**REPORT #791**

## TAX SECTION

# New York State Bar Association

Report on Proposed Amendments to the
New York State Real Estate Transfer Tax Regulations
and the New York State Real Property Transfer
Gains Tax Regulations

April 29, 1994

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April 29, 1994

The Honorable James W. Wetzler
Commissioner of Taxation and Finance
Building 9, W. A. Harriman Campus
Albany, New York 12227-1215

Re: Proposed Amendments to State Real Property Transfer Tax and Gains Tax Regulations

Dear Commissioner Wetzler:

Enclosed is a report by the New York State Bar Association Tax Section on the proposed amendments to the New York State real estate transfer tax regulations and the New York State gains tax regulations.

The report commends the Department of Taxation and Finance for its continued efforts to alleviate the hardships caused by these taxes on transfers involving troubled real estate. The regulations reflect a welcome commitment by the Department to interpreting the gains tax statute in a manner that imposes the tax only on true economic gain. The Department is to be commended for its comprehensive efforts to update the regulations and provide needed guidance.

The report goes on to make a number of comments on the proposed regulations. Among the comments are those relating to the fair market value limitation on the calculation of consideration for transfer tax purposes in conveyances involving recourse debt. In addition, the report makes a number of suggestions regarding the determination of original purchase price and consideration under the gains tax regulations.

The comments made by the report are largely of a technical nature. Overall, the report concurs with the substantive provisions of the proposed regulations.

We hope these comments are useful. Please feel free to call me if you have any questions or if we can be of further help.

Very truly yours,

Michael L. Schler
Chair, Tax Section

cc: William F. Collins, Esq.

Tax Report # 791

New York State Bar Association Tax Section

# Report on Proposed Amendments to the New York State Real Estate Transfer Tax Regulations and the New York State Real Property Transfer Gains Tax Regulations

April 29, 1994

New York State Bar Association Tax Section

# Report on Proposed Amendments to the New York State Real Estate Transfer Tax Regulations and the New York State Real Property Transfer Gains Tax Regulations

## I. INTRODUCTION

This report (the "Report")[1] comments on proposed amendments (the "Amendments") to the New York State real estate transfer tax[2] regulations (the "Transfer Tax Regulations") and the New York State real property transfer gains tax[3] regulations (the "Gains Tax Regulations"). The Amendments were proposed by the New York State Department of Taxation and Finance (the "Department") on February 7, 1994. The Department is to be commended for its continued efforts to alleviate the hardships caused by the imposition of State transfer tax and Gains tax on transfers involving interests in troubled real estate. We applaud the Department's efforts to modify existing policy, by regulation,

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[1] The principal author of this Report was Joanne M. Wilson, with substantial assistance and commentary from Carolyn Joy Lee, David E. Kahen and Richard L. O'Toole. Helpful comments were received from Michael L. Schler and Linda Z. Swartz. In addition, a report prepared by an ad hoc committee comprised of members of the New York State Bar Association Tax Section and the Association of the Bar of the City of New York Committee on State and Local Taxation, dated September 25, 1991, entitled "Application of the New York State 10% Tax on Gains Derived from Certain Real Property Transfers to Transfers Involving Interests in Troubled Real Estate," was extremely helpful in preparing this Report.

[2] Tax Law Article 31, §§1400 through 1421 (herein, the "State transfer tax").

[3] Tax Law Article 31-B, §§1440 through 1449-c (herein, the "Gains tax").

to provide State transfer tax relief (in the form of a fair market value limit on certain consideration components) for conveyances involving recourse indebtedness. We also appreciate the equitable result the Department has achieved in its determination of a transferee creditor's original purchase price" for Gains tax purposes. That determination seeks to align a creditor's original purchase price with its actual out-of-pocket costs incurred in connection with the real estate.

All these efforts reflect a welcome commitment to modifying and interpreting the Gains tax statute in a manner that imposes the tax only on true economic gain. Finally, we commend the Department for its comprehensive efforts in updating the regulations to reflect recent legislative amendments and providing interpretive guidance.

## II. BACKGROUND

### A. State Transfer Tax

The following is a summary of applicable State transfer tax provisions addressed by the Amendments to the Transfer Tax Regulations.

The State transfer tax is imposed on certain conveyances of real property located within New York State at a rate of .4% of consideration.[4]

[4] Tax Law §1402.

Conveyances pursuant to devise, bequest or inheritance are excluded from the definition of “conveyance” for State transfer tax purposes.[5]

The State transfer tax applies to conveyances pursuant to, or in lieu of, a mortgage foreclosure, as well as conveyances resulting from or in lieu of the enforcement of liens or security interests on (or in) shares of stock in a cooperative housing corporation and associated proprietary leases, or on or in ownership interests in other entities with an interest in real property.[6] Currently, the rules for determining the calculation of consideration on such conveyances generally are derived from the definition of “consideration” contained in Tax Law Section 1401(d) and specific rules governing the calculation of consideration on conveyances involving troubled real estate contained on Forms TP-584 and TP-584.1 and the associated instructions.

At present, the statutory and regulatory determinations of consideration for State transfer tax purposes on a conveyance pursuant to, or in lieu of, a mortgage foreclosure or upon a conveyance of shares of stock in a cooperative housing corporation (and associated proprietary leases) or interests in other entities resulting from the enforcement (or in lieu of enforcement) of a security interest do not distinguish between conveyances involving recourse and nonrecourse indebtedness.[7] As indicated in the Department's Memorandum on the Substance of the Proposed Rule (the “Memorandum”),

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[5] Tax Law §1401(e).

[6] Tax Law §1401(e).

[7] Tax Law §1401(d); Transfer Tax Regulations §§575.1(d), 575.11(a)(2), 575.11(a)(3).

the Amendments are intended to modify existing policy relating to the State transfer tax calculation of consideration applicable to conveyances involving recourse indebtedness.

State transfer tax returns on Form TP-584 generally must be filed, and the tax reflected thereon must be paid, no later than the 15th day after the date of the conveyance; however, prior to this filing and payment date, a recording officer is not permitted to record a conveyance instrument unless the State transfer tax return has been filed and the tax reflected thereon has been paid.[8] A State transfer tax return is not required to be filed in the case of a conveyance of an easement or a license to a public utility where the consideration is $2.00 or less and is clearly stated in the instrument of conveyance.[9]

B. Gains Tax

The following is a summary of applicable Gains tax provisions addressed by the Amendments to the Gains Tax Regulations.

The Gains tax applies to certain transfers of real property within New York State and imposes a 10% levy on gain derived from these transfers.[10] "Gain" is defined as the "difference between the consideration for the transfer of real property and the original purchase price of such property . . . ."[11] The calculation of taxable gain thus requires a determination of the "consideration" received by the transferor,

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[8] Tax Law §§1409(a); 1410(a).

[9] Tax Law §1409(a).

[10] Tax Law §§1441, 1443.

[11] Tax Law §1440(3).

and a determination of the transferor's original purchase price (or “OPP”) for the transferred property.

> The definition of a taxable “transfer” includes a: sale, exchange, assignment, surrender, mortgage foreclosure, transfer in lieu of foreclosure, option, trust indenture, taking by eminent domain, conveyance upon liquidation or by a receiver, or transfer or acquisition of a controlling interest in any entity with an interest in real property.[12]

The Gains tax clearly applies both to foreclosures and to transfers in lieu of foreclosure, and applies to transfers of direct interests in real property[13] and to transfers[14] or acquisitions of controlling (50% or more) interests in entities that own real property.[15] In the case of a transfer pursuant to a mortgage foreclosure action, the defaulting mortgagor is to furnish a statement of tentative assessment to the referee prior to the sale; if the defaulting mortgagor fails to provide the statement, the referee is required to compute gain using zero for the original purchase price, and to pay the tax to the extent proceeds remain after payment to lienholders qualifying for payment under Sections 1354(1) through (3) of the Real Property Actions and Proceedings Law.[16] The transferee is not subject to any personal liability for taxes determined to be due from the defaulting mortgagor, and the transferee is not forbidden from transferring consideration to the referee.[17]

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[12] Tax Law §1440(7).

[13] Tax Law §§1440(4), 1440(6).

[14] Effective July 1, 1989, the definition of the term “transfer of real property” was expanded to include not only the acquisition of a controlling interest in an entity with an interest in real property, but also the transfer of a controlling interest in such an entity. Tax Law §1440(7).

[15] Tax Law §1440(2).

[16] Gains Tax Regulation §590.59(A).

[17] Tax Law § 1447 (3)(b)(1); Gains Tax Regulations §§590.59(B), 590.59(C).

In the case of a mortgage foreclosure conveyance, consideration is generally the higher of the bid price or the foreclosure judgment plus continuing liens and, in the case of a deed in lieu of foreclosure conveyance, consideration is generally the amount of outstanding indebtedness discharged plus continuing liens; however, effective April 15, 1993, transfers to a mortgagee or lienor or its agent or nominee pursuant to a mortgage foreclosure action or by deed in lieu of foreclosure are subject to a special rule that limits consideration to the fair market value of the real property.[18] The same consideration "cap" is also applicable to transfers resulting from the enforcement of a security interest in cooperative housing corporation stock and associated proprietary leases.[19] The Amendments address collateral questions presented by the 1993 legislation, including (1) the treatment of such conveyances effectuated through a bankruptcy proceeding, (2) the determination of the original purchase price of the mortgagee or lienor upon the transfer, and (3) the availability of the consideration cap provisions in the context of a conveyance to a wholly-owned or partially-owned affiliate of the creditor.

The original purchase price of real property generally is the consideration paid or required to be paid to acquire the real property, plus the consideration paid or required to be paid for the construction of any capital improvements made or required to be made to the property, determination of the original purchase price of the mortgagee or lienor upon the transfer, and (3) the availability of the consideration cap provisions in the context of a conveyance to a wholly-owned or partially-owned

[18] Tax Law §§1440(1)(d)(i), 1440(1)(d)(ii).

[19] Tax Law § 1440(1)(d)(iii).

affiliate of the creditor. The original purchase price of real property generally is the consideration paid or required to be paid to acquire the real property, plus the consideration paid or required to be paid for the construction of any capital improvements made or required to be made to the property, plus certain fees incurred to sell the property.[20] Certain specific acquisition costs are allowable in determining original purchase price. Prior to the April 15, 1993 changes to the Gains tax provisions, costs that the Department did not allow as part of original purchase price included construction-period interest paid on a loan where the proceeds of the loan were used to acquire the real property or interest therein or paid on a note or bond secured by a purchase money mortgage, and tax abatement fees. Also, prior to these statutory changes, the Department maintained that payment of the special additional mortgage recording tax was not includible in original purchase price. Chapter 57 of the Laws of 1993, effective April 15, 1993, expanded and clarified the definition of original purchase price to specifically include customary advertising and marketing costs incurred to sell the real property, mortgage recording taxes, including the special additional mortgage recording tax paid by the transferor in connection with the acquisition of real property, the conversion of real property to cooperative form or the construction of a capital improvement, customary costs, fees and expenses incurred by a transferor to acquire a Real Property Tax Law Section 421-a real estate tax exemption (subject to an amortization requirement over the term of the benefit), and interest costs incurred on a loan during a construction period where the proceeds of the loan were used by the transferor to acquire the real property.[21]

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[20] Tax Law §1440(5)(a).

[21] Tax Law §1440(5)(a).

Upon a transfer or acquisition of a controlling interest in an entity that owns an interest in real property, the transferor's original purchase price generally is the original purchase price of the real property as held by the entity, apportioned to the interest in the entity that the transferor is transferring.[22] In the case of a transfer or acquisition of a controlling interest where the mere change exemption is not applied, the original purchase price of the real property as held by the entity may be stepped-up to reflect the consideration recognized on the transfer or acquisition of the controlling interest.[23] A step-up in original purchase price is not permitted if less than a controlling interest is acquired. A transferor's original purchase price when any percentage interest in an entity is resold generally is the apportioned amount of the entity's original purchase price, determined without regard to a step-up in original purchase price due to a transfer or an acquisition of a controlling interest; however, if the transferor's acquisition of the interest in the entity resulted in the acquisition or transfer of a controlling interest, the transferor's original purchase price is the apportioned amount of the fair market value of the real property at the time such interest was acquired, if higher.[24]

Chapter 61 of the Laws of 1989 amended the Gains tax installment payment rules to require that, in addition to the other prerequisites for electing to pay any Gains tax liability in installments, the Gains tax liability must exceed $10,000 in

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[22] Gains Tax Regulation §590.49(A).

[23] Gains Tax Regulation §590.49(B).

[24] Gains Tax Regulation §590.49(C).

order to be able to elect to pay the tax in installments.[25] Moreover, interest is imposed on the deferred payment of Gains tax.[26]

As a procedural matter, the Gains tax provisions require that, at least 20 days prior to the transfer, the transferor and the transferee submit to the Department pre-transfer audit questionnaires (Forms TP-580 and TP-581, respectively).[27] These questionnaires are used by the Department to make a tentative assessment of the amount of Gains tax due on the transfer; in response to the filing of these questionnaires, the Department furnishes copies of its tentative assessment (Form TP-582) to the transferor and the transferee.[28] The tentative assessment has two practical effects. First, it sets forth the amount of Gains tax that generally must be paid in order to record an instrument of transfer.[29] Second, it sets forth the amount of tax for which the transferee generally has personal liability. Specifically, the statute provides that:

> whenever [the Department] shall inform the transferee that a tentative assessment of [Gains] tax exists, any sums of money, property or other consideration, which the transferee is required to transfer over to the transferor shall be subject to a first priority right for any [Gains] taxes stated to be due from the transferor to the state in such tentative assessment, and . . . the transferee is forbidden to transfer to the transferor any such sums of money, property or

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[25] Tax Law §1442(c).

[26] Tax Law §1442(c).

[27] Tax Law §1447.

[28] Tax Law §1447.2.

[29] Tax Law § 1447(1)(f)(1). A special rule applies in the case of mortgage foreclosure actions whereby a conveyance by a court of appropriate jurisdiction, or an officer thereof (e.g., a referee), resulting from an action to foreclose a mortgage, can be recorded without being accompanied by a statement of tentative assessment or an exemption affidavit. Tax Law §1447 (1)(f)(1).

> consideration to the extent of the amount of the state's claim stated in such tentative assessment . . . For the transferee's failure to comply . . . the transferee . . . shall be personally liable for the payment to the state of any such taxes stated in such tentative assessment. . . .[30]

For transfers occurring on or after June 16, 1992 and before February 1, 1995, Chapter 172 of the Laws of 1992 eliminated transferee liability exposure for Gains tax purposes in the case of transfers of shares of stock in a cooperative housing corporation and associated proprietary leases or transfers of ownership interests in entities with an interest in real property that result in a transfer or acquisition of a controlling interest, to a secured party pursuant to an action to enforce a lien, security interest or other rights with respect to such assets.[31] The Amendments clarify that relief from transferee liability applies to such transfers made by a debtor in bankruptcy. One observation worth noting with respect to this provision is that the expiration of the February 1, 1995 sunset date without continuance of the transferee liability protection (either by legislative extension or other Department directive/interpretation to that effect) would lead to an odd result whereby transferees of conveyances pursuant to an action to enforce a lien would not be afforded liability protection but

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[30] Tax Law §1447(3)(a). Again, special rules apply in the case of mortgage foreclosure actions, which permit the transferee in an action to foreclose a mortgage to pay consideration to the officer conducting the sale and release the transferee from personal liability for Gains tax determined to be due from the mortgagor. Tax Law §1447(3)(b)(1). Further, as an alternative to personal liability, a transferee with transferee liability exposure may post a bond. Tax Law §1447(3)(c). Finally, the balance of this section of the Report discusses recent legislative changes that have provided expanded relief from transferee liability exposure for UCC enforcement conveyances and certain deed in lieu and similar conveyances.

[31] Tax Law §§1447(2)(b)(2). The Department has indicated in TSB-M 92(2)-R that, pursuant to this statutory provision, transferee protection is extended to cover the transfer of an ownership interest in an entity with an interest in real property pursuant to an action to enforce a lien, security interest, etc. that results in a transfer or acquisition of a controlling interest in such entity.

transferees of conveyances in lieu of such an enforcement action would have such protection pursuant to the 1993 legislative changes discussed below, which changes have no comparable sunset date.

Chapter 57 of the Laws of 1993 further modified the provisions relating to transferee liability to provide complete relief from transferee liability exposure where a transfer is in lieu of foreclosure or in lieu of the enforcement of a security interest on or in shares of stock in a cooperative housing corporation or in other ownership interests in entities with an interest in real property, provided that no cash is paid by the transferee to the transferor. If a cash payment is made by the transferee, the transferee's liability is generally limited to the amount of such cash payment. The transferee liability relief provided by the 1993 legislative changes will not apply if the Commissioner determines that the lien, security interest or other rights were created for the primary purpose of effectuating the transferee's ultimate acquisition of the interest in real property in a transaction that limits or eliminates transferee liability.[32]

## III. SUMMARY OF PRINCIPAL COMMENTS

Our most significant comment on the Transfer Tax Regulations is to urge the Department to consider revising the application of the fair market value limitation on the calculation of consideration in conveyances involving recourse indebtedness.

[32] Tax Law §1447(2)(b)(3).

As currently drafted, the regulatory relief provided by the Department for conveyances involving recourse indebtedness does not achieve its perceived objective in certain fact patterns (e.g., situations involving continuing liens.) Other principal comments address clarification of the application of the recourse rule to partially guaranteed indebtedness, clarification of the definition and scope of key terms and practical guidance on the filing procedures.

Our principal comments on the Gains Tax Regulations relate to suggested clarifications of the manner of calculating the original purchase price of a mortgagee, secured creditor or its affiliate upon a conveyance of property from a debtor in various troubled debt conveyance scenarios, and the application of the transferee liability provisions. Other comments relate to the suggested modifications of regulations interpreting the 1993 legislative changes to the definition of original purchase price, regulations addressing transfers from a debtor to an entity partially owned by a creditor and regulations addressing transfers of interests in entities to a secured creditor.

## IV. COMMENTS ON THE AMENDMENTS

The following are our substantive comments and suggestions on the Amendments. As a preliminary procedural matter, we strongly urge the Department to maintain the current numbering system utilized by the Gains Tax Regulations and to add new regulations either by amending and expanding existing related sections, or by adding new sections to the end of the existing regulations, rather than renumbering the existing regulations. Although this may be viewed as a minor point, continued adherence to the current numbering system will significantly assist tax practitioners in their future research efforts.

This is particularly important in the state tax area, where considerable research is conducted by computer, and where there are fewer services and treatises one can count on to find the former section number of a renumbered regulation.

A. Amendments to the Transfer Tax Regulations

Section 3 of the Amendments significantly revises Section 575.11 of the Transfer Tax Regulations, addressing conveyances pursuant to, and in lieu of, foreclosure and adding new provisions dealing with the enforcement of a security interest or similar rights on or in shares of stock in a cooperative housing corporation or on or in other stock interests, partnership interests or other ownership interests in entities owning real estate. Outlined below are our comments and suggestions relating to these provisions. In some instances, the provisions of the Transfer Tax Regulations upon which we comment below are replicated in the Amendments to the Gains Tax Regulations. In those instances, we have noted that the issue arises in both contexts and have made comments and suggestions below that are equally applicable to the Gains Tax Regulations, except as otherwise specified.

1. Section 575.11 of the Transfer Tax Regulations and various provisions of the Gains Tax Regulations contain rules for the calculation of consideration in loan default scenarios, the correct application of which depend on whether the conveyance is “pursuant to foreclosure,” “in lieu of foreclosure,” etc. and on the identity of the transferee, i.e., whether the transferee is the mortgagee or lienor, or its agent or nominee or an entity wholly owned by the mortgagee or lienor. To invoke certain of these rules it is necessary that the conveyance be “in lieu of foreclosure.”

The circumstances in which a “deed in lieu” is transferred can be quite varied, ranging from a performance default by the mortgagor (such as a failure to satisfy net worth covenants) to a case in which the loan has been accelerated and a foreclosure proceeding is pending. Rather than adopting a regulatory definition at this point, we suggest that the Department develop informal and flexible internal guidance, and that it monitor closely the kinds of troubled property scenarios presented in pre-transfer audit filings as transfers in lieu of foreclosure, to develop indicia of transfers in lieu of foreclosure.

We also suggest that the regulations be broadened--consistent with the tenor of the last sentence of Section 575.11(a)(3)(ii) of the Transfer Tax Regulations--to indicate that the rules applicable to a transferee that is an entity wholly owned by the mortgagee or lienor apply to any transferee whose relationship with the mortgagee or lienor is such that a conveyance between them would be fully exempt from State transfer tax and Gains tax because of the availability of a 100% “mere change in form” exemption (e.g., parent/subsidiary corporations, or brother/sister corporations with identical beneficial ownership).

2. A “deed in lieu” conveyance to a mortgagee or lienor or its agent, nominee or an entity wholly owned by such mortgagee or lienor frequently involves the post-conveyance survival of the mortgage or lien position (through the use of non-merger language and/or separate entities) to enable a subsequent foreclosure to eliminate junior lienholders. We suggest that the Amendments be clarified to apply Section 575.11(a)(2) of the Transfer Tax Regulations (and similar “deed in lieu” provisions) in this typical fact pattern by replacing

the words “cancellation of the debt” with the phrase “the discharge of the transferor with respect to the debt.”

3. Guidance should be provided on the effective date of the State transfer tax provisions reflected in Section 3 of the Amendments relating to the determination of consideration for conveyances involving recourse indebtedness. The Department's Memorandum indicates that these provisions are intended to modify existing policy relating to the calculation of consideration. In light of the sound economic basis for this policy, we recommend that it be effective on the date on which the Amendments become effective, but with a reference to the effect that the change is not intended to provide any inference as to the state of the law prior to the Amendments.

4. There is a consistent, and we believe unnecessarily vague, approach in the manner in which “consideration” is defined throughout the Amendments. The Amendments indicate that “consideration includes, but is not limited to, the sum of . . .” (emphasis added). Given that the Department includes various “catch-all” categories in the list of the components of consideration--for example, Transfer Tax Regulation Section 575.11(a)(2)(i)(c) provides that consideration includes “('c') the sum of any other amount paid by the grantee for the real property”--there appears to be no need for the “includes, but is not limited to” caveat, which raises an uncertainty in the determination of consideration. We suggest that the phrase “includes, but is not limited to” be replaced with the word “means” or “is” as appropriate throughout the Amendments when used in connection with the definition of consideration for State transfer tax or Gains tax purposes.

5. Transfer Tax Regulation Section 575.11(a)(2)(ii) is designed to provide a pro-taxpayer calculation of consideration in the case of a deed in lieu conveyance involving recourse indebtedness. Presumably, through this change, which is mirrored in the foreclosure rules, the State intended to incorporate in the Transfer Tax Regulations (subject to statutory constraints requiring legislative action) rules similar to the 1993 legislative changes in the calculation of Gains tax consideration in various debt workout conveyances. The Department's modified policy seems appropriately focused on precisely how much recourse indebtedness is being discharged by the conveyance of the real property. This approach is similar to the federal income tax calculations of amount realized and cancellation of indebtedness income in conveyances involving recourse debt contained in Treasury Regulation §1.1001-2(c), example 8. We commend the Department for exercising its regulatory power to effectuate this policy in the case of conveyances involving recourse indebtedness; however, we suggest that a technical modification is necessary in order to accomplish the Department's objective.

As currently drafted, the proviso in Transfer Tax Regulation Section 575.11(a)(2)(ii) caps at the fair market value of the property the element of consideration contained in Transfer Tax Regulation Section 575.11(a)(2)(ii)(a), i.e., the portion of consideration consisting of the unpaid balance of the debt secured by the mortgage. The fair market value cap should be operative with respect to all of the elements of consideration contained in Transfer Tax Regulation Section 575.11(a)(2)(ii). For example, as currently drafted, clause (a), as capped by the proviso at fair market value, is duplicative of amounts included in clause (b), which include any remaining liens on the property. Similar concerns also arise in the determination of consideration

on a foreclosure or similar action involving recourse debt (Transfer Tax Regulation Sections 575.11(a)(3)(i) [proviso language] and 575.11(a)(3)(iv) [proviso language]).

To illustrate the issue regarding the application of the fair market value cap in the context of conveyances involving continuing liens, assume X is the owner of real property encumbered by a first mortgage lien held by Bank A securing nonrecourse indebtedness of $10 million and a second mortgage lien held by Bank B securing recourse indebtedness of $5 million. The first mortgage is not in default but X has defaulted in the payment of the indebtedness secured by the second mortgage lien. The fair market value of the property is $12 million. X conveys the property to Bank B in lieu of foreclosure of the second mortgage lien, with Bank B taking the property subject to the first mortgage lien of $10 million. The proviso in Transfer Tax Regulation Section 575.11(a)(2)(ii) would be inapplicable in this fact pattern because the property's fair market value of $12 million is not less than the unpaid balance of debt owed to Bank B ($5 million). Thus, the consideration on the conveyance would be equal to $15 million, the total of the unpaid indebtedness secured by the second mortgage lien and the amount of the first mortgage lien continuing to encumber the property.

Since the indebtedness owed to Bank B is recourse indebtedness, the conveyance of the property subject to the first mortgage lien held by Bank A causes a discharge of only $2 million of indebtedness (the value of the property in excess of the Bank A debt) and thus consideration on the conveyance should equal $12 million rather than $15 million. This result, which we believe is consistent with the Department's policy objectives, can be achieved by capping the consideration in clause “a” of Transfer Tax Regulation Section 575.11(a)(2)(i) (with

corresponding changes in Transfer Tax Regulation Sections 575.11(a)(3) [proviso language referring to Regulation Section 575.11(a)(3)(i)(b)(1)], 575.11(a)(3)(iv) [proviso language referring to Regulation Section 575.11(a)(3)(iii)(a)(2)(i)] and 575.15(i) [proviso language]) at the excess of the fair market value of the real property over continuing liens and encumbrances taken into account in clause “b” of such section.

In the case of a foreclosure or deed in lieu of foreclosure transfer involving recourse indebtedness, the transfer may, for a variety of reasons, include a cash payment from the transferee to the transferor. We believe that such a cash payment should not prevent the fair market value of the real property from determining the amount of consideration for State transfer tax purposes. There are a variety of ways to analyze a cash payment made from a transferee/creditor to a transferor/borrower in a distressed debt situation. One approach is to treat the amount of the cash advance as an additional funding of the loan. This view of the transaction should not alter the treatment provided for in the Amendments. Alternatively, it is possible to bifurcate the transaction, with a portion of the real property viewed as being sold, in a cash transaction, to the transferee, and the remainder of the property being transferred in satisfaction of the recourse indebtedness. Under this approach, the fair market value of the real property should also control the calculation of consideration for State transfer tax purposes. Finally, in many cases, the payment of cash from the transferee to the transferor will be, as a practical matter, a payment to enlist the transferor's cooperation or to settle threatened litigation claims made by the transferor, and will not independently represent a transfer of value in consideration of the conveyance of real property.

This suggestion, i.e., capping all of the elements of consideration contained in Gains Tax Regulation Section 571.11(a)(2) at the property's fair market value, can-be accomplished by indicating that where the sum of the amounts described in clauses “a”, “b” and “c” of Gains Tax Regulation Section 571.11(a)(2)(i) exceeds the fair market value of the real property at the date of the conveyance, the consideration for the conveyance shall be the fair market value of the property.

Similarly, in the context of conveyances pursuant to UCC enforcement actions involving recourse debt, the fair market value cap contained in the proviso in Transfer Tax Regulation Section 575.11(a)(15)(ii) should operate to limit the consideration otherwise described in clauses (a) and (b) of Section 575.11(a)(15)(i).

6. The definition of recourse indebtedness indicates that a debt is recourse debt to the extent that, as of the date of the conveyance, the grantor or a person related to the grantor, including any guarantor, bears the economic risk of loss for that debt beyond any loss attributable to the value of the property securing the debt. The Amendments suggest a bifurcation approach but it would be helpful if they provided an explicit bifurcation rule, which we suggest be illustrated with the following example: Bank A made a nonrecourse loan of $10 million to individual X secured by a mortgage on a parcel of New York State real property owned by X. X also provided a personal recourse guarantee of the “last” $1 million--that is, if the value of the mortgaged parcel decreased to less than $10 million, X would be obligated to pay the difference between $10 million and the value of the mortgaged parcel to Bank A up to a maximum

amount of $1 million.[33] X defaults on the loan and deeds the real property, which at the time of the transfer is worth $8 million, back to Bank A in a deed in lieu of foreclosure conveyance in discharge of the $9 million nonrecourse component of the loan. Simultaneously, Bank A discharged X from any obligation under his personal guarantee. We suggest that the regulation treat the loan as having a $9 million nonrecourse component and a $1 million recourse component and treat the real property conveyance as discharging the $9 million nonrecourse component of the loan, resulting in State transfer tax consideration of $9 million. This is the economically correct result because, in fact, the property can be used to satisfy exactly $9 million of indebtedness but no part of the excess $1 million personal obligation can be satisfied by the conveyance of the property. We urge the Department not to adopt a bifurcation approach that attributes a portion of the fair market value of the real property being conveyed—equal to the product of (i) the value of the property ($8 million in this fact pattern) and (ii) the ratio of the recourse component of the loan to the entire loan (10% in this fact pattern)--to the satisfaction of the recourse component of the loan and thus includible in consideration, because the conveyance of the property does not, in fact, discharge the recourse component of the loan.

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[33] If, in the fact pattern described herein, instead of a guarantee of the "last" $1 million, X had guaranteed the "first" $1 million (i.e., X is liable for any deficiency only if the mortgaged parcel is worth less than $1 million), the conveyance of the real property, with a value of $8 million, to Bank A would have resulted in no continuing recourse exposure to X. Thus, the consideration for State transfer tax purposes in this situation should be $10 million, the full amount of nonrecourse indebtedness discharged as a result of the conveyance of the collateral. The loan should be viewed as having no operative recourse component at the time of the conveyance. If at the time of the conveyance the property was worth $600,000 and X was liable for a $400,000 deficiency, the State transfer tax consideration should equal $9.6 million, the amount of nonrecourse indebtedness discharged as a result of the conveyance.

7. It would be helpful if the Amendments clarified (i) that a debt that was originally nonrecourse will be treated as recourse so long as the conversion to recourse indebtedness and the conveyance of the property are not, in substance, integrated steps of a single transaction[34] or part of a "plan" to take advantage of the recourse debt rules and (ii) that the assets and net worth of the mortgagor, related party or guarantor are not relevant unless the facts and circumstances indicate that the primary motive for denominating a debt as recourse was to minimize State transfer taxes.

8. Each of the various conveyance alternatives includes in the determination of consideration "amounts paid by the grantee for the real property." We recommend clarifying this provision to exclude from the definition of consideration State and local transfer taxes involuntarily paid by the transferee, i.e., taxes that are not contractually assumed, and that are paid by the transferee in order to record the conveyance document.

9. We suggest that the Department issue some form of guidance addressing what evidence, if any, the grantor and grantee should submit with Form TP-584 to establish the fair market value of the real property in the case of conveyances

[34] We suggest that the applicable anti-avoidance rule be one that is patterned on the federal step-transaction doctrine, which treats a series of formally separate "steps" as a single transaction if the steps are, in substance, integrated, interdependent, and focused toward a particular result. The step-transaction analysis relies on three primary, and alternative, tests: the binding commitment test, the end result test and the interdependence test. Under the binding commitment test, a series of transactions is collapsed if, at the time the first step is taken, there is a binding commitment to take the later step. Under the end result test, the step-transaction doctrine will be invoked if it appears that a series of formally separate steps are really prearranged parts of a single transaction intended from the outset to reach the ultimate result. The third test, and middle-ground approach, is the interdependence test. This test focuses on whether the steps are so interdependent that the legal relations created by one transaction would have been fruitless without completion of the series.

involving recourse indebtedness. We suggest that the penalty relief provisions be expanded to provide relief for deficiencies arising from valuation disputes on audit when the fair market value reported on the State transfer tax filing was consistent with the value as determined by the Gains tax pre-transfer audit process or is otherwise a good faith determination. This should be exclusively a relief provision and not a safe harbor or audit guideline.

It is possible that the parties will disagree as to the fair market value of the property and desire to file separate TP-584 forms. Therefore, we suggest that the filing procedures be amended to reflect the possibility that different fair market values could be reported by the transferor and transferee, with the tax paid based upon the fair market value of the property as reported by the payor of the tax. In addition, the rules should be clarified to enable the recording officer to accept the deed for recording upon the receipt of such payment, notwithstanding inconsistent State transfer tax filings, perhaps with a statement to the effect that the right to record a deed does not in any way undercut the State's audit rights.

10. In the past, representatives of the State have orally asserted that the transfer of stock of a cooperative housing corporation in connection with a UCC enforcement action may involve two transfers, the first of which occurs when the creditor enforces its lien by obtaining possession of the collateral and the second of which takes place when the creditor is the successful bidder at auction or otherwise takes title to the collateral (although typically the mere change in form exemption would fully exempt the second transfer).

Rulings issued by the Department (dated December 4, 1991 and January 21, 1992) addressing the circumstances in which a creditor's exercise of rights results in a conveyance indicate that mere possession of the collateral upon a default is not determinative of the issue of whether a transfer has occurred; rather, the focus is on whether the facts and circumstances indicate that the debtor has lost sufficient incidents of ownership, such as use and occupancy rights, with the result that the creditor has obtained dominion and control of the real property. This is a confusing standard for what constitutes a conveyance, and raises the risk that taxpayers will be assessed penalties in a context where the ability to comply with these rules is, at best, difficult. The Amendments should therefore specify that there is only one transfer of real property in this situation, i.e., the conveyance from the debtor/grantor to the secured party or other grantee.

11. We suggest clarifying Transfer Tax Regulation Section 575.11(a)(16) to avoid any overlap between that section and Section 575.11(a)(15). Section 575.11(a) (16) should relate to a conveyance of real property pursuant to a secured party's enforcement of a lien, security interest or other rights to or in shares of stock (other than stock of a cooperative housing corporation).

B. Amendments to the Gains Tax Regulations

Outlined below are our comments and suggestions regarding the Gains Tax Regulations. These comments are divided into two sections, the first of which addresses regulations that are being revised to incorporate prior statutory changes to the Gains tax provisions and the second of which deals with other regulations that are being revised by the Amendments (in some

instances only to make conforming changes or to cross reference revised regulations). We understand and appreciate the Department's desire to provide prompt guidance on the interpretation of prior Gains Tax legislative changes, and our comments and suggestions with respect to these regulations are provided below. We also note that comments and suggestions have been offered for your current or future consideration (in the second section below) with respect to sections of the Gains Tax Regulations that do not address recent legislative changes but were included in the Amendments and raised issues of importance for clarification or guidance.

Comments Concerning Gains Tax Regulations that are Being Revised to Incorporate Prior Statutory Changes:

1. Section 590.15(b) of the Gains Tax Regulations contains a list of specific costs that may included in the computation of OPP if incurred in connection with the acquisition of real property. This list includes mortgage recording taxes paid on purchase money mortgages, including, effective for transfers occurring on or after April 15, 1993, the special additional mortgage recording tax. We urge the Department to delete the reference to the April 15, 1993 effective date for the inclusion in OPP of the special additional mortgage recording tax or, alternatively, to indicate in the regulation that the inclusion of the 1993 legislation effective date does not create any inference as to the state of the law prior to the enactment

of such legislation.[35] The same issue arises in the seventh item of the list contained in the second paragraph of the answer in Section 590.17(d) of the Gains Tax Regulations.

Section 590.15(c) of the Gains Tax Regulations, which identifies specific costs that are not includible in OPP as allowable costs to acquire property, has been revised to reflect the 1993 legislative changes expanding and clarifying the definition of OPP. The regulation indicates that, effective for transfers occurring on or after April 15, 1993, construction period interest paid or required to be paid on a loan incurred to acquire real property that is attributable to the portion of the real property that is the subject of the capital improvement is includible as a cost of a capital improvement. The regulation should be revised to make clear that it covers loans incurred to refinance existing property loans to the extent refinancing proceeds are used to pay off the existing property loan. We suggest that the phrase "or to discharge an existing obligation the proceeds of which were used to acquire the real property" be inserted after the phrase "to the extent that such loan proceeds were used to acquire the real property" to deal with refinancings, utilizing a tracing methodology. The same issue arises in the fourth item of the list contained in the second paragraph of the answer in Section 590.17(d) of the Gains Tax Regulations and we suggest that the same new phrase contained in the preceding sentence be inserted after the existing language contained therein.

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[35] We note that this issue was addressed in the context of a conversion of real property to cooperative ownership in Matter of Classic Residences. Inc., DTA No. 810986 (1/27/94). The Administrative Law Judge, relying on existing Gains Tax Regulation Section 590.39, which includes in OPP the mortgage recording tax paid on mortgages resulting from the conveyance of title to a cooperative corporation, determined that the taxpayer was entitled to include special additional mortgage recording tax in the calculation of OPP even though it could have applied for a credit for this portion of the mortgage recording tax.

Section 590.15(c) of the Gains Tax Regulations has also been revised to address the 1993 legislative changes dealing with purchase money indebtedness. The regulation indicates that, effective for transfers occurring on or after April 15, 1993, purchase money mortgage interest that is attributable to the acquisition of real property and that accrues during a construction period with respect to a capital improvement on such real property is includible in OPP as a cost of a capital improvement. We suggest clarifying the regulation to indicate it covers all purchase money indebtedness, whether or not secured by a recorded mortgage. This clarification can be accomplished by replacing the word “mortgage” with the word “indebtedness” in the two places it appears in the second item of the list contained in the answer in Section 590.15(c). The same issue arises in Section 590.17(d) of the Gains Tax Regulations and we suggest the replacement of the phrase “interest incurred on a note or bond secured by a true purchase money mortgage” with the phrase “interest incurred on purchase money indebtedness” in the fifth item of the list contained in the second paragraph of the answer in Section 590.17(d).

2. Section 590.16(a) of the Gains Tax Regulations deals with the inclusion in original purchase price of expenses incurred to acquire a real estate tax exemption under Section 4 21-a of the Real Property Tax Law (“RPTL”) and includes in OPP “legal, accounting and filing fees incurred by a transferor in connection with purchasing such real estate tax exemption from another real property owner and the amount actually paid to such real property owner for the tax exemption.” We suggest that this language be modified to indicate that the costs incurred in order to satisfy low-income housing production requirements of the Section 4 21-a program, including the cost of purchasing

negotiable certificates and related legal, accounting and filing fees incurred by a transferor, be included in OPP.

3. Section 590.60(a) of the Gains Tax Regulations addresses transfers of real property pursuant to a mortgage foreclosure, or any other action to enforce a lien that is governed by the Real Property Actions and Proceedings Law (the "RPAPL"), such as the enforcement of a mechanic's lien pursuant to Article 3 of the Lien Law, including such a transfer by a debtor in bankruptcy. We suggest additional clarification as to the application of the mortgage foreclosure rules to conveyances by a debtor in bankruptcy. The mortgage foreclosure provisions should govern conveyances by a debtor in bankruptcy when the conveyance is the result of a state or federal court foreclosure proceeding (i.e., in New York, for example, a proceeding governed by Article 13 of the RPAPL) under the jurisdiction of the Bankruptcy Court. Moreover, we suggest that the regulations be clarified to indicate that the mortgage foreclosure rules will be applicable to transfers by a debtor in bankruptcy that may not necessarily be effectuated through a state or federal court foreclosure proceeding, but which occur under the Bankruptcy Court's jurisdiction and under circumstances where the provisions of the RPAPL, specifically, the distribution provisions of RPAPL Section 1354, are followed. The Department should be fully protected against any potential for misuse of the mortgage foreclosure provisions by a debtor in bankruptcy if a prerequisite to such use is adherence to the provisions of RPAPL Section 1354.

4. Throughout Section 590.60 of the Gains Tax Regulations there are references to conveyances to a “mortgagee, secured creditor or lienor . . . either in its own name or through an entity wholly owned by such mortgagee, secured creditor or lienor, or any agent or nominee thereof.” The reference to “either in its own name or through an entity” could be viewed as requiring a nominee or agency relationship between the lender and the “entity”; this language is confusing and different from other references in both the Gains Tax Regulations and Transfer Tax Regulations. We suggest that the language be conformed throughout the regulations to indicate that these rules are applicable where the transferee is the mortgagee, secured creditor or lienor, or its agent or nominee, or an entity whose relationship with such mortgagee, secured creditor or lienor is such that a conveyance between them would be fully exempt (or partially exempt in the case of regulations dealing with entities partially owned by the mortgagee[36]) from tax because of the availability of a full (or partial, if applicable) mere change in form exemption.

5. Section 590.60(b)(1)(i) of the Gains Tax Regulations should be expanded to replace the phrase “mortgagee, secured creditor or lienor” with the word “transferee” in order to contemplate conveyances to transferees other than the mortgagee, such as agents, nominees or wholly-owned affiliates of the mortgagee, as contemplated in the question to which this answer responds.

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[36] References in the balance of this Report to “mortgagee” include the terms “secured creditor” and/or “lienor” except if noted to the contrary.

6. Section 590.60(b)(3)(i) of the Gains Tax Regulations generally addresses the determination of a mortgagee's original purchase price following a foreclosure transfer and specifically focuses, in (i), on the principal amount of the debt secured or that was secured by the mortgages or other liens held by the mortgagee, secured creditor or lienor. The intent of this provision, as expressed in the Memorandum, is to enable the mortgagee's original purchase price to reflect its true investment in the property. The regulation does not directly address situations in which a party acquires indebtedness for an amount that is more or less than the outstanding principal amount of the debt and subsequently acquires the property from the mortgagor, frequently through a wholly-owned affiliate. In general, we believe that the proposed regulation “works” to cause the transferee's original purchase price to be equal to the outstanding principal amount of the debt, even if the transferee purchased the debt at a premium over, or discount from, its face amount. In the case of an acquisition of debt at a discount, we note that the consequence of the regulation would be to permit the transferee's OPP to exceed <u>its</u> actual investment in the property (although the OPP will not exceed the investment of the original lender). To address the issue of whether a person who acquired debt at a discount should enjoy the potential benefit of avoiding Gains tax on some portion of its true economic gain on a future sale of the real property interest that secures such debt, consideration could be given to applying step-transaction or “plan” principles (discussed previously with respect to the conversion of non-recourse debt to recourse debt) as appropriate to limit a transferee's OPP to its actual investment in the debt in any case where the debt acquisition and the property conveyance are integrated steps in a single transaction.

Alternatively, the regulations could provide that in all cases the lender/transferee's OPP is based on its actual investment in the debt. We note, however, that such a rule of general application would not permit OPP to reflect the actual investment of the lending community, only the investment of that particular (last) lender.

7. Gains Tax Regulation Sections 590.60(b)(3)(iii) and (iv) provide that expenses of the foreclosure sale or costs of the action incurred and paid or required to be paid by the transferee and other expenses incurred prior to the transfer of the real property that are necessary to maintain the real property, preserve its value or to preserve the priority and validity of its lien(s) are includible in original purchase price when the provisions of Gains Tax Regulation Section 590.60(b)(3) are operative (i.e., when the fair market value of the real property is less than the sum of such amounts plus the principal amount of the debt secured by the mortgage and continuing liens and encumbrances on the property). The existing Gains Tax Regulations generally contemplate that, in addition to the consideration reported on a conveyance of real property, certain pre-acquisition costs and other costs are includible in original purchase price. We recommend that the costs described in Sections 590.60(b)(3)(iii)(expenses of the foreclosure sale, etc.) and (iv) (expenses incurred pre-transfer to preserve property, etc.) be viewed as pre-acquisition or acquisition related costs that are includible in original purchase price whether or not the fair market value of the real property is less than the total of such costs plus the principal amount of the indebtedness and continuing liens. We recommend that if a mortgagee's original purchase price following a transfer is the consideration determined in accordance with Section 590.60(b), the expenses of the foreclosure sale and expenses incurred in connection with the

acquisition of the real property to maintain the real property, preserve its value or preserve the priority and validity of its lien be treated as additional expenses increasing original purchase price. Moreover, we suggest that a mortgagee's original purchase price following a foreclosure or other similar transfer be increased to reflect amounts incurred and paid or required to be paid by the mortgagee to obtain a discharge of subordinate liens,[37] as well as other costs and expenses necessary to secure title to the real property (e.g., New York State, New York City and local transfer taxes). In addition, Section 590.60(b)(3)(iv) indicates that expenditures incurred by the mortgagee prior to the transfer of the real property that are necessary to maintain the real property, preserve its value or to preserve the priority or validity of its lien(s) are includible in original purchase price pursuant to the provisions of such section. This regulation does not focus on when these expenses are paid and should be clarified to indicate that payment could occur prior to, simultaneously with, or after the transfer of the real property. For example, there may be a payment to settle a lien dispute or other payment that is incurred to maintain the real property, preserve its value or preserve the priority and validity of a lien, which is not paid until the conveyance occurs or shortly thereafter.

We suggest that the phrase “are necessary” contained in Section 590.60(b)(3)(iv) of the Gains Tax Regulations be replaced with the phrase “were expended” to eliminate factual inquiries going beyond the mere incurrence of the expense.

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[37] Although subordinate liens would be discharged upon a foreclosure conveyance, a transferee may find it desirable or necessary to reach a settlement with a subordinate lienholder to facilitate the quick resolution of the foreclosure proceeding and the conveyance of the property.

In these kinds of situations, the lender's actual payment of expenses should stand as sufficient evidence of the need for such expenditures. In addition, the reference to “its lien(s)” in this section should be deleted and replaced with the phrase “the lien(s) held by the mortgagee, secured creditor or lienor.”

Section 590.60(f) of the Gains Tax Regulations should be modified to conform to the provisions of Tax Law Section 1440.1(d)(ii) by adding the phrase “or in lieu of any other action to enforce a security interest” after the phrase “in lieu of an action to foreclose a mortgage or in lieu of any other action that would be otherwise governed by the provisions of Real Property Actions and Proceedings Law, such as in lieu of enforcement of a mechanics' lien pursuant to Article 3 of the Lien Law.”

8. Section 590.60(c) of the Gains Tax Regulations addresses the calculation of consideration in the case of a transfer pursuant to a mortgage foreclosure or similar action to a transferee that is unrelated to the mortgagee. As previously noted in comments to the Transfer Tax Regulations, the Department indicates that consideration “includes, but is not limited to,” the sum of the bid price plus continuing encumbrances. We suggest that all references to “includes, but is not limited to” be changed to “is,” “means” or some similar word.

9. Section 590.60(d) of the Gains Tax Regulations addresses the calculation of consideration in the case of a transfer of real property pursuant to a mortgage foreclosure or a similar action where the transferee is an entity beneficially owned in part by the mortgagee and in part by a person unrelated to the mortgagee. We suggest the phrase “beneficially owned in part by” be replaced by the phrase “as to which a partial mere

change in form exemption would be available if a transfer of real property occurred between the entity and.” The regulations also do not address the calculation of such entity's original purchase price of property following such a transfer. We suggest that the regulations be expanded to address this issue and propose that a bifurcation approach be used, whereby (a) as to that portion of the transferee that is beneficially owned by the mortgagee, the transferee's original purchase price is calculated with reference to the original purchase price rules that govern conveyances to mortgagees; and (b) the balance of the transferee's original purchase price is calculated with reference to the rules for determining original purchase price in the case of conveyances to transferees unrelated to the mortgagee.

10. Section 590.60(f)(3) of the Gains Tax Regulations provides rules governing the determination of a mortgagee's original purchase price following a deed in lieu conveyance. The same issues that were discussed with respect to the calculation of original purchase price in the context of a mortgage foreclosure conveyance are applicable in a deed in lieu conveyance. Moreover, Section 590.60(f)(3)(ii), which provides for the inclusion in OPP of continuing liens or encumbrances on the property, excludes from the calculation of OPP the amount of any liens or encumbrances to the extent they are or will be subsequently cancelled or discharged without consideration. This provision raises a number of uncertainties. First, it appears unclear whether the words “to the extent that” in this provision are intended to bifurcate liens or encumbrances when such liens or encumbrances are cancelled or discharged at a substantial discount. One approach would be for the lien to be bifurcated into two components, one of which is the amount of the payment in satisfaction of the lien and the other being the amount of the lien discharged without any consideration, with only the former

amount includible in OPP. This appears to be the approach taken in Gains Tax Regulation Section 590.60(f), example 1. We suggest that, if the result in this example demonstrates the Department's intent with respect to this issue, the text of Section 590.60(f)(3) of the Gains Tax Regulations be clarified to indicate that OPP is limited to any amount paid to discharge the lien prior to a subsequent transfer of the real property and if the lien is not discharged prior to such subsequent transfer the full amount of the lien is includible in OPP. This approach would also cure the uncertainty in the proposal whereby encumbrances that will be subsequently cancelled or discharged without consideration after the transfer are not includible in OPP. In many cases, there is a great deal of uncertainty as to whether a subordinate lien remaining on the property will be foreclosed out, settled at some discount or fully paid off.
There should be an ability to reflect actual events in the calculation of original purchase price, and since one does not need to determine OPP until a transfer occurs, there should be no administrative problem in determining OPP at a later date by reference to actual events.

11. Section 590.60(f)(3)(iii) of the Gains Tax Regulations includes in original purchase price other expenses incurred by the mortgagee, subsequent to the debtor's default but prior to the transfer of the real property to the mortgagee, which are necessary to maintain the real property, preserve its value or preserve the priority or validity of its lien(s).

We previously commented on the time element contained in the corresponding provision pertaining to mortgage foreclosure conveyances. In that case (Gains Tax Regulation Section 590.60(b)(3)(iv)), the regulation focuses on the incurrence of the expense prior to the transfer. In the deed in lieu situation, the regulation requires that the expense have been incurred subsequent to the debtor's default but prior to the transfer. We raise the same concerns here as we raised in connection with the mortgage foreclosure rules and suggest (i) that the phrase “subsequent to the debtor's default but prior to the transfer of the real property to the mortgagee, secured creditor, lienor or entity which are necessary” be deleted and (ii) the reference to “its lien(s)” be replaced with the phrase “the lien(s) of the mortgagee, secured creditor or lienor.” Moreover, we note that whereas the mortgage foreclosure rules included in OPP the costs of the foreclosure action paid or required to be paid by the mortgagee, there is no comparable provision in the deed in lieu of foreclosure provision. We suggest that a comparable provision be inserted in the deed in lieu provision to include in original purchase price expenses paid by the transferee in connection with obtaining title to the property, for example, New York State, New York City and local transfer taxes paid by the transferee in order to record the conveyance document, as well as any actual consideration paid by the transferee to, or for the benefit of, the transferor in connection with the conveyance.

12. The Gains Tax Regulations do not address the calculation of consideration and original purchase price in the case of a transfer of real property in lieu of an action to foreclose a mortgage or other similar action to an entity partially owned by the mortgagee and partially owned by an unrelated person.

We recommend that the regulations address this issue and that the bifurcation approach suggested in connection with mortgage foreclosure conveyances be followed here.

13. Section 590.60(g) of the Gains Tax Regulations addresses the Gains tax results of a secured party's enforcement of a lien, security interest or other rights on or in shares of stock in a cooperative housing corporation and/or associated proprietary leases or other ownership evidenced by stock certificates, partnership interests, etc. This regulation raises the same issues addressed in the Transfer Tax Regulations concerning the timing of the conveyance and what constitutes enforcement of a lien. As we had previously recommended, the regulations should specify that there is only one transfer of real property in this situation.

14. Section 590.60(h)(3) of the Gains Tax Regulations addresses the calculation of original purchase price following a transfer of shares of stock of the cooperative housing corporation and/or associated proprietary leases. This regulation refers to the secured creditor's original purchase price, although the question posed in (h) indicates that the transferee could be a secured creditor or an entity wholly owned by such secured creditor, or an agent or nominee thereof. Thus, it appears appropriate to expand the answer to refer to the secured creditor's <u>or entity's</u> original purchase price. This provision also raises the concerns previously discussed dealing with continuing encumbrances that are subsequently cancelled or discharged in part without consideration. The payment of cooperative housing corporation maintenance charges and other payments to maintain the cooperative unit, preserve its value or preserve the priority or the validity of liens should also be included in OPP and we suggest deleting the phrase “subsequent to

the debtor's default but prior to the transfer as a direct result of the debtor's failure to pay such amounts” from the provision in Section 590.60(h)(3)(iii). Again, where a lender pays such costs they should be treated as part of the lender's OPP, without regard to whether there was a technical default at the time of payment. Further, as discussed above, the determination of original purchase price should include any actual consideration paid by the transferee to or for the benefit of the transferor in connection with the conveyance.

15. Section 590.60(i) of the Gains Tax Regulations should be clarified to indicate that it applies to conveyances pursuant to the enforcement of a lien, security interest or other right on or in shares of stock other than shares of stock in a cooperative housing corporation, the conveyance of which shares are governed by the provisions of Section 590.60(h) of the Gains Tax Regulations. Moreover, the regulation should be expanded to clearly cover transfers by a debtor in bankruptcy, with an appropriate cross reference added to Gains Tax Regulation Section 590.66. Also, Section 590.60(i)(1)(v) should be revised to include in consideration a reasonable apportionment to the interests in real property owned by the entity of any other amount paid by the transferee <u>to or for the benefit of the transferor</u> for the transfer.

Additionally, the proviso in Section 590.60(i)(2) refers only to a secured party and should be broadened by adding “or entity's” after the phrase “the secured party's” in the first sentence thereof. Also, as noted above, the regulation should clarify the treatment of continuing liens or encumbrances that are discharged at a discount and indicate whether a bifurcation approach (consistent with the approach in Gains Tax Regulation Section 590.60(f), example 1) should apply in this situation. We

suggest that the parenthetical in Section 590.60(i)(2)(i) be modified to provide that the entity's original purchase price for purposes of this determination should take into account increases in the entity's original purchase price resulting from prior transfers or acquisitions of a controlling interest in the entity. Finally, Section 590.60(i)(2)(ii) should be expanded to add to the list of includible OPP costs expenses that are incurred to preserve or maintain the collateral or preserve the priority or validity of the lien.

Section 590.60(i)(3) should be revised to change the word “by” to the phrase “to reflect” to confirm that amounts described in clauses a-e of Gains Tax Regulation Section 590.60(i)(2)(ii) are not added to an entity's OPP but cause an increase of such OPP to a figure that reflects such amounts.

16. The Gains Tax Regulations do not appear to address the calculation of consideration or the transferee's original purchase price in the case of conveyances in lieu of the enforcement of a security interest or other rights in shares of stock of a cooperative housing corporation or other stock interests, partnership interests or instruments. Tax Law Section 1440.1(d)(ii) clearly applies to a “transfer of real property [which term includes a transfer or acquisition of a controlling interest] to a mortgagee or lienor ... in lieu of foreclosure or any other action to enforce a security interest . . .” (emphasis added). The proposed regulations, however, address only deeds in lieu of an action under the RPAPL, and do not appear to include rules for an in-lieu type transfer of a controlling interest.

Given the language of the statute, we see no reason why Gains Tax Regulation Section 590.60(i) refers only to transfers pursuant to enforcement actions, and Section 590.60(f) refers only to transfers in lieu of mortgage foreclosures or in lieu of RPAPL actions. We urge that the regulations include a comprehensive set of rules, like those provided in Section 590.60(i), for transfers of controlling interests in lieu of a foreclosure or other enforcement action.

17. The 1993 legislative changes, which provide relief in the form of a fair market value limit on consideration in various conveyance situations involving discharges of indebtedness, require that, in preparing transferor and transferee Gains tax questionnaires, a property's fair market value be determined. First, it would be useful if the Department could provide more definitive guidance, either in regulations, audit guidelines, or additional instructions to the Forms TP-580 and 581, as to the documentation of fair market value that will be acceptable at the pre-transfer audit stage. Specifically, we suggest that the Department indicate that, although an independent appraisal of the property being conveyed is desirable, other objective evidence (e.g., internal bank appraisals) can suffice to establish value. By using this approach, the Department would evidence its recognition of the fact that independent appraisals can be burdensome, time consuming and expensive, and generally may be unnecessary, particularly when the value of the real property is significantly less than the transferor's original purchase price. Moreover, guidance would be helpful as to how the Audit Division intends to deal with the pre-transfer audit process in cases involving inconsistent transferor and transferee questionnaires, where the parties disagree as to the fair market value of the property.

Finally, it would be helpful to have some form of technical guidance specifying the procedure by which a transferee in a non-foreclosure transfer can unilaterally secure a statement from the Department indicating that the recording officer is permitted to record the deed and identifying the maximum transferee liability exposure that the Department can assert against the transferee (which liability will be determined under the provisions of Tax Law Section 1447(b)(3)).

18. Section 590.72(d) of the Gains Tax Regulations specifically exempts from personal liability a transferee in an action to foreclose a mortgage and does not forbid the transferee from transferring the consideration to the person conducting the foreclosure sale. This provision indicates that an action to foreclose a mortgage includes any action governed by the RPAPL, such as the enforcement of a mechanic's lien pursuant to Article 3 of the Lien Law. Consistent with the provisions of Regulation Section 590.60, the transferee liability provision here should specifically refer to transferee liability protection for transferees when the transferor is a debtor involved in a bankruptcy proceeding. Moreover, as previously noted, we suggest that the transferee liability protection cover both conveyances by debtors in bankruptcy when the conveyance is the result of a state or a federal foreclosure action as well as conveyances conducted in the Bankruptcy Court pursuant to rules following the provisions of RPAPL Section 1354.

Section 590.72(e) of the Gains Tax Regulations addresses the transferee liability issue in the context of the enforcement of a lien, security interest or other rights on or in shares of stock in a cooperative housing corporation or other ownership interests evidenced by stock certificates or other instruments. This provision should be expanded to specifically

include ownership interests evidenced by partnership interests. This provision should also refer to transfers by a debtor in bankruptcy. The second paragraph of the answer indicates that the relief from transferee liability described in this provision is also applicable in the case of transfers to a party named to act on behalf of the secured party or creditor, giving as an example thereof a conveyance to a wholly-owned subsidiary of the secured party or creditor in full satisfaction of the debt.
Again, the language “to act on behalf of” suggests a nominee or agency type arrangement, which does not appear to be crucial to the conclusion reached in this provision. We suggest language as indicated earlier in our discussion of Section 590.60 of the Gains Tax Regulations. Additional guidance is also needed concerning the application of these rules to a transferee that is partially affiliated with the secured party or creditor.

19. Section 590.72(f) of the Gains Tax Regulations raises the same issues as previously discussed with respect to Section 590.72(e). This provision limits the transferee liability of a mortgagee, lienor, cooperative housing corporation or other secured party or creditor in an “in-lieu-of” transfer to any sums of money paid by such party to the transferor for the transfer. The regulations should address the treatment of installment obligations or other property paid to a transferor, which presumably, like a cash payment, should not be afforded transferee liability protection. The regulation continues by carving out from transferee liability exposure certain payments made by the transferee, namely State Transfer Tax, New York City real property transfer tax and other local transfer taxes, the transferee's payment of amounts to parties holding liens against the real property in order for the transferee to obtain clear and marketable title to the real property, and amounts paid to the Bankruptcy Court to fund a plan of reorganization where such

amounts were used for such purposes. The regulation should indicate that the list of payments is not all-inclusive, and that the transferee is permitted to demonstrate that a payment for an expense other than the expenses expressly set forth in the regulation -- for example, a transferee's payment of an obligation that, if left unpaid, would interfere with or impair the transferee's ownership of the property -- should not trigger transferee liability. This fact pattern raises the issues discussed above concerning how a transferee achieves a comfort level as to its transferee liability exposure, and what procedures are available to enable a transferee to record a deed in the absence of the issuance of a tentative assessment and return and payment of the tax reflected thereon.

Comments Addressing Other Gains Tax Regulations (i.e., Regulations that are Not Being Revised to Incorporate Prior Statutory Changes):

1. Section 590.33 of the Gains Tax Regulations deals with the taxability of sale/leaseback transactions. The regulation indicates that a sale/leaseback of real property located in New York State is a transfer subject to the Gains tax. We suggest that the regulation be modified to reflect what we believe already is the law--that a sale/leaseback transaction generally is a transfer subject to the Gains tax except when the sale/leaseback transaction does not shift beneficial ownership of the property (which is generally determined under federal income tax principles governing incidents of ownership) and is, in substance, a mortgage rather than a conveyance. The recording of a sale/leaseback transaction with respect to which a Gains tax exemption is sought in reliance upon the mortgage exemption should be conditioned on compliance with applicable mortgage

recording taxes. The transfer would, obviously, be subject to audit.

2. Section 590.40 of the Gains Tax Regulations identifies the costs incurred to create ownership interests in cooperative or condominium form that are includible in original purchase price. We suggest expanding the list of includible costs to cover any local transfer taxes (not just New York City real property transfer taxes) paid as a result of the conveyance of title to a cooperative housing corporation.

3. Section 590.44 of the Gains Tax Regulations deals with the aggregation rules applicable to the subdivision of real property. This section should be clarified to limit its applicability to transferors who actually engage in the subdivision of the real property. The regulations should confirm that the aggregation provisions applicable to subdivisions do not extend to lenders who acquire title to subdivided parcels in enforcement of lien rights or to subsequent acquires of interests in the subdivided parcels from the taxpayer who effected the subdivision, from such lenders or otherwise; as to these transferors, the general aggregation rules should apply.

4. With respect to Section 590.46(b) of the Gains Tax Regulations, which addresses the aggregation of transferred or acquired interests in entities owning real property, we recommend that the Department consider adding the following example:

(a) A, the owner of 100% of the stock of a corporation, sells 40% of the stock to an unrelated party, X.

At the time of the sale, A and X have no agreement or understanding to enter into a future sale. Four years later, A sells his remaining stock in the corporation (i.e., 60%) to X.

We believe that, assuming A and X had no agreement or understanding at the time of the 40% transfer to engage in the subsequent sale, the transfers should not be aggregated. The first transfer will not be taxable. The second transfer (of 60% of the stock of the corporation) will itself be a taxable transfer/acquisition.

5. Section 590.46(f) of the Gains Tax Regulations provides that, if a person or group of persons acting in concert transfers or acquires a 50% or more interest in an entity with an interest in real property and tax is paid on the transfer, a second transfer or acquisition of a controlling interest occurs if within a three-year period the same person or group of persons acting in concert transfers or acquires an additional interest in the entity. We suggest that the regulation be clarified to specify that if the initial acquisition or transfer of a controlling interest in an entity with an interest in real property occurs and no Gains tax is payable on the transfer because the consideration for the acquisition or transfer is less than $1 million, the initial acquisition or transfer should not be aggregated with subsequent acquisitions or transfers. Moreover, the regulations should clearly state that transfers or acquisitions of interests in an entity at a time when the entity does not hold an interest in New York real property will not be aggregated with transfers or acquisitions that occur while the entity owns an interest in New York real property. The entity's acquisition or disposition of New York real property is an independent transaction that will be subject to the Gains tax rules; there is no reason (and no statutory basis) for imposing

the Gains tax regime on transfers of interests in entities that own no New York real property interests.

6. Section 590.47 of the Gains Tax Regulations focuses on the identity of the transferor and transferee in the case of a transfer or an acquisition of a controlling interest in an entity with an interest in real property. Clarification is needed to address the identity of the transferor and transferee in the case of a transfer or acquisition of a controlling interest effectuated through an admission and dilution transaction, a redemption, or a merger. The regulation as currently drafted suggests that the entity is not the transferor or the transferee with respect to a transfer or acquisition of a controlling interest effectuated through an admission or redemption and that the other beneficial interest holders in the entity, whose interests in the entity either decrease (in the case of an admission) or increase (in the case of a redemption), are the transferors or transferees, respectively. This treatment is also suggested in the example contained in the last sentence in existing Gains Tax Regulation Section 590.54(b). We suggest that the Department consider whether the entity is more appropriately treated as the transferor or transferee (at least for some purposes as discussed in the following paragraph) with respect to a transfer or acquisition of a controlling interest effectuated through an admission or redemption, because the entity is the actual “transferor” of the interest and because, in cases where a large number of owners may be present, imposing filing requirements on, and collecting tax from, each owner may be unwieldy.

The identification of the transferor and transferee may be relevant for purposes of (i) calculating gain and the amount of tax due, (ii) determining liability for the tax, including transferee liability, and (iii) imposing reporting obligations. The Department may wish to consider whether the identification of the transferor and transferee may differ, depending on the purpose of the inquiry. For example, in the case of a merger, the shareholders may be appropriately viewed as the transferors for purposes of calculating gain and the amount of tax due, while the corporation may best be viewed as the transferor for liability and reporting purposes.

7. Section 590.50(b) of the Gains Tax Regulations should be clarified to indicate that the original purchase price of real property held by an entity may be increased when a transfer or acquisition of a controlling interest in such entity occurs and a partial mere change exemption is applicable. In this situation, it is suggested that the original purchase price of the real property held by the entity may be increased to reflect the consideration realized on the portion of the transfer or acquisition not covered by the mere change exemption.

8. The question posed in Section 590.53(b) of the Gains Tax Regulations should be expanded to inquire as to whether a taxable transfer <u>or acquisition</u> has occurred when real property ("Whiteacre") is transferred to a corporation that already owns other real property ("Blackacre") in exchange for stock and the transferor of Whiteacre acquires 51% of the voting stock of the transferee corporation. The answer should indicate that two taxable events have occurred. The first transfer is the conveyance of Whiteacre to the corporation, which will be a taxable transfer qualifying for a 51% mere change in form exemption. The second transfer is the acquisition by the real

property transferor of a controlling interest in an entity that owns Blackacre.

9. Section 590.55(a) of the Gains Tax Regulations deals with the taxability of a merger of a corporation owning real property into another corporation. The answer indicates that the merger of a corporation that owns real property into another corporation may result in a transfer within the scope of the Gains tax, where the transaction results in the transfer or the acquisition of a controlling interest in an entity that owns real property in New York State. The regulation should also address whether the deed conveyance from the merged company into the survivor triggers Gains tax, particularly where the shareholders of the merged company receive a controlling interest in the surviving entity. For the reasons discussed below, we suggest that the Department consider deviating from a formalistic approach to mergers--under which the nominal identity of the surviving entity controls the determination of whether Gains tax is triggered--and instead look at the substance of the transaction to determine whether there has been a shift of a controlling interest in any real property.

Under the Department's current interpretation, the merger of a large corporation into a smaller corporation (with the smaller corporation surviving) triggers Gains tax on the real property interests held by the larger corporation. To take a simple illustration, consider the merger of Corporation X (which owns real property) and Corporation Y (which does not), in a merger in which the X shareholders are to own 80% of the survivor corporation and the Y shareholders are to own 20%. If X merges into Y, the Department imposes tax on 20% of the gain in X's property, but if Y merges into X, no tax is due. As this example illustrates, the Gains tax places a premium on the identity of

the survivor, and as a result can act as a barrier to frustrate otherwise valid business reasons for having the smaller corporation be the surviving entity.

To illustrate the consequences when both entities own real property, assume that Corporation X and Corporation Y own New York State real property valued at $10 million and $2 million, respectively. If Corporation X merges into Corporation Y (with Corporation Y surviving) and the shareholders of Corporation X acquire 80% of the stock of Corporation Y, two transfers have occurred for Gains tax purposes. The first transfer is the deed conveyance of the properties owned by Corporation X to Corporation Y. The Department's position is that this is a taxable transfer that qualifies for an 80% mere change in form exemption (i.e., 20% of the gain inherent in Corporation X's New York State real property interests will be subject to tax). The second transfer is the transfer of a controlling interest (i.e., the 80% transfer of shares of Corporation Y from the existing Corporation Y shareholders to the Corporation X shareholders) in the New York State real property held by Corporation Y, which would cause 80% of the gain inherent in Corporation Y's real property to be subject to tax. If, instead, Corporation Y is merged into Corporation X with Corporation X surviving and the shareholders of Corporation Y receiving 2 0% of Corporation X, only one transfer occurs -- that is, the transfer that results from the deed conveyance of the properties owned by Corporation Y to Corporation X, which conveyance qualifies for a 20% mere change in form exemption (i.e., 80% of the gain inherent in Corporation Y’s New York State real property interests is subject to tax). There is no transfer of real property by X, nor any transfer of a controlling interest in the New York State real property owned by Corporation X since the Corporation X

shareholders have not transferred a 50% or more interest in Corporation X to the Corporation Y shareholders.

In general, the focus of the Gains tax is, as with other transfer taxes, more on the formal steps involved in a transaction; hence the current difference in outcome depending on the identity of the survivor entity. Given the unique nature of mergers, however, we believe that this regulation should be reconsidered, and specifically that the Department should consider imposing tax in connection with a merger only where the merger results in a transfer or acquisition of a controlling interest in one or both of the merging entities[38]. Thus, tax would be imposed on property held by a corporation involved in a merger transaction not simply where a deed to such property is transferred to a surviving entity but only where there has been a beneficial ownership shift of 50% or more of the interests in the real property owned by either or both of the merging transferor entity or the surviving transferee entity. We believe this approach is appropriate for mergers because in a merger of a transferor entity into a transferee entity, the transferee essentially “becomes” the transferor -- that is, the merged entity is absorbed into the survivor. See BCL §906. As a result, the deed conveyance in a merger, which signifies the transfer by operation of law from the merged entity to the survivor, is different from the typical, non-merger circumstance in which a deed is conveyed from one entity to another.

[38] These comments, although focused on the regulation addressing corporate mergers, are equally applicable to partnership mergers.

10. Section 590.66 of the Gains Tax Regulations deals with transfers pursuant to a plan under the liquidation or reorganization provisions of the Bankruptcy Code. The last paragraph of the answer indicates that a trustee in bankruptcy may file the returns on behalf of a bankrupt transferor, and should withhold the tax due until it is paid. The withholding responsibility of a trustee in bankruptcy should be clarified. This provision suggests that the trustee in bankruptcy may be liable for a failure to withhold. This provision should be clarified to indicate that the trustee in bankruptcy has no liability for failure to withhold and that any transferee liability rests solely with the actual transferee.

11. The example contained in Section 590.69(e) of the Gains Tax Regulations should indicate that it is based on the assumption that the aggregation of Parcel 1 and Parcel 2 is necessitated by the aggregation provisions of the regulations.

12. Section 590.71(a), example 1, of the Gains Tax Regulations contains an illustration of the application of the installment payment provisions. We suggest that the example be expanded to cross reference the obligation to pay interest on the installment payments as set forth in Regulation Section 590.71(b).

13. Section 590.72(a) of the Gains Tax Regulations deals with transferee liability when the Gains tax is paid in installments. The response to the question posed in Section 590.72(a) indicates that, if the transferee failed to withhold, or failed to post a bond, the transferee is personally liable for the Gains taxes due up to the amount of tax stated to be due in the tentative assessment that remains unpaid.

This provision should be modified to indicate that transferee liability is capped at the amount of consideration paid to or on behalf of the transferor. Similarly, the response in Section 590.72(b) of the Gains Tax Regulations should be modified accordingly.

14. Section 590.72(c) of the Gains Tax Regulations addresses whether the transferee is subject to personal liability pursuant to Section 1447(3)(a) of the Tax Law where the transferor fails to file a required questionnaire. The answer indicates that the transferee is not subject to personal liability for the tax as a result of the transferor's failure to file the required questionnaire. Further, it provides that, except as provided in subdivisions (d), (e) and (f) of Section 590.72 of the Gains Tax Regulations, the transferee is subject to personal liability only for the transferee's failure to file a required questionnaire, for the transferee's act of supplying willfully false or fraudulent information on a questionnaire, or for the failure to withhold consideration from the transferor in an amount equal to the tax shown on the tentative assessment and return or to post a bond with the Commissioner of Taxation and Finance for such amount. The question and answer should clarify that, if the transferee's failure to file the required questionnaire causes the Department not to issue a tentative assessment and return, then the transferee is subject to personal liability to the extent of the amount of tax shown on a subsequently issued tentative assessment or notice of determination, which liability would be capped at the amount of consideration paid by the transferee to or on behalf of the transferor. The regulations or some other form of guidance from the Department should also specify what the State's policies are with respect to incomplete filings. For example, if the State only receives the required questionnaire from the transferee, is

it the Department's policy to issue a tentative assessment in an amount equal to 10% of the consideration reflected on the transferee's questionnaire? Alternatively, does the Audit Division generally not issue a tentative assessment when it does not receive a complete filing, i.e., a pre-transfer filing that includes both a transferor and a transferee questionnaire?

15. Section 590.73(a) of the Gains Tax Regulations sets forth the statute of limitations for assessment of the Gains tax. In general, the statute of limitations is three years from the later of the date of the transfer or the date on which a questionnaire required by Section 1447 of the Tax Law is filed or the applicable affidavit required by Tax Law Section 1447(1)(f)(ii) is filed with the Department or its agent. The regulation should specify that the statute of limitations can be different for a transferor and a transferee, based on the date on which the respective parties filed their applicable questionnaires. It should be clarified that a transferee who has complied with the 20-day pre-transfer filing requirement by filing Form TP-581 should have no exposure beyond three years after the date of the transfer even if the transferor's statute of limitations has never begun to run because it has never filed a transferor questionnaire on Form TP-580. Similarly, Section 590.73(c) of the Gains Tax Regulations, which addresses the procedures for an extension of the statute of limitations by agreement between the Commissioner of Taxation and Finance and the person liable for the tax, should indicate that a consent to an extension agreed to by a transferor does not extend the statute of limitations with respect to the transferee, and vice versa.

16. Section 590.74 of the Gains Tax Regulations deals with refunds. We request clarification that, as stated in the current regulation, the refund period with respect to installment elections made prior to April 19, 1989, which period extends for two years from the later of the date of transfer or the date that the entire tax is paid, relates to the entire transaction and all gains tax installments payments made with respect to the transaction.

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As a final administrative matter, we recommend that guidance be provided on the effective date(s) of the Amendments. In particular (and subject to the requirements of the State Administrative Procedures Act),[39] we suggest that the Gains Tax Regulations interpreting specific statutory changes be effective as of the effective date of the statutory change to which they relate. Examples of proposed regulations that interpret specific statutory changes include the expansion of the term "transfer of real property" to include a transfer of a controlling interest in an entity owning real property (effective July 1, 1989) and the provisions addressing the costs includible in OPP[40] and the rules governing troubled debt conveyances[41] (effective April 15, 1993). Changes reflecting a modification of existing policy, such as the

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[39] In preparing this Report we have not researched the Department's authority, in promulgating regulations interpreting statutory provisions, to make such regulations retroactive to the effective date of the statute.

[40] This general reference to the effective date for regulations dealing with costs includible in OPP is subject to the previously noted comment suggesting the deletion of the April 15, 1993 effective date for the inclusion in OPP of items that have been held to be, or might properly be held to be includible in OPP under prior law.

[41] We suggest that the April 15, 1993 effective date apply to both the calculation of consideration on such conveyances, as well as the determination of the transferee's original purchase price.

changes to the Transfer Tax Regulations with respect to troubled debt conveyances involving recourse debt, should be effective as of the date on which the Amendments are adopted and published as final regulations, i.e., they should apply to transfers or conveyances of interests in real property occurring on or after such date. With respect to the determination of an entity's original purchase price in its real property interests and an interest holder's original purchase price in its interest in such entity, we suggest the following: (i) The proposed changes to renumbered Gains Tax Regulation Sections 590.50(b) and 590.50(c) (i.e., the regulation addressing a conveyance of an interest in an entity owning real property other than in a troubled property context), should be given retroactive effect as of October 22, 1990. These proposed changes both expand the regulation to reflect the taxability of transfers of controlling interests (relating to legislative changes effective July 1, 1989) and embellish upon the components of a transferor's OPP (which seems appropriately to relate to existing regulations that were effective as of October 22, 1990). As a result, an October 22, 1990 effective date, being the later of the two effective dates noted in the preceding sentence, seems appropriate. (ii) With respect to the provisions governing debt workout-type conveyances of interests in entities owning real property that are addressed in several subsections of Gains Tax Regulation Section 590.60, the April 15, 1993 effective date of the related statutory changes should apply. We further believe that the Amendments do not alter the calculation of OPP of the entity or of a transferee of an interest in such entity for transactions that occurred prior to such effective dates, i.e., there is no recalculation of OPP with respect to pre-Amendment effective date transfers of interests in entities owning N.Y. real property. (iii) Further, we assume that transfers grandfathered from previous changes in the regulations (e.g., the 1990 amendments to existing Gains Tax

Regulation Section 590.49(c)) are not affected by any of the proposed changes to Gains Tax Regulation Section 590.49(c) (renumbered as Gains Tax Regulation Section 590.50(c) by the Amendments).