

New York State Department of Taxation and Finance
Office of Tax Policy Analysis
Technical Services Division

TSB-A-02(5)R
Real Estate Transfer Tax
September 18, 2002

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. M020326A

On March 26, 2002, the Department of Taxation and Finance received a Petition for Advisory Opinion from Paul, Hastings, Janofsky & Walker LLP, 75 East 55th Street, New York, NY 10022.

The issues raised by Petitioner, Paul, Hastings, Janofsky & Walker LLP, are:

1. Whether for purposes of the Real Estate Transfer Tax (hereinafter the “transfer tax”), the consideration for an assignment of lease includes both (a) the net present value (“NPV”) of the difference between the fair market rental value of the leased property and the actual rent payable under the Lease and (b) the value of the Leasehold Improvements acquired in the conveyance.
2. Whether in calculating the NPV of the difference in fair market rental value and actual rent, such amount may be reduced by the estimated cost of hypothetical commissions and other costs.
3. Whether in calculating the NPV of the difference in fair market rental value and actual rent, such amount may be reduced by subtracting 50% of such difference, which represents the amount that Landlord could have received if Tenant had allowed Landlord the opportunity to exercise its recapture rights under the Lease prior to the assignment.

Petitioner submits the following facts as the basis for this Advisory Opinion.

Petitioner represents the owner (“Landlord”) of an office building located in midtown Manhattan (the “Building”), which contains Class A office space. Landlord and Tenant entered into the Lease for certain office space in 1997 (the “Demised Property”). The Lease expires in year 2013.

The Demised Property contains approximately 370,000 square feet and the Lease requires payment of rent by Tenant of approximately \$42 per square foot. After entering into the Lease, Tenant made a substantial investment in leasehold improvements to the Demised Property (the “Leasehold Improvements”).

In 2001, Tenant assigned the Lease to a third party (“Buyer”), in connection with Buyer’s purchase of all of the membership interests in a limited liability company (“Seller”) owning the assets of certain business units of Tenant. At the time, a licensed real estate broker provided Seller and Buyer with an analysis estimating the fair market rental value for the Demised Property to be approximately \$75 per square foot and the NPV of the difference between the fair market rental value and actual rent to be approximately \$69 million using a discount rate of 9%.

TSB-A-02(5)R
Real Estate Transfer Tax
September 18, 2002

At the time of the conveyance, the unamortized cost of Tenant's investment in the Leasehold Improvements allocated to the business units being sold was approximately \$80 million. In addition, in entering into the transaction, Buyer ascribed an additional \$25 million in value to such Leasehold Improvements (i.e., totaling \$105 million for the Leasehold Improvements), which represented the difference between the fair market value and the book value of the Leasehold Improvements.

Petitioner states that if the conveyance did not qualify as a "reorganization" under the pertinent provisions of the Lease, Tenant could not assign the Lease to Buyer unless Tenant first offered Landlord the opportunity to "recapture" the Lease. If Landlord elected to recapture the Lease and subsequently leased the Demised Premises for an increased rent to another person during the term of the Lease, Landlord would have been required to share 50% of the proceeds of such increased rent with Tenant, after deducting commissions and other costs, if any, incurred by Landlord in re-letting the Demised Premises. Tenant, however, did not offer Landlord any such right of recapture and, therefore, the assignment occurred over Landlord's objection. Buyer took occupancy of the Demised Property, the Leasehold Improvements were conveyed to the Buyer and the Buyer is carrying the cost of those Leasehold Improvements on its books and records.

Buyer paid approximately \$275 million in cash to Seller at the time of closing. Buyer acquired approximately \$15.75 billion in assets, mostly representing securities, and assumed corresponding liabilities of approximately \$15.475 billion.

Buyer's agreement with Seller required that at the time of closing the business units being sold have a net book value of \$238 million. The balance sheet that accompanied the conveyance reflected that the Seller's assets included approximately \$80 million in Leasehold Improvements. Seller allocated an additional \$25 million of the purchase price to the difference between the fair market value and the book value of such Leasehold Improvements.

In publicly issued statements Seller attributed \$12 million of the purchase price to goodwill and \$263 million of the purchase price to the net value of the assets acquired (which included a book value of \$238 million, \$80 million of which represented the book value of the Leasehold Improvements, plus another \$25 million in additional value allocated to the Leasehold Improvements).

Applicable Law and Regulations

Section 1402 of the Tax Law imposes the real estate transfer tax on each conveyance of real property or interest therein when the consideration exceeds five hundred dollars.

Section 1401(c) of the Tax Law provides:

“Real property” means every estate or right, legal or equitable, present or future, vested or contingent, in lands, tenements or hereditaments, including buildings, structures and other improvements thereon, which are located in whole or in part within the state of New York. It shall not include rights to sepulture.

Section 1401(d) of the Tax Law provides, in part:

“Consideration” means the price actually paid or required to be paid for the real property or interest therein, including payment for an option or contract to purchase real property, whether or not expressed in the deed and whether paid or required to be paid by money, property, or any other thing of value. It shall include the cancellation or discharge of an indebtedness or obligation. It shall also include the amount of any mortgage, purchase money mortgage, lien or other encumbrance, whether or not the underlying indebtedness is assumed or taken subject to.

Section 1401(e) of the Tax Law provides:

“Conveyance” means the transfer or transfers of any interest in real property by any method, including but not limited to sale, exchange, assignment, surrender, mortgage foreclosure, transfer in lieu of foreclosure, option, trust indenture, taking by eminent domain, conveyance upon liquidation or by a receiver, or transfer or acquisition of a controlling interest in any entity with an interest in real property. Transfer of an interest in real property shall include the creation of a leasehold or sublease only where (i) the sum of the term of the lease or sublease and any options for renewal exceeds forty-nine years, (ii) substantial capital improvements are or may be made by or for the benefit of the lessee or sublessee, and (iii) the lease or sublease is for substantially all of the premises constituting the real property. 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; or a release of lien of tax pursuant to this chapter or the internal revenue code.

Section 1401(f) of the Tax Law provides, in part:

“Interest in the real property” includes title in fee, a leasehold interest, a beneficial interest, an encumbrance, development rights, air space and air rights, or any other interest with the right to use or occupancy of real property or the right to receive rents, profits or other income derived from real property. . . .

TSB-A-02(5)R
Real Estate Transfer Tax
September 18, 2002

Opinion

With respect to issue (1), Tenant's assignment of the Lease to Buyer constitutes a conveyance of real property or interest therein, as does Buyer's purchase of the ownership interest in the Leasehold Improvements acquired as a part of the assets of certain business units of Tenant. Accordingly, the transfer tax will be imposed if the consideration attributable to the real property or interest therein exceeds \$500.

For purposes of calculating the transfer tax due on Tenant's assignment of the Lease to Buyer, the overall consideration paid by Buyer to Seller is required to be apportioned between the value of Tenant's Leasehold interest and the value of Seller's other assets.

For purposes of determining the fair market value of the Leasehold interest so transferred, it is reasonable to value the Leasehold interest as the present (discounted) worth of the difference between the fair market rental value and the actual rent payable under the Lease, when contractual rent as of the date of conveyance is less than the current market rent. In addition, if the Demised Property is improved by Tenant, then the value of the Leasehold interest is to be increased by the fair market value (not the cost) of the Leasehold Improvements.

As an advisory opinion merely sets forth the applicability of pertinent statutory and regulatory provisions to "a specified set of facts" (Tax Law, section 171. Twenty-fourth; 20 NYCRR 2376.1) and the determination of the discounted worth of the rent savings and the fair market value of Tenant's Leasehold Improvements are subjective findings, this Opinion makes no determination respecting the actual amount of consideration required to be recognized on Tenant's assignment of the Lease.

With respect to issues (2) and (3), there is no legal authority for allowing a reduction in consideration; i.e., the fair market value of the Leasehold interest in this case, based upon commissions or other costs whether actually incurred or hypothetically forecast. Further, there is no legal basis to reduce the amount of consideration based on the amounts Landlord would have received in this case if it had exercised its recapture rights under the Lease.

DATED: September 18, 2002

/s/
Jonathan Pessen
Tax Regulations Specialist IV
Technical Services Division

TSB-A-02(5)R
Real Estate Transfer Tax
September 18, 2002

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