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Co-op Flip Tax Fees and How They Impact Shareholders

By Brett M. Stack
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Purchasing and selling New York City co-operative ("co-op") apartments share many aspects with purchasing real property, but with some unique features such as paying a "flip tax."

Typically, when a seller transfers ownership of a co-op unit's interest (i.e. shares/stock certificate and proprietary lease) to a purchaser at closing, the co-op typically charges the seller fee known as a "flip tax." The flip tax is not actually a "tax," but a "transfer fee" that helps the co-op financially in various ways.

One of the primary functions of the flip tax is to fund the reserve account to be used for capital improvements and repairs. This helps the co-op to not impose, or impose at a lesser amount, maintenance increases or assessments levied against co-op shareholders. Less frequent maintenance increases and assessments help co-op boards effectively manage not only the co-op's financials, but also shareholders unit carrying costs.


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The statute governing the flip taxes is New York Business Corporation Law ("BCL") §501 "Authorized Shares" subsection (c). In order to comply with New York BCL ("BCL") §501(c), the flip tax charge must apply equally to all shares in the co-op. BCL §501(c) states in part "each share shall be equal to every other share of the same class," prohibiting unequal treatment of shareholders holding the same class of shares (Fe Bland v. Two Trees Management Co., 66 N.Y.2d 556).

In the case of *Fe Bland*, the court found that a flip tax could not be imposed in different amounts for a shareholder who bought from

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a Sponsor as opposed to a shareholder who bought from another shareholder [*Id.*].

The actual amount of the flip tax fee can vary depending on what is stated in the co-op's proprietary lease and/or by-laws. Some different flip tax fee calculation methods are as follows:

Percentage of Gross Sales Price (*very common*): A fee, typically a percentage (1% to 3%), calculated on the gross sales price (gross sales price calculations for each co-op may differ based on how drafted in the proprietary lease and by-laws);

Percentage of Net Profit: Typically a percentage, calculated on the profit made from sale (net profit calculations for each co-op may differ based on how drafted in the proprietary lease and by-laws);

Flat Fee: A fixed sum of money;

Per Share Fee (*very common*): Amount collected by co-op is based on the amount of shares being transferred; and

Ownership Duration: Flip tax fee will decrease the longer a shareholder owns a unit in the co-op. NOTE: The fiscally responsible party (purchaser or seller) for flip tax payment can be subject to negotiations in the contract of sale.

Before purchasing a co-op apartment, potential purchasers (and prospective sellers) should both read the proprietary lease and by-laws in order to determine how the flip tax is implemented.

Affordable housing co-ops are an outlier to the normal flip tax calculation methods, which tend to charge higher flip tax fees. HDFC co-ops follow the same rules as non-HDFC co-ops, except the flip tax can be split based on the shareholder's profit from the sale. The sale profits are split between the selling shareholder and the board (see fact sheet here).

For example: a flip tax can be 80/20 split of the seller's profit whereby 80% of the seller's profit goes to the seller and 20% of the seller's profit goes to the HDFC co-op. Using real numbers: if a Seller purchased a unit for $50,000 and subsequently sells to an eligible HDFC purchaser for $100,000, the total profit from the sale is $50,000. The Seller will be entitled to $40,000 and the HDFC co-op will be entitled to $10,000.

For co-ops to collect the flip tax fee, language for the fee must be incorporated in the proprietary lease and/or by-laws. If proper procedures per the proprietary lease and by-laws are not followed by the board (i.e. calling a meeting of shareholders) then a flip tax amendment may not be valid (*Zimiles v. Hotel des Artistes, Inc.,* 216 A.D.2d 45, 627 N.Y.S.2d 382; *Pello v. 425 E. 50 Owners Corp., 19 Misc. 3d 1125(A)*). Board members alone cannot provide consent of the shares/ shareholders (*Bailey v. 800 Grand Concourse Owners,* 199 A.D.2d 1, 604 N.Y.S.2d 562).

If there is no flip tax in the proprietary lease and by-laws at the time of collection, then it cannot be levied upon shareholders. Different cases provide caveats to the foregoing. If a contract of sale is fully executed, closing did not occur, and all closing pre-conditions are met before a resolution is successfully voted upon to include a flip tax in the proprietary lease and/or by-laws, then the flip tax is not valid for collection upon the parties in the contract (*Lioi v. Westview Equities*, 8 Misc.3d 719, 795 N.Y.S.2d 442, 2005

N.Y. Slip Op. 25201). Case law provides some examples on how the laws are applied.

In *Lioi* a shareholder entered into contract with a bona-fide purchaser on October 2004. The contract was contingent on purchaser obtaining financing and co-op board approval. On Nov. 30, 2004, the board held a meeting to retroactively impose a flip tax effective on Nov. 1, 2004 via an amendment to the proprietary lease.

The court stated that since the contract's financing contingency was satisfied before the flip tax vote and board approval was obtained on the same day at the flip tax vote the transaction was essentially complete. It noted, however, that the need for board approval would not change its decision. Instead it concluded "as between buyer and seller, the contract was binding as to all terms. As such it was effective as between them prior to board approval and ratification of the flip tax." [*Id.*].

In the case of *People v. Prottas*, 2020 N.Y. Misc. LEXIS 3169, the proper procedures were not followed to impose a flip tax fee resulting in the court's dismissal of Defendants claim. For many years the subject co-op operated at a deficit.

In 2012 or 2013 Prottas, the managing agent, worked with the co-op's attorneys to amend the co-op by-laws, so shareholders would be allowed to sell their shares to outsiders, rather than only selling them back to the co-op, and purchasers would have to pay the co-op both a $25,000 transfer fee and a $25,000 per bedroom flip tax.

As a result of the foregoing fees, bona fide purchasers did not want to purchase a unit in the co-op. Prottas then proceeded to obtain financing and purchase the units in an entity without paying any required flip tax(es), which the board was not aware of. The court found the imposition of transfer fees was a part of a "scheme" by Prottas [*Id.*].

It should also be noted that change in beneficial ownership of an entity shareholder does not trigger flip tax (i.e. transfer in Lessee/shareholder itself is not an assignment, unless provided for explicitly in the proprietary lease and/or by-laws) (*Board of Directors of Big Deal Realty on Greene St., Inc. v. 60G 133 Greene St. Owner, LLC,* 2020 N.Y. Misc. LEXIS 3881).

Some condominiums in Manhattan are currently also imposing flip taxes to generate income. This trend shows the industry believes collecting flip tax fees is a good method of income generation for various types of properties.

Before purchasing a co-op apartment, potential purchasers (and prospective sellers) should both read the proprietary lease and by-laws in order determine how the flip tax is implemented. Prospective purchasers of co-op apartments should also ask their attorney to confirm with the Managing Agent the amount of flip tax payable to see if the information is properly reflected in the proprietary lease and by-laws. Properly drafted flip tax language in the proprietary lease and by-laws is essential to a well-managed co-op.