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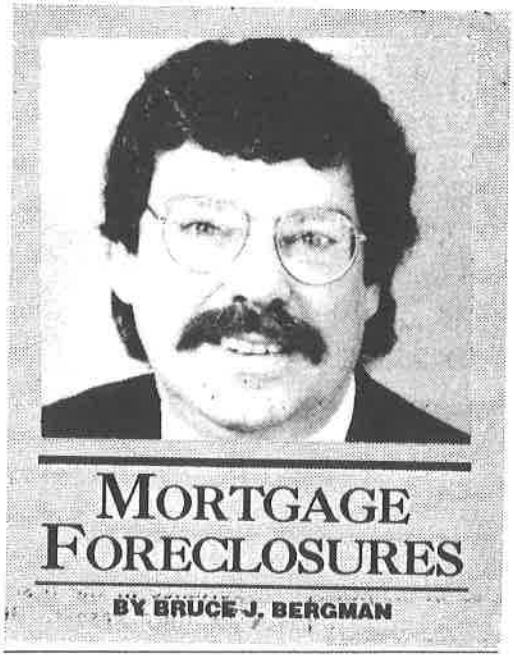
REAL ESTATE UPDATE

Food for Thought

Can Lender Shift Obligation for Transfer Taxes to Bidder?

THIS SOUNDS like a crushingly mundane topic, of the variety to repose in the pile labeled "I know it must be important but I'll get to it some day." Assuming it is to be believed when the writer offers the opinion, the subject is neither pedantic nor a soporific; rather it has genuine practical significance in the everyday world of mortgage foreclosure. While the portent is concededly less monumental for perhaps a single $100,000 residential foreclosure, it has more meaning across a broad portfolio of defaulted loans and for commercial cases where the bid price could be $5 million or $50 million or more.

The inquiry is this. Should a foreclosing lender be able to shift the obligation to pay transfer taxes to a successful foreclosure sale bidder, so long as that obligation appears in the terms of sale (which are first recited prior to bidding and then signed by the bidder)? Although the proposition that the lender should be so able is too obvious to create a stir almost anywhere, there is some negative reaction to it in Queens County, which has generated an unreported decision condemning the procedure. (*Home Savings of America v. Vonkrusenstierna*, short form order, Oct. 17, 1995, Index No. 775/93). Although unreported, the existence of this case is known in Queens far more prominently than its unreported status would suggest.



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Lender's View

From a lender's perspective, such a result is bitterly ironic. A borrower's default is immediately an expensive and vexatious problem. When foreclosure ensues, the process can be tortuous and time consuming. The goal at the conclusion is to sell the property for the highest price, a sum, it is hoped, which will make the lender whole. One way to render the bidding more enticing, with less room for confusion about numbers, is to remove from the foreclosing plaintiff the obligation to pay the transfer tax of $4 per thousand dollars of consideration and in New York City, the applicable real property transfer tax of 1 percent. In that way, the plaintiff can compute its upset price, safe in the knowledge that if the bidding goes that far, the net proceeds can be clearly determined in advance.

Even if all this is a mere convenience for the foreclosing lender, should it not be available? Lenders certainly think it should be and traditional case law agrees.[1] But the contrarian underground view is still to a degree circulated in Queens County, and sometimes

beyond. If the controversy is ill-founded, as is the view here, perhaps it can and should be dispelled.

It would be highly unusual for a judgment of foreclosure and sale to contain a decretal paragraph as to payment of real estate transfer taxes. The subject is one of those areas simply and customarily left unstated — such as the time of the auction sale, or the amount of the bid deposit, or the place and time of the closing, among others. In other words, the court does not write the contract (the terms of sale). Indeed, statute offers only a barebones framework for the judgment of foreclosure and sale. RPAPL §1351(1) merely provides that the judgment shall direct that the mortgaged premises, or so much as sufficient to discharge the mortgage debt plus cost and expenses and which can be separately sold without material injury to interested parties, be sold under the direction of the sheriff of the county, or a referee.[2] Further guidance is found in RPAPL §1354 (Distribution of Proceeds of Sale) and RPAPL §1371 (Deficiency Judgment.) Case law provides additional direction,[3] but hardly a comprehensive guide.

If the judgment of foreclosure and sale is silent as to transfer taxes, how might the signed terms of sale which obligate a bidder to pay those taxes be condemned? Before answering the question (and then critiquing that answer), appreciating what foreclosing plaintiffs always assumed or anticipated will be helpful.

To be sure, transfer tax statutes impose the obligation to pay taxes upon the grantor or transferor.[4] Because the referee at a foreclosure sale executes and delivers the deed, such officer fits the definition of "grantor" or "transferor."[5] Otherwise bound to pay the transfer tax, the referee promulgates terms of sale which are mutually signed by the referee and the foreclosure sale bidder/purchaser. The purchaser thereby memorializes assent to the terms first orally announced.

Terms of Sale

The precise nature of the terms of sale is somewhat elusive. It has been referred to as a contract with the court,[6] although it has also been viewed as a proceeding by which the successful bidder submits himself to the jurisdiction of the court as to all matters connected with the sale and purchase of the property.[7] The most recent case to contemplate the issue rather clearly treated the terms of sale as a contract.[8]

The referee, bound by the statute to pay transfer taxes, enters into what, in some sense at least, is a contract. And as a general proposition, so long as not against public policy, a contract can vary the terms that statute would otherwise impose.[9] Real estate contracts of sale will frequently shift the obligation to pay transfer taxes to the purchaser and the practice is unassailable. In the instance of a foreclosure sale, that also seemed to be the aphorism and case law supported it. Prior to the unreported case in Queens County previously mentioned,[10] the only judicial discussion of transfer tax liability in this context tacitly accepted the efficacy of a contract to rearrange the tax payment burden:

> Where the written contract between the referee and the highest bidder does not contain an agreement that the purchaser will pay the tax . . . the referee has the obligation to pay such taxes out of the proceeds of the sale."[11]

The lucid implication, of course, is that a contract could obligate the purchaser to pay the transfer tax — just what lenders always believed and relied upon.

Not incidentally, in 1989 the applicable state statute (Tax L. §1404) was amended to provide joint and several liability for the tax upon both grantor and grantee.[12] That a purchaser could thus be a party liable to pay tax thereby banished whatever drama or perceived uniqueness the concept may have had. This lends ready support to the proposition that a contract can validly require a purchaser to pay a transfer tax.

Queens Decision

Mindful of the underpinning for traditional notions that foreclosing plaintiffs expect to exclude transfer tax payments from the sale proceeds they receive, what assault emerges from the differing position in Queens County? That lone case [13] seems to endorse the argument of a foreclosure sale purchaser seeking to disavow its contractual obligation to pay the transfer tax, to the effect that the terms of sale are void as contrary to the judgment. But the terms of sale were not contrary to the judgment. Rather, they addressed a factor not dealt with in the judgment.

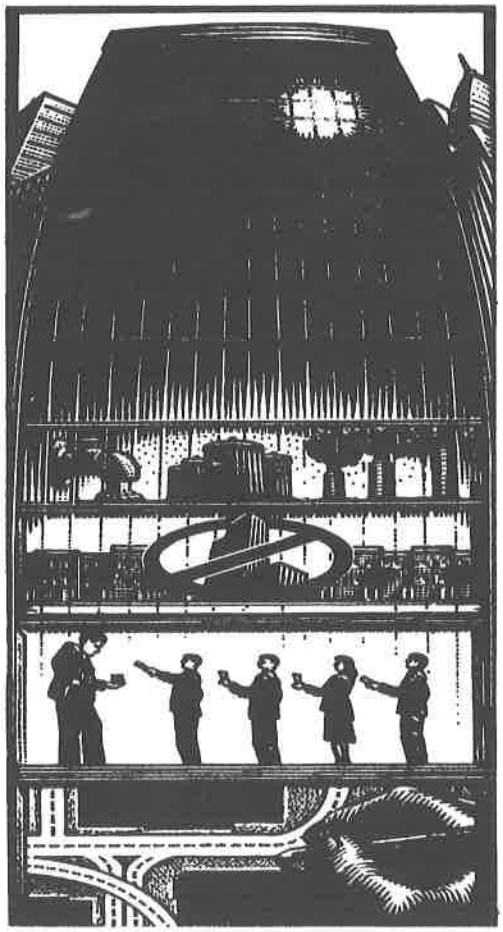

ILLUSTRATION BY JOHN MACDONALD

Again, this is not unlike the instance of the contract deposit. The judgment is silent on that subject too, but the terms of sale typically require a 10 percent deposit and no court finds this violative of the judgment of foreclosure and sale. Even though 10 percent is customary (a judgment's silence notwithstanding), a demand for 25 percent can be appropriate if circumstances warrant.[14] That too does not run afoul of any argument that it varies the dictates of the judgment. Similarly, even though a judgment will not specify the form of bid deposit, a referee can demand a deposit in cash, [15] free of condemnation that he is varying the terms of the judgment.

The next point of the Queens decision is the mantra that a referee serves in a ministerial capacity and lacks power to vary the terms of the court's judgment. That is, of course, entirely correct and in the case examples relied upon [16] the referee did indeed vary the terms of the judgment. In *Ercolani v. Sam and Al Realty Co.*,[17] for example, the referee paid taxes and liens which the judgment decreed the premises were to be sold "subject to."

A similar, clear defalcation occurred in the other case relied upon, *Crisona v. Macaluso.*[18] There, the judgment specifically required the referee to pay taxes, assessments and water rates which were a lien. The referee orally announced at the sale that such taxes had to be paid in addition to the bid price, but the terms of sale nevertheless complied with the judgment. Understandably, the ruling was that the referee's oral declaration contradicted the judgment of foreclosure and sale and was ineffectual. Critically, neither case stands for the proposition that a term not addressed in the judgment of foreclosure and sale, but agreed to in writing by the bidder, can be declared of no effect.

The next pronouncement is that a referee may make a sale only upon terms in conformity with the judgment and the applicable statutes.[19] That too is accurate, [20] but finds no application to the subject question. Nor are the case authorities cited by the Queens court helpful. In *Zouppas* v. *Yannikidou*,[21] a partition action, the judgment provided that the property be sold subject to two specific liens for which precise monetary sums were set forth.

In the terms of sale, the referee added "subject to lien for unpaid New York Estate Tax and Federal Estate Tax." This differs discernibly from the judgment. What is worse, those purported estate tax liens were vague and amorphous, tending to discourage bidding because of uncertainty in the amounts of those possible prior liens. The court's condemnation of the referee's liberties was appropriate, but is not analogous to the transfer

tax issue.

The Queens case continues with accepted aphorisms: that the referee is a grantor or transferor and is therefore the party to pay the transfer tax; that the only funds he has are sale proceeds; that failure to pay the transfer taxes is a bar to recordation of the referee's deed; that the purchaser is entitled to a recordable deed — from all of which the court somehow concluded that terms of sale obliging the successful bidder to pay the transfer tax are void.

Regardless of whether one finds the decision palatable, it seems to beg the underlying question: Is an addition to the terms of sale on a point as to which the judgment is otherwise silent automatically subject to sanction?

Varying the terms of sale from those prescribed in the judgment will almost invariably be condemned. But supplying a missing term is, as previously discussed, hardly uncommon or unacceptable. It is clear that where additions to the terms of sale impose conditions which are vague or indefinite, those additions can be rejected by a court.[22]

Transfer taxes, though, are hardly vague. Rather, they are mathematically determinable and therefore do not meet the test for condemnation.

So here is the disorder and here is the dilemma. Foreclosing plaintiffs suffer enough by way of detainment and roadblocks to their efforts, in New York State more than most other states, and in the New York metropolitan area (particularly New York City) more than in the rest of the state.

Their burdens have lately been increased with the 1997 amendment of RPAPL §1354(2) requiring all real estate taxes which are a lien to be paid out of sale proceeds. (This creates more effort for the plaintiff, occasional uncertainty if taxes cannot be precisely ascertained and perhaps a less attractive sale as the tax amounts increase the upset price.)

Refraining from including transfer taxes in the upset price simply makes the sale easier. Foreclosing plaintiffs would prefer to (and have always assumed they could) derive the benefit available to any seller of property, even though technically the plaintiff is not the grantor — that is, to contractually shift a payment burden. Foreclosure judgments do not address the point, as they are silent on any number of others, and arguments that transfer taxes are in a different category are infrequent and problematic.

But then, that case is floating around out there in the underground. Foreclosing plaintiffs could achieve certainty by inviting inclusion of a tax shifting provision in the judgment.

That approach presents two problems though. It might impede issuance of the judgment, which is antithetical to the plaintiff's objective. Moreover, if this is a gray area (although the argument here is that it should not be) it opens the door to declination by some judges (or clerks), which would then create pervasive inconsistency.

And if the amounts at issue tend not to be so large, what plaintiff will sacrifice the conclusion of its foreclosure case while at the same time incurring legal expense to convincingly establish the principal? Better that what the *Trefoil*[23] case knew and took for granted remains the real wisdom.

(1) *Trefoil Capital Corp. v. Creed Taylor, Inc.*, 125 Misc. 2d 152, 479 NYS2d 308 (1984), rev'd other gds., 121 A.D.2d 874, 504 NYS2d 112 (1st Dept. 1986).

(2) RPAPL §1351(2) addresses procedures to redeem in the partial foreclosure case and subd.(3) is the provision allowing a junior mortgagee to be paid surplus directly out of sale proceeds without necessity to initiate a surplus money proceeding.

(3) For a delineation of case law directives concerning what the judgment of foreclosure and sale must provide, see 2 *Bergman on New York Mortgage Foreclosures*, §27.01[3][b], Matthew Bender & Co., Inc. (rev. 1997).

(4) N.Y. Tax L. §1404(a); N.Y.C. Admin. Code §11 46-4.0.

(5) RPAPL §1353(1); N.Y. Tax L. §1401(e).

(6) *Lane v. Chantilly Corp.* 251 N.Y. 435, 167 N.E. 578 (1929); *Willets v. Van Alst*, 26 How. Pr. 325 (1861); *Katzeff v. Cohn*, 139 Misc. 2d 1076 (1988); *Gomez v. Bobker*, 128 Misc. 2d 662, 490 NYS2d 416 (1985).

(7) *Willets v. Van Alst*, 26 How. Pr. 325 (1861).

(8) *Citibank v. Liebeskind*, A.D.2d , 656 NYS2d 39 (2d Dept. 1997).

(9) *Dolman v. U.S. Trust Co. of N.Y.*, 2 NY2d 110, 157 N.Y.S.2d 537 (1956); *Andy Floors v. Tyler Const. Corp.*, 202 A.D.2d 938, 609 NYS2d 692 (3d Dept. 1994); *State of New York by Robert Abrams v. Solil Mgt. Corp.*, 128 Misc. 2d 767, 491 NYS2d 243 (1985).

(10) *Home Sav. of America v. Vonkrusenstierna*, short form order, Oct. 17, 1995, Index No. 775/93.

(11) *Trefoil Capital Corp. v. Creed Taylor, Inc.*, *supra* at note 1.

(12) §1404 Liability for tax (a) The real estate transfer tax shall be paid by the grantor. If the grantor has failed to pay the tax imposed by this article at the time required by section fourteen hundred ten of this article or if the grantor is exempt from such tax, the grantee shall have the duty to pay the tax. Where the grantee has the duty to pay the tax because the grantor has failed to pay, such tax shall be the joint and several liability of the grantor and the grantee. See also *Galuth Realty Corp. v. Greenfield*, 103 A.D.2d 819, 478 NYS2d 51 (2d Dept. 1984); *In re Assay Partners*, 149 A.D.2d 63, 544 NYS2d 1008 (1st Dept. 1989).

(13) *Home Sav. of America v. Vonkrusenstierna*, short form order, Oct. 17, 1995, Index No. 775/93.

(14) *Portnoy v. Hill*, 10 Misc. 2d 1004, 167 NYS2d 255 (1956).

(15) *Alben Affiliates v. Astoria Terminal, Inc.*, 34 Misc. 2d 246, 226 NYS2d 1007 (1962), citing *Baring v. Moore*, 5 Page 48.

(16) *Ercolani v. Sam and Al Realty Co.*, 17 NY2d 299, 270 NYS2d 604 (1966); *Crisona v. Macaluso*, 33 A.D.2d 569, 305 NYS2d 441 (2d Dept. 1969).

(17) *Supra* at note 16.

(18) *Supra* at note 16.

(19) *Home Sav. of America v. Vonkrusenstierna*, *supra* at note 8.

(20) See 2 *Bergman New York Mortgage Foreclosures* §27.03[1], Matthew Bender & Co., Inc. (Rev. 1997).

(21) 15 A.D.2d 52, 225 NYS2d 557 (1st Dept. 1962).

(22) *Zouppas v. Yannikidou*, 15 A.D.2d 52, 225 NYS2d 557 (1st Dept. 1962); *House Mart Inc. v. Giacalone*, 28 Misc. 2d 674, 210 NYS2d 376 (1960).

(23) *Supra* at note 1.