
Co-op

THE ACCIDENTAL TAX COLLECTOR

BY CAROL J OTT

How New York's new pied-à-terre tax could leave co-op boards responsible for collecting a tax they may not have the legal authority to enforce.

Tucked into this year's state budget is New York's new pied-à-terre tax. Initially projected to raise an estimated $500 million the first year, it was enacted with very little, if any, consultation with the co-op/condo community about how it would actually work.

That oversight has now left every co-op board between a rock and a hard place.

Designed to raise revenue from New York City homes owned by people whose primary residence is elsewhere, it will be collected through the property

GET READY FOR SHAREHOLDER DISCONTENT

Communication is key, and even though final Department of Finance rules haven't been promulgated (as of mid-July), there are steps your board and management company can take now to navigate what will be undeniably rough waters. These steps are a combination of math and notification.

First, reduce the chance of financial surprises. Orsid New York is doing just that by creating building spreadsheets to pinpoint which apartments could be affected the first year of the pied-à-terre tax, regardless of residency status. "Basically," says Dennis DePaola, chief legal officer at Orsid New York, "we're listing all the shares of a building, putting in the building's market value according to the Department of Finance and then doing some calculations. If an apartment is valued over a million dollars, which is the threshold for the first year of the city's pied-à-terre tax, we'll send the shareholder a notice telling them they could be affected."

The math is fairly straightforward. You'll need to look at your building's tax bill and note its market value, then create a spreadsheet with every unit, its allocated shares and a total of your building's shares. Then, for each unit, have the spreadsheet do the following calculation for each apartment's market value:

$$\text{UNIT MARKET VALUE} = \left(\frac{\text{BUILDING MARKET VALUE}}{\text{TOTAL BUILDING SHARES}} \right) \times \text{SHARES PER UNIT}$$

Once you determine which apartments might be affected by the tax (based on market value), check whether the shareholders of those apartments have a mortgage and make sure your managing agent, or board, knows which bank holds it. Because the co-op's lien generally takes priority over the lender's security interest, the lender has every incentive to keep the account current while a dispute is resolved. "If it turns out that the pied-à-terre tax becomes contested," says Michael Wolfe, president of Wolfe Realty Services, "I'd be writing to the lender saying they're in default because the co-op still has first lien on the apartment." The lender will pay the co-op while any dispute continues, and you will have protected your building's budget.

tax system. Collecting the tax from owners of single-family homes and condominium apartments is relatively straightforward. They receive a property tax bill, and if they owe a surcharge, they pay it.

For co-ops, however, the process becomes far more complicated.

Welcome to Your New Role: Tax Collector

The new surcharge will be added to the co-op corporation's property tax bill. That means the corporation — not the shareholder — is responsible for paying the city first, even though the tax is ultimately owed by the shareholder.

"It's not a great situation," says Dan Wollman, president of Gumley Haft Management. Boards traditionally budget for property taxes by setting aside one-twelfth of the annual bill each month. "So when the city adds a couple of taxes on top of that, we won't really have enough money set aside. Then you've got people who don't want to pay it, leaving the co-op in a very awkward position."

Dennis DePaola, chief legal officer at Orsid New York, sees an even bigger problem. "We've got no idea how we're going to collect these amounts," he says. Shareholders are going to object, "but suddenly we've got a six-figure variance on our taxes. It's going to affect the co-op's cash flow while those objections are worked out. And at the end of the day the city is going to say, 'You owe the tax, period, end of game.'"

And that's where the legislation runs headlong into the way cooperatives actually operate.

A Problem the Legislature Didn't Solve

Although co-ops and condominiums may look identical, legally they are worlds apart. That distinction sits at the heart of the pied-à-terre tax. Condominium owners hold title to real property; co-op shareholders own shares in a corporation and receive a proprietary lease. The corporation, not the shareholder, owns the real estate. That distinction has enormous practical consequences. The board must collect a tax that many attorneys believe existing proprietary leases never contemplated.

"How do we collect?" asks DePaola. "There's nothing in the proprietary lease that allows a co-op to collect this type of tax from a shareholder."

Stuart Saft, a partner at Holland & Knight, agrees.

"I don't think a board has the authority to go after a shareholder," he says. "There's nothing in the proprietary lease that says the board has the right to pay this tax on the shareholder's behalf or sue to recover it. That's why every proprietary lease has to be modified."

Amending a proprietary lease, however, is no small task, says Dale Degenshein, partner at Fox Rothschild. It requires shareholder approval, a process that can be lengthy and politically difficult. Even then, she says, changing the lease may not solve the immediate problem if shareholders simply refuse to pay.

How Will the City Decide Who Owes the Tax?

How the city determines who qualifies as a nonresident shareholder is central to how this new tax will work.

One tool already exists: the annual co-op/condo tax abatement program. Each year, shareholders certify whether the apartment is their primary residence. Managing agents submit that information to the Department of Finance, which uses it to determine the building's tax abatement (unless your building doesn't pay staff prevailing wages and has chosen to opt out of the abatement).

Most buildings use the tax abatement amount as an opportunity to assess all shareholders, without actually having to ask them to write checks. "Our accounting department figures out, on a per share basis, how much the abatement is worth," says Wollman. "Based on the abatement list the city has returned, we calculate a share assessment, and then give each qualifying shareholder a share abatement. If someone no longer qualifies for the abatement, they will have to write a check for the share assessment," he says.

Most years the process works smoothly. The problems arise when the city gets it wrong.

Take Stuart Saft's experience. Although he had lived in his apartment for more than 40 years, the city mistakenly revoked his co-op tax abatement. "I couldn't get anybody to pay attention to me," he recalls. "Finally I wrote the Department of Finance thanking them for giving me permission to stop paying New York City and New York state income taxes because apparently the apartment was no longer my primary residence." Ten days later, his abatement was restored.

The tax abatement mistake was inconvenient. A pied-à-terre mistake could be far more costly.

Under the current rules, both the cooperative and the shareholder will receive notice of any tax due, and the shareholder will have 30 days to challenge the determination. If the shareholder is incorrectly identified, or never receives the notice, that deadline could easily be missed. “The shareholder has to fight with the city,” says DePaola. “But the co-op is still liable for the tax.” If it goes unpaid, he warns, the building could face penalties, interest and even a tax lien.

Ordinary Co-ops

The pied-à-terre tax will raise revenue for the city, although given the city’s total budget of $126 billion, the potential revenue raised from this tax seems minuscule. The city comptroller issued a report in April warning that the projected revenue of $500 million may not be achieved. Many predict the collapse of the pied-à-terre market entirely.

For buildings that converted from rentals into co-ops four or five decades ago, that prediction may not be far off. Matthew Klein, president of London Terrace Towers, a 750-unit co-op in Chelsea, thinks there may be twenty apartments now being used as pieds-à-terre in his co-op. “People who bought their apartments 30 years ago could be using them as pieds-à-terre now,” he says. “They’re not wealthy people and probably bought their apartment at a low price. They’re now living in Boca, maybe on Social Security, and keep the apartment so they can come up and visit their children or grandchildren. Now they are going to be taxed on their one-bedroom apartment.” When people think of the pied-à-terre tax, he says, they think of Zohran Mamdani standing in front of Ken Griffin’s $238 million apartment, not the schoolteacher whose one-bedroom apartment has appreciated over the years.

“You have people who will say that the tax puts them over the top,” says Klein. “Then you have people who won’t even buy a pied-à-terre because of the tax, and then you’re going to have buildings like mine. We’re going to take a vote and probably not allow pieds-à-terre anymore because it’s too much of a hassle.” For the co-op community, at least, the “hassle” that Klein wants to avoid in the future may be the beginning of the end for co-op pieds-à-terre.

Final Rules

The city has issued final rules on how the pied-à-terre tax will actually work, but boards and affected shareholders will be notified by August 30 about any tax owed. For boards, it’s time to consult with your attorney regarding any proprietary lease updates, consult with your management company to make sure they are putting systems in place to document how the surcharge will be handled, consult with your accountant to see how they will handle this liability, and communicate with shareholders who may be affected.

Whether the pied-à-terre tax ultimately raises the projected revenue remains to be seen. What is already clear is that cooperative boards have been handed an entirely new administrative responsibility — one that could affect their cash flow, expose them to legal uncertainty and force them to rethink how they govern their buildings. ■