Are New York Real Property Transfer Taxes for Real?

By Andrew S. Katzenberg

As estate planners, we frequently find ourselves advising clients on wealth transfer strategies involving real property, as it is often the asset a client is most willing to relinquish control over. Accordingly, real property, such as a vacation home or an investment property, can become the subject of a gift, utilizing a client's federal estate and gift tax exemption, or a sale to a family trust, intended to transfer the future appreciation on such property and avoid gift and estate tax. When advising a client with respect to transferring real property situated in New York State and/or New York City, it is imperative to consider the attendant transfer tax consequences.

I. New York State and New York City Real Property Transfer Tax

New York State and New York City both impose real property transfer taxes on the conveyance of real property situated in the State and City of New York, respectively. New York State imposes a tax of $2 for every $500 of consideration (*i.e.*, a .4% transfer tax) on the transfer of any type of real property.[1] In addition, New York State imposes a 1% tax on the conveyance of *residential*[2] property if the consideration is $1,000,000 or more.[3] This has come to be known as the "mansion tax."

New York City imposes a tax of 1% on transfers of residential property where the consideration is $500,000 or less and 1.425% where the consideration is more than $500,000.[4] Real property that is not characterized as residential is taxed either at 1.425% or 2.625%, depending if the consideration is more than $500,000.[5] If the consideration is more than $500,000, the higher tax rate is applied to the entire conveyance not just the amount over $500,000.[6]

Make no mistake that these taxes can have a real economic impact. The average sales price for a residential property in Manhattan is $1,650,000[7]. Therefore, the sale of the average New York City residence would generate $46,612.50 in combined New York State and New York City transfer taxes. Obviously, this tax is magnified with larger residences. For example, the sale of a $10,000,000 New York City residence would generate $282,500 in combined New York State and New York City transfer taxes. These transfer taxes hinder the use of real property, residential or otherwise, in wealth transfer planning, but we can greatly benefit our clients by understanding when these taxes are imposed and how to minimize or avoid them.

II. Avoiding Real Property Transfer Taxes

Both New York State and New York City exempt from transfer taxes transfers of real property made without consideration.[8] Therefore, gifts or bequests of real property are exempt from transfer taxes of this nature.[9] However, clients who have already utilized part or all of their federal exemption and wish to avoid federal gift tax may have to resort to strategies such as a sale to a trust for a promissory note and/or cash, which is a transfer subject to the real property transfer tax. Note that while a sale of real property to a grantor trust avoids gift and capital gains taxes, it is not exempt from the real property transfer tax. One approach to avoid the New York

transfer taxes is to turn the real property into intangible property through the use of a wrapper (*e.g.*, a limited liability company ("LLC"), a limited partnership or a corporation).

A. New York State Rules

The New York State real property transfer tax and mansion tax are imposed on the transfer of an interest in real property or a *controlling interest* in any entity holding an interest in real property.[10] For this purpose, "controlling interest" means a 50% or greater interest in the entity which owns real property.[11] The regulations further provide that a transfer of a controlling interest occurs when a person or group of persons *acting in concert* transfer or acquire a 50% interest in such entity.[12] Persons will be deemed "as acting in concert when the unity with which the sellers or purchasers have *negotiated and will consummate* the transfer of ownership indicates they are acting as a single entity" (*emphasis added*).[13]

Therefore, where there are multiple transfers or acquisitions, such transfers will be aggregated to determine if a controlling interest was transferred.[14] However, separate transfers or acquisitions occurring three years apart will not be combined unless the transfers were so timed as to avoid the real property transfer tax.[15] The regulations provide an example of an impermissible tax avoidance plan: purchasing a 40% interest in an entity owing real property and simultaneously contracting to purchase another 20% interest in such entity three years and one day later.[16] Two important inferences can be drawn from this example regarding the aggregation of transfers more than three years apart. First, the later transfer must be so closely timed to the three-year exception as to imply that the date was not arbitrarily chosen but specifically planned. Second, the purchaser must have bound himself by contract to acquire a controlling interest giving certainty to that fact which triggers the tax.[17]

Placing real property into an LLC, for example, and transferring less than a 50% interest (a "non-controlling interest") will not trigger the New York State real property transfer tax. If additional transfers of non-controlling interests in the same LLC occur, which when aggregated would be equal to or greater than a 50% interest in the entity, the real property transfer tax will not be triggered if (i) the dates of the transfers are not so closely timed as to imply a tax avoidance plan and (ii) no party is bound to make the additional transfer(s).

It should be noted that the "acting in concert" language in the regulation does not modify the three-year rule and applies only to a group of persons, not the same parties in multiple transactions, making transfers or acquiring a 50% interest in an entity. This is a divergence from the New York City rule, as discussed below.

B. New York City Rules

New York City imposes a real property transfer tax on any transfer of an interest in real property[18] or a controlling economic interest in real property where the consideration exceeds $25,000.[19] New York City has the same definition of "controlling interest" as New York State (*i.e.*, a 50% or more interest in an entity).[20] However, New York City's aggregation rule for multiple transfers is much broader than New York State's rule. Aggregation is triggered on any "related" transfers.[21] The term "related" is not defined in the Rules of the City of New York

("RCNY"), but there are several examples and illustrations in the regulations which provide guidance.

Transfers made within three years of each other are presumed to be related, but this presumption can be rebutted.[22] Therefore, the contrapositive should also be true - transfers outside of three years are presumed not to be related, but this presumption can also be rebutted.

Also, transfers made *pursuant to a plan* are deemed related.[23] The following illustrations from the RCNY are examples of plans which are deemed related.

"X Corporation owns real property in New York City. A, B and C each own 1/3 of X's outstanding stock. A and B, *acting in concert*, each sell their entire interest in X Corporation to D. B's sale occurs four years after A's sale. The transfers made by A and B are related (*emphasis added*)."[24]

"A owns 4% of the outstanding stock of X. B, C, D, E, F, G, H and I each own 12% of the outstanding stock of X. J *enters into agreements* with A, B, C, D and E to purchase their interests in X over a five year period. All of the transfers to J are related (*emphasis added*)."[25]

Though these illustrations help to clarify what New York City will deem to be related transfers, they also leave much unanswered. Exactly what is a plan? Could something less than a binding contract between parties be characterized as a plan? More importantly, can the same parties not be considered as "acting in concert" or "pursuant to a plan" regardless of the facts at the time of the later transfers?

Similar to New York State law, placing real property into an LLC and transferring less than a 50% interest in such entity will not trigger the real property transfer tax in New York City. As for additional transfers of non-controlling interests, the New York City Department of Finance (the "NYCDF") could always argue that there is a plan to transfer additional non-controlling interests when the parties to both transfers are the same, and that the transfers are therefore related and subject to aggregation. This argument is overly broad and with little merit.[26] It is neither supported by the rule, which is focused on whether there is a plan in place at the time of the first transaction not whether the parties are the same, nor any of the illustrations under the RCNY. Therefore, additional transfers of non-controlling interests should not be subject to the transfer tax as long as the facts support that the transactions are not related, meaning there is no agreement or plan in place requiring the later transfer(s). A transferor with the right to transfer his remaining interest to any third-party prior to an additional transfer should meet this requirement. Similar to New York State law, to avoid being subject to the New York City transfers tax, the later transfer(s) *must* occur outside of the three-year window. The longer the time period between the transfers, the stronger the presumption that they are not related pursuant to a plan and the greater likelihood that the NYCDF will not challenge this presumption.

III. Conclusion

When advising clients on multiple transfers of an interest owning real property located in New York State but outside of New York City, one can take comfort in the New York State three-year safe harbor rule[27] to avoid the transfer tax.

However, regarding to an entity owning real property located in New York City, the only certainty is if multiple transactions fall outside the aggregation rules under the RCNY, then those same transactions will fall outside the scope of aggregation rules under New York State law. Therefore, the analysis should focus on whether the aggregation rules under the RCNY apply to additional transfer(s) of an interest in an entity owning real property.

Unfortunately, unlike New York State law, there is no safe harbor under the RCNY, and there will always be a tax risk associated with making additional transfers. Practitioners should determine the level of that risk based on the facts and circumstances and advise clients to enable them to make informed decisions.

-Andrew S. Katzenberg is an associate at Kleinberg, Kaplan, Wolff & Cohen, P.C. in the Trusts and Estates group, where his practice focuses on wealth preservation, estate and trust administration, charitable organizations and charitable giving.

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[1] New York Tax Law (TL) § 1402. *See also* N.Y. Comp. Codes R. & Regs. tit. 20 § 575.2 (N.Y.C.R.R.).

[2] Residential real property means the following premises that are or may be used in whole or in part as a personal residence at the time of conveyance: a one-, two-, or three-family house; an individual condominium unit; a cooperative apartment unit. TL § 1403(a).

[3] *Id. See also* 20 N.Y.C.R.R. § 575.3. The 1% tax is imposed on the entire conveyance, not just the amount over $1,000,000.

[4] N.Y.C. Admin. Code §§ 11-2102a(9)(i) and Rules of the City of New York (R.C.N.Y.) tit. 19 § 23-03(b)(9). *See also* N.Y.C. Admin. Code §§ 11-2102b(1) and R.C.N.Y. tit. 19 § 23-03(c)(3) (tax rate applied to transfers of economic interests in residential real property).

[5] N.Y.C. Admin. Code §§ 11-2102a(9)(ii) and R.C.N.Y. tit 19 § 23-03(b)(10). *See also* N.Y.C. Admin. Code §§ 11-2102b(1) and R.C.N.Y. tit. 19 § 23-03(c)(4) (tax rate applied to transfers of economic interests in real property other than residential real property).

[6] R.C.N.Y. tit. 19 §§ 23-03(b)(10) and 23-03(c)(4).

[7] Citi Habitats, Manhattan Residential Sales Market Report, Fourth Quarter 2014, http://www.citi-habitats.com/media/pdf/Q4_2014_Sales_Manhattan.pdf.

[8] TL § 1405(b)(4) and R.C.N.Y. tit. 19 § 23-03(j)(1). *See also* N.Y.C. Admin. Code §§ 11-2102 (only applies to transfers for consideration).

[9] TL § 1405(b)(4) and R.C.N.Y. tit. 19 § 23-03(j)(1). New York City also specifically excludes a conveyance of an economic interest in real property as a gift from the transfer tax. R.C.N.Y. tit. 19 § 23-03(j)(1). Whereas, New York State does not include the conveyance of an interest in an entity with an interest in real property as exempt from real property transfer taxes. TL §§ 1401(e) and 1405(b)(4).

[10] TL §§ 1402 (a) and 1401(e).

[11] TL § 1401 (b) and 20 N.Y.C.R.R. § 575.1(b).
[12] 20 N.Y.C.R.R. § 575.6(a).
[13] 20 N.Y.C.R.R. § 575.6(b).
[14] 20 N.Y.C.R.R. § 575.6(d).
[15] *Id.*
[16] *Id*.
[17] Even if there is no binding contract but a plan, the application of the "step transaction" doctrine is unlikely since the later transaction would not occur until over three years after the original transaction.
[18] N.Y.C. Admin. Code §§ 11-2102a and R.C.N.Y. tit. 19 § 23-03(a)(1).
[19] N.Y.C. Admin. Code §§ 11-2102b(1) and R.C.N.Y. tit. 19 § 23-03(a)(2)(i).
[20] N.Y.C. Admin. Code §§ 11-2101(8) and R.C.N.Y. tit. 19 § 23-02 - Controlling Interest (1).
[21] R.C.N.Y. tit. 19 § 23-02 - Controlling Interest (1).
[22] R.C.N.Y. tit. 19 § 23-02 - Controlling Interest (2). Where multiple interests in an entity are transferred, the aggregation rule may apply to part, and not all, of the transfers. R.C.N.Y. tit. 19 § 23-02 - Controlling Interest (2) - Illustration (iv).
[23] *Id*. The following is an illustration of transfers not pursuant to a plan: "X Corporation owns real property in New York City worth $3,000,000. A, B and C each own 1/3 of X and are unrelated. In 1987, A loses a lawsuit related to her business and transfers her 1/3 interest in X in satisfaction of a $1,000,000 judgment. In 1989, pursuant to a separation agreement, B transfers his 1/3 interest in X to his spouse. The transfers by A and B are not related." R.C.N.Y. tit. 19 § 23-02 - Controlling Interest (2) - Illustration (xi).
[24] R.C.N.Y. tit. 19 § 23-02 - Controlling Interest (2) - Illustration (i).
[25] R.C.N.Y. tit. 19 § 23-02 - Controlling Interest (2) - Illustration (viii).
[26] The "step transaction doctrine" could be applied; however, all of the transactions contemplated in this article require over three years between them, thereby diluting its application. *See also Matter of GKK 2 Herald LLC*, New York City Tax Appeals Tribunal, Administrative Law Judge Division, TAT(H) 13-25(RP), April 1, 2015 (applying the step transaction to two transactions which occurred on the same day).
[27] The three-year rule under New York State law essentially acts as a safe harbor since the exception to it is so limited. *See* 20 N.Y.C.R.R. § 575.6(d).