

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

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Real Property Transfer Gains Tax  
Real Estate Transfer Tax  
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1994 Amendments to the Real Property  
Transfer Gains Tax and the  
Real Estate Transfer Tax

On June 9, 1994, Chapter 170 of the Laws of 1994 was enacted. Included in Chapter 170 were substantive amendments to Article 31-B of the Tax Law, Tax on Gains Derived From Certain Real Property Transfers (the gains tax) and Article 31 of the Tax Law, Real Estate Transfer Tax (the transfer tax).

This memorandum is provided to give a summary of the amendments.

**Gains Tax Provisions**

**I. Definition of Original Purchase Price**

**Additions to Original Purchase Price**

Section 1440.5 (a) of the Tax Law was amended to add to the definition of "original purchase price" (1) New York State real estate transfer tax, New York City real property transfer tax and any similar local real estate transfer taxes paid or required to be paid by the transferor upon the transfer of real property and (2) a prorated portion of certain lease-up costs, i.e., amounts paid or required to be paid by the transferor for costs incurred in connection with the creation of a lease or sublease that is in existence at the time that the real property is transferred. Such costs would include brokerage fees and commissions, professional fees and payments to or on behalf of a tenant as an inducement to enter into a lease or sublease, and must be customary, reasonable and necessary under rules and regulations prescribed by the Commissioner. However, these lease and sublease related costs will not be added to original purchase price under this provision if they may be included in original purchase price under any other provision of section 1440.5 of the Tax Law. In addition, these costs are included in original purchase price only to the extent of the unexpired term of the lease or sublease, determined as of the date of transfer. The includible amount of such costs is determined by multiplying the total amount of such costs by a fraction, the numerator of which is the number of months remaining on the term of the lease or sublease as of the date of transfer, determined without regard to any unexercised options to renew such lease or sublease, and the denominator of which is the sum of (A) the number of months of the expired portion of the term of such lease or sublease at the time of transfer and (B) the number of months remaining on the term of such lease

or sublease at the time of transfer, determined without regard to any unexercised options to renew such lease or sublease.

Construction Period

A new paragraph (h) was added to section 1440.5 of the Tax Law to expand the current interpretation of the term "construction period." Pursuant to this new paragraph, the construction period commences when the transferor begins to actively pursue the plan of construction, development or renovation. Activities that evidence the fact that the transferor has begun to actively pursue such a plan include, but are not limited to, the following: authorizing the preparation of architectural and construction plans; retaining contractors; seeking zoning approvals, building permits or other pre-construction approvals from government or regulatory agencies; authorizing the preparation of feasibility studies or environmental impact studies; making arrangements to obtain substantially all of the funds necessary for the payment of the construction costs; arranging for the demolition of existing structures on the construction site; and conducting soil tests or other engineering studies. The fact that the transferor has undertaken any of the foregoing activities, in and of itself, is not determinative of whether the construction period has commenced. The transferor's overall actions must demonstrate affirmatively that the transferor has begun to actively pursue a plan of construction, development or complete renovation of all or part of the real property to which such plan relates.

The construction period ends, for real property that is held by the transferor for such transferor's own use, when the real property is ready to be placed in service. For real property that the transferor constructs, develops or renovates with the intent of immediate resale or for purposes of immediately leasing in its entirety to unrelated third parties, the construction period ends when the real property is sold or leased, respectively. For real property that the transferor constructs, develops or renovates and then sells or leases by sections or units, the construction period ends for each section or unit when the section or unit is sold or leased and ends for the entire real property when all the sections or units are ready to be placed in service and at least 50 percent of the sections or units are sold or leased. The real property or section or unit is considered to be leased on the earlier of the date it is occupied by the tenant or the date when the tenant's obligation to pay rent begins to accrue. The

construction period is also considered to be terminated if the plan of construction, development or renovation is suspended.

As a result of this amendment extending the beginning and end of the construction period, the transferor is allowed to include in original purchase price certain costs (e.g., real property taxes on the land prior to the time the physical construction work starts, and interest on construction and acquisition loans) incurred during this expanded period.

#### Effective Date

The amendments to the definition of original purchase price took effect June 9, 1994, and apply to transfers occurring on or after such date. Thus, in the case of partial or successive transfers or transfers pursuant to a condominium or cooperative plan, original purchase price includes these additional amounts added to original purchase price to the extent that such additional amounts (1) are directly related to the cooperative shares or condominium units, or in the case of partial or successive transfers, to the interests in real property, that are transferred on or after June 9, 1994, and (2) are reasonably allocated to such shares, units or interests in real property.

## **II. Builders' Exemption**

#### Section 1443.8

Section 1443 of the Tax Law was amended by adding new subdivision eight which provides a full or partial exemption from the gains tax if a capital improvement ("a qualifying capital improvement") has been constructed on the real property being transferred during a specified period of time ("the qualifying period"). The method of calculating the amount of such exemption is set forth in new paragraph (i) which was added to section 1440.5 of the Tax Law.

#### Section 1440.5(i)

Subparagraph (A) of new paragraph (i) provides that, in the case of a transfer of real property on which a "qualifying capital improvement" has been constructed, there shall be added to original purchase price (as determined under paragraphs (a) through (h) of section 1440.5 of the Tax Law), the amount of "qualifying capital improvement costs" incurred during the "qualifying period" to construct the "qualifying capital improvement." It is further provided that, in the case of a transfer of real property which consists of a building or other structure on which a "qualifying capital improvement" has been constructed, the "qualifying capital improvement costs" incurred

during the "qualifying period" will only be added to original purchase price if the total amount of such costs incurred to construct the "qualifying capital improvement" exceeds a specified percentage of the original purchase price of the real property attributable to the building or other structure, excluding the original purchase price attributable to the land, determined immediately prior to the commencement of the construction work on the "qualifying capital improvement." The specified percentage is 15% for property acquired by the transferor on or after January 1, 1985, and 25% in all other cases.

#### Definitions

Subparagraph (B) of new paragraph (i) contains definitions of the terms "qualifying capital improvement," "qualifying period" and "qualifying capital improvement costs."

"Qualifying capital improvement" means a capital improvement to real property for which construction actually commences on or after January 1, 1994, and before January 1, 1996, and which is distinct and separate from any other capital improvement to such real property for which construction actually commenced prior to January 1, 1994.

"Qualifying period" means the period of time beginning on the date the construction of the "qualifying capital improvement" actually commences and ending on the earlier of (1) December 31, 1997, or (2) the date the "qualifying capital improvement" is ready to be placed in service. The construction of a "qualifying capital improvement" actually commences when the plan of construction for the capital improvement is essentially implemented and the physical labor directly related to the construction starts.

"Qualifying capital improvement costs" are all costs incurred for the construction of a "qualifying capital improvement" that are otherwise included in original purchase price, other than legal fees, interest, points and fees related to loans the proceeds of which were used either to make the "qualifying capital improvement" or acquire the real property, insurance costs, real property taxes, advertising and marketing costs, accounting fees, mortgage recording taxes and other similar costs as determined under rules and regulations prescribed by the Commissioner of Taxation and Finance.

#### Effective Date

These amendments also took effect June 9, 1994, and apply to transfers occurring on or after such date. However, the law provides that nothing in these amendments requires or authorizes the refunding or crediting of any gains tax actually paid or the cancellation of any gains tax assessment issued prior to June 9, 1994.

### **III. Aggregation**

Section 1440.7 of the Tax Law was amended by subdividing its provisions into three separately lettered paragraphs. New paragraph (a) consists of existing language except that the words "or transfers" are deleted from the definition of "transfer of real property" as such phrase is unnecessary. New paragraph (c) consists entirely of existing language. In new paragraph (b), the definition of "transfer of real property" is amended to set forth all of the rules with respect to aggregation of consideration in the case of partial or successive transfers of real property.

#### Three-Year Rule

In new subparagraph (i) of paragraph (b), the definition of "transfer of real property" is amended to require the aggregation of consideration for partial or successive transfers of interests in contiguous or adjacent real property by a transferor or related transferors to one or more transferees if such transfers occur within a three-year period and without regard to the existence of an agreement or plan to effectuate by partial or successive transfers a transfer that would otherwise be included in the coverage of Article 31-B and without regard to the use of the real property. However, the consideration from certain transfers of contiguous or adjacent real property will not be aggregated. The consideration from a transfer of real property by a transferor will not be aggregated with the consideration from a transfer of real property by such transferor's estate. In addition, the consideration from the following transfers of real property will not be aggregated with the consideration from any other transfer for purposes of this subparagraph: a transfer of real property pursuant to a mortgage foreclosure or any other action to enforce a lien or security interest, a transfer of real property upon liquidation or by a receiver, a transfer of real property pursuant to a taking by eminent domain or a transfer of real property pursuant to a divorce proceeding.

#### Tenants in Common, Joint Tenants and Tenants by the Entirety

In new subparagraph (ii) of paragraph (b), the definition of "transfer of real property" is amended to

require the aggregation of consideration for all partial or successive transfers of interests in real property by tenants in common, joint tenants or tenants by the entirety of such real property to one or more transferees if such transfers occur within a three-year period and without regard to the use of such real property or whether such transfers were pursuant to a plan or agreement.

#### Cooperative and Condominium Plan Transfers

New subparagraph (iii) of paragraph (b) codifies current rules with regard to transfers pursuant to a cooperative or condominium plan, i.e., that the consideration from such transfers is aggregated. No change has been made to the aggregation rules with regard to transfers pursuant to a cooperative or condominium plan.

#### Transfer of Subdivided Parcels

New subparagraph (iv) of paragraph (b) amends the definition of "transfer of real property" to provide that the consideration from the transfer or transfers of interests in subdivided parcels of real property must be aggregated, without regard to the existence of an agreement or plan to effectuate by partial or successive transfers a transfer that would otherwise be included in the coverage of Article 31-B and without regard to the use of such property.

New subparagraph (iv) of paragraph (b) also amends the statutory provision that consideration is not aggregated in connection with the sale of subdivided parcels improved with residences to transferees for use as their residences. New subparagraph (iv) provides that consideration from the transfer of parcels located in a residential subdivision will not be aggregated where such parcels have been substantially improved for residential use and transferred to a transferee who intends to construct residential dwellings on such parcels or has constructed or is constructing residential dwellings on such parcels. The term substantial improvement is defined to include the new construction of streets, sewers or utility lines. In addition, new subparagraph (iv) states that consideration from the transfer of parcels located in a residential subdivision will not be aggregated where such parcels have been improved or partially improved with a residential dwelling. Further, subparagraph (iv) sets forth several factors which may demonstrate that a subdivision is a residential subdivision. These factors may include zoning restrictions, the existence of contracts entered into by the transferor to transfer developed parcels or contracts entered into by the transferee to build residences or other similar circumstances.

### Effective Date

The amendments to aggregation took effect June 9, 1994, and will apply to transfers occurring on or after such date, with two exceptions:

- (1) For partial or successive transfers of interests in contiguous or adjacent real property, as described in section 1440.7(b) (i) of the Tax Law, if there are transfers occurring both before and after June 9, 1994, the consideration from such transfers will be aggregated only if the consideration from both such transfers would have been aggregated under the law and rules in effect immediately prior to June 9, 1994. If all such transfers occur on or after June 9, 1994, then the provisions of this new law will be applicable.
- (2) For partial or successive transfers of interests in real property, as described in section 1440.7(b) (ii) of the Tax Law, the consideration from such transfers which occur before June 9, 1994, will be aggregated with the consideration from such transfers occurring on or after June 9, 1994, only if such transfers occur within a three-year period.

## **Transfer Tax and Gains Tax Provisions**

### **IV. Real Estate Investment Trusts**

#### Rate Reduction

Sections 1402 and 1441 of the Tax Law, which impose the transfer tax and the gains tax respectively, were amended to reduce the rate of tax for "real estate investment trust transfers," as such term is described below, that occur on or after June 9, 1994, and before July 1, 1996. The reduced rate of tax for transfer tax is \$1.00 for each \$500 or fractional part of consideration. The reduced rate of tax for gains tax is 2 1/2% of the gain. The definition of a "real estate investment trust transfer" is the same for the transfer tax and the gains tax.

#### Real Estate Investment Trust Transfer

The new provisions set forth that a "real estate investment trust transfer" is any transfer or conveyance of real property to a real estate investment trust, as defined in Internal Revenue Code section 856, (referred to hereinafter as a REIT) or to a partnership or corporation in which the REIT owns a controlling interest (including a transfer to or acquisition by the REIT, or a partnership or

corporation controlled by the REIT, of a controlling interest in an entity that owns real property) that occurs in connection with the initial formation of the REIT. However, to qualify as a "real estate investment trust transfer," the following two conditions must be satisfied:

- (1) The grantor/transferor must receive, as consideration for the transfer or conveyance to the REIT or to a partnership or corporation controlled by the REIT, ownership interests in the REIT and/or a controlled partnership or corporation. The value of those ownership interests must be equal to an amount not less than 40% of the value of the equity interest in the real property or interest therein conveyed or transferred to the REIT and/or a controlled partnership or corporation. The grantor/transferor must then retain those ownership interests for the next 2 years (except in the case of death). In general, the value of the equity interest in the real property is computed by subtracting from the consideration the unpaid balance of any loans secured by mortgages or other liens on the real property or on an interest in an entity which owns the real property. Mortgages and other encumbrances placed on the real property or interest therein, in anticipation of the formation of the REIT, will not be subtracted. This provision is intended to preclude unsecured loans from being converted into secured loans solely to permit a transaction to meet this requirement.
- (2) At least 75% of the cash proceeds received by the REIT from the sale of ownership interests upon its initial formation (e.g., the public offering of stock by the REIT) must be used for the following purposes: (a) to make payments on loans secured by any interest in real property owned directly or indirectly by the REIT; (b) to pay for capital improvements to real property owned directly or indirectly by the REIT; (c) to pay lease-up costs (i.e., costs incurred to induce a tenant to enter into a lease) associated with real property owned directly or indirectly by the REIT; (d) to acquire additional properties or interests in real property (other than acquisitions to which a reduced rate of tax is applicable without regard to this use of proceeds test); and (e) for reserves established to make payments on secured loans, make capital improvements or pay lease-up costs.



Measuring Consideration: Fair Market Value

For purposes of measuring consideration for "real estate investment trust transfers" under the transfer tax and the gains tax, the law provides that the fair market value of the real property will be calculated by dividing the net cash flow from operations with respect to the real property for the 12-month period ending 2 months prior to the transfer or conveyance by the sum of (1) the federal long-term rate compounded semi-annually determined under section 1274(d) of the Internal Revenue Code in effect 30 days prior to the date of transfer or conveyance plus (2) two percentage points. It is anticipated that net cash flow from operations will be defined by the Department to mean the gross cash flow from the operation of the real property less operating expenses related to the property, including an amortized portion of leasing commissions, tenant improvements and other capital costs. However, no deduction will be allowed for the payment of debt service, taxes (other than real property taxes and special assessments) and depreciation. If either the net cash flow from operations calculation or the capitalization rate do not result in an accurate representation of the fair market value of the real property, the Commissioner of Taxation and Finance may adjust either figure. In lieu of this method for determining fair market value, the taxpayer may utilize any other method for determining fair market value approved by the Commissioner of Taxation and Finance (e.g., appraisals).

Effective Date

The REIT provisions took effect June 9, 1994, and generally apply to qualified transfers occurring on or after such date and before July 1, 1996. The law also provides that the reduced tax rates will apply to any "real estate investment trust transfer" occurring on or after July 1, 1996, if such transfer is pursuant to a binding written contract entered into before July 1, 1996, between a grantor/transferor and a REIT, or a corporation or partnership in which a REIT owns a controlling interest, provided that (1) the fact that such transfer may occur is disclosed in the prospectus relating to the initial formation of such REIT and (2) the date of execution of such contract is confirmed by independent evidence, such as the recording of the contract, payment of a deposit or other facts and circumstances determined to be acceptable by the Commissioner of Taxation and Finance.

New York City

Amendments concerning REITS were also made to the New York City Real Property Transfer Tax.

## **V. Forms and Instructions**

The Tax Department is presently revising its forms and instructions to conform to the foregoing amendments made to the transfer tax and gains tax by Chapter 170. The revised forms and instructions will be made available shortly.