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N.Y. Real Property Law Journal

A publication of the Real Property Law Section of the New York State Bar Association

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Message from the Outgoing Section Chair

I want to thank the RPLS officers, committee chairs and members for making my tenure as Section Chair extremely rewarding and enjoyable. During this past year we accomplished a great deal. Our membership zoomed to make our Section the second largest in the New York State Bar Association with more than 4,000 active members. We increased the diversity of our membership and encouraged younger members to take leading roles as committee chairs. We modernized our NYSBA website and created our Real Property Law Section Community, which has popular communications tools used by our members and Committees to share their knowledge and ideas. We expanded law school and host firm participation in our Student Internship Programs so that we now have seven law schools throughout the state participating in our Fall and Spring internship programs. We continued to have stellar Summer and Annual Meetings, where we socialize at dinners and events and learn at outstanding CLE programs.

You are in excellent hands, being led by Section Chair Leon T. Sawyko, with assistance from First and Second Vice-Chairs Mindy Stern and Patricia E. Watkins, Secretary Thomas Hall and Budget Officer Spencer Compton. Our leadership is strong as is the interest of our members to become Committee Chairs, District Representatives and Section Delegates. Please remain active in our Section and continue to recommend our Section to your friends and associates, both for its intellectual and social benefits, as I surely will. Friends made at RPLS meetings and events last a lifetime.

Sincerely,
David L. Berkey
Past Section Chair

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Turn the page on write-downs and write-offs

Message from the Incoming Section Chair

Tempus Fugit. As I write this column in late August, it has just dawned on me that almost one quarter of my time as Chair of the Section has already passed and this is my first opportunity to communicate with all Section members.

This column may read as a litany of thank-yous, and for good reason. First I wish to thank the Executive Committee for allowing me to serve as Chair of one of the most successful Sections in the New York State Bar Association.

As an officer for the past three years, I have been fortunate to serve with Steve Alden, Ben Weinstock and Dave Berkey, my immediate predecessors. In addition, the current officers are Mindy Stern and Trish Watkins, first and second Vice-Chairs respectively, and Spencer Compton, our Budget Officer. We have now been joined by Tom Hall, this year's Secretary. As officers, we are charged with setting direction for the Section. I have found the discussions at the officers' meetings to be informative, robust and productive.

Personally, I must give particular thanks to David Berkey, the immediate past Chair, who has served as an outstanding example of how to direct the Section. He has been very decisive, direct, timely and organized, a combination of attributes which I will work hard to emulate. David has served the Section well and we all owe him a debt of gratitude.

Continuing with the thank-yous, special thanks must be given to Mindy Stern for the outstanding program that a record number of you enjoyed at our summer meeting at the Basin Harbor Club in Vermont on Lake Champlain. This was a beautiful location with outstanding CLE presentations and the opportunity to socialize with members from across the state. Those who attended can share with the rest of the Section the benefits of attending the summer meeting and I urge all of you to consider attending the 2016 summer meeting which will be held at Long Wharf Hotel in Boston July 14 to 17, 2016.

Further thanks are extended to Jeff Chancas, Jeff Moerdler and John Santemma, who have completed their terms as Executive Committee Members-at-Large, and to Larry Wolk, who has completed his term as Section representative to the NYSBA House of Delegates. Thank you for your service. In addition, Ken Block, co-chair of Real Estate Construction; Joe DeSalvo, co-chair of Title and Transfer; Dennis Greenstein, co-chair of Condominiums and Co-Operatives; Tom Hall, co-chair of Title and Transfer; Robert Zinman, co-chair Real Estate Workouts and Bankruptcy; and Elizabeth Woods, co-chair of Public Interest, have resigned or completed their terms as chairs. I thank them for their past service and look forward to their continued participation in Section activities. With this change of roles, we welcome the following new committee chairs:

- Daniel Webster, Public Interest
- Daniel Zinman, Real Estate Workouts and Bankruptcy
- Gavin Lankford, Real Estate Construction
- Dale Degenshein, Condominiums and Co-Operatives
- Toni Ann Barone and Gil Hoffman have moved to new positions as co-chairs, Title and Transfer

As of the most recent tally, our Section consists of approximately 4,050 members, second only to the Trusts and Estates Law Section.

With the size of our Section comes tremendous diversity. We have members who are practicing in mega-firms as well as solo practitioners. We have attorneys from the New York City area and from upstate, in-house counsel and government employees. While we as an officers group and as an Executive Committee know that we cannot serve everyone's needs all of the time, we hope that, with the wide variety of programs and initiatives, all of our members will find increased value in their membership. Our goal is to give each member a reason to continue his or her membership in the Section.

To maintain the relevance of the Section for all, I urge you to forward your comments and suggestions to any of the officers or members of the Executive Committee regarding topics for continuing education programs, challenges for you as real estate lawyers, and any issues which you feel the Section should address.

Looking forward, it is appropriate that goals be expressed for the coming year. While we already have a very strong Section, I hope to continue its growth through the following:

1. Increase membership.
2. Increase diversity in the membership and on the Executive Committee.
3. Provide something meaningful for all of our members, recognizing the wide variety of practices represented in the Section.
4. Present relevant, useful continuing education programs, trying to reach as many members of the Section as possible.
5. Complete a review and amendment of our existing By-Laws to help the Section run more efficiently.

6. Maintain our outstanding representation at the State level through our delegates to the State Bar House of Delegates.

The Section exists for you, the members. It can become stronger and you can receive more value only through your participation. I urge all of you to look at the list of committees set forth at the end of this journal. You can make this Section stronger by joining one or more of those committees which are in tune with your interests. You can join simply by contacting any of the committee chairs listed. They would be happy to add you to their rosters and include you in all committee activities.

In addition, I suggest you go to the State Bar website, join the Real Property Law Section Community and engage in or simply monitor interesting discussions on everyday issues affecting our practices.

I hope to see many of you at the State Bar Annual Meeting, January 25 to 30, 2016. As in past years, our Section will meet on Thursday of that week, January 28, at the New York Hilton Midtown followed by our annual lunch at the 21 Club on that same day.

Finally, thank you for your interest and participation in the Section. I, the other officers and all Executive Committee members will do our best to maintain the Section as a vibrant, meaningful, enjoyable Section.

Leon T. Sawyko

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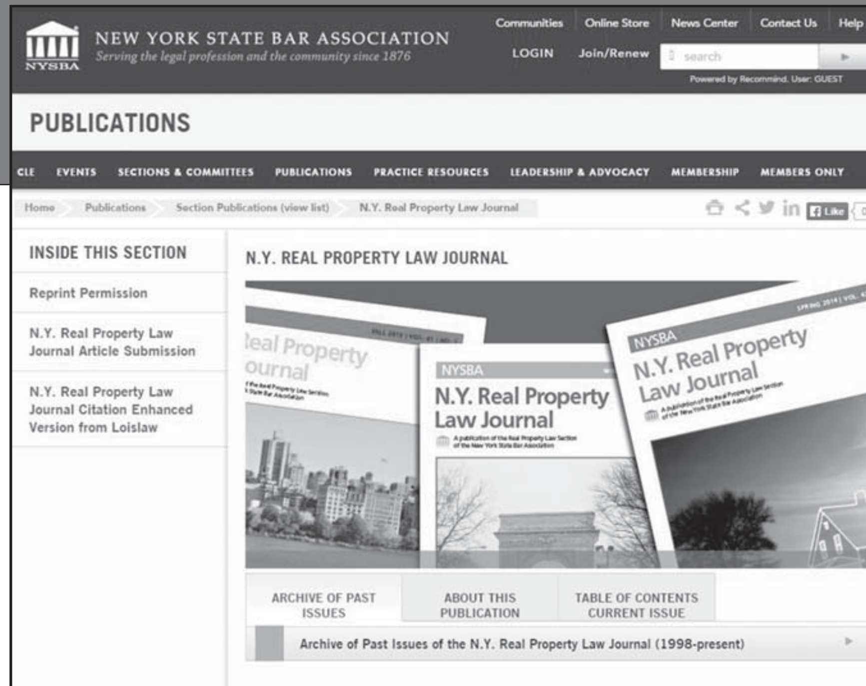

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NEW YORK STATE BAR ASSOCIATION

The Unforeseen and Unfortunate Consequences of Donating a Facade Conservation Easement

By Jeremy M. Klausner

Congress enacted I.R.C. § 170(h), also known as the Federal Historic Preservation Tax Incentives Program ("Program"), to promote voluntary private preservation of historic structures.[1] The concept was simple. The Program provided charitable contribution deductions for taxpayers contributing certain real property interests to "qualified organizations" that were made "exclusively for conservation purposes."[2] In order to facilitate these voluntary contributions, the Program authorized not-for-profit entities to accept such contributions.[3] As simple as the concept was in theory, it could not have turned out to be more complicated in practice when it involved conservation easements, and especially facade conservation easements.

In donating a facade conservation easement, a taxpayer agrees not to modify the facade of his or her historic property.[4] To create such an easement, a taxpayer executes and delivers a conservation deed of easement to an authorized charity, which is recorded in the chain of title and which must be enforceable in perpetuity. The valuation of such easements was (and largely still is) quite difficult because there is no market for them, and because there were very little data available to compare an easement-encumbered property with a comparable unencumbered property. Based on the guidance available, many appraisers determined the value of a facade easement to be approximately 11% of the fair market value of the entire property.

In July 2004, citing improper claims of charitable contribution deductions for conservation easements, the IRS issued Internal Revenue Bulletin 2004-28.[5] In that bulletin, the IRS put would-be donors on notice that "in appropriate cases," it intended to "disallow such deductions and… impose penalties and excise taxes."[6] What the IRS was really saying was that, despite its own guidance, the valuations of conservation easements were being inflated. In the case of facade conservation easements, the "appropriate cases" were legion, spawning a cottage industry for tax professionals and real estate appraisers in defending and valuing such easements. As readers may be aware, the IRS was successful in disallowing, in whole or in part, a great number of facade conservation contribution deductions.[7]

There are a number of frequently asked questions among taxpayers who have had their facade contribution deductions disallowed. The first question is invariably whether the taxpayer can have the easement removed or otherwise sue the donee organization for damages. Similar questions are asked with respect to the appraisers and return preparers involved in reporting and substantiating the deduction. Finally, easement contributors who lost their deductions often want to know if they still must comply with the donee organizations' attempts to enforce deed restrictions. This Article provides answers to these questions, with particular emphasis on issues arising in the context of recent facade easement litigation.

1. Can I Get My Easement Removed?

Taxpayers who contributed a facade conservation easement to a donee organization and later had the charitable contribution deduction denied by the IRS often ask whether it is possible to have the easement removed. The short answer is that most donors will not be able to have their easements removed. The theory behind seeking removal of an easement is that a tax deduction was an expected subsequent event that did not occur. An alternate theory is based in contract for those donors with "side" or "comfort" letters. As detailed below, all donors face an uphill battle to remove easements. Donors with "side" or "comfort" letters have a better chance of obtaining money damages than those without such letters.

a. Treating the Tax Deduction as a Condition Subsequent

As noted, many taxpayers ask whether they can get the easement removed because they did not receive an anticipated tax deduction. In other words, the taxpayer did not get his end of the bargain. Since there is generally no bargain or contract between donors and donee organizations, one might instead argue that receipt of the tax deduction attached to the donation is a condition subsequent that can defeat the gift. The short answer to this theory is that the condition subsequent argument is not viable for facade easements. Any right to remove an easement based on a condition subsequent must be created by deed or simultaneously with the creation of the real property interest. Neither is the case with conservation easements because the reservation of a condition subsequent would make the gift conditional and the easement non-perpetual, thereby defeating (rather than protecting) any anticipated tax deduction.

New York recognizes two situations in which a condition subsequent can defeat an interest in real property.[8] The first is where the condition at issue is a covenant running with the land. A covenant running with the land is generally a promise to do or refrain from doing certain things with respect to real property. Such a cov-

enant must be contained in the deed creating the interest. Facade conservation easements create a covenant running with the land because the donor promises to refrain from changing the property's facade and to maintain the facade in good condition. Thus, the right to remove such a restriction would also need to be contained in the conservation deed of easement. An example would be a deed that created a conservation easement "so long as the IRS does not disallow the grantor's charitable contribution deduction claimed with respect to this deed." Unfortunately, conservation deeds containing provisions allowing for the subsequent removal of easements (or other conservation restrictions) would not qualify for a charitable contribution deduction in the first place because the restrictions would not be considered "perpetual."[9]

Second, New York recognizes a right of reacquisition for real property retained by a grantor and triggered by a condition subsequent. This is classified as a future estate under the New York Estates, Powers and Trusts Law ("EPTL").[10] Pursuant to the EPTL, however, a right of reacquisition arises where there is the simultaneous creation of an estate on a condition subsequent. Generally, creation of an estate on a condition subsequent occurs when a conditional gift is made expressly by will or in a deed of conveyance. Upon the occurrence of the subsequent event, termination of the estate is not automatic; the grantor must exercise the right of reacquisition (sometimes called "right of entry" or "right of re-entry") in order to terminate the estate and recover possession of and title to the property. The possibility that a grantor could reacquire full possession of and title to a previously donated conservation easement would again defeat the requirement that the gift be "perpetual," and such a conditional grant would not qualify for a charitable contribution deduction.[11]

b. Comfort Letters as Breach of Contract

The prospect for having an easement removed may be better for donors with so-called "side" or "comfort" letters. In the period leading up to and immediately after the issuance of Internal Revenue Bulletin 2004-28, the landscape in which the IRS would allow or disallow conservation easement deductions was uncertain. In this time of uncertainty, some qualified easement holding charities, including the National Architectural Trust ("NAT"), issued "side" or "comfort" letter agreements to a small number of donors. In these letters, the donee organization agreed that if the IRS disallowed a donor's charitable contribution deduction, the charity would (i) refund any cash contribution[12] and (ii) join together with the donor to extinguish the easement.[13] Although there are impediments to enforcing comfort letter agreements, including the statute of limitations, they offer donors some hope to either remove the easement or obtain a monetary judgment for damages against the donee organization.

As noted, the threshold issue for having an easement removed is the statute of limitations. The contract limitations period in New York[14] and Massachusetts[15] is six years (and only three years in Washington, D.C.[16]). In New York, the limitations period is measured from the date of the breach of contract. This begs the question: when is a comfort letter agreement breached? While it would certainly be dependent on the specific language of the agreement, the general concept is that the donee organization will refund cash contributions and join together with the donor to remove the easement. In that situation, it seems logical that the agreement is not breached until the donee organization refuses a request to either refund the cash or help extinguish the easement. If the donee organization has already refused such a request, the limitations period would run from that date. If no request has yet been made, and there is therefore no refusal, the statute of limitations has not yet begun to run. An aggrieved taxpayer with a comfort letter agreement who has not yet requested the return of a cash contribution or the extinguishment of an easement would do well to precipitate a breach if he or she intends to pursue any such claim.

A second impediment to having an easement removed is the doctrine of merger, which is followed in New York. The merger doctrine generally provides that in a real estate transaction, once the deed is delivered its terms are all that survive and the parties may not litigate any claims arising out of the underlying contract. The only exception to the merger doctrine is where the parties clearly intended that a particular provision of the contract survive the delivery of the deed.[17] Although comfort letters do not specifically state they will survive delivery of a deed of easement, the fact that they pertain to events that can only occur after delivery could be sufficient to show the parties intended their terms to survive.

Even if successful in avoiding the merger doctrine, donors in New York who want the easement extinguished are faced with New York's Environmental Conservation Law ("ECL"). Pursuant to ECL § 49-0307, a conservation easement held by a not-for-profit conservation organization may only be modified or extinguished based upon the following narrowly construed events:

(1) As provided in the instrument creating the easement;

(2) In a proceeding pursuant to section nineteen hundred fifty-one of the real property actions and proceedings law; or alternatively,

(3) Upon the exercise of the power of eminent domain.[18]

Subsection (3) of ECL § 49-0307 is clearly of no use to donors because the power of eminent domain is reserved to the government. With respect to subsection (1), however, the United States Tax Court ("Tax Court") has held that certain facade easement deeds provide for their own extinguishment. For example, in *Graev v. Commissioner of Internal Revenue*,[19] the Tax Court held that the easement at issue gave the donee organization (NAT) the right to abandon the easement, and therefore found that § 49-0307(1) was satisfied. In other words, the deed did provide for its own modification or extinguishment, i.e., by NAT's abandoning it. The Court went on to reason, therefore, that NAT had the ability to honor, and in fact intended to honor, the comfort letter agreement in that case by abandoning the easement. While there is certainly an argument to be made based on *Graev*, the author thinks the Tax Court went too far. While the deed in that case provided that NAT had the right to "abandon some or all of its rights" under the easement, that is not the same as extinguishing the easement. In a contract action, as discussed below, where monetary damages would be sufficient to make a taxpayer whole, it is difficult to see a New York Court forcing a donee organization to abandon any property rights it has. This is because it is generally understood that the law abhors a forfeiture. Obviously, facade conservation deeds that do not contain this language would not be amenable to a *Graev*-based argument.

That leaves subsection (2) of ECL § 49-0307,[20] or section 1951 of New York's Real Property and Proceedings Law ("RPAPL"). Pursuant to RPAPL § 1951, a court may declare an easement's restriction unenforceable only if the restriction is of no actual and substantial benefit to the party enforcing the easement because: (1) the easement's purpose has already been accomplished; or (2) changed conditions make it impossible to accomplish the easement's purpose.[21] There is an argument available to donors whose properties are in registered historic districts that the easement's purpose has already been fulfilled. As is repeatedly argued by the IRS, local landmark preservation laws already accomplish the same purpose as the easement. Unfortunately for this argument, many taxpayers have already argued the opposite, and several United States Tax Court cases have assigned value to facade easements, holding that New York's landmark preservation laws are not as comprehensive as the restrictions in certain facade easement deeds.[22] Taxpayers already receiving value for their easements will be estopped from claiming that the easement's purpose has been fulfilled, and those taxpayers that have not may face an uphill battle, at least in New York. A recent opinion of the full Tax Court, however, held that there was no value in similar facade easement restrictions even though they were more comprehensive than local preservation laws in Boston, Massachusetts.[23] One thing is for certain—taxpayers who have litigated in Tax Court and had their easements valued at zero would have the best chance of convincing a court that their particular easement is not more restrictive than local preservation laws.

In sum, taxpayers who contributed a facade conservation easement to a donee organization and later had their charitable contribution deduction denied by the IRS face difficulty in having the easement removed. However, as discussed below, an action for monetary damages by a taxpayer who has a "side" or "comfort" letter has significantly more chance for success. In this regard, the same considerations would apply for the statute of limitations and the merger doctrine, but instead of having to contend with the ECL, the aggrieved taxpayer would only have to demonstrate money damages arising from the breach of the comfort letter agreement. Such damages may be measured by the diminution in value of the property caused by the easement, or more likely, the economic loss caused by the disallowance of the tax deduction associated with the easement contribution. Since the author is unaware of any reported decisions on the issue, it would be interesting to see whether a court deciding the issue of damages would include as damages a taxpayer's attorneys' fees spent in defending the charitable contribution deduction in an audit or litigation with the IRS.

2. What Are Taxpayers' Remedies When Their Deduction Is Disallowed Due to the Negligence of the Donee Organization?

In challenging facade contribution deductions, the IRS puts compliance with every regulation under a microscope. While generally losing on hyper-technical grounds, the IRS has been successful in challenging deductions on the ground that they were taken in the wrong year. This situation arises where a taxpayer delivers a facade easement deed to a donee organization and the organization does not get the deed recorded until the following year. The taxpayer, believing the gift is complete upon delivery, takes the deduction in the earlier year. The IRS has argued, and the Tax Court has agreed, that the gift of a conservation easement is not complete until recorded.[24] Sometimes the deed is not recorded in the same year because the taxpayer delivers it in late December. In other instances, the deed is not timely recorded because the donee organization does not efficiently do so. The IRS also scrutinizes the contemporaneous acknowledgement letters provided by donee organizations for compliance with I.R.C. § 170(f)(8). That section requires such letters to contain a statement that no goods or services were received in exchange for the contribution, or the value of any goods or services that were provided. Where the required language is missing, the absence of the language can defeat the entire deduction.

As noted, there is generally no agreement between a donor and a donee organization. Thus, a donee organization is under no contractual duty to efficiently record a deed or provide a compliant acknowledgement letter and a breach of contract claim will likely not survive a well-drafted motion to dismiss. Even the handful of comfort letter agreements do not specifically impose a duty to record or provide an appropriate acknowledgment (although the letters offer some protection against any disallowance of the taxpayer's deduction, presumably including a loss caused by the donee organization's own doing). Thus, it seems, the only other available claim is for negligence. The black letter elements of a claim of negligence are the existence of a duty owed by one party to another, a breach of the duty, and that the breach of duty causes harm.[25] The question to be answered, at least with respect to the recordation of the deed and the issuance of the contemporaneous written acknowledgment, is whether a donee organization owes a duty of care to a donor to do its paperwork properly.

a. No Statutory Duty of Donee Organization to Provide Contemporaneous Acknowledgment

It has been suggested that donee organizations may have a statutory duty to provide donors with contemporaneous written acknowledgment letters that contain the information required by the applicable statute, I.R.C. § 170(f)(8)(B). The theory is that an unexcused violation of a statutory standard of care is negligence *per se*.[26] The negligence *per se* theory, however, is unavailing because the duty to provide a compliant contemporaneous written acknowledgement is squarely placed on the taxpayer, not the donee organization. Pursuant to I.R.C. § 170(f)(8)(A), "[n]o deduction shall be allowed…unless the *taxpayer* substantiates the contribution by a contemporaneous written acknowledgment…that meets the requirements of subparagraph (B)" (emphasis added). Subparagraph (B) of I.R.C. § 170(f)(8) merely lists those requirements and does not place a duty on the donee organization to fulfill them. The plain language of the statute puts the duty on the taxpayer to obtain a written acknowledgment and ensure that the acknowledgment complies with the statutory requirements. The legislative history also makes clear that it is the taxpayer, not the donee organization, who is required to obtain the written acknowledgment:

> Difficult problems of tax administration [that] arise with respect to fundraising techniques in which an organization that is eligible to receive tax deductible contributions provides goods or services in consideration for payments from donors.… [T]he committee believes that there will be increased compliance with present-law rules governing charitable contribution deductions if a taxpayer who claims a separate charitable contribution…is required to obtain substantiation from the donee indicating the amount of the contribution and whether any goods, service, or privilege was received by the donor in exchange for making the contribution…[27]

A recent opinion from the United States Tax Court confirms that it is the taxpayer who has the duty to obtain the contemporaneous written acknowledgment. In a case involving the taxpayers' failure to substantiate charitable contributions with the required written acknowledgment, *Kunkel v. Commissioner*,[28] the Court concluded that the taxpayers "*were required to obtain*, but did not obtain, contemporaneous written acknowledgments for their contributions."[29] The Court also noted that the taxpayers failed to obtain acknowledgments from a Church although "[t]he Church was evidently equipped to provide such receipts."[30] Again, cases such as *Kunkel* confirm that the duty is on the taxpayer to obtain the acknowledgment, not for the donee organization to provide it. Since there is no statutory duty placed on the donee organization, there can be no negligence *per se*.[31]

Given the clear statutory language and the recent case law on the issue, it is difficult to rationalize how a court would find that a donee organization has a common law duty to provide a compliant written acknowledgment. Thus, it seems clear that a donee organization is under no duty to provide an acknowledgment. If a written acknowledgment is provided, however, the natural question is whether the donee organization has a duty to make sure it complies with the statutory requirements. For the same reasons cited above, the answer must be no. Again, it is relatively clear that it is the taxpayer's responsibility to obtain a written acknowledgement and confirm that it complies with the statutory requirements.

b. Possible Duty on Part of Donee Organizations for Timely Recordation of Conservation Deeds—but Only for Post-2012 Easements

A related question arises with respect to whether a donee organization owes a donor the duty to record a conservation deed of easement in the same year it was delivered. In the wake of the *Rothman* and *Zarlengo* Tax Court decisions, the answer may be "yes." *Rothman*, decided in 2012, held that a facade easement contribution is not a completed gift until it is recorded. The opinion in *Rothman* is based on a New York statute that provides for the creation and recordation of conservation easements, NY ECL § 49-0305. *Rothman* interprets that statute to mean that a conservation easement is not created until it is recorded. The author has argued that *Rothman* is an overstatement of ECL § 49-0305. Although it is beyond the scope of this article, all

that is required to create a conservation easement in New York is a deed memorializing the donation, in writing, subscribed by the grantor and delivered to and subscribed by the grantee.[32] Thus, although there is no New York opinion yet on this topic, a New York court might reject the reasoning in *Rothman* and hold that a conservation easement is created when the deed is delivered, not when it is recorded. The *Zarlengo* opinion clarified *Rothman* somewhat, holding that a conservation easement is not protected in perpetuity until it is recorded. Since perpetual protection is a requirement for the grant of a conservation easement to be allowed as a deduction, this rationale makes more sense, though it is also subject to criticism.[33]

Prior to *Rothman* and *Zarlengo*, there was no reason to believe that recordation of a conservation deed was the operative date of the gift. This is because it has long been held that a gift is generally complete for federal tax purposes when a competent donor irrevocably transfers present legal title, dominion, and control of the property constituting the gift to a donee who accepts the gift.[34] It would certainly have been reasonable to rely on State law, which the author believes does not require recordation to create a conservation easement. It would also have been reasonable to expect that a brief delay in recording a deed would not lead to disallowance of a charitable contribution deduction. Thus, prior to 2012, donors will be hard-pressed to impose a duty on donee organizations in this regard. Even if such a duty can be imposed, it begs a second question as to what would be a reasonable delay in recording a deed. That leads to issues of proof such as when the deed was delivered to the donee organization, whether the deed was properly executed by the donor, how it was delivered, when it was actually received, and other similar questions. The author has seen many cases where deeds were delivered by donors at or close to the end of December. These would be much harder cases than say, where a deed was delivered in September and not recorded until the following year. Thus, whether a donor is entitled to damages as a result of the donee organization's failure to record a deed of easement is fact-intensive.

3. What Are Taxpayers' Remedies When Their Deduction Is Disallowed Due to the Negligence of a Return Preparer?

Taxpayers who contributed a facade conservation easement to a donee organization and later had their charitable contribution deduction denied by the IRS may also be entitled to damages from their return preparer. While there does not appear to be a duty on a donee organization to provide a sufficient acknowledgment letter, there certainly is a duty on a return preparer to ensure that a client's return is properly substantiated. Return preparers should be well aware of the acknowledgement letter requirements contained in I.R.C. § 170(f)(8)(B).[35] There is little question that return preparers are responsible not only to ensure that such letters comply with section 170(f)(8), but also to alert taxpayer-clients when acknowledgement letters are necessary (if they have not already been provided).

The premise for a claim against a return preparer is obviously grounded in negligence theories of malpractice. In New York, the elements of a professional malpractice claim are (i) negligence of the professional; (ii) that such negligence was the cause of the loss; and (iii) actual damages.[36] Thus, if a return preparer failed to catch a faulty acknowledgment letter, and that failure led to the disallowance of a charitable contribution, it would appear that the elements of a professional malpractice claim are satisfied. Moreover, most professionals carry liability insurance, so there is a source from which a judgment can be recovered.

A malpractice claim against the return preparer is not, however, a foregone conclusion. The biggest issue that taxpayers will face in succeeding on a malpractice claim is the statute of limitations. In New York, the statute of limitations for professional malpractice is three years,[37] and the general rule appears to be "a malpractice action against an accountant for negligence in preparing an income tax return must be commenced within three years from the deadline for filing such a return."[38] New York has a tolling provision, however, that the limitation period runs from the end of continuous representation on a particular matter rather than from the incident complained of. This tolling provision is applicable to accountants.[39] Therefore if a return preparer represents a taxpayer in an audit regarding the faulty acknowledgment letter, the limitations period would not begin to run until the end of the audit. Non-New York courts may not agree.[40] Since the rule in New York is three years from the due date of the return, unless that rule is challenged and changed, donors will only be able to claim against return preparers for returns filed after 2011.

4. What Are a Taxpayer's Remedies Against an Appraiser?

Taxpayers who contributed a facade conservation easement to a donee organization and later had their charitable contribution deduction denied by the IRS often ask whether they are entitled to damages from the appraiser who prepared the appraisal that served as the basis for the charitable contribution deduction. There are two issues to be addressed with respect to appraisers. First is whether there is a claim for negligence if an appraiser's valuation is rejected by the IRS or a court. Second is the question of an appraiser's negligence if his appraisal is found not to be a "qualified appraisal" pursuant to the applicable regulations.

a. Valuation

An appraiser's valuation is merely an opinion. Although there are certain guidelines that appraisers must follow,[41] reasonable appraisers often differ in their valuations of the same property without being negligent. The valuation of facade easements is particularly difficult because there is no market for such easements and because there is still not a significant amount of data available for appraisers to compare the values of easement-encumbered properties with similarly situated unencumbered properties. Up until about 2005, appraisers concluded that residential facade easements were worth about 11% of the value of the entire property. This conclusion was based on applicable case law,[42] an article authored by IRS employee Marc Primoli,[43] and the 1994 IRS Audit Technique Guide. In 2003, both the Audit Technique Guide and a revised version of the Primoli article omitted any reference to the 10% to 15% range, but little other guidance was available. Even today, when more data is available, appraisers disagree on the value of facade easements. Some appraisers maintain that paired sales analyses confirm the 11% range of value; other appraisers simply reject that facade easements in historic districts have any value at all. Absent an abundance of proof that an appraiser simply fabricated a value or blatantly ignored industry standards, the difficulty of establishing that an appraiser provided a negligent valuation is overwhelming. Consequently, taxpayers will face considerable difficulty in obtaining damages against an appraiser with respect to a valuation issue.

b. Qualified Appraisal

For charitable contribution deductions of property with a claimed fair market value in excess of $5,000, a taxpayer must obtain a "qualified appraisal" from a "qualified appraiser." For charitable contribution deductions of property with a claimed fair market value in excess of $500,000, a taxpayer must attach to the return on which the deduction is first claimed a "qualified appraisal" from a "qualified appraiser." There are numerous technical requirements for "qualified appraisals" that can be found in IRS Publication 561[44] and the relevant Treasury Regulations. The IRS has aggressively sought to disallow charitable contribution deductions related to facade easements based on failure to comply with these substantiation requirements. In particular, the IRS often cites to alleged hyper-technical deficiencies in an effort to disqualify a "qualified appraisal." Fortunately, the IRS is not often successful on these grounds.

In cases where a deduction is disallowed because a taxpayer's appraisal was found to be not a "qualified appraisal," the question of the appraiser's malpractice (if any) will be extremely fact-specific. Under common law principles, an appraiser would be negligent if he or she failed to meet the accepted standard of care in the appraisal profession to ensure that he or she provided a qualified appraisal. For example, the IRS often attacks qualified appraisals because they provide a valuation based on "market value," instead of "fair market value." However, the appraiser invariably defines "market value" within the appraisal in the same manner as "fair market value" is defined for federal tax purposes. If an appraisal were hypothetically determined to be not qualified on this basis, would another court (or a jury) determine that the appraiser fell below the appropriate standard of care? In other words, the hyper-technical requirements for a "qualified appraisal" are different considerations from what a reasonable appraiser would consider sufficient to meet those requirements, and therefore may not constitute negligence.

The stage at which the determination is made as to whether there was a qualified appraisal is also important. If a taxpayer's deduction is disallowed during audit based on a non-qualified appraisal and the matter ends there, an IRS employee's determination will carry little weight in a subsequent negligence action. If, however, the determination carries the authority of the Tax Court or another court of competent jurisdiction, that is significantly better evidence for the taxpayer that the appraiser was negligent in providing a "qualified appraisal."

Finally, a taxpayer could make the argument that the requirements for a "qualified appraisal" constitute a statutory standard of care, and failure to meet that standard or care constitute negligence *per se*. As noted above with respect to written acknowledgment letters, it is the taxpayer's obligation to substantiate his return with a "qualified appraisal." There is no statute mandating that the appraiser include all necessary information in an appraisal, nor any indication that the "qualified appraisal" requirements are designed to protect taxpayers from appraiser negligence. Therefore, taxpayers should expect difficulty in prevailing under a theory of negligence *per se*.

c. Statute of Limitations

In New York the three-year statute of limitations for professional malpractice applies to appraisers.[45] Unfortunately, there is little guidance on when the limitations period begins to run, and the same above-described arguments regarding return preparers may apply with respect to appraisers. As such, an attorney who brings a malpractice claim against an appraiser should do so at the earliest possible time.

5. Do I Have to Do the Maintenance Required by the Donee Organization?

Finally, taxpayers who contributed a facade conservation easement to a donee organization and later had their charitable contribution deduction denied by the IRS often ask whether they must continue to perform the maintenance required by the donee organization. The short answer to this question is "yes." Unless the easement is extinguished or modified, it is enforceable at law by

the donee organization. The conservation deeds of easement generally contain arbitration provisions for donors (or their successors in interest) to challenge actions of the donee organizations.

6. Conclusion

The donation of a conservation easement to a qualified donee organization is a gift of a property interest. It is meant to be permanent. While donors may be entitled to a tax deduction for making such a gift, the denial of a deduction does not invalidate the gift. Donors frustrated by the denial of their deduction have still created an enforceable, perpetual restriction on the use of the encumbered property and those restrictions will prove almost impossible to remove. Those donors provided with side agreements by donee organizations are in a significantly better position to seek some form of recompense when deductions are disallowed.

The substantiation requirements for a charitable contribution deduction with respect to a conservation easement are complicated. Where taxpayers rely in good faith on professionals to report and substantiate such deductions, those professionals are held to the standards of care applicable to their industries. Where those standards have not been met, taxpayers will have professional malpractice claims to pursue.

In short, donors should never expect to have easements removed. In certain cases, money damages may be available. Since the harm to donors whose deductions are disallowed is more economic than anything else, perhaps this is the right result.

Endnotes

1. I.R.C. § 170(h) (2014).
2. *Id.*
3. National Historic Preservation Act, Pub. L. No. 89-665, 80 Stat. 915 (1966); Tax Reform Act of 1969, Pub. L. No. 91-172, 83 Stat. 487, 549 (1969); H.R. Rep. No. 91-782, at 75 (1969) (Conf. Rep.); Act of Dec. 17, 1980, Pub. L. No. 96-541, 94 Stat. 3204 (1980).
4. A historic conservation easement only qualifies for a deduction if the property is a "certified historic structure," i.e., a property inside a registered historic district or that is listed on the National Register of Historic Places. I.R.C. § 170(h)(4)(A)(iv), (C) (2014).
5. IRS, Internal Revenue Bull. No. 2004-28, 31, http://www.irs.gov/pub/irs-irbs/irb04-28.pdf (last updated July 12, 2004).
6. *Id*.
7. *See* IRS, Facade Easement Contributions Brief (Aug. 27, 2009), http://www.irs.gov/pub/irs-utl/facade_easement_brief_june_2009_final_revision_08272009.pdf (providing guidelines as to when deduction is disallowed).
8. *See* Suffolk Bus. Ctr., Inc. v. Applied Digital Data Sys., Inc., 78 N.Y.2d 383, 386-87, 581 N.E.2d 1320, 1321, 576 N.Y.S.2d 65, 66-67 (1991) (discussing a thorough and direct application of the conditions subsequent as covenants or future interests).
9. I.R.C. § 170(h)(2)(c) (2014).
10. N.Y. Est. Powers & Trusts Law § 6-4.6 (McKinney 2015).
11. The same analysis would apply if the easement were subject to terminate automatically upon the occurrence of a specified event. In that case, there would be a "possibility of reverter" at the time the easement was created, again defeating the "perpetual" requirement. *See* N.Y. Est. Powers & Trusts Law § 6-4.5 (McKinney 2015) ("A right of reacquisition is the future estate left in the creator or in his successors in interest upon the simultaneous creation of an estate on a condition subsequent.").
12. Taxpayer's donating facade conservation easements were also generally requested to make a cash contribution to the donee organization, generally equal to 10% of the value of the easement donated. These contributions were used to fund the organization's inspection and enforcement efforts. *See* Scheidelman v. Comm'r, 682 F.3d 189, 193. (2d Cir. 2012).
13. At the time these letters were provided, the applicable case law seemed to hold that such letters did not affect the deductibility of an easement contribution. *Compare* O'Brien v. Comm'r, 46 T.C. 583, 592 (1966), *with* Graev v. Comm'r, 140 T.C. 377, 379 (2013) (specifically holding that such a comfort letter made the gift conditional, and therefore the deduction was disallowed).
14. This Article focuses primarily on New York law due to the number of facade easements at issue there. While the law of other jurisdictions may differ, the general considerations to be addressed are consistent from jurisdiction to jurisdiction. CPLR 213 (McKinney 2015).
15. Mass. Gen. Laws Ann. ch. 260, § 2 (West 2015).
16. D.C. Code § 12-301 (2015).
17. TIAA Global Invs., LLC v. One Astoria Square LLC, 127 A.D.3d 75, 85, 7 N.Y.S.3d 1, 8 (1st Dep't 2015) (citing Ka Foon Lo v. Curis, 29 A.D.3d. 525, 526, 815 N.Y.S.2d 131, 133 (2d Dep't 2006)).
18. N.Y. Envtl. Conserv. Law § 49-0307.
19. 140 T.C. 377, 403-04 (2013).
20. N.Y. Envtl. Conserv. Law § 49-0307(2).
21. *See* N.Y. Real Prop. Acts. Law § 1951 (McKinney 2015); *see generally* Garrett v. Vill. of Asharoken, 185 A.D.2d 873, 586 N.Y.S.2d 1002 (2d Dep't 1992) ("Although it need not be alleged that a restriction on the use of land is of no benefit to the party seeking to enforce it before such a restriction can be declared unenforceable..., it must nevertheless be alleged and proven that the restriction is of no 'actual and substantial benefit.'") (citation omitted); Nature Conservancy v. Congel, 296 A.D.2d 840, 744 N.Y.S.2d 281 (4th Dep't 2002) (granting in its entirety plaintiffs' motion for a permanent injunction because defendants failed to prove that the restrictive covenant was "of no actual and substantial benefit" to plaintiffs).
22. *See* Gorra v. Comm'r, 106 T.C.M. (CCH) 523, 2013 WL 5988939 at *10-13, *23-*25 (2013); Zarlengo v. Comm'r, 108 T.C.M. (CCH) 155, 2014 WL 3907047 at *19-*20 (2014).
23. *See* Chandler v. Comm'r, 142 T.C. 279 (2014); Kaufman v. Comm'r, 107 T.C.M. (CCH) 1262, 2014 WL 1282750 (T.C. 2014), *aff'd*, 784 F.3d 56 (1st Cir. 2015).
24. Rothman v Comm'r, 103 T.C.M. (CCH) 1864, 2012 WL 2094306 at *12 (2012), *vacated in part*, 104 T.C.M. (CCH) 126, 2012 WL 3101513 (2012); Zarlengo, 108 T.C.M. 155, 2014 WL 3907047 (2014). It should be noted that in *Zarlengo*, the Tax Court also held that since the deduction could not be taken in the earlier year (i.e., the year the deed was delivered), it could be taken in the later year (i.e., the year the deed was recorded) if the Court had jurisdiction over the later year. Even if the Court does not have jurisdiction over the later year, there is an argument to be made to allow the deduction under the Internal Revenue Code's mitigation statute, I.R.C. § 1311.
25. Jiminez v. Shahid, 83 A.D.3d. 900, 901, 922 N.Y.S.2d 123, 124 (2d Dep't. 2011).
26. Cordero v. N.Y.C., 112 A.D.2d. 914, 916, 492 N.Y.S.2d 430, 433 (2d Dep't 1985).
27. H.R. Rep. No. 103-111, pt. 7, at 785 (1993).
28. 109 T.C.M. (CCH) 1379, 2015 WL 1546471 (2015).
29. *Id*. at *11.
30. *Id*. at *3.

31. In addition, an element of negligence *per se* for the violation of a statute is that the statute is designed to prevent an injury to the class of persons to which the injured party belongs. *See generally* Johnson v. Sawyer, 4 F.3d 369 (5th Cir. 1993). There is absolutely no indication that I.R.C. § 170(f)(8) was designed to protect donors from the negligence of donee organizations in the context of written acknowledgment letters. If that were the case, the statute would provide that donee organizations *shall* provide taxpayers with written acknowledgments that comply with the statutory requirements. In this regard, it has also been suggested that I.R.C. § 6511 imposes a duty upon donee organizations to provide the necessary written acknowledgement. Since (i) I.R.C. § 6511 is only applicable to *quid pro quo* donations, which facade easement contributions are not, (ii) I.R.C. § 6511 is designed to protect government revenue and not taxpayers, and (iii) it is clearly the taxpayer's responsibility to obtain the written acknowledgment, I.R.C. § 6511 is not likely to provide a basis for a negligence *per se* claim.
32. N.Y. Gen. Oblig. Law. § 5-703 (McKinney 2015); N.Y. Envtl. Conserv. Law § 49-0305(1) (McKinney 2015).
33. Even an unrecorded conservation deed is enforceable against the grantor. The possibility that a grantor could deliver the deed, then turn around and quickly sell the property prior to recordation, without the knowledge of the purchaser or the donee organization, is remote at best.
34. *See* Guest v. Comm'r, 77 T.C. 9, 16 (1981) (quoting Weil v. Comm'r, 31 B.T.A. 899, 906 (1934), *aff'd*. 82 F.2d 561 (5th Cir. 1936)).
35. I.R.C. § 170(f)(8)(B) (2014).
36. Reibman v. Senie, 302 A.D.2d 290, 290, 756 N.Y.S.2d 164, 164 (1st Dep't 2003).
37. CPLR 214(6) (McKinney 2015).
38. Goulding v. Solomon, 123 Misc. 2d 954, 956, 475 N.Y.S.2d 723, 725, 1984 N.Y. Misc. LEXIS 3115, *4-5 (N.Y. Civ. Ct., Bronx Cnty 1984).
39. Wilkin v. Dana R. Pickup & Co., 74 Misc. 2d 1025, 1026-27, 347 N.Y.S.2d 122, 125, 1973 N.Y. Misc. LEXIS 1690, *5 (Sup. Ct., Allegany Cnty 1973).
40. *See, e.g.,* Murphey v. Grass, 267 P.3d 376, 164 Wash. App. 584, 2011 Wash. App. LEXIS 2493 (2011) (holding that a business's claim against accountant alleging negligent preparation of state tax returns did not accrue for purposes of three-year statute of limitations until appeals division of Department of Revenue denied business's petition for correction of tax assessment); *see also* Caroline Rule, What and When Can a Taxpayer Recover From a Negligent Tax Advisor, 92 J. Tax'n 176, 179-80 (Mar. 2000) (summarizing the rules regarding statute of limitations issues and provides a survey of the then-current case law).
41. *See* Appraisals Standards Board, Unif. Standards of Prof'l Appraisal Practice (2014), www.uspap.org.
42. Hilborn v. Comm'r, 85 T.C. 677, 680, 85 T.C. No. 40, 1985 U.S. Tax Ct. LEXIS 23, *9 (1985).
43. Scheidelman v. Comm'r, 682 F.3d 189, 196, 2012-1 U.S.T.C. (CCH) P50, 402, 109 A.F.T.R.2d (RIA) 2536 (2d Cir. 2012) ("Internal Revenue Service Engineers have concluded that the proper valuation of a facade easement should range from approximately 10 percent to 15 percent of the value of the property.") (quoting Mark Primoli, IRS, Facade Easement Contributions (2000)), an excerpt of which is available at http://www.forbes.com/sites/peterjreilly/2011/07/05/facade-easement-deduction-allowed (last visited Aug. 17, 2015).
44. *See* IRS, Determining the Value of Donated Property, Publ'n No. 561, http://www.irs.gov/pub/irs-pdf/p561.pdf (last updated April 2007).
45. CPLR 214(6) (McKinney 2015); *see also* Early v. Rossback, 262 A.D.2d 601, 602, 692 N.Y.S.2d 465, 466-67 (2d Dep't 1999), *rev'd on other grounds sub nom.*, Bros. v. Florence, 95 N.Y.2d 290, 306, 739 N.E.2d 733, 742, 716 N.Y.S.2d 367, 376 (2000).

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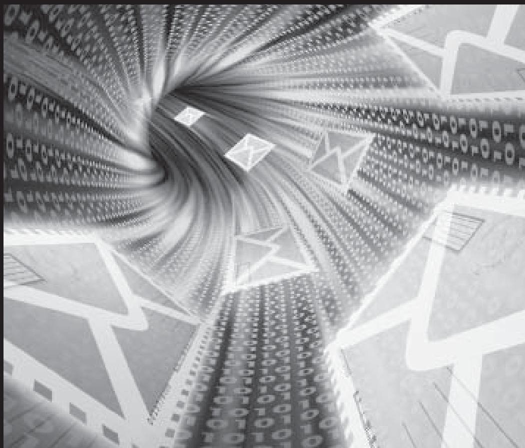

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Partnerships and § 1031 Exchanges: Available Options for Partners and Partnerships

By William F. Webster and Pamela A. Michaels

Like any taxpayer, a partnership (and a limited liability company taxed as a partnership, generally referred to herein as a "partnership") can engage in a like-kind exchange under I.R.C. § 1031 to defer paying tax on capital gains.[1] Difficulties can arise, however, when the individual partners desire different outcomes with regard to the sale of property by the partnership. Some partners may wish for the partnership to stay together and do an exchange; others may want to do their own exchange with their portion of the property; still others may wish to receive cash and simply pay the tax. What alternatives are available to the partners in the Northeast?

Partners Doing Separate Exchanges

A taxpayer must own a capital asset to do a 1031 exchange. The fact that a partnership owns a capital asset does not mean that the individual partners have an ownership interest in that asset. The partners merely own partnership interests. Partnership interests are specifically excluded from Section 1031 under I.R.C. § 1031(a)(2)(D).[2] Therefore, if an individual partner wants to do a 1031 exchange, the partner must convert his or her partnership interest into an interest in the capital asset owned by the partnership.

One method for accomplishing this, known as a "drop and swap," involves the liquidation of a partnership interest by distributing an interest in the property owned by the partnership. After completion of the "drop," the former partner will have converted his or her partnership interest into an interest in the actual property itself, as a tenant-in-common with the partnership. The property can then be sold, with the former partner and the partnership each entitled to do what they wish (sale or exchange) with their respective interests.

Related to the "drop and swap" is the "swap and drop." This involves the same two steps, but in reverse order. The partnership completes the exchange (the "swap"), and then distributes an interest in the replacement property to the departing partner.

Holding Period Issues

Both the "drop and swap" and the "swap and drop" alternatives raise potential holding period issues. If the "drop" occurs close in time to the "swap" (or vice versa), there may be some question as to whether the relinquished property (or replacement property) was "held for investment." Also, if the drop appears too close in time to the swap, the partner's exchange may be deemed an exchange by the partnership under the *Court Holding* case.[3] Clearly, the more time that passes between the "drop" and the "swap" (or vice versa), the better.

Regarding the above issues, a line of federal cases provides taxpayer-friendly authority against challenges by the IRS.[4] However, some state taxing authorities (notably, the California Franchise Tax Board) aggressively challenge exchanges, and argue that they are not bound by these federal cases.[5] Also, changes made in 2008 to the federal partnership tax return (i.e., IRS Form 1065) make it easier to detect when "drop and swap" transactions have occurred, thus making such transactions more vulnerable to challenge by taxing authorities.[6]

Partners Getting Cashed Out

In some instances, a majority of the partners may want the partnership to complete an exchange, but one or more of the other partners may want to be "cashed out" with the sale of the relinquished property. One way to accomplish this is for the partnership simply to receive cash from the sale in an amount sufficient to purchase the departing partners' partnership interests. This cash, however, would be "boot," and would require the partnership to allocate the resulting gain among all of the partners.

A better alternative, known as a partnership installment note ("PIN") transaction, results in the gain associated with the "boot" being recognized only by the departing partners. In a PIN transaction, instead of receiving cash, the partnership receives an installment note in the amount necessary to cash out the departing partner(s). The note is transferred to the departing partner(s) as consideration for their partnership interests. If at least one payment under the note is to be received in the year following the exchange, then the gain associated with the note will be taxed under the I.R.C. § 453 installment method[7] and recognized only when the actual payments are received by the departed partner(s).

Exchanges Followed by Contribution

When an individual completes an exchange and then immediately contributes the replacement property to an entity, or when an entity exchanges property immediately after receiving it as a contribution, a holding period issue could arise. Such an issue was resolved in the taxpayer's favor in *Magneson v. Commissioner*.[8] The *Magneson* case involved an exchange by an individual, followed immediately by a contribution of the replacement property to a general

partnership. *Magneson* provides useful authority against challenge by the IRS, and the same logic was applied at the state level in *Marks v. Department of Revenue*,[9] although its application in other states is not clear.

Election Under I.R.C. § 761

As stated above, partnership interests are specifically excluded from the application of Section 1031.[10] A very narrow exception applies to a partnership that has elected, under I.R.C. § 761(a), not to be subject to the partnership taxation provisions of Subchapter K. The election applies only to a partnership: (i) for investment purposes only and not for the active conduct of business; (ii) where the partners hold title to the property as co-owners; (iii) where each owner reserves the right to separately take or dispose of his or her share of the property; and (iv) which has no active trade or business.[11] If a partnership makes such an election, a partnership interest will be treated as an interest in the underlying assets and can be exchanged under Section 1031.

Endnotes

1. I.R.C. § 1031(a)(1) (2008).
2. *Id.* § 1031(a)(2)(D).
3. *See* Comm'r v. Court Holding Co., 324 U.S. 331, 333-34, 65 S.Ct. 707, 708 (1954).
4. *See e.g.*, Bolker v. Comm'r, 760 F.2d 1039, 1043 (9th Cir. 1985) (holding that taxpayer who acquired property with intent to exchange it for like-kind property held that property for investment); Maloney v. Comm'r, 93 T.C. 89, 98 (1989) (holding that exchange qualifies for non-recognition treatment under § 1031 because property received was held for investment purposes); Miles H. Mason, 55 T.C.M. (CCH) 1134 (1988) (holding that the transaction should be properly characterized as a pro rata distribution of partnership assets in liquation pursuant to § 731 followed by a like-kind exchange pursuant to § 1031 because the exchange was done in their individual capacities and not as partners).
5. *See* 830 Mass. Code Regs. 62.5A.1 (2008); *see also* Thomas W. Henning, *Swap and Drop*, 66-5 USC L. Sch. Inst. on Major Tax Planning ¶ 503 (LexisNexis 2014).
6. *See* IRS Form 1065, U.S. Return of Partnership Income (2014), *available at* http://www.irs.gov/pub/irs-pdf/f1065.pdf.
7. I.R.C. § 453(b)(1) ("The term 'installment sale' means a disposition of property where at least 1 payment is to be received after the close of the taxable year in which the disposition occurs.").
8. Magneson v. Comm'r, 753 F.2d 1490 (9th Cir. 1985); *see also* 26 U.S.C. § 1031(a).
9. Marks v. Dep't of Revenue, 2007 Ore. Tax LEXIS 111 (Or. T.C. July 24, 2007).
10. I.R.C. § 1031(a)(2)(D).
11. *Id.* § 761(a).

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Real Property Tax Law § 420-a: Exemption from Real Property Taxation

By Karen M. Richards

I. Introduction

It is well-settled in New York that, unless specifically exempt by law, "all real property within the state shall be subject to real property taxation, special ad valorem levies and special assessments."[1] Section 420-a of the New York Real Property Tax Law (RPTL) grants an exemption from taxation for real property owned by a corporation organized or conducted exclusively for religious, educational or charitable purposes, as well as for hospital or moral or mental improvement of men, women or children purposes.[2]

Statutes exempting real property from taxation are strictly construed against a corporation seeking an exemption, since an exemption from taxation is a renunciation of the State's sovereignty,[3] and "the depletion of taxable property will obviously increase the private taxpayers' burden."[4] Thus, the well-settled rule is that any doubt, ambiguity, or uncertainty as to whether property is exempt from taxation must be resolved against exemption and in favor of the sovereign.[5] Although exemption statutes are strictly construed against a corporation, courts nonetheless avoid a "narrow and literal" interpretation, since such an interpretation would thwart the Legislature's intent and defeat the statute's purpose.[6]

Part II of this article briefly discusses the elements a corporation must establish to qualify for a real property tax exemption pursuant to RPTL § 420-a. Part III focuses on two exemption cases decided by the Court of Appeals in 2014, *Merry-Go-Round Playhouse, Inc. v. Assessor of the City of Auburn* and *Maetreum of Cybele, Magna Mater v. McCoy*.[7]

II. Establishing Entitlement to an RPTL § 420-a Exemption

Article 4 of the Real Property Tax Law contains many provisions allowing exemptions from real property taxes, such as section 420-a, entitled "Nonprofit organizations; mandatory class." The word "mandatory" is misleading because a corporation must establish that it qualifies for an exemption.[8] Qualification for an exemption is founded on a number of requirements: (1) that the corporation owns the property; (2) that the corporation is organized or conducted exclusively for the purposes enumerated in section 420-a; (3) that the property itself is used primarily in furtherance of those purposes; (4) that no pecuniary profit, except reasonable compensation, inure to the benefit of any of its officers; and (5) that it is not a guise for profit-making operations to avoid paying real property taxes.[9]

A. A Corporation Must Hold Legal Title to the Property

As clearly provided by the statute, the property must be owned by a corporation. In other words, a corporation seeking a tax exemption must hold legal title to the property.[10] In *Al-Ber, Inc. v. New York City Department of Finance*, a not-for-profit organization providing religious, educational, and charitable services to the Islamic community was merely a lessee, and neither an option to purchase the property nor an obligation to pay all property taxes during the 99-year term of the lease made it eligible for a RTPL § 420-a exemption.[11]

Legal ownership on the taxable status date determines whether the property is subject to taxation for the entire ensuing taxable year, "irrespective of the property's subsequent acquisition by a tax-exempt entity during the taxable year."[12] Thus, the taxable status date is of special significance to a qualifying tax-exempt corporation, since it must own and use the property for an exempt purpose prior to or on the taxable status date to qualify for an exemption.[13] If title to the property is taken after the taxable status date, the corporation will not receive an exemption for that year, although an exemption may be granted in subsequent years.[14]

B. A Corporation Must Be "Organized or Conducted Exclusively" for the Purposes Enumerated in the Statute

A corporation must also be "organized or conducted exclusively" for "religious, charitable, hospital, educational, or moral or mental improvement of men, women or children purposes."[15] The phrase "or conducted" expanded the number of corporations potentially eligible for an exemption. Its breadth was argued in *St. Joseph's Health Center Properties v. Sgroi*, where the issue was whether real property owned by a not-for-profit corporation and used to provide housing for staff of a separate hospital corporation was conducted exclusively for hospital purposes.[16] In a closely divided decision, the Court of Appeals held that the ownership and use by a separate exempt corporation did not forfeit the exemption "simply because the user though empowered to carry out a function which is part of an exempt purpose is not itself empowered to carry out *all* of the functions of the exempt purpose."[17]

In *Youth Building Corp. v. Board of Assessors of Nassau County*, the owning corporation was created for the

purpose of purchasing and leasing real property to its charitable affiliate.[18] Leasing, rather than owning, property enabled the charitable affiliate to retain its eligibility for public financing, while indirectly violating regulations imposed by New York State to determine eligibility. However, the Court of Appeals held that the subject property was not exempt from taxation because the owning corporation was not itself organized or conducted exclusively for charitable purposes and the activities carried on by it were statutorily denied to its charitable affiliate.[19]

C. A Corporation Must "Use" the Property Exclusively for the Purposes Enumerated in RPTL § 420-a

RPTL § 420-a provides that the property must be "used exclusively" to further the purposes enumerated in the statute.[20] The Legislature intended to exempt those corporations whose activities are principal to its purposes, not those which only perform a "thread" of the purposes enumerated in the statute.[21] "Exclusively," however, is not read literally. The Court of Appeals has broadly defined it to mean "principal or primary purpose."[22]

Courts often review a corporation's certificate of incorporation to determine whether it exists to engage in one of the exempt purposes enumerated in RPTL § 420-a.[23] As stated by one court, "the certificate of incorporation must admit of no construction which would permit corporate activity for purposes not specified as exempt under the statute."[24] However, "the determination of an organization's primary purpose may turn upon the extent to which the corporation pursues the various purposes for which it was created, and is not necessarily dependent solely upon the language of the document pursuant to which the organization operates."[25]

"There seems to be little doubt that, today, an organization's actual activities are more important to a determination of its property's tax exempt status than are its corporate purposes."[26] Thus, the crucial issue is whether a corporation's principal or primary use of the property aligns with the statutorily tax exempt permitted purposes.[27] Regardless of whether the use is the sole use of a property or a use reasonably incident to a corporation's exempt purpose, it is the actual or physical use of a property that is determinative, as demonstrated in *Mt. Tremper Lutheran Camp v. Board of Assessors in Town of Shandaken*.[28]

In *Mt. Tremper*, petitioner, owner of a 372-acre campsite, maintained that its primary use of the premises was for Christian camping and that its nonexempt uses were incidental to its primary use, therefore qualifying petitioner for an exemption.[29] The court disagreed, finding the nonexempt uses of the property were "cumulatively substantial."[30] Since Christian camping provided 65% of the organization's income and nonexempt uses accounted for 25% of its income, the organization was not exclusively organized for tax exempt practices in view of its actual practices and was not entitled to an exemption.[31]

A different outcome resulted in *Shephardic Congregation of South Monsey v. Town of Ramapo*, where a religious corporation owned a three-story building, which contained a synagogue on the ground floor and a residence for the Rabbi and his family on the second and third floors.[32] The Supreme Court denied relief from taxation, finding the property's primary use as a residence was not necessary or incidental to petitioner's exempt purpose.[33] Reversing, the Appellate Division, Second Department, stated, "notwithstanding that more than one half of the premises [was] used by [the Rabbi] and his family for personal use, given the comprehensive nature of [the Rabbi's] duties for [petitioner], nearly all of which occur[ed] on the premises, the residential use of the subject premises [was] necessary and reasonably incidental to furthering [petitioner's] primary exempt purpose, thereby qualifying the premises for a full tax exemption."[34]

Purposes and uses merely auxiliary or incidental to a corporation's primary exempt purpose and use will not defeat an exemption.[35] For example, in *Paws Unlimited Foundation, Inc. v. Maloney*, petitioner was a not-for-profit organization dedicated to charitable purposes, one of which was to shelter rescued, abandoned, and abused animals.[36] It operated its 105-acre parcel of property not only as a shelter but also as a kennel to board private pets for a fee. The appellate court concluded that the boarding operation was reasonably incidental to the primary exempt use of the property, as only one-quarter of the kennels were used to board private pets and any money received was used exclusively to further petitioner's charitable goals, and the undeveloped portion of the property was an integral part of petitioner's operation because it shielded neighbors from noise generated by the sheltered animals.[37]

However, portions of property not put to uses reasonably incidental to or in furtherance of a corporation's exempt purpose are taxable.[38] Generally, the non-exempt portion is separated from the exempt portion and the taxes are then assessed on a pro rata portion of the total value of the property. A case in point is *Ellis Hospital v. Assessor of the City of Schenectady*, where a not-for-profit hospital's four-level garage, built for its visitors and staff, was originally exempt from real property taxation.[39] However, when the hospital leased specifically designated parking spaces in the garage for the exclusive use of "owners, employees and business invitees" of a medical office building built by a developer on the hospital's property, the assessor made the garage partially taxable.[40] The Appellate Division, Third Department, focused on whether the use of the garage to supply parking for the medical office building was in furtherance of or

reasonably incidental to the hospital's exempt purposes. The court noted, "[t]he private practice of medicine by a hospital's attending physicians is primarily a commercial enterprise and, therefore, a medical office building utilized by a hospital's attending physicians is too remotely related to the hospital's function of providing health care to the community to warrant a tax exemption."[41] It therefore found the use of the medical office building did not sufficiently further the hospital's exempt purposes to satisfy the "used exclusively" test, and use of the leased parking spaces for the medical office building was also not used primarily for the hospital's main and exempt purpose. Consequently, the assessor's determination that 22% of the parking garage was taxable was upheld.[42]

In *Viahealth of Wayne v. VanPatten*, petitioner, a not-for-profit organization organized exclusively for hospital purposes, leased portions of its property and had the burden of demonstrating that the leased spaces were being used exclusively for hospital purposes.[43] Petitioner established that one tenant, a not-for-profit corporation organized exclusively for hospital purposes, was using the leased space exclusively for those purposes, as it was being used in support of a general hospital by its physicians and staff and its x-ray units and laboratories.[44] Therefore, this space was tax exempt on a proportionate square foot basis, as those services fulfilled primary hospital purposes.[45] However, petitioner failed to establish that space leased to other not-for-profit organizations was being used exclusively for tax-exempt hospital purposes, and therefore, these portions of petitioner's property were not entitled to an exemption pursuant to RPTL § 420-a(1)(a).[46]

If the property is not actually being used due to a lack of suitable buildings or improvements, a corporation may qualify for an exemption by demonstrating "the construction of such buildings or improvements is in progress or is in good faith contemplated."[47] Showing improvements are in good faith contemplated requires providing concrete and definite plans for using the property for exempt purposes and failure to do so will result in denial of an exemption.[48] Merely claiming there are plans does not satisfy this requirement.[49] If a corporation cannot demonstrate an estimated completion date for improvements, an exemption may be denied, and an exemption previously granted may be withdrawn if existing plans take too long to come to fruition.[50] In addition, an exemption may be denied if a corporation cannot demonstrate a source of funding.[51]

For example, in *World Buddhist Ch'an Jing Center, Inc. v. Schoeberl*, petitioner, a religious corporation, failed to provide the assessor with "concrete and definite plans to renovate and use existing buildings for exempt purposes at any time in the foreseeable future."[52] The court did not doubt "petitioner's good faith future intentions,"[53] but good faith intentions did not demonstrate entitlement to an exemption.[54]

"Constant daily use [of a property] is not contemplated or compelled," but "[w]hen used, the use must be for the purpose which the law recognizes as earning the exemption."[55] *Young Women's Christian Association of Rochester and Monroe County v. Wagner* is a case in point.[56] After petitioner closed one floor of a residential building during a period of a severe drop in occupancy, the assessor removed the tax exemption, contending "that where a portion of a building once devoted to one of the exempt purposes, is temporarily shut off from use," there should be a pro rata forfeiture of exemption.[57] The court disagreed. Petitioner was not required to demonstrate construction or improvements were in progress or in good faith contemplated because this was not a situation where there was "a very serious removal of potentially valuable land from the tax rolls; the very situation which [the statute] was designed to strike."[58] Instead, petitioner was "an ongoing operation, the land is both used and improved, though not operating at full capacity."[59] In restoring the exemption, the court stated:

> Petitioners should not be penalized by a forfeiture of part of their exemption for their act of good business sense in temporarily closing off an entire floor.… A pertinent analogy may be instructive on this point. What the respondent proposes is analogous to holding that a church which loses parishioners due to cynical times should lose its exemption pro rata according to the number of empty pews. Even should the church, as a matter of convenience, close off the back pews, no municipality would be permitted to tax the church property pro rata.[60]

Although there may be a legitimate need for discontinuing use of the property, a more than temporary lack of actual use merits restoring the property to the tax roll, as occurred in *Wyckoff Heights Hospital v. Mann*.[61] In this case, the hospital was not entitled to a continuing exemption because its charitable use of the hospital had been abandoned, there were no indications the property would be used by the hospital for tax exempt purposes, and the property was for sale.[62]

D. An Organization Must Establish It Is Not a Guise for Profit-Making Operations

If a corporation leases its property, the leased property must continue to be devoted to exempt purposes and any money paid for using the property cannot exceed the amount of the carrying, maintenance, and depreciation charges.[63] There are a few situations, however, where a corporation can make a profit and not lose its real property tax exemption. One of those situations existed in *Salvation Army v. Town of Ellicott Board of Assessment Re-*

view.[64] In this case, petitioner's thrift store was operated to provide work therapy and rehabilitation opportunities for homeless men who reside at Salvation Army shelters. The court found the stores were:

> an integral part of the program of rehabilitation and therapy under the religious and charitable purposes for which the Salvation Army was incorporated, and not solely as a profit-making enterprise. As such, their operation furthers the Army's exempt purposes. They are an essential part of the Army's religious and charitable activities and purposes and would not exist if not for these objectives.[65]

Therefore, the court concluded that the profit-making aspect of the thrift store operation was incidental to the main exempt purpose for which the stores were established and did not destroy petitioner's entitlement to an exemption under RPTL § 420-a.[66]

In *Sisters of St. Joseph v. City of New York*, petitioner leased its tax-exempt property, formerly used as a convent, rent-free to Catholic Charities of the Diocese of Brooklyn for use as a senior citizens' center.[67] Six months later, Catholic Charities sublet the property to a tax-exempt corporation for an annual rental fee of $24,000 to be paid to Catholic Charities, but no portion of rental payments inured to the benefit of petitioner.[68] The issue before the Court was "whether property owned by one charitable organization and leased to another charitable organization is subject to real property taxation if the rental income derived from such property exceeds the carrying, maintenance and depreciation charges thereon."[69] The Court concluded it was taxable, even though the owner organization did not receive any of the rental payments.

> While it may appear harsh to hold an owner liable for real property taxes when it derives no pecuniary benefits from the demised premises, this result is mandated in this case, for a contrary holding would allow a tax-exempt organization in the future to lease its property to another tax-exempt organization with the expectancy that such organization would sublease the property and obtain a profit from the rental proceeds. This court will not construe *** the Real Property Tax Law in such a manner as to establish a tax loophole, for the Legislature could not have intended its express mandate to be so easily circumvented.[70]

RPTL § 420-a(1)(b) provides that an organization or association cannot "be a guise or pretense for directly or indirectly making any other pecuniary profit for such corporation or association or for any of its members or employees."[71] This was one of the issues explored by the State Board of Real Property Services (the "Board"), when its opinion was requested as to the taxable status of property owned by a nonprofit organization.[72] Although there was no question as to the eligibility of the organization's purposes or its use of the property, there was an issue as to the grantor of the property, which retained

> "an exclusive perpetual easement in, on, above or beneath" the property for all purposes including pipelines, power transmission lines and communication lines. The question [was] if this easement, referred to in the deed as "an easement in gross, freely alienable and assignable by" the grantor, pursuant to which the grantor is receiving revenue, renders any portion of the property to be taxable.[73]

Since the nonprofit organization did not benefit monetarily from the easement, there was no issue as to whether it was a guise or pretense for making a pecuniary profit disqualifying it from a real property tax exemption. The Board thus opined, "[i]f the easement rights retained by the grantor do not interfere with the nonprofit organization's use of its property, the existence of such rights should not adversely affect the organization's exemption eligibility."[74]

III. A Theater and a Pagan Religion Are Entitled to a Real Property Tax Exemption

In November 2014, the Court of Appeals heard two cases where petitioners had been denied a real property tax exemption pursuant to RPTL § 420-a. One of the petitioners was a not-for-profit theater corporation, while the other was a not-for-profit religious corporation.

In *Merry-Go-Round Playhouse, Inc. v. Assessor of City of Auburn*, petitioner, a not-for-profit theater corporation, operated a professional summer stock theater and a year-round youth theater.[75] Petitioner previously leased apartments for its summer actors and staff through various landlords, but as its operation grew, leasing apartments became "cumbersome and difficult,"[76] and therefore it purchased two apartments to house only actors and staff.[77] No income was derived from the properties, and in fact, petitioner had to rely on charitable donations "to make ends meet with these two properties."[78]

Petitioner's applications for exemptions pursuant to RPTL § 420-a were denied by the city assessor, and when the denials were upheld by the city's Board of Assessment Review, a long legal battle ensued. The supreme court "determined that petitioner had failed to establish both that its summer theater was an exempt purpose under the statute and that the use of the apartment buildings to house its employees was reasonably incidental to its primary purpose" and thus was not entitled to an exemption under RPTL § 420-a.[79]

The Appellate Division, Fourth Department, unanimously reversed.[80] By applying a "fair reading" of the purposes set forth in petitioner's certificate of incorporation, it concluded "that [petitioner] was founded for the purpose of promoting and presenting theatrical arts, i.e., for purposes of education and the moral and mental improvement of men, women and children."[81] The appellate court also concluded petitioner's use of the properties was reasonably incidental to its primary or major purpose, "i.e., the properties are intended to house staff and actors who work in petitioner's theaters and to help cultivate petitioner's community amongst its artists."[82]

The state's highest court unanimously affirmed the appellate court's decision. The Court found petitioner was clearly "organized exclusively for an exempt purpose, in that it is intended to promote appreciation of the arts/musical theater, thereby providing education to the community and advancing the moral or mental improvement of area residents."[83] While petitioner's summer stock productions did not have the same educational component as its youth theater, it was nonetheless "geared toward promoting the arts."[84]

Although petitioner charged admission to its summer productions, petitioner asserted, without contradiction, that it either broke even or operated at a loss, and there was no indication petitioner was organized for the purpose of making a profit. The "bare fact" that it charged admission did not nullify petitioner's exempt purpose, for as the Court noted, "[a] 'commercial patina' alone is not enough to defeat tax exempt status."[85] Thus, "this limited commercial aspect [did] not preclude [petitioner] from receiving a tax exemption."[86]

In determining whether the property was being used exclusively for an exempt purpose, the court compared this case to *St. Luke's Hospital v. Boyland*.[87] In *St. Luke's*, the hospital owned ten apartment buildings, which were occupied by its doctors and nurses and their families and also by non-hospital personnel.[88] The Court recognized "it was customary for hospitals to provide such living arrangements and that some of its staff would have sought employment elsewhere if housing had not been made available."[89] Therefore, the Court held the hospital was entitled to a partial exemption for those portions of the buildings occupied by its employees "because supplying living accommodations for hospital personnel and their immediate families is a hospital purpose."[90]

The Court also compared *Merry-Go-Round* to *Yeshivath Shearith Hapletah v. Assessor of the Town of Fallsburg*, where it addressed whether housing facilities on a 31-acre parcel of property used for religious instruction during the summer months were exempt from taxation.[91] The property included religious and educational facilities, housing accommodations, and 10 acres of woodland used by students for hiking. The Court determined the housing units provided to faculty and staff and students and their families were necessary and reasonably incidental to the primary purpose of the facility.[92] Without housing, "its primary purposes of providing rigorous religious and educational instruction at the yeshivath would be seriously undermined," and this was so "notwithstanding the existence of limited housing facilities nearby."[93]

After making these comparisons, the Court found petitioner demonstrated that it was entitled to an RPTL § 420-a tax exemption.

> Petitioner established that the housing is used to attract talent that would otherwise look to other theaters for employment, that the living arrangement fosters a sense of community and that the staff spends a significant portion of its off-hours in furtherance of theater-related pursuits. In addition, similar to the situation presented by St. Luke's, the record shows that petitioner would have difficulty recruiting qualified staff if it did not provide housing, which would undermine its primary purpose. Although we have not previously addressed the provision of tax exempt housing in relation to an arts organization, the statute does not elevate one exempt purpose over another. Under these circumstances, the use of the property to provide staff housing is reasonably incidental to petitioner's primary purpose of encouraging appreciation of the arts through theater.[94]

In *Maetreum of Cybele, Magna Mater v. McCoy*, a not-for-profit religious corporation purchased a three-acre parcel of property which contained a three-story, twelve bedroom main house, formerly an inn, as well as a small caretaker's cottage, several out buildings, a recently constructed outdoor temple, and "processional paths."[95] Petitioner was the corporate entity for the Cybeline Revival, a pagan following founded in 1999, but which has ancient origins.[96]

In 2009, the town assessor denied petitioner's application for an exemption pursuant to RPTL § 420-a, which the Board of Assessment Review upheld. Petitioner then commenced proceedings pursuant to RPTL article 7 and CPLR article 78.

At the nonjury trial, petitioner called four witnesses. Respondents called none. Petitioner's trial testimony and exhibits revealed the religion had seven priestesses, most of whom had bedrooms in the main building of the property, since convent-style living is a component of the Cybeline Revival.[97] Each priestess' personal room had an altar, although there was also an altar on the main floor of the building. Two of the priestesses lived there fulltime, one of them being a state employee,[98] along with a novi-

tiate, a woman seeking asylum from another country, and a guest temporarily residing in the building on a charitable basis. During a two-year period, charitable guests and spiritual seekers resided temporarily on the property, but no one was required to pay for their stay and little actual financial support was provided by guests. Petitioner also established that evening praise, rituals, religious instruction, and spiritual counseling occurred throughout the main building, the outdoor temple, two other outdoor areas, along the processional paths, and in the caretaker's cottage.[99]

Despite the testimony and exhibits presented by petitioner at trial, the supreme court judge dismissed petitioner's applications for exemption from real property taxes, finding "the property primarily is used to provide affordable cooperative housing to a small number of co-religionists, with the religious and charitable uses of the property being merely incidental to that primarily non-exempt use."[100] The Appellate Division, Third Department, reversed.[101]

The only issue before the appellate court was whether the property was primarily used for religious or charitable purposes. It rejected respondents' argument "that the property was used primarily to provide cooperative housing because, in essence, the few adherents of the Cybeline Revival have in effect just continued the property's former residential use, as evidenced by the financial support coming from these few adherents and by the 'friends of friends' guests."[102] The court stated, "these arguments contend that there is some threshold amount of activity and public benefit that must be demonstrated, which confuses the standard that is simply whether the property was used primarily for religious and charitable purposes."[103]

The appellate court found petitioner's trial "testimony established that the Cybeline Revival stresses communal living among its adherents, as well as providing hospitality and charity to those in need, and the members consider this property the home of their faith," and it also established that "religious and charitable activities [were conducted] throughout the property on a regular basis."[104] Petitioner thus satisfied the legal requirements necessary to receive a real property tax exemption, as it met its burden of demonstrating the property was used primarily for religious and charitable purposes, and accordingly, the appellate court granted the petitions.[105]

In a brief memorandum decision, with all seven judges concurring, the Court of Appeals held the appellate court properly granted the petitions.[106] Without further analysis, the Court opined, "[p]etitioner adequately established its entitlement to the RPTL 420-a exemption, as the proof at trial established that petitioner 'exclusively' utilized the property in furtherance of its religious and charitable purposes."[107]

IV. Conclusion

Although exemptions are supposed to be strictly construed against a corporation claiming an exemption, the bar appears to be woefully low. The proliferation of corporations receiving tax exemptions pursuant to RPTL § 420-a for properties erodes a municipality's tax base and imposes a correspondingly higher burden on non-exempt property owners. However, when municipalities point out the detrimental financial effects of granting exemptions, these compelling arguments universally fail.[108]

Endnotes

1. N.Y. Real Prop. Tax Law (RPTL) § 300; *see* Grace v. N.Y. State Tax Comm'n, 37 N.Y.2d 193, 196 (2d Dep't 1975) (stating an exemption is "allowed only as a matter of legislative grace"); *see also* N.Y. Const. art.16 § 1) (providing an absolute exemption for real property "used exclusively for religious, educational or charitable purposes as defined by law and owned by any corporation or association organized or conducted exclusively for one or more of such purposes and not operating for a profit").
2. RPTL § 420-a(1)(a) (providing "[r]eal property owned by a corporation or association organized or conducted exclusively for religious, charitable, hospital, educational, or moral or mental improvement of men, women or children purposes, or for two or more such purposes, and used exclusively for carrying out thereupon one or more of such purposes either by the owning corporation or association or by another such corporation or association as hereinafter provided shall be exempt from taxation as provided in this section").

   Although Real Property Tax Law § 420-a references "corporation or association," this article only uses the word "corporation" and corporation refers to a not-for-profit corporation.
3. Bd. of Educ. of City of Jamestown v. Baker, 241 A.D. 574, 575, *aff'd*, 266 N.Y. 636 (4th Dep't 1935); *see also* Application of N.Y. State Teachers' Retirement System v. Sgroi, 447 N.Y.S.2d 57 (4th Dep't 1981) *aff'd*, 56 N.Y.2d 690 (1982).
4. 2 Op.Counsel SBEA No. 92, 1972 WL 19609 (N.Y. Bd. Of Equalization & Assessment) (stating "there is an obvious necessity for tax revenue, and the depletion of taxable property will obviously increase the private taxpayers' burden. Therefore, exemptions are to be strictly construed against the party claiming them"); *see also* Community-General Hosp. of Greater Syracuse v. Town of Onondaga, 80 Misc. 2d 96, 98, 362 N.Y.S.2d 375 (Sup. Ct. Onondaga Cnty. 1974) (stating "[w]hen a tax exemption on real property is granted there is an increase in the tax burden on other taxpayers").
5. City of Lackawanna v. State Bd. of Equalization & Assessment, 16 N.Y.2d 222, 230, 212 N.E.2d 42 (1965).
6. Symphony Space v. Tishelman, 60 N.Y.2d 33, 36 (1983); Matter of Assoc. of Bar v. Lewisohn, 34 N.Y.2d 143, 153 (1974); Delancey Street Foundation, Inc. v. Bd. of Assessment Review, 491 N.Y.S.2d 381, 382 (2d Dep't 1985); Erie Cnty. Water Authority v. Erie Cnty, 364 N.Y.S.2d 626, 629 (4th Dep't 1975).
7. Merry-Go-Round Playhouse, Inc. v. Assessor of City of Auburn, 24 N.Y.3d 362 (2014); Maetreum of Cybele, Magna Mater, Inc. v. McCoy, 975 N.Y.S.2d 251 (3d Dep't 2013), *aff'd*, 24 N.Y.3d 1023 (2014).
8. 8 Op.Counsel SBEA No. 51 (N.Y.Bd. Equal. & Ass.), 1982 WL 82645, at *1 (stating "[o]rganizations which qualify for exemption under section 420-a of the RPTL are not statutorily required to apply for exemption, but assessors may not grant exemptions pursuant to either section 420-a or 420-b in the absence of properly completed application forms").
9. Lackawanna Cmty. Dev. Corp. v. Krakowski, 12 N.Y.3d 578, 581 (2009); Maetreum of Cybele, Magna Mater, Inc. v. McCoy, 975 N.Y.S.2d 251 (3d Dep't 2013), *aff'd*, 24 N.Y.3d 1023

(2014); Hapletah v. Assessor v. Town of Fallsburg, 79 N.Y.2d 244, 249 (1992); Pine Harbor, Inc. v. Dowling, 932 N.Y.S.2d 239 (2011). A corporation has the burden of establishing a right to exemption from real property taxation. Ass'n. for Neighborhood Rehab., Inc. v. Bd. of Assessors of the City of Ogdensburg, 917 N.Y.S.2d 734 (3d Dep't 2011); Ksiaze Chylinski-Polubinski Trust, Inc. v. Bd. of Assessment Review for the Town of DeKalb, 799 N.Y.S.2d 631 (2005). This burden involves presenting clear and convincing proof that an applicable statute grants an exemption. If an exemption was granted, it can be withdrawn if the law governing the exemption changed, if there was a change in the use of the property, or if the exemption was erroneously awarded in the first instance. Lake Forest Senior Living Community, Inc. v. Assessor of City of Plattsburgh, 898 N.Y.S.2d 369 (3d Dep't 2010) (finding petitioner's provision of housing to middle-income seniors at market rates, without subsidy, did not constitute a charitable activity and thus was not entitled to an exemption pursuant to RPTL § 420-a).

10. Al-Ber, Inc. v. N.Y. City Dep't of Fin., 915 N.Y.S.2d 309 (2d Dep't 2011); *see also* Jewish Bd. of Family and Children's Service, Inc. v. Shaffer, 436 N.Y.S.2d 58 (1981), *appeal denied*, 54 N.Y.2d 605 (2d Dep't 1981) (finding petitioner's grant to commercial developer of an option to purchase petitioner's parcel did not alter court's conclusion that petitioner, a corporation conducting a school devoted to the treatment and education of socially deviant and delinquent youths, was entitled to an exemption).

11. 915 N.Y.S.2d 309, 310 (2011).

12. Long Island Power Auth. v. Shoreham Wading River Ctr. Sch. Dist., 88 N.Y.2d 503, 512, *reargument denied*, 88 N.Y.2d 1010 (1996); *see also* RPTL § 302.

    An exception to the general rule is real property owned by the federal government or New York State or any of its departments or agencies. RPTL § 404(1) provides New York State and its departments and agencies are exempt from taxation. *See* 2 Op. Counsel SBEA No. 80, 1972 WL 19597 (N.Y. Bd. Equal. & Ass.) (stating this statute "is merely a restatement of the common law principle that the property of the sovereign is immune from taxation unless it is specifically made taxable by law"); 2 Op. Counsel SBEA No. 96, 1973 WL 20527 (N.Y. Bd. Equalization & Assessment) (stating "the sovereign state is immune from taxes from the date of acquisition and becomes taxable only where a statute clearly makes it so").

13. 2 Op. Counsel N.Y. SBEA No. 34 (1972), 1972 WL 19565 (stating "[t]herefore, when property owned by a private individual or organization on the taxable status date is transferred to a tax exempt organization subsequent to taxable status date, such property remains subject to taxation for that fiscal year for which the taxes are levied").

14. *Id*.

15. RPTL § 420-a(1)(a) (McKinney 2013).

    Legislation was proposed to amend RPTL § 420-a(1) by adding a new paragraph, (c)(1), to define "organized and conducted exclusively" as requiring that "a corporation's or association's organizational documents limit the purpose of such corporation or association to one or more exempt purposes, as set out in [the statute]. Furthermore, the corporation or association shall not be empowered to engage in activities which in themselves are not in furtherance of one or more such purposes." 2013 N.Y. Assembly Bill No. 3272; *see also* 2013 N.Y. Senate Bill No. 881.

16. St. Joseph's Health Ctr. Props. v. Srogi, 51 N.Y.2d 127 (1980).

17. *Id*. at 133 (emphasis in original).

18. Youth Bldg. Corp. v. Bd. of Assessors of Nassau Cnty., 56 N.Y.2d 765, *reargument denied*, 57 N.Y.2d 674 (1982).

19. 56 N.Y.2d at 767; *see also* J-Cap Found., Inc. v. Fin. Admin. of the City of N.Y., 481 N.Y.S.2d 109 (2d Dep't 1984) (denying tax exemption where petitioner conducted itself primarily for the purpose of permitting its charitable affiliate to accept public funding while indirectly receiving the benefits accruing from the ownership of property which it could not purchase openly without losing State aid).

20. RPTL § 420-a(1)(a).

    Legislation was proposed to amend RPTL § 420-a(1) by adding a new paragraph, (c)(1), to define "used exclusively" as requiring a corporation or association to use its property only for exempt purposes. "Uses which may be helpful to the exempt organization but would not, if done on land owned by an otherwise taxable entity, qualify for tax exemption shall subject the portion of the property so used to real property taxation. Such phrase shall be strictly construed and shall be intended to limit exemptions to property and improvements utilized solely for exempt purposes. Where an exempt organization utilizes its land for other purposes, including but not limited to, the sale of products made on the land commercially or the sale of timber, or otherwise leases the land for commercial purposes, or allows the placement or construction of improvements on land for commercial purposes, that portion of such property and any improvements thereon if such improvements are not utilized for wholly exempt purposes shall be subject to real property taxation." 2013 N.Y. Assembly Bill No. 3272 ; *see also* 2013 N.Y. Senate Bill No. 881.

21. Lower E. Side Action Project, Inc. v. Town of Liberty, 334 N.Y.S.2d 333 (Sup. Ct. Sullivan Cnty. 1972), *amended on other grounds*, 387 N.Y.S.2d 342 (1972) (stating "[t]he activity of every membership corporation has at a least a thread of religion, charity or education within its activities and it is not the intent of the Legislature to exempt them all").

22. Merry-Go-Round Playhouse, Inc. v. Assessor of City of Auburn, 24 N.Y.3d 362, 367-8 (2014) (stating "[t]he test of entitlement to a tax exemption under the 'used exclusively' clause of the statute is whether the use is 'reasonably incidental' to the primary or major purpose of the [corporation or association]. Put differently, the determination of whether the property is used exclusively for the statutory purposes depends upon whether its primary use is in furtherance of the permitted purposes" (citation omitted)); *accord* Yeshivath Shearith Hapletah v. Assessor of Town of Fallsburg, 79 N.Y.2d 244, 250 (1992).

23. *See, e.g*., Merry-Go-Round, 24 N.Y.3d 362 (4th Dep't 2013), *aff'd*, 24 N.Y.3d 362 (2014).

    Courts may also take into account whether the Internal Revenue Service granted the corporation tax-exempt status. *See, e.g*., Plattsburgh Airbase Redevelopment Corp. v. Rosenbaum, 101 A.D.3d 21, 23 (3d Dep't 2012) (stating "a property owner seeking a real property tax exemption who demonstrates that it is a not-of-profit entity 'whose tax-exempt status has been recognized by the Internal Revenue Service and whose property is used solely for [charitable] purposes has made a presumptive showing of entitlement to exemption" (citations omitted)).

24. Mt. Tremper Lutheran Camp, Inc. v. Bd. of Assessors of Shandaken, 417 N.Y.S.2d 796 (3d Dep't 1979) (citations omitted).

25. Mohonk Trust v. Bd. of Assessors of Gardiner, 47 N.Y.2d 476, 484 (1979).

26. 12 Op. Counsel SVRPS No. 20, 2008 WL 6898699 at *2 (N.Y. Bd. Real. Prop. Serv.).

27. Merry-Go-Round Playhouse, 24 N.Y.3d at 368 (applying a "fair reading" of the purposes set forth in petitioner's certificate of incorporation, the court concluded that it was founded for one of the statutorily tax exempt purposes).

28. 417 N.Y.S.2d 796 (3d Dep't 1979); *see also* Adult Home of Erie Sta. Inc. v. Assessor & Bd. of Assessment Review of City of Middletown, 10 N.Y.2d 205, 216 (2008).

29. *Id*. at 797.

30. *Id*. at 798.

    The purposes set forth in petitioner's corporate certificate were as follows: "To assume ownership and operation of the facility known as Mt. Tremper Lutheran Camp…to organize, conduct and maintain summer camps and centers for

instructive and recreative purposes…to diffuse a general knowledge of religion, literature, art and science…to assist other religious, civic, fraternal movements and organizations for kindred purposes." *Id*. at 798. The court found "[t]he stated recreational purpose does admit to a use not exclusively or primarily related to the enumerated tax exempt purposes. Petitioner's certificate of incorporation, therefore, fails to meet the statutory requirement of exclusive organization for an enumerated purpose." *Id*. This alone merited denial of an exemption. *Id*.

31. *Id*. at 798.

32. 849 N.Y.S.2d 662, 663 (2d Dep't 2008).

33. *Id*.

34. *Id*. at 664.

35. Congregation Rabbinical College v. Tartikov, Inc. v. Town of Ramapo, 72 A.D.3d 869, 871 (2d Dep't 2010), *lv. to appeal granted*, 15 N.Y.3d 704 (2010), *aff'd*, 17 N.Y.3d 763 (2011).

36. 937 N.Y.S.2d 423, 424 (3d Dep't 2012).

37. *Id*. at 425.

38. RPTL § 420-a(2) (McKinney 2013); *see In re* Miriam Osborn Mem'l Home Assoc. v. Assessor of City of Rye, 80 A.D.3d 118, 138, 909 N.Y.S.2d 493, 507 (2d Dep't 2010) (stating "[w]here the use of an otherwise nonexempt portion of such property is not reasonably incidental to the use of the property for its primary, exempted purpose, that portion is taxable, and thus, the property owner receives only a partial tax exemption"); Syracuse Univ. v. City of Syracuse, 459 N.Y.S.2d 645, 646 (4th Dep't 1983) (stating "to the extent that nonexempt uses do occur on the premises and where they cannot be said to be merely 'incidental' purposes, an allocation or partial exemption is mandated").

39. 732 N.Y.S.2d 659 (3d Dep't 2001).

40. *Id.*

41. *Id.* at 661.

42. *See also In re* St. Francis Hosp. v. Taber, 907 N.Y.S.2d 263, 268 (2d Dep't 2010) (where the parking spaces were not specifically designated but were instead available on a first-come, first-served basis, the court found the lack of specifically designated spots did not prohibit the assessor from determining that a portion of the parking garage was taxable, and there was no need for the assessor "to describe by metes and bounds or other physical factors the portion which is exempt and the portion which is taxable"); *In re* Vassar Bros. Hosp. v. City of Poughkeepsie, 948 N.Y.S.2d 403, 407 (2d Dep't 2012) (finding it irrelevant that only 40 of the 250 parking spaces were reserved, with the remaining 210 spaces available on a first-come, first-served basis, because "[i]t is the actual or physical use of the property that is determinative for the purposes of the 'used exclusively' inquiry, and a substantial portion of the parking garage is allocated for a use not reasonably incidental to the purpose of the hospital").

43. 936 N.Y.S.2d 466, 467 (4th Dep't 2011).

44. *Id.* (where this portion of leased space was rented to Wayne Medical Group, a division of Rochester General Hospital).

45. *Id.*

46. *Id.* (where the other not-for-profit corporations were Finger Lakes Migrant Health Care Project, Inc., Wayne Cnty. Rural Health Network, and Rushville Health Center).

47. RPTL § 420-a(3) (McKinney 2013).

48. World Buddhist Ch'an Jing Ctr., Inc. v. Shoeberl, 846 N.Y.S.2d 392, 394 (3d Dep't 2007); *see also* Upstate Properties Dev., Inc. v. City of Syracuse, 27 Misc. 3d 1205A, 1205A (Sup. Ct. Onondaga Cnty. 2010) (where petitioner failed to submit any proof, such as permits, applications, or plans, to demonstrate its good faith intentions to make improvements).

49. Inward House Corp. v. Frey, 227 A.D.2d 845, 846 (3d Dep't 1996); World Buddhist, 846 N.Y.S.2d at 395; Chautauqua Rails to Trails, Inc. v. Assessors of Town of Chautauqua, 231 A.D.2d 878, 878-79 (4th Dep't 1996).

50. Econ. Opportunity Comm'n of Nassau Cnty., Inc. v. Village of Hempstead, 539 N.Y.S.2d 39, 41 (2d Dep't 1989).

    The statute does not provide a time frame by which construction must be commenced. Legislation was proposed to repeal and amend RPTL § 420-a(3) to provide that "in good faith contemplated" would mean definite plans for utilizing and adapting the property for exempt purposes within five years and the full execution of such plans within seven years of taking title to the property. If no part of the contemplated physical improvements to the land were commenced within the five years and completed within the seven years, the property owner that received the benefit of the exemption had to pay all property taxes that would have been owed. N.Y.S. 879, 236th Sess. (2013); *see also* N.Y.A. 1708, 236th Sess. (2013).

51. *See* Econ. Opportunity Comm'n., 539 N.Y.S.2d at 41, *appeal denied*, 74 N.Y.2d 608 (1989) (where petitioner could not provide an estimate as to when construction would be complete and failed to submit documentary proof of its efforts to obtain additional funding, it was not entitled to an exemption); New Creation Fellowship of Buffalo v. Bd. of Assessment Review, 735 N.Y.S.2d 291, 291 (4th Dep't 2001) (where religious corporation was entitled to an exemption as it established it had approved plans for improvements to the land and had started to implement those plans by removing brush and debris and by grading the land).

52. World Buddhist, 846 N.Y.S.2d at 395.

53. *Id*.

54. *Id*.; *see also* Ksiaze Chylinski-Polubinski Trust, Inc. v. Bd. of Assessment Review for Town of DeKalb, 799 N.Y.S.2d 631, 634 (3d Dep't 2005) (where petitioner alleged it spent over $100,000 renovating buildings on its property, on the application for exemption, it answered that no improvements or buildings were contemplated, and questions regarding financial resources for improvements and when construction would begin were marked "[n]ot applicable," its failure to prove necessary improvements were in progress or contemplated in good faith resulted in denial of an exemption).

55. Congregation Emanu-el of N.Y. v. N.Y., 150 Misc. 657, 659 (Sup. Ct. N.Y. Cnty. 1934), *aff'd*, 243 A.D. 692 (1st Dep't 1935).

56. Young Women's Christian Ass'n of Rochester & Monroe Cnty. v. Wagner, 409 N.Y.S.2d 167, 171 (Sup. Ct. Monroe Cnty. 1978) (rejecting assessor's argument for "a most exacting and literal interpretation of the word 'use'").

57. *Id*.

58. *Id*. at 172.

59. *Id*.

60. *Id*. at 173.

61. Wyckoff Heights Hosp. v. Mann, 476 N.Y.S.2d 629 (2d Dep't 1984), *appeal denied*, 64 N.Y.2d 605 (1985); *see also* Welch v. City of Utica, 435 N.Y.S.2d 892, 893 (Sup. Ct. Oneida Cnty. 1981) (where a building formerly owned by the All Nations Faith Temple, which had been granted a tax exemption, was sold at public auction and boarded up, and was not being used for any religious purpose).

62. *Id*. at 629.

63. RPTL § 420-a(2) (2013); Legion of Christ, Inc. v. Town of Mount Pleasant, 877 N.Y.S.2d 656, 665 (Westchester Cnty. Ct. 2009) (finding amount paid by the lessee and sub-lessees for the use of the property did not exceed the amount of the carrying, maintenance and depreciation charges on the property and petitioner was therefore entitled to an exemption pursuant to RPTL § 420–a(2)); Pine Harbor, Inc. v. Dowling, 89 A.D.3d 1192, 1994, (3d Dep't 2011) ("The 'critical factor' in ascertaining whether an exemption may be granted (or here, withdrawn) under RPTL § 420-a is 'whether the provider subsidizes the rentals or charges less than fair market rental rates.'" (quoting TAP, Inc. v. Dimitriadis, 853 N.Y.S.2d 214, 215 (3d Dep't 2008))); Ass'n for Neighborhood Rehab., Inc. v. Bd. of Assessors of the City of Ogdensburg, 917 N.Y.S.2d 734

(3d Dep't 2011) (noting a charitable organization providing housing to the indigent is allowed an exemption even though a small percentage of its tenants can pay market rate and an entity helping homeless people, alcoholics, drug addicts, and other afflicted members of society can obtain an exemption though most tenants pay market rate); Lake Forest Senior Living Cmty., Inc. v. Assessor of City of Plattsburgh, 898 N.Y.S.2d 369 (3d Dep't 2010) (finding petitioner's provision of housing to middle-income seniors at market rates, without subsidy, did not constitute a charitable activity and thus was not entitled to an exemption pursuant to RPTL § 420–a(1)(a) for property used exclusively for charitable purposes).

64. 474 N.Y.S.2d 649 (4th Dep't 1984).
65. *Id*. at 649 (citations omitted).
66. *Id*.
67. 49 N.Y.2d 429, 434 (1980).
68. *Id*. at 434-35.
69. *Id*. at 436-37.
70. *Id*. at 441-42 (also concluding "[t]he imposition of real property taxes, under the circumstances of this case, simply does not infringe upon plaintiff's right to practice freely its religion. Plaintiff does not now contend, nor could it, that the taxation of its real property, leased to another, in any way prevents plaintiff from freely and openly exercising its religious beliefs. Indeed, the very existence of the lease itself militates against a finding that the property in question was to be used for the practice of plaintiff's religion").
71. RPTL § 420-a(1)(b); *see* Baldwin Research Inst., Inc. v. Bd. of Assessment Review of Town of Amsterdam, 887 N.Y.S.2d 373, 376 (3d Dep't 2009), *lv. to appeal denied*, 14 N.Y.3d 702 (2010) (where salaries exceeding local averages did not, in itself, raise issues of fact precluding summary determination).
72. 10 Op. Counsel N.Y. SBRPS No. 103 (2000), 2000 WL 854280 (N.Y. Bd. Real. Prop. Serv.).
73. *Id*.
74. *Id*.
75. 24 N.Y.3d 362, 365 (2014).
76. Transcript of Oral Argument at 22, 1.9.
77. Merry-Go-Round, 24 N.Y.3d at 366.
78. *Supra* note 76, at 25, l.6-7; 28, l.6-7.
79. Merry-Go-Round Playhouse, Inc. v. Assessor of City of Auburn, 24 N.Y.3d 362, 366 (2014).
80. *Id*.
81. Merry-Go-Round Playhouse, Inc. v. Assessor of City of Auburn, 24 N.Y.3d 362, 366 (4th Dep't 2013).
82. *Id*.
83. 24 N.Y.3d at 367.
84. *Id*.
85. *Id*., *quoting* Matter of Symphony Space v. Tishelman, 60 N.Y.2d 33, 38-39 (1983).
86. *Id*. at 367.
87. St. Luke's Hospital v. Boyland, 12 N.Y.2d 135 (1962).
88. *Id*. at 141.
89. 24 N.Y.3d at 368 (*citing St. Luke's* at 143).
90. 12 N.Y.2d at 141.
91. Yeshivath Shearith Hapletah v. Assessor of the Town of Fallsburg, 79 N.Y.2d 244 (1992).
92. *Id*. at 252.
93. *Id*. at 251.

    The Court also found a trailer occupied by the corporation's caretaker was tax exempt. The caretaker lived in the residence year-round and his full-time job was to maintain the premises during the summer months and to keep the property secure during the remaining months of the year. "Thus, the use of the residence [was] clearly incidental to the maintenance of the…facility which serves the religious purposes for which petitioner's corporation was organized, and thus, [the trailer] was also tax exempt." *Id*. at 251 (citations omitted). The Court noted the facts in Yeshivath Shearith Hapletah differed from those in Yeshivas Bais Yehudi v. Assessor of Town of Ramapo, 486 N.Y.S.2d 63 (2d Dep't 1985), where the caretaker to whom residential accommodations were provided rent free only devoted approximately two or slightly more days to his employment with petitioner and was self-employed as a house painter. 79 N.Y.2d at 251.
94. 24 N.Y.3d at 368-69.
95. 975 N.Y.S.2d 251 (3d Dep't 2013).

    The property had been purchased by the head of the Cybeline Revival and a founder of the faith and three other women with a goal of establishing affordable housing for transsexual women, and a not-for-profit corporation was established to manage the property. *Id* at 253. One of the original owners later sold her interest in 2004 to a Cybeline adherent, and at that time, the property was dedicated as the home of the religion and title to the property was transferred to petitioner. *Id*. In 2009, petitioner received tax-exempt status from the Internal Revenue Service. *Id*.
96. *Id*.; *see* Holy Spirit Assoc. for the Unification of World Christianity v. Tax Comm. of the City of N.Y., 55 N.Y.2d 512, 518 (1982) (stating "[i]n determining whether a particular ecclesiastical body has been organized and is conducted exclusively for religious purposes, the courts may not inquire into or classify the content of the doctrine, dogmas, and teachings held by that body to be integral to its religion but must accept that body's characterization of its own beliefs and activities and those of its adherents, so long as that characterization is made in good faith and is not sham").
97. Matreum of Cybele, Magna Mater, 975 N.Y.S.2d at 253.
98. Transcript of Oral Argument before Ct. of Appeals, p. 4, l. 23-25, p. 5, l.1.
99. *Id.* at 254.
100. *Id*. at 252.
101. *Id*. (recognizing a "taxpayer seeking a real property tax exemption bears the burden of proof [as] tax exemption statutes are strictly construed against the property owner," but also recognizing an exemption must "not be so narrowly interpreted as to defeat [its] settled purpose to encourage, foster and protect religious institutions as a public benefit" (citations omitted)).
102. *Id*. at 253.
103. *Id.* (citation omitted).
104. *Id*. (citations omitted).
105. *Id.*
106. Maetreum of Cybele, Magna Mater v. McCoy, 24 N.Y.3d 1023 (*citing* Matter of Yeshivath Shearith Hapletah v. Assessor of Town of Fallsburg, 79 N.Y.2d 244, 249 (1992) *quoting* Matter of Assoc. of Bar of City of N.Y. v. Lewisohn, 34 N.Y.2d 143, 153 (1974)).
107. *Id*. (*citing* Maetreum of Cybele, Magna Mater 975 N.Y.S.2d at 254).
108. In Maetreum of Cybele, Magna Mater v. McCoy, the city noted that exempting the apartment buildings from taxation would add to the city's financial woes by removing approximately one million dollars of assessed valuation off the tax rolls, resulting in a loss of between $35,000-40,000 in school, city and county taxes. Transcript of Oral Argument before Ct. of Appeals, p.3, l.6-9.

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Tax Certiorari: Recent Appellate Division Split in Interpreting New York Real Property Tax Law § 727(1)

By Daniel M. Lehmann

I. Introduction

A recent Appellate Division, Fourth Department, Real Property Tax Law (RPTL) decision created a Division split concerning the automatic three year tax assessment freeze under RPTL § 727(1) after reducing a tax assessment. The Fourth Department in *Torok Trust v. Town Board of Town of Alexandria*[1] affirmed the trial court and held that a property owner who successfully reduced an assessment for a tax year did not have to bring subsequent reduction challenges for the next three tax years while the initial reduction challenge was pending.[2] The Third Department (and Second Department) held the opposite.[3] Both the Third and Fourth Departments support their conclusions on contrary interpretations of the legislative intent of RPTL § 727.[4]

II. RPTL § 727

RPTL § 727(1) provides that,

> [e]xcept as hereinafter provided,...where an assessment being reviewed pursuant to this article is found to be unlawful, unequal, excessive or misclassified by final court order or judgment, the assessed valuation so determined shall not be changed for such property for the next three succeeding assessment rolls prepared on the basis of the three taxable status dates next occurring on or after the taxable status date of the most recent assessment under review in the proceeding subject to such final order or judgment. Where the assessor or other local official having custody and control of the assessment roll receives notice of the order or judgment subsequent to the filing of the next assessment roll, he or she is authorized and directed to correct the entry of assessed valuation on the assessment roll to conform to the provisions of this section.[5]

III. The Third Department's Interpretation of RPTL § 727

In *Scellen v. Assessor for the City of Glen Falls*, the property owner brought a tax certiorari proceeding under RPTL Article 7 to reduce its 1998 tax year assessment.[6] The property owner reached a reduction agreement with the City in December 2000 but did not agree on whether RPTL § 727 required a reduction in the unchallenged 1999 through 2001 assessments based on the reduced 1998 assessment. The property owner moved to compel reduction of the 1999 through 2001 assessments. The trial court held that the property owner waived its right to reductions because it failed to commence challenges to those assessments.[7]

The Third Department affirmed, supporting its conclusion on the

> statutory scheme underlying RPTL article 7 [that] evinces a clear legislative intent that a separate proceeding be timely commenced to challenge each tax assessment for which relief is sought,[8] and the legislative history of RPTL 727 gives no indication that the Legislature intended to relieve petitioner of this requirement in the case of assessment rolls established during the pendency of a prior RPTL article 7 proceeding.[9]

The Third Department recently reaffirmed its *Scellen* holding.

In *Highbridge Broadway, LLC v. Assessor of the City of Schenectady*, the commercial property owner became eligible in 2005 for the 10 year business investment property tax exemption under RPTL § 485-b.[10] The property owner only applied for the exemption in 2008, at which time it was granted. In July 2008, the property owner brought an RPTL Article 7 challenge for an assessment reduction because the assessor undervalued the exemption. The School District was notified but did not appear. In 2011, the trial court found for the property owner and that the property owner was entitled to the exemption from 2008 through 2014. The property owner conceded that it waived the exemption for 2005 through 2007.

Thereafter, the City and County issued refunds to the property owner for previously paid tax years in accordance with the 2011 judgment. The District did not respond. The trial court held that the District did not have to refund for the 2008 tax year because it utilized the 2007 pre-exemption assessment roll but that it did have to refund for 2009 through 2011 because the property owner was not required to file an application every year to apply the exemption.[11]

The Third Department stated that the issue was "whether [the property owner] was required to annually commence separate proceedings while its 2008 challenge was pending in order for the court's 2011 judgment increasing the RPTL 485–b exemption to be binding on the subsequent years."[12] The District relied on *Scellen* that a separate annual challenge must be brought and the Third Department

agreed. It reasoned that "property owners must preserve their right to relief through annual challenges to the assessment pending a determination of the original assessment challenge. Since petitioner failed to do so here, Supreme Court lacked jurisdiction to direct the District to refund payments made based on the 2009 through 2011 assessments."[13]

IV. The Second Department's Concurrence with the Third Department

It seems that the Second Department agrees with the Third Department.

In *Jonsher Realty Corp./Melba, Inc. v. Board of Assessors*, the property owner brought RPTL Article 7 proceedings challenging the assessments for tax years 1998 through 2006.[14] The trial court directed a reduction of the assessments and refund of overpayments. The Second Department affirmed in 2010.

The property owner then brought a Civil Practice Law and Rules (CPLR) Article 78 proceeding to force the assessor to calculate transition assessments under RPTL § 1805(3) for the 2007 tax year and to refund any overpayments triggered by the granted 2006 assessment reduction. The trial court granted the requested relief.[15]

The Second Department reversed and held that the property owner was time-barred because it should have properly brought an RPTL Article 7 challenge right after the filing of the final assessment roll in 2007, which has a 30-day statute of limitations, and not the CPLR Article 78 challenge after appellate affirmance, which has a four-month statute of limitations.[16]

The property owner argued that the four-month statute of limitations applied because recalculation of the 2007 assessment under RPTL § 1805 only became necessary after the trial court reduced the 2006 assessment and the Second Department affirmed in 2010.[17]

The Second Department disagreed and, citing *Scellen*, stated that it found the Third Department's analysis to be persuasive. It reasoned that because the property owner sought an assessment reduction for 2006, it knew or should have known that if it was successful, it would be entitled to transition assessments in the following years and that judicial resolution could take several years. The property owner should have preserved its challenge to the 2007 assessment by exhausting its administrative remedies by filing timely, annual grievances with the assessing authorities and if it did not receive the requested relief, to then timely bring a separate RPTL Article 7 proceeding to challenge those assessments no later than 30 days after the filing of the final assessment roll. Because it failed to do so, the property owner was not entitled to its requested relief.[18]

V. The Fourth Department's Interpretation of RPTL § 727

However, the Fourth Department reached the opposite conclusion.

In *Torok Trust v. Town Board of Town of Alexandria*, the property owner brought a tax certiorari proceeding in July 2007 pursuant to RPTL Article 7 to reduce the tax assessment on its property for the 2007 tax year.[19] The School District was served but did not intervene. The property owner reached an agreement with the Town in January 2009 to reduce the assessment for the 2007 tax year. The parties agreed that RPTL § 727 applied to the settlement and that, if the property owner had previously paid any taxes levied prior to the settlement order, the District would refund the excess based on the reduced assessment. The District issued a refund for the 2007 school tax year but not for the 2008 school tax year. The property owner moved to compel issuance of the 2008 refund and the District argued that the property owner never brought a tax certiorari proceeding for the 2008 tax year. The trial court held for the property owner.

The Fourth Department considered the plain language of the statute, which imposes a three year assessment freeze where an "order or judgment" determines that the assessment is "unlawful, unequal, excessive or misclassified."[20] The court reasoned that the parties' reduction stipulation had the same effect as a judicial determination. Therefore, the freeze applied to next three succeeding assessment rolls—the 2008 through 2010 tax years—which must have the same assessment as the tax year under review.[21]

Further, the court noted that RPTL § 727(1) states that where the assessor received the order or judgment after the next assessment roll has already been filed, the assessor must correct the assessed valuation and then the property owner may apply for a refund under RPTL § 726(1)(c).[22] Therefore, there was an automatic assessment reduction for the 2008 tax year without the property owner bringing a separate reduction challenge.[23]

The court supported its conclusion with the legislative intent of RPTL § 727 to "reduce the need for [annually] repeated litigation in challenging tax assessments."[24]

VI. A Wrinkle in the Third Department's Position?

The Third Department's interpretation of the legislative history and intent of RPTL § 727 in *Rosen v. Assessor of the City of Troy*[25] is seemingly at odds with the Third Department's interpretation in *Scellen*,[26] and instead is in accord with the Fourth Department's interpretation in *Torok*.[27]

In *Rosen*, the issue was whether RPTL § 727 included stipulations settling an RPTL Article 7 assessment challenge when there was no express trial court finding that the challenged assessment was "unlawful, unequal, excessive or misclassified."[28]

The Third Department in *Rosen* held that the Legislature's intent included stipulations and was not "nar-

rowly restricted to those instances in which an assessment is expressly and judicially determined to be 'unlawful, unequal, excessive or misclassified,' as this interpretation would eviscerate the statute's intent."[29]

The Third Department in *Rosen* explained the statute's intent. "The legislative history of RPTL 727, enacted in 1995, indicates that its purpose was to prevent assessing units from increasing judicially reduced assessments in succeeding years, to prevent taxpayers from perpetually challenging their assessments and to spare all parties the time and expense of repeated court intervention."[30]

VII. Conclusion

Time will tell whether the First Department will join the RPTL § 727(1) fray. Time will also tell whether the Court of Appeals will resolve this split. Until this disparity is resolved, the cautious tax certiorari practitioner in the First, Second, Third, and even Fourth Department jurisdictions should timely file real property tax assessment reduction grievances and challenges every tax year, regardless of whether or not the property owner is in the process of achieving or has achieved assessment reductions for certain tax years by stipulation or judicial order. No one has ever lost a real property tax assessment reduction proceeding because of filing too often.

Endnotes

1. 128 A.D.3d 97, 7 N.Y.S.3d 748 (4th Dep't 2015).
2. *Torok Trust*, 128 A.D.3d at 99-101, 7 N.Y.S.3d at 750-51.
3. *See* Scellen v. Assessor for the City of Glen Falls, 300 A.D.2d 979, 979-81, 753 N.Y.S.2d 536, 537 (3d Dep't 2002); *see also* Jonsher Realty Corp./Melba, Inc. v. Board of Assessors, 118 A.D.3d 787, 789-90, 988 N.Y.S.2d 203, 206 (2d Dep't 2014).
4. *See Scellen*, 300 A.D.2d at 980, 753 N.Y.S.2d at 537 (holding that the statutory scheme underlying RPTL article 7 evinces a clear legislative intent that a separate proceeding be timely commenced to challenge each tax assessment for which relief is sought).
5. N.Y. Real Prop. Tax Law § 727(1) (McKinney 2015).
6. *Scellen*, 300 A.D.2d at 980, 753 N.Y.S.2d at 537; cf. Wagner & Stoll, L.L.C. v. City of Schenectady, 107 A.D.3d 1225, 1228-29, 967 N.Y.S.2d 238, 241-42 (3d Dep't 2013). ("Although no RPTL article 7 petition was filed for 2011, the parties' stipulation reflected their agreement that the reduced assessment would apply to the two years that were the subject of the RPTL article 7 petitions as well as the three-year period thereafter.").
7. *Scellen*, 300 A.D.2d at 980, 753 N.Y.S.2d at 537.
8. *Id.* (citing N.Y. RPTL §§ 702, 704, 706; N.Y.C.C.R. tit. 22, ch. II, § 202.59(d)(2) (McKinney 2015)).
9. *Scellen*, 300 A.D.2d at 980, 753 N.Y.S.2d at 537.
10. *Highbridge*, 124 A.D.3d at 1193, 2 N.Y.S.3d at 680.
11. *Id.* at 1194, 2 N.Y.S.3d at 681.
12. *Id.*
13. *Id.* at 1195, 2 N.Y.S.3d at 681-82.
14. 118 A.D.3d 787, 787, 988 N.Y.S.2d 203, 205 (2d Dep't 2014); *see also* MRE Realty Corp. v. Assessor of the Town of Greenburgh, 8 Misc.3d 1027(A), 806 N.Y.S.2d 446 (Sup. Ct. Westchester Cnty. 2005), *aff'd*, 33 A.D.3d 802, 822 N.Y.S.2d 629 (2d Dep't 2006) (affirming Supreme Court ruling that under moratorium statute property owner was not entitled to reductions and refund of excess real property taxes).
15. *Jonsher Realty Corp.*, 118 A.D.3d at 787, 988 N.Y.S.2d at 205.
16. *See id.* at 789, 988 N.Y.S.2d at 206.
17. *Id.* at 788-89, 988 N.Y.S.2d at 206.
18. Although distinguishable on the facts, it is arguable whether the dictum in ELT Harriman, LLC. v. Assessor of Town of Woodbury is consistent with the Third or Fourth Department. 128 A.D.3d 201, 208, 209, 210-11, 7 N.Y.S.3d 422, 426, 427, 428 (2d Dep't 2015) (citing legislative history of RPTL § 727).
19. 128 A.D.3d 97, 98, 7 N.Y.S.3d 748, 749 (4th Dep't 2015).
20. *Id.* at 99, 7 N.Y.S.3d 750.
21. *Torok Trust*, 128 A.D.3d at 99-100, 7 N.Y.S.3d at 750.
22. *Id.* at 100, 7 N.Y.S.3d 748 (referencing N.Y. Real Prop. Tax Law § 726(1)(c) (McKinney 2015). An owner may only apply for a tax refund under this statute after a final order or judgment has been received by the assessor and the assessor has rendered a new assessment of the property.).
23. *Id.* at 100, 7 N.Y.S.3d at 750.
24. *Id.* at 100, 7 N.Y.S.3d at 750-51.
25. *See* 261 A.D.2d 9, 12-13, 699 N.Y.S.2d 787, 790 (3d Dep't 1999).
26. *See* Scellen v. Assessor for the City of Glen Falls, 300 A.D.2d 979, 980-81, 753 N.Y.S.2d 536, 537 (3d Dep't 2002).
27. *See* Torok Trust v. Town Bd. of Town of Alexandria, 128 A.D.3d 97, 99-100, 7 N.Y.S.3d 748, 750-51 (4th Dep't 2015).
28. Rosen, 261 A.D.2d at 12, 699 N.Y.S.2d at 789.
29. *Id.* at 12, 699 N.Y.S.2d at 790.
30. *Id.*

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Important Questions and Answers on the New and Old Rules of the Loft Law

By Adam Leitman Bailey and Dov Treiman

Q1. What is a loft?

A1. The word "loft" has no legal meaning. The word "loft" is used in several laws and in the naming of the New York City Loft Board, which was set up for the purpose of taking illegal residential tenancies in buildings that were originally built for commercial use. These buildings, in their original configuration, are not safe for residential occupancy. In the Loft Law[1] and several related laws, procedures are set up to protect and preserve the residential occupancies through renovations to these buildings to bring them up to the safety standards that are normal in apartment buildings. Not all commercial buildings qualify for this process. Those that do are called "interim multiple dwellings."[2]

Q2. What is the difference between a "loft" and an "interim multiple dwelling" ("IMD")?

A2. Although the "Loft Law" uses the word "loft," the word is never defined. However, an "interim multiple dwelling"[3] is a dwelling space that meets certain statutory criteria for being brought under the jurisdiction of the New York City Loft Board as the residential spaces in a qualifying building are transitioned to protection under a form of rent stabilization.

Q3. Is the end of the legalization process in an IMD rent stabilization?

A3. Once the legalization process for an IMD is completed, the affected units come under the Emergency Tenant Protection Act of 1974 (ETPA).[4] While rent stabilization needs a building to have six or more residential units to come into effect for a particular building, ETPA buildings that were IMDs can have as few as three units. However, ETPA buildings use the same Rent Stabilization Code as rent-stabilized buildings.[5]

Q4. What is the difference between an IMD tenant and a rent-stabilized tenant?

A4. Once the New York City Loft Board determines that a building is an IMD, the Loft Board's regulations cover the tenancy.[6] Those regulations bear some similarities to rent stabilization, but they are tailored to the process of moving the building towards legalization. In many buildings, this means radical architectural changes, while in rent stabilization, the buildings' architecture tends to remain completely unchanged. However, some things, like the rights to succeed to a tenancy, are the same in IMD regulations and in rent stabilization. So, while the laws are similar, they are also dissimilar. Each is its own system.

Q5. Can any building come under the Loft Law?

A5. There are actually two different loft laws, although they are found in one section of Article 7C of the Multiple Dwelling Law.[7] These are referred to as "Old Loft Law"[8] buildings and "New Loft Law"[9] buildings.

Q6. What qualifies a building to come under the Old Loft Law?

A6. In order for a building to qualify as an IMD under the Old Loft Law, the building in question must:

1. Have been used for manufacturing, commercial, or warehouse purposes;
2. Not have a certificate of occupancy for residential occupancy;
3. Have three or more residences from April 1, 1980 thru December 1, 1981 ("the window period");[10]
4. Be located in a zone where
    a. residential use is permitted as of right or
    b. by minor modification or
    c. in an area under study for such use or
    d. can be achieved by special permit;
5. Not be governmentally owned. [11]

Q7. What qualifies a building to come under the New Loft Law?

A7. The only difference between the Old Loft Law and the New Loft Law is in determining which buildings come under the control of the New York City Loft Board while the building is being transitioned from illegal residential use to legalized rent stabilization. Once a building is brought under the control of the New York City Loft Board, the rules and regulations for bringing those buildings out of Loft Law coverage and under rent stabilization are identical under the Old and New laws. There is only one set of regulations to cover both—except in determining if the building is an IMD at all.

The chart below shows the differences between the Old and New Loft Laws, both of which are still in effect:

Qualification	Old Loft Law[12]	New Loft Law[13]
History of the Building	Former factory, warehouse or commercial edifice	Nothing in particular.
Number of Units Needed to Bring the Building Under Loft Law	3	3
Residential Certificate of Occupancy	Lacking	Lacking
Governmental Ownership	Lacking	Lacking
Window Period	April 1, 1980 thru December 1, 1981	January 1, 2008 through December 31, 2009
Description of Unit	None	Not be located in a basement or cellar. Have at least one entrance that does not require passage through another residential unit. Have at least one window opening onto a street, yard, or court. Be at least 400 square feet in area.
Zoning	The building must not only be zoned for residential occupancy or easily be converted to such.	The building must not only be zoned for residential occupancy or easily be converted to such, but be located in certain specific geographic areas that are set forth in the Loft Law, in various parts of Manhattan, Brooklyn, and Queens.

Like the Old Loft Law, the New Loft Law has its own window period. The New Loft Law window period is January 1, 2008 through December 31, 2009. In addition:

1. The building must have three or more residential units during the window period.
2. The qualifying units must
   a. Not be located in a basement or cellar;
   b. Have at least one entrance that does not require passage through another residential unit;
   c. Have at least one window opening onto a street, yard, or court; and
   d. Be at least 400 square feet (until June 30, 2015, 550 square feet thereafter[14]) in area.
3. The building must not only be zoned for residential occupancy or easily be converted to such, but must also be located in certain specific geographic areas that are set forth in the Loft Law, in various parts of Manhattan, Brooklyn, and Queens.[15]

Q8. Is Loft Law protection limited to tenants who caused the building to qualify as an IMD?

A8. It is the unit that was occupied by the tenant that gets the protection, not the actual tenant who was in occupancy in the "window period" described in A4(3). If the number of units goes down from three units after there was such residential occupancy during the "window period," the building remains an IMD.[16]

Q9. Does the building have to have cast iron architecture to qualify as an IMD?

A9. While many of the buildings that came under the old loft law led to the commonly held belief that cast iron architecture was required for a building to qualify as an IMD that was largely coincidence. The Loft Law largely tracks New York City's Zoning Resolution.[17] Neither the Zoning Resolution nor the Loft Law sets forth what kind of building may qualify, only that it have a history of having been used for manufacturing, commercial, or warehouse purposes. Many of the buildings that were previously used for manufacturing, commercial, or warehouse purposes that were rezoned as residential were, in fact, cast iron architecture.

Q10. Does a tenant have to be an artist to qualify for IMD protection?[18]

A10. This is the same kind of question as Q7 (cast iron architecture). The Loft Law itself does not require that the tenant be an artist to qualify for IMD protection. However, many of the Old Loft Law buildings are located in zoning where only artists (certified by the New York City Department of Cultural Affairs or New York State Council on the Arts) may reside in buildings erected in that zone as Joint Living Working Quarters for Artists.[19] This is actually a zoning issue rather than a Loft Law issue, but the Loft Law follows the Zoning Resolution on such questions and, in fact, most Old Loft Law tenants were artists. New Loft Law tenants are less likely to be.

Q11. How long does it take an IMD to complete the legalization process?

A11. Historically, most buildings take at least 10 years from when the petition is first filed to place a building under the Loft Board to when the Loft Board sets the rents and directs that leases be issued

under the Emergency Tenant Protection Act. However, 20 years is not uncommon.

Q12. Is a landlord allowed to collect rent during legalization?

A12. Technically, but only technically, a landlord is allowed to collect rent during legalization.[20] However, if the landlord cannot make a showing that it has diligently pursued the legalization process, then it cannot sue for the rent. In actual practice, nearly no landlord can convince a court that it has diligently pursued the legalization process. As a result, IMD buildings rarely generate income from the residential tenants during the period of Loft Law coverage. Since for many such buildings all of the tenants are residential, there is no income and no one to complain to about it.

Q13. Can any more buildings be brought under the Loft Law?

A13. The Loft Board is no longer accepting coverage applications.[21] However, there are still many coverage applications pending. Where these applications are disputed, they have to be tried in a hearing process. The New York City Office of Administrative Trials and Hearings ("OATH") conducts these hearings.[22]

Q14. What kind of evidence may be used in a hearing before OATH?

A14. The formal rules of evidence do not apply before OATH, but it still requires that the evidence presented before it be reasonably reliable. While it is still possible for cases to be tried under the Old Loft Law, because the evidence for it is from some 35 years ago, useful evidence and useful witnesses are vanishing.

Q15. Can a tenant be evicted from an IMD where the lease only allows commercial use of the premises and the unit is actually being used residentially?

A15. The very purpose of the Loft Law is to protect such tenancies. Such tenants may not be evicted.[23]

Q16. What are the steps for bringing an IMD out of being an IMD?

A16. Basically, there is a four-step process,[24] with numerous sub-steps (some of which are outlined here):

1. The owner files an alteration application with the Department of Buildings.
    a. DOB reviews the plans and issues an Objection Sheet and a list of requirements, including the requirement that the Loft Board certify the completion of its narrative statement process described below.
2. Within 15 days of filing the alteration application, the owner files with the Loft Board the plans it has filed with the DOB together with a "narrative statement" that describes the work that is necessary and why it is being done.
    a. The Loft Board then schedules a conference among the owner (who may have an attorney present) and the tenants (who may have attorneys present) to discuss the narrative statement and to negotiate changes to it.
    b. At the completion of this process, if there is agreement, the Loft Board issues a certificate.
    c. If there is no agreement, the tenants have the right to file an alternative plan with the DOB or a diminution of services complaint.
    d. If the DOB accepts the tenant plan, the Loft Board may order a proceeding to determine which plan to use. The purpose of such proceeding is the determination of whether the Owner's plan unreasonably interferes with the tenants' use of their units.
    e. Upon the completion of that process, and its satisfaction that the DOB's other objections have been met, the Loft Board will then certify that the narrative statement process is completed.
3. Once there is a certificate that the narrative statement process is completed, the owner may file for building permits at the DOB.
4. Upon the issuance of the building permits:
    a. The owner files the building permit with the Loft Board.
    b. The owner performs the permitted construction.
    c. The Loft Board monitors the construction, meeting with the Owner as necessary. The Owner is required to file monthly reports with the Loft Board.
    d. The owner files for a Temporary Certificate of Occupancy or Compliance Form (indicating that fire and safety standards are now in place).
    e. The Owner does the construction necessary for a final Certificate of Occupancy and clears the building of violations.
    f. The Owner requests an inspection from the DOB for a Certificate of Occupancy.
    g. If the DOB finds the building in compliance, it requests certification from the Loft Board.
    h. If the Loft Board issues a Certificate of No Objection, the DOB issues a Certificate of Occupancy.

i. The Owner applies to the Loft Board for rent increases based on code compliance costs as well as for Rent Guidelines Board increases.

j. The Loft Board certifies that the legalization process is complete and sets the rents for the units.

k. The Owner then registers the building as a multiple dwelling with the New York City Department of Housing Preservation and Development and as rent regulated, registering it with the New York State Division of Housing and Community Renewal (DHCR) and the building comes under the Emergency Tenant Protection Act and is governed under the Rent Stabilization Code.

Q17. What are the deadlines for completion of the various stages under the Loft Law?

A17. The deadlines are as follows:

The deadlines for Old Loft Law buildings are as follows:

Filing of the alteration application with the DOB: 9/1/99

Filing for a building permit with DOB: 3/1/00

Bringing a building up to fire and safety standards: 6/1/12

Obtaining a Certificate of Occupancy: 7/2/12

The deadlines for New Loft Law buildings are as follows:

For buildings that came under the Loft Law in 2010:

Filing of the alteration application with the DOB: 3/21/11

Filing for a building permit with DOB: 6/21/11

Bringing a building up to fire and safety standards: 18 months from alteration application

Obtaining a Certificate of Occupancy: 12/21/12

For buildings that came under the Loft Law in 2013:

Filing of the alteration application with the DOB: 6/11/14

Filing for a building permit with DOB: 9/11/14

Bringing a building up to fire and safety standards: 18 months from alteration application

Obtaining a Certificate of Occupancy: 3/11/16

Q18. What happens if an Owner is out of compliance with the deadlines?

A18. The Loft Board has jurisdiction to issue heavy fines. However, these are relatively rare. However, all landlords who fail to comply with the deadlines are subject to being deprived of any possible court proceeding to compel the tenant to pay the rent.[25]

Q19. Can an IMD go directly to Cooperative or Condominium status?

A19. If there is an offering plan for a Cooperative or a Condominium, as part of the legalization process, the owner files the offering plan with the Loft Board and the Loft Board will issue an exemption form to start taking the building out of Loft Board jurisdiction.

Q20. Who can file an alteration application to legalize an IMD?

A20. The only persons who can file an alteration application on behalf of an owner are a registered architect or a professional engineer,[26] regardless of how minor the work may be or how obvious.

Q21. Does a tenant have to cooperate with the legalization process?

A21. This largely depends on what one means by "cooperate." The law sets forth several circumstances where the tenant has to provide access to the dwelling. While there are procedures for compelling that access, those procedures take time. Further, the actual legalization procedures, even if they were to proceed apace, takes years to complete, but subtle lacks of cooperation are impossible to prosecute and the process therefore drags on for years.

Q22. Are there ways to remove an IMD from the IMD process?

A22. In spite of the fact that it has not yet been legalized by the issuance of a Certificate of Occupancy, an IMD can be taken out of the process[27] if:

1. The owner has purchased all rights to all the IMD units;
2. Under certain circumstances, the Owner has purchased the improvements to the units;
3. The Loft Board has declared the IMD units abandoned;[28]
4. The owner has filed a Declaration of Intent form for each IMD unit indicating the owner's intent to convert all of the IMD units in the building back to commercial use.

Q23. If the owner purchases the improvements from a tenant, does that exempt the unit from rent stabilization after conversion?

A23. Throughout NYC, if the number of residential units in the building is fewer than six, then for such a unit, the purchase of the improvements removes the unit from potential rent stabilization coverage. In Manhattan, if there are more than six residential units in the building, then such unit will not be subject to the Loft Law, but will be subject to rent stabilization when the legaliza-

tion process is complete.[29] In Brooklyn and Queens, such unit will be unregulated.[30]

Q 24. Does a new owner of an IMD get any special consideration for noncompliance with the deadlines?

A 24. Where title to the IMD was conveyed to a new owner after the code compliance deadline has passed, the new owner may file an extension application for the passed deadline within 90 calendar days from acquiring title.[31] In order to qualify as a "new owner," it must be an unrelated entity or unrelated natural person to whom ownership interest is conveyed for a bona fide business purpose and not for the purpose of evading the law. However, such applications are not granted automatically.

Q 25. If someone disagrees with a Loft Board Order, is there any right of appeal?

A 25. If there is a written ruling by a staffer of the Loft Board, there is a right of appeal to the full Board. A disagreeing party with an order of the full Loft Board can take an appeal to New York State Supreme Court. The court usually sides with the Loft Board.

Q 26. Who hears adversarial administrative proceedings under the Loft Law?

A 26. Most of these proceedings are before the New York City Office of Administrative Trials and Hearings (OATH) although some may be heard by the Environmental Control Board. The rules of procedure before those bodies are their own and not unique to the Loft Law.

Q 27. What are harassment proceedings in an IMD?

A 27. Both the courts and the Loft Board have jurisdiction regarding harassment in an IMD. For purposes of Loft Law, harassment means, anything done by the landlord or its agents that interferes with or disturbs the comfort, repose, peace or quiet of an occupant in the occupant's use or occupancy of its unit if such conduct is intended to cause the occupant to vacate the building or unit, or to surrender or waive any rights of such occupant under the occupant's written lease or other rental agreement or the law.[32] This definition of "harassment" does not include the landlord making buyout offers and, in fact, the Loft Law encourages buyout offers. Nearly unique to the Loft Law, if the Loft Board finds the complaint to be filed in bad faith, the Loft Board may assess a penalty against the tenant. If the Loft Board finds that there has been harassment, the owner is disqualified from buying out IMD rights and can be subjected to a fine. The courts may award damages or an injunction.

Q 28. Is there a hardship procedure allowing for escape from the IMD process?

A 28. There is such a procedure,[33] but it is nearly never successful and is simply not worth pursuing.

Q 29. Can a landlord buy out of the IMD process?

A 29. A landlord can completely buy a tenant's IMD rights under the procedures set forth in the Loft Regulations.[34] The Loft Regulations also specifically call for the owner buying the tenant's improvements if the tenant is moving out.[35] Such a purchase removes that unit from Loft Law protection. However, in Manhattan, it does not remove the unit from ultimate rent stabilization if the building has six or more residential units, while it does do so in Queens and Brooklyn. All of these procedures require filings with the Loft Board.

Q 30. Does the Owner have to buy the improvements at the price set by the tenant?

A 30. The Owner can decline to buy the improvements at all or it can contest the tenant's price, in which case a proceeding before the Loft Board will set what the proper price should be.[36]

Q 31. Can a landlord evict a tenant who is in a protected unit in an IMD?

A 31. A landlord can evict a tenant from a protected unit in an IMD on grounds of:[37]

1. A tenant can be evicted on grounds of nonprimary residence, provided the tenant's lease is expired.
2. The tenant is committing or permitting a nuisance in such unit; or is maliciously or by reason of gross negligence substantially damaging the building; or his or her conduct is such as to interfere substantially with the comfort and safety of the landlord or of the other occupants of the same building or of adjacent buildings or structures.
3. The premises are being used for illegal purposes.
4. The tenant renders a smoke detector inoperative.
5. A tenant sublets the premises without following the proper procedures.

Q 32. Does a tenant have succession rights similar to succession rights in rent stabilization?

A 32. The succession rights in a loft unit are essentially the same as in rent stabilization.[38]

Q 33. What happens if the tenant abandons the unit?

A 33. With certain procedures before the Loft Board, the Loft Board can declare a unit abandoned by the tenant. If there is such a finding, it has the same legal effect as if the landlord bought the tenant out.[39]

Endnotes

1. N.Y. Mult. Dwell. Law § 280 (McKinney 1982).
2. N.Y. Mult. Dwell. Law § 281(McKinney 2012).
3. N.Y. Mult. Dwell. Law § 281 (McKinney 2012).
4. Ch. 576, § 1, 1974 N.Y. Laws 1.
5. 9 N.Y. Comp. Rules & Regs. § 2520.1 et seq. (1985).
6. N.Y. Mult. Dwell. Law § 282 (McKinney 2010).
7. N.Y. Mult. Dwell. Law § 280 (McKinney 1982).
8. N.Y. Mult. Dwell. Law § 281(1) (McKinney. 2012).
9. N.Y. Mult. Dwell. Law § 281(5) (McKinney 2012).
10. N.Y. Mult. Dwell. Law § 281(2) (McKinney 2012).
11. N.Y. Mult. Dwell. Law § 281(1) (McKinney 2012).
12. *Id.*
13. N.Y. Mult. Dwell. Law § 281(5) (McKinney 2012).
14. *Id.*
15. *Id.*
16. N.Y. Mult. Dwell. Law § 281(3) (McKinney 2012).
17. N.Y. Mult. Dwell. Law § 280 (McKinney).
18. N.Y. Mult. Dwell. Law § 276 (McKinney).
19. *Id.*
20. N.Y. Mult. Dwell. Law § 285(1) (McKinney 2012).
21. N.Y. Mult. Dwell. Law § 282-a (McKinney 2011).
22. N.Y. Mult. Dwell. Law § 282 (McKinney 2010).
23. N.Y. Mult. Dwell. Law § 286(1) (McKinney 2012).
24. N.Y. Mult. Dwell. Law § 284 (McKinney 2012).
25. N.Y. Mult. Dwell. Law § 285(1) (McKinney 2012); New York, N.Y., R.C.N.Y. §2-01.1.
26. N.Y. Mult. Dwell. Law § 300 (McKinney 2012).
27. New York, N.Y., R.C.N.Y. § 2-01.
28. New York, N.Y., R.C.N.Y. § 2-10(f).
29. Acevedo v. Piano Bldg. LLC, 70 A.D.3d 124, 891 N.Y.S.2d 41 (1st Dep't 2009).
30. Caldwell v Am. Package Co., 57 A.D.3d 15, 866 N.Y.S.2d 275 (2d Dep't 2008); Gloveman Realty Corp. v Jefferys, 18 A.D.3d 812, 795 N.Y.S.2d 462 (2d Dep't 2005).
31. New York, N.Y., R.C.N.Y. § 2-01(b).
32. New York, N.Y., R.C.N.Y. § 2-02.
33. New York, N.Y., R.C.N.Y. § 2-03(a).
34. New York, N.Y., R.C.N.Y. § 2-07(f).
35. *Id.*
36. New York, N.Y., R.C.N.Y. § 2-07(g).
37. New York, N.Y., R.C.N.Y. § 2-08.1.
38. New York, N.Y., R.C.N.Y. § 2-08.1(c).
39. New York, N.Y., R.C.N.Y. § 2-10(f); *see* New York, N.Y., R.C.N.Y. § 2-08.1.

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Bergman on Mortgage Foreclosures: Borrower Waiver of Counterclaim Enforced

By Bruce J. Bergman

There being no end to the obfuscation and dilatory tactics of defaulting borrowers—from a mortgagee's vantage point, of course—an off-encountered tactic is attacking the plaintiff with a counterclaim. That represents not merely a defense (although it is that) but an *offense* as well, thereby perceived as being an even more potent ploy.

But what if the lender's mortgage contains a provision by which the borrower waives the right to oppose a foreclosure action with counterclaims? Can that be enforceable to protect the lender? The question arises with some frequency and so it may be helpful to respond, "Yes," reconfirms a new case: *KeyBank National Association v. Chapman Steamer Collective, LLC.*[1]

Traditionally this has been so. It is hardly uncommon for mortgage documents—the note, the mortgage, or both—to provide waiver by the borrower in any foreclosure action of defenses or counterclaims. While some defenses are not susceptible to waiver in the mortgage at the inception, for example the statute of limitations[2] or the ability to redeem,[3] where the right to otherwise assert defenses, counterclaims or offsets is waived in the mortgage it is honored by the courts.[4]

Here is how the concept plays out in practice, in the real world as presented in the new case.

A mortgage foreclosure action was begun. In addition to a usual answer with sundry denials and perhaps a laundry list of fanciful affirmative defenses, the defendants counterclaimed, asserting (among other things) that the lender, as part of a series of predatory lending practices, induced the defendants into mortgaging the premises founded upon unfulfilled promises of access to further development funding.

The plaintiff appropriately moved for summary judgment and to dismiss the defendants' counterclaim. The defendants opposed, of course, and in addition (a side point to emerge here) cross-moved to compel certain disclosures, which if successful would greatly mire the case in delay.

As to the discovery issue—certainly important but only peripheral to this discussion—the court ruled that the borrowers could not demonstrate how further discovery might reveal or lead to relevant evidence to oppose summary judgment, or that facts to support that opposition might be within the exclusive knowledge or control of the foreclosing plaintiff. While this is standard stuff, it is quite helpful.

But on the point of the counterclaim, the lender's mortgage contained an efficacious waiver by the borrower of the ability to interpose a counterclaim. Both the trial court and the Second Department ruled that the plaintiff was entitled to judgment as a matter of law to dismiss the counterclaim because the defendants validly waived the ability to counterclaim pursuant to the express terms of the mortgage.

So, there are meaningful takeaways from this decision. One point is that a lender's mortgage should advisedly contain a provision waiving defenses and counterclaims. It is recognized that some lenders are constrained to use standard forms which might not have such a provision, but if there is any leeway to insert it, it can be quite important. The second aspect is that if there *is* such a clause, and it is appropriately written, it will be enforced by the courts; that is to say, a counterclaim will be stricken and a foreclosure will be allowed to proceed when there is a waiver by a borrower of using counterclaims.

Endnotes

1. 117 A.D.3d 991, 986 N.Y.S.2d 598 (2d Dept. 2014).
2. See, *inter alia*, *Shapely v. Abbott*, 42 N.Y.443 (1870) and discussion and further case citation at 1 *Bergman on New York Mortgage Foreclosures*, §5.511[6][f], LexisNexis Matthew Bender (rev. 2014).
3. See, *inter alia*, *Hughes v. Harlam*, 166 N.Y.427, 60 N.E.22 (1901) and discussion and further case citation at 1 *Bergman on New York Mortgage Foreclosures*, §4.07, LexisNexis Matthew Bender (rev. 2014).
4. *Baron Associates, LLC v. Garcia Group Enterprises*, 96 A.D.3d 793, 946 N.Y.S.2d 611 (2d Dept. 2012), citing *Quest Commercial, LLC v. Rovner*, 35 A.D.3d 576, 577, 825 N.Y.S.2d 766 (2d Dept. 2006); *Petra Cre CDO 2007-1, Ltd. v. 160 Jamaica Owners, LLC*, 73 A.D.3d 883, 904 N.Y.S.2d 699 (2d Dept. 2010); *Parasram v. DeCambre*, 247 A.D.2d 283, 668 N.Y.S.2d 454 (1st Dept. 1998).

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