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New York Court of Appeals Permits Challenge to New York City's Property Tax System

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Tax Equity Now NY LLC v. City of New York, 2024 N.Y. Slip Op. 01498, Issued March 19, 2024 **The sharply divided decision could upend the City's historical treatment of residential properties and could have broad implications for civil litigation in New York.**

On March 19, 2024, the New York Court of Appeals issued an important decision reviving in part a sweeping challenge to New York City's property tax system. The plaintiff in the case, *Tax Equity Now NY LLC v. City of New York*, alleges that the City "imposes substantially unequal tax bills on similarly-valued properties" that bear "little relationship" to fair market value, leading to "staggering inequities," including along racial lines.[1] The Court's holding leaves in place much of the existing tax framework, notably relating to state-law caps on annual tax increases and taxes on commercial properties, but the sharply divided decision reinstates certain claims against the City and could upend the City's historical treatment of residential properties. The decision also could have broad implications for civil litigation in New York, especially relating to New York's liberal pleading standards and claims brought under the federal Fair Housing Act.

Background

New York City's property tax system has a storied history. Article 18 of New York's Real Property Tax Law ("RPTL") was enacted in 1981, over widespread criticism and a Governor's veto, to stave off an impending crisis. For hundreds of years, tax rates were applied to only a percentage of a property's market value, with localities assessing commercial and industrial property at higher ratios than residential property.[2] In 1975, the Court of Appeals held that state law precluded these "fractional assessments" and required tax rates to be applied to full market value.[3] That decision "reverberated throughout the state" by threatening an "unwelcome shift of a significant portion of the property tax burden from businesses to homeowners."[4] The Legislature therefore enacted the current statute, which allows for all real property in the City to be assessed using fractional assessments at a uniform percentage of value. *See* RPTL §§ 305, 1801 *et seq.* Article 18 establishes four different classes of real property in New York City. "Class One" contains primarily one-, two-, and three-family residential property. "Class Two" contains all other residential property, including condos, co-ops, and large rental buildings. "Class Three" contains "utility real property." "Class Four" contains all other real property.[5] In order to avoid abrupt changes in tax liability, Article 18 provides a formula for determining the portion of annual taxes that each of these classes will bear, with state law capping the amount by which each share can increase every year. The statute further establishes caps on year-to-year increases for individual parcels within each class. For example, assessment increases for Class One properties cannot exceed 6% annually and 20% over any five-year period.[6] Within this framework, the City undertakes the assessment and collection of real property taxes. First, the City determines each parcel's *taxable value* by estimating its market value and multiplying it by the fractional assessment rate the City has set for that parcel's class. The City has elected to assess Class One properties at 6% of their market value, and to assess all

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other classes at 45% of their market value.[7] The City then multiplies that market value by the *tax rate* for the class, which is the rate required to satisfy each class's share. The City then further makes adjustments for various abatements and exemptions.[8]

The Court of Appeals Ruling

In *Tax Equity Now NY LLC v. City of New York*, a membership organization committed to pursuing legal and political reform, but "frustrated with the political process,"[9] brought suit against the City and State contending that New York City's property tax system is inequitable, unlawful, and unconstitutional.[10] Broadly speaking, the plaintiff ("TENNY") alleges that property taxes are not uniform and not based on fair-market value, and that the City's tax system has a discriminatory disparate impact on racial minorities, in violation of state and federal law.[11] The New York State Appellate Division dismissed TENNY's claims,[12] but the Court of Appeals reversed that ruling in part. The Court held that TENNY's constitutional claims were "foreclosed by the deferential standard applied to taxation legislation and policy," as the tax system currently in place serves the rational purpose of maintaining stability over time.[13] Moreover, the Court "easily dispose[d]" of TENNY's claims against the State of New York, explaining that "the gravamen of the complaint is a challenge to *the City's* real property tax scheme and, by so focusing, fails to separately explain why the State is liable for the City's methodological choices."[14] Nevertheless, the Court concluded that the complaint has sufficiently pleaded various causes of action against the City for statutory violations of the RPTL and the federal Fair Housing Act in the context of residential properties. Applying New York's "liberal pleading standard," the Court held that TENNY's complaint sufficiently alleges causes of action "on the general basis that the system is unfair, inequitable, and has a discriminatory impact" on certain property owners.[15]

1. **Lack of Uniformity in Tax Assessments**

First, the Court held that TENNY has adequately pleaded a violation of RPTL § 305, which provides that "[a]ll real property in each assessing unit shall be assessed at a uniform percentage of value (fractional assessment)," based on disparate assessment and taxation of properties within Classes One and Two as compared to "fair market value."[16] With respect to Class One property (e.g., one-, two-, and three-family residences), TENNY alleged with data "generated by the City's Independent Budget Office," City-official admissions, and charts depicting geographic disparities that the City assesses taxes in a manner that sometimes requires application of the state-law caps on annual increases, resulting in disparate tax burdens for properties depending on the rate at which their value appreciates, both from borough to borough and within boroughs. Thus, "older properties in faster-appreciating neighborhoods are assessed and taxed at a lower effective rate than other properties of identical market value."[17] The Court rejected the argument that the law requires the City only to *assess* properties uniformly, without regard for the amount of taxes ultimately paid due to "factors outside of the City's control, such as the application of state legislatively mandated caps and exemptions."[18] Construing the statute as a "whole," the Court held that state law "directs the City to ensure that its assessment is based on the property's fair market value" uniformly within each class, while taking into account the state-law caps on increases. According to the Court, the City could do so by lowering assessment ratios so that assessments in rapidly appreciating areas do not implicate the caps while making up any shortfall by raising tax rates uniformly across the class.[19] The Court similarly held that TENNY has adequately alleged, with the support of "publicly-available records," external reports, and City-official admissions, that the City's real property tax system violates RPTL § 305 with respect to its treatment of Class Two condos and co-ops.[20] As the Court explained, the City assesses condos and co-ops that were constructed before 1974 (a category that includes 98% of all City co-ops) by comparing them to rental properties that were built before 1974 and therefore rent-stabilized, even though condos and co-ops do not qualify for rent stabilization "and are, in fact, sold (and rented) at much higher market values."[21] According to the complaint, this causes large disparities in taxes applicable to condos and co-ops depending on whether they were built before or after 1973. The Court rejected the argument that these disparities

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result from RPTL § 581, which requires assessment of condos and co-ops as if they were rental properties, yet does not require the City to "assess a luxury condominium or cooperative as if it were a regulated apartment where the properties differ in meaningful ways."[22] Three judges dissented from the Court's holding. Judges Garcia, Singas, and Cannataro argued that the law's requirement that property be "*assessed* at a uniform percentage of value (fractional assessment)" required the City to do just that: apply a uniform assessment rates, and nothing more, because the statute was never intended to address perceived inequities in the tax system, which serves "rational legislative objectives."[23] They noted that the Legislature enacted statutory caps despite widespread criticism that the system was "at best ineffective and at worst unfair," and warned that the "policy considerations underlying the caps are now written out of New York law," which was a task best left for the Legislature.[24] As for Class Two properties, they similarly reasoned that the Court was seeking to "eliminate perceived disparities by 'interpreting' [state law] to accomplish exactly what those who opposed the legislation's passage warned it did not do."[25] Ultimately, the dissenting judges believed the Court had erroneously read the tax laws "as *requiring* the city to provide equal tax treatment for all properties of equal market value," when the proper method of obtaining such treatment would be through the political process.[26]

2. **Discriminatory Impact on Racial Minorities**

The Court also held that TENNY had sufficiently pled several causes of action under the federal Fair Housing Act, which prohibits discrimination in housing.[27] According to the Court, TENNY had sufficiently alleged that the City "disproportionately burden[s] racial minorities" in Class One properties because owners in majority-minority districts allegedly pay higher tax rates than those in majority-white districts, and higher taxes allegedly "inhibit mobility and place a disproportionate burden on the purchase, ownership and renting of Class One properties."[28] The Court emphasized that it must "accept[] these allegations as true" and repeatedly noted that the complaint includes "hard data" and "examples," such as that properties in majority-minority neighborhoods are over-assessed by $1.9 billion and over-taxed by $376 million, making it more difficult for minorities to buy, own, and rent homes.[29] In addition to Class One properties, the Court held that the complaint adequately alleges discrimination in the treatment of Class Two properties because the City favors owners of Class Two condos and co-ops (who are disproportionately white) over owners of Class Two rental buildings, who in turn pass higher taxes on to renters (who are disproportionately not white), which in turn disproportionately affects the search for affordable housing in New York City.[30 Finally, the Court held that the complaint adequately alleges that the City perpetuates segregation, on the grounds that "blacks and whites are [allegedly] the most isolated from other races" in certain neighborhoods, and that disproportionate tax burdens "suppress minority mobility into wealthier, whiter neighborhoods."[31] The Court emphasized that it was applying New York's "liberal pleading standards," which do not require "allegations defeating every alternative explanation."[32] Thus, while the Court noted that individuals may "choose to live in a different neighborhood or move into or out of a community for reasons unrelated to—or despite—high taxes," which the Court recognized "may present obstacles for TENNY[] . . . as this case progresses," the Court reiterated that "at the pleading stage, we do not consider whether TENNY will eventually establish its cause of action, only whether it has alleged facts that support a legally viable claim."[33] Critically, the Court held that the Appellate Division wrongly applied a limiting principle for claims arising under the Fair Housing Act— the "robust causality" requirement previously recognized by the United States Supreme Court in *Inclusive Communities Project, Inc. v. Texas Dep't of Hous. and Community Affairs*, in which the Supreme Court explained that "a disparate impact claim that relies on a statistical disparity" must fail unless the disparity is actually *caused* by the defendant's policy. 576 U.S. 519, 542 (2015).[34] In the Court's view, that analysis applies only to an "evidentiary record generated during discovery," not to a motion to dismiss, where—under New York's liberal pleading standard—"plaintiff's factual assertions are accepted as true and we need only determine whether the facts fit any cognizable legal theory."[35] Judges Garcia and Singas dissented, arguing that the complaint must allege a "robust" causal connection between the alleged impact and

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challenged policies because "failings at the pleading stage lead inexorably to a failing at later procedural stages."[36] Applying a "robust" causation requirement, Judges Garcia and Singas would have held that TENNY failed to allege that the City "caused" housing disparities because TENNY did not allege sufficient concrete facts or statistical evidence showing that the property tax system, "as opposed to other factors," inhibits the ability of minority residents to relocate or own homes, adding that the "mere identification of higher tax rates in particular neighborhoods does not state a claim" under the FHA.[37]

What It Means

The Court's ruling could have significant implications for New York City's property tax system. Although it leaves in place much of the State's overall tax framework, TENNY will now have the opportunity to substantiate its claims through litigation and pursue systemic reform against the City. As the dissent noted, this decision may result in the removal of important policy issues from the democratic process, where they had previously been hotly contested in Albany. "Instead of all interested stakeholders participating through their elected representatives in an effort to balance competing interests, [the Court's] new rule virtually guarantees that," if TENNY succeeds, "the parties here will craft new tax policy in a settlement conference room."[38] The Court's decision also could have broad implications for civil litigation in New York, especially relating to impact claims in other cases. Here, the plaintiff successfully navigated threshold pleading challenges, such as standing, where other plaintiffs bringing similar claims have failed,[39] and convinced a slim majority on the Court that the complaint adequately alleged causes of action for broad, systemic claims of illegality in the City's property tax system. Interested parties may therefore view the case as a roadmap for seeking reform through similar claims in the future. It is important to note that the Court's decision could have apparent limitations as well. As in other recent cases,[40] the Court repeatedly stressed that this ruling was based, in significant part, on the "liberal pleading standards" that apply at the outset of a case in New York state court, and it acknowledged that Fair Housing claims must satisfy a more robust causation requirement following development of an evidentiary record, which will likely prove complex. Moreover, the Court repeatedly emphasized that the complaint's allegations were "supported with independent studies and the City's own data of widening disparities," resulting from its "annually-repeated assessment methodology"—unique factors that may not exist in other cases.[41] [1] *Tax Equity Now NY LLC v. City of N.Y.* ("*TENNY*"), 2024 WL 1160498, at *1 (N.Y. Ct. App. Mar. 19, 2024). [2] *See Matter of O'Shea v. Board of Assessors of Nassau County*, 8 N.Y.3d 249, 253 (2007); *Matter of Hellerstein v. Assessor of Town of Islip*, 37 N.Y.2d 1, 13 (1975). [3] *See Matter of Hellerstein*, 37 N.Y.2d at 14. [4] *See Matter of O'Shea*, 8 N.Y.3d at 253. [5] *See* RPTL § 1802(1). [6] *See* RPTL § 1805. [7] Thus, for example, a Class One property with a $100,000 market value would have a $6,000 taxable value, and a Class Two property would have a $45,000 taxable value. [8] *See TENNY*, 2024 WL 1160498, at *2. [9] 2024 WL 1160498, at *9 (Garcia, J., dissenting in part). [10] 2024 WL 1160498, at *3. [11] *Id.* [12] Mr. Rokosky was counsel for the State in the Appellate Division prior to joining Gibson Dunn, but he played no role in the Court of Appeals. [13] *TENNY*, 2024 WL 1160498, at *12-13. [14] *Id.* at *14 (emphasis added). [15] *See id.* at *1. [16] *Id.* at *4-9. [17] *Id.* at *4-5. [18] *Id.* at *6. [19] *See id.* at *6-8. [20] *See id.* at *8-9. [21] *Id.* at *5. [22] *Id.* at *9. [23] *Id.* at *15-19 (Garcia, J., dissenting in part). [24] *Id.* at *18. [25] *Id.* [26] *Id.* at *15. [27] *See id.* at *9-12. [28] *Id.* at *9. [29] *Id.* at *9-10. [30] *Id.* at *9. [31] *Id.* at *11-12. [32] *Id.* at *12. [33] *Id.* [34] *Id.* at *11. [35] *Id.* [36] *Id.* at *20 (Garcia, J., dissenting). [37] *Id.* [38] *Id.* [39] *See, e.g.*, *Robinson v. City of New York*, 143 A.D.3d 641 (1st Dep't 2016). [40] *See, e.g.*, *Taxi Tours Inc. v. Go New York Tours, Inc.*, 2024 WL 1097270, at *2 (N.Y. Ct. App. Mar. 14, 2024). [41] *TENNY*, 2024 WL 1160498, at *6.

The Court's opinion is available here. Our lawyers are available to assist in addressing any questions you may have regarding developments at the New York Court of Appeals, or any other state or federal appellate courts in New York. Please feel free to contact any member of the firm's Appellate and Constitutional Law practice group, or the following authors: Mylan L. Denerstein – Co-Chair, Public Policy Practice Group, New York (+1 212.351.3850, mdenerstein@gibsondunn.com) Akiva Shapiro – Chair, New York

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