THE MORTGAGE OBSERVER

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Stein's Law

How New York State Shoots Itself in the Foot on Revolving Mortgage Loans

A multistate developer wanted to set up a credit line secured by mortgages on a few available properties, one in New York City. Knowing from experience that New York State had a mortgage recording tax, the developer resigned itself to paying that tax as the price of using New York property as collateral. The developer reluctantly prepared to write a five-digit check to support New York's various governments.

Then the developer started to move toward a closing. Someone saw the word "revolving" in the developer's credit line agreement. The loan documents allowed the developer to borrow on the credit line, repay and then borrow again to meet the developer's cash needs. The developer soon learned that this meant it would, in theory, owe a mortgage recording tax both for the initial closing and borrowing of the loan, and then again every time it repaid and borrowed. The state tax officials take the position that once any mortgage loan has been repaid, even temporarily, any additional borrowing of that loan incurs another tax.

Joshua Stein

Unfortunately, the developer contemplated using its secured credit line just like any other revolving credit line. The developer would borrow and repay multiple times over the course of a year. If this required the developer to pay a tax every time, then payment of the tax would dwarf all other borrowing costs. The tax amounts to 2.8 percent of each borrowing. The tax would simply make it impossible for the developer to use the credit line.

Given the business deal with the developer's lender, someone suggested that the developer could limit the New York piece of the revolving loan so it falls within a $3 million "safe harbor" in the New York tax law. That's a special provision that says revolving loans below $3 million don't incur multiple taxes with each repayment followed by another borrowing.

If a revolving loan as a whole amounts to $3 million or more, though, then the safe harbor won't apply even if the New York mortgage secures only some smaller piece of the loan. The New York collateral needs to secure the entire loan, which

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must be less than $3 million. Moreover, as a price of qualifying for the safe harbor, the borrower must, in practice, pay off and release the mortgage when the borrower sells the property, losing the opportunity to deliver to the buyer a tax-paid mortgage, for which the buyer may pay a little extra at closing. Other technical restrictions on availability of the safe harbor also made it difficult for the developer to use.

Before long, the developer threw up its hands, and decided not to record a New York mortgage at all. It just cost too much and created too many problems to have New York real property secure a revolving loan. So, instead of writing a five-digit check to pay mortgage recording tax, the developer saved some money. And the New York taxing authorities received zero instead of the check for mortgage recording tax the developer would have reluctantly paid if New York accommodated revolving mortgage loans.

This all happened because New York law and tax officials cling to a hyper-technical interpretation of the mortgage recording tax. They insist that any repayment and additional borrowing of a mortgage loan incurs a new tax. In practice, that means New York real property can't secure revolving loans, because no sane borrower will pay another 2.8 percent tax every time it borrows again. And, as a result, New York effectively turns down whatever mortgage recording tax payments the state could collect if the mortgage recording tax accommodated revolving loans.

As the easiest way to accommodate revolving loans—i.e., to make it practical to use New York real estate to secure them—the state could expand the safe harbor so it applies to all revolving loans. Ideally the state could also cut away some of the technical issues that limit the practical usefulness of the safe harbor. The state could, in effect, say that if a loan is in fact a revolving loan, then it only incurs mortgage recording tax once, not multiple times.

New York State must think that today's interpretations of the mortgage recording tax will somehow allow the state to collect multiple iterations of mortgage recording tax on any revolving loan. In practice, what really happens is New York real property doesn't secure revolving loans, so no one pays any mortgage recording tax at all on them.

If the state fixed its treatment of revolving loans, this would not only raise a bit of money, it would also encourage at least one type of commercial real estate financing that is commonplace outside New York.

What does New York have against revolving mortgage loans?

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