

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

TSB-A-03(1)R
Real Estate Transfer Tax
October 9, 2003

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. M030422F

On April 22, 2003, a Petition for Advisory Opinion was received from New York State Urban Development Corporation (d/b/a Empire State Development Corporation) and Milstein Brothers 42nd Street LLC, 633 Third Avenue, New York, New York 10017.

The issue raised by Petitioners, New York State Urban Development Corporation (d/b/a Empire State Development Corporation) (ESDC) and Milstein Brothers 42nd Street LLC (Milstein), is whether certain conveyances, in connection with Empire State Development Corporation's 42nd Street Development Land Improvement Project (the Project) are exempt from real estate transfer tax imposed pursuant to Article 31 of the Tax Law.

Petitioners submit the following facts as the basis for this Advisory Opinion.

The conveyances at issue are:

1. The conveyance by Milstein, a private entity, by one or more deeds, of a fee on limitation to 42nd St. Development Project, Inc. (42DP), a wholly owned subsidiary of ESDC, and, simultaneously, of a reversionary interest in Site 8 North (the Reversionary Interest) to the City of New York (City).
2. The creation of the ground lease of Site 8 North between 42DP and Milstein for a term of 40 years (the Ground Lease).
3. The reversion or reconveyance of Site 8 North to Milstein, effectuated by (a) the limitations contained in each of the deeds described in conveyance "1" above providing for the mandatory reversion to Milstein upon the expiration of a stated term of 40 years, which is co-terminous with the term of the Ground Lease (the Limitation), (b) the earlier exercise by Milstein, at any time after the 20th anniversary of the completion of construction of new improvements on Site 8 North, of a purchase option pursuant to the Ground Lease for a nominal exercise price of \$10.00 (the Option) or (c) the earlier termination of the Ground Lease due to a default thereunder or otherwise (the Early Termination).

In 1980, the City entered into a memorandum of understanding with ESDC for the redevelopment of the Project area, which is located in the West 42 Street/Times Square district. The redevelopment was conceived as a joint effort, to be implemented by public agencies and private developers designated by the City and ESDC. A comprehensive study and plan of the Project area, aimed at turning Times Square into a safe, lively center for entertainment, shopping, commuting, and business, was commissioned and completed in 1981. The plan (the Project Plan) was approved by ESDC and the City's Board of Estimate in 1984.

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In 1986, pursuant to section 402 of the Business Corporation Law and section 6262 of the New York State Urban Development Corporation Act (the UDC Act), ESDC created 42DP as a wholly-owned subsidiary corporation of ESDC for the purpose of implementing the Project. The Project involves the development of new office towers, entertainment/retail facilities, hotels, and other improvements in the Project area, which ESDC has divided into various sites.

Pursuant to the Project Plan, ESDC has acquired or is currently in the process of acquiring, generally through exercise of ESDC's condemnation powers, fee title to approximately 13 acres of land in midtown Manhattan. Upon acquisition of the respective sites, it has been the practice of ESDC to convey title to the land and all buildings and improvements then or thereafter located thereon to 42DP as a fee on limitation, subject to reversionary rights in such property simultaneously conveyed by ESDC to the City. Such reversionary rights are triggered following substantial completion of new improvements on the site or upon the occurrence of certain other events. Also upon acquisition of a site, 42DP enters into a long-term ground lease for such site with a designated developer that is responsible for developing the site, funding certain acquisition costs, and undertaking certain improvements on and in connection with the site. Upon the exercise of its reversionary rights, the City succeeds to the interest of 42DP as the lessor under the respective ground leases. The ground leases generally grant a purchase option to the lessee thereunder.

Milstein is currently the fee owner of Site 8 North of the Project, a parcel located on the east side of Eighth Avenue between West 41st and 42nd Streets. The site is currently comprised of a parking lot and billboard sign but does not include buildings or other improvements. 42DP has designated Milstein as the developer of Site 8 North.

However, because Milstein owns Site 8 North, certain aspects of ESDC's customary acquisition and conveyance process for the Project (e.g., condemnation) are inappropriate. Accordingly, Milstein, 42DP, and the New York City Economic Development Corporation (acting on behalf of the City) have entered into a letter agreement dated October 21, 2002. Under the terms of the letter:

- Milstein would voluntarily convey by one or more deeds for no consideration, the fee on limitation to 42DP, and, simultaneously, the Reversionary Interest to the City.

- Simultaneously with such conveyances, 42DP and Milstein would enter into the Ground Lease, a 40 year "triple net" lease under which Milstein would develop, construct, and operate a new building at Site 8 North and retain all of the costs and burdens of ownership of Site 8 North throughout the lease term. Payments under the Ground Lease would be limited to (a) base rent in the nominal amount of \$10.00 per year, (b) payments in lieu of real estate taxes, sales taxes and mortgage recording taxes, and (c) a theater surcharge relating to the rehabilitation of the historic 42nd Street mid-block theaters.

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- The fee interest in Site 8 North would revert or be reconveyed to Milstein in all events, by virtue of (a) the Limitation, (b) the earlier exercise by Milstein of the Option or (c) the Early Termination.

Under section 6266 of the UDC Act, the conveyance of fee title to 42DP would bring Site 8 North within the provisions of the Project Plan. Among other things, this would exempt the site from provisions of the City's zoning resolution and instead impose certain design, use and operating guidelines applicable to the Project. While 42DP would hold record title to the site for these limited purposes, the Ground Lease, the Limitation and the Option, taken together would contemplate, and the parties to the transaction would intend, that Milstein would remain the beneficial owner of the site at all times. Under the terms of the Ground Lease, the Limitation and the Option, Milstein would be entitled to all the benefits and would bear all the burdens of ownership of Site 8 North.

More specifically, any and all appreciation in the value of Site 8 North would accrue to the benefit of Milstein pursuant to the Limitation and the Option. Milstein would retain the right to lease space within the site to third parties and would retain all rent and other income required to be paid under any such lease. Milstein would have the right to place leasehold mortgages on its interest in the site and would retain the proceeds of any such mortgage. Milstein would have the right to sell or otherwise transfer its interest in the site, provided that its transferee is not a "Prohibited Person" under certain City guidelines and meets certain financial and experience criteria. As the beneficial owner of the site, Milstein would have the right in its own name to initiate and defend real estate assessment contests regarding the site. Furthermore, for financial reporting and federal, State and City income tax purposes, Milstein would be the owner of Site 8 North.

ESDC, 42DP and the City (collectively, the "Public Parties"), on the other hand, would have no beneficial interest in Site 8 North. The Public Parties would have no obligation to improve, replace, service, adjust, repair, or maintain any portion of the site. The Public Parties would have no interest in any condemnation awards with respect to the site or any proceeds from insurance maintained by Milstein. Consequently, as among the Public Parties and Milstein, all condemnation awards or insurance proceeds would be the sole property of Milstein. Although the Ground Lease would provide the Public Parties with certain monetary remedies in the event of a default by Milstein thereunder (e.g., liquidated damages and the right to place liens on the property with respect to unpaid payments in lieu of real estate taxes and other unpaid amounts), such remedies are intended to be analogous to rights the Public Parties would have in their governmental capacity against private owners for similar defaults (e.g., levying fines and imposing tax liens).

Further, Milstein would receive no monetary consideration for the original conveyance of the site to 42DP, and 42DP and the City would not assume any monetary obligations in respect of the site.

Applicable law and regulations

Section 1402(a) of the Tax Law imposes the real estate transfer tax on each conveyance of real property or interest therein and provides, in part:

A tax is hereby imposed on each conveyance of real property or interest therein when the consideration exceeds five hundred dollars, at the rate of two dollars for each five hundred dollars or fractional part thereof; provided, however, that with respect to (A) a conveyance of a one, two or three-family house and an individual residential condominium unit, or interests therein; and (B) conveyances where the consideration is less than five hundred thousand dollars, the consideration for the interest conveyed shall exclude the value of any lien or encumbrance remaining thereon at the time of conveyance.

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.

(i) In the case of the creation of a leasehold interest or the granting of an option with use and occupancy of real property, consideration shall include but not be limited to the value of the rental and other payments attributable to the use and occupancy of the real property or interest therein, the value of any amount paid for an option to purchase or renew and the value of rental or other payments attributable to the exercise of any option to renew.

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

“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:

“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. It shall also include an option or contract to purchase real property. It shall not include a right of first refusal to purchase real property.

Section 1405(b) of the Tax Law provides, in part:

The tax shall not apply to the following conveyances:

* * *

6. Conveyances to effectuate a mere change of identity or form of ownership or organization where there is no change in beneficial ownership, other than conveyances to a cooperative housing corporation of the real property comprising the cooperative dwelling or dwellings;

Section 575.7(c)(1) of the Real Estate Transfer Tax Regulations (Regulations) provides:

An option to purchase real property is an interest in real property. Where an option to purchase real property is coupled with the granting of the right to use and occupancy of the real property, a conveyance subject to the transfer tax has occurred. Therefore, the creation of a lease coupled with the granting of an option to purchase the real property, regardless of the term of the lease, is a conveyance subject to the transfer tax.

Opinion

Section 1402 of the Tax Law imposes a tax on each conveyance of real property or interest therein when the consideration exceeds five hundred dollars. Section 1401(e) defines the term “conveyance,” in part, as the transfer or transfers of interest in real property or the transfer or acquisition of a controlling interest in any entity with an interest in real property. Section 1401(f) provides that “interest in the real property” includes an option or contract to purchase real property. Transfer of an interest in real property shall include the creation of a leasehold or sublease coupled

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with the granting of an option to purchase the real property. See section 575.7(c)(1) of the Regulations.

The three conveyances at issue are deemed conveyances within the meaning of section 1401(e) of the Tax Law. However, section 1405(b)(6) of the Tax Law provides an exemption from the transfer tax to the extent that a conveyance effectuates a mere change of identity or form of ownership or organization where there is no change in beneficial ownership.

Under the terms of the Ground Lease, the Limitation and the Option, Milstein would be entitled to all the benefits and would bear all the burdens of ownership of Site 8 North. Any and all appreciation in the value of Site 8 North would accrue to the benefit of Milstein pursuant to the Limitation and the Option. Milstein would retain the right to lease space within the site to third parties and would retain all rent and other income required to be paid under any such lease. Milstein would have the right to place leasehold mortgages on its interest in the site and would retain the proceeds of any such mortgage. Milstein would have the right to sell or otherwise transfer its interest in the site. Petitioner represents that as the beneficial owner of the site, Milstein would have the right in its own name to initiate and defend real estate assessment contests regarding the site. Furthermore, for financial reporting and federal, State and City income tax purposes, Milstein would be the owner of Site 8 North. The Public Parties would have no obligation to improve, replace, service, adjust, repair, or maintain any portion of the site. The Public Parties would have no interest in any condemnation awards with respect to the site or any proceeds from insurance maintained by Milstein. Consequently, as among the Public Parties and Milstein, all condemnation awards or insurance proceeds would be the sole property of Milstein.

Accordingly, based upon the preceding paragraph, Milstein would remain the beneficial owner of the site at all times.

Therefore, (1) the conveyance of the fee on limitation for Site 8 North to 42DP, and simultaneously of the Reversionary Interest to the City, (2) the creation of the Ground Lease between 42DP and Milstein, and (3) the reconveyance of Site 8 North to Milstein by Limitation, Option, or Early Termination are all exempt from the real estate transfer tax as conveyances that constitute a mere change of identity or form of ownership or organization pursuant to section 1405(b)(6) of the Tax Law.

DATED: October 9, 2003

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