STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION   PETITION NO Z980521A

On May 21, 1998 the Department of Taxation and Finance received a Petition for Advisory Opinion from Beth Israel Medical Center, 555 West 57th Street, New York, New York 10019.

The issues raised by Petitioner, Beth Israel Medical Center, are as follows:

1. Whether the purchase of materials or services by the contractor for the construction of the Improvements or payments to the contractor for the construction of the Improvements will be subject to New York State or New York City sales or use taxes (sales tax).

2. Whether the Ground Lease from Petitioner to the Trust or any payments under the Ground Lease are subject to sales tax.

3. Whether the Leaseback from the Trust to Petitioner or any payments under the Leaseback are subject to sales tax.

4. Whether the acquisition of the Improvements by Petitioner upon the exercise of its option to purchase to be implemented by assignment of the leasehold interest under the Ground Lease to Petitioner is subject to sales tax.

5. Whether the lease and leaseback transaction will be disregarded as a mere financing arrangement for sales tax purposes so that the overall transaction will be regarded as the construction of improvements by a contractor for an organization that is exempt from sales tax under Section 1115(a)(15) of the Tax Law.

6. Whether the New York State or New York City mortgage recording taxes (the mortgage recording tax) apply to all or any part of the lease and leaseback transaction.

7. Whether the Ground Lease from Petitioner to the Trust is subject to New York State Real Estate Transfer Tax (the transfer tax).

8. Whether the Leaseback from the Trust to Petitioner is subject to the transfer tax.

9. Whether the acquisition of the Improvements by Petitioner upon the exercise of its option to purchase to be implemented by assignment of the leasehold interest under the Ground Lease to Petitioner will be subject to transfer tax.

Petitioner submits the following facts as a basis for this advisory opinion.

Petitioner is a voluntary nonprofit hospital corporation and constitutes an exempt organization under Section 1116(a)(4) of the Tax Law. Petitioner plans to construct an emergency facility, intensive care unit, operating room suites, service dock and underground parking (the "Facility"). The funding for such construction (the "Funding") is being implemented through a financing device commonly referred to as a "synthetic lease".

The Facility will be constructed at the Kings Highway Division of Petitioner in Brooklyn, New York. Petitioner is and will remain fee owner of the land on which the Facility will be constructed. The anticipated construction cost is approximately $11 million and will be done in conjunction with a related equipment financing of approximately $3 million. The Facility will be added as a wing to the existing buildings at the site, and will obtain hot water and possibly other basic services from the existing buildings.

Petitioner is seeking to build the Facility and to finance this development on a long term basis. It is Petitioner's intention to maintain and utilize the new Facility together with the other buildings situated at the Kings Highway Division Hospital and to integrate its operation into the services provided at that Hospital. Petitioner desires to receive 100% financing for the project at rates of interest commensurate with its investment grade rating. The size of the project is relatively small and the cost associated with the issuance of tax-exempt revenue bonds for an offering of this size would be prohibitive. Because the Facility is of a special purpose nature and it will be located within the existing Hospital campus and attached to the existing buildings, it would be difficult if not impossible to attract private development capital to construct and own the Facility. Due to indenture requirements under its existing bonds, it is of importance to Petitioner to avoid assuming significant debt.

As a result of the foregoing considerations, Petitioner desires to proceed with a form of financing known as an off balance sheet financing, or as a "synthetic lease", which is essentially a credit operating lease providing 100% financing with characteristics of ownership for Petitioner. However, in order to achieve the "off-balance sheet" nature of the financing, it is necessary to meet certain tests established under Financial Accounting Standards, and for this reason the structure incorporates a "lease and leaseback" arrangement which is similar to a so-called "sale-leaseback" financing.

The land will be leased pursuant to a 49-year lease (the "Ground Lease") by Petitioner to a trust (the "Trust") established and beneficially owned by a financial institution (the "Lender") that will provide the Funding for the construction. At the same time, the Trust will lease the land back to Petitioner as lessee on a triple net lease basis under which Petitioner will be responsible for all expenses (the "Leaseback"). During the term of the Leaseback, rent under the Ground Lease will be a nominal $1.00 annually.

Under the Ground Lease, the Trust, as lessee under the Ground Lease, is obligated to construct the improvements. However, under the Leaseback, Petitioner as lessee under the Leaseback, would be responsible for actually implementing construction of the improvements comprising the emergency facility (the "Improvements") and will be obligated to complete the construction regardless of the sufficiency of the Funding amount. Legal title to the Improvements will vest in Petitioner as fee owner as the Improvements are constructed.

The Leaseback will have an Interim Term of 16 months, which is the anticipated period of construction. This is followed by a Base Term of three years and eight months, and by 10 one-year Renewal Terms, so that, if all Renewal Terms were exercised, the aggregate term of the lease would be 15 years. At the expiration of the Leaseback, Petitioner, as lessee under the Leaseback, has the choice to: (i) acquire the Trust's position as lessor under the Ground Lease by taking an assignment of the Ground Lease (the "Purchase Option") for a price equal to the then outstanding lease balance ("Purchase Option Price"), or (ii) allow the Leaseback to expire. The Purchase Option Price varies downward from approximately 92 percent of the cost of construction at the end of the fifth year of the Ground Lease to 50 percent of cost at the end of the fifteenth year of the Ground Lease, and is equal to the amount which would be the unpaid balance of principal and interest on the Funding if it were a loan. When Petitioner exercises the option, the Ground Lease is extinguished. If the Purchase Option is not exercised at the end of the Leaseback, possession of the Improvements is returned to the Trust by virtue of termination of the Leaseback. In this event, Petitioner must make a termination payment equal to 44 percent of Funding, and the Ground Lease will continue for the balance of its 49-year term. Thus, unless Petitioner exercises its Purchase Option, it will have paid 94 percent of the Funding (50 percent plus 44 percent) and lose possession of the Improvements. The Leaseback termination payment is so close to the Purchase Option Price and the penalty so heavy for failure to purchase that it is highly likely that the Purchase Option will be exercised. It is not contemplated that the Trust would retain the Ground Lease in any circumstances, and the lease documentation will require Petitioner to find a third party to take an assignment of the Ground Lease if the Purchase Option is not exercised.

The Lender will provide to the Trust 100 percent of the Funding. Rent under the Leaseback will be paid monthly in arrears. During the Interim Term (i.e., the anticipated period of construction), rent will consist of the amount which would constitute "interest" only on the Funding if it were a loan, and thereafter rent will consist of the amount which would constitute the monthly interest and principal amortization payment sufficient to amortize 50 percent of the Funding by the end of the maximum 15 year term. The "interest" component of the rent for the purpose of this computation is based on the rate on United States Treasury obligations at the time of execution, plus an agreed upon margin.

Under the terms of the Leaseback, the construction of the Improvements is to be carried out under plans and specifications prepared by Petitioner's architects, the contractor constructing the Improvements will be selected by Petitioner, the terms of the construction contract will be established by Petitioner and construction supervision will be carried out by Petitioner. When construction is completed, equipment selected and purchased by Petitioner, and financed by a separate sale and leaseback transaction, will be installed in the Improvements, after which Petitioner will control and operate the medical facility.

Petitioner presently has a sales tax exemption certificate, and desires to follow a procedure in which the contractor purchasing materials for construction of Improvements for Petitioner, acting on behalf of Petitioner as lessee under the Leaseback, will present Form ST-119.1, Exempt Organization Certification, to sellers of taxable materials and services in order to be exempted from the payment of sales tax, as it would if there were no lease and leaseback structure being utilized in the transaction.

The Trust will deposit the Funding into a third-party escrow that will disburse the funds for construction purchases and certain transaction costs. This format, compelled by accounting rules requiring the lessor to be the nominal payer for the Improvements, is merely incidental to the lease and leaseback format and does not reflect the substance of the transaction. In true economic terms, Petitioner is the true borrower of the Funding and purchaser of the construction material. Petitioner, as lessee under the Leaseback, will determine when and to whom payments are to be made. The rent that, as a matter of underlying economics, is interest and amortization on the Funding, and the intended option payment, that as a matter of the underlying economics, is a payment of the outstanding principal balance, are all made by Petitioner from funds it is indirectly borrowing through the synthetic lease arrangement, so that all the underlying payments, as an economic matter, actually come from Petitioner.

The Lender has not been selected, but will be a financial institution primarily engaged in the business of making loans.

Applicable Law and Regulations

Sales Tax

Section 1101(b)(5) of the Tax Law defines "sale, selling or purchase" as follows:

> Sale, selling or purchase. Any transfer of title or possession or both, exchange or barter, rental, lease or license to use or consume (including, with respect to computer software, merely the right to reproduce), conditional or otherwise, in any manner or by any means whatsoever for a consideration, or any agreement

therefor, including the rendering of any service, taxable under this article, for a consideration or any agreement therefor.

Section 1101(b)(9) defines "capital improvement" as follows:

(9) Capital improvement. (i) An addition or alteration to real property which:

(A) Substantially adds to the value of the real property, or appreciably prolongs the useful life of the real property; and

(B) Becomes part of the real property or is permanently affixed to the real property so that removal would cause material damage to the property or article itself; and

(C) Is intended to become a permanent installation.

Section 1105 of the Tax Law provides, in part:

Imposition of sales tax. On and after June first, nineteen hundred seventy-one, there is hereby imposed and there shall be paid a tax of four percent upon:

(a) The receipts from every retail sale of tangible personal property, except as otherwise provided in this article.

(b) The receipts from every sale, other than sales for resale, of gas, electricity, refrigeration and steam, and gas, electric, refrigeration and steam service of whatever nature, and from every sale, other than sales for resale, of telephony and telegraphy and telephone and telegraph service of whatever nature except interstate and international telephony and telegraphy and telephone and telegraph service and from every sale, other than sales for resale, of a telephone answering service.

(c) The receipts from every sale, except for resale, of the following services:

* * *

(5) Maintaining, servicing or repairing real property, property or land, as such terms are defined in the real property tax law, whether the services are performed in or outside of a building, as distinguished from adding to or improving such real property, property or land, by a capital improvement as such term capital improvement is defined in paragraph nine of subdivision (b) of section eleven hundred one of this chapter, but excluding services rendered by an individual who is not in a regular trade or business offering his services to the public.

Section 1115(a) of the Tax Law provides, in part:

Exemptions from sales and use taxes. (a) Receipts from the following shall be exempt from the tax on retail sales imposed under subdivision (a) of section eleven hundred five and the compensating use tax imposed under section eleven hundred ten:

* * *

(15) Tangible personal property sold to a contractor, subcontractor or repairman for use in erecting a structure or building of an organization described in subdivision (a) of section eleven hundred sixteen, or adding to, altering or improving real property, property or land of such an organization, as the terms real property, property or land are defined in the real property tax law; provided, however, no exemption shall exist under this paragraph unless such tangible personal property is to become an integral component part of such structure, building or real property.

(16) Tangible personal property sold to a contractor, subcontractor or repairman for use in maintaining, servicing or repairing real property, property or land of an organization described in subdivision (a) of section eleven hundred sixteen, as the terms real property, property or land are defined in the real property tax law; provided, however, no exemption shall exist under this paragraph unless such tangible personal property is to become an integral component part of such structure, building or real property.

(17) Tangible personal property sold by a contractor, subcontractor or repairman to a person other than an organization described in subdivision (a) of section eleven hundred sixteen, for whom he is adding to, or improving real property, property or land by a capital improvement, or for whom he is about to do any of the foregoing, if such tangible personal property is to become an integral component part of such structure, building or real property; provided, however, that if such sale is made pursuant to a contract irrevocably entered into before September first, nineteen hundred sixty-nine, no exemption shall exist under this paragraph.

Section 1116(a) of the Tax Law provides, in part:

Exempt organizations. (a) Except as otherwise provided in this section, any sale or amusement charge by or to any of the following or any use or occupancy by any of the following shall not be subject to the sales and compensating use taxes imposed under this article:

* * *

(4) Any corporation, association, trust, or community chest, fund or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation, (except as otherwise provided in subsection (h) of section five hundred one of the United States internal revenue code of nineteen hundred fifty-four, as amended), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office;

Section 526.7 of the Sales and Use Tax Regulations provides, in part:

Sale, selling or purchase. (Tax Law, S 1101(b)(5)) (a) Definition. (1) The words sale, selling or purchase mean any transaction in which there is a transfer of title or possession, or both, of tangible personal property for a consideration.

(2) Among the transactions included in the words sale, selling or purchase are exchanges, barters, rentals, leases or licenses to use or consume tangible personal property.

* * *

(c) Rentals, leases, licenses to use. (1) The terms rental, lease and license to use refer to all transactions in which there is a transfer for a consideration of possession of tangible personal property without a transfer of title to the property. Whether a transaction is a "sale" or a "rental, lease or license to use" shall be determined in accordance with the provisions of the agreement. (See section 527.15 of this Title for special rules pertaining to certain leases of motor vehicles, vessels and noncommercial aircraft.)

(2) Where a lease (other than one described in section 527.15 of this Title) with an option to purchase has been entered into, and the option is exercised, the tax will be payable on the consideration given when the option is exercised, in addition to the taxes paid or payable on each lease payment.

(3) A lease which has been entered into merely as a security agreement, but which does not in fact represent a transaction in which there has been a transfer of possession from the lessor to the lessee, is not a "sale" within the meaning of the Tax Law.

Cross-reference: See section 527.15 of this Title for special rules pertaining to certain leases of motor vehicles, vessels and noncommercial aircraft.

Section 526.8 of the Sales and Use Tax Regulations provides, in part:

Tangible personal property. (Tax Law, S 1101(b)(6)) (a) Definition. The term tangible personal property means corporeal personal property of any nature having a material existence and perceptibility to the human senses....

* * *

(c) Tangible personal property does not include:

(1) real property;...

Section 541.3(d) of the Sales and Use Tax Regulations provides, in part:

Contracts with exempt organizations. (1) Tangible personal property incorporated into real property owned by a governmental entity or by an exempt organization is exempt, whether the contract is on a lump sum, time and material, cost-plus, or other basis.

(2) Purchase for contracts (other than agency contracts). (i) Tangible personal property sold to a contractor, subcontractor, or repairman for use in erecting, repairing, adding to, or altering a structure or building owned by an exempt organization, described in section 1116(a) of the Tax Law, is exempt when it is to become an integral component part of such structure or building.

Example 1: An exempt organization contracts to have a building erected on its land. Purchases by its contractor of tangible personal property, such as nails, sheetrock, and plywood that become part of the structure are exempt.

Example 2: A building is being erected for an exempt organization. Glass in the windows is broken and a glazier is engaged by the general contractor to repair the windows. The charges for such repairs are exempt and the purchase of the new glass is exempt.

Example 3: A contractor builds a structure on speculation and subsequently sells the structure to an exempt organization. The contractor is not entitled to the tax exemption on the purchase of tangible personal property incorporated into the structure.

Example 4: The owner of real property enters into a contract to erect a building to be leased, under a long-term lease, to an exempt organization. The contractor's purchases are not exempt as the owner of the building is not an exempt organization.

Example 5: A contractor or a nonexempt entity owns land on which a building is erected to the specifications of an exempt organization. Under the terms of the contract, the organization will not own the land or the building until it is completed and ready for occupancy. The building materials are not exempt as the exempt organization will not own the building at the time the materials are incorporated into the real property.

(ii) Purchases of tangible personal property incorporated into the real property of an exempt organization by subcontractors and repairmen are accorded the same treatment as purchases by the prime contractor.

(iii) Tangible personal property purchased by a contractor, which remains tangible personal property after installation, is exempt from the tax when purchased for and sold to an exempt organization.

Example 6: An exempt organization contracts to have a new wing built onto their existing building. The new wing includes the addition of a cafeteria. The contractor may purchase, exempt from the tax, the tangible personal property that becomes part of the capital improvement to real property and the tangible personal property which remains tangible personal property.

(iv) Except for agency contracts, contractors' purchases of construction supplies which do not become part of an exempt organization's real property and are used or consumed by the contractor, as well as purchases of taxable services, such as electricity used by the contractor, are subject to the tax.

Cross-reference: For purchases under an agency contract, see paragraph (4) of this subdivision.

The following types of property and services are representative, but not intended to be all-inclusive, of contractor's purchases which are subject to tax, irrespective of whether the contractor has a time and material, lump sum, or other type of contract (except agency contract), with an exempt organization:

(a) construction machinery and equipment, including rentals and repair parts;

(b) contractors' office supplies;

(c) contractors' supplies, tools, and miscellaneous equipment, whether purchased or rented, including materials to make forms and scaffolding; and (d) any other items purchased or rented by a contractor for his use in performing the contract and not incorporated into the realty.

* * *

(b) If the customer is an exempt organization other than a governmental entity, the prime contractor must obtain an exempt organization certification from his customer and retain it as part of his records. Copies of the certification must also be furnished to all subcontractors on the job. The subcontractors must retain a copy of the certification in their records with a copy of the contract which identifies the project and the location. When purchasing tangible personal property for incorporation into the exempt project, the prime contractor and subcontractor will issue a properly completed contractor exempt purchase certificate to the supplier.

(3) Maintaining, installing, repairing and servicing tangible personal property and real property. Charges for maintaining, installing, repairing and servicing tangible personal property and real property are exempt from the tax when the exempt organization is the payer of record. When these charges are billed to and paid by a tenant, the charges (excluding charges for interior cleaning and maintenance services of a janitorial nature performed on a regular contractual basis for a term of not less than 30 days) are subject to the tax on the full invoice price, except for the charges billed to and paid by a tenant which qualifies as an exempt entity pursuant to section 1116(a) of the Tax Law.

(4) Agency contracts. (i) If an exempt organization described in section 1116(a)(3), (4), (5) or (6) of the Tax Law enters into an agency contract with the prime contractor and all subcontractors, all purchases for such contract are exempt as long as the property and services are purchased by the contractor or subcontractor as agent for the exempt organization. In order to create a principal/agent relationship all of the following conditions must be met:

(a) purchases must be billed or invoiced by the vendor to the exempt organization or to the contractor specifying that the contractor is acting as agent for the exempt organization (e.g., X contractor, as agent for Y, name of exempt organization) and identify the place of delivery;

(b) payment must be made by the exempt organization or by the contractor, acting as agent, directly to the vendor from a special fund created by the exempt organization for this specific purpose;

(c) deliveries must be made to the job site; or under certain circumstances (such as where the materials require additional fabrication before installation on the job site or for storage to protect the materials from theft or vandalism prior to installation at the job site) deliveries may be made to a site, other than the job site, providing the ultimate delivery of the materials is made to the job site. Where delivery is made to a site, other than the job site, the purchases must be billed or invoiced by the vendor to the exempt organization or to the contractor as agent, identify the place of delivery, the exempt organization's full name and address and the job site location where the materials will ultimately be delivered for installation; and

(d) the contractor must furnish the vendor with the exempt organization certification when acting as agent for such organization. A statement signed by a responsible officer of the exempt organization which identifies the contract and the contractor, as agent for the exempt organization, must be either made on the exempt organization certification or appropriately attached thereto.

If the proposed agency contract differs from the requirements of this subparagraph, copies of the proposed contract and procedures may be submitted for an opinion to the Instructions and Interpretations Unit, Sales Tax Section, Technical Services Bureau, W.A. Harriman Campus, Albany, N.Y. 12227.

(ii) All purchases or rentals of materials, equipment, tools, and supplies by an exempt organization or by a contractor or subcontractor, as agent for an organization which is exempt from sales taxes under section 1116(a)(3), (4), (5) or (6), are exempt from sales and use taxes when the contract fully complies with the requirements set forth in subparagraph (i) of this paragraph.

Opinion-Sales Tax

Issue #1

Throughout the Ground Lease/Leaseback transaction Petitioner remains the owner of the fee interest in the land and the Improvements as they are constructed. Petitioner is exempt from sales tax under Section 1116(a)(4) of the Tax Law. As such, and in accordance with Section 1115(a)(15) of the Tax Law and Section 541.3(d)(2) of the Sales and Use Tax Regulations, the purchase of materials by a contractor which are incorporated into the real property of Petitioner is exempt from sales tax. The contractor should furnish its supplier with a properly completed Contractor Exempt Purchase Certificate (Form ST-120.1) in order to purchase materials exempt from tax under Section 1115(a)(15).

The construction of the Facility constitutes a capital improvement as defined in Section 1101(b)(9) of the Tax Law. Therefore, the purchase of services to real property described in Section 1105(c)(5) of the Tax Law by a contractor from a subcontractor for the construction of the Facility are not subject to sales tax. Likewise, the payments to the contractor for the services of constructing the Facility, and for materials which become part of the Facility, are not subject to sales tax. The contractor should obtain a properly completed Certificate of Capital Improvement (Form ST-124) from its customer and furnish a copy of such certificate to its subcontractors in order for the contractor to purchase services to real property from its subcontractors without payment of tax. See Section 541.5(b)(4) of the Sales and Use Tax Regulations.

Purchases by the contractor of construction supplies which do not become part of Petitioner's real property, as well as purchases of taxable services, such as electricity used by the contractor, are subject to sales tax unless the contractor enters into an agency contract and acts as agent of Petitioner in accordance with Section 541.3(d)(4) of the Sales and Use Tax Regulations. If the contractor qualifies as an agent of Petitioner, the contractor may purchase all tangible personal property and services for its contract with Petitioner exempt from tax if the contractor furnishes its suppliers with an Exempt Organization Certification (Form ST-119.1), along with a statement signed by a responsible officer of Petitioner identifying the agency contract and the contractor as agent for Petitioner. See Section 541.3(d)(4)(i)(d) of the Sales and Use Tax Regulations.

Issues #2, #3

As provided in Section 526.8 of the Sales and Use Tax Regulations real property is excluded from the definition of tangible personal property. Therefore, the Ground Lease and Leaseback are not subject to sales tax since they apply to real property.

Issue #4

Any sale of tangible personal property to Petitioner resulting from its exercise of its option to purchase at the expiration of the Leaseback would be exempt from sales tax since Petitioner is an exempt organization under Section 1116(a)(4) of the Tax Law.

Issue #5

As to whether the Ground Lease and Leaseback constitute a financing transaction, please see the discussion below with respect to the mortgage recording tax. Regardless of how the Ground Lease and Leaseback are characterized for purposes of the mortgage recording tax, a contractor's purchases of materials that become part of the Facility will be exempt under Section 1115(a)(15) of the Tax Law since Petitioner owns the Facility.

Applicable Law and Regulations-Mortgage Recording Tax

Subdivisions 1, 1-a and 2 of Section 253 of the Tax Law impose taxes on the recording of a mortgage of real property in the State measured by the principal debt or obligation, which is, or under any contingency, may be secured at date of execution thereof or at any time thereafter. Also, in addition to the Statewide mortgage recording taxes, Section 253-a of the Tax Law authorizes New York City to impose a tax on the recording of mortgages of real property situated within New York City.

Section 250.2 of the Tax Law defines the term "mortgage" as follows:

> The term "mortgage" as used in this article includes 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. An assignment of rents to accrue from tenancies, subtenancies, leases or subleases of real property, within any city in the state having a population of one million or more, given as security for an indebtedness, shall be deemed a mortgage of real property for purposes of this article...

Section 253.3 of the Tax Law provides as follows:

> Notwithstanding any other provision of law to the contrary, the mortgage recording tax shall not be imposed upon any mortgage executed by a voluntary non-profit hospital corporation or upon any mortgage executed by or granted to the dormitory authority.

Section 641.6(b) of the Mortgage Recording Tax Regulations states in part as follows:

(b) The following are examples of instruments which are mortgages when given as security for a debt or the performance of an obligation:

(1) an instrument in the form of an absolute deed, which is merely security;....

It has been noted that: "The courts are not concluded [sic] by the designation or form of the instruments which the parties have adopted, and where it appears that the real transaction was a pledge of an interest in real property as security for the payment of a debt, and that on payment of the debt the security is to be canceled or surrendered, the instrument will be construed as a mortgage, regardless of whether the parties have designated it a "deed" or "lease" and have used a form appropriate for such an instrument. Thus, a sublease given to secure a debt under an agreement that the lease should be canceled on payment of the debt and that the lessor should account to the lessee for rents received in excess of disbursements is a mortgage." (77 NY Jur 2d, Mortgages and Deeds of Trust, § 29, p.406)

New York courts have recognized, in the context of the application of the mortgage recording tax and in other cases not involving tax issues, that "an instrument which purports to be a conveyance of real property in fee may in fact be a mortgage depending upon the circumstances surrounding the giving of such an instrument." Matter of Atlantic Cement Co. v. Murphy, 30 AD2d 456, 457, affd, 28 NY2d 502. In Atlantic Cement, the Court stated that the question of whether or not a deed should be taxed as a mortgage must be determined by the intention of the parties. Id., at 458. The parties' intent "may be gathered from the oral testimony, the circumstances attending the transaction, the conduct of the parties, as well as from the fact of the written contract. Id. ... From a reading of the record, it becomes apparent that the "production payment" is a device which attempts to return the old title concept of mortgages, whereby the mortgagee was actually given title to the property as security rather than simply a lien. The courts no longer permit an instrument, which is in actuality a means of giving security for a loan, to be considered anything but a mortgage. The present instrument is no exception to this long-established rule." Id., at 458. In Atlantic Cement, the Court confirmed the Tax Commissions's determination that the instrument constituted a mortgage.

Opinion-Mortgage Recording Tax

The substance of the creation of the Ground Lease/Leaseback as well as the described intent of the parties to the transaction results in a finding that the Ground Lease/Leaseback constitutes a mortgage given by Petitioner, as mortgagor to the Trust as mortgagee. As the Petitioner is a voluntary nonprofit hospital corporation the recording of the Ground Lease/Leaseback would be exempt from the mortgage recording tax.

Applicable Law-Real Estate Transfer Tax

Section 1402 of the Tax Law imposes the transfer tax on each conveyance of real property or interest therein when the consideration for the conveyance exceeds $500.00.

Section 1401(e) of the Tax Law defines the term "conveyance", in part, as follows:

> (e) "Conveyance" means the transfer or transfers of any interest in real property by any method, ... Notwithstanding the foregoing, conveyance of real property shall not include a conveyance pursuant to devise, bequest or inheritance; **the creation**, modification, extension, spreading, severance, consolidation, assignment, transfer, release or **satisfaction** of a mortgage; a mortgage subordination agreement, a mortgage severance agreement, an instrument given to perfect or correct a recorded mortgage;...

Opinion-Real Estate Transfer Tax

As the creation of the Ground Lease/Leaseback constitutes the creation of a mortgage, such transactions do not constitute conveyances pursuant to Section 1401(e) of the Tax Law, and they are therefore not subject to transfer tax. Furthermore, the acquisition of the Improvements by Petitioner upon the exercise of its option to purchase to be implemented by assignment of the leasehold interest under the Ground Lease is analogous to and constitutes the satisfaction of a mortgage. Thus, this transaction is not a conveyance subject to transfer tax in accordance with Section 1401(e) of the Tax Law.

DATED: October 7, 1998

/s/
John W. Bartlett
Deputy Director
Technical Services Bureau

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