

# FEDERAL STANDARD ABSTRACT TITLE NEWS

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## WRAPS & SPREADS ARE DANGEROUS ( WE ARE NOT TALKING ABOUT FOOD!!! )

### **NEW YORK STATE TO TAX WRAP MORTGAGES, SPREADER AGREEMENTS AND ADDITIONAL COLLATERAL MORTGAGES; NONRESIDENTS WHO SOLD OR WILL SELL SHARES OF STOCK IN A CO-OP IN 2004 TO PAY TAXES ON GAIN**

On November 18, 2004, important changes to Articles 11 & 22 of the Tax Law become effective. These changes will affect how mortgages are used to facilitate real estate transactions involving properties within the New York City. The changes will also affect certain sellers of co-ops, statewide.

#### ***Wrap Mortgages***

An amendment to Article 11 Tax on Mortgages (Part Q) requires that New York State impose mortgage tax on wraparound mortgage transactions on New York City property mortgages recorded on or after November 18, 2004. The result is a mortgage tax on the full amount of a wrap mortgage. Previously, mortgage tax only needed to be paid on the amount of the new money lent under the wrap mortgage. The amount of the existing senior mortgage that was wrapped around was treated as exempt from mortgage tax since the applicable tax had been paid on that portion of the debt at the time of its recording.

Effective as to mortgages recorded on or after November 18, 2004, and only as to wrap mortgages secured by property within the New York City, mortgage tax will be due on both the amount of the new money and the principal balance of the existing mortgage around which it wraps.

#### ***Spreader or Additional (Collateral Security) Mortgages***

The second type of mortgage affected by the new legislation is the practice of spreading mortgages - usually to give an existing lender additional collateral security; to move mortgages from one property to another, both owned by the same or

related borrowers or from the property owned by one borrower to property owned by another unrelated entity with the result that the existing mortgage debt can be used to reduce the mortgage tax in subsequent mortgage financing.

Similar to wrap mortgages, the changes only apply to instruments recorded on or after November 18, 2004, affecting properties in New York City. While the drafters have crafted the prohibition so the New York City borrowers owning multiple properties in the same named entity are mostly affected, the amendment will close the door on many new transactions.

Before the change in the law, documents such as mortgage modification, extension, consolidation or spreader arrangements that merely modify the terms or add additional property to secure an existing mortgage loan was not subject to additional mortgage tax. The recording of new mortgages given solely as additional security for an existing debt, irrespective of the identity of the property owner, was allowed. Furthermore, prior to the changes, additional mortgage tax would not become due under any of these types of instruments except where the principal amount secured by the underlying mortgage was increased, *i.e. an additional loan of new money is made and consolidated with the original debt and spread to other property, or where unpaid and accrued interest is capitalized as principal debt.* Under the new changes, the recording of supplemental mortgage documents will only be allowed "so long as the document does not create any new or greater indebtedness."

In the context of a spreader agreement, a lender may have required a mortgage on additional property from a borrower to enhance the lender's security position *i.e., as a condition for some modification of the loan terms.* The spreader agreement adding new property would be deemed a supplemental mortgage instrument and exempt from additional tax provided that no new money was being secured. Current interpretation of the tax law would even allow the lender to subsequently release the original property from the lien of the spread mortgage without the imposition

of additional mortgage tax. Assuming the cooperation of the lender, this device would allow owners of multiple properties the luxury of moving their mortgage debt from property to property to maximize the equity value of individual properties. Also subject to the new laws is the common practice of lenders who take mortgages beyond the primary mortgage on other properties owned by a borrower, *i.e.*, a residence as additional security for a debt owed by a business entity. As applied to spreader agreements or additional mortgages, this practice is now sharply restricted. With respect to properties within New York City, the new law effectively precludes spreading or otherwise transferring mortgages, or the adding of additional mortgages to properties owned by any entity, other than the mortgagor under the existing underlying mortgage.

To determine if a spreader or additional mortgage is subject to the assessment of mortgage tax under Section 255, one must determine whether the subsequent spreader agreement or additional mortgage instrument imposes a lien on property in New York City that was not covered by the original mortgage agreement. Where the original mortgage encumbers property located outside New York City and is spread to property within the City, or such NYC property is to become the subject of additional collateral security mortgage, such instrument will attract mortgage tax, unless perhaps the property is owned by the same entity that is the mortgagor under the underlying mortgage.

#### ***Non-Residents to Pay Tax on Co-op Gains***

The new legislation under Article 22 Personal Income Tax (Part H) requires nonresident individuals, estates, and trusts to include in their New York source income any gain from certain sales, conveyances, or other dispositions (sales or transfers) of shares of stock in a co-op. Nonresidents who sold or will sell shares of stock in a co-op on or after January 1, 2004, may have to adjust their 2004 estimated income tax payments as described below. The gain will be includable in New York source income if (1) the gain is includable in federal adjustable gross income for the year, and (2) the gain is in connection with the grant or transfer of proprietary leasehold by the owner of the shares, where the co-op represented by the shares is located in New York State. New York source income is the numerator of the income percentage that is used to determine the New York State personal income tax of a nonresident.

As part of the new law, effective for sales or transfers covered by the new law that occur on or after November 18, 2004, nonresidents will be required to pay New York estimated income tax on the gain related to the sale or transfer within 15 days of the sale or transfer unless an exemption applies. The estimated income tax payments will

be made with new Form IT-2664, *Nonresident Cooperative Estimated Income Tax Payment Form*. However, nonresidents who sold or transferred shares in 2004 prior to November 18, or who are exempt from the 15-day estimated income tax payment rule for sales or transfers on or after November 18, will not have paid this estimated income tax. Accordingly, to take into account the increase in their New York personal income tax attributable to the inclusion of the gain in their New York source income, these taxpayers may have to adjust their September 15, 2005, or January 15, 2005, estimated income tax payments, or may have to begin making estimated income tax payments on September 15 or January 15. For information on how to amend your estimated income tax payments or to begin making estimated income tax payments, see Form IT 2105-I, *Instructions for Form IT-2105*.

New Form IT-2664 and a TSB-M containing more detailed information concerning the estimated income tax rules and exemptions that take effect on November 18 will be issued prior to the November 18 effective date.

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### **EFFECTIVE JULY 6, 2004 E-TAX FORMS REQUIRED FOR NEW YORK, BRONX, QUEENS & KINGS COUNTY**

Beginning on July 6, 2004, the party preparing the City of New York Real Property Transfer Tax form (RPTT), State Transfer Tax form (TP-584) and Equalization form and (RP-5217NYC) for title closings MUST create these forms and enter ALL the required data into the NYC ACRIS E-Tax forms system. The system is available over the internet at [www.ci.nyc.ny.us/html/dof/html/acris.html](http://www.ci.nyc.ny.us/html/dof/html/acris.html) or at the borough offices of the City Register in Manhattan, Brooklyn, Queens or the Bronx. E-Tax forms preparation must be done prior to the closing and the applicable forms printed with the City assigned special code number must be brought to the closing for signature. Only forms printed from the ACRIS system will be accepted for recording after July 6, 2004. Failure to submit proper forms at the closing may result in delay or adjournment. It is suggested that you check with the office hosting the closing to assure that internet access will be provided should any corrections or amendments to the E-Tax forms be needed at the time of closing. The ACRIS and the E-Tax system does not apply to the Richmond County Clerk's Office. Documents to be recorded in that County require paper RPTT, TP-584 and RP-5217NYC forms.

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If you have any questions, comments, suggestions, or would like to contribute to the newsletter, please e-mail us at [fsa@federalstandardabstract.com](mailto:fsa@federalstandardabstract.com).

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