

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

TSB-M-95 (1)R
Mortgage Recording Taxes
August 9, 1995

Counsel Opinion - August 4, 1995

This Opinion of Counsel, dated August 4, 1995, was issued to address the issue of whether negative pledge agreements constitute mortgages within the context of Article 11 of the Tax Law.

STEVEN U. TEITELBAUM, Counsel. -- The Division of Taxation has received numerous inquiries as to whether negative pledge agreements constitute mortgages within the context of Article 11 of the Tax Law.

In general, a negative pledge agreement is an agreement, covenant or promise made by a borrower of funds to a lender of funds that the borrower will not sell, transfer, convey or otherwise encumber real property. The agreement may cover all of the borrower's property or may cover only specifically identified property. Representatives of the real estate and commercial lending industries have indicated that lenders frequently include negative pledge agreements in standard commercial loan documents. These documents, we are advised, are typically not recorded, although they may be recorded in certain circumstances.

Article 11 of the Tax Law imposes, and authorizes certain localities to impose, mortgage recording taxes (hereinafter referred to collectively as the "mortgage recording tax"). Section 250(2) of Article 11 defines "mortgage" for purposes of the tax as including "every mortgage or deed of trust which imposes a lien on or affects the title to real property, notwithstanding that such property may form a part of the security for the debt or debts secured thereby". Section 641.6(b) (9) of the Regulations of the Department of Taxation and Finance (20 NYCRR 641.6[b] [9]) includes, as an example of an instrument which is a mortgage if given as security for a debt or the performance of an obligation, "an agreement not to transfer, sell, convey or otherwise encumber real property, otherwise known as a negative pledge agreement."

To constitute a mortgage for purposes of the mortgage recording tax, a negative pledge agreement must either impose a lien on real property or affect title to real property. Whether an instrument is a mortgage under Article 11 depends, in large measure, upon the intention of the parties, as "may be gathered from the oral testimony, the circumstances attending the transaction, the conduct of the parties, as well as from the face of the written contract" (Matter of Atlantic Cement Co. v Murphy, 30 AD2d 456, 458 [3d Dept., 1968], *affd* 28 NY2d 502 [1971]). A negative pledge agreement by itself does not impose a lien on real property. "The creation of a lien is an affirmative act, and the intention to do such an act cannot be implied from an express negative" (Knott v Shepherdstown Mfg. Co., 5 S.E. 266 [West Virginia, 1888], quoted in Osborne, Law of Mortgages, §44 [1971]).

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A negative pledge agreement generally does not affect title to real property. A violation of a negative pledge agreement, in general, gives rise to a breach of contract action. The lender may be empowered by the default to call for the acceleration or immediate repayment of the entire debt. Where there is no adequate remedy at law, a lender may enjoin the violation of the agreement (see, Kelly v Central Hanover Bank & Trust Co., 11 F. Supp. 497 [S.D.N.Y., 1935]). In an appropriate case, a third party might be enjoined from performing an act which induces or continues a party's breach of a negative covenant (Harry Rogers Theatrical Enterprises v Comstock, 225 App Div 34, 36 [1st Dept., 1928]). Thus, a prospective purchaser with notice could be enjoined from taking title to property which is the subject of a negative pledge agreement.

The intent to affect title to property may be gleaned from the instrument itself and through the parties' actions (Matter of Atlantic Cement Co. v Murphy, *supra*). Among the factors to be examined is whether the agreement describes particular real property and contains other indicia of such an intent. The deciding factor indicating an intent to affect title to real property in the case of a negative pledge agreement, however, is the actual recording of the instrument. The recording of the negative pledge agreement puts the public on notice of the lender's interest in the real property. By invoking the protections of the Recording Act, the parties will be demonstrating clearly an intent to affect conveyances to third parties.

Accordingly, it is my opinion that negative pledge agreements constitute mortgages for purposes of the mortgage recording tax only where the agreement is recorded. I will recommend the adoption of amendments to the regulations to clarify the application of section 641.6(b) (9).

/s/ Steven U. Teitelbaum
Counsel