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City Transfer Tax on Multiple Units



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Own^ging a large apartment in New York City has historically been a prudent investment, and the inventory of multi-bedroom apartments has, over the years become woefully insufficient for the demand. As an increasingly common solution to the space problem, prospective purchasers often buy adjacent condominium units from developers, and combine them into a single unit either before or after their purchase. Ideally, buyers will convince sponsors to accept their designs so that the combination of multiple units is completed prior to closing. Such customizations often come at a price. Building the home of one's dreams through a sponsor is usually expensive, but worth it to most buyers in order to simply move into their finished new home upon closing.

However, many sponsors refuse to combine units in advance of initial closings, for fear of causing delays. Sponsors usually prefer to deliver units as soon as possible in order to close, collect the sale price, and satisfy their construction loans. Accordingly, most buyers of multiple units purchase their units separately, which often leads to higher rates of taxation.

Imposing a Transfer Tax

New York State imposes a transfer tax at the rate of \$2 for every \$500 of consideration, regardless of the type of use or amount in question. However, the New York City Department of Finance imposes the real property transfer tax (RPT) at rates that are dependent both upon the amount of consideration and

the type of property being transferred. The transfer tax rate for a one, two or three-family house and individual residential condominium or cooperative unit is 1 percent when the consideration is \$500,000 or less, and 1.425 percent when the consideration is greater than \$500,000. All other properties are subject to a higher tax rate of 1.425 percent when the consideration is \$500,000 or less, and 2.625 percent when the consideration is greater than \$500,000. A transfer of multiple residential units, or a "bulk transfer," is subject to these higher tax rates.¹

In most arm's-length transactions, sellers pay the RPT. However, most sponsors shift the responsibility for transfer taxes to the buyer (in addition to the so-called mansion tax of 1 percent of the purchase price, which is always a buyer responsibility). The transfer tax issue for buyers of multiple condominium units is whether all the units being purchased are deemed individual residential condominium units for purposes of the RPT, or a bulk purchase. The basic litmus test to determine whether the single unit or "bulk" rate applies is whether or not there are multiple kitchens in the unit. If there are multiple kitchens, then the transfer tax is payable at the bulk rate of 2.625 percent (unless the second kitchen is kosher), though even with a single kitchen, there is more to the determination.

For example, a couple agrees to buy adjacent units 1A and 1B from the same sponsor, each unit priced at over \$1,000,000. The buyers ask the sponsor to combine the apartments into single unit 1AB prior to closing. Buyers will almost always request that the sponsor remove the second kitchen during the course of construction. But the sponsor declines, and advises the buyers they may only buy the units separately, with a promise to cooperate with the buyer's future efforts to so combine them. The buyers believe they are

simply purchasing two contiguous units which they will combine themselves after closing, solely for residential use. As such, they expect that the RPT should be paid at the rate of 1.425 percent. However, as discussed below, as a practical matter The Finance Department requires the buyers to prove this. In the event the buyers are unable to do so, they may be required to pay the RPT at the higher bulk rate of 2.625 percent.

Where the sponsor combines the units prior to closing, it will have obtained (a) a letter of completion from the New York City Department of Buildings, (b) a reallocation of a single tax lot covering all units, and (c) a certificate of occupancy for the condominium, showing the previously single units as having been combined, often with a new designation for the combined unit, e.g., unit 1AB. In such instance, there is nothing for the buyer to do but to pay the transfer tax at the rate of 1.425 percent. But if the buyer has to combine the units subsequent to closing, the situation is more complex, as the buyer must obtain everything a sponsor is required to deliver, and more.

If the buyer simultaneously purchases units 1A and 1B, the Automated City Register Information System (ACRIS) on which the RPT form is created has been devised so that the rate of taxation is automatically bumped from 1.425 percent up to 2.625 percent when two sets of RPT filings for such contiguous units are created. Even if the RPT forms were somehow created at the lower rate, it is likely that the Finance Department clerks would reject the deeds when submitted for filing. Some buyers stagger their closings and file separate deeds and RPT's on different dates.

Separate closings present risks for buyers who need to be certain that they will own both units. Furthermore, in the event of an audit, to convince the Finance Department

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that both units were purchased with the sole intent of combining them, having separate closings undermines the argument, as the simultaneous purchase of both units seems to be an important component of proving such intent (as further discussed below). Also, interest and penalties may be imposed for payment at the residential rate, unless the buyer successfully proves its intent to combine for residential use.

Determining Rate of Taxation

The Finance Department maintains that it treats taxation rates of purchases of multiple units on a case-by-case basis, but buyers are forced to pay at the higher rate, forcing appeals. Buyers should be entitled to know their rate of taxation with certainty before proceeding with their purchase. The following is from a June 19, 2000 finance memorandum: "The department will examine all of the applicable facts and circumstances in determining whether two or more apartments or units have been physically combined. The issuance of a revised certificate of occupancy, a letter of completion from the Buildings Department or a revised tax lot designation reflecting the joining of two or more apartments or units will be acceptable evidence of such a combination. However, the absence of any of these documents will not be determinative. The fact that two or more units or apartments will be combined following the transfer will not be sufficient to permit the transaction to be treated as a transfer of an individual apartment or individual residential condominium unit taxable at the lower rates." The foregoing begs the question, what actually is determinative, if anything?

There was a recent letter ruling from the Finance Department on this subject, FLR 13-4953 dated March 28, 2014, in which the buyer purchased two separate condominium units from a sponsor. The subject condominium was an existing non-residential building being converted to residential condominiums. The condominium's offering plan offered the space as separate units. The buyers entered into two separate purchase agreements before the construction was completed. The buyers asked the sponsor to combine and deliver the space as a single larger unit, but the sponsor declined.

Accordingly, in anticipation of having to convince the Finance Department that indeed these units should be taxed at the individual residential condominium unit rate of 1.425 percent, the buyers sought to match the requirements set forth by the department in a prior similar letter ruling (FLR 094901-021 dated June 25, 2010) in which the department agreed that the buyer was entitled to pay the transfer tax at the residential rate of 1.425 percent.

In negotiating virtually identical purchase

agreements for the two units, the buyers convinced the sponsor to (i) recognize and acknowledge that it was the buyers' intention to combine the units into a single unit following the closings, (ii) approve such combination on the condition that the buyers complied with all applicable requirements of the condominium's declaration and by-laws, (iii) agree that the closings of the units would occur simultaneously so that buyers could be assured of owning both units, and (iv) agree that the purchase agreements would be cross-defaulted, so that the buyers did not risk being stuck with only one of the units on account of a sponsor default. The buyers also obtained a single title insurance policy covering both units. Prior to the closings, the buyers also hired an architect to prepare plans for the physical combination of the units.

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Despite the careful structuring to establish intent, at closing, the buyers elected to report the transaction as a bulk sale of two condominium units for consideration in excess of \$500,000, resulting in an applicable tax rate of 2.625 percent.² The buyers did not want to be exposed to interest and penalties in the event of an audit, even though they were likely to prevail based upon the facts.

Promptly after the closings, the buyers made an application to the condominium's board of managers for consent to combine the units, which was received. Then, following submission of the architect's plans and drawings to both the condominium and the Buildings Department, together with an application for a building permit to combine the units into a single unit, the buyers received the requisite building permits.

Shortly thereafter, demolition was initiated so that a wall was broken through and one kitchen was removed, and the units were physically combined. After all the finish work was completed months later, the buyers obtained a letter of completion, the condominium's declaration was amended to reflect the combining of these units, and a single tax lot number was obtained for such combined unit. Since the applicants from the 2010 letter ruling were successful, these buyers followed the same procedures, thinking that if they matched the 2010 letter ruling requirements, the Finance Department would have to rule in their favor as well. And indeed, the department issued the aforementioned

letter ruling in favor of these buyers, stating that the transfer of these two units constituted a transfer of an individual residential unit condominium.

Although these buyers proceeded as diligently as possible, it still took over a year following the closing to complete construction and obtain the requisite sign-offs. However, the Finance Department imposes a one-year statute of limitations on appealing the RPT assessment. There are no clear guidelines on the department's website (including on their letter ruling and appeals application forms) as to the point in the combination process at which the department will deem the purchase of multiple units as residential, rather than bulk. Without further guidance from the department, it seems prudent to fulfill all requirements of the 2010 and 2014 letter rulings to hopefully ensure that a buyer will obtain a refund, but if that will take more than one year, it imperils the buyer's refund. The imposition of clear, uniform guidelines would simplify the existing confusion on this subject.

We have been advised by the Finance Department that it is not uncommon for buyers to miss the one-year deadline, as many are unaware of this time limit. Tax Law Section 1412 does provide for the one-year limitation, but the department's website, letter ruling instructions and appeal instructions are all unclear in this regard. There is a question of the appropriateness of a one-year statute of limitations in which to file a letter ruling application. When the buyer's renovations to combine the units are extensive, as they often are on large and multiple units, it may not be possible to complete the required tasks in order to appeal prior to the expiration of the statute of limitations. Perhaps proof that construction timely commenced within the year should toll the statute of limitations.

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1. The rate at which the New York City mortgage recording tax is imposed also varies depending upon similar factors. The mortgage recording tax is beyond the scope of this article.

2. A Finance Department representative has advised that buyers filing at the bulk rate should include a note that the higher payment is being made "under protest," and that it will be appealed.