

New York State Department of Taxation and Finance
Office of Tax Policy Analysis
Technical Services Division

TSB-A-02(4)R
Real Estate Transfer Tax
July 26, 2002

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. M010821A

On August 21, 2001, the Department of Taxation and Finance received a Petition for Advisory Opinion from HSBC Mortgage Corporation (USA), 2929 Walden Avenue, Depew, New York 14043 (herein referred to as Petitioner). Additional information related to the Petition was received on October 17, 2001 and January 22, 2002.

The issues raised by Petitioner, based on the facts described in this Petition, are:

1. Whether real estate transfer tax is payable on the sale of the Premises as a transfer by Original Seller to Purchaser, for a consideration equal to the Original Purchase Price payable to Original Seller under the Contract.
2. Whether real estate transfer tax is imposed on the assignment of the Contract by Purchaser to Petitioner.
3. Whether real estate transfer tax is imposed on the "resale" of the Premises by Petitioner to Purchaser under the Purchase and Financing Agreement.
4. Whether mortgage recording tax is payable upon the recordation of the Mortgage, measured by the Base Amount.

Petitioner submitted the following facts as the basis for this Advisory Opinion.

Petitioner is a wholly-owned subsidiary of HSBC Bank USA, and a member of the Hong Kong Shanghai Banking Corporation Group of companies that engage in financial operations throughout the world. Petitioner has substantial mortgage lending operations in New York State. Petitioner is developing a new "cost-plus sale" form of financing that will be utilized by certain individuals in New York as a vehicle to finance their purchase of residences.

In this type of transaction, there is a "Purchaser" who desires to acquire an "Asset" from an "Original Seller," and there is a "Financier" who has the capital to pay Original Seller for the Asset. Purchaser identifies the desired Asset, the Financier buys the Asset from Original Seller, and Financier then resells the Asset to Purchaser at the cost paid by the Financier plus an agreed-upon profit. Purchaser's payment of the resale price may be made at the time of the sale or, subject to agreement with the Financier, in installments over time, or in a lump sum at a future date.

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Petitioner proposes to use the following transaction structure to finance residential purchases. The transaction structure will provide financing to a home purchaser on the same economic terms as a conventional mortgage loan. Under Petitioner's home finance program the following transactions (collectively, the "Overall Transaction") will occur:

1. A home-buyer (the "Purchaser") will enter into a contract (the "Contract") to buy a home (the "Premises") from a seller ("Original Seller") for the agreed upon sales price (the "Original Purchase Price"). For purposes of illustration, assume that the Original Purchase Price is \$100,000.
2. In accordance with usual practices, upon entering into the Contract, Purchaser will pay Original Seller a deposit. For purposes of illustration, assume the deposit is \$5,000 (the "Earnest Money Amount I").
3. The Contract between Purchaser and Original Seller will provide, or Original Seller will separately agree by executing an "Assignment Rider," that Purchaser may assign its rights under the Contract to Petitioner.
4. Purchaser will apply to Petitioner for financing under Petitioner's home finance program. Petitioner will process the application in accordance with its usual underwriting practices. If Petitioner approves the application, it will issue a commitment letter to Purchaser specifying the terms of the financing. For purposes of illustration, assume Petitioner's commitment is to provide financing of \$80,000.
5. At a single closing involving Original Seller, Purchaser and Petitioner, Seller will "sell" the Premises to Petitioner, which will "resell" the Premises to Purchaser. These transactions will proceed at the closing as follows:
 - (a) Purchaser issues to Petitioner a "Promise to Purchase," which represents an undertaking to purchase the Premises from Petitioner once Petitioner has purchased the Home from Original Seller.
 - (b) Purchaser then assigns the Contract to Petitioner and Petitioner accepts assignment.
 - (c) Purchaser makes a payment to Petitioner ("Earnest Money Amount II") in an amount equal to the Original Purchase Price under the Contract, less the Earnest Money Amount I previously paid by Purchaser and less the amount of the financing to be provided by Petitioner. Using the illustrative figures specified above, the amount of this additional payment would equal \$15,000. (Any purchase price adjustments under the Contract in favor of Purchaser

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would reduce this amount; any purchase price adjustments in favor of Original Seller would increase this amount. For purposes of our example, we will assume that there are no purchase price adjustments).

- (d) Petitioner makes a payment to Original Seller equal to the Earnest Money Amount II plus the Base Amount being financed by Petitioner. Using the illustrative figures above, Petitioner would pay \$95,000 to the Original Seller. At Petitioner's request, Original Seller executes a deed in favor of Purchaser.
 - (e) Purchaser and Petitioner sign a Purchase and Financing Agreement (the "PFA") providing for the resale of the Premises from Petitioner to Purchaser.
 - (f) Petitioner delivers to Purchaser the deed to the Premises issued by Original Seller.
 - (g) Purchaser executes and delivers to Petitioner a Mortgage securing its payment obligations under the PFA.
 - (h) Purchaser and Petitioner execute a "Tax Matters Agreement" under which Petitioner and Purchaser agree on the federal, state and local tax treatment of the Overall Transaction.
6. Under the PFA, Purchaser will buy the Premises from Petitioner for an amount (the "Purchase Price") equal to the sum of the "Base Amount" plus the "Profit Amount" (plus any additional miscellaneous amounts that may be due from Purchaser to Petitioner). The Base Amount is the amount of the financing provided by Petitioner at the time of the Closing – \$80,000 in the example above. The Profit Amount is a stated amount reflecting a return to Petitioner on the Base Amount, over the term of the PFA, at an agreed rate of profit (the "Profit Rate"). For example, assuming a fifteen-year term (i.e., 180 monthly payments) and an 8% Profit Rate (i.e., 0.67% per month), the Profit Amount on a Base Amount of \$80,000 would be \$57,613.90. The total purchase price Purchaser will agree to pay to Petitioner under the PFA to purchase the Premises would, in this example, be \$137,613.90. As with a conventional mortgage loan, this amount would be paid in 180 monthly installments of \$764.52 each.

The PFA would also provide for a "rebate" of the Profit Amount in the event of a full or partial prepayment of the Base Amount. In the event of a proposed prepayment in full (for example upon the Purchaser's sale of the Premises), Purchaser would be entitled to a contemporaneous rebate of a portion of the Profit Amount. Purchaser would effectively be required to pay only the unamortized balance of the Base

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Amount and any accrued and unpaid Profit Amount to the date of prepayment. In the event of a partial prepayment, Purchaser would be entitled to a contemporaneous rebate equal to the portion of the Profit Amount that would have otherwise accrued on the amount prepaid after the date of prepayment. In effect, Purchaser's payment of Profit Amount would be identical to its payment of interest on a conventional mortgage loan.

7. The Mortgage will secure Purchaser's obligations (i) to pay the Base Amount; (ii) to pay the Profit Amount as it is earned in accordance with the PFA; (iii) to pay any incidental amounts owed to Petitioner (*e.g.*, late charges and unpaid escrow amounts); and (iv) to otherwise perform Purchaser's obligations under the Mortgage and the PFA. The granting clause of the Mortgage will state that the Mortgage secures Purchaser's obligation to pay the Base Amount, and set forth that amount. The Mortgage will contain a clause which will specifically state that for purposes of the Mortgage Recording Tax the maximum amount of principal indebtedness that is secured by the Mortgage at execution, or which under any contingency may become secured at any time thereafter, is the Base Amount. In addition, the Mortgage references the parties' Tax Matters Agreement. That agreement explicitly provides that, for all tax purposes, the Overall Transactions constitute a borrowing by Purchaser of the Base Amount, and again recites that the maximum principal amount secured by the Mortgage is the Base Amount.
8. The Tax Matters Agreement will recite that: "At Purchaser's request, Petitioner is providing financing for the purchase of the [Premises] by accepting an assignment of the [Contract] from Purchaser, purchasing the [Premises] from Original Seller and then immediately reselling the [Premises] to Purchaser on a deferred payment basis." The Tax Matters Agreement will set forth the express agreement of Petitioner and Purchaser that the Overall Transaction is to be characterized as the purchase of the Premises by Purchaser from Original Seller for the Original Purchase Price (*i.e.*, \$100,000), financed in part by a mortgage loan from Petitioner in the principal amount of the Base Amount (*i.e.*, \$80,000).

The Tax Matters Agreement will further describe specific federal, state and local tax returns and filings the parties may make consistent with their agreement. Pursuant to the agreement, the parties will treat the Overall Transaction as a purchase of the Premises by Purchaser from Original Seller and a financing of part of the purchase price by Petitioner, and accordingly Original Seller and Purchaser will file a single real estate transfer tax return reflecting the sale of the Premises by Original Seller to Purchaser for the Original Purchase Price (*i.e.*, \$100,000). The Tax Matters Agreement will also state that for mortgage recording tax purposes the Mortgage

secures a maximum principal amount of indebtedness equal to the Base Amount (i.e., \$80,000).

Applicable Law and Regulations - Real Estate Transfer Tax

Section 1402 of the Tax Law imposes the real estate transfer tax on each conveyance of real property or interest therein when the consideration exceeds five hundred dollars. Section 1402-a of the Tax Law imposes, in addition to the tax imposed by Section 1402, a tax on each conveyance of residential real property or interest therein when the consideration for the entire conveyance is one million dollars or more.

Subdivision (d) of Section 1401 of the Tax Law provides, in part:

“Consideration” means the price actually paid or required to be paid for the real property or interest therein, including payment for an option or contract to purchase real property, whether or not expressed in the deed and whether paid or required to be paid by money, property, or any other thing of value. It shall include the cancellation or discharge of an indebtedness or obligation. It shall also include the amount of any mortgage, purchase money mortgage, lien or other encumbrance, whether or not the underlying indebtedness is assumed or taken subject to.

Subdivision (e) of Section 1401 of the Tax Law provides:

“Conveyance” means the transfer or transfers of any interest in real property by any method, including but not limited to sale, exchange, assignment, surrender, mortgage foreclosure, transfer in lieu of foreclosure, option, trust indenture, taking by eminent domain, conveyance upon liquidation or by a receiver, or transfer or acquisition of a controlling interest in any entity with an interest in real property. Transfer of an interest in real property shall include the creation of a leasehold or sublease only where (i) the sum of the term of the lease or sublease and any options for renewal exceeds forty-nine years, (ii) substantial capital improvements are or may be made by or for the benefit of the lessee or subleasee, and (iii) the lease or sublease is for substantially all of the premises constituting the real property. Notwithstanding the foregoing, conveyance of real property shall not include a conveyance pursuant to devise, bequest or inheritance; the creation, modification, extension, spreading, severance, consolidation, assignment, transfer, release or satisfaction of a mortgage; a mortgage subordination agreement, a mortgage severance agreement, an instrument given to perfect or correct a recorded mortgage; or a release of lien of tax pursuant to this chapter or the internal revenue code.

Subdivision (f) of Section 1401 of the Tax Law provides, in part:

"Interest in the real property" includes title in fee, a leasehold interest, a beneficial interest, an encumbrance, development rights, air space and air rights, or any other interest with the right to use or occupancy of real property or the right to receive rents, profits or other income derived from real property....

Subdivision (b) of Section 1405 of the Tax Law provides, in part:

The tax shall not apply to the following conveyances:

* * *

2. Conveyances which are or were used to secure a debt or other obligation....

Section 575.11(a) of the Real Estate Transfer Tax Regulations provides, in part:

The following are examples of conveyances which are subject to the real estate transfer tax.

* * *

(13) A conveyance of real property to an industrial development agency (IDA) by a person who is not the beneficiary of the IDA financing, at the direction of such beneficiary, with such beneficiary subsequently leasing the property from the IDA, is subject to tax. In such a conveyance, the beneficiary of the IDA financing and not the IDA is deemed to be the grantee, and therefore the exemption described at section 575.9(c)(1) of this Part does not apply.

Applicable Law and Regulations - Mortgage Recording Tax

Article 11 of the New York State Tax Law ("Tax Law") imposes taxes on the recording of mortgages of real property, based on the principal debt or obligation secured by the mortgage being recorded. Tax Law §253 and New York City Administrative Code, §11-2601.

Section 648.1 of the Mortgage Recording Tax Regulations provides, in part:

(a) A mortgage for an indefinite amount is one where it is not possible to determine from the terms of the mortgage itself the maximum amount of principal debt or obligation which is, or under any contingency may be, secured at the date of execution thereof or at any time thereafter.

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(b)(1) If a mortgage secures the repayment of a specific sum of money and also contains provisions that set forth that the mortgage may secure additional amounts, which represent expenses incurred by the mortgagee on behalf of the mortgagor in the event of the mortgagor's failure to perform a covenant or obligation under the terms of the mortgage relating to maintaining the real property, preserving its value and protecting the mortgagee's lien, the expenses in the event of a foreclosure, and interest and late payment charges, which shall be referred to for purposes of this Part as incidental amounts, such a mortgage is not a mortgage for an indefinite amount, provided that such failure to perform a covenant or obligation under the terms of the mortgage resulting in such expenses being incurred by the mortgagee, constitutes a condition of default under the terms of the mortgage.

Section 648.2(a)(1) of the Mortgage Recording Tax Regulations provides:

When a mortgage for an indefinite amount is presented for recording, the mortgagee may file with the recording officer a sworn statement of the maximum amount secured or which under any contingency may be secured by the mortgage at the date of execution or any time thereafter. Provided, however, that the maximum amount secured or which under any contingency may be secured by the mortgage at the date of execution or any time thereafter as set forth in such statement can in no event be less than that portion of such amount secured which is determinable by the terms of the mortgage. Such sworn statement may be a separate document or be contained in the mortgage instrument itself. If the sworn statement is filed or a statement is contained in the mortgage itself stating such maximum amount, the taxes described in Part 642 of this Title shall be based and computed on such maximum amount.

Opinion - Real Estate Transfer Tax

As noted above, Section 1405(b)(2) of the Tax Law provides that conveyances which are or were used to secure a debt are exempt from the real estate transfer tax. Section 575.11(a)(13) of the regulations stands for the premise that a conveyance by a third party (i.e., Original Seller in the present case) to a lender (i.e., Petitioner), at the direction of a borrower (i.e., Purchaser), where the property is subsequently conveyed by the lender to the borrower, is subject to the real estate transfer tax as a conveyance from the third party, as grantor, to borrower, as grantee.

The Overall Transaction involved in the proposed financing involves several transactions that are or may be considered "conveyances" within the meaning of Section 1401(e) of the Tax Law. These include (a) Purchaser's assignment of its interest in the Contract to Petitioner; (b) Original Seller's conveyance of the Premises by means of a deed issued to Purchaser and delivered to Petitioner; (c) Purchaser's execution of the PFA, under which purchaser agrees to purchase the

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Premises from Petitioner on a deferred payment basis; (d) Petitioner's delivery of the Original Seller's deed to purchaser; and (e) the eventual fulfillment of Purchaser's obligations under the PFA through the payment of the total amount due to Petitioner thereunder.

Of these transactions, only the deed by Original Seller to Purchaser, described in item (b) above, is a taxable conveyance for purposes of the real estate transfer tax. The remaining transactions, items (a), (c), (d) and (e) above, are entered into solely to effect and secure Petitioner's financing of Purchaser's acquisition of the Premises.

Thus, with respect to issue (1) the real estate transfer tax (including the "additional tax" imposed under Section 1402-a, if applicable) is payable on the sale of the Premises as a conveyance by Original Seller to Purchaser. The consideration for the conveyance is equal to the Original Purchase Price payable under the Contract.

With respect to issues (2) and (3), the assignment of the Contract by Purchaser to Petitioner and the "resale" of the Premises by Petitioner to Purchaser under the PFA are not subject to the real estate transfer tax as these transactions are entered into solely to effect and secure Petitioner's financing of Purchaser's acquisition of the Premises.

Opinion - Mortgage Recording Tax

The mortgage recording tax is imposed on the recording of a mortgage on real property, and is computed based on the amount of "principal debt or obligation which is, or under any contingency may be secured" by the recorded mortgage. With certain exceptions not relevant here, the term "principal debt or obligation" does not include interest payable on the indebtedness secured by the mortgage, nor does it include incidental amounts that may become secured by the mortgage in the event the mortgagee incurs expenses to maintain and preserve the value of the mortgaged premises or protect the validity of the mortgagee's lien. See In re Park and 46th St. Corp. v. State Tax Commission, 295 N.Y. 173 (1946) ("It must be remembered that it is the principal sum of a loan, not the interest to be paid thereon, which measures a mortgage tax." Id., at 179, quoting Matter of New York State Gas & Electric Corp. v Gilchrist, 209 A.D. 771 (1924), aff'd 240 N.Y. 552 (1925).

It is concluded that the "Profit Rate" does not constitute a part of the "principal debt or obligation" secured by the Mortgage, but rather is an incidental amount within the meaning and intent of Section 648.1(b)(1) of the mortgage recording tax regulations. In Petitioner's financings, the granting clause of the Mortgage will state that the Mortgage secures Purchaser's obligation to pay the Base Amount, and sets forth that amount. The Mortgage will contain a clause which will specifically state that, for purposes of the mortgage recording tax, the maximum amount of principal indebtedness that is secured by the Mortgage at execution, or which under any contingency may become secured at any time thereafter, is the Base Amount. In addition the mortgage references the parties' Tax Matters Agreement. That agreement explicitly provides that, for all tax purposes, the

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Overall Transactions constitute a borrowing by Purchaser of the Base Amount, and again recites that the maximum principal amount secured by the Mortgage is the Base Amount.

Thus, with respect to issue (4), it is concluded that the recording of the mortgage results in the imposition of the mortgage recording tax computed solely on the Base Amount.

DATED: July 26, 2002

/s/
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NOTE: The opinions expressed in Advisory Opinions are limited to the facts set forth therein.