

New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB-A-93 (18)R
Real Estate Transfer Tax
Real Property
Transfer Gains Tax
Mortgage Recording Tax
October 28, 1993

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. M930910A

On September 10, 1993, a Petition for Advisory Opinion was received from Midtown Realty Company, 1775 Broadway, New York, New York 10019.

The issues raised by Petitioner, Midtown Realty Company, are:

1. Whether the conveyance of title to a condominium unit or units (the "IDA Unit(s)") by Petitioner to the New York City Industrial Development Agency (hereinafter "IDA") in connection with the transactions described herein will be subject to New York State Real Property Transfer Gains Tax (hereinafter the "gains tax") or New York State Real Estate Transfer Tax (hereinafter the "transfer tax").

2. Whether an IDA Title Termination (including reversion of fee title to the IDA Unit(s) to Petitioner) with respect to any or all of the IDA Unit(s), will be subject to gains tax or transfer tax.

3. Whether the creation or termination of the IDA-Petitioner Overlease (the "Overlease") whether the creation is in connection with an Original Conveyance, in connection with a new conveyance of the IDA Unit(s) following a Pre-Date Termination, in connection with Newsweek, Inc.'s (hereinafter the "Tenant") lease of Additional Unit(s), or any similar creation and whether the termination is in connection with the termination of the Overlease upon the expiration of its term or upon an IDA Title Termination with respect to any or all of the IDA Unit(s), or any similar termination will be subject to gains tax or transfer tax.

4. Whether the creation of the Prime Lease or portion thereof in connection with the Original Conveyance, in connection with a new conveyance following a Pre-Date Termination or in connection with Tenant's lease of Additional Unit(s) will be subject to gains tax or transfer tax.

5. Whether any of the transactions described herein between Petitioner and the IDA will result in the imposition of any New York State or New York City mortgage recording tax.

Petitioner is the owner in fee simple of the land and building known as 1775 Broadway, New York, New York (collectively, the "Building"). The Building is an existing 25-story commercial office building containing approximately 580,000 rentable square feet. The Building is partially occupied by commercial tenants and partially vacant. Petitioner is currently negotiating a lease with the Tenant in respect of approximately 203,000 square feet of space in the Building.

Petitioner has been informed that certain economic development benefits will be offered by the City of New York (the "City") to Tenant in connection with Tenant's relocation to, and occupancy of, space in the Building. In particular, it is contemplated that the IDA will issue bonds

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on behalf of Tenant to finance leasehold improvements to be made to the space leased by Tenant, and Tenant will benefit from a real estate tax abatement on the space to be occupied by Tenant, with the agreement that certain payments in lieu of real estate taxes ("PILOT Payments") will be made. Thus Tenant, which had been considering relocation outside of the City, will be given a financially attractive location within the City. Petitioner has been informed that, in order to obtain IDA financing and tax benefits for the portions of the Building to be occupied by Tenant, the IDA must take title to such space, which will then be leased back to Petitioner.

The IDA will not take title to the entire Building. Instead the Building will be converted to condominium ownership. It is presently contemplated that the Building will be divided into two condominium units unless more condominium units are necessary to comply with IDA requirements resulting from the delivery of space to Tenant in more than one stage. Petitioner will convey to the IDA title to the IDA Unit(s) to be occupied by Tenant for zero or nominal consideration (the "Original Conveyance"). Petitioner will retain title to the condominium unit(s) other than the IDA Unit(s). Concurrently with the Original Conveyance, the IDA will net lease the IDA Unit(s) to Petitioner for zero or nominal net rent, with the exception of certain specific obligations with respect to PILOT Payments which are discussed herein. Petitioner will, in turn, sublease the IDA Unit(s) to Tenant (the "Prime Lease") for a rent negotiated between Petitioner and Tenant. Petitioner has been informed that Tenant will, in turn, sub-sublease the IDA Unit(s) to the IDA for zero or nominal consideration, and the IDA will, in turn, sub-sub-sublease the IDA Unit(s) back to Tenant.

It is presently contemplated that Petitioner will convey to the IDA title to the IDA Unit(s) subject to an existing mortgage (the "Mortgage") on the Building held by Principal Mutual Life Insurance Company (the "Mortgagee"). The IDA will have no obligation to make payments on the Mortgage.

The IDA's title to the IDA Unit(s) will end automatically without further action on a date certain (the "Date") in approximately 15 years and 8 months, or earlier upon the occurrence of certain events. (Such ending of the IDA's title with respect to any or all of the IDA Unit(s), through the delivery of a deed, are referred to as an "IDA Title Termination". An IDA Title Termination that occurs on the Date is referred to herein as an "On-Date Termination". An IDA Title Termination that occurs prior to the Date is referred to herein as a "Pre-Date Termination".) The IDA Unit(s) when reconveyed to Petitioner following an IDA Title Termination, Pre-Date Termination or any other similar termination, will not be reconveyed subject to nor will Petitioner assume any mortgage(s) placed on such Unit(s) by the IDA for the benefit of Tenant.

The precise list of events that would cause a Pre-Date Termination is still being negotiated among the parties. Among the events being considered are: (a) the termination of the Prime Lease; (b) the election by the IDA to end the IDA title; (c) the IDA Unit(s) becoming subject to real estate taxes; and (d) the election by Petitioner to end the IDA title, which election may only be made under certain circumstances, such as upon Petitioner making PILOT Payments due to Tenant's failure to do so. In addition, it is possible that in the case of some or all of these events, the ending of the IDA's

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title will be accomplished by the IDA executing and delivering to Petitioner a deed to any or all of the IDA Unit(s).

Immediately after obtaining title to the IDA Unit(s), the IDA will lease the IDA Unit(s) back to Petitioner for zero or a nominal rent pursuant to the Overlease. The terms of the Overlease are still being negotiated, but it is contemplated that the provisions of that lease will not differ materially from those described herein. The term of the Overlease will be co-extensive with the term of the IDA's title to the IDA Unit(s), approximately 15 years and 8 months. The IDA agrees in the Overlease that it will not have a beneficial interest in the IDA Unit(s). The Overlease will be a fully net lease, obligating Petitioner to pay all costs and expenses of maintaining and operating the IDA Unit(s) and to indemnify the IDA, its officers, directors, and employees for any liabilities arising from the operation of the IDA Unit(s). The IDA will have no obligation to improve, replace, service, adjust, repair or maintain any portion of the IDA Unit(s).

If Petitioner defaults under the Overlease, the IDA may take any action at law or equity to enforce the terms of the Overlease. However, the IDA will not have the right to terminate the Overlease or otherwise impair Petitioner's estate, except as otherwise provided in the PILOT Mortgage as discussed herein. Petitioner may voluntarily assign or transfer its interest in the Overlease, subject to the then-existing tenancies and subtenancies, provided that: (a) Petitioner transfers all of its interests in the IDA Unit(s), including its reversionary interests; (b) the assignee or transferee agrees to assume all of Petitioner's obligations under the Overlease; and (c) the assignee or transferee is not prohibited by law from entering into a transaction with the IDA. Petitioner may also mortgage its interest in the Overlease and its reversionary interest without the IDA's consent. The IDA will not have the right to sell, assign, convey, lease, or otherwise encumber its title to the IDA Unit(s) without Petitioner's consent. Any attempt by the IDA to dispose of the IDA Unit(s) without Petitioner's consent will be void.

The terms of the Prime Lease are still being negotiated, but it is contemplated that the provisions of that lease will not differ materially from those described herein. Petitioner will sublease the IDA Unit(s) to Tenant. The terms of the Prime Lease is 15 years and 8 months, and Tenant will have an option to extend the term for an additional 15 years. Tenant will not have an option to purchase the IDA Unit(s). Under the Prime Lease, Tenant's rent payments will include a portion of the Building's operating expenses and charges, but not real estate taxes. Tenant will pay all real estate taxes imposed on the IDA Unit(s) until the Unit(s) become exempt from real estate taxes. Once the IDA Unit(s) become tax exempt, Tenant will make PILOT Payments under a separate agreement with the IDA. Petitioner will not receive consideration from Tenant, directly or indirectly, in connection with the Prime Lease, other than payments under the Lease. A separate agreement will provide that Petitioner will make certain payments in the event that Tenant fails to make PILOT Payments. As security for this obligation, Petitioner will grant a mortgage on Petitioner's leasehold estate in the IDA Unit(s) to the IDA (the "PILOT Mortgage"). Petitioner will be entitled to reimbursement from Tenant for any payments made by Petitioner with respect to the IDA Unit(s).

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The Prime Lease gives Tenant the option to occupy additional space in the Building ("Additional Unit(s)"). To the extent that Tenant exercises an option to occupy an Additional Unit, Petitioner may, at Tenant's option and provided certain conditions are met, convey to the IDA title to the Additional Unit, subject to any existing mortgage. The Additional Unit will be leased back to Petitioner and will automatically become part of the IDA Unit(s) for purposes of the Overlease. The IDA or Petitioner, upon the request of the other, will execute an amendment to the Overlease confirming the inclusion of an Additional Unit in the Overlease, providing that the terms of the amendment do not vary from the Overlease.

Upon an IDA Title Termination with respect to any IDA Unit(s), whether an On-Date Termination or a Pre-Date Termination, Petitioner will have a full fee simple title to such Unit(s). In addition, the Overlease will no longer apply to such Unit(s) or, upon an IDA Title Termination with respect to all the Unit(s), the Overlease will terminate. Upon or after a Pre-Date Termination, Petitioner may once again convey to the IDA title to any or all of such Unit(s), and such Unit(s) would again be subject to the Overlease (and the Prime Lease to the extent such Unit(s) were not otherwise subject to such lease) or a new such lease would be entered into with respect to such Unit(s).

At the time of any conveyance by Petitioner to the IDA or at the time of any IDA Title Termination, it is possible that any or all of the IDA Unit(s) (or Petitioner's interest in such Unit(s)) will be subject to a mortgage placed on such Unit(s) (or Petitioner's interest in such Unit(s)) by Petitioner. Similarly, Petitioner may obtain financing secured by a mortgage (or may otherwise permit the placing of a mortgage) which will be a lien on any or all of the following: (a) all or a portion of Petitioner's leasehold position under the Overlease; (b) all or a portion of Petitioner's interest in the IDA Unit(s); and (c) all or a portion of the IDA's title in the IDA Unit(s). (The IDA has agreed to subject its title to any mortgage at Petitioner's request.) Under all circumstances, as against the IDA, Petitioner will be the beneficiary of any proceeds received under any debt secured by the lien of such mortgage and as against the IDA will be the party with ultimate economic liability to repay any such debt.

For federal, state and local tax and financial reporting purposes, Petitioner will treat itself as the owner of the IDA Unit(s). Petitioner will have the right in its own name to apply to governmental agencies in matters covering the IDA Unit(s) and to initiate contests regarding legal requirements of the IDA Unit(s). As between the IDA and Petitioner, all condemnation awards or insurance proceeds will be the sole property of Petitioner. Petitioner, without prior consent from the IDA, may assign or transfer its interest in the IDA Unit(s) with notice to the IDA and the assignee or transferee's certification that it is not proscribed from accepting the assignment or transfer. As between the IDA and Petitioner, Petitioner assumes all risk of loss and retains the potential for any profit through the Prime Lease and its ability to transfer its interest in the IDA Unit(s).

The gains tax is a ten percent tax on the gain derived from the transfer of real property, which includes the transfer or acquisition of a controlling interest in an entity with an interest in real property, where the real property is located in New York State and where the consideration for the transfer is \$1 million or more.

Section 590.5 of the Gains Tax Regulations provides as follows:

590.5 Lease/sublease as a transfer of real property. [Tax Law, §1440(7)]

(a) Question: Is the creation of a leasehold or sublease a transfer of real property?

Answer: Yes. The creation of a leasehold or sublease is a transfer of an interest in real property, but only where:

(1) the sum of the term of the lease or sublease and any options for renewal exceeds 49 years;

(2) substantial capital improvements are or may be made by or for the benefit of the lessee or sublessee; and

(3) the lease or sublease is for substantially all of the premises constituting the real property. Substantially all is defined to mean 90 percent of the total rentable space, of the premises exclusive of common areas. (See section 590.56 of this Part, relating to an assignment of a lease.)

For the purpose of determining whether a lease or sublease is for substantially all of the premises constituting the real property, premises shall include, but not be limited to the following:

1) an individual building, except for space which constitutes an individual condominium or cooperative unit;

(2) an individual condominium or cooperative unit; or

(3) where a lease or sublease is of vacant land only, any portion of such vacant land.

(b) Question: Is the creation of a leasehold for a term of less than 49 years ever taxable?

Answer: Yes. If a leasehold is coupled with the granting of an option to purchase the property, the transfer is taxable regardless of the term of the lease. Section 590.67(a) of the Gains Tax Regulations provides, in part, as follows:

590.67 Transfers pursuant to industrial development agency projects.
[Tax Law, §1440]

(a) Question: How are transfers of interests in real property to and from an industrial development agency (IDA) treated for purposes of the gains tax?

Answer: When the company (the beneficiary of an industrial revenue bond financing) transfers fee title to the real property to the IDA solely for the purpose of receiving tax-exempt financing, and simultaneously leases such property back, upon which the company will construct an improvement, the company will be considered the owner of the project and there will not be a taxable event for gains tax purposes until the company transfers an interest in the land or building to a party other than the IDA. This is also true for ground leases/subleases or other similar transactions which are designed to facilitate industrial revenue bond financings.

Section 575.7 of the Transfer Tax Regulations states as follows:

575.7 Leases and subleases (Tax Law, §1401(d)(e), (f)) (a) Creation of a taxable lease or sublease not coupled with an option to purchase. The creation of a lease or sublease is a conveyance subject to tax only where:

(1) the sum of the term of the lease or sublease and any options for renewal exceeds 49 years, and

(2) substantial capital improvements are or may be made by or for the benefit of the lessee or sublessee, and

(3) the lease or sublease is for substantially all of the premises constituting the real property. "Substantially all" means ninety percent or more of the total rentable space of the premises, exclusive of common areas. "Premises" means each unit of real property which, at the time that the lease or sublease is created, is capable of being sold separately.

For the purpose of determining whether a lease or sublease is for substantially all of the premises constituting the real property, premises shall include, but not be limited to the following:

(1) an individual building, except for space which constitutes an individual condominium or cooperative unit;

(2) an individual condominium or cooperative unit; or

(3) where a lease or sublease is of vacant land only, any portion of such vacant land.

Moreover, Section 575.11(a) of the Transfer Tax Regulations provides, in part, as follows:

(a) The following are examples of conveyances which are subject to the real estate transfer tax.

* * *

- (13) A conveyance of real property to an industrial development agency (IDA) by a person who is not the beneficiary of the IDA financing, at the direction of such beneficiary, with such beneficiary subsequently leasing the property from the IDA, is subject to tax. In such a conveyance, the beneficiary of the IDA financing and not the IDA is deemed to be the grantee, and therefore the exemption described at paragraph (1) of subdivision (c) of section 575.9 of this Part does not apply.
- (14) A conveyance of real property by an IDA to a person who is not the beneficiary of the IDA financing where such conveyance is made at the direction of such beneficiary is subject to tax. In such a conveyance, the beneficiary of the IDA financing is deemed to be the grantor or the conveyance.

Section 575.11(b) of the Transfer Tax Regulations provides as follows:

"(b) The following are examples of conveyances which are not subject to the real estate transfer tax.

(1) A conveyance of real property by the beneficiary of the industrial development agency (IDA) financing to the IDA, in connection with the receipt of such financing is not subject to tax.

(2) A conveyance of real property by the IDA, as grantor, to the beneficiary of the IDA financing, as grantee is not subject to tax."

Section 250 of the Tax Law defines the term "mortgage" to include "every mortgage or deed of trust which imposes a lien on or affects the title to real property, notwithstanding that such property may form a part of the security for the debt or debts secured thereby."

In the matter of Macy & Co. v. Bates, 280 App. Div. 292 the Court held, in part, as follows:

A mortgage, whether in form or equitable, imports a debt or obligation to be secured, due from the mortgagor to the mortgagee, a right to foreclose, and the reciprocal right to redeem. Without those elements there can be no mortgage, and they are absent here.

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With respect to issue "1", the focus of Section 590.67 of the Gains Tax Regulations and Section 575.11 of the Transfer Tax Regulations is to exclude from gains tax and transfer tax respectively the transfer of title to real property to an IDA for the purpose of obtaining IDA financing, where the grantor remains the beneficial owner of the property. In the instant case, while Petitioner is not the beneficiary of the IDA financing, the transfer of the condominium units will not result in a change in beneficial ownership since Petitioner retains all the benefits and burdens of ownership of the IDA Units. Accordingly, in keeping with the intent of Section 590.67 of the Gains Tax Regulations and Section 575.11 of the Transfer Tax Regulations, the conveyance of title to the condominium units in connection with the transactions described herein will not be subject to gains tax or transfer tax.

Concerning issue "2", pursuant to Section 590.67 of the Gains Tax Regulations and Section 575.11 of the Transfer Tax Regulations since Petitioner remains the beneficial owner of the condominium units, an IDA Title Termination with respect to any of the units will not result in a change in beneficial interest. Therefore, an IDA Title Termination with respect to any of the units will not be subject to gains tax or transfer tax.

As for issue "3", pursuant to Section 590.67 of the Gains Tax Regulations and Section 575.11 of the Transfer Tax Regulations the lease back of property by an IDA to the beneficiary of the IDA financing, is not subject to gains tax and transfer tax, respectively, since the beneficiary of the IDA financing remains the beneficial owner of the property. In the instant case, while Petitioner is not the beneficiary of the IDA financing, Petitioner is the beneficial owner of the property. Therefore, in keeping with the intent of Section 590.67 of the Gains Tax Regulations and Section 575.11 of the Transfer Tax Regulations, the creation or termination of the IDA-Petitioner Overlease whether in connection with an Original Conveyance, in connection with a new conveyance following a PreDate Termination, in connection with Tenant's lease of Additional Unit(s) or any similar creation, and whether the termination of the Overlease upon the expiration of its term or upon an IDA Title Termination with respect to any or all of the IDA Unit(s) or any similar creation or termination will not be subject to gains tax or transfer tax.

With respect to issue "4", pursuant to Section 590.5 of the Gains Tax Regulations and Section 575.7 of the Transfer Tax Regulations the creation of a lease for a term of less than 49 years, including renewal periods and not coupled with an option to purchase is not subject to gains tax and transfer tax respectively. Accordingly, since the creation of the Petitioner-Tenant Prime Lease or portion thereof in connection with its original creation, in connection with a new conveyance following a Pre-Date Termination or in connection with Tenant's Prime Lease of Additional Unit(s) will be for a term of less than 49 years, including renewal periods and contains no options to purchase such leases will not be subject to gains tax or transfer tax.

Concerning issue "5", pursuant to Section 250 of the Tax Law and Macy & Go. v. Bates, supra, while the transactions described in issues "1", "2", "3" and "4" affect title to the real property such conveyances are not given as security for the payment of a debt or for the performance of an obligation. Accordingly, for purposes of Article 11 of the Tax Law no mortgage exists and such

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transactions will not be subject to New York State and New York City mortgage recording taxes.

With respect to the taxability of the PILOT Mortgage, the powers of an IDA, as set forth in Article 18-A of the General Municipal Law, include the power to acquire and use real property and the power to mortgage or otherwise dispose of such property (General Municipal Law § 858). Section 874 of the General Municipal Law provides that in the exercise of its powers, the IDA is "performing a governmental function" and shall be required to pay no taxes upon its activities. To the extent that the creation of the PILOT Mortgage is authorized by Section 858 of the General Municipal Law, the recording of such PILOT Mortgage, as heretofore described, is exempt from the imposition of New York State and New York City mortgage recording taxes.

It is noted that this opinion does not address the application of Article 11 of the Tax Law, the Tax on Mortgages, to Petitioner's mortgaging of its interest in the IDA-Petitioner Prime Lease or all or a portion of Petitioner's reversionary interest in the fee interest in the IDA Unit(s).

DATED: October 28, 1993

/s/
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NOTE: The opinions expressed in Advisory Opinions
are limited to the facts set forth therein.