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In this installment of Real Assessment, Yalamanchili and Weber explore recent changes to New York's real estate transfer tax.

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On April 19 then-Gov. Andrew Cuomo signed into law the New York budget bill, which includes substantial changes to the real estate transfer tax (RETT). The new law, which applies to real estate transactions occurring on or after July 1, makes two major changes to the RETT by broadening the scope of who is subject to the tax and clarifying the responsibility of who pays it.

What the Old Law Was

New York has long imposed a transfer tax on the conveyance of real property or a real property interest if the consideration for the conveyance is greater than $500. A conveyance of real property is defined to include "the transfer or transfers of any interest in real property *by any method*"[1] (emphasis in original). The definition is purposely broad and, generally, all conveyances of real property are presumed taxable.[2] But there are numerous exemptions — such as a lease of less than 49 years, a conveyance without consideration, and a conveyance in connection with the federal Bankruptcy Act. The tax may be imposed on a wide range of transactions involving real property, including when a deed is not recorded, and thus the RETT may not be collected directly by a local recorder's office. Because the RETT may be imposed in many unexpected circumstances, it may result in significant new risk to unaware individuals.

The transfer tax is paid by the grantor of the conveyance unless contractual language shifts the liability to the grantee. Before the changes took effect, the previous law stated that only individuals, entities, and other persons acting in a fiduciary or representative capacity could be defined as grantors.

Further, the old law said that if the grantor did not pay the transfer tax, whether because of a contractual agreement or bad faith, the taxpaying responsibility shifted to the grantee. And if the grantor failed to pay the tax despite having the duty to do so, both the grantor and grantee would be jointly and severally liable. In other words, if the grantee had to pay the transfer tax after the grantor failed to do so in bad faith, the tax could be collected — either partially or fully — from either the grantor or the grantee.

[1] N.Y. Tax Law section 1401(e).

[2] 20 NYCRR 575.4.

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What the New Law Is

The first major change under the new law was extending the definition of who a person is for transfer tax purposes. Whereas originally only an individual, entity, or other fiduciary or representative actually conveying the property could be held liable for the tax, the law now states that a person is any individual, entity, or an officer or employee of an entity.[3] This means that any officer or employee of any entity — whether active or dissolved — can be held liable for transfer tax. Beyond officers and employees of corporations, the same definition also includes members, managers, and employees of any partnership or limited liability company — provided that the individual is under a duty to act for the entity.

The second major change was expressly establishing the grantor as the party responsible for paying the transfer tax. While the grantor and grantee remain jointly liable for payment of the transfer tax, the only way a grantor can shift the obligation of its payment is by providing for that arrangement in a contract agreement. The legislation added language giving the grantee a statutory cause of action to recover the amount of "payment of such tax, interest and penalties by the grantee" when the grantor failed to do so despite an obligation.[4]

Implications of the New Law

While the new law may only be a few months old, its implications going forward can be easily identified. When a corporation has an officer or an employee sign a tax form on its behalf, the new law now exposes them to personal liability for the tax. This is important because the purpose of purchasing property in the name of an entity is usually to ensure that potential liabilities arising from such a transaction fall solely on the entity. As a result, officers and employees may need to obtain indemnity protection from the entity, so if the entity — as grantor — fails to pay transfer tax, the officer or employee at least has a course of action to recover any liability that the bill imposes on the individual. Similarly, a strict reading of its language seems to imply that the new law can pierce the veil of corporations and LLCs when it becomes necessary and hold those corporate officers or employees personally liable for, say, a grantee in a real estate transaction to pay the transfer tax despite the corporation or LLC having the obligation to do so. If so, this would be an extreme departure from corporate structure norms.

The lack of a definition for the new term "under a duty to act" in RETT 1401(a) is worth mentioning. The determination of whether an individual is a person under a duty to act for a grantor will likely be based on an examination of the facts of the case, with the main inquiry likely revolving around whether the individual had the requisite authority and control over the grantor's activities. Though serving as an officer or employee of a business should not, by itself, warrant the exposure to liability under the new law, its vague phrasing will likely cause some type of totality of the circumstances analysis on a case-by-case basis. Factors to be considered may include whether the person had the authority to write checks for the grantor, sign tax forms on behalf of them, or was otherwise involved in — or had access to — the grantor's financial affairs.

The new changes are not all problematic. By providing grantees an explicit cause of action in the event they end up footing the bill for transfer tax despite not having the obligation to do so, the law provides them protection and a right of recourse. At the very least, this will likely limit occurrences in which grantees are unable to recover transfer tax costs that they end up paying despite not having to do so.

Extending liability for payment of the RETT to individual officers and employees of the grantor may not seem significant since presumably the grantee entity will pay the RETT — and the individuals will never face liability. However, it isn't always obvious or clear whether the RETT is due and owing, and therefore, the entity may fail to pay it. This is particularly true if there is no deed being recorded, so there is no opportunity for a recorder's office to ask about the tax. For example, if an entity assigns a tenant's interest

[3] N.Y. Tax Law section 1401(a).

[4] N.Y. Tax Law section 1404(a).

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under a lease to another entity, the RETT may impose a tax. Also, entering into a lease with a purchase option may require payment of the RETT, but many entities may not be aware of this provision. Similarly, if parties terminate a lease, upon payment of a termination fee by the landlord that transaction might be considered a conveyance of real property subject to the RETT. Finally, the sale of an entity that owns real property may also be subject to the RETT, but without recordation of a deed. In each of these cases, the RETT may apply — but the grantor, grantee, and individual officers and employees of each may, in good faith, be unaware. Because late fees, interest, and penalties are imposed for failure to timely pay the RETT, these situations may impose liability on officers and employees.

It may be weeks or months after the transaction before the employee or grantor learns of the imposition of the RETT, at which point the proceeds of the transaction may have been distributed and therefore may no longer be available to support an indemnity by the entity to the individual. Thus, even an indemnity from the grantee entity may not be worth much in that situation. Consulting an accountant or attorney before finalizing any transaction involving real property can help avoid these difficult situations. ■

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