

FROM AFFORDABLE TO PROFITABLE: THE PRIVATIZATION OF MITCHELL-LAMA HOUSING & HOW THE NEW YORK COURT OF APPEALS GOT IT WRONG

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I. INTRODUCTION

With the upturn in the economy since the 2008 financial crisis, demand for residential real estate in New York City has increased, resulting in heightened tensions with the city's efforts to maintain affordable housing units, especially for low- and middle-income individuals. Specifically, New York City must confront the increasing loss of affordable housing through the conversions of public and quasi-public units to private, for-profit accommodations in light of the growing demand for residential space and the high return of these conversions. In addition to factors like income and rental rates, the general availability of housing stock—which is directly affected by these for-profit conversions—significantly impacts whether New York City can maintain affordable housing for future years. Based on a combination of these factors (e.g., income, rental rates, and availability of housing stock), a recent study indicates that New York City now ranks thirty-first among the seventy-six largest cities with regard to gross rent-to-income ratios, demonstrating the pressing reality of New York City's affordable housing dilemma.¹

Generally, housing is considered affordable when a household pays no more than thirty percent of its income to rent; the 2011 Housing and Vacancy Survey (“HVS”), however, reported that the median gross rent-to-income ratio for all renters in New York City was

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¹ 2014 *Income and Affordability Study*, NEW YORK CITY RENT GUIDELINES BD. 3, 8–9 (Apr. 10, 2014), available at http://www.nycrgb.org/downloads/research/pdf_reports/ia14.pdf (“Despite ongoing efforts by a number of government agencies and non-profit groups, housing affordability remains an issue . . .”).

33.6 percent.² This ratio means that half of all households residing in rental housing pay more than 33.6 percent of their income to gross rent, placing New York City rental housing outside the purview of housing that is considered affordable.³ Furthermore, the cost of living in New York City as compared to larger cities nationwide is high. According to the Council for Community and Economic Research's Cost of Living Index ("COLI"), which tracks the cost of living in more than 300 urban areas, Manhattan is approximately 2.2 times more expensive to live in than the national average, Brooklyn is approximately 1.7 times more expensive, and Queens is roughly 1.5 times more expensive.⁴ This same study found that significantly more income is required to live in New York City even compared to Boston, given the same living standards.⁵ Someone moving from Boston who makes \$51,642 a year would need to make \$81,978 to have the same living conditions in Manhattan with respect to groceries, transportation, and housing.⁶ The Housing Opportunity Index ("HOI") also found that between 2008 and 2012, the New York City metropolitan area was the least affordable area to buy a home in for the eighteenth straight quarter.⁷ Therefore, preserving affordable housing units in New York City is imperative, especially for low- and middle-income families, given that the general living costs in the city are high even in comparison to other large cities nationwide.

In addition to analyzing the rent-to-income ratio as a measure of New York City's need to maintain and provide affordable housing, poverty and unemployment rates are also significant indicators. For example, while the New York City unemployment rate fell to 8.7 percent in 2013 (after a 0.2 percentage point increase in 2012), it still remained above the U.S. unemployment rate of 7.4 percent.⁸ This 1.3 percentage point difference between the city's unemployment rate and the national unemployment rate is the largest gap between the two

² 2013 *Income and Affordability Study*, NEW YORK CITY RENT GUIDELINES Bd. 3, 9 (Apr. 4, 2013), available at http://www.nycrgb.org/downloads/research/pdf_reports/ia13.pdf; see also 2014 *Income and Affordability Study*, *supra* note 1, at 8.

³ 2013 *Income and Affordability Study*, *supra* note 2, at 8–9 (stating that for 2011, the median income for all rental households was \$38,447, and rent-controlled tenants continued to have the lowest household income, earning a median of \$28,000 in 2010).

⁴ 2014 *Income and Affordability Study*, *supra* note 1, at 10–11.

⁵ *Id.* at 11.

⁶ *Id.*

⁷ *Id.*

⁸ *Id.* at 5.

figures since 2004.⁹ Moreover, the Census Bureau reports that the New York City poverty rate for all individuals was 21.2 percent in 2012, an increase from 20.9 percent in the previous year and 5.3 percent higher than the national poverty rate.¹⁰ Poverty rates, however, vary widely depending on the borough. Rates range from as low as 11.6 percent in Staten Island to 31.0 percent in the Bronx.¹¹ Nevertheless, these statistics indicate that maintaining affordable housing in New York City has become a challenge considering the high cost of living and the growing disparity between rent and income.

Yet, despite the high poverty and unemployment rates in certain boroughs, a shortage of affordable housing stock remains. According to the HVS of 2011, the New York City vacancy rate for housing inventory was 3.12 percent, which was below the five percent threshold required for rent regulation to continue under state law.¹² This low vacancy rate translates into the availability of just 67,818 vacant units out of more than 2.1 million rental units city-wide.¹³

In addition to the limited housing stock, New York City also faces poor housing conditions due to overcrowding. For example, 11.5 percent of all rental housing in New York City in 2011 was overcrowded (defined as more than one person per room, on average) and 4.3 percent was severely overcrowded (defined as an average of more than 1.5 persons per room).¹⁴ Thus, even the current housing units in use for the purpose of providing affordable housing implicate quality concerns due to the large volume of residents forced to live in limited spaces. Any further erosion of affordable housing stock would not only prevent certain families from receiving affordable housing, but it would also increase the current problem of overcrowding.

In an attempt to provide much needed low-cost, sanitary housing, New York City has created different forms of housing units and passed legislation, including both public housing and rent control laws. The purpose of public housing is to provide decent and safe rental housing for eligible low-income families, the elderly, and persons with disabilities.¹⁵ Public housing comes in all sizes and types, from

⁹ *Id.*

¹⁰ *2014 Income and Affordability Study*, *supra* note 1, at 7–8 (discussing that the national poverty rate was “15.9% for the nation as a whole in both 2011 and 2012”).

¹¹ *Id.*

¹² *2014 Housing Supply Report*, NEW YORK CITY RENT GUIDELINES BOARD 3 (May 29, 2014), *available at* http://nycrgb.org/downloads/research/pdf_reports/14HSR.pdf.

¹³ *Id.*

¹⁴ *Id.* at 4.

¹⁵ HUD’s Public Housing Program, U.S. DEPARTMENT OF HOUSING AND URBAN

scattered single family houses to high-rise apartments for the elderly.¹⁶ Unlike private apartments subject to rent control laws, public housing is built and maintained by a government authority or office.¹⁷ In contrast, rent control laws operate in the private sector by protecting vulnerable tenants living in privately operated units from excessive or sudden increases in rent.¹⁸ Public housing and private units regulated by rent control laws are only two examples of how both private and public efforts are essential to maintaining affordable housing for the future.

Limited dividend housing is another type of affordable housing created through a combination of public and private efforts. Chapter 823 of the State Housing Law of 1926 establishes limited dividend housing for the purpose of correcting housing conditions that were considered a menace to the health, safety, morals, welfare, and reasonable comfort of the citizens of the state.¹⁹ The limited dividend housing program encouraged the development of safe and affordable housing by providing developers with real estate tax exemptions for a period of up to fifty years in exchange for a six percent limitation on profits.²⁰ The existence of these different types of housing accommodations demonstrates that each model and legislation plays a different but significant role in preserving affordable housing in New York City.

This Comment specifically focuses on the housing units formed under Article II of the New York Private Housing Finance Law (“PHFL”). The PHFL is a compilation of various programs relating to state and municipal assistance for housing developed by private entities, which were previously contained in the Public Housing Law or had been enacted as separate unconsolidated laws.²¹ In 1955,

DEVELOPMENT (Sept. 20, 2013, 12:00 PM), http://portal.hud.gov/hudportal/HUD?src=/topics/rental_assistance/phprog.

¹⁶ *Id.*

¹⁷ Jennifer C. McScotts, *Dwelling Together: Using Cooperative Housing to Abate the Affordable Housing Shortage in Canada and the United States*, 32 GA. J. INT’L & COMP. L. 131, 137 (2004).

¹⁸ *Id.* at 140.

¹⁹ Gail Benzman & Christopher Boyd, *Affordable No More: New York City’s Looming Crisis in Mitchell-Lama and Limited Dividend Housing*, CITY OF N.Y. OFFICE OF THE COMPTROLLER 1, 6 (Feb. 18, 2004), available at http://comptroller.nyc.gov/wp-content/uploads/documents/Feb18-04_Mitchell-Lama_Report.pdf [hereinafter *Affordable No More*].

²⁰ *Id.* at 7.

²¹ David J. Sweet & John D. Hack, *Mitchell-Lama Buyout: Policy Issues and Alternatives*, 17 FORDHAM URB. L.J. 117, 117 n.1 (1989).

Senator MacNeil Mitchell and Assemblyman Alfred Lama sponsored legislation to amend the PHFL with the addition of Article II, establishing another type of affordable housing known as Mitchell-Lama housing.²² In 1961, the legislature amended the PHFL again to incorporate the already-existing limited dividend housing program and placed the PHFL under the supervision of the Department of Housing and Community Renewal (“DHCR”).²³ With both limited dividend housing and Mitchell-Lama housing, these programs built 292 housing developments (totaling more than 149,000 units of affordable housing) in New York City between 1928 and 1978; the vast majority of these developments, after 1955, were Mitchell-Lama housing.²⁴ For both programs, the respective supervising agencies strictly controlled cooperative maintenance charges and rent increases to ensure their long-term affordability.²⁵

Presently, much-needed affordable housing stock, specifically Mitchell-Lama housing, is at risk of being lost. Housing developments representing more than 6,500 units of affordable housing are in the process of leaving the supervision of Mitchell-Lama and limited dividend housing programs.²⁶ From an estimation provided by the New York City Comptroller, at least fifty-nine Mitchell-Lama developments, representing 40,000 units of affordable housing, are scheduled to retire their subsidized mortgages and withdraw from the Mitchell-Lama program between 2004 and 2016.²⁷ Between 2004 and 2007 alone, the Mitchell-Lama program has experienced an annual loss of more than 5,000 units.²⁸ Throughout New York City, HVS estimates that existing vacancy rates could not begin to meet the growing demand for affordable housing.²⁹ The Census reported that in some areas of New York City, there is virtually no vacant affordable housing stock.³⁰

In light of the pressing public policy concerns to preserve affordable housing, like Mitchell-Lama housing, government efforts

²² Maria Cristiano Anderson & Paula A. Franzese, *Article: Solutions to the Crisis in Affordable Housing: Proposed Model for New York City*, 3 RUTGERS J.L. & URB. PUB. POL’Y 84, 87–88 (2006).

²³ *Affordable No More*, *supra* note 19, at 3.

²⁴ *Id.*

²⁵ *Id.*

²⁶ *Id.* at 16.

²⁷ *Id.*

²⁸ *2014 Housing Supply Report*, *supra* note 12, at 8.

²⁹ *Affordable No More*, *supra* note 19, at 16.

³⁰ *Id.*

should focus on maintaining the limited affordable housing stock that remains. This includes prohibiting individuals from converting Mitchell-Lama housing into private market rate housing without realizing the tax consequences of these transfers. Courts have recently had the opportunity to interpret state and city tax laws in favor of preserving much needed affordable housing stock (in the form of Mitchell-Lama housing). But the New York Court of Appeals did precisely the opposite when, on December 17, 2014, it affirmed the holding in *Trump Village Section 3, Inc. v. City of New York*, an appellate court decision to privatize Mitchell-Lama housing without tax consequences.³¹ This decision severely undermined the urgent need to preserve affordable housing in New York City.

Mitchell-Lama housing consists of both rental projects and cooperatives, but this Comment focuses primarily on the dissolution of Mitchell-Lama cooperatives, specifically the means by which these cooperatives exit out of the Mitchell-Lama program. The purpose of this Comment is to demonstrate how *Trump Village Section 3, Inc.* was wrongly decided. In this case, the Court of Appeals interpreted the relevant state and tax laws to permit Mitchell-Lama housing companies to take advantage of real estate tax exemptions both in the initial formation of the Mitchell-Lama housing company and now at the dissolution stage. This decision prevents New York City from collecting necessary tax revenue and incentivizes other Mitchell-Lama cooperatives to privatize in a manner that circumvents real property transfer tax requirements. Specifically, this Comment demonstrates that the way a Mitchell-Lama cooperative dissolves and reconstitutes into a private market rate cooperative is analogous to how a private corporation dissolves and reincorporates into a new corporation for both tax and securities law purposes. In contrast to its holding, the Court of Appeals should have recognized these conversions to constitute “transfers” under the relevant tax laws. Thus, these conversions should be subject to the same tax consequences that would be implicated if a private housing corporation outside the Mitchell-Lama program had attempted to dissolve.

Part II of this Comment discusses the importance of preserving Mitchell-Lama housing stock. Part III of this Comment provides background about Article II of the PHFL and how the Mitchell-Lama Housing Program operates. It also discusses a prior New York Court of Appeals decision, which already recognized the dissolution of a

³¹ *Trump Vill. Section 3, Inc. v. City of New York*, 24 N.E.3d 1086 (N.Y. 2014).

Mitchell-Lama cooperative as an “offering” under securities law, subjecting the dissolution of these cooperatives to disclosure requirements and supervision by the New York State Attorney General. Part IV of this Comment provides the factual background of *Trump Village Section 3, Inc.* and its procedural history. Part V of this Comment discusses how the New York Court of Appeals wrongly decided *Trump Village Section 3, Inc.* It also offers reasons for why the relevant real property transfer taxes should apply to all Mitchell-Lama for-profit cooperative conversions, regardless of how the privatization is effectuated. Part VI concludes.

II. THE IMPORTANCE OF PRESERVING MITCHELL-LAMA HOUSING COOPERATIVES

Mitchell-Lama Housing is a successful and unique form of affordable housing. The program’s inception was the first time a law in New York authorized state and local low-cost loans for private middle-income housing developments, in addition to condemnation and tax exemptions, and it appropriated \$50 million for this purpose.³² Combined with the extensive federal subsidies available under Title I of the 1949 Housing Act, the Mitchell-Lama program eventually produced 269 developments across the state with more than 105,000 units.³³ Mitchell-Lama cooperative housing falls under the category of “social housing” which is non-profit and non-governmental housing.³⁴ Sometimes, however, social housing is affected by government intervention through subsidies or privatization programs, which is how Mitchell-Lama cooperatives are able to operate at below-market-rate rent costs.³⁵ These types of limited equity housing cooperatives are powerful options for communities organizing against gentrification and displacement because, while they are supported by government intervention, they still empower the tenants by providing a vehicle for ownership in real property.³⁶

New York City is not the only place that has attempted to use models of social housing, like Mitchell-Lama cooperatives, to confront the issue of affordable housing. For example, the Canadian National Housing Act (“CNHA”) provides the means for cooperative

³² Amy Lavine, *From Slum Clearance to Economic Development: A Retrospective of Redevelopment Policies in New York*, 4 ALB. GOV’T L. REV. 212, 249 (2011).

³³ *Id.*

³⁴ McScotts, *supra* note 17, at 138.

³⁵ *Id.*

³⁶ *Id.* at 150.

development aimed at the purpose of affordable housing.³⁷ Housing cooperatives created under Section 95 of the CNHA are considerably less expensive to operate when compared to similar public housing.³⁸ The difference in cost can be attributed to the fact that housing in Canada leans toward mixed income communities while public housing is strictly low income.³⁹ Operating a Section 95 cooperative is twenty percent less expensive than public or private non-profit housing, possibly because cooperatives are tenant-managed rather than controlled by staff like non-profits.⁴⁰ The success of affordable housing options in Canada through limited and zero profit cooperatives demonstrates the necessary role that limited-profit housing companies play in maintaining affordable housing, especially for New York City.

The affordable housing issue in New York City will not be remedied by only public housing or social housing alone; rather, the vitality of both types of housing stock are crucial to the maintenance of affordable housing for both lower- and middle-income families. Exercise of a voluntary dissolution under § 35 of the PHFL can produce two related results, both of which raise controversial public policy questions.⁴¹ First, a Mitchell-Lama owner can reap a potentially great profit from what was intended to be a government program for middle-income housing.⁴² Second, middle-income tenants who live in buildings that have dissolved and reconstituted as completely private market rate housing may be forced to move out because of increased rent or maintenance costs.⁴³ Even if present tenants are protected, apartments that become vacant will no longer be set aside.⁴⁴ Therefore, Mitchell-Lama housing is essential to the success of preserving affordable housing in New York City, both because of the quantity of units it provides and because of the kind of living arrangement it offers to tenants.

III. ABOUT MITCHELL-LAMA HOUSING, THE DISSOLUTION PROCESS, AND *EAST MIDTOWN PLAZA HOUSING CO. V. CUOMO*

A. *Creation of Mitchell-Lama Housing, Oversight, and the Buyout*

³⁷ *Id.* at 153.

³⁸ *Id.* at 154.

³⁹ *Id.*

⁴⁰ McScotts, *supra* note 17, at 154.

⁴¹ Sweet & Hack, *supra* note 21, at 120–21.

⁴² *Id.*

⁴³ *Id.*

⁴⁴ *Id.*

Provision

Sponsored by State Senator MacNeil Mitchell and Assemblyman Alfred Lama, Article II of the New York Private Housing Finance Law (commonly known as the “Mitchell-Lama Housing Program”) was enacted in 1955 and governs limited-profit housing companies within the state of New York.⁴⁵ In response to the scarcity of affordable, safe, and sanitary housing, the Mitchell-Lama Housing Program serves to increase the development of adequate housing accommodations for low- and middle-income families.⁴⁶ Unlike traditional forms of public housing that are largely operated by government agencies and funded primarily by government financing, the Mitchell-Lama Housing Program seeks to foster cooperation between both the public and private sectors “through the most effective and economical concentration and coordination of Federal, State, local and private resources and efforts.”⁴⁷ Thus, the program is designed to encourage private enterprises to invest in housing companies that are subject to laws regulating their rents, profits, dividends and dispositions of property.⁴⁸

The Mitchell-Lama Housing Program’s collaborative efforts between government and private enterprises work through the city and state’s provision of low-interest and long-term mortgages to private housing companies that finance up to ninety-five percent of total development costs.⁴⁹ Additionally, under the Mitchell-Lama Housing Program, private developers also may receive certain real estate tax

⁴⁵ *Affordable No More*, *supra* note 19, at 5; *see also* N.Y. PRIV. HOUS. FIN. LAW § 10 (McKinney 2013).

⁴⁶ *See* N.Y. PRIV. HOUS. FIN. LAW § 11 (“[T]here exists in municipalities in this state a seriously inadequate supply of safe and sanitary dwelling or non-housekeeping accommodations for families and persons of low income . . . due, in large measure, to over-crowding and concentration of the population, improper planning, excessive land coverage, lack of proper light, air and space, improper sanitary facilities and inadequate protection from fire hazards.”); *Affordable No More*, *supra* note 19, at 5.

⁴⁷ N.Y. PRIV. HOUS. FIN. LAW § 11-a (“It is the purpose of this article to enable municipalities to undertake projects directly or in combination with the Federal government, private enterprise and any of the other responsible components of the community, to accomplish the public purposes herein described through the most effective and economical concentration and coordination of Federal, State, local and private resources and efforts.”).

⁴⁸ N.Y. PRIV. HOUS. FIN. LAW § 11 (“[R]equire that provision be made by which private free enterprise may be encouraged to invest in companies regulated by law as to rents, profits, dividends and disposition of their property or franchises and engaged in providing such housing facilities and other facilities incidental or appurtenant thereto for families or persons of low income.”).

⁴⁹ *Affordable No More*, *supra* note 19, at 5 (citing N.Y. PRIV. HOUS. FIN. LAW §§ 22(2), 23(1)).

exemptions depending on the municipality.⁵⁰ In exchange for these benefits, the government requires Mitchell-Lama projects to comply with guidelines that limit their profits, including rent regulations that set the minimum and maximum rent prices based upon a tenant's annual income rather than market rates.⁵¹

To ensure adherence to the Mitchell-Lama Housing Program guidelines and regulations, government agencies oversee the housing project's compliance. The type of government agency that conducts this supervision is dependent upon which type of loan is financed to the housing project. For example, the Department of Housing Preservation and Development ("HPD") supervises housing projects with New York City mortgages, whereas the Department of Housing and Community Renewal ("DHCR") supervises projects with state mortgages.⁵² The responsibilities of these agencies include collecting debt service payments on loans, setting rent prices, reviewing project expenditures, and generally enforcing regulations that govern their specific developments.⁵³ In addition, DHCR also publishes an Annual Report with the names of all of the current Mitchell-Lama housing projects and their original mortgage information, rent per unit, and number of dwelling units.⁵⁴

Along with stipulating the guidelines for participating in the program, the Mitchell-Lama Housing Program also provides instructions on how a housing project may exit the program. Although its original enactment included this procedure for withdrawal, the initial Mitchell-Lama housing statute prior to 1959 made exiting the program very difficult since mortgage pre-payments to effectuate a withdrawal were nearly impossible.⁵⁵ Before a Mitchell-Lama housing company could dissolve and withdraw from the program, it had to meet the following conditions: (1) receive approval from the state or municipal regulatory agency involved in its oversight; (2) ensure that

⁵⁰ N.Y. PRIV. HOUS. FIN. LAW § 33 ("Upon the consent of the local legislative body of any municipality in which a project is or is to be located, the real property in a project shall be exempt from local and municipal taxes, other than assessments for local improvements, to the extent of all or part of the value of the property included in such project which represents an increase over the assessed valuation of the real property, both land and improvements, acquired for the project at the time of its acquisition by the limited-profit housing company.").

⁵¹ Anderson & Franzese, *supra* note 22, at 87–88 (citing *Affordable No More*, *supra* note 19, at 5).

⁵² *Affordable No More*, *supra* note 19, at 5.

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ Sweet & Hack, *supra* note 21, at 123.

thirty-five years had passed since the occupancy date; and (3) repay to the municipality the total of all tax benefits that the project had received.⁵⁶ As a result, attempting to exit out of the Mitchell-Lama Housing Program prior to 1959 was complicated and potentially profitless.⁵⁷

Because the original scheme for the Mitchell-Lama Housing Program failed to create a significant number of affordable housing projects, the legislature reacted by providing further incentives to developers through the addition of an initial “buyout” provision.⁵⁸ Under this amendment, owners of Mitchell-Lama projects had “the option of dissolving the housing company on or after the fifteenth anniversary of the occupancy date.”⁵⁹ Additionally, a housing company no longer needed consent from its respective regulatory agency for dissolution, but still had to repay its government mortgage and surrender its future tax exemptions.⁶⁰ Even more enticing for developers was that the 1959 amendment waived repayment of the tax benefits previously received by the housing company.⁶¹ Subsequently, the legislature amended this buyout provision in 1960 to increase the minimum period before which a housing company may exit the program from fifteen to twenty years. It also extended this buyout privilege to projects with both municipal and state loans.⁶² Today, these amendments only encourage the recent trend in Mitchell-Lama housing dissolutions that is threatening the preservation of this type of affordable housing. Dissolution would not only yield high profits in light of the demand for more real estate space in New York City, but the actual process for dissolving is now easier.

B. Dissolution and Reconstitution

Section 35 of the PHFL governs the process for withdrawal from the Mitchell-Lama Housing Program (statutorily referred to as “dissolution”).⁶³ The current legislation, which includes the 1959 and 1960 amendments, effectuates dissolution by requiring developments with loans made prior to May 1, 1959 to abide by the original, stricter

⁵⁶ *Id.*

⁵⁷ *Id.*

⁵⁸ *Id.* at 124.

⁵⁹ *Id.*

⁶⁰ *Id.*

⁶¹ Sweet & Hack, *supra* note 21, at 124.

⁶² *Id.*

⁶³ N.Y. PRIV. HOUS. FIN. LAW § 35 (McKinney 2013).

dissolution process. This former dissolution process required the housing company to remain in the program for thirty-five years regardless of whether the original mortgage was paid in full.⁶⁴ Developments with loans made after May 1, 1959 may take advantage of the 1959 and 1960 amendments by opting to buyout of the program after twenty years from the occupancy date, assuming prepayment of the mortgage and all indebtedness.⁶⁵

Although § 35 of the PHFL no longer requires post-1959 developments to obtain formal “consent” from their respective supervising agencies in order to proceed with dissolution, state and city regulatory agencies have enacted procedures to oversee the dissolution process.⁶⁶ Procedurally, the housing development must provide a “notice of intent” one year in advance of dissolution to both its respective supervising agency and tenants⁶⁷ along with detailed information about the present and proposed future status of the development.⁶⁸ Subsequent to disseminating the notice of intent, submitting any required documentation to the agency, and receiving notice from the agency to proceed to the next step, the project owner(s) may hold a public information meeting.⁶⁹ The project owner must provide notice of the public meeting to both tenants and public officials, including state legislators who represent the district where the housing development is located.⁷⁰ Additionally, for the protection of tenants, regulations exist to govern applicable transitions into rent stabilization laws post-dissolution.⁷¹ As part of procedure, the local taxing authorities will also terminate tax exemptions upon dissolution, and the housing development owners must pay any fees owing under the program.⁷² The process concludes when the DHCR (or HPD)

⁶⁴ *Affordable No More*, *supra* note 19, at 6; N.Y. PRIV. HOUS. FIN. LAW § 35(1).

⁶⁵ *Affordable No More*, *supra* note 19, at 6; N.Y. PRIV. HOUS. FIN. LAW § 35(2).

⁶⁶ Sweet & Hack, *supra* note 21, at 126 (“In 1987, faced with the initial group of Mitchell-Lama buyouts, New York State and New York City issued regulations governing withdrawal from the program.”).

⁶⁷ *Affordable No More*, *supra* note 19, at 6 (citing N.Y.C.R.R. tit. 9 § 1750 (1988)); N.Y.C.R.R. tit. 28 § 3-14(i) (2012).

⁶⁸ Sweet & Hack, *supra* note 21, at 126.

⁶⁹ *Id.*

⁷⁰ *Id.*

⁷¹ *Id.* See also *Affordable No More*, *supra* note 19, at 6 (“If a housing project was occupied prior to January 1, 1974, upon its buy out buildings that were occupied on or after January 1, 1974 are not afforded any rental protections under the law and the units become market rate housing. Tenants, however, may receive federal assistance to cover increases if the developments originally received Federal Section 236 or Section 8 housing assistance.”).

⁷² Sweet & Hack, *supra* note 21, at 126.

issues a certificate to the Secretary of State that the housing development owner(s) satisfied all legal prerequisites and that the agency has “no objections” to the dissolution.⁷³ Despite these elaborate procedural barriers that may appear to be an obtainment of “consent” from the supervising agency, these procedures do not confer power to the regulatory agency to reject an application for dissolution if the development’s owner(s) meet the statutory requirements.⁷⁴

The basic process for dissolution applies to both rental and cooperative projects, but additional requirements exist for cooperative developments.⁷⁵ Unlike rental property, cooperatives function without a sole owner; rather, cooperatives operate similar to a corporation where the residents are both the tenants and the shareholder-owners of the housing company.⁷⁶ Therefore, the housing company must receive approval from its shareholders to expend money for preliminary steps toward dissolution, such as paying for a comparability study.⁷⁷ In addition, according to the New York Court of Appeals, the New York State Attorney General (“Attorney General”) has the authority to oversee these types of Mitchell-Lama conversions to ensure appropriate public disclosure and adherence to securities law, requiring the Mitchell-Lama cooperative to file an offering plan with the Attorney General if it is exercising its voluntary dissolution rights.⁷⁸ Finally, once the housing company has filed an offering plan which has been approved by both the Attorney General and its respective supervising agency, it must also hold a shareholder vote and receive a two-thirds majority to effectuate the corporate act of dissolution.⁷⁹

Apart from the procedural and statutory requirements for voluntary dissolution, Mitchell-Lama cooperatives that opt to exit from the program may become a privatized corporation in two ways. Traditionally, the old housing cooperative incorporated under the Mitchell-Lama Housing Program that wishes to become a private cooperative upon dissolution may transfer all its assets to a newly

⁷³ *Id.*

⁷⁴ *Id.*

⁷⁵ *Id.* at 127.

⁷⁶ DUKEMINIER ET AL., PROPERTY 898 (7th ed. 2010) (“In a housing cooperative, the title to the land and building is held by a corporation; the residents own all the shares of stock in the corporation and control it through an elected board of directors.”).

⁷⁷ Sweet & Hack, *supra* note 21, at 127 (citing NYCRR Tit. 9 § 1750.7-13(d)).

⁷⁸ *E. Midtown Plaza Hous. Co., Inc. v. Cuomo*, 981 N.E.2d 240, 244–45 (N.Y. 2012).

⁷⁹ Sweet & Hack, *supra* note 21, at 127 (citing NYCRR Tit. 9 § 1750.7-13(d)).

reconstituted for-profit cooperative.⁸⁰ Alternatively, Mitchell-Lama cooperatives are now attempting dissolution and reconstitution by simply amending their certificates of incorporation and removing all references to the PHFL.⁸¹ This amendment of the cooperative's certificate of incorporation is now being used to avoid paying real estate transfer taxes with housing companies, arguing that the transaction is not a "transfer or conveyance" of interests in real property.⁸² Because owners are using this method to avoid tax liability, this second option for privatization is now under scrutiny.

C. *East Midtown Plaza Housing Co. v. Cuomo: The Mitchell-Lama Dissolution (and Reconstitution) Process is an "Offer and Sale" under Securities Law*

East Midtown Plaza Housing Company ("East Midtown") was a Manhattan housing cooperative organized under the Mitchell-Lama Housing Program with 746 units spanning across six buildings.⁸³ East Midtown attempted to invoke its voluntary dissolution rights under PHFL § 35.⁸⁴ In 2004, East Midtown originally proposed to dissolve and privatize by transferring its assets to a newly-incorporated private cooperative with a formal issuance of new shares.⁸⁵ Because the housing cooperative held a shareholder vote for privatization prior to filing a cooperative offering plan with the Attorney General's office, both the Attorney General and the Department of Housing Preservation and Development (the cooperative's supervising agency)

⁸⁰ N.Y. PRIV. HOUS. FIN. LAW § 35(3) ("Upon such dissolution, title to the project may be conveyed in fee to the owner or owners of its capital stock or to any corporation designated by it or them for the purpose, or the company may be reconstituted pursuant to appropriate laws relating to the formation and conduct of corporations.").

⁸¹ See *E. Midtown Plaza Hous. Co.*, 981 N.E.2d at 243 ("Under the [2004] proposed privatization plan, East Midtown would dissolve and all its assets would be transferred to a newly incorporated private cooperative, accompanied by a formal issuance of new shares in the entity . . . Unlike the 2004 proposal, the 2008 plan did not contemplate a transfer of property or a physical exchange of shares. Rather, the privatization was to be effectuated by an amendment to East Midtown's certificate of incorporation.").

⁸² *Trump Vill. Section 3, Inc. v. City of New York*, 24 N.E.3d 1086, 1087 (N.Y. 2014) ("Plaintiff commenced this action seeking, among other things, a declaratory judgment that the RPTT is inapplicable because the tax applies only to transfers and conveyances of real property or economic interests in real property, from one entity to another, and not to plaintiff's exit from the Mitchell-Lama program as a result of a 'reconstitution.'").

⁸³ *E. Midtown Plaza Hous. Co.*, 981 N.E.2d at 242–43.

⁸⁴ *Id.*

⁸⁵ *Id.*

held the vote improper for failing to abide by dissolution procedures.⁸⁶ In 2008, after following the proper procedural sequence, the Attorney General accepted East Midtown's offering plan. Instead of dissolving and transferring shares to a new private cooperative, however, East Midtown revised its original proposal to effectuate privatization through amending its certificate of incorporation without requiring the physical exchange of shares.⁸⁷

The litigation arose because of the Attorney General's refusal to accept the amendment, not because East Midtown was attempting to privatize through amending its certificate of incorporation. East Midtown held a shareholder vote to pass the amendment using a "one-vote-per-share rule" rather than a "one-vote-per-household" formula as directed by its certificate of incorporation.⁸⁸ Therefore, East Midtown petitioned the court to compel the Attorney General to accept its amendment and to declare "that the Attorney General lacked jurisdiction over East Midtown's efforts to exit the Mitchell-Lama program on the theory that the Martin Act did not apply to the transaction."⁸⁹ Essentially, East Midtown asked the court to determine whether the Attorney General had jurisdiction to oversee Mitchell-Lama cooperative conversions by requiring the cooperative to file an offering plan with the Attorney General.⁹⁰ The government argued that the Attorney General has authority pursuant to the General Business Law Article 23 (the "Martin Act")⁹¹ which regulates the offer and sale of securities within or from New York.⁹²

The Martin Act requires that a person file an offering plan with

⁸⁶ *Id.*

⁸⁷ *Id.*

⁸⁸ *Id.* at 243–44.

⁸⁹ *E. Midtown Plaza Hous. Co.*, 981 N.E.2d at 244.

⁹⁰ *Id.* ("East Midtown argues that it should not have been required to file an offering plan because the Attorney General lacks authority over its withdrawal from the Mitchell-Lama program."). The secondary issue in this case involves whether a vote for dissolution by a Mitchell-Lama cooperative whose certificate of incorporation is expressly silent on the issue should be on a per share or a per apartment basis. *Id.* at 247.

⁹¹ *Id.* at 244 ("[H]owever it is packaged, the privatization of a Mitchell-Lama cooperative complex comfortably falls within the parameters of the Martin Act.").

⁹² *Kralik v. 239 E. 79th St. Owners Corp.*, 832 N.E.2d 707, 709 (2005) ("The Martin Act governs the offer and sale of securities in and from New York State, including securities representing 'participation interests' in cooperative apartment buildings. The Attorney General bears sole responsibility for implementing and enforcing the Martin Act, which grants both regulatory and remedial powers aimed at detecting, preventing and stopping fraudulent securities practices.").

the New York State Attorney General prior to making or participating in “a public offering or sale” of securities consisting of participation interests or investments in real estate.⁹³ Under the Martin Act, the Attorney General reviews cooperative apartments’ “disclosures required by General Business Law § 352-e for sufficiency” and investigates and initiates civil or criminal actions when fraud is suspected.⁹⁴ The purpose of these required disclosures is to safeguard the purchasers of cooperatives and condominiums.⁹⁵ East Midtown argued that the Martin Act does not apply to a Mitchell-Lama cooperative attempting to privatize upon dissolution by amending its certificate of incorporation, because the transaction does not involve an “offering or sale” of securities.⁹⁶

The New York Court of Appeals held that the Attorney General does have jurisdiction to govern the dissolution and privatization of a Mitchell-Lama cooperative pursuant to the Martin Act.⁹⁷ To arrive at this conclusion, the Court analyzed whether the act of amending a Mitchell-Lama cooperative’s certificate of incorporation as a means to privatize amounted to a “sale or offering” for the purposes of the Martin Act.⁹⁸ In its analysis, the Court looked to federal securities law for guidance, acknowledging that the Martin Act was drafted similarly to the federal securities acts of 1933 and 1934.⁹⁹ In support of its practice of referencing federal securities law and federal court decisions interpreting federal securities law, the Court of Appeals noted that the remedial purposes of the state and federal securities statutes are the same and that “the General Business Law § 352e–(1) (a) makes specific reference to the Federal Securities Act of 1933.”¹⁰⁰

With regard to federal securities law, federal courts have held that in certain situations altering the rights of shareholders of existing securities can constitute a “purchase or sale.”¹⁰¹ When determining

⁹³ *E. Midtown Plaza Hous. Co.*, 981 N.E.2d at 244 (citing GEN. BUS. LAW § 352-e).

⁹⁴ *Kralik*, 832 N.E.2d at 709.

⁹⁵ *Kerusa Co. LLC v. W10Z/515 Real Estate Ltd. P’ship*, 906 N.E.2d 1049, 879 (N.Y. 2009).

⁹⁶ *E. Midtown Plaza Hous. Co.*, 981 N.E.2d at 244.

⁹⁷ *Id.* at 244–46.

⁹⁸ *Id.* at 245.

⁹⁹ *Id.* (“Although the Martin Act was enacted in 1921, its present form generally tracks the Federal securities acts of 1933 and 1934. Accordingly, we have looked to Federal court decisions construing those statutes when interpreting our own.”) (quoting *People v. Landes*, 645 N.E.2d 716, 718 (N.Y. 1994)).

¹⁰⁰ *Id.* (internal quotation marks omitted) (quoting *State v. Rachmani Corp.*, 525 N.E.2d 704, 726 (N.Y. 1988) (citations omitted)).

¹⁰¹ *E. Midtown Plaza Hous. Co.*, 981 N.E.2d at 245.

whether a change in the rights of shareholders amounts to a “purchase or sale” of securities, federal courts generally consider the following factors: (1) “whether there has occurred such significant change in the nature of the investment or in the investment risks as to amount to a new investment;”¹⁰² and (2) what the economic reality of the transaction is and “whether it lends itself to fraud in the making of an investment decision.”¹⁰³ New York courts have similarly applied the federal courts’ analysis of placing emphasis on substance and economic reality over form when determining a sale or purchase of security.¹⁰⁴

In *East Midtown Plaza Housing Co. v. Cuomo*, the Court found that East Midtown’s act of amending its certificate of incorporation to remove itself from the Mitchell-Lama Housing Program would result in substantial changes to the nature of its shareholders’ interests.¹⁰⁵ After effectuating privatization, the tenant-shareholders would be able to sell their shares at market rate prices, whereas under the Mitchell-Lama program, the same shareholders would be limited to the not-for-profit resale price of shares under Mitchell-Lama law.¹⁰⁶ Tenant-shareholders no longer would be limited to selling their shares to purchasers who meet the qualifications of Mitchell-Lama’s income restrictions for tenants. Additionally, privatization would result in the loss of government subsidized financing and certain property tax exemptions and tax benefits.¹⁰⁷ Effectuating privatization may also result in potential increases to maintenance charges for each tenant-shareholder. Privatization would also enable the cooperative to impose a “flip tax” to be paid to the housing company from the proceeds of each subsequent sale of shares after dissolution.¹⁰⁸

In light of these changes in shareholders’ rights upon

¹⁰² *Gelles v. TDA Indus., Inc.*, 44 F.3d 102, 104 (2d Cir. 1994) (quoting *Abrahamson v. Fleschner*, 568 F.2d 862, 868 (2d Cir. 1977), *cert. denied*, 436 U.S. 905 (1978)) (internal quotations omitted).

¹⁰³ *E. Midtown Plaza Hous. Co.*, 981 N.E.2d at 245 (quoting THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION, § 12.6.[1] (2013)); *see also* *Rathborne v. Rathborne*, 683 F.2d 914, 920 (5th Cir. 1982) (“The crucial question is not whether the transaction fulfills the requisites of a common law sale; the core issue is whether the transaction has transformed the plaintiff into the functional equivalent of a purchaser or seller—has the plaintiff been forced to exchange his stock for shares representing a participation in a substantially different enterprise?”).

¹⁰⁴ *E. Midtown Plaza Hous. Co.*, 981 N.E.2d at 245.

¹⁰⁵ *Id.* at 246.

¹⁰⁶ *Id.*

¹⁰⁷ *Id.*

¹⁰⁸ *Id.*

privatization, the Court of Appeals correctly deduced that excluding this type of cooperative conversion from the ambit of the Martin Act would elevate form over substance.¹⁰⁹ The Court concluded that whether the housing company effectuates dissolution through a formal reconstitution and physical exchange of shares or through amending its certificate of incorporation, the economic realities of both transactions have the same results—“privatization and market value resale potential.”¹¹⁰ Therefore, to protect the public from any fraud in the “offering and sale” of securities,¹¹¹ the Attorney General properly has jurisdiction to require a Mitchell-Lama cooperative contemplating dissolution to file an offering plan pursuant to the Martin Act so shareholders can be informed when deciding the benefits and drawbacks of withdrawal from the Mitchell-Lama Housing Program.¹¹²

IV. MITCHELL-LAMA DISSOLUTION: TAX ISSUES PROMPTED BY *TRUMP VILLAGE SECTION 3, INC. v. CITY OF NEW YORK*

Similar to *East Midtown Plaza Housing Co. v. Cuomo*, where the Court had to determine whether the transaction of amending a Mitchell-Lama cooperative’s certificate of incorporation to dissolve and reconstitute was an offering and sale under securities law, the Court in *Trump Village Section 3, Inc. v. City of New York* also had to categorize the transaction under tax law. Trump Village Section 3, Inc. (“Trump Village”) consists of three, twenty-three-story buildings in Brooklyn that incorporated in 1961 under the Mitchell-Lama Housing Program.¹¹³ Like any typical Mitchell-Lama cooperative, Trump Village received a low interest mortgage loan from the government and real property tax exemptions but had to abide by the program’s restrictions on resale to third parties.¹¹⁴ Trump Village remained in the Mitchell-Lama Housing Program for approximately forty-five years and repaid

¹⁰⁹ *Id.*

¹¹⁰ *E. Midtown Plaza Hous. Co.*, 981 N.E.2d at 246.

¹¹¹ *Id.* at 245 (“We have emphasized that General Business Law § 352-e (1)(a) should be liberally construed to give effect to its remedial purpose of protecting the public from fraudulent exploitation in the offer and sale of securities”) (internal quotation marks omitted) (quoting *All Seasons Resorts v. Abrams*, 497 N.E.2d 33, 35 (N.Y. 1986)).

¹¹² *Id.* at 246.

¹¹³ *Trump Vill. Section 3, Inc. v. City of New York*, 974 N.Y.S.2d 469, 471 (N.Y. App. Div. 2013) *aff’d*, 24 N.E.3d 1086 (N.Y. 2014).

¹¹⁴ *Id.*

its governmental mortgage loan on October 15, 2005.¹¹⁵ In 2007, with the permission of the State of New York and upon receiving the necessary shareholders' vote, Trump Village elected to exit out of the Mitchell-Lama Program pursuant to § 35 of the PHFL, reconstituting itself as a private corporation under the New York Business Corporation Law¹¹⁶ through amending its certificate of incorporation.¹¹⁷ Trump Village removed language referencing the PHFL from its stock certificates and bylaws, exchanging old stock certificates for new ones without altering the number of shares.¹¹⁸ The housing company kept its original name, number of and names of its shareholders, and its tax identification number.¹¹⁹ After Trump Village terminated its participation in the Mitchell-Lama Housing Program, the New York City Department of Finance ("City Department") issued a tax deficiency notice to Trump Village in the amount of \$21,149,592.50 with interest and penalties for failing to pay a real property transfer tax (hereinafter "RPTT") pursuant to New York State Tax Law § 1201(b) and Administrative Code of the City of New York § 11-2102(a).¹²⁰

The issue in this case hinged on the interpretation of New York City's tax law, determining whether amending a Mitchell-Lama cooperative's certificate of incorporation to effectuate privatization constitutes a taxable transfer or conveyance for the purposes of Administrative Code of the City of New York § 11-2102(a), a city tax empowered by New York State Tax Law § 1201(b).¹²¹ Generally and with qualifications, Administrative Code of the City of New York § 11-2102(a) imposes a tax "on each deed at the time of delivery by a grantor to a grantee when the consideration for the real property and any improvement thereon (whether or not included in the same deed) exceed twenty-five thousand dollars."¹²² The tax is applicable to conveyances of real property exceeding \$25,000.¹²³ While Trump

¹¹⁵ *Id.* at 472.

¹¹⁶ The New York Business Law governs the formation and dissolution of private corporations. N.Y. BUS. CORP. § 201 (McKinney 2013) ("A corporation may be formed under this chapter for any lawful business purpose or purposes except to do in this state any business for which formation is permitted under any other statute of this state unless such statute permits formation under this chapter.")

¹¹⁷ *Trump Vill. Section 3, Inc.*, 974 N.Y.S.2d at 472.

¹¹⁸ *Id.*

¹¹⁹ *Id.*

¹²⁰ *Id.*

¹²¹ *Id.*

¹²² Administrative Code of the City of New York § 11-2102(a).

¹²³ *Id.*

Village argued that reconstitution under the Mitchell-Lama Housing Program is not a conveyance of real property,¹²⁴ the City Department considered the transaction a conveyance of underlying real property between the “old” Mitchell-Lama cooperative to the “new” private cooperative with the certificate of incorporation acting as the deed for the transfer.¹²⁵

The New York Supreme Court “awarded summary judgment to the City defendants declaring that Trump Village’s actions constituted a ‘transfer’ and a ‘conveyance’ of real property, and that Trump Village was subject to the RPTT.”¹²⁶ The plaintiff, however, appealed to the appellate division, which reversed the lower court’s decision. The appellate division agreed with Trump Village and found that Trump Village “did not transfer or convey real property or an interest in real property within the meaning of New York State Tax Law § 1201 (b) and Administrative Code of City of New York § 11-2102(a),” holding that the housing company essentially remained the same entity except for the removal of some restrictions.¹²⁷ Alternatively, the appellate division also noted that an exception under § 11-2106(b)(8) of the city’s tax code that imposes the RPTT specifically to transfers of land and buildings to a cooperative housing corporation, even if the transactions merely effect a change in ownership, was inapplicable.¹²⁸ It found the exception irrelevant by concluding that § 11-2102(a) did not apply on its face to a housing cooperative terminating its participation in the Mitchell-Lama Housing Program.¹²⁹ The City Department appealed the case to the New York Court of Appeals, and

¹²⁴ Trump Vill. Section 3, Inc. v. City of New York, 974 N.Y.S.2d 469, 472 (N.Y. App. Div. 2013) *aff’d*, 24 N.E.3d 1086 (N.Y. 2014).

¹²⁵ *Id.* at 474 (“Here, the City defendants essentially contend that, by voluntarily dissolving and subsequently reconstituting, Trump Village became a new corporation and that, accordingly, the amended certificate of incorporation constituted a deed. Thus, they conclude that the purported deed was delivered at the time of execution, and that the purported deed was delivered by an ‘old’ Trump Village to a ‘new’ Trump Village.”).

¹²⁶ *Id.* at 472–73.

¹²⁷ *Id.* at 475.

¹²⁸ *Id.* (“[T]he City defendants cannot establish the applicability of the RPTT by reference to a statutory exemption which would only be relevant if the tax were applicable in the first instance”) (citing *Matter of Grace v. New York State Tax Comm.*, 332 N.E.2d 886 (N.Y. 1975)).

¹²⁹ *Id.*

the Court affirmed the appellate division's decision.¹³⁰

V. THE NEW YORK COURT OF APPEALS GOT IT WRONG IN *TRUMP VILLAGE SECTION 3, INC.*

A. *The Decision in Trump Village Section 3, Inc. Elevates Form over Substance*

Although confronted with the same transaction, the Court of Appeals in *East Midtown Plaza Housing Co.* categorized the voluntary dissolution of a Mitchell-Lama cooperative as an “offering and sale,” an essential transfer under securities law.¹³¹ In contrast, the Court in *Trump Village Section 3, Inc.* did not categorize the same method of dissolution and privatization as a “transfer” for the purposes of assessing real estate transfer taxes.¹³² In fact, the Court in *Trump Village Section 3, Inc.* glossed over the relevance of the fairly recent decision in *East Midtown Plaza Housing Co.* While the Court explicitly recognized that “[t]he [prior] decision addressed the impact of privatization on shareholders and focused on the rights of the shareholders, and *the substantial changes in the nature of their interests*,” the Court dismissed the significance of its only precedent regarding Mitchell-Lama dissolutions.¹³³ With one conclusory statement and without a developed discussion of why its prior decision was not controlling, the Court simply stated that “[*East Midtown Plaza Housing Co.*] lends no support for defendants’ imposition of an RPTT where there has been a Mitchell-Lama privatization.”¹³⁴ The Court failed to consider, however, that its reasoning in *East Midtown Plaza Housing Co.* for how the dissolution of Mitchell-Lama housing affects and changes the substantial rights of its shareholders directly supports reversing the appellate division in *Trump Village Section 3, Inc. v. City of New York*.¹³⁵ Amending one’s certificate of incorporation to dissolve a Mitchell-Lama housing company is a valid transfer that triggers real property transfer taxes, considering the significant changes in ownership rights and in the nature of the property.

Moreover, analysis of the relevant tax laws at issue in *Trump Village*

¹³⁰ *Trump Vill. Section 3, Inc. v. City of New York*, 24 N.E.3d 1086, 1087 (N.Y. 2014).

¹³¹ *E. Midtown Plaza Hous. Co., Inc. v. Cuomo*, 981 N.E.2d 240, 246 (N.Y. 2012).

¹³² *Compare E. Midtown Plaza Hous. Co.*, 981 N.E.2d at 240, *with Trump Vill. Section 3, Inc.*, 24 N.E.3d at 1086.

¹³³ *Trump Village Section 3, Inc.*, 24 N.E.3d at 1089 (emphasis added).

¹³⁴ *Id.*

¹³⁵ *See E. Midtown Plaza Hous. Co.*, 981 N.E.2d at 246.

Section 3, Inc. demonstrates that the voluntary dissolution of a Mitchell-Lama cooperative through amending its certificate of incorporation is a taxable transfer contemplated by both the New York State and New York City tax laws. The relevant statute discussed in *Trump Village Section 3, Inc.* is § 1201 of the New York State tax law, which gives New York City authority to promulgate tax codes, including Administrative Code of the City of New York § 11-2102.¹³⁶ The appellate division in *Trump Village Section 3, Inc.* noted that New York City only argued for the imposition of the city RPTT on the basis of part (a) of § 11-2102 and never reached the merits of whether a voluntary dissolution of a Mitchell-Lama cooperative is considered a taxable transfer under part (b) or part (c) of the city's tax code.¹³⁷ Generally, § 11-2102(a) requires imposition of a tax on "each deed at the time of delivery by a grantor to a grantee when the consideration for the real property and any improvement thereon (whether or not included in the same deed) exceed twenty-five thousand dollars."¹³⁸ The subsequent subsections of part (a) provide the details as to how the tax is applied and at what rates, but the Court of Appeals in *Trump Village Section 3, Inc.* was only concerned about whether or not the tax should be imposed upon a particular kind of Mitchell-Lama cooperative's voluntary dissolution.¹³⁹ To understand the different components of § 11-2102(a), the administrative code provides definitions for significant terms used in subsequent sections of the city's tax law. For example, the relevant term "deed" is defined as:

Any document or writing (other than a will), regardless of where made, executed or delivered, whereby any real property or interest therein is created, vested, granted, bargained, sold, transferred, assigned or otherwise conveyed, including any such document or writing whereby any

¹³⁶ N.Y. TAX § 1201 (McKinney 2013) ("[A]ny city in this state having a population of one million or more, acting through its local legislative body, is hereby authorized and empowered to adopt and amend local laws imposing in any such city any or all of the types of taxes set forth in the following subdivisions of this section, such taxes to be administered and collected by the fiscal officers of such city.").

¹³⁷ *Trump Vill. Section 3, Inc. v. City of New York*, 974 N.Y.S.2d 469, 475 n.1 (N.Y. App. Div. 2013) *aff'd*, 24 N.E.3d 1086 (N.Y. 2014).

¹³⁸ ADMIN. CODE OF THE CITY OF N.Y. § 11-2102(a).

¹³⁹ *Trump Vill. Section 3, Inc. v. City of New York*, 24 N.E.3d 1086 (N.Y. 2014) ("We are presented with the following question: Does a taxable transfer pursuant to Tax Law § 1201 (b) and section 11-2102 (a) of the Administrative Code of the City of New York occur when a residential housing cooperative corporation terminates its participation in the Mitchell-Lama program and amends its certificate of incorporation as part of its voluntary dissolution and reconstitution as a cooperative corporation governed by the Business Corporation Law?").

leasehold interest in real property is granted, assigned or surrendered.¹⁴⁰

For the purposes of a Mitchell-Lama cooperative dissolution, the deed in the transaction is manifested in the certificate of incorporation. By amending the certificate of incorporation, the cooperative, in writing, is able to transfer, grant, or assign the real property—the cooperative building and possibly the land underneath it—from the old affordable housing cooperative under the Mitchell-Lama Housing Program to the new private housing cooperative that will be incorporated under the state’s Business Corporation Law. The notion of a “deed” for the relevant city tax law is loosely defined to contemplate other written documents that effectively provide the mode for transferring real property interests, demonstrating an emphasis on substance over form.

Another pertinent definition for understanding § 11-2102(a) is the meaning of the term “economic interest in real property,” which the code defines as including “the ownership of shares of stock in a corporation which owns real property.”¹⁴¹ In both *East Midtown Plaza Housing Co.* and *Trump Village Section 3, Inc.*, there was no dispute among the parties that the shareholders of a Mitchell-Lama cooperative hold economic interests in real property. Like shareholders in traditional private cooperatives, the tenant-owners of a Mitchell-Lama cooperative each hold shares within the housing company and have rights to the real property where the tenant-shareholders reside.¹⁴²

The Court of Appeals in *Trump Village Section 3, Inc.* also did not directly address the administrative code’s § 11-2106(b) exemption. It agreed with the appellate division, articulating that because § 11-2102(a) does not apply on its face, the exemption “only applies where there has been a conveyance in the first place, and thus, because there was no conveyance, the exemptions and the exceptions to those exemptions are not relevant.”¹⁴³ Nevertheless, the Court in reaching its conclusion still echoed the language and concerns of § 11-2106(b) even if it stated that the exemption was irrelevant. The Court

¹⁴⁰ ADMIN. CODE OF THE CITY OF N.Y. § 11-2101(2).

¹⁴¹ *Id.* § 11-2101(6).

¹⁴² NYC Administrative Code § 11-2101 (defining real property as “[e]very estate or right, legal or equitable, present or future, vested or contingent, in lands, tenements or hereditaments, which are located in whole or in part within the city of New York”).

¹⁴³ *Trump Village Section 3, Inc.*, 24 N.E.3d at 1089.

addressed whether or not Trump Village became a new corporation,¹⁴⁴ which is relevant because under the § 11-2106 exemption the tax imposed by this code shall not apply to:

A deed, instrument or transaction conveying or transferring real property or an economic interest therein that *effects a mere change of identity or form of ownership or organization* to the extent the beneficial ownership of such real property or economic interest therein remains the same, *other than a conveyance to a cooperative housing corporation of the land and building or buildings comprising the cooperative dwelling or dwellings.*¹⁴⁵

Not only did the Court find that the city's transfer tax did not apply, but the Court supported its conclusion by reasoning that Trump Village remained the same entity. Yet, the § 11-2106 exemption applies specifically to transactions where the ownership or organization of the real property or economic interest effectively remains the same. Therefore, by providing a carve out for instances where an organization reorganizes through a mere change in identity, the legislature qualitatively recognized that these types of transactions would normally fall within the ambit of this tax code as written, but for the inclusion of this exemption.

The Court in *Trump Village Section 3, Inc.* incorrectly dismissed the relevance of the § 11-2106(b)(8) exemption. The legislature would not have explicitly addressed the kinds of transactions that result in the ownership or organization remaining the same if these types of transfers would not otherwise fall with § 11-2102 in the first instance. Therefore, not only does § 11-2102 apply to Mitchell-Lama cooperative conversions to for-profit entities, but the method of conveyance at issue in *Trump Village Section 3, Inc.* is described specifically by the legislature in § 11-2106(b)(8).

Although § 11-2106(b)(8) functions to waive the RPTT for certain transactions, dissolution and reconstitution of a Mitchell-Lama cooperative through an amendment of its certificate of incorporation is excluded from the § 11-2106(b)(8) waiver in two ways. Most conspicuously, the statute explicitly provides a caveat that bars conveyances to cooperative housing corporations of real property comprising a cooperative dwelling from being exempt from the

¹⁴⁴ *Id.* at *4-6. ("We first address defendants' argument that Trump Village became an entirely new corporation.").

¹⁴⁵ Administrative Code of the City of NY § 11-2106(b)(8) (emphasis added).

RPTT.¹⁴⁶ Here, the transfer of economic interest in real property is between the old Mitchell-Lama cooperative and the newly reincorporated private cooperatives. The plain text of § 11-2106(b)(8) alone already limits the waiver of RPTT from extending to conveyances to cooperative dwelling units.

Alternatively, the § 11-2106(b)(8) exemption may not even apply as an initial matter because the transaction involves a corporation significantly changing the substance of its ownership, organization, and operation so as to create a new corporation. As the Court of Appeals reiterated in *East Midtown Plaza Housing Co.*, the dissolution process for a Mitchell-Lama cooperative involves a substantive change of rights and interests of the shareholders, not just a mere change in identity or ownership.¹⁴⁷ Therefore, assuming that § 11-2102 on its face applies since Mitchell-Lama conversions are conveyances of real property through amendments to their certificate of incorporations (effectively deeds) for amounts over the statutory requirement, the transaction may be characterized as beyond mere changes in ownership. Thus, these cooperatives which are attempting to privatize would not be exempt from paying RPTT under § 11-2106(b)(8).

The Court in *Trump Village Section 3, Inc.* failed to recognize that amending one's certificate of incorporation to remove references to the PHFL and placing the prior Mitchell-Lama housing company within the purview of the Business Corporation Law is not just a mere technical change in form. The once affordable housing company that functioned under the restrictions, protections, and benefits of the Mitchell-Lama housing program will dissolve and cease to exist. As a result, the newly reorganized housing company will be subject to the private housing market without supervision from government agencies like the Department of Housing and Community Renewal or the Housing Preservation Department.

Nevertheless, the Court in *Trump Village Section 3, Inc.* ignored the substantial changes that shareholders of a Mitchell-Lama housing company endure after privatization. It simply noted that reincorporation "cannot be deemed the formation of a new corporation, but should be regarded as the continuation of the existing one."¹⁴⁸ In support of this conclusion, the Court improperly

¹⁴⁶ *Id.*

¹⁴⁷ *E. Midtown Plaza Hous. Co., Inc. v. Cuomo*, 981 N.E.2d 240, 246 (N.Y. 2012).

¹⁴⁸ *Trump Vill. Section 3, Inc. v. City of New York*, 24 N.E.3d 1086, 1089 (N.Y. 2014) (citing *People ex rel. Consol. Kansas City Smelting & Ref. Co. v. Secretary of State*, 13 A.D. 50, 51 (N.Y. App. Div. 1897)).

relied on *People ex rel. Consol. Kansas City Smelting & Ref. Co. v. Secretary of State*, a case from 1857 involving an already private corporation (not even a housing corporation) that amended its certificate of incorporation to proceed under the Business Corporation Law. This case, however, is distinguishable because it involves an already existing private company that was once incorporated under the Manufacturing Act of 1848 but had decided to amend its certificate of incorporation so that it may be organized under the Business Corporation Law.¹⁴⁹

With the dissolution of a Mitchell-Lama housing company, the change in substantial ownership rights is much more significant than substituting reference to one act over another. Amending its certificate of incorporation to remove references to the PHFL is akin to the other available dissolution option where the housing company formally transfers its assets to a newly-incorporated private cooperative with a formal issuance of new shares.¹⁵⁰ The economic reality of the Mitchell-Lama cooperative transforms to the point that tenant rents are affected, the value of shareholders' units increase dramatically, and future tenant-purchasers will no longer be subjected to income restrictions.¹⁵¹ Contrary to the Court's interpretation in *Trump Village Section 3, Inc.*, the prior Mitchell-Lama affordable housing company does not continue after privatization. It dissolves completely. The housing cooperative that reemerges from this process is wholly private and subject to market rates. Thus, the change from a quasi-public housing company to a purely private housing company is a significant and substantive shift beyond mere formalities, necessitating the payment of the relevant real property transfer taxes.

B. Analogies between New York City and the State's Real Estate Transfer Tax

Tax legislation should be applied in a way that gives effect to the economic substance of a transaction.¹⁵² To understand the full extent and appropriate implementation of tax legislation, courts should be cognizant of its legislative history. For example, Administrative Code of the City of NY § 11-2102 mirrors New York State Tax Law § 1402(a), which states that a real estate transfer tax is "imposed on each

¹⁴⁹ See generally *People ex rel. Consol. Kan. City Smelting & Ref. Co. v. Sec'y of State*, 13 A.D. 50 (N.Y. App. Div. 1897).

¹⁵⁰ See generally discussion *supra* Part C.

¹⁵¹ *Id.*

¹⁵² 595 *Investors Ltd. P'ship v. Biderman*, 531 N.Y.S.2d 714, 717 (N.Y. Sup. Ct. 1988).

conveyance of real property or interest therein when the consideration exceeds five hundred dollars, at the rate of two dollars for each five hundred dollars or fractional part thereof.”¹⁵³ The state tax law describes conveyance as:

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[.]¹⁵⁴

Again, the definition of “transfer” for the purposes of the state real property tax does not exclude the transaction involved when a Mitchell-Lama cooperative amends its certificate of incorporation to effectuate dissolution and privatization. Like the New York City administrative code, the state tax statute also has an exemption to its real estate transfer tax (RETT) similar to Administrative Code of the City of NY § 11-2106(b). The New York State Tax Law § 1405(b)(6) provides that the state RETT does not apply when the conveyance “effectuates a mere change of identity or form of ownership or organization where there is no change in beneficial ownership.”¹⁵⁵ Like the New York City code, the state tax law contemplates transactions where an entity reorganizes and provides an exemption to the tax law for those instances. For example, the New York State Tax Appeals Tribunal held that § 1405(b)(6) did not apply to a merger of CBS Corporation and Viacom, Inc.¹⁵⁶ Like *Trump Village Section 3, Inc.*, the merger involved a restatement in Viacom’s certificate of incorporation, but no issuance of “new” stock.¹⁵⁷ The Tribunal held that the merger “resulted in a taxable conveyance of an interest in real property by CBS to Viacom.”¹⁵⁸ In reaching this conclusion, the administrative law judge noted that the exemption under § 1405(b)(6) only applied where there was no change in “beneficial ownership” and

¹⁵³ N.Y. STATE TAX LAW § 1402(a). Similar to Administrative Code of the City of NY § 11-2102, this real property transfer tax contemplates a monetary threshold in order to apply to the transaction.

¹⁵⁴ N.Y. STATE TAX LAW § 1401(e).

¹⁵⁵ N.Y. STATE TAX LAW § 1405(b)(6).

¹⁵⁶ Maria T. Jones and Melissa S. Blades, *2006-2007 Survey of New York Law: Article: State and Local Taxation*, 58 SYRACUSE L. REV. 1133, 1140 (2008) (citing *In re Viacom, Inc.*, 5 N.Y. Tax Rep. (CCH) ¶ 405-723, at 45,607, 45,610 (N.Y.S. Tax App. Trib. May 3, 2007)).

¹⁵⁷ *Id.* at 1141.

¹⁵⁸ *Id.*

where “beneficial ownership” is something more than a mere financial interest, articulating that “beneficial ownership” was marked by “dominion and control over the property.”¹⁵⁹

In applying the statutory interpretation of the Viacom case to a Mitchell-Lama cooperative attempting dissolution, a change in “dominion and control over the property” is evident. Most significantly, after dissolution, the shareholders will be able to control the selling price of the unit. In addition, shareholders will also be free from the restriction imposed by the Mitchell-Lama program of conveying their units to only buyers within certain income ranges. The housing corporation will also have control over the ability to impose “flip taxes” on sales subsequent to dissolution in order to raise revenue for the cooperative. If the state collects tax revenue from RETT upon dissolution of a Mitchell-Lama cooperative, then New York City should not be barred from receiving this revenue when the city code and the state tax law are nearly identical in language and function.

To support the contention that the New York State real property transfer tax is applicable to a Mitchell-Lama cooperative effectuating dissolution through amending its certificate of incorporation, the New York State Department of Taxation and Finance (the “Department”) released an advisory opinion on the issue.¹⁶⁰ The advisory opinion confronted the same transaction before the Court in *Trump Village, Section 3, Inc.* where a property located in New York City, organized under the Mitchell-Lama Housing Program, and supervised by a government agency, DHCR, attempted to dissolve and privatize through amending its certificate of incorporation.¹⁶¹ The Department concluded that “the conversion of the not-for-profit housing company (PHFL company) to a private cooperative housing corporation (BCL corporation) constitutes a conveyance . . . of the real property comprising the cooperative dwelling, subject to the [state real estate transfer tax].”¹⁶²

The Department also addressed similar concerns that the Court in *Trump Village Section 3, Inc.* considered—namely, whether the transaction constituted a transfer or conveyance of real property and whether the transaction fell into the exemption with the tax law with

¹⁵⁹ *Id.*

¹⁶⁰ See N.Y. State Comm’r of Taxation & Fin., Advisory Op. TSB-A-10(2)(R), available at http://www.tax.ny.gov/pdf/advisory_opinions/real_estate/a10_2r.pdf.

¹⁶¹ *Id.*

¹⁶² *Id.*

regard to change in ownership.¹⁶³ The Department recognized that while the transfer of ownership of real property may not be the conventional method, dissolution of the non-for-profit housing cooperative must still occur in order to remove the restrictions imposed by the Mitchell-Lama Housing Program.¹⁶⁴ Unlike the Court in *Trump Village Section 3, Inc.*, which did not find removal of these limitations significant (considering it failed to even discuss them),¹⁶⁵ the Department noted that the dissolution and privatization would result in a “substantive change in the nature of the ownership of the entity that owns the property,” affecting the benefits and restrictions of the appurtenant shares.¹⁶⁶

Both state and city real estate transfer tax statutes also allude to the need for “consideration” as part of the transfer of real property which would implicate these taxes.¹⁶⁷ Although not addressed by the Court in *Trump Village Section 3, Inc.*, the Department had no issue in finding consideration in these types of transactions, referring to consideration as the “amount of cash received by the Sponsor; the amount of any mortgages, liens, or encumbrances on the real property; and the fair market value of the shares in the cooperative housing corporation after reconstitution.”¹⁶⁸ In analyzing how the state real estate transfer tax is implicated upon this transaction, the Department first recognized that the significant changes in rights by the shareholders regarding ownership of the cooperative dwelling

¹⁶³ *Id.*

¹⁶⁴ *Id.*

¹⁶⁵ *Trump Vill. Section 3, Inc. v. City of New York*, 24 N.E.3d 1086, 1088 (N.Y. 2014) (“While defendants assert that a new corporation must have been formed because Trump Village had to ‘dissolve’ under the PHFL before ‘reconstituting’ as a corporation no longer governed by the restrictions of the PHFL, the corporation in the amended certificate of incorporation, Trump Village Section 3, Inc., is the same corporation that was named in the original certificate of incorporation.”); *see also* *Trump Vill. Section 3, Inc. v. City of New York*, 974 N.Y.S.2d 469, 474–75 (N.Y. App. Div. 2013) *aff’d*, 24 N.E.3d 1086 (N.Y. 2014) (“Upon amending its certificate of incorporation, Trump Village remained the same entity, although it was relieved of various restrictions previously imposed upon it by the Mitchell-Lama housing program.”).

¹⁶⁶ N.Y. State Comm’r of Taxation & Fin., *supra* note 160.

¹⁶⁷ Compare Administrative Code of the City of NY § 11-2102(a) (“tax is hereby imposed on each deed at the time of delivery by a grantor to a grantee when the *consideration* for the real property . . .”) (emphasis added) with N.Y. CLS TAX § 1402 (“A tax is hereby imposed on each conveyance of real property or interest therein when the *consideration* exceeds five hundred dollars . . .”) (emphasis added).

¹⁶⁸ N.Y. State Comm’r of Taxation & Fin., *supra* note 160.

already implicate the state real estate transfer tax on its face. Nevertheless, like the city tax law, the state transfer tax also has an exemption for transactions that effectuate mere changes in identity. Here, the Department held that amending its certificate of incorporation was a mere change in ownership or organization, especially because the percentage of shares in the old cooperative would remain for the new cooperative. Like the city tax law, however, the state exemption to RETT has a caveat for “conveyances to a cooperative housing corporation of real property comprising the cooperative dwellings.”¹⁶⁹ Hence, the transaction falls within the purview of this state tax statute, and its special exemption for mere changes in ownership does not apply.

The legislative history of § 1201—which authorizes New York City’s ability to impose the real estate transfer tax—also supports the contention that tax statutes like Administrative Code of the City of New York § 11-2102 were intended to close gaps and loopholes in real property transfer taxes by “permitting the taxation of transfers of controlling interest in corporations . . . which own real property.”¹⁷⁰ Allowing a Mitchell-Lama cooperative to take advantage of a loophole by avoiding an otherwise applicable transfer tax due to the method of how the cooperative dissolves and privatizes would be contrary to the purpose for these types of transfer taxes. Section 1201 was amended to include real property “transfers of controlling economic interest in real property,” recognizing that it is common to convey property without having it reflected in a traditional “deed.”¹⁷¹ Both the legislative history of § 1201 and the analysis of the Department regarding § 1405(b)(6) in ruling that these types of Mitchell-Lama dissolutions are subject to the state RETT manifest the purpose of these tax statutes, which is to give effect to the “substance of the transaction rather than legal form.”¹⁷²

VII. CONCLUSION

The New York Court of Appeals ignored its own precedent and issued a misguided decision in *Trump Village Section 3, Inc.* The Court in *East Midtown Plaza Housing Co.* had already ruled that amending a Mitchell-Lama cooperative’s certificate of incorporation to remove references to the Private Housing Finance Law is considered an

¹⁶⁹ *Id.*

¹⁷⁰ 1981 N.Y. Sess. Laws 2636–37(McKinney); 1981 NY Legis. Ann., at 481.

¹⁷¹ 1981 N.Y. Sess. Laws 2636–37(McKinney).

¹⁷² *Id.*

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“offering or sale” for the purposes of securities law. Rather than remain consistent and provide uniformity among laws regarding these same types of conversions, the Court of Appeals distinguished *East Midtown Plaza Housing Co.* in a cursory fashion. The Court was persuaded that the housing company named in the amended certificate of incorporation was the same named company in the original Mitchell-Lama certificate of incorporation, despite its transformation into a completely private entity that would no longer be subject to any of the Mitchell-Lama housing regulations. Thus, the Court in *Trump Village Section 3, Inc.* concluded that this method of effectuating dissolution and privatization by a Mitchell-Lama cooperative is not a “transfer” pursuant to city and state tax laws. Analysis of New York City’s relevant real property transfer tax, however, demonstrates that this dissolution method is a transfer of a real property interest subject to real property transfer tax obligations. Additionally, both the state and local real estate tax laws contemplate transfers of property ownership or controlling interest through reorganization within the plain reading of the tax codes. Further, because New York City’s tax law is based on the state’s tax law, the legislative history behind the state’s tax statute reveals the purpose of these types of transfer taxes. A recent advisory opinion held that the state real estate transfer tax applies to a Mitchell-Lama cooperative seeking privatization through amending its certificate of incorporation. Therefore, New York City’s similar transfer tax should also apply to the same transaction.

Moreover, public policy concerns over preserving affordable housing stock in New York City supported the reversal of the appellate division in *Trump Village Section 3, Inc.*; yet, the Court of Appeals affirmed without considering the implications of its decision. Allowing these housing companies to gain the benefit of being exempted from real property transfer taxes both in the initial formation of the Mitchell-Lama housing and now in exiting the program would only provide more incentives for these cooperatives to privatize. Considering the present affordable housing crisis in New York City, the judiciary should have given effect to the purposes of these tax statutes. Generally, these real estate transfer taxes are more lenient on housing companies attempting to become affordable housing stock—to encourage the development of much needed affordable housing units. The state and local legislatures did not intend to forgo these transfer tax revenues for housing entities attempting to gain a profit by converting out of affordable housing programs to become private market rate housing. This recent decision in *Trump Village Section 3,*

Inc. incentivizes the dissolution of low- and middle-income housing by allowing these entities to take advantage of tax waivers intended to promote the creation of affordable housing. The only option left for preserving current Mitchell-Lama housing is through legislative action that would explicitly require all Mitchell-Lama housing cooperatives that are leaving the affordable housing program to pay the proper transfer taxes, regardless of how the cooperative attempts to effectuate dissolution. Otherwise, New York City risks further depletion of this critical affordable housing stock.