
CLIENT ADVISORY

NOVEMBER 2007

HOUSE-PASSED LEGISLATION WOULD EASE "80/20 INCOME RULE" FOR COOPERATIVES

The Internal Revenue Code provides certain tax benefits to tenant-shareholders in a "cooperative housing corporation." Among other things, cooperative shareholders enjoy tax deductions for interest on their mortgages, as well as for their proportionate share of the cooperative's property taxes and mortgage interest. However, in order for a cooperative's shareholders to qualify for these and other deductions, **Internal Revenue Code § 216** requires that at least 80 percent of the cooperative's total income must be derived from income from tenant-shareholders, rather than from leases on commercial space or other non-qualified sources. Under this provision, commonly referred to as the "80/20 rule," shareholders lose their tax benefits if the cooperative's non-qualified income exceeds 20 percent. This rule has sometimes operated to prevent cooperatives that have sizable commercial space from maximizing their commercial rents, which would otherwise reduce the maintenance burden on their shareholders.

Proposed federal legislation recently passed by the House of Representatives, if adopted by the Senate and signed into law, would change this provision of the tax law. Under the House-passed act, **H.R. 3648**, the definition of a qualifying cooperative housing corporation would be revised to include buildings passing any one of three alternative tests. Tenant-shareholders would enjoy their tax benefits of cooperative ownership if during any tax year, (1) 80% or more of the cooperative's income is derived from tenant-shareholders (the same as the current provision); *or* (2) 80% or more of the cooperative's square footage is used or available for use by tenant-shareholders for residential purposes or for purposes ancillary to residential use; *or* (3) 90% or more of the corporation's expenditures were paid or incurred for the acquisition, construction, management, maintenance, or care of the cooperative's property for the benefit of tenant-shareholders.

The House-passed act has been referred to the Senate Finance Committee for consideration. Representatives of cooperatives may wish to contact the offices of senators serving on that committee, including Senator Charles E. Schumer of New York, to urge their support for this measure.

APPELLATE DIVISION CLARIFIES THAT MARTIN ACT DOES NOT PRECLUDE PRIVATE CLAIMS FOR FRAUD AGAINST SPONSORS

New York's anti-securities fraud statute, the Martin Act, provides the New York State Attorney General with broad authority to seek relief against fraudulent practices in the sale of securities, including interests in cooperatives and condominiums. However, the Martin Act does not preclude private citizens from bringing common-law fraud claims arising from transactions governed by this statute, according to the recent appellate decision in **Kramer v. W10Z/515 Real Estate Limited Partnership**, 2007 WL 2993665, 2007 N.Y Slip Op. 7763 (1st Dep't Oct. 16, 2007).

360 Lexington Avenue, New York, New York 10017 Tel: (212) 922-9250 Fax: (212) 922-9335 <http://www.ganshore.com>

IMPORTANT NOTE: The material in this newsletter is provided for information purposes only and should not be construed as legal advice. Because the particular facts and circumstances of every situation differ, you should not act or refrain from acting on the basis of this information without consulting an attorney. This material may constitute Attorney Advertising as defined by the New York Court Rules.

In Kramer, plaintiff purchasers of a condominium unit sued the sponsor and other parties for fraud. Defendants moved to dismiss on the ground that the Attorney General enjoys exclusive jurisdiction to enforce the Martin Act, relying on a series of prior decisions rejecting attempts by private parties to bring fraud claims arising from transactions subject to the statute. The Appellate Division permitted the suit to proceed. It reaffirmed the rule that only the Attorney General may bring a suit under the Martin Act, and that there is no private right of action created under that statute. However, the court held, this does not prevent a private party from bringing an action for common-law fraud arising from the same transaction.

The Appellate Division acknowledged that it had issued a series of prior decisions suggesting that whenever the Attorney General would have jurisdiction to challenge an allegedly fraudulent sale of securities in a cooperative or condominium, no private action for fraud could be brought. However, the court held, this rule was intended to apply to situations in which the plaintiff was seeking to sue based on the statute itself, and should not bar a claim that satisfies all the elements of common-law fraud independent of the statute. The court noted that the Martin Act was enacted to protect purchasers of securities from exploitation, and that construing it to narrow the rights that purchasers enjoyed even before the statute was enacted would be contrary to its remedial purpose.

CREATING CONFLICT OF DECISIONS, COURT HOLDS THAT REAL ESTATE CONTRACT CANNOT BE CREATED BY E-MAIL

In this Internet era, many communications that would formerly have taken place in writing or by facsimile are now transmitted via e-mail. Courts and the State Legislature have recognized that many types of binding legal transactions can be effectuated electronically, and that sending an e-mail containing a person's name can sometimes reflect his or her intent to be bound by its contents.

However, in Vista Developers Corp. v. VPP Realty LLC, N.Y.L.J. Oct. 22, 2007, p. 20, col. 3 (Sup. Ct. Queens Co.), a court determined that an exchange of e-mails cannot create a binding contract for the purchase or sale of real property. The court reasoned that under the Statute of Frauds, contracts for the transfer of an interest in real property are required to be in writing. The court discussed a 1994 amendment to the Statute of Frauds, providing that an electronic communication via a facsimile or computer process transmitting electronic signals, containing symbols intended to authenticate the writing, may constitute a signed writing sufficient to satisfy the Statute of Frauds. The court found, however, that this provision amended a different section of the Statute of Frauds from the one that governs real property transactions, and hence did not apply to such transactions. This made sense, the court concluded, because the purpose of the Statute of Frauds for real estate transactions is to eliminate uncertainty as to whether a contract has been entered into, such as by distinguishing provisional "agreements to agree" from binding contracts. Significantly, however, the court's decision suggests that an e-mail exchange could never create a valid real estate contract under the Statute of Frauds, no matter how specific the words the parties employed.

The court acknowledged that its ruling conflicted with the earlier decision in Rosenfeld v. Zerneck, 4 Misc. 3d 193, 776 N.Y.S.2d 458 (Sup. Ct. Kings Co. 2004), which held that an e-mail bearing the sender's typed name at the bottom could create a binding real estate contract. An appellate court decision or further amendment to the statute may clarify the issue, but until that occurs, parties and counsel must ensure that all real estate contracts are documented and executed in hard-copy form.