New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB-A-88 (2) R
Real Property Transfer
Gains Tax
July 26, 1988

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. M880504B

On May 4, 1988, a Petition of Advisory Opinion was received on behalf of Loomis J. Grossman located at Haviland Road, Harrison, New York 10528.

The issues raised concern the application of the Real Property Transfer Gains Tax imposed by Article 31-B of the Tax Law (hereinafter the "Gains Tax") to the following factual situation.

On May 29, 1958, Petitioner, as landlord, entered into a lease with Aaron Levine and Anna Levine (the "Levine's"), as tenants for the premises known by the street addresses of 645-649-651 Madison Avenue and 18 East 60th Street, New York (collectively the "demised premises"). A memorandum of such lease was recorded in the New York County Office of the City Register of the City of New York (the "City Register's Office"). On September 10, 1959, the lease was assigned by the Levine's to the 645-651 Madison Avenue Corporation (hereinafter the "Madison Corp."), which assignment was recorded in the City Register's Office.

On August 1, 1973, certain lease amendments were agreed to between Petitioner and Madison Corp. Such amendments were recorded in the City Register's Office. On May 30, 1975, the lease was assigned by Madison Corp. to Presidential Realty Corporation (hereinafter "Presidential"), which assignment was recorded in the City Register's Office.

Presidential assigned the lease to the Equitable Life Assurance Society of the United States (hereinafter "Equitable Life") by an assignment dated September 19, 1975, which assignment was later recorded in the City Register's Office. The lease was subsequently assigned by Equitable Life to the Equitable-Nissei Madison Company (hereinafter "Equitable-Nissei") on July 15, 1981, which assignment was recorded in the City Register's Office.

The lease provides for an initial term of thirty years commencing on June 1, 1958. Petitioner also granted the tenant the right to extend the term of the lease for two additional thirty year periods under certain terms and conditions.

Moreover, the lease provides that the net annual rent to be paid by the tenant to the landlord during each lease renewal option term would be 6% of the fair market value of the demised premises, considered as unimproved as of a date six months before commencement of the renewal term, plus $4,800, however, in the case of the first lease renewal option, not less than $56,000, and in the case of the second lease renewal option, not less than the greater of $56,000 (which is the net annual rent during the lease's initial thirty year term), or the net annual rent payable by the tenant during the first renewal term.

The lease provisions governing the lease renewal options provide that the parties shall have the opportunity to agree on the value of the land which pursuant to the rental formula would amount to an agreement on the new annual rent payable during the lease renewal option term. In the absence of such agreement, the lease provides that the net annual rental for the lease renewal option term shall be fixed and determined by arbitration.

Equitable-Nissei has given Petitioner notice that it desires to exercise the first lease renewal option. Pursuant to negotiations which have taken place between Petitioner and Equitable-Nissei, the landlord and tenant have tentatively agreed to the rent that will be paid during the first thirty year lease renewal option term. This tentative agreement contemplates that the tenant will pay the landlord a net per annum rent of $1,300,000 during the first ten years, $1,400,000 during years eleven through twenty, and $1,500,000 during years twenty-one through thirty.

In addition to negotiating the exercising of the first lease renewal option, the tenant and landlord have negotiated, and the landlord has tentatively agreed to provide the tenant, an additional thirty year renewal option under economic terms to be determined in a manner identical to those provided under the two lease renewal options provided in the lease.

It is Petitioner's contention that neither the modification of the lease to determine the rental payments during the first lease renewal option nor the grant of an additional thirty year renewal option are transfers subject to the gains tax since the modification merely establishes the rent payable to the landlord by the tenant during the first lease renewal option in a manner specifically provided for under the terms of the lease. Such modification in Petitioner's opinion is a non-substantial amendment to a grandfathered lease. The grant of the additional renewal option viewed independent from the grandfathered lease in the opinion of Petitioner is not a transfer of real property since such right provides, at most, for the creation of a leasehold interest of less than forty-nine years.

Section 1443.6 of the Tax Law provides an exemption from the gains tax where a transfer of real property occurring after the effective date of Article 31-B (March 28, 1983) is pursuant to a written contract entered into on or before the effective date of such article, provided that the date of execution of such contract is confirmed by independent evidence, such as recording of the contract, payment of a deposit or other facts and circumstances as determined by the Tax Department.

Gains Tax Regulation 590.21(a) provides, in pertinent part, that where a contract entered into on or before March 28, 1983 is amended after such date, such contract will continue to be exempt by reason of section 1443.6 of the Tax Law as long as the amendment is of a nonsubstantial nature.

Where a grandfathered lease is modified, such modifications will result in the creation of a new lease for gains tax purposes if the modifications are determined to be substantial in nature. The determination of what constitutes substantial modifications to a grandfathered lease must be made on a case by case basis. If the modifications made to a grandfathered lease are determined to be substantial in nature, a new lease is deemed to be created for gains tax purposes and the terms of such new lease are deemed to start on the effective date of such modifications.

The modification to a grandfathered lease to determine and set forth the rental payments for a renewal period in the specific manner provided for in the grandfathered lease, does not constitute a substantial modification to such lease. Therefore, a new lease is not created for purposes of the gains tax as a result of such modification, and such modification, in and of itself, does not result in the imposition of the gains tax.

As for the grant of an additional renewal option, the term of such renewal option will not be aggregated with the term of a lease created prior to the effective date of the statute for purposes of determining whether such lease and renewal option meet the criteria of a taxable lease, provided no substantial changes have been made to the grandfathered lease. Rather, the renewal option will be viewed independently for purposes of the gains tax.

Gains Tax Regulation 590.5 provides that:

(a) Q. Is the creation of a leasehold or sublease a transfer of real property?

A. Yes. The creation of a leasehold or sublease is a transfer of an interest in real property, but only where:

1) the sum of the term of the lease or sublease and any options for renewal exceeds 49 years, and

2) substantial capital improvements are or may be made by or for the benefit of the lessee or sublessee, and

3) the lease or sublease is for substantially all of the premises constituting the real property.

"Substantially all" is defined to mean 90% of the total rentable space, exclusive of common areas.

(b) Q. Is the creation of a leasehold for a term of less than 49 years ever taxable?

A. Yes. If a leasehold is coupled with the granting of an option to purchase the property, the transfer is taxable regardless of the term of the lease.

Accordingly, since the term of the additional renewal option is for less than forty-nine years and is not coupled with an option to purchase the property, the grant of the additional renewal option is not subject to the gains tax. However, it should be noted that the term of the additional renewal option would be aggregated with the terms of any subsequent options to renew or will be coupled with an option to purchase to determine the application of the Gains Tax.

DATED: July 26, 1988

s/FRANK J. PUCCIA
Director
Technical Services Bureau

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