

Practice Update

New York State Legislators Reintroduce Bill Proposing Tax on Mezzanine Debt and Preferred Equity Investments

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In the January 2023 legislative session, New York State Senators Salazar, Brisport, Hoylman, Jackson, Myrie, and Rivera submitted a bill, S-318 which seeks to impose a mortgage tax on mezzanine debt on, and preferred equity investments in, real estate. An identical bill was submitted by New York State Representatives Epstein, Cruz, Simon, Rosenthal, Reyes, Glick, Carroll, and Anderson, H-407. Both bills are substantially similar to unsuccessful efforts in prior legislative sessions, all submitted by the same core group backing this latest attempt. The tax imposed by the proposed bills would act like a mortgage recording tax and would require mezzanine lenders and preferred equity investors to file Uniform Commercial Code (UCC) financing statements to perfect their security interest in their collateral. The proposed bills provide that said security interests would be unenforceable if the UCC financing statement is not filed at the state and local levels and the tax paid. At current mortgage tax rates, mezzanine loans and preferred equity investments in excess of \$500,000 would be subject to a maximum tax burden of 2.80 percent (1.75 percent basic rate + 1.05 percent New York City rate).

Numerous industry groups, such as the Mortgage Bankers Association, the Real Estate Board of New York, and the Commercial Real Estate Finance

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Council, are monitoring the bills and will undoubtedly resume their opposition to the tax as an unnecessary burden on a real estate industry already severely impacted by the pandemic, interest rate hikes, and inflation. These industry groups have previously argued that so-called “rescue capital” provided by mezzanine lenders and preferred equity investors would become more expensive at a time when borrowers need it the most, with the increased costs merely passed on to tenants, who are already struggling, in the form of higher rents. Additional expenses may also incentivize lenders and investors to avoid doing business in the state of New York.

The bills also fail to address multi-state transactions and define “mezzanine debt” and “preferred equity investment” so broadly that their reach may extend to taxing traditional joint ventures and non-real estate deals as well. The proposed modification to Section 291(k) of the New York Real Property Law defines “mezzanine debt” and “preferred equity” “related to the real property upon which a mortgage instrument is filed” to include “non-traditional financing techniques ... where the financing source has special rights or preferred rights such as (i) the right to receive a special or preferred rate of return on its capital investment; and (ii) the right to an accelerated repayment of the investors capital contribution.” The language provides that the mezzanine debt or preferred equity filing is required “whenever a mortgage instrument is recorded,” but is not clear if the obligation exists even when no mortgage is filed. This language also suggests that an actual security interest may not be required, and a simple change in control right, for example, might be sufficient, if the other conditions are met, to trigger the filing obligation and the tax.

This proposed tax died in committee when the 2019-2020 and 2021-2022 legislative sessions ended, and then-Governor Cuomo’s 2021-2022 budget did not include the proposed tax. Governor Hochul submitted her new budget to the legislature last week, and the proposed tax was not included.

Akerman is following this pending legislation closely and will report on any meaningful developments.

Please reach out to [Steven Chudnow](#) if you would like a copy of the proposed legislation or want to discuss this in more detail.

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