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

TSB-A-94 (8) R
Real Property
Transfer Gains Tax
June 14, 1994

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. M940513A

On May 13, 1994, a Petition for Advisory Opinion was received from Strausman-Mayfair Associates, L.P., 98 Cuttermill Road, Great Neck, New York 11021.

The issue raised by Petitioner, Strausman-MayfairAssociates, L.P., is whether the extension of an existing lease for an aggregate term of beyond forty-nine years is subject to the Real Property Transfer Gains Tax (hereinafter the "gains tax").

Petitioner, as lessor, entered into a lease agreement on April 9, 1968 for certain real property in New York, for a term of 21 years, ending December 31, 1989, with an option to renew the lease for an additional 21 years. On January 17, 1989, after the original 21 year term, and the option to renew expired, an extension of the lease for a term of 5 years was agreed upon. The extension, which began on December 31, 1989, expires on December 31, 1994. On March 24, 1994, Petitioner and the tenant extended the lease agreement for an additional period of 23 years starting December 31, 1994 and ending on December 31, 2017.

Presently, the tenant has assigned the lease with Petitioner's consent and the new tenant wants to extend the lease term from 23 years to 30 years (i.e., an additional seven years).

Under the terms of the lease substantial capital improvements are or may be made by or for the benefit of the lessee and the lease is for substantially all of the premises constituting the real property. In addition, the lease contains a right of first refusal.

Pursuant to Sections 1441 and 1443.1 of the Tax Law and Section 590.1 of the Gains Tax Regulations the gains tax is a ten percent tax on the gain derived from the transfer of real property, which includes the acquisition or transfer of a controlling interest in any entity with an interest in real property, where the property is located in New York State and where the consideration for the transfer is one million dollars or more.

Section 1440.7 of the Tax Law provides, in pertinent part, as follows:

> 7. "Transfer of real property" means the transfer or transfers of any interest in real property by any method ... 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...

Section 590.5 of the Gains Tax Regulations provides, in part, as follows:

(a) Question: Is the creation of a leasehold or sublease a transfer of real property?

Answer: 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;

(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 percent of the total rentable space of the premises, exclusive of common areas. (See section 590.56 of this Part, relating to an assignment of a lease.) For the purpose of determining whether a lease or sublease is for substantially all of the premises constituting the real property, premises shall include, but not be limited to the following:

(i) an individual building, except for space which constitutes an individual condominium or cooperative unit;

(ii) an individual condominium or cooperative unit; or

(iii) where a lease or sublease is of vacant land only, any portion of such vacant land.

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

Answer: 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.

Section 590.30 of the Gains Tax Regulations provides as follows:

Question: Is the term right of first refusal, contained in a lease agreement, considered an option?

Answer: No. A right of first refusal grants the recipient the right to buy the real property at the same price that has been offered to the seller and the seller accepts or proposes to accept from a third-party buyer. The right of first refusal does not grant the lessee the ability to compel an unwilling owner of the real property to sell. In contrast, an option gives the optionee the right to purchase property at an agreed-upon price from the option or, if he chooses, at any time within the option period.

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optionee may compel an unwilling option or to convey the real property upon the exercise of the option. Consequently, a lease for less than 49 years containing a right of first refusal is not a transfer of real property and is not taxable under the gains tax. Accordingly, a purchase of real property pursuant to the exercise of a right of first refusal is not exempt under the grandfather exemption.

In Syosset Shopping Center Associates, Adv Op St Tx Comm, September 14, 1987, TSB-A-87(8)R the Tax Commission opined that a long-term lease originally executed in the early nineteen fifties for an initial term of 75 years, and later extended for an additional 30 years after March 28, 1983 (the effective date of the gains tax) with the remaining term on the original lease being 37 years, was considered to be the creation of a new lease effective as of the date of the modification. Therefore, the 30 year term was aggregated with the 37 years remaining on the original lease to determine whether the term of the new lease exceeded forty-nine years, and, thus, would be subject to the gains tax.

In the instant case, Petitioner entered into a lease on April 9, 1968, prior to the enactment of the gains tax, for a term of 21 years. Subsequently, on January 17, 1989, the lease was extended for an additional 5 years and on March 24, 1994, for an additional 23 years. Presently, the tenant wants to extend the term of the lease for an additional 7 years. Pursuant to Syosset Shopping Center Associates, supra, where a lease entered into prior to the effective date of the statute is modified to extend the term of the lease, such modification constitutes the creation of a new agreement between the parties and is, therefore, the creation of a new leasehold. Accordingly, the term of such leasehold would begin as of the date of the first modification. Thus, the term of the new agreement, in the instant case, would be deemed to be 35 years (i.e., 5 year renewal on January 17, 1989 plus present 30 year renewal).

Pursuant to Section 1440.7 of the Tax Law and Section 590.5 of the Gains Tax Regulation the creation of a lease is a transfer of real property subject to the gains tax where the term of lease and any options for renewal exceed forty-nine years and certain other conditions as set forth therein are present, unless the lease contains an option to purchase real property. In cases where 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 and the other specific condition as set forth in Section 1440.7 of the Tax Law being met. Pursuant to Section 590.30 of the Gains Tax Regulations, a right to first refusal contained within a lease does not constitute an option. Therefore, since the term of the new agreement will be

for less than 49 years and the lease does not contain an option to purchase, pursuant to Section 1440.7 of the Tax Law and Section 590.5 of the Gains Tax Regulations such lease is not subject to the gains tax.

DATED: June 14, 1994

/s/
PAUL B. COBURN
Deputy Director
Taxpayer Services Division

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