

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

TSB-A-95 (5)R
Real Property Tax
Mortgage Recording Taxes
June 26, 1995

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. M950216A

On February 16, 1995, a Petition for Advisory Opinion was received from Stanley Stahl, c/o Stahl Park Ave., 247 Park Avenue, New York, NY 10172.

The issues raised by Petitioner, Stanley Stahl, are:

1. Whether Petitioner will be subject to the Real Estate Transfer Tax (hereinafter the "transfer tax") and the Real Property Transfer Gains Tax (hereinafter the "gains tax") upon the conveyance of title to a condominium unit or units by Petitioner to the New York City Industrial Development Agency (the "IDA").
2. Whether Petitioner will be subject to the transfer tax and the gains tax upon the reversion or reconveyance of an IDA unit or units to Petitioner.
3. Whether Petitioner will be subject to the transfer tax and the gains tax upon the creation or termination of the Overlease or, creation of the Prime Lease or, the addition or deletion of the additional Units in the IDA Unit under either lease.

Petitioner, d/b/a Stahl Park Avenue Co. (hereinafter "Stahl"), is currently the fee owner and ground tenant of the premises known as 277 Park Avenue (the "Building"), in the Borough of Manhattan, block #1302, lot #1 (to be known as lots 1001-1018 upon formation of the condominiums described herein).

Stahl has been advised, pursuant to a resolution adopted by IDA on August 9, 1994, that certain economic development benefits were authorized in order to induce Donaldson, Lufkin & Jenrette, Inc. ("DLJ") to retain its offices in New York City (the "City"). The IDA has agreed to participate in the transaction described herein and to confer tax benefits upon DLJ to reduce its costs of operating and maintaining its City offices. Moreover, the IDA will help finance the cost of equipment and leasehold improvements. DLJ will enter into various agreements with the IDA to facilitate the transactions.

In order to convey the economic development benefits, the IDA must have a proprietary interest in the property being benefitted. Thus, the Building will be converted to a condominium regime of ownership comprising eighteen condominium units (the "Units"). Seventeen condominium units, comprising seventeen floors of the Building, will be occupied by DLJ (the "DLJ" Space). The remaining space in the Building will be allocated to a separate condominium unit (the "Stahl Unit").

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Stahl will convey title to all or a portion of the DLJ Space in Unit increments to the IDA (the portion of the DLJ Space conveyed is hereinafter referred to as the "IDA Unit").

The title to the IDA Unit will revert back to Stahl on March 31, 2016, which date is also the expiration date of the Overlease. Moreover, title to the IDA Unit will also automatically revert back to Stahl when the benefits being afforded to DLJ, or any of the leases or subleases entered into with DLJ, terminate.

The purchase price for the IDA Unit will be zero or a nominal amount. Immediately following the conveyance by Stahl to the IDA, the IDA will triple net lease the IDA Unit back to Stahl pursuant to the Overlease. The term of the Overlease will be approximately 22 years.

While the IDA holds record title to the IDA Unit, the Overlease provides, and the parties to the transaction intend, that Stahl will be the beneficial owner of the IDA Unit and will bear all the burdens of ownership thereof. The Overlease further relieves the IDA from any obligations to improve, replace, service, repair or maintain any portion of the IDA Unit. Moreover, Stahl will agree to indemnify the IDA, its directors, officers and employees of any liabilities arising from the operation of the IDA Unit. The Overlease further provides that Stahl, as the beneficial owner of the IDA Unit, will have the right in its own name to apply to governmental agencies in matters concerning the IDA Unit and to initiate contests regarding legal requirements of the IDA Unit.

The IDA affirmatively agrees in the Overlease that it will not have any beneficial interest in the IDA Unit and therefore no interest in any condemnation awards as to the IDA Unit or any proceeds from insurance maintained by Stahl or DLJ. As between the IDA and Stahl, all condemnation awards or insurance proceeds will be the sole property of Stahl.

Stahl retains free transferability of the IDA Unit. Stahl may assign or transfer its interest in the Overlease, subject to then existing tenancies and subtenancies, provided that (1) Stahl transfers all its interests in the IDA Unit, including any reversionary interests; (2) notice is given to the IDA of the assignment and transfer and the identity and of the transferee or assignee; and (3) the assignee or transferee certifies that it is not among the groups proscribed from entering into transactions with the IDA. Stahl may also mortgage its interest in the Overlease and its reversionary interest. At Stahl's request, the IDA will subject its title to the IDA Units to any such mortgage, subject to certain restrictions, such as limitations on the mortgagee's ability to foreclose against the IDA's title.

The IDA will not have the right to sell, assign, convey, lease, or otherwise encumber its title to the IDA Unit without Stahl's consent. Any attempt by the IDA to dispose of the IDA Unit without Stahl's consent will be void.

Petitioner represents that pursuant to the Declaration of Condominium filed in connection with the conversion of the Building to a condominium regime defines "Unit Owner" as "the Person or Persons owning the simple interest in the Unit; provided, however, that the person holding both

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the Future Estate and being the IDA Unit Overlessee shall for all purposes hereof, and the IDA shall not for any purposes whatsoever, be deemed to be the Unit Owner of the IDA Unit." Therefore, Stahl will be the "owner" of the IDA Unit for all purposes of the Declaration and Condominium's by-laws, and, as such, Stahl will be responsible for paying monthly common charges and any other expenses assessed against condominium unit owners. Stahl will also have the right to make any alterations, additions, installations, improvements and substitutions to the IDA Unit, provided that any changes meet all laws.

The parties to the transaction have executed a waiver pursuant to Section 339-r of the Real Property Law and, therefore, the IDA Unit will be transferred subject to an existing mortgage on the Building. The exiting mortgage will continue to encumber Stahl's fee title to the condominium units in the Building not conveyed to the IDA, Stahl's interest as lessee under the Overlease and Stahl's reversionary interest in the IDA Units. The IDA will have no obligation to make payments on the mortgage and the Mortgagee's ability to foreclose against the IDA's title will be limited.

Immediately following the Stahl-IDA sale-leaseback transaction, Stahl and DLJ will enter into an agreement (the "Prime Lease") to sublease to DLJ the IDA Unit for an initial term of approximately 22 years. Under the Prime Lease, DLJ's rent payments will include a portion of the Building's operating expenses and taxes. If and until such time that a Unit subject to the Prime Lease becomes an IDA Unit, DLJ will pay the real estate property taxes attributable to that Unit. Thereafter, DLJ will make payments in lieu of real estate taxes under a separate agreement with the IDA ("PILOT payments").

A separate agreement with IDA provides that Stahl will make certain payments in the event that DLJ fails to make PILOT payments. As security for this obligation, Stahl will grant a mortgage on Stahl's leasehold estate in the IDA Units to the IDA (the "PILOT Mortgage"). Stahl has represented that it is entitled to reimbursement from DL3 for any PILOT payments made by Stahl for the IDA Unit. In the Prime Lease DLJ acknowledges that Stahl is the holder of the beneficial and economic interest as the landlord under the Prime Lease.

Stahl has been informed and the recital to the Overlease states that DLJ will sub-sublease the IDA Unit to the IDA, and the IDA will, in turn, sub-sub-sublease the IDA Unit back to DLJ. The sublease-leaseback between IDA and DLJ is necessary for the IDA to provide financing to DL3 for improvements to the IDA Unit and the acquisition of equipment. The Overlease further states that the IDA is deemed not to have assumed, or be responsible for, any obligations of DL3 under the Prime Lease.

Stahl also represents that it will claim to be the owner of an IDA Unit for federal, state and local income tax purposes for as long as it holds a leasehold position under the Overlease and a reversionary interest in the unit.

In accordance with Section 1402 of the Tax Law, a transfer tax is imposed on each conveyance of real property or interest therein at the time that the instrument effecting the conveyance is delivered by a grantor to a grantee when the consideration for the conveyance exceeds five hundred dollars.

Section 575.7 of the Transfer Tax Regulations provides as follows:

Section 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. For purposes 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:

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

(ii) an individual condominium or cooperative unit; or

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

Section 575.9 of the Transfer Tax Regulations provides, in part, as follows:

* * *

(c) In addition to the exemptions described in subdivision (b) of this section, certain transactions are not subject to the real estate transfer tax. These include:

(1) conveyances to any of the governmental organizations or entities described in subdivision (b) of this section, including any instrumentality or agency of the United Nations;

Section 575.11 of the Transfer Tax Regulations provides, in part, as follows:

575.11 Examples of taxable and nontaxable conveyances. (a) The following are examples of conveyances which are subject to 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 section 575.9(c)(1) 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 of the conveyance.

* * *

(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.

Pursuant to Sections 1441 and 1443.1 of the Tax Law and Section 590.1 of the Gains Tax Regulations the gains tax is a ten percent tax on the gain derived from the transfer of real property, which includes the acquisition or transfer of a controlling interest in any entity with an interest in real property, where the property is located in New York State and where the consideration for the transfer is one million dollars 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 or more of the total rentable space of the premises, exclusive of common areas. (See section 590.57 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:

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

(ii) an individual condominium or cooperative unit; or

(iii) 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 590.68(a) of the Gains Tax Regulations provides as follows:

(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: Where 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 and interest

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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.

However, in a situation where the IDA obtains the real property directly from a third party at the direction of the company and leases the property to the company, the transfer to the IDA will be subject to the gains tax if the consideration for the transfer is \$1 million or more.

In The Chase Manhattan Bank, N.A., Adv Op Comm T&F, February 8, 1993, TSB-A-93(1.1)-R, the Commissioner advised that while the petitioner was not the beneficiary of the IDA financing, the transfer of certain condominium units to the New York City Industrial Development Agency (the "IDA Units") would not result in a change in beneficial ownership since the petitioner retains all the benefits and burdens of ownership of the IDA Units, and therefore, the transfer of title to such IDA Units to the IDA would not be subject to the gains tax and the transfer tax. Moreover, the Commissioner advised that the reversion of fee title to the IDA Units to the petitioner would not result in a change in beneficial interest and, therefore, would not be subject to the gains tax and the transfer tax. The Commissioner further advised that the creation of certain leases and leasebacks between IDA and the petitioner and the petitioner and the bond financing recipient were not subject to the gains tax and the transfer tax.

In Resnick Water St. Development Co., Adv Op Comm T&F, January 12, 1993, TSB-A-93(2)-R the Commissioner advised that while the petitioner was not the beneficiary of the IDA financing, the transfer of certain condominium units to the New York City Industrial Development Agency (the "IDA Units") would not result in a change in beneficial ownership since the petitioner retains all the benefits and burdens of ownership of the IDA Units, and therefore, the transfer of title to such IDA Units to the IDA would not be subject to the gains tax and the transfer tax. Moreover, the Commissioner advised that the reversion of fee title to the IDA Units to the petitioner would not result in a change in beneficial interest and, therefore, would not be subject to the gains tax and the transfer tax. The Commissioner further advised that the creation of certain leases and leasebacks between IDA and the petitioner and the petitioner and the bond financing recipient were not subject to the gains tax and the transfer tax.

With respect to issue "1", the focus of Section 590.68(a) of the Gains Tax Regulations and Section 575.11 of the Transfer Tax Regulations is to exclude from the gains tax and transfer tax 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. Moreover, pursuant to The Chase Manhattan Bank, N.A., *supra*, and Resnick Water St. Development Co., *supra*, the transfers of certain condominium units to the New York City Industrial Development Agency were deemed not to result in a change in beneficial ownership since the petitioner retained all the benefits and burdens of ownership of the IDA Units. In the instant case, while Petitioner is not the beneficiary of the IDA financing, the transfer of the condominium unit or units to the IDA will not result in a change in

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beneficial ownership since Petitioner retains all the benefits and burdens of ownership of the IDA unit or units. Accordingly, in keeping with the intent of Section 590.68(a) of the Gains Tax Regulations and Section 575.11 of the Transfer Tax Regulations, and pursuant to The Chase Manhattan Bank, N.A., supra, and Resnick Water St. Development, supra, the transfer of title to the condominium unit or units to the IDA will not be subject to gains tax or transfer tax.

Concerning issue "2", pursuant to Section 590.68(a) of the Gains Tax Regulations and Section 575.11 of the Transfer Tax Regulations, The Chase Manhattan Bank, N.A., supra, and Resnick Water St. Development Co., supra, since Petitioner remains the beneficial owner of the condominium unit or units, the reversion or reconveyance of an IDA unit or units to Petitioner will not result in a change in beneficial interest. Therefore, the reversion or reconveyance of an IDA unit or units to Petitioner will not be subject to gains tax or transfer tax.

As for issue "3", pursuant to Section 590.68(a) of the Gains Tax Regulations and Section 575.11 of the Transfer Tax Regulations the leaseback 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 590.68(a) of the Gains Tax Regulations and Section 575.11 of the Transfer Tax Regulations, and The Chase Manhattan Bank, N.A., supra, and Resnick Water St. Development Co., supra, the creation or termination of the Overlease, whether in connection with the addition or deletion of additional Units in the IDA Unit, will not be subject to gains tax or transfer tax.

In addition, 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 Prime Lease, in connection with the

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addition or deletion of additional Units in the IDA Units will be for a term of less than 49 years, including renewal periods and contains no options to purchase, the creation of the Prime Lease will not be subject to gains tax and transfer tax.

DATED: June 26, 1995

/s/
PAUL B. COBURN
Deputy Director
Taxpayer Services Division

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