STATE OF NEW YORK
STATE TAX COMMISSION

ADVISORY OPINION PETITION NO. M831019B

On October 19, 1983, a Petition for Advisory Opinion was received from Metromedia, Inc., 1 Harmon Plaza, Secaucus, N.J. 07094; RM Branford Corporation c/o Blyth Eastman Paine Webber Incorporated, 1221 Avenue of the Americas, New York, N.Y. 10020; Branford Associates Limited Partnership, c/o Gaston Snow & Ely Bartlett, One Federal Street, Boston, Mass. 02110 and Katella Corporation, c/o Blyth Eastman Paine Webber Incorporated, 1221 Avenue of the Americas, New York, N.Y. 10020.

The issue raised is whether the real property gains tax imposed under Article 31-B of the Tax Law is imposed on a long-term net lease, and on a purchase option contained in such lease, where (i) the lease is entered into as part of a simultaneous sale and leaseback transaction, (ii) the sale price of the property in question represents the fair market value of such property and (iii) the real property gains tax is payable in full on the sale of the property.

The pertinent facts are as follows. The parties to the transaction are contemplating entering into a simultaneous sale and leaseback of the land and improvements known as 205-15 East 67th Street, New York, New York (hereinafter collectively the "Property"). The transaction will include the following steps:

1. Metromedia, Inc. (hereinafter "Metromedia") will sell to Branford Associates Limited Partnership (hereinafter "Master Lessor") an estate for 22 years in the land (hereinafter the "Estate for Years") and the fee interest in the improvements.

2. Metromedia will sell the remainder interest in the land (hereinafter the "Remainder Interest") to Katella Realty Corporation or an affiliate or subsidiary thereof (hereinafter the "Remainderman"). The aggregate purchase price for the Estate for Years, the fee interest in the improvements and the Remainder Interest will be the fair market value of the Property.

3. The Master Lessor, as lessor, will enter into a lease of the Property (hereinafter the "Lease") with RM Branford Corporation (hereinafter the "Sublessor"), as lessee.

4. The Sublessor, as lessor, will enter into a sublease of the Property (hereinafter the "Sublease") with Metromedia, as lessee.

5. The Remainderman, as lessor, will enter into a lease of the land (hereinafter the "Ground Lease") with the Master Lessor, as lessee. The Ground Lease will become effective only if the Sublessor exercises or is deemed to have exercised, its first renewal option under the Lease (see following paragraph).

The initial terms of the Sublease and Lease will be 20 years and 22 years respectively. Metromedia will have options to renew the Sublease for seven renewal terms of five years each; the Sublessor will have options to renew the Lease for a first renewal term of three years and for six subsequent renewal terms of five years each. The initial term of the Ground Lease will be three years, with options to renew for twelve renewal terms of five years each. If Metromedia exercises a renewal option under the Sublease, the Sublessor will automatically be deemed to have exercised the corresponding renewal option under the Lease. If a renewal option under the Lease is so deemed exercised, or if the Sublessor itself exercises one of such renewal options, (i) the term of the Ground Lease will commence (in the case of the first such renewal option) or (ii) the corresponding renewal option under the Ground Lease will automatically be deemed exercised (in the case of the second through seventh of such renewal options).

The Lease will give the Sublessor an option (hereinafter the "Purchase Option") to purchase the improvements and the Estate for Years from the Master Lessor at the end of the initial term of the Sublease and at the end of any renewal term of the Sublease. The Purchase Option will be assigned to Metromedia under the Sublease. If Metromedia exercises the Purchase Option, the Remainderman and the Sublessor will also be obligated to convey their interests in the Property to Metromedia. The total option price for the Property will be its fair market value, determined as if all renewal options under the Sublease, Lease and Ground Lease were exercised and the Property were sold subject to such leases.

The Sublease, Lease and Ground Lease also provide a mechanism pursuant to which Metromedia can be compelled to repurchase the Property at a pre-established price in the event the Property is condemned or substantially destroyed by casualty or in the event Metromedia can no longer conduct business economically on the Property.

The Sublease, Lease and Ground Lease will each be "net leases," with the lessee thereunder obligated to pay all expenses associated with the use and operation of the Property. The lessee is also permitted to make capital improvements to the Property.

Net rent under the Sublease (i.e., the fixed rent payable by Metromedia, not including payments made on account of real estate taxes, insurance, utilities and similar expenses), when discounted at a rate of approximately 12.14%, will equal the original purchase price for the Estate for Years and the improvements. During the first five years of the initial term of the Lease and Sublease, net rent payable under the Lease will be slightly greater than that payable under the Sublease; during the remainder of the term, net rent under the Lease and Sublease will be equal. The difference between the net rent payable under the Lease and Sublease, when discounted at a rate of approximately 12.14% will be less than $1,000,000.

It was the intent of the Legislature to subject a simultaneous sale and leaseback to the gains tax imposed under Article 31-B of the Tax Law only on the sale aspect of the transaction. This intent is realized through the following application of the gains tax to the transactions described herein.

First, the transfer by Metromedia to the Master Lessor of the Estate for Years and the fee in the improvements is fully subject to the gains tax on the difference between the consideration, which equals the fair market value of the property, and Metromedia's original purchase price in the property. Similarly, the gain on the sale of the remainder interest to the Remainderman for the fair market value of this interest is subject to the gains tax.

Secondly, with respect to the transfers of the Estate for Years in the land and the fee in the improvements, the consideration to the Master Lessor for the Lease, which includes the Option to Purchase, is the present value of the lease payments. It is appropriate to utilize a net rent amount to determine the present value of the lease payments. Net rent means the amount payable by the Sublessor for the use of the property, excluding payments for real estate taxes, insurance, utilities and similar expenses. Further, the facts justify the use of a discount factor of 12.14% to calculate the present value of the lease payments. The Master Lessor may allocate his original purchase price of the property between the value of the lease interest and the value of the reversionary interest. Assuming that the reversionary interest has a nominal value, this method of analyzing the lease transaction will result in little or no gain on this transfer from the Master Lessor to the Sublessor.

If the Sublease occurred before September 4, 1984, the rules in effect at that time defined the consideration for the Sublease as the present value of the difference between the Sublease payments and the Lease payments. Petitioner states that consideration defined in this manner would be less than $1,000,000. Accordingly, if the Sublease occurred before September 4, 1984 it would not be subject to the gains tax. If the Sublease occurred after September 4, 1984, the effective date of Chapter 900 of the Laws of 1984, the consideration for the Sublease would be the present value of the Sublease payments, unreduced by the present value of the lease payments.

The Ground Lease, if effective, from the Remainderman to the Master Lessor must be analyzed in the same manner as the Lease. The consideration for the Ground Lease is the present value of the lease payments due under it. Again, it is appropriate to determine the present value of the lease payments by using the discount factor of 12.14% and utilizing the net rent amount. The Remainderman may allocate his original purchase of the remainder between the value of the interest leased and the value, if any, of the reversion.

Finally, if Metromedia exercises its purchase option to purchase the Estate for Years and the fee in the improvements, the original purchase price of the Master Lessor on this transfer will be the amount the Master Lessor paid for these interests when he acquired them, plus the cost of any capital improvements made by the Master Lessor to the property after the granting of the lease; plus the gain recognized, if any, by the Master Lessor on the Lease. This increase in original purchase price for any recognized gain on the prior lease was authorized by Chapter 900 of the Laws of 1984 and would only apply to transfers after September 4, 1984.

The original purchase price of the Remainderman on the transfer of the remainder to Metromedia will likewise be the amount the Remainderman paid to acquire the remainder interest plus any gain recognized on the Ground Lease by the Remainderman.

DATED: May 9, 1985

s/FRANK J. PUCCIA
Director
Technical Services Bureau

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