

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

TSB-A-93 (11) R
Real Property
Transfer Gains Tax
June 23, 1993

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. M930122B

On January 22, 1993, a Petition for Advisory Opinion was received from Andrew Feiner, Esq. and William Korman, CPA, c/o Zellermyer, Gratch & Jacobs, P. C., 950 Third Avenue, New York, New York 10022.

The issues raised by Petitioners, Andrew Feiner, Esq. and William Korman, CPA, are:

1. Assuming the transaction occurred prior to April 15, 1993, what will be the consideration for the transfer of real property in lieu of foreclosure from a partnership to a bank for purposes of the Real Property Transfer Gains Tax (hereinafter the "gains tax").
2. Whether the result in issue "1" would be different if the real property is transferred to the bank pursuant to a formal foreclosure proceeding.
3. Whether the result in issue "1" would be different if the bank loan to the partnership was a recourse loan.

A partnership owns a leasehold interest in a commercial site and a fee interest in another. Both the leasehold and the fee interest are situated in New York State. The leasehold and fee interest have a combined appraised fair market value of \$10,000,000. The partnership's only other asset is a cash bank account in the amount of \$50,000.

Several years ago, the bank loaned \$30,000,000 to the partnership on a nonrecourse basis, secured by a mortgage on the leasehold and fee interests. Nearly two years ago, as part of a workout, the bank received a further security interest in the cash account (by way of a lock-box security interest in the rent derived from the real property). In addition, A, B and C, the partners of the partnership, personally guaranteed the interest and a portion of the principal of the debt to the bank.

In exchange for cancellation of the \$30,000,000 bank debt and a release of the partners' guaranty, the bank and the partnership agreed to transfer all of the partnership's property (the real property and the bank account) to the bank in lieu of foreclosure. The agreement between the bank and the partnership does not make any allocation of consideration between the real property and the cash account.

Section 1440.1 of the Tax Law provides, in pertinent part, as follows:

Sec. 1440. Definitions.-- In this article:

1. (a) "Consideration" means the price paid or required to be paid for real property or any interest therein, less any customary brokerage fees related to the transfer if paid by the transferor, including payment for an option or contract to purchase or use real property. Consideration includes any price paid or required to be paid, whether expressed in a deed and whether paid or required to be paid by money, property, or any other thing of value and including the amount of any mortgage, purchase money mortgage, lien or other encumbrance, whether the underlying indebtedness is assumed or taken subject to. Consideration includes the cancellation or discharge of an indebtedness or obligation.

* * *

(c) In the case of a transfer which includes other assets which are in addition to real property or an interest therein and for which there is no reasonable apportionment of the consideration for such real property or interest, consideration means that portion of the total consideration which represents the fair market value of such real property or interest (emphasis added)

Section 1445 of the Tax Law provides, in part, that "[a] person claiming to have erroneously paid the tax imposed by this article may file an application for refund within two years from either the date of transfer or the date of payment, whichever is later."

Section 590.59 of the Gains Tax Regulations provides, in pertinent part, as follows:

* * *

(d) Question: When property is acquired in a mortgage foreclosure, how is the original purchase price calculated for a subsequent transfer?

Answer: When the transferor purchased real property at a foreclosure sale and later sells the property, the original purchase price is the price he paid for the property (the bid price). In the event the mortgagee is the successful bidder in an action to foreclose a mortgage, his original purchase price will be the higher of the price paid (the bid price) or the amount of judgement in foreclosure as established by the referee to be due the mortgagee. Such amount would generally include the amount of mortgage debt, the expenses of the sale and the cost of the action.

In any event, the successful bidder's original purchase price would be increased by any other liens that the property was taken subject to, or the bidder became liable for, along with any capital improvements the bidder made and any allowable selling costs incurred to sell the property. (emphasis added)

With respect to issue "1", pursuant to Section 1440.1(a) of the Tax Law where real property was transferred in lieu of foreclosure prior to April 15, 1993, the consideration for such transfer was the amount of indebtedness or obligation cancelled or discharged as a result of the transfer. Moreover, pursuant to Section 1440.1(c) of the Tax Law in the case of a transfer which included other assets which were in addition to real property or interest therein, the consideration must be apportioned between the real property and the other assets. Accordingly, in the instant case where the partnership transferred its real property interest and lock-box security interest to the bank in exchange for cancellation and discharge of its indebtedness, the consideration for the transfer of the real property was the total consideration for the transfer (\$30,000,000) multiplied by a fraction, the numerator of which was the fair market value of the real property interest being transferred, (\$10,000,000) and the denominator was the fair market value of the real property plus the value of the other assets, (\$10,050,000).

Concerning issue "2", pursuant to Section 590.Sg(d) of the Gains Tax Regulations the consideration for the transfer of real property in a foreclosure sale prior to April 15, 1993 was the higher of the price paid by the transferee (the bid price) or the amount of the judgement in foreclosure as established by the referee to be due the mortgagee. Pursuant to Section 1440.1(c) of the Tax Law, in the case of a transfer which included other assets which were in addition to real property or an interest therein the consideration must be apportioned between the real property and the other assets. Therefore, in the instant case in the event of a mortgage foreclosure the result reached in issue "1" would apply (assuming the judgement in foreclosure was \$30,000,000 and the bid price did not exceed such amount).

As for issue "3", the result reached in issue "1", for purposes of calculating the tax due as of the date of transfer, would not be different. However, if recovery of any deficiency due the mortgagee was realized against the guarantors of the partnership's debt or the partnership itself the taxpayer would be entitled to apply for a refund within the time prescribed by Section 1445 of the Tax Law.

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It is noted that for periods commencing on or after April 15, 1993 a different result would be reached as a result of the amendment of Section 1440.1 of the Tax Law which added a new paragraph "d". Paragraph "d" established a new method of determining the amount of consideration in the case of a mortgage foreclosure or a transfer in lieu of foreclosure. (See TSB-M-93(1)-R).

DATED: June 23, 1993

/s/
PAUL B. COBURN
Deputy Director
Taxpayer Services Division

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