of high-end residences where sellers and purchasers can realize a significant benefit.

The RPT now allows for a deduction from consideration whereby the amount of a pre-existing lien which continues after the closing may be excluded from taxable consideration. That is, if the seller has an existing mortgage on the property and the mortgage is assigned to the purchaser's lender, the seller may deduct the amount of the mortgage from the taxable consideration. Since the mortgage recording tax need not be paid again, the purchaser saves the mortgage recording tax on the assigned mortgage. This exclusion is only permitted on transfers of one-to-three family homes, individual residential cooperatives, individual residential condominiums or an economic interest in such properties and only if the transaction complies with several requirements.

The Department of Finance Regulations provide some general rules of thumb:

1. A mortgage that is discharged or reduced in principal amount within three months after the date of transfer or delivery of the deed is presumed to be in connection with the transfer and is excluded from consideration.

2. If the terms of a mortgage are materially altered in connection with or in anticipation of the transfer, the mortgage may *not* be excluded from taxable consideration. The terms will be considered materially altered if (i) the mortgagee is different (which will be typical) and (ii) there is a change of 10% or more in either the interest rate or repayment term remaining as of the date of the modification.

Example 1: Seller owns a condominium subject to a mortgage held by Lender X. The mortgage has a remaining principal balance of $2,500,000, bears interest at 7% and has a remaining repayment term of twenty years. Seller sells the condominium to Purchaser for $5,000,000. Purchaser obtains a mortgage loan from Lender Y for $4,000,000 and uses $1,000,000 of his own cash to fund his purchase. At closing, Lender X assigns the existing mortgage to Lender Y for $2,5000,000. Purchaser's mortgage loan from Lender Y (in the amount of $4,000,000) must have an interest rate of between 6.3% and 7.7% and must have a term between 18 and 22 years

* Mr. Kearns is a partner and Ms. Molloy is an associate of Olshan Grundman Frome Rosenzweig & Wolosky LLP. Nina Krauthamer, a tax partner of the Firm, assisted in this article's preparation.

for the assigned $2,500,000 mortgage to be considered an excludible lien. Transfer tax and recording tax will apply to the additional $1,500,000 loaned by Lender Y.

Terms that survive closing must be incorporated to prevent a purchaser from refinancing or satisfying the assigned mortgage within three months after the transfer thereby making the transaction non-excludable and resulting in seller paying the increased transfer tax as well as any interest and penalties that may be assessed. One method a seller can use to encourage compliance is by highlighting the purchaser's mortgage recording tax savings.

The potential mortgage recording tax and RPT savings can be substantial when the continuing lien exclusion is utilized. The difficulty arises in structuring the transaction in accordance with the legal requirements. However, as illustrated above, it can be financially prudent for both parties to obtain counsel familiar with these rules to assist them in structuring their deal to comply with the guidelines governing the continuing lien deduction. Any provisions requiring a purchaser to comply should be expressly set forth in the contract of sale.