

CLIENT ADVISORY

MAY 2004

CO-OP PERMITTED TO INCREASE CHARGES TO SHAREHOLDERS TO PRESERVE THEIR TAX DEDUCTION

Internal Revenue Code, § 216 grants a tax deduction to cooperative shareholder-tenants for the portion of maintenance payments that is attributable to their share of the building's real estate taxes and interest. This deduction is only available, however, if eighty percent or more of the gross income of the cooperative corporation is derived from the tenant-shareholders. A cooperative with commercial tenants must therefore monitor the rents received from those tenants to avoid exceeding twenty percent of total income and thereby jeopardizing the shareholders' tax deductions.

In Citipark II Associates, Ltd. v. Lincoln Plaza Tenants Corp., Index No. 605769/99 (Sup. Ct. N.Y. Co. December 2, 2003), the lease between the cooperative and its garage tenant provided that after February 1999, the amount of rent would be the fair market value of the space, to be determined (if the parties could not agree) by an appraisal procedure. In 2000, an independent appraiser determined a fair market rental value that pushed the cooperative's rental income above the twenty percent limit. Instead of refunding any excess payment to the garage, however, the cooperative imposed special assessments that assured that its income from its shareholders exceeded eighty percent of its total income, notwithstanding the increased rent from the garage. It claimed to have used the assessments to pay for repairs and renovations.

The garage sued, arguing that there was no need for the assessments and that the failure to refund the excess rent was a violation of the lease, as well as of the Internal Revenue Code. The Court granted the cooperative summary judgment dismissing the case. It held that the since the lease contained no restrictions on how the maximum rent limit was to be reached, the cooperative was free to make any assessments it felt necessary, "for whatever reasons." Despite this strong statement, the Court went on to find that the garage had failed to submit evidence that the assessments were not necessary, thus implying that evidence of bad faith in the imposition of the assessments might have led to a different result.

CO-OP TRANSFER FILING FEE CHALLENGED

When real estate is transferred in New York City, the deed must be filed with a Real Property Transfer Tax Return and the transfer tax due. Until 2002, **Real Property Law, § 333(3)**, had also required that the City impose a \$25.00 fee "for each real property transfer tax form filed." Since New York Law (**Real Estate Transfer Tax Law, § 1405-B**) explicitly makes the transfer tax applicable to cooperative shares (although such shares are not real property), transfers of cooperatives clearly required both the filing of a tax return and the filing fee. In 2002, the Legislature amended § 333(3) to raise the fee to \$50.00, but the statute as amended now requires the fee "for each real property transfer reporting form submitted for recording..."

(emphasis added). This is a different form, required by **Real Property Law, § 333(1-e)**, that is only used in real estate transactions and not in cooperative transfers. There thus appears to be no statutory direction to collect the fee in cooperative transfers, although the New York City Department of Finance (“the DOF”) has been doing so.

In response to a class action brought in March 2004 by a seller who paid the \$50.00 fee under protest, (**Schwartz v. New York City Department of Finance, Index No. 104785/04 (Sup. Ct. N.Y. Co.)**), the DOF has conceded the error and now accepts transfer tax returns for cooperatives without the fee. Litigation is proceeding to determine whether the City will pay refunds to all those who paid the fee since January 1, 2003.

CARPETING REQUIREMENT ENFORCED

Although it arose in an eviction proceeding in a rental building, a recent decision involving a requirement of carpeting in apartments should be of interest to cooperatives and condominiums, which commonly have similar requirements.

In **Fraken Builders, Inc. v. Ciccone, NYLJ February 3, 2004, p. 17, col. 1 (City Ct. New Rochelle)**, the House Rules of the building, which were incorporated into the lease by reference, required that apartment floors be “covered with rugs or carpeting to the extent of at least 80 percent of the floor area of each room excepting only kitchens, pantries, bathrooms and hallways.” Instead of large rugs or wall-to-wall carpeting, the tenant placed small, machine washable, bathroom type rugs on her floors, allegedly to accommodate her allergies and asthma. According to her own measurements, the rugs covered only 62 percent of the living and dining rooms and 65 percent of the bedroom. She argued, however, that the rugs were placed in pathways where the tenant was most likely to walk and the total floor area should be reduced by the parts of the floor covered by boxes and furniture. If such untrafficked space was deducted, she contended, her rugs covered more than 80 percent of the remaining floors. In addition, she argued that in view of her allergies and asthma, enforcement of the carpeting requirement would create a condition detrimental to her health and therefore violated the landlord’s warranty of habitability under **§ 235-b, Real Property Law**.

The Court disagreed. It found that the Tenants’ interpretation would “in effect, require a landlord . . . to individually measure each item on the apartment floor, . . . and then make a subjective judgment as to which routes a reasonable apartment dweller would travel in the course of a given day.” As for the “warranty of habitability” argument, the Court concluded that the lease’s carpeting requirement served a legitimate and reasonable purpose – that of noise abatement for the other tenants – and that even the tenant’s own expert witness had testified that the tenant’s complaints could be addressed by hypoallergenic carpeting and vacuuming. The Court granted the landlord a judgment of eviction.