



**REPRESENTING THE BUYER:  
COOP AND CONDO CONTRACT  
AND  
DUE DILIGENCE MATTERS**



**NATIONAL  
LAW INSTITUTE**  
Continuing Legal Education

# Representing the Buyer: Coop and Condo Contracts and Due Diligence Matters

## PRESENTED BY

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## **DUE DILIGENCE: FINANCIAL STATEMENTS**

- Buyer's attorney needs to conduct due diligence on the financial condition of the Coop or Condo Building
- The attorney should request the building's financial statements from the managing agent or selling broker

## ACCOUNTANT'S OPINION LETTER

- “We conducted our audit in accordance with auditing standards generally accepted in the United States.”
- “In our opinion, the financial statements present fairly, in all material respects, the assets and members’ equity and its revenues, expenses and retained earnings.”

## FINANCIAL STATEMENTS

- Assuming the purchaser is pre-qualified, does the purchaser's lender accept unaudited financial statements?
- Pose question to buyer at the time of retention.
- Many smaller buildings do not have audited financials. However, loans are still available.

## **FINANCIAL STATEMENTS: When Representing the Buyer**

- What does it mean to a buyer if financials are unaudited?
- Ask the lender or mortgage broker if their institution grants loans to buildings with unaudited financials.
- Unaudited financials do not necessarily prevent } financing.

## **FINANCIAL STATEMENTS: When Representing the Buyer**

- Do the financials reflect that the building is meeting its' operating expenses with operating income (maintenance and common charges).
- Do not count flip tax revenue and one time injections of income.

## FINANCIAL STATEMENTS

- Shares are not publicly traded
- The goal is not to maximize profit but to meet operating expense. Building's can run at a loss.
- Look at income before depreciation and amortization
- Attorney should obtain specific answers to financial questions
- Read the notes to financial statements
- Identify Amount of Reserve Fund



## FINANCIAL STATEMENTS

- Compare latest accounting period with period immediately prior (three years)
- Comparison of one year to the next will reflect noteworthy variations
- The variations tell a story
- Are there substantial maintenance arrears or substantial accounts payable increases?
- Encourage clients to seek a second opinion on the financials

## **FINANCIAL STATEMENTS: When Representing a Coop Buyer**

- The attorney and client must be satisfied that the building is easily handling its obligations to pay the underlying mortgage and real estate taxes
- The smaller these obligations are as percentage of maintenance income, the more likely it is that the building will not have difficulty in refinancing

## **FINANCIAL STATEMENTS: When Representing a Coop Buyer**

- Confirm **New** IRC § 216 (the "80/20 Rule) is not violated.
- "Classic" 80/20 Rule; or
- 80% of square footage available to shareholders; or
- 90% of expenses are for Coop's acquisition, construction, maintenance, and management of its property for the benefit of its shareholders

## BOARD MINUTES

- It is critical that minutes are reviewed for both Coop and Condo purchases. They Reflect:
  - Financial concerns
  - Building maintenance issues
  - Various problems (other unit owners)
  - Changes in building policy
  - Not all buildings permit inspection of minutes

## REVIEWING CO-OP OFFERING PLAN

- Review of the Offering Plan is especially important if there are still unsold shares
- Provided sponsor complies with Article 23-A of the General Business Law, the Offering Plan will include up to date financial disclosures by the holder of unsold shares, including how many unsold shares exists, and whether the holder is in default in this or any other building

## CO-OP OFFERING PLAN

- If disclosures are not current or show financial weakness, purchase may be more speculative than the usual home purchase, and purchaser should be advised
- The number of sponsor-owned unsold shares allocated to apartments as a percentage of the building should be determined and a judgment made as to whether or not the purchaser is actually buying into a cooperative

## CO-OP OFFERING PLAN

- If a large percentage of units are held by the sponsor as rentals, it may be hard to run the building in the best interest of the owner occupants or for potential purchasers to obtain financing.
- A large number of sublets can suggest an inability to resell at an acceptable price, which discourages share lenders and potential underlying mortgagees.

## CO-OP PROPRIETARY LEASE

- Lease term must exceed the term of the proposed financing, or the purchaser will have difficulty obtaining the financing.
- Risk of unsold shares - Will lease be renewed?
- Unusual conditions with respect to assignment or sublease.
  - Consent required unless transfer is to a family member or due to death
- Flip tax/fees on assignment and sublet)



## CO-OP HOUSE RULES

- Classification of directors (is current management entrenched through term system)
- Unusual provisions and fees associated with respect to assignment and sublet
- Review Co-op Certificate of Incorporation

## **CO-OP UNDERLYING BUILDING MORTGAGE**

- What is the due date of any balloon payment?
- What are the terms of the building financing?
- Were terms competitive when taken?
- Are terms very uncompetitive today?

## CO-OP TAX ABATEMENTS

- When do they expire?
- How are they credited to unit owners?
- Portion of deductible maintenance
- History of maintenance increases or assessments
- Anticipated increases in maintenance or assessments
- Limitations of financing

## **MISCELLANEOUS....BUT IMPORTANT**

- Subletting policies
- Number of Shares allocated to the unit
- Number of units in the building and the building wide mortgage amount
- Pet policy
- Guest policy
- Are utilities paid by shareholder or building

## **SPECIAL ISSUES**

- Roof rights
- Proposed alterations
- Home business
- Combining apartments (certificate of occupancy issues, generally results in disproportionately high maintenance).

## PHYSICAL INSPECTION

- Not usually obtained for an apartment in a multiple dwelling, but may be advisable if:
  - small building
  - ground floor unit (vermin and water damage)
  - top floor unit (water damage)
- Confirm contract terms (seller is owner of record, # of shares, % common elements, monthly charges, social security # of clients)

## DECLARATION AND BY-LAWS

- Verify current dates of declaration, by-laws rules and regulations, and amendments thereto.
- Review declaration, bylaws and rules and regulations for unusual provisions and procedures governing sales of unit.

## CONDO DUE DILIGENCE: BUDGETS

- Determine if budget includes all proposed renovations and changes in services
- Aging building – determine how or proposed alterations will be financed.
- Many condominiums cannot borrow money for repairs; some may follow RPL §339-jj, which permits borrowing under certain circumstances; 5 years of operation, for repairs or replacement, approval of majority in common interest of association.



## CONDO MISCELLANEOUS DUE DILIGENCE

- Obtain a copy of power of attorney form used by the condominium and explain to client along with right of first refusal.
- Check contract description against seller's title report.
- Special Issues
  - Roof rights
  - Proposed alterations

## **CONDO DUE DILIGENCE: CONFIRM**

- Common area charges
- No claims or litigation pending
- Payment of utilities
- Special assessments (current, past, contemplated and pending)
- Unit's common interest

## CONTRACT OF SALE

- NYSBA Real Estate Forms
- Variations Clearly Identified
- A Rider Amends the Form Contract to Address Unique Issues & Protections
- Form Contract and Seller's Rider Drafted By Seller Counsel
- Purchaser Should Submit Purchaser's Rider

## WHAT IS A DELIVERY DATE?

- The date when fully executed contract has been delivered.
- The date contract is in full force and is the date from when time periods are measured.
- Upon the delivery date:
  - Seller's counsel should seek payoff existing mortgage or share loan.
  - Purchaser's counsel should confirm timely loan application with client and order title/lien search.

## CONDITIONS TO DELIVERY

- When delivering the proposed contract, seller's attorney should clearly indicate a time frame for return of a signed contract.
- Personal Property included in sale
- Should be explicated stated in the contract as to what is included and what is not.

## **CONTRACT MISCELLANEOUS....BUT IMPORTANT**

- Storage Units and Parking Space are not necessarily included.
- Contract Deposit
  - Generally 10% of sales price
  - Can be negotiated

## MORTGAGE CONTINGENCY CLAUSE

- Allows for the return of purchaser's contract deposit (typically 10% of sales price) if the purchaser is unable to obtain financing.
- Net effect of the escrow provision is to tie up the down payment and require agreement of the parties or a judgment before the funds are released.
- Most litigation between buyers and sellers of real estate arises out of buyer's attempts to obtain financing

## **MORTGAGE CONTINGENCY CLAUSE**

- Two to One Courts Favor Buyers
- But a Brand New World We are Now In
- 2009 is not the summer of 2005



## **MORTGAGE CONTINGENCY CLAUSE**

- Clause is conditioned upon the issuance of a commitment not upon closing of the loan.
- Seller and Purchaser have right to cancel if loan commitment not obtained by specified date.

## **MORTGAGE CONTINGENCY CLAUSE**

- Loss of the commitment is on the purchaser – but courts have failed to act accordingly by allowing a purchaser to rescind where mortgage commitment has been cancelled after issuance (and expiration of the contract condition) due to loss of the purchaser's employment.

## MORTGAGE CONTINGENCY CLAUSE

- Purchaser should be wary of making representations about ability to obtain loan unless she has fully completed a pre-qualification process with the lender.
- Two elements to issuance of a loan
  - does borrower has sufficient income and assets to repay loan
  - is the value of the property is sufficient to adequately secure repayment

## MORTGAGE CONTINGENCY CLAUSE

- Purchaser's attorney may want to ask for the addition of the loan closing condition.
- Seller's attorney should add "unless failure to close the loan is due to the fault of the purchaser does not protect seller from a failure to close that is not due to the fault of the purchaser."
- Seller's attorney should add a representation by purchaser that the purchaser has sufficient income and assets to qualify for the loan and does not know of any judgments, claims or other matters that would impair his ability to obtain the loan.

## MORTGAGE CONTINGENCY CLAUSE

- Seller's attorney should add a representation by purchaser that contract is not contingent on sale of property, rental income or refinancing of property.
- *Friend v. McGarry*, Purchaser allowed to cancel pursuant to mortgage contingency, when lender conditioned loan on sale of property and purchaser was unable to sell.

## MORTGAGE CONTINGENCY CLAUSE

- Seller's attorney should add a representation by purchaser that purchaser has not, within the past two years, been denied consent by an apartment corporation or condominium association with respect to any proposed purchase by Purchaser of any other cooperative apartment or condominium unit. In addition, Purchaser has not been rejected in an application for a loan within the past five (5) years.

## MORTGAGE CONTINGENCY CLAUSE

- Four Contracts of Sale  
Condo – 1998 & 2000  
Co-op – 1989 & 2001
- Institutional Lender & Mortgage Broker  
Earlier contracts – required application to institutional lenders
- Requirement satisfied if mortgage broker submits to an institutional lender

## MORTGAGE CONTINGENCY CLAUSE

- Purchaser is required to:
  - make prompt application to an institutional lender (or mortgage broker) for the commitment including making all required payments
  - pursue application with diligence and cooperate in good faith to obtain the commitment.
- Stated loan amount is maximum amount of loan
- Post v. Mengoni Purchaser is not entitled to return of down payment where purchaser applied for more than amount specified in contract.



## MORTGAGE CONTINGENCY CLAUSE

- Vafa v. Cramer  
Purchaser who failed to apply within the specified time period was not entitled to a refund of the deposit.
- Falk v. Goodman  
Understating Income was deemed a lack of good faith
- Allen v. Smith  
Two purchasers, application by only one, not the one with greater income was a lack of good faith

## **MORTGAGE CONTINGENCY CLAUSE**

- Purchaser may reject a commitment if its expiration date occurs before scheduled closing.
- Purchaser must strictly comply with notice provisions.
- Some courts have been lenient on the purchaser as to time periods: time to apply for a loan; time to obtain the commitment; and time to cancel where no date for cancellation was specified.
- What about the board interview?

## SELLER'S RIDER

- “Not Previously Rejected” Clause

“Purchaser represents that Purchaser has not been previously rejected by any lender, apartment corporation, condominium association or its board of directors in connection with seeking financing on a prior contract to purchase a condominium unit or cooperative apartment.”

## SELLER'S RIDER

- “Act Promptly” Clause

“Purchaser agrees to apply promptly upon execution hereof for any title search or title insurance and any survey to be obtained by them in connection with this sale. Purchaser agrees to send copies of all surveys and title reports to Seller’s attorney upon receipt and to notify seller’s attorney of any defects or objections to the title by a separate writing within 10 days of the receipt by

## SELLER'S RIDER

- “Act Promptly” Clause (cont’d)

...purchaser of any such title report or survey, as the case may be. Any defects or objections to which the seller is not as so notified shall be deemed waived by purchaser. If it shall appear from such defect or objection that time shall be required within which to remove same, then the seller shall be entitled to a reasonable adjournment of the closing within which to clear

## SELLER'S RIDER

- "Act Promptly" Clause (cont'd)

...such defect or objections, provided however, any adjournment request or effort by the seller in attempting to cure a proposed title objection or defect shall not be deemed a waiver of the seller's right to refuse to cure any objection or defect in title which seller is not required hereunder to cure or an admission on the seller's part that an objection does, in fact,

## SELLER'S RIDER

- "Act Promptly" Clause (cont'd)

...exist. Seller shall have no more than thirty day adjournment of the Closing to cure a title defect or objection that can be remedied by the payment of money, and no more than sixty day adjournment of the Closing to cure a title defect or objection that can not be cured solely by the payment of money.

## **PURCHASER'S RIDER**

- “Failure to Fund” Clause  
“Issuance of Commitment”

If Purchaser's institutional lender, through no fault of Purchaser, fails or refuses to fund the Loan it has committed to make pursuant to the written loan commitment letter, Purchaser may cancel this contract by giving prompt notice to seller, provided purchaser has complied with Purchaser's obligations hereunder.



## PURCHASER'S RIDER

- “Failure to Fund” Clause (cont’d)

...In such an event this contract shall be deemed cancelled and thereafter neither party shall have any further rights against, or obligations or liabilities to, the other by reason of this Contract, except that the Down payment shall be promptly refunded to purchaser.”

## **PURCHASER'S RIDER**

- “Bad Neighbor” Clause

“That neither the Seller nor any person acting on behalf of the Seller have made any written complaint to the Corporation, Managing Agent of any unit owner or tenant of the building regarding noise, offensive odors, offensive conduct, lack of heat or hot water, or any other disturbance or adverse condition affecting the Unit.”

## PURCHASER'S RIDER

- “Board Approval For Unit Work” Clause  
“All alterations or improvements which have been made in or to the Unit by the Seller which require board approval were made in compliance with all board rules and regulations and were paid in full.
- “Holes In The Ceiling” Clause  
Upon the removal of any light fixture or chandelier, seller, at seller’s expense and prior to the closing, shall install a working builder’s standard light fixture or cap the exposed area.

## PURCHASER'S RIDER

- “Holes In The Wall” Clause

“In the event that the removal of anything which has been affixed to the wall results in a hole larger than an ordinary nail hole, then Seller shall repair the hole in question so as to create a uniform surface and appearance to the wall in question.”

## **PURCHASER'S RIDER**

- Caveat Emptor – Buyer Beware
- New York courts require purchaser to inspect the premises, ask questions about conditions observed in the inspection and a duty to check readily available information, such as taxes and schools.
- Inspection required twice, before contract and before closing.

## **CAVEAT EMPTOR – BUYER BEWARE**

- New York law does not require a seller to disclose conditions to the purchaser (except perhaps dangerous conditions).
- Further, the “as is” clause will help protect seller unless seller engages in fraudulent concealment, misrepresentation or partial disclosure.

## **MORE CAVEAT EMPTOR**

- “As is” and merger clause do not bar a fraud claim
- Exceptions to Caveat Emptor
  - Affirmative misrepresentation
  - Partial disclosure
  - Active concealment
  - Superior knowledge
  - Fact peculiarly known

## MORE CAVEAT EMPTOR

- Anything the seller says to a purchaser can be held against the seller.
- Anything the seller says to a broker may have to be disclosed to purchaser.
- Purchaser has statutory right to request information about death or felonies and seller must decide whether or not to respond. No duty to disclose deaths or felonies. RPL § 443-a
- Purchase should verify presence of smoke alarm and CO2 detector.



## MERGER CLAUSE & AS IS PROVISION

- Because of the disclaimers in the “as is” clause and merger provision, the purchaser must add to the contract all prior all and written representations and agreements.
- A purchaser is barred from making a claim after the closing that is based on “patent” defects known to the purchaser prior to closing, even in newly constructed units. They are merged into the deed and do not survive delivery.

## DEPOSITS AND DEFAULTS

- Escrow Provision
  - The net effect of the escrow provision is to tie up the down payment and require agreement of the parties or a judgment before it is released.
  - Courts favor seller's with respect to defects when purchaser had the opportunity to inspect.
  - Courts favor buyer's with respect to financing contingency lapses.

## **SELLER DEFAULT & PURCHASER'S REMEDY**

- Each unit is unique. Courts will almost always grant specific performance to a purchaser, because money damages inadequately compensate for this loss.
- To obtain specific performance, the purchaser must show that it was ready and able to perform at closing.

## **PURCHASER'S DEFAULT AND SELLER'S REMEDY**

- Absent a clause specifying or limiting the seller's remedy in the event the purchaser wrongfully refuses to take title, or otherwise defaults, the seller may always retain the purchaser's down payment as liquidated damages.
- Purchaser is not entitled to a return of the down payment even if the seller resells the property to a third party for an amount equal to or in excess of the original contract price.

## DEPOSITS AND DEFAULTS

- Misrepresentation as to occupants exposed at board interview causing the Coop Board to reject a purchaser is material breach.
- Glanzer v. Altman,  
Purchaser's failure to submit application within 10 days per contract was breach entitling seller to liquidated damages; purchaser's misrepresentation of bankruptcy status was material breach.

## DEPOSITS AND DEFAULTS

- Rosenbloom v. Estate of Zuckerman  
Purchaser who stated in contract that the amount to be financed was “none” could not cancel when co-op approved application as all-cash purchase.

## RISK OF LOSS

- Purchaser is entitled to receive premises in the condition as of the contract date, not closing date.
- GOL 5-1311:
  - “Material damage” – Seller cannot enforce contract and Purchaser recovers down payment
  - “Immaterial damage” – Seller can enforce contract but there is an abatement in sales price
  - “Material” is undefined
  - Confirm with opposing party that damage is material before canceling the contract

## **ADJOURNMENTS AND TIME OF THE ESSENCE**

- New York form contracts do not make time of the essence.
- If the contract does not explicitly state that time is of the essence, it is not, and either party will be allowed a reasonable adjournment.



## ADJOURNMENTS AND TIME OF THE ESSENCE

- Because there are so many variables that may affect the parties' ability to close, it is usually prudent not to make time of the essence, and explain reasons to client.
  - Seller – clearing title, obtaining stock and proprietary lease
  - Purchaser – loan commitment, obtaining clear to close from bank, coordinating lender attorney

## **ADJOURNMENTS AND TIME OF THE ESSENCE**

- If either party refuses without good reason to cooperate in scheduling the closing, the other party may make time of the essence after the contract is signed demanding performance by the other within a reasonable time by giving clear, distinct, and unequivocal notice of the demand.

## **PURCHASES BY MARRIED AND UNMARRIED COUPLES**

- Pre 1996 – H & W taking possession of stock and lease as joint tenants with rights of survivorship
- Pre 1996 – H & W without explicitly stating possession as joint tenants with rights of survivorship were Tenants in Common (one-half interest of the deceased in property passes directly to decedent's estate)

## **PURCHASES BY MARRIED AND UNMARRIED COUPLES**

- Even though there are no known heirs other than the spouse, responsible cooperative boards will insist that the survivor undertake the expense of probating the deceased estate before selling co-op.
- This is to protect the co-op from liability caused by a transfer that is subject to a claim from some unknown party or taxing authority.
- Co-op “Title Insurance” (Leasehold Insurance)

## PRE-CLOSING

- Attorneys should exchange their calculation of apportionments and agree to them in advance of closing, keeping small discrepancies in perspective.
- Seller's attorney should arrange Automated City Register Information System ("ACRIS") filing.
- Obtain insurance and put utilities in name of Purchaser as of the closing date.

## PRE-CLOSING

- Cancel utilities as of the closing date. Cancel insurance upon completion of the closing.
- Condo units – confirm title policy insures condominium has been validly created.
- Co-op units - lien search continuation faxed to closing office in advance of closing.

## PRE-CLOSING

- If closing takes place shortly after payments are due, determine whether payment will be noted by time of closing. Seller should have proof of recent payments.
- Photo ID, Check Book, Pre-Closing Inspection Appliance in working order.

## CLOSING COSTS

- Comprised of the following
  - Percentage of Sales Price (varies by sales price)
  - Percentage of Financed Amount (varies by loan amount)
  - Flat Fees
  - Add to basis of property not deductible in year of purchase transaction



## TAXES AND REAL ESTATE: THE BASICS

- Points are deductible if:
  - % of amount borrowed not a flat fee
  - Loan on principal residence secured by property
  - Must be paid with funds other than lender's
  - Reflected on HUD-1 form lines 801 & 802

## TAXES AND REAL ESTATE: THE BASICS

- Points:
  - Origination Points
- Refi Points
  - Generally not deductible on year paid but ratably over term of loan
  - If property is sold, unamortized points are deductible in year of sale

## TAXES AND REAL ESTATE: THE BASICS

- Rented Home (Vacation or Temporary Rental)
- Two Limitations - Deducting costs (maintenance, repair, depreciation, insurance and utilities)
  - Test #1 - Personal Use Test
  - Taxpayer ("T") uses home for less than the greater of (i) 15 days per year or (ii) 10% of the number of days the residence is rented at Fair Market Value ("FMV")

## TAXES AND REAL ESTATE: THE BASICS

- Rented Home (Vacation or Temporary Rental)
- Two Limitations - Deducting costs (maintenance, repair, depreciation, insurance and utilities)
  - TEST #2 - Passive Loss Limitation (Section 280 A) investors can only deduct losses from rental activities to the extent of their income from rental activity.

## TAXES AND REAL ESTATE: THE BASICS

- Rented Home (Vacation or Temporary Rental)
- Passive Loss Limitation (Section 280 A)
  - AGI < \$100,000 not subject to 280A and can offset ordinary/non-passive income up to \$25,000.
  - AGI > \$100,000 – the \$25,000 permissible deduction is reduced by 50% of the excess and completely phased out at \$150,000

## TAXES AND REAL ESTATE: THE BASICS

- Home Office
- Two considerations in determining Home Office Deduction
  - Relative importance of activity performed at each business location
  - Time spent at each location

## TAXES AND REAL ESTATE: THE BASICS

- Home Office
  - Requires no other fixed location for administration or management of business
  - Does not preclude meeting customers, client or patients at a fixed location away from home
  - Examples
    - Writer / Jewelry Maker / Designer - Yes
    - Teacher / Plumber / Anesthesiologist - No

## TAXES AND REAL ESTATE: THE BASICS

- Home Office
  - Calculation of Home Office Deduction
    - Gross income derived from business
    - Deduct share of mortgage interest and real estate taxes on a proportionate basis
    - T deducts non-home related expenses of running business (business phone and office supplies)



## **TAXES AND REAL ESTATE: GAIN ON SALE OF RESIDENCE**

- Post May 7<sup>th</sup> 1997 – Rollover provision and \$125,000 exclusion no longer apply
- T can exclude up to \$250,000 (\$500,000 if T is married and files a joint return) of gain realized on the sale of a principal residence
- To be eligible T must have owned the residence and occupied it as a principal residence for periods “aggregating two year or more out of the five years prior to the sale”

## **TAXES AND REAL ESTATE: GAIN ON SALE OF RESIDENCE**

- Change of Employment, health or other unforeseen circumstances and move is more than 50 miles – T is able to benefit from a fraction of the \$250,000 / \$500,000 exclusion
- $[(18 \text{ months} / 24 \text{ months}) \times \$250,000]$

## TAXES AND REAL ESTATE: GAIN ON SALE OF RESIDENCE

- Example One:
  - H&W each own a home separately and used as a principal residence before marriage. Neither spouse meets the use requirement of the other spouse's residence.
  - H's gain is \$200,000 and W's gain is \$300,000
  - H&W must realize gain of \$50,000 on W's gain

## TAXES AND REAL ESTATE: GAIN ON SALE OF RESIDENCE

- Example Two:
  - Unmarried taxpayers A&B own a house as joint owners, with each owning a 50% interest. They sell the house after owning and using the home as a principal residence for two years.
  - Gain from sale is \$256,000
  - A & B are each eligible to exclude \$128,000

## TAXES AND REAL ESTATE: GAIN ON SALE OF RESIDENCE

- Example Three:
  - A buys a house in 1991 and uses it as his principal residence. In 2004, A's friend B moves in with A and A sells a 50% interest in the house, with A realizing a \$136,000 gain. In 2006, A sells remaining 50% interest to B and realizes a gain of \$138,000.
  - A may exclude \$114,000 on second transfer to B.

## TAXES AND REAL ESTATE: GAIN ON SALE OF RESIDENCE

- Example Four:
  - Surviving Spouse Penalty
  - H& W buy in a home in 1985 for \$250,000.
  - 2005 home is worth \$750,000 and H dies.
  - If W sells in 2005 she is entitled to \$500,000 exclusion.
  - If W sells in 2006 (or thereafter) an exemption of \$250,000 is available to W
  - However, since the property was jointly held, W will benefit from the step up in basis attributable to H's half interest. Accordingly, W's new basis is \$500,000 (W original basis of \$125,000 and \$375,000 of FMV step up basis of H's half). As a result no tax is due since all proceeds are sheltered by \$500,000 basis and the \$250,000 exemption.

## **TAX AND ESTATE PLANNING WITH REAL ESTATE ASSETS**

- Gain on Sale of Property Substantially Exceeds \$250,000 / \$500,000
- Convert to rental property and hold for a sufficient period to qualify for 1031 exchange treatment.

## **PRE-1977 JOINT TENANCIES BETWEEN HUSBAND AND WIFE**

- Portion of the property passes to the surviving spouse by operation of law, it is sheltered from estate tax by the unlimited marital deduction.
- The surviving spouse gets a corresponding step up in basis for the one-half of the property which was included in the deceased spouse's estate.



## **PRE-1977 JOINT TENANCIES BETWEEN HUSBAND AND WIFE**

- Joint tenancies between husband and wife created prior to 1977 enjoy special estate tax treatment. The property value property is included in the estate of the first spouse to die based on the proportionate share of the purchase price furnished by the decedent.
- So if decedent furnished all the consideration for the property, then the full value of the property will be included in the deceased spouse's estate. The income tax benefit to the surviving spouse is a full step up in basis.
- If it is a pre-1977 spousal joint tenancy, do not sever the joint interest without considering the consequences of receiving only a one-half, rather than a full, step-up in basis when one spouse dies.

## FOREIGN SELLER AND WITHHOLDING TAX

- §1445 – the purchase of a real property interest must deduct and withhold from the purchase price where the seller is a foreign person
- Avoid withholding requirement by obtaining seller certification (FIRPTA)
- Withholding is 10% and furnished to IRS within 20 days of sale

## FOREIGN SELLER AND WITHHOLDING TAX

- No withholding requirements when:
  - Value of residence transferred is less than \$300,000
  - Required for a \$5,000 dirt farm
  - A Withholding Certificate is provided by IRS

## **EXTENSION OF § 121 BENEFIT TO HEIR OR ESTATE**

- The \$250,000 exclusion will be available to the heir or estate of such decedent or to a qualified revocable trust left by such decedent.
- Two year residency period of decedent applies to heir
- A qualified revocable trust may be treated as having been owned by the decedent by virtue of the power to revoke

## MORTGAGE RECORDING TAX

- Tax on Recording of Mortgages
- Does Not Apply to Coops
- Rates Differ By County
- Bank Pays  $\frac{1}{4}$  Point of the Tax
- Under \$500,000 1.800% paid by borrower  
Over \$500,000 1.925% paid by borrower

## CEMAs

- Consolidation, Extension and Modification Agreement
- Assigns and Merges Prior Mortgage Into New Mortgage
- Only Pay Tax on “New Money”
- Saves Money on Mortgage Tax
- At the Discretion of Assigning Bank



**REPRESENTING THE BUYER:  
COOP AND CONDO CONTRACT  
AND  
DUE DILIGENCE MATTERS**



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