<u>Article - Credit Line Mortgages in New York</u>

The taxation of mortgages executed in New York to secure lines of credit is of continuing concern. The basic proposition, grounded in Section 250 of the Tax Law, as interpreted in a 1953 Opinion of the New York Attorney General (1953 Opns Att Gen 198), is that a re-advance represents new and further indebtedness which is subject to mortgage recording tax upon recording of a further instrument evidencing the re-advance. Absent payment of the additional tax due, the mortgage cannot, under Tax Law Section 258, be modified, released or otherwise transacted of record, and it cannot be enforced in any action or proceeding. Case law indicates, further, that a personal action cannot be maintained on the indebtedness, in lieu of an action to enforce the security, without payment of the additional mortgage tax. The payment of interest and penalties must also be taken into account.

It has been common practice, when a credit line is also secured by property outside of New York or the New York property is intended to secure only a part of a credit line, to have the New York mortgage secure an identifiable portion of the overall indebtedness, and to expressly provide in the mortgage that this amount is to be repaid last. Only on repayment of the credit line below that amount and the re-advance of funds would additional mortgage tax become due. Structuring the loan in this manner was approved in a 1993 Advisory Opinion (TSB-A-93(15)-R)of the Department of Taxation and Finance (“Tax Commission”). A “Last Dollar” title policy endorsement insures with no exception for mortgage tax that payments made will not for the policy be deemed applied against the indebtedness secured by the insured mortgage.

Other structures have developed to enable re-advances to be made without additional mortgage tax being due. It has been common practice, for example, for a party affiliated with the credit line borrower to execute a guarantee mortgage to secure the credit line obligations of the primary obligor. The guaranty mortgage does not secure the borrower's revolving obligation, only a sum certain that could be owed the lender, which could be equivalent to the maximum amount outstanding at any one time under the credit line. Notwithstanding generally accepted practice, the Tax Commission has informally advised that it may end this manner of avoidance by taxing the guarantee mortgage as amounts are re-advanced under the borrower's primary obligation. Guarantee mortgages will then need to be expressly non-revolving and secure the last amounts repaid under the borrower's loan. This change in position, if made, is expected to be prospective. In addition, it should not be an issue for a guarantee mortgage when re-advances to the borrower are not subject to additional mortgage tax under Tax Law, Section 253-b, discussed below.

Borrowers and lenders have also entered into agreements, under which the borrower makes payments by purchasing participation interests in its loan, and the lender makes re-advances by purchasing back those participations. While this structure was approved in a 1983 letter of the Tax Commission to counsel at a major Manhattan law firm, with the 1989 amendment to Real Property Law Section 275 and its prohibition against the warehousing of mortgages to avoid mortgage tax, a borrower's purchases will presumably now be held to result in the mortgage being dormant to the extent of the participation interests purchased, and each re-advance to be a mortgage taxable event.

Section 253-b was added to the Tax Law by Chapters 924 and 925 of the Laws of 1985 effective December 20, 1985 to provide that re-advances in connection with a mortgage encumbering owner-occupied real property improved or to be improved by a one to six family dwelling will not be mortgage taxed. Also, no tax will be due on the transfer of the property, subject to the mortgage, to a person related to the original obligor or obligors by blood, marriage or adoption. The Tax Commission has informally advised that the transferee can be an entity in which a majority interest is held either by the transferor or by related persons who need not be in occupancy of the premises.

Section 253-b was expanded by Chapters 489 and 490 of the Laws of 1996 to allow the same favorable tax treatment to other credit line mortgages securing a maximum principal indebtedness outstanding at any one time of less than $3,000,000 recorded on and after November 6, 1996. Based on conversations with the Tax Commission, it is expected that this commercial credit line provision will be applied as follows.

An unsecured term loan of $3,000,000 or more, whether or not in existence prior to November 6, 1996, can without mortgage recording tax being imposed on re-advances be modified and split after that date into two separate notes or amended to become two separate tranches in a loan facility, one being a newly secured revolving credit obligation for less than $3,000,000 and the balance a unsecured or separately secured term loan. However, a single mortgage lien cannot secure both a credit line facility for less than $3,000,000 and a term loan facility when they aggregate $3,000,000 or more and receive the benefit of Section 253-b.

The protection of the Section 253-b will not be afforded if an unsecured revolving credit facility of $3,000,000 or more, entered into at any time, is modified such that only a less than $3,000,000 identifiable portion of the overall credit line is later secured by a mortgage. The definition of “credit line mortgage” in Tax Law Section 253-b (2) requires taking into account the entire “credit agreement or other financing arrangement”.

Lastly, the benefit of Section 253-b will not be afforded to a mortgage securing advances under a line of credit recorded prior to November 6, 1996, even if the mortgage is modified and severed to result in a credit line mortgage of less than $3,000,000. In amending Section 253-b for commercial credit lines, Chapter 490 provides that the change applies “to all credit line mortgages recorded on or after” its effective date.

Other transactions will require clarification. For example, Section 253-b provides that a commercial credit line mortgage for less than $3,000,000 made pursuant to a building loan contract can not be afforded the benefits of that Section. What if the advances are to be used to reimburse the borrower for improvements made and there is no building loan agreement? What if there is no formal building loan agreement but the advances are to be made “in consideration of the borrowers “express promise” to make an improvement, which is within the definition of a “building loan contract” under Lien Law Section 2?

It is also uncertain how Section 253-b is to be applied to commercial credit line mortgages securing less than $3,000,000 when advances are first made for the acquisition of the parcel being mortgaged, and re-advances are made to enable the purchase of other real property to which the mortgage is spread. The Tax Commission has informally advised that a credit line mortgage can be executed to encumber multiple parcels which will be released as they are sold off; but the application of Section 253-b to the spreading of a credit line mortgage to other property has not been addressed. These and other issues regarding the statute require clarification.

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