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Expert Analysis

Buyers Face Penalties for Sellers' Failure to File Income Statements

For many years now,¹ the City of New York has required that each year owners of “income-producing property” (as more particularly described below) file a statement of income and expenses (known as the RPIE statement).² The purpose of the imposition of the filing requirement was to assist the Department of Finance in establishing a more accurate method for determining the assessed value of real property.³ The imposition of such a disclosure and filing requirement has been held to be constitutional.⁴

Significant penalties may be imposed against a property owner who fails to timely file the required RPIE statement. If the penalties are not paid, the outstanding amounts will eventually work their way onto the real property tax bills, becoming a lien upon the property. This could result in a substantial injustice to a property owner who has purchased the property without any notice of a former owner's failure to file the RPIE statement. This article will explore the filing requirement of the RPIE statement, the enforcement procedures followed by the New York City Department of Finance, and their effect upon purchasers of “income-producing property” in the city.

'Income-Producing' Property

The filing requirement applies only to “income-producing property,” defined as property owned for the purposes of securing an income from the property itself.⁵ The filing requirement applies to (a) rental properties, (b) many cooperative buildings (unless the cooperative has less than 2,500 square

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feet of commercial space, not including the garage), (c) commercial condominium buildings or rented commercial and/or professional space in residential condominium buildings, as well as the residential units if the majority of the residential space is operated as a rental, (d) units in a residential condominium owned by the sponsor, and (e) business-operating properties such as hotels and motels, parking garages and parking lots, department stores, power plants providing electricity for sale, theaters and cinemas, and net leased properties.⁶

The term “income-producing property does not include (i) any property with an assessed value of \$40,000 or less, (ii) exclusively residential property containing 10 dwelling units or less, (iii) mixed-use property that has six residential units or less AND no more than one commercial unit, (iv) residential cooperative buildings with less than 2,500 square feet of commercial space, not including the garage, (v) residential condominiums where less than the majority of the residential space is operated as a rental, (vi) property rented to the owner or an entity related to the owner, including family members, (vii) owner-occupied property, (viii) property owned by a not-for-profit or governmental entity and not rented to any commercial, non-exempt tenants, (ix) property that is vacant and uninhabitable and that has no existing leases, including vacant, non-income-producing land. For (ii) and (iii) both occupied and vacant units must

be counted to determine whether the filing requirement applies.

Section 11-208.1 of the New York City Administrative Code requires that the required statement be filed no later than Sept. 1 of each year for the preceding year.⁷ A property owner is only required to file a RPIE statement covering the period in which it owned the income-producing property, and is not required to file a statement for any property that the owner no longer owned at year end. A failure to timely comply with the filing requirement results in the imposition of penalties. The penalty is as high as 3 percent of the assessed value of the property, and can rise to 4 percent if the statement is not filed by Dec. 31 of that year. A failure to timely file the RPIE statement the following year can result in a penalty of up to 5 percent of the assessed value of the property for both years. The scope of the penalty is ultimately decided after notice and a hearing.⁸

For the first time in the fiscal year 2012-2013, unpaid penalties for failure to timely file RPIE statements are showing up on the city's real estate tax records for collection.

Real Estate Tax Records

The decision was made some time ago to turn the unpaid penalties over to the New York City Department of Finance for collection by entering them on the tax rolls, but there apparently were problems in executing this transition. Accordingly, for the first time in the fiscal year 2012-2013, and with what may well be described as very little publicity, these unpaid penalties for failure to timely file RPIE state-

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ments are showing up on the city's real estate tax records for collection. This means that one could acquire income-producing property in, say, July or August, 2013, and the failure of the prior owner (your seller) or even a predecessor owner (if the property flipped quickly) to file the year 2012 statement (required to be filed by Sept. 1, 2013) will result in a penalty in the form of a real estate tax item and with super-priority being entered against your property after closing.

There is no way or method for a prospective purchaser to check the public records to affirm that a prospective seller has fulfilled its filing obligations for 2012 or for prior years. Worse still, because the purchaser does not have access to the seller's records, purchaser cannot cure the failure to file once purchaser becomes aware of the problem, raising the prospect of the penalty being increased later for a failure to file that is completely beyond the power of the purchaser to cure.

As bad as that situation is, it gets worse. Because of delays in posting charges on the tax records, we are now seeing penalties for failure to timely file RPIE statements for tax year 2011 (which statements were due Sept. 1, 2012) appearing on the tax records for the first time in the first half 2013-2014. This means that a property owner who sold in January 2012 (or perhaps even one who sold during the 2011 year⁹) and who failed to timely file an RPIE statement for the 2011 year causes the entry of the penalty on the tax rolls that is enforceable against the property itself!

The Department of Finance does have plans to post a list of properties for which, according to the department's records, returns are required to be filed. But no such list currently exists, and, when it is compiled it will be based on department information that is likely to be dated (since the issue of whether a particular piece of property requires a filing can change from year to year) and will accordingly be at least somewhat inaccurate.

The penalties that are imposed are entered only after notice and a hearing in accordance with Section 11-208.1(d) of the Administrative Code and Section 33-04 of the Rules of the City of New York. Evidence may be presented and defenses raised at such a hearing. Matters to be reviewed include: whether or not an income and expense statement was filed and, if not, what penalties should be imposed; whether or not an income and expense statement was timely filed and, if so, what penalties should be imposed; and whether or not a defective

income and expense statement was filed and, if so, what penalties should be imposed.¹⁰

Purchasers can and should take steps to protect themselves at the time they enter into contract, shifting the burden to the owner of the property covered by the filing.

An "innocent owner" defense has been allowed. Such a defense allows a purchaser who was not the party responsible for filing the income and expense statement, the failure to file of which gave rise to the penalty, the ability to avoid the penalty and the resulting lien. It is important to realize that the existence of such a defense exists as a matter of departmental policy and not by statute or regulation. As such this defense is allowed on an ad hoc basis with no formal written standards or criteria, and is subject to change in policy, withdrawal or disaffirmance.

Whether or not the "innocent owner" defense continues to be available in this context, and regardless of its scope if it is available, any prospective purchaser would be well-advised to avoid this problem rather than having to deal with it. After all, responding to notices, appearing at hearings and compiling the facts you need to avoid liability in these cases takes time and money, and the penalty is not covered by any policy of title insurance that may be issued in connection with the purchase.¹¹

Protecting Purchasers

Some options that come to mind in order to protect oneself from the risk of future liability include: requiring a seller to furnish proof that all income and expense statements that are required to be filed prior to the date of closing (at least to the extent that compliance cannot be checked on the department's records) have in fact been filed and that such filings were sufficient to comply with all requirements under the law, and/or requiring the seller to represent (which representation should survive closing) that all income and expense statements that are required to be filed prior to the date of closing (at least to the extent that compliance cannot be checked on the department's records) have in fact been filed and that such filings were sufficient to comply with all requirements under the law.

In conclusion, the procedure that the Department of Finance has adopted to enforce its requirement that income and expense statements be filed on many New York City properties each year is causing consternation on the part of purchasers of real property, imposing a little-known risk that can result in unanticipated expense. With light being shed on the issue, purchasers can and should take steps to protect themselves at the time they enter into contract, shifting the burden to the owner of the property covered by the filing.

So long as the city fails to maintain a publicly available list of the properties owned by persons who failed to comply with this requirement and fails to take steps to minimize the number of "innocent owners" caught in the law's widely cast net, prospective purchasers will need to require sellers to confirm compliance with the filing requirement of New York City Administrative Code Section 11-208.1. Those that do not invite a foreseeable problem.

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1. This requirement was imposed by Local Law 24/1986.
2. "Owners" is read to include net lessees where the lessee owns the building itself during the lease term. 19 RCNY Section 33-02(d)(4).
3. New York City Local Law 24/1986, Section 1.
4. *Kew Gardens Assn v. Tyburski*, 70 N.Y.2d 325 (1988).
5. N.Y. City Adm. Code Section 11-208.1(e).
6. There is a pretty exhaustive list of properties whose use triggers the filing requirement at 19 RCNY Section 33-01(b)(1).
7. What constitutes the "preceding year" depends on the facts. Where an owner keeps books or records on an annual basis, the preceding year ended the previous Dec. 31. Where the owner maintains books and records on a fiscal year basis, the preceding year is the last fiscal year concluded as of the first day of August preceding the filing date. N.Y. City Adm. Code Section 11-208.1(a)(2).
8. N.Y. City Adm. Code Section 11-208.1(d)(1).
9. The filing obligation, as well as the penalty for failure to comply, runs to any owner during the year for his/her/its period of ownership. Accordingly, any person who owned the real property during the 2011 year could theoretically trigger the penalty.
10. 19 RCNY Section 33-04(a)(7).
11. The penalty is not a lien on the land until entered on the tax records. That point in time is long after the policy is issued, and therefore is excluded from policy coverage under Exclusion from Coverage 3(d): "Defects, liens, encumbrances, adverse claims, or other matters...attaching or created subsequent Date of Policy."

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