taxnotes®

state

Volume 95, Number 12 ■ March 23, 2020

Tenants, Taxes, and Tax Assessment Challenges

by Sujata Yalamanchili and Henry A. Zomerfeld

Reprinted from *Tax Notes State*, March 23, 2020, p. 1035

Tenants, Taxes, and Tax Assessment Challenges

by Sujata Yalamanchili and Henry A. Zomerfeld


Sujata Yalamanchili


Henry A. Zomerfeld

Sujata Yalamanchili is a partner and Henry A. Zomerfeld is a senior associate with Hodgson Russ LLP in Buffalo, New York.

The authors thank Lindsay Munschauer, associate at Hodgson Russ, for her assistance on the research conducted for this article.

In this inaugural installment of Real Assessment, the authors discuss *Larchmont Pancake House* and New York's rules regarding the ability to challenge property tax assessments.

In New York state, the ability to challenge property tax assessments is important for property owners and others affected by the state's high property tax rates. New York follows the general rule that only "aggrieved" parties may challenge real property assessments.[1] As interpreted by the courts, this means the assessments have a direct adverse effect on the petitioner. Typically, a property owner is the aggrieved party. However, can a tenant who pays property taxes be aggrieved and therefore bring an assessment challenge? According to a recent New York Court of Appeals case, not unless the tenant is legally obligated to pay the property taxes.[2]

The Larchmont Pancake House (LPH) is a family-operated IHOP franchise that was owned, along with the real property it sat on, by Frank and Susan Carfora. Eventually, two of the Carforas' daughters, Irene Corbin and Portia DeGast, became co-owners of LPH.

Following the deaths of the Carforas, the real property was transferred to a revocable trust, the Carfora Trust, and eventually to the Carforas' daughters, who also owned and operated LPH, the tenant and operator at the property. Neither the trust nor the daughters, personally, operated at the property. In the meantime, LPH continued to operate the franchise and to pay all operating costs, including the property taxes.

Administrative grievance complaints challenging the property tax assessments were timely filed by LPH for tax years 2010, 2011, 2012, and 2013. An authorization signed by DeGast as president or owner of LPH was attached to each complaint.

The assessments were confirmed by the board of assessment review, which prompted LPH to initiate tax certiorari proceedings for each of the four tax years under article 7 of the Real Property Tax Law (RPTL), which were brought in Westchester County Supreme Court.

Respondents moved to dismiss the actions, claiming that (1) the supreme court lacked jurisdiction since LPH was not the owner of the real property and therefore could not have filed a

[1] Real Property Tax Law (RPTL) section 704(1).

[2] *See Larchmont Pancake House v. Board of Assessors*, 33 N.Y.3d 228 (2019).

grievance challenging the assessment, and (2) LPH was not an aggrieved party under RPTL section 704(1).

The supreme court denied the motion and the respondents appealed. The appellate division reversed, agreeing with both of the respondents' claims. The case eventually made it to the court of appeals, which held that the identity of an aggrieved party can take two forms: the "quintessential aggrieved party" is the owner of the real property, but so is a tenant "who is bound by his lease to pay an assessment."[3]

Under RPTL article 7, a taxpayer is deemed aggrieved when the assessment has a "direct adverse [e]ffect on the challenger's pecuniary interest."[4] In this case, the court of appeals found that the property tax assessment had only a "remote and consequential impact" on LPH and not the direct adverse effect needed to create standing.[5] LPH did not own the property, the trust did. The Carfora Trust, as the owner, would suffer a direct adverse effect if the property taxes went unpaid.

Of crucial importance to the court's holding was the fact that LPH was not "*legally responsible*" (emphasis added) for paying the real estate taxes. The fact that LPH paid the operating costs did not rise to the level of a contractual obligation. Moreover, the court noted (by way of footnote reference) that LPH never claimed that this arrangement ever "imposed any sort of legal obligation with regard to payment of the real property taxes."[6] Since LPH was a "non-owner with no legal authorization or obligation to pay the real property taxes," it was not an aggrieved party under article 7 of the RPTL.[7]

The dissent, in a lengthy opinion, found that the majority's conclusion would preclude aggrieved taxpayers from judicial review. The majority's "conclusion is as wrong as it sounds."[8] Among other reasons, the dissent pointed out, LPH paid the taxes and thus was aggrieved because the assessment had a "direct adverse [e]ffect" on its pecuniary interests.[9] "If you don't believe me, you have never paid taxes," said Judge Wilson.[10]

So what direction can parties take from this case? Following *Larchmont Pancake House*, the tenant must have a legal obligation to pay the real estate taxes in order to be deemed aggrieved and therefore have standing to bring an assessment challenge. Under RPTL section 524(3), an owner of real property may designate a tenant (or another individual) as an agent with authority to file the grievance on the owner's behalf. For properties occupied by a single tenant, the *Larchmont Pancake House* ruling provides guidance on how a well-drafted lease can preserve a tenant's ability to challenge property tax assessment. For multi-tenanted properties, however, *Larchmont Pancake House* creates more questions than answers. For example, for properties where each tenant pays its pro rata share of the property taxes and has the right to challenge the assessment in the lease, who selects counsel and pays the legal expenses? If the challenge is successful, are the tax savings passed on to all the tenants? What if only some of the tenants want to participate in the assessment challenge? New York case law is murky on these points.

In *Matter of Waldbaum Inc. v. Finance Administrator of the City of New York*, a case from the court of appeals cited in the *Larchmont* majority opinion, the court held that a "fractional lessee lacks standing to maintain a tax certiorari proceeding unless the lease expressly confers the right to assert the lessor's undivided property interest in a challenge of the assessment, or unless the lessee is required to pay directly the taxes levied against the lessor's undivided parcel."[11] In that case, the court reversed the appellate division and held that the tenant, Waldbaum, was not aggrieved because it was not the sole party legally responsible to pay the taxes and had no contractual entitlement to bring a proceeding in the landlord's name. Similar holdings followed.

[3] *Id.* at 237-238.

[4] *Id.* at 237 (brackets in original).

[5] *Id.* at 238 (brackets in original).

[6] *Id.* at 239, n.1.

[7] *Id.* at 240.

[8] *Id.* at 241.

[9] *Id.* at 246 (brackets in original).

[10] *Id.*

[11] 74 N.Y.2d 128, 132 (1989).

The first department, following *Waldbaum*, held in *919 Third Ave. Assocs. v. P.J. Clarke's Inc.* that a fractional lessee is not an aggrieved party because the lease did not authorize an independent protest and the lessee was not obligated to pay the entire real estate tax.[12] The lease required the lessee to pay 11 percent of the real estate tax attributed to the land portion as additional rent.[13] The lessee was not obligated to pay real estate taxes on the entire property.[14]

Although the lease permitted the lessee to challenge "Impositions," that term, as defined in the lease, did not include real estate taxes.[15] The lease further provided that the tax assessor's final evaluation was to be conclusive as between the parties.[16] Imperatively, the court reasoned that while the lessee's pecuniary interests were affected, that alone did not permit the assessment challenge by the lessee.[17] That was because the lease did not explicitly give the lessee the right to bring an assessment challenge.[18]

However, the third department found differently in *K-Mart Corp. v. Board of Assessors of County of Tompkins*, holding that a fractional lessee was an aggrieved party.[19] In *K-Mart*, the petitioner was a fractional lessee and the lease required the petitioner to pay a pro rata share of taxes.[20] Accordingly, "the tax assessments directly and adversely affected petitioner's pecuniary interest as the taxes were passed directly (to the extent of petitioner's share) from the owner to the lessee under the lease terms."[21] The lease provision was relevant to the court's holding, as the lease allowed the lessee to assert the lessor's undivided property interest in an RPTL article 7 proceeding. The lease provided:

> Tenant may contest any such Impositions in any manner permitted by law, in Tenant's name and whenever necessary in Overlandlord's or Landlord's name, provided such contest is not prohibited by the terms of any Fee Mortgage or Leasehold Mortgage. Landlord shall cooperate with Tenant [petitioner] and execute any documents or pleadings required for such purpose without charge.[22]

The third department went on to reason that its interpretation of the lease provision as conferring an undivided interest was consistent with the public policy as it avoids "the fracture of assessment challenges, preventing duplicative petitions, avoiding multiple litigation in the same parcel by parties of unknown relation to the taxed premises, and ensuring proportional assessments among all entities having obligations flowing out of a divided assessment unit."[23]

The fourth department, as cited by the court in *K-Mart*, held similarly in *Ames Department Stores v. Assessor of Town of Concord*.[24] In that case, the court was confronted with the issue of whether a lessee responsible only for a pro rata share of property taxes is aggrieved. The town contended that the general rule that lessees of entire parcels who are obligated to pay taxes are aggrieved does not apply to fractional lessees.[25] In analyzing the RPTL, the court reasoned that there is no distinction between full and fractional plot lessees in the context of who is aggrieved.[26] The court, however, did not perform an analysis of the lease other than noting that the lessee was to pay the pro rata share of taxes.

Landlords and tenants have a mutual interest in keeping the property tax assessment low, even if the tenants pay the taxes. So allowing tenants to directly contest property tax assessments may

[12] 166 A.D.2d 382, 384 (1st Dep't 1990).

[13] *Id.* at 382.

[14] *Id.*

[15] *Id.*

[16] *Id.*

[17] *Id.* at 384.

[18] Interestingly, the lessee and owner both brought assessment challenges. The lessee explained that it brought the challenge because the owner had not sought a sufficient reduction and the lessee wanted to preserve its right to do so given its obligation to pay a share of the property taxes.

[19] 176 A.D.2d 1034 (3d Dep't 1991).

[20] *Id.*

[21] *Id.* (citing *Matter of Ames Department Stores v. Assessor*, 102 A.D.2d 9, 11 (4th Dep't 1984)).

[22] *Id.* at 1034-1035 (brackets in original).

[23] *Id.* at 1035 (citing *Waldbaum*, 74 N.Y.2d at 134).

[24] 102 A.D.2d at 9.

[25] *Id.* at 11.

[26] *Id.* (citing RPTL section 704(1)).

empower tenants to seek lower assessments, for the benefit of the tenant and the landlord. For multi-tenanted properties, to avoid duplicate filings, it remains good practice to name the landlord as an applicant for the grievance before the board of assessment review as well as a petitioner in the article 7 petition. That way, even when the lease permits such a filing, the tenant adds an additional layer of protection from dismissal should there be litigation over the lease provisions. This is also consistent with judicial economy and avoiding duplicative filings as was highlighted in *Waldbaum*.[27] Landlords may also want to consider designating one or more tenants as the lead tenant to file a grievance.

Another option is for tenants to have the right to require a landlord to file a grievance if a set percentage of the tenants (by square footage or headcount) request a challenge to the assessment or if it increases by a set figure or percentage. This might allow a more orderly process that is fair to all the tenants. In that case, it might make sense for all the tenants (regardless of whether they sought the challenge), to bear the cost of the challenge. In turn, they should all share any tax savings that result from the challenge. Since RPTL section 727 provides for a three-year freeze of any reduced assessment brought about by litigation, whether by settlement or court order, landlord and tenants have all the more reason to challenge an assessment. If successful, there would not only be a three-year freeze, but refunds of paid taxes are also available. In light of that, additional provisions should be in the lease to ensure that if the tenant pays the taxes, then in the event refunds are issued as the result of an assessment challenge, those would be credited to the tenant. Similar consideration should be given to including clauses in the lease regarding the selection of counsel and payment of legal fees and costs for an assessment challenge. ■

[27] *Waldbaum*, 74 N.Y.2d at 134.