

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

TSB-A-93 (3)R
Real Property
Transfer Gains Tax
January 19, 1993

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. M921207C

On December 7, 1992, a Petition for Advisory Opinion was received from Prudential Insurance Company of America, 10 Rockefeller Plaza, New York, New York 10020.

The issue raised by Petitioner, Prudential Insurance Company of America, is whether for purposes of Section 1440.1 of the Tax Law, unpaid principal and interest on a second mortgage which is either released, cancelled, discharged or annulled will be included in the consideration received by a limited partnership with respect to the conveyance of property to Petitioner pursuant to the terms of the reorganization plan.

Petitioner loaned \$90,000,000 (the "Loan") to a New York limited partnership (the "Partnership"). The Loan is secured by a first mortgage on a commercial building located in New York City (the "Property"). The Property is also currently encumbered with a second mortgage (the "Second Mortgage") which secures a loan made to the Partnership by an Illinois general partnership ("Second Mortgagee"). The Second Mortgagee and Petitioner are not affiliated. However, the Second Mortgagee is an affiliate of the general partner of the Partnership.

The Partnership defaulted on the Loan and Petitioner initiated a foreclosure proceeding. Thereafter, the Partnership filed a petition in the United States Bankruptcy Court for the Southern District of New York (the "Bankruptcy Court"). The bankruptcy filing stayed the foreclosure.

The Partnership has proposed a reorganization plan under Chapter 11 of the United States Bankruptcy Code (the "Plan"). Under the terms of the Plan, the Property will be transferred to Petitioner free and clear of all liens and encumbrances in satisfaction of the Loan. The Plan also provides that immediately prior to the conveyance of the Property to Petitioner the Second Mortgage will be discharged in full with no consideration being paid to the Second Mortgagee. The Second Mortgage will be discharged pursuant to the Plan and the action of the Bankruptcy Court in confirming the Plan.

Specifically, the Plan provides that the Second Mortgage will not be paid under the terms of the Plan and that such mortgage, as well as other secured claims to related parties, will be "cancelled, released, discharged and annulled." The Plan requires the Second Mortgagee to execute documents dated as of the confirmation date of the Plan in recordable form to evidence the "release, cancellation, discharge or annulment" of the Second Mortgage. After the conveyance of the Property to Petitioner, the Second Mortgagee will have no interest whatsoever in the Property, nor will the Second Mortgagee have recourse against the Partnership with respect to the discharge of the Second Mortgage.

Section 1440.1 of the Tax Law provides 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 of obligation.

(b) In the case of (i) the granting of an option with use and occupancy of real property or (ii) the creation of a leasehold or sublease that is a transfer of real property, as defined in subdivision seven of this section, consideration shall also include the value of the rental and other payments attributable to the use and occupancy of the real property or interest therein and the value of any option to purchase or renew included in such transfer.

(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. In the case of a transfer of a controlling interest in an entity with an interest in real property to the controlling interest for the purpose of ascertaining the consideration for the transfer of such controlling interest. (emphasis added) Section 590.65 of the Gains Tax Regulations provides as follows:

590.65 Bankruptcy. [Tax Law, §1440(1), (7)]

Question: Is a transfer pursuant to a plan under the liquidation or reorganization provisions of the Bankruptcy Code taxable?

Answer: Yes. Section 1440(7) of the Tax Law defines transfer of real property to include a transfer of any interest in real property, including a conveyance upon liquidation or by a receiver. Therefore, such a conveyance is subject to the gains tax.

The U.S. Bankruptcy Court held that the debtor is not exempt from liability for the gains tax under section 1146(c) of the Federal Bankruptcy Code, In re Jacoby Bender, Inc., 40 BR 10, 15 (Bkrcty. 1984).

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Consideration is defined to include the cancellation or discharge of an indebtedness or obligation. Therefore, the consideration for a transfer or real property pursuant to a liquidation or reorganization plan is the amount paid by a purchaser of the real property pursuant to such a plan plus the amount of liens the property was taken subject to (if any) or, in the case of a transfer to a creditor mortgagee, the amount of indebtedness extinguished.

A trustee in bankruptcy may file returns on behalf of a bankrupt transferor, and should withhold the tax due under the gains tax until the tax is paid.

In John S. Pereira, Adv Op Comm T & F, May 23, 1991, TSB-A-91(4)R the Commissioner held that in situations where the transferee is not the sole mortgagee and additional mortgages do not survive the transfer, the consideration for the transfer in bankruptcy would be the portion of the indebtedness the transferee/mortgagee extinguished or the bid price, whichever was higher.

Accordingly, pursuant to Section 1440.1 of the Tax Law, Section 590.65 of the Gains Tax Regulations and John S. Pereira, supra, since in the instant case the second mortgage will be discharged by the Second Mortgagee prior to the transfer of the Property to Petitioner and Second Mortgagee will have no interest in the Property being transferred to Petitioner, the consideration received by the Partnership for the transfer of the Property to Petitioner will be the portion of the indebtedness extinguished by Petitioner pursuant to the terms of the reorganization plan.

DATED: January 19, 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.