

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

TSB-A-95 (7)R  
Real Property Tax  
August 22, 1995

STATE OF NEW YORK  
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. M950215B

On February 15, 1995, a Petition for Advisory Opinion was received from Port Jefferson Development Corp., c/o Robert Pryor, Esq., Pryor & Mandelup, P.C., 675 Old Country Road, Westbury, New York 11590.

The issues raised by Petitioner, Port Jefferson Development Corp., are:

1. Whether for purposes of the Real Property Transfer Gains Tax (the "gains tax") the consideration received by Petitioner from the transfer of 10 units in a foreclosure proceeding was the bid price from the sale of the units or the amount of the unpaid mortgage debt.
2. Whether for purposes of the gains tax construction costs in the amount of \$579,400, incurred but not yet paid by Petitioner was to be included in the consideration received by Petitioner from the transfer of the condominium units pursuant to the condominium plan.

Petitioner was formed for the purpose of acquiring property and constructing condominium units thereon. Petitioner ultimately acquired property and constructed 133 condominium units thereon. A significant portion of the funds that it used to acquire the property and construct the condominium units was borrowed from Norstar Bank (the "Bank") in the form of a mortgage secured by the property and condominium units.

At some point in time, the Bank declared that the mortgage was in default approximately at a time when the total mortgage indebtedness (inclusive of all principal, interest and any other additions) totaled \$3,073,079. Petitioner states that as a result of the Bank's foreclosure, the remaining 10 units on hand were sold at a foreclosure sale to the Bank free and clear of the Bank's mortgage lien for a total sales price of \$1,100,405. The net sales proceeds were used to pay down the mortgage leaving an approximate mortgage balance of \$2,000,000 which, to date, has never been reduced or modified. However, the Tax Department's Audit Division (the "Audit Division") included the total mortgage indebtedness in computing the consideration received by Petitioner from the transfer of the 133 condominium units.

In addition, at or about the time of the sale of the 10 units, Petitioner incurred but has not paid construction costs of \$579,400. Petitioner states that the Audit Division erroneously added this amount to the consideration it received from the transfer of the 133 condominium units.

On July 20, 1993, Petitioner filed a claim for refund and reported a total consideration of \$19,321,520 received for all 133 units sold including the 10 units at issue. The consideration of \$19,321,520 was equal to the sum of (a) the actual sales price of the initial 123 units of \$18,521,520 and (b) the estimated sales price of the remaining 10 units of \$1,000,000. Petitioner, however, concedes that the actual consideration for the sale of the remaining 10 units was actually \$1,100,405 rather than its original estimate of \$1,000,000 and that the total sales price received for the sale of the 133 units was \$19,421,925.

On May 19, 1995, the Audit Division denied Petitioner's claim for refund On the basis that the consideration should include the total mortgage indebtedness as well as the amount of the construction costs incurred by the Petitioner. The Audit Division stated that where the mortgagee is the successful bidder in an action to foreclose a mortgage the consideration for the transfer of real property is the higher of the bid price or the amount of judgment in foreclosure. Thus, since the mortgagee was the successful bidder in the foreclosure proceeding, the consideration was the total mortgage indebtedness of \$3,073,079. In addition, the Audit Division stated that by agreement the Bank agreed to pay the construction cost incurred by Petitioner but not yet paid in the amount of \$579,400. Therefore, such payment by the Bank constituted consideration to Petitioner for the transfer of the 10 condominium units.

Petitioner has filed a bankruptcy petition and currently remains under the jurisdiction of the Bankruptcy Court. The Joint Disclosure Statement pursuant to Section 1125 of the Bankruptcy Code states as follows:

a. Secured Claim (Class 1). Class 1 consists of the senior Secured Claim of Norstar, arising out of its mortgage lien of the Units. As of the Commencement Date, the outstanding indebtedness owed by the Debtor to Norstar under the Loan Agreements was \$3,073,079.12. However, because Norstar's mortgage lien was released on twenty-two units without payment of the appropriate release payments, Norstar's Claim is currently undersecured. The Proponents believe that the remaining ten Units have a gross sale value of approximately \$800,000, which is the amount of the highest all-cash offer to purchase the Units that the Debtor has made known to the Proponents.

Upon the Effective Date, Norstar will receive that portion of the Escrow Account which represents Release Funds held in trust for Norstar from the sale of its collateral, which on January 1, 1991 amounted to approximately \$198,167.37. In addition, as payment of its Class 1 Claim, upon the Effective Date Norstar will receive the Units, free and clear of all liens and encumbrances subject only to the terms of the following paragraph.

Over the course of this proceeding, the Fox Meadow Condominium Homeowner's Association (the "Homeowner's Association") and the Class 3 Trust Fund Creditors have separately questioned the priority of Norstar's mortgage lien on the Units, each arguing that their respective Class 6 and Class 3 Claims have a prior entitlement to the Units and/or the proceeds of the sale of the Units. Norstar has disputed and continues to dispute the merit of both of those claims. However, both

of these claims are settled under the Plan. Pursuant to an agreement between Norstar and the Homeowner's Association dated June 11, 1990, which agreement is annexed as Exhibit A to the Plan and incorporated therein, the Homeowner's Association have abandoned their claim to a senior interest in the Units in consideration of Norstar's agreement to pay all outstanding condominium maintenance charges in full from the proceeds, if any, of sale of the Units by Norstar to a third party or parties. The Homeowner's Association has, pursuant to that agreement, assigned its Class 6 Claim to Norstar to the extent of payments made pursuant to the Agreement.

Pursuant to Sections 1441 and 1443.1 of the Tax Law and Section 590.1 of the Gains Tax Regulations the gains tax is a ten percent tax on the gain derived from the transfer of any interest in real property, which includes the acquisition or transfer of a controlling interest in any entity with an interest in real property, where the real property is located in New York State and where the consideration for the transfer is one million dollars or more.

At the time of the transfer of the 10 condominium units, Section 1440.1 of the Tax Law defined the term "consideration", in part, to mean:

1. (a) "Consideration" means the price paid or required to be paid for real property or any interest therein, less any customary brokerage fees related to the transfer if paid by the transferor, including payment for an option or contract to purchase or use real property. Consideration includes any price paid or required to be paid, whether expressed in a deed and whether paid or required to be paid by money, property, or any other thing of value and including the amount of any mortgage, purchase money mortgage, lien or other encumbrance, whether the underlying indebtedness is assumed or taken subject to. Consideration includes the cancellation or discharge of an indebtedness or obligation. (emphasis added)

In addition, at the time of the transfer of the 10 condominium units, Section 590.10(a) of the Gains Tax Regulations provided as follows:

590.10            Transferee Pays Debt of Transferor [Tax Law, § 1440, subd. 1.)

(a)            Question: Does the payment of legal fees by the transferee constitute additional consideration if the lawyer was retained by the transferor, but it is agreed that the fee is to be paid by the transferee?

Answer: Yes. Such payment by the transferee would constitute a discharge of an indebtedness or obligation of the transferor and would be additional consideration. This is true

for any case in which the transferee agrees or is directed to pay a debt the transferor owes.

Moreover, at the time of the transfer of the 10 condominium units, Section 590.59 of the Gains Tax Regulations provided, in part, as follows:

\* \* \*

- (d) When property is acquired in a mortgage foreclosure, how is the original purchase price calculated for a subsequent transfer?

Answer: When the transferor purchased real property at a foreclosure sale and later sells the property, the original purchase price is the price paid for the property (the bid price). In the event the mortgagee is the successful bidder in an action to foreclose a mortgage, his original purchase price will be the higher of the price paid (the bid price) or the amount of judgment in foreclosure as established by the referee to be due the mortgagee. Such amount would generally include the amount of mortgage debt, the expenses of the sale and the cost of the action . . . .

Although the above cited regulation only makes reference to the method to be used to establish the mortgagee's "original purchase price" of the real property received in a foreclosure proceeding, at the time of the transfer of the units to the Bank, Section 1440.5(a) of the Tax Law defined the term "original purchase price" to mean the consideration paid or required to be paid by the transferor to acquire the interest in real property.

Accordingly, with respect to issue "1" since the Bank was the successful bidder and received the 10 condominium units in a foreclosure proceeding, pursuant to Section 1440.1(a) of the Tax Law and Section 590.59(d) of the Gains Tax Regulations as cited herein, the consideration from the transfer of the 10 units includes the higher of the price paid (the bid price) or the amount of judgment in foreclosure. In the instant case, assuming the total mortgage indebtedness of \$3,073,079 represents the amount of the judgment in foreclosure, this amount was required to be included in the consideration for the transfer, as it was higher than the bid price of \$1,101,405.

Concerning issue "2", the Bank, by agreement, agreed to pay the construction costs incurred by Petitioner but not yet paid in the amount of \$579,400 as a condition of the transfer of the 10 condominium units to the Bank. Pursuant to Section 1440.1(a) of the Tax Law and Section 590.10(a) of the Gains Tax Regulations as cited herein, the discharge by the transferee of an indebtedness or

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obligation of the transferor as a condition of the transfer of the real property to the transferee is deemed a consideration for the transfer of the real property. Therefore, since the Bank relieved Petitioner of its obligation to pay the construction Costs in the amount of \$579,400, such amount constitutes consideration received by Petitioner for the transfer of the 10 condominium units.

DATED: August 22, 1995

/s/  
PAUL B. COBURN  
Deputy Director  
Taxpayer Services Division

NOTE: The opinions expressed in Advisory Opinions  
are limited to the facts set forth therein.