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ASK THE FORMER REGULATOR

Practical Implications of Transfer Tax Amendment

"I read that the tax law on grossing up of transfer taxes was amended this summer. Can you explain the change in the law as well as any disclosure requirements related to my client's offering plan?"

By Erica F. Buckley

Question: I am an attorney for a sponsor on a project in Manhattan. I read that the tax law on grossing up of transfer taxes was amended this summer. Can you explain the change in the law as well as any disclosure requirements related to my client's offering plan?

Answer: For readers unfamiliar with this area of practice, let me begin with what it means to "gross up" for purposes of real estate transfer taxes and why it is done. It should come as no surprise that the sale of a residential condominium unit or cooperative shares in New York City is a taxable event. Among the multitude of fees and costs paid at the closing table, one of the parties has to pay New York State Real Estate Transfer Tax (levied pursuant to Tax Law §1402), New York City Real Property Transfer Tax (imposed per N.Y.C. Admin Code §11-2102), and, on a purchase or sale with a consideration of $1

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million or more, the so-called "Mansion Tax" (imposed pursuant to Tax Law §1402-a, with the rate imposed escalating on a progressive scale in accordance with Tax Law §1402-b).

Tax Law §1404(a) decrees that the grantor (sponsor) shall pay the New York State Real Estate Transfer Tax set forth in §1402, while separate sections of the Tax Law impose the so-called "Mansion Tax" on the grantee (buyer). But as any attorney who has represented the purchaser of a condo unit or cooperative shares from a sponsor knows, the contract for a sponsor unit or shares will invariably require the grantee (buyer) to pay all transfer taxes, and that's where the concept of grossing up comes into play.

When a grantee agrees to pay New York State Real Estate Transfer Tax instead of the grantor, (which §1404(a) imposes upon a grantor), the amount of the transfer tax itself is deemed additional consideration paid for the condo unit or cooperative shares. Thus, when calculating the total consideration paid by the grantee, one would gross up the purchase price with the amount of New York State Real Estate Transfer Tax that the grantee was paying instead of grantor. That sum, which we can call the "grossed-up total consideration" paid by grantee, is the amount upon which all transfer taxes would be calculated. One would not gross up a "Mansion Tax," because, statutorily, "Mansion Tax" is imposed upon a grantee. Grossing up the total consideration had been a pervasive practice designed to immunize grantees from claims of tax underpayment, but it was not explicitly required by the text of the Tax Law.

In the state's budget, passed in April, was an amendment to Tax Law §1404, and the statute is silent on gross-ups no longer. §1404(a), effective as of July 1, 2021, now reads, in pertinent part:

The real estate transfer tax imposed pursuant to section fourteen hundred two of this article *shall be paid by the grantor and such tax shall not be payable, directly or indirectly, by the grantee except as provided in a contract between grantor and grantee or as otherwise*

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provided in this section. * * * In the case of a conveyance of residential real property as defined in subdivision (a) of section fourteen hundred two-a of this article, if the tax imposed by this article is paid by the grantee pursuant to a contract between the grantor and the grantee, *the amount of such tax shall be excluded from the calculation of consideration subject to tax under this article.*

(Emphasis supplied).

In other words, if the grantee agreed in its contract to pay the New York State Real Estate Transfer Tax that the grantor would otherwise be liable for under §1404(a), then when calculating the total consideration that grantee has paid for the unit, the amount of the New York Real Estate Transfer Tax paid is no longer included. This is the elimination of the gross-up, and it is good news for purchasers who almost always agree to pay all of the transfer taxes when acquiring a residential condo unit or cooperative shares from a sponsor. Notably, the statute leaves the parties free to negotiate these terms in a contract of sale.

It is also important to note that nothing in the revised §1404(a) alters grossing up of New York City Real Property Transfer Tax, and, therefore, grossing up a grantee's total consideration for purposes of calculating the amount of New York City Real Property Transfer Tax due is anticipated to continue.

So, about your client's offering plan …

There are other considerations too. Attorneys for sponsors have received deficiency comments from the Department of Law involving the 2021 changes to the Tax Law, and from those comments, it appears as though the Department of Law wishes to ensure that the revised law is followed to the letter, meaning it would be insufficient to simply file an amendment to the offering plan that states which of the parties is liable for paying transfer taxes or how they are calculated and apportioned. Tax Law §1404(a) requires these matters to be set forth in the contract, not the offering plan, and, therefore, the purchase agreement may also need to be amended. As a practical matter, attorneys for sponsors will need to update their model contract rider to include the transfer of the obligation to pay transfer taxes when it is a negotiated deal term.

In deficiency comments, the Department of Law has also guided sponsors to remove grossing-up language from the offering plan's terms: "[if the Plan includes disclosure regarding the calculation of [New York State Real Estate Transfer Tax] payable by a Purchaser based on the 'grossed-up' consideration, remove from the Plan all references to such grossed-up consideration payable by a Purchaser." If you receive this comment, it might require you to amend and restate the section of your offering plan that outlines the typical closing costs for a purchaser.

Whether this change in the law is material to your client's purchasers is fact sensitive. Erring on the side of caution, disclosing the statutory revision will make the most amount of sense. To that end, below is an unofficial example of disclosure on the change to the New York State Tax Law that has been deemed acceptable by the Department of Law (which is of course subject to change should the office issue more formal guidance):

The New York State Legislature passed the 2021-2022 New York State budget, which amended Section 1404(a) of the New York State Tax Law (the "**Tax Law Amendment**"). The Tax Law Amendment eliminates the requirement to "gross up" the consideration of a unit when a purchaser enters into a contact agreeing to pay the New York State Real Estate Transfer Tax ("**RETT**") at the closing of title to the unit. Pursuant to the Tax Law Amendment, a purchaser who, after April 1, 2021, executes a contract that obligates the purchaser to pay the RETT at the closing of title to the unit, or a purchaser who closes title to a unit after July 1, 2021, will no longer pay the portion of the RETT based on grossed-up consideration. The RETT is 0.4% for residential conveyances with consideration of less than $3,000,000.00 and 0.65% for residential conveyances with consideration of $3,00,000.00 or more. Therefore, the Plan is hereby amended to remove all references to such grossed-up consideration paid by a purchaser with respect to the RETT.

Finally, keep in mind, this is good news for all concerned. What purchaser wouldn't want to know that they will be paying less in transfer taxes than originally estimated?