

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

TSB-A-04(3)R
Real Estate Transfer Tax
August 5, 2004

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. M040209B

On February 10, 2004, the Department of Taxation and Finance received a Petition for Advisory Opinion from Fort Hamilton Housing LLC, c/o Richard R. Upton, Esq., Patterson, Belknap, Webb, & Tyler LLP, 1133 Avenue of the Americas, New York, NY 10036-6710.

The issue raised by Petitioner, Fort Hamilton Housing LLC, is whether certain conveyances, in connection with the rehabilitation and reconstruction of military housing units located at Fort Hamilton Military Base are exempt from the real estate transfer tax imposed pursuant to Article 31 of the Tax Law.

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

Introduction

The United States Army (the "Army") currently owns and operates a military family housing facility, consisting of real property (the "Land") and improvements (together, the "Facility"), as part of the Fort Hamilton Military Base. The Facility has deteriorated and is in need of considerable repair and rehabilitation if the Army is to provide suitable housing to its personnel. As described in greater detail below, the Army intends to lease the Land and transfer title to the improvements for 50 years to Petitioner, a Delaware limited liability company, which will demolish or rehabilitate the existing housing and improvements, construct new housing and improvements and rent the housing to Army and other military personnel. The Army and GMH Military Housing – Fort Hamilton LLC ("GMH"), a privately owned Delaware limited liability company, will be the only members of Petitioner. In connection with obtaining bond financing needed for the rehabilitation and construction of the Facility, Petitioner will sublease the Facility back to the Army which, in turn, will sub-sublease the Facility back to Petitioner. Both the sublease and the sub-sublease will be for terms of less than 49 years. No rent is required to be paid under any of the leases. A leasehold mortgage will be recorded with respect to each of the three leases. The Army will execute and record the leasehold mortgage on behalf of itself (as lessee under the sublease and lessor under the sub-sublease), and the Army will execute and record the leasehold mortgage on behalf of Petitioner (as lessee, sublessor and sub-sublessee).

A. The Project and the Housing Initiative

Like much of the Army's existing housing facilities across the country, the housing and related improvements that form the Facility at the Fort Hamilton Military Base are drastically in need of repair and rehabilitation. Petitioner was formed pursuant to the Military Housing Privatization Initiative of the 1996 Defense Authorization Act (the "Housing Initiative") for the purpose of designing, financing, constructing, rehabilitating, renovating, managing, operating and

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maintaining suitable military residential housing units and related ancillary facilities for the Army and other military personnel at the Facility (the activities and transactions concerning the Facility collectively constitute the "Project").

The Housing Initiative provides for the ownership, operation and management of military housing by non-governmental entities and authorizes the Department of Defense to invest through limited partnerships or other eligible entities which own, operate, and manage the housing. See P.L. 104-106 110 Stat. 186 (codified at 10 U.S.C. §§ 2871-2885). Specifically, the Housing Initiative authorizes the Secretary of Defense to "enter into contracts for the lease of military family housing units or military unaccompanied housing units to be constructed," and to "convey or lease [existing] property or facilities (including ancillary supporting facilities) to eligible entities for purposes of using the proceeds of such conveyance or lease to carry out activities" under the Housing Initiative. See 10 U.S.C. §§ 2874(a), 2878(a).

B. Petitioner

The Army and GMH will be the only members of Petitioner. Petitioner will be governed by an operating agreement (the "Operating Agreement"), which provides the Army with extensive rights (described below). GMH will serve as the manager of Petitioner. The initial capital of Petitioner will come from a capital contribution made by the Army and the proceeds of bonds secured by the leasehold mortgage that is the subject of this request. GMH will not be required to make any capital contribution to Petitioner for at least three years after the start of the Project, if ever. The amount of GMH's capital contribution, if any, will be determined at a future date and will be dependent upon future events, including varying construction and renovation costs incurred in the early stages of the Project. GMH will not be entitled to receive any distributions from Petitioner until it makes a capital contribution.

The Operating Agreement provides conditions and limitations on GMH's future distributions from Petitioner. Once GMH makes its capital contribution, it will be eligible to receive its share of distributions from available cash. Annual cash distributions are applied first to reduce debt, pay incentive management fees, and pay interest on GMH's adjusted capital investment. The remaining cash available for distribution will then be distributed 90% to the Army and 10% to GMH. However, GMH's annual distributions may not exceed 16.5% of its capital contribution. Upon dissolution, proceeds from the liquidation of Petitioner's assets will be distributed in a similar manner. The liquidating proceeds will be used to (1) pay off debts and set up reserves for contingencies, (2) make certain distributions to GMH, and (3) make distributions to the Army and GMH in accordance with the positive balances in their capital accounts. In the event proceeds from the liquidation of Petitioner's assets are insufficient to pay the distributions to GMH in (2) above, the agreement provides that the Army will release certain funds under its control to pay them.

Where not otherwise provided in the Operating Agreement, every aspect of Petitioner's affairs shall be managed exclusively by GMH. In addition, major decisions will require unanimous approval by the Army and GMH, including the sale of all or substantially all of the assets of

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Petitioner, the sale or disposal of the Project, and the pledge or other encumbering of Petitioner's assets except in conjunction with the financing.

GMH will receive no compensation for its role as manager of Petitioner, although an affiliate of GMH will receive a monthly property management fee over the term of the Project in return for its management services.

Petitioner will contract for all necessary services, including architectural, engineering and construction services, and will supervise demolition, renovation and construction, as applicable, of the housing and ancillary facilities in accordance with plans approved by the Army. Following construction, Petitioner will operate, manage and maintain the resulting residential units and related ancillary facilities in close cooperation with the Army and subject to rules and regulations specified by the Army for the remaining period of the Ground Lease (defined below). Additional rights and obligations of the parties in the Project are set forth in the Operating Agreement and the ground lease, which are summarized in the following paragraphs.

C. Proposed Transactions

The Army will lease the Land at the Fort Hamilton Military Base to Petitioner (the "Leased Property") pursuant to a ground lease (the "Ground Lease") for 50 years, with a 25 year renewal option. Pursuant to the Ground Lease, Petitioner will develop, maintain and operate the Facility. Petitioner is not required to pay any rent under the Ground Lease. Immediately after execution of the Ground Lease, Petitioner will sublease the Leased Property back to the Army (the "Army Sublease"), and the Army will then immediately sub-sublease the Leased Property back to Petitioner (the "Company Sublease"). Both the Army Sublease and Company Sublease are tied to, and will expire upon termination of, the leasehold mortgage (defined below).

The Ground Lease will provide that title to certain housing and ancillary facilities currently existing at the Facility (the "Existing Housing") will vest in Petitioner for no consideration. Title will, however, revert back to the Army upon termination of the Ground Lease. Petitioner will be obligated to demolish or substantially renovate most of the Existing Housing and to construct new residential units, which are intended to house military personnel and their families, and ancillary facilities, both pursuant to designs and specifications approved by the Army (the "New Housing") (the Existing Housing and the New Housing are referred to collectively as the "Housing"). As will be the case with the Existing Housing, title to the New Housing will vest in Petitioner pursuant to the Ground Lease, but only for the term of the Ground Lease. All right, title and interest in the Housing will revert to the Army upon expiration of the Ground Lease for no consideration.

D. Army Control of the Project and Petitioner

Development of the Facility will be in furtherance of the Army's governmental functions. Pursuant to the Ground Lease, the Project will be under the general supervision of the Army, and certain actions undertaken by Petitioner will be subject to the Army's approval. As discussed above,

the Army must approve all designs and specifications for the New Housing, and Petitioner is required to comply with all rules and regulations issued by the Army with respect to the Leased Property. Furthermore, the Army will maintain a significant degree of control over the Facility throughout the term of the Ground Lease. For instance: (1) the Army will have the right to enter the Leased Property for any purpose; (2) the Army may impose restrictions on access to the Leased Property by Petitioner; and (3) Petitioner is required to purchase from the Army or the Army's designee all police, fire and utility services.

In addition, the Army will limit rental rates Petitioner is allowed to charge for military personnel residing in the Housing to the applicable U.S. military service personnel "Basic Allowance for Housing," which is set on an annual basis by Congress and based upon such factors as geographic location, pay grade and dependency status of military personnel. This is the same rent currently paid by service members who live in the Existing Housing. Both the Army and Petitioner expect that 100% of the Housing will be rented to military personnel, and, accordingly, that all rental rates will be subject to the Basic Allowance for Housing.

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;...

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 a 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:

"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 of the Tax Law provides, in part:

(a) The following shall be exempt from payment of the real estate transfer tax:

1. The state of New York, or any of its agencies, instrumentalities, political subdivisions, or public corporations (including a public corporation created pursuant to agreement or compact with another state or the Dominion of Canada).
2. The United Nations, the United States of America and any of its agencies and instrumentalities.

The exemption of such governmental bodies or persons shall not, however, relieve a grantee from them of liability for the tax.

(b) The tax shall not apply to the following conveyances:

1. Conveyances to the United Nations, the United States of America, the state of New York, or any of their instrumentalities, agencies or political subdivisions...;

4. Conveyances of real property without consideration and otherwise than in connection with a sale, including conveyances conveying realty as bona fide gifts;

* * *

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(b) of the Real Estate Transfer Tax regulations (the “Regulations”) provides, in part:

Consideration in the case of the creation of a taxable lease or sublease.

(1) In the case of the creation of a lease which constitutes a conveyance subject to tax, the consideration used to compute the tax is the present value of the right to receive rental payments or other payments attributable to the use and occupancy of the real property. Such consideration also includes the present value of rental or other payments attributable to any renewal term. In the case of the creation of a taxable sublease, the consideration is computed in the same manner as in the creation of a taxable lease except that the value of the remaining prime lease rental payments must be subtracted.

Section 575.9 of the Regulations provides, in part:

Exemptions and non-taxable transactions.

(a) Certain governmental organizations or entities are exempt from the payment of the real estate transfer tax. In addition, there are certain types of transactions to which this tax does not apply.

(b) The exemption for certain governmental organizations or entities does not extend to the grantee: that is, if the exempt governmental entity conveys title to real property to a nonexempt individual or entity, there will be a tax due which is payable by the grantee. The exemption for governmental organizations or entities includes the following:

(1) the State of New York, or any of its agencies, instrumentalities, political subdivisions, or public corporations including a public corporation created pursuant to agreement or compact with another state or the Dominion of Canada. A public corporation includes a public benefit corporation such as the Urban Development Corporation. (For a full definition of public corporation, see section 66 of the General Construction Law);

(2) the United Nations; and

(3) the United States of America and any of its agencies or instrumentalities.

(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;

* * *

(4) conveyances without consideration and otherwise than in connection with a sale, including conveyances by bona fide gift;

Section 575.10 of the Regulations provides, in part:

To the extent that a conveyance effectuates a mere change of identity or form of ownership or organization and there is no change in beneficial ownership, the real estate transfer tax does not apply.

Examples of transactions where the issue of change in beneficial ownership would arise include the following:

* * *

(d) the conveyance by a person to a partnership in exchange for an interest in the partnership. Such conveyance is not taxable to the extent of the grantor's interest in the partnership.

Section 575.11 of the Regulations provides, in part:

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

* * *

(7) A conveyance by the United Nations, the United States of America, the State of New York, or any of their agencies, instrumentalities or political subdivisions is subject to tax unless the grantee is another of such governmental organizations or entities.

(8) A conveyance by a partner to the partnership as a contribution of partnership assets is subject to tax to the extent that there is a change in beneficial ownership.

Title 10 of the United States Code ("10 U.S.C.") § 2667, provides, in part:

Leases: non-excess property of military departments

(a) Whenever the Secretary of a military department considers it advantageous to the United States, he may lease to such lessee and upon such terms as he considers will promote the national defense or be in the public interest, real or personal property that is -

(1) under the control of that department; and

(2) not excess property, as defined by section 102 of title 40.

* * *

(e) The interest of a lessee of property leased under this section may be taxed by State or local governments. A lease under this section shall provide that, if and to the extent that the leased property is later made taxable by State or local governments under an Act of Congress, the lease shall be renegotiated.

10 U.S.C. § 2872 provides:

General authority

In addition to any other authority provided under this chapter for the acquisition or construction of military family housing or military unaccompanied housing, the Secretary concerned may exercise any authority or any combination of authorities provided under this subchapter in order to provide for the acquisition or construction by eligible entities of the following:

(1) Family housing units on or near military installations within the United States and its territories and possessions.

(2) Military unaccompanied housing units on or near such military installations.

10 U.S.C. § 2874(a) provides:

(a) Lease Authorized. The Secretary concerned may enter into contracts for the lease of housing units that the Secretary determines are suitable for use as military family housing or military unaccompanied housing.

10 U.S.C. § 2878, which provides for the conveyance or lease of existing property and facilities, provides in part:

(a) Conveyance or Lease Authorized. The Secretary concerned may convey or lease property or facilities (including ancillary supporting facilities) to eligible entities for

purposes of using the proceeds of such conveyance or lease to carry out activities under this subchapter.

* * *

(d) Inapplicability of certain property management laws. -

The conveyance or lease of property or facilities under this section shall not be subject to the following provisions of law:

(1) Section 2667 of this title.

Opinion

Petitioner proposes that the transactions described above are not subject to the real estate transfer tax because the Facility is not subject to state taxation. Petitioner further asserts that the transfer pursuant to the Ground Lease is exempt under the provisions of the real estate transfer tax because no consideration is payable according to the terms of the Ground Lease and because the transfer to Petitioner under the Ground Lease is a mere change of form or identity of ownership.

A. Whether the Facility is Subject to State Taxation

The issue of taxability of private interests in land on a military installation that is subject to exclusive federal jurisdiction has been addressed by the New York courts in the context of real property tax assessments. These decisions have historically found that the State possessed the requisite jurisdiction to tax such private interests. (See *Matter of Fort Hamilton Manor, Inc. v. Boyland*, 4 NY2d 192 [1958]; *Matter of Black River Limited Partnership v. Astafan*, 166 A.D. 2d 914 (4th Dept 1990).) These cases relied upon federal law which clearly permitted the ad valorem taxation by a state or local government of the property interest of a lessee.

Petitioner contends that 10 U.S.C. § 2878 renders the provisions of 10 U.S.C. §2667(e), which among other provisions provides for state and local taxation of the property interests of tenants to which the government has leased property for the purpose of promoting national defense or the public interest, inapplicable to the facts surrounding the transactions presented in this case. However, 10 U.S.C. § 2878(d) is concerned with the inapplicability of certain property management laws, and does not specifically reference laws which provide for taxes upon the conveyance of real property. Petitioner has not demonstrated any other provisions contained in the Housing Initiative which explicitly address the issue of private interests in land on military installations. As such, it appears that 10 U.S.C. § 2878 does not support exclusive federal preemption over the taxation of private interests in real property on a military base.

The real estate transfer tax is not an ad valorem or real property tax. Rather, it is a transaction tax that is imposed on the conveyance of real property or an interest in real property. Absent any federal preemption of state taxation in this case, the plain language of the Tax Law and

the Regulations clearly provides that the conveyances in this case are subject to tax. Based on the provisions clearly articulated in sections 1402 and 1405 of the Tax Law and in sections 575.9(a) and (b) and 575.11(a)(7) of the Regulations, it is clear that in imposing a tax on conveyances from a government organization or entity, such as the Army, to a non-exempt party, such as Petitioner, New York State is not taxing the federal government. However, it is also clear that, because of the exemption applicable to the Army, any tax due in this case would be payable by Petitioner.

B. Whether the Transactions Represent a Mere Change of Identity for No Consideration

Mere Change of Identity

Based on section 1405(b)(6) of the Tax Law and section 575.10 of the Regulations, the conveyances described in this Advisory Opinion are not subject to tax to the extent of the Army's interest in Petitioner. From the information provided, there are only two members of Petitioner, the Army and GMH. Where not otherwise provided in the Operating Agreement, every aspect of Petitioner's affairs shall be managed exclusively by GMH. In addition, major decisions will require unanimous approval by the Army and GMH, including the sale of all or substantially all of the assets of Petitioner, the sale or disposal of the Project, and the pledge or other encumbering of Petitioner's assets except in conjunction with the financing.

In addition, upon formation of Petitioner, GMH received the right to receive future distributions, contingent upon its making a capital contribution at a later date. Thus, at the time of the conveyance, GMH will hold an economic interest in the form of a right to future distributions which is contingent only upon events under its own control. Generally, available cash from operations (as well as dissolution) will be distributed 90% to the Army and 10% to GMH, but GMH's share will be limited to 16.5% of its capital contribution.

From the information provided, it appears that there will be a partial change in beneficial ownership upon the conveyance from the Army to Petitioner. As managing member of Petitioner, GMH will have substantial influence and control of Petitioner's assets, including the management and disposition of the real property. Such influence and control is held solely by the Army prior to the conveyance, but is shared equally after that time.

Since the provisions of the operating agreement are complex, and the distribution of proceeds is based upon future contingencies, it is difficult to measure the change in beneficial interest from an economic perspective. However, it does appear that the Army will retain no less than a 90% interest in the underlying real property, and GMH will acquire not more than a 10% interest in the underlying real property.

Consideration

Pursuant to section 1401(e) of the Tax Law, the Ground Lease is a conveyance of real property subject to tax because the sum of the term of the lease including options for renewal exceeds 49 years, substantial capital improvements are or may be made by or for the benefit of the

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lessee, and the lease is for substantially all of the premises constituting the property. The Sublease and the Sub-sublease are both for terms less than 49 years and would not be taxable.

With respect to the taxable Ground Lease, section 1401(d)(i) of the Tax Law provides, in part, that 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. Section 575.7(b)(1) of the Regulations provides the consideration used to compute the tax would be the present value of the right to receive rental payments or other payments attributable to the use and occupancy of the real property, including the present value of rental or other payments attributable to any renewal term. However, the Ground Lease provides for no rent payments to be given by Petitioner as lessee. Consequently, based on section 1401(d)(i) of the Tax Law and section 575.7(b)(1) of the Regulations, there would be no consideration derived from the present value of the rent payments.

As shown in the example at section 575.11(a)(8) of the Regulations, the conveyance of the Facility by the Army to Petitioner as a contribution of assets to Petitioner is subject to tax to the extent that there is a change in beneficial interest. The regulations do not specify how the consideration would be determined for such a conveyance. However, section 1401(d) of the Tax Law provides that consideration includes the price paid for real property or any interest therein, whether paid by money, property, or *any other thing of value*. In this case, it is evident that the consideration for the transfer would be derived from the value of the membership interest in Petitioner received by the Army. The consideration for the Facility would be a component of the total value of such membership interest, and may be measured by the fair market value of the real property or interest therein apportioned based upon the percentage change in beneficial interest.

DATED: August 5, 2004

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