

February 15, 2001

Re: Ruling Request  
Real Property Transfer Tax  
FLR 004766-021

Dear Mr. \_\_\_\_\_ :

This letter responds to your request, dated June 23, 2000, for a ruling applying the New York City Real Property Transfer Tax ("RPTT") to the hypothetical facts described below. This office received additional information relating to this request on September 21 and November 8, 2000.

#### FACTS

The hypothetical facts presented are as follows:

The Taxpayer, a 39-year old woman, is a 99-percent limited partner in a limited partnership and the owner of 100 percent of the stock of a corporation that is the general partner in that limited partnership. The limited partnership holds only one asset, commercial real property (the "Property") located in New York City. The Property is encumbered by mortgages totaling approximately \$41,000,000.

The Taxpayer proposes to transfer her limited partnership interest (the "LP Interest") to a trust (the "Trust") that will terminate on the earlier of the Taxpayer's death or seven years from the date of the trust agreement (the "Trust Term"). Nothing other than the LP Interest will be transferred to the Trust. At the time the LP Interest is transferred to the Trust, the "net fair market value" of the LP Interest will be determined. The "net fair market value" will be the fair market value of the LP Interest as finally determined for federal gift tax purposes less the amount of any indebtedness encumbering the Property.

The Trust will pay the Taxpayer an annuity (the "Annuity") equal to 20 percent of the net fair market value of the LP Interest for each year of the Trust Term. The Annuity will be paid first from income derived by the Trust, and, if that income is not sufficient to pay the Annuity in any year, from the Trust's principal. If the Trust's income exceeds the amount of the Annuity, that income will be added to the Trust's principal.

The Trust will be irrevocable. Under sections 671 and 677 of the Internal Revenue Code (the "IRC"), the Taxpayer will be treated as owner of the Trust and will be subject to federal income tax on the Trust's income during the Trust Term. The Taxpayer will be the initial trustee; she will have the right to add or substitute trustees. During the Trust Term, The Trustees will not pay or apply any portion of the Trust income or principal for the benefit of any person other than the Taxpayer.

At the end of the Trust Term, the principal of the Trust, including the LP Interest, will be transferred to a

discretionary trust for the benefit of Taxpayer's husband and children (the "Subsequent Beneficiaries"). The trustees of the discretionary trust will have absolute discretion to determine the timing, amount, and the beneficiary to receive any payments from that trust. Following the death of the Taxpayer and her husband, any remaining assets of the discretionary trust generally will be divided among the Taxpayer's children or their heirs.

While the exact valuation of the LP Interest will be determined when it is transferred to the Trust, you anticipate that its fair market value will be determined to be approximately \$51 million. Because the Property is encumbered with indebtedness totaling \$41 million, you estimate the net fair market value will be about \$10 million. On that basis, you have estimated that the Taxpayer would receive approximately \$2 million a year.

You anticipate that the transfer of the LP Interest to the Trust will be a gift under federal tax law and, using the values set out above, you have determined the value of that gift. Starting with the LP Interest's estimated value of \$51 million, you subtracted the mortgages of \$41 million, resulting in \$10 million. You then determined that, as of the date of your submission, the present value of the \$2 million annual annuity for federal gift tax purposes would be \$9,927,392. Because you expect that the Annuity will be a qualified interest for the federal gift tax under IRC section 2702(b)(1), you subtracted it from \$10 million, resulting in \$72,608. On that basis, you have represented that when the LP Interest is transferred the Taxpayer will be making a gift valued at \$72,608 for federal gift tax purposes.

## ISSUES

You have requested a ruling that the Taxpayer's transfer of the LP Interest to the Trust will be exempt from the RPTT, in whole or part, as a mere change in the form of ownership under section 11-2106(b)(8) of the New York City Administrative Code (the "Code"). In addition, you have asked for a ruling addressing the RPTT consequences arising out of the transfer, following the Trust Term, of the LP Interest to a discretionary trust for the benefit of the Subsequent Beneficiaries.

## CONCLUSIONS

Based upon the facts presented and the representations submitted, we have determined that the Taxpayer's transfer of the LP Interest to the Trust will be not be exempt from the RPTT by reason of Code section 11-2106(b)(8). We have also determined that the Annuity payments and the amount of the mortgages on the Property will be included in the consideration for the transfer of the LP Interest to the Trust. We have also concluded that no RPTT will be imposed upon the transfer, following the Trust Term, of the LP Interest to a discretionary trust for the benefit of the Subsequent Beneficiaries.

## DISCUSSION

The RPTT applies to each instrument transferring an economic interest in New York City real property when the consideration for that interest exceeds \$25,000, unless the transfer is otherwise exempt. Code § 11-2102(b).

Transfer of an economic interest. Under Code section 11-2101, an economic interest in real property includes the ownership of an interest in a partnership that owns real property in the City. Code section 11-2101.7 provides that a "transfer" of an economic interest in property occurs when the interest transferred constitutes a "controlling interest" in the entity owning the property. Under Code section 11-2101.8, an interest in a partnership is a controlling interest if it represents 50 percent or more of the capital, profits, or beneficial interests in the partnership.

In this case, the limited partnership owns real property in New York City. As a result, the LP Interest is an economic interest in real property. Because the LP Interest represents over 50 percent of the capital, profits, and beneficial interest in the partnership, that interest is a controlling economic interest in the Property. Thus, when the Taxpayer transfers the LP Interest to the Trust, it will be a transfer of an economic interest in real property, subject to the RPTT, unless it is otherwise exempt.

Mere change exemption. Code section 11-2106(b) exempts from tax certain transactions that would otherwise be subject to the RPTT. Under paragraph (8) of that subdivision, an instrument transferring an economic interest in real property that effects a mere change of identity or form of ownership is exempt from the RPTT to the extent that the beneficial ownership of the property remains the same. Section 23-05(b)(8)(iv) of title 19 of the Rules of the City of New York (the "RCNY") provides that the determination of the beneficial ownership of an economic interest before a transaction and the extent to which the beneficial interest remains the same following the transaction, will be based on the facts and circumstances.

The Taxpayer owns 100 percent of the LP Interest. She proposes to irrevocably transfer the LP Interest to the Trust. During the seven-year Trust Term, the Taxpayer will be the beneficiary of the Trust. Following the Trust Term, the Subsequent Beneficiaries will become the Trust's beneficiaries. Thus, to determine the extent to which the beneficial ownership of the LP Interest remains the same, we must determine the extent of her beneficial interest in the LP Interest during and after the Trust Term.

At most, the Taxpayer has retained a seven-year interest in the LP Interest. The value of her ownership for federal gift tax purposes could be determined by dividing the value of the ownership interest between her term interest and the Subsequent Beneficiaries' remainder interest. The result of so doing is that the Taxpayer's interest during the Trust Term would be less than 39 percent of the value of the LP Interest and Subsequent Beneficiaries interest would be greater than 61 percent of that value.<sup>1</sup>

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<sup>1</sup> Section 20.2031-7 of the Federal Income Tax regulations provides a method to determine the fair market value of term estates and remainder interests. Paragraph (d)(2)(ii) of that section addresses term of years and life interests. Table B of that section shows that with an eight-percent interest rate (the applicable rate in July 2000, see Revenue Ruling 2000-32, 2000-27 IRB 1), the present value of a remainder interest in property after seven years is .614662 of the property's value. The value of the retained interest for seven years can be obtained by subtracting .614662 from 1.0, resulting in .385338.

The value of the Taxpayer's term interest would then be reduced a small amount, because she is only 39 years old, by the provision that ends the Trust Term on her death. Under Table S of that section, using an eight percent interest rate, the remainder interest in property where the holder of the life interest is 39 years old is .08938. The value of the Taxpayer's life estate can be found by subtracting .08938 from 1.0, resulting in .91862.

However, although the Taxpayer will be the Trust's sole beneficiary during the Trust Term, the facts and circumstances indicate that she will not be the beneficial owner during that term. If she had an ownership interest during the Trust Term, the income she would receive would depend on the income from the LP Interest, and she would also bear the risk of gain or loss. However, her only right as a beneficiary will be to receive the Annuity. The amount of the Annuity will be fixed: if income derived by the Trust is not sufficient to pay the Annuity in any year, it must be paid from the Trust's principal; if the Trust's income exceeds the amount of the Annuity, that income will be added to the Trust's principal. In addition, you have represented that the present value of the Annuity will be approximately equal to the equity value of the LP Interest. The Taxpayer's interest in the LP Interest is thus similar to that of a seller of property who takes back a seven-year nonrecourse installment note. Following the Trust Term, all principal and income will be for the benefit of the Subsequent Beneficiaries. As a result, the Subsequent Beneficiaries, not the Taxpayer, bear the benefit or detriment in any profit, gain, or loss derived from the LP Interest and are the beneficial owners of that interest during the Trust Term.

Based on the facts and circumstances presented, we conclude that the Taxpayer's right to receive the Annuity will not constitute a beneficial interest in the LP Interest following its transfer to the Trust. As a result, no part of the transfer is exempt from tax under Code section 11-2106(b)(8).

Consideration. Code section 11-2101.9 defines "consideration" as the price paid or required to be paid for the property by money, property, or anything of value. It includes the amount of any indebtedness on the property, whether or not that indebtedness is assumed.

The Property is encumbered with mortgages totaling \$41 million, which will remain on the Property after the LP Interest is transferred to the Trust. Under Code section 11-2101.9 and 19 RCNY section 23-02 "Consideration" (3)(i), the amount of that mortgage is included in consideration.

Following the transfer, the Trust will pay the Taxpayer annual payments of approximately \$2 million for seven years. The amount of the Annuity is fixed at the time the LP Interest is transferred to the Trust and is not related to the income from, or appreciation in, the Property. The Trust has no discretion concerning payment of the Annuity, and the Trust is irrevocable. You have advised us that the present value of the Annuity at the time of the transfer will be approximately equal to the net fair market value of the LP Interest at that time. Based on the foregoing, it is our opinion that the Annuity payments will be included in consideration for the transfer.

Federal gift tax law supports that conclusion. Concerning valuation of gifts, IRC section 2512 provides that "[w]here property is transferred for less than an adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration shall be deemed a gift,...." You have represented that, under federal gift tax law, the gift portion of the transfer is only \$72,608. Thus, your representation supports our conclusion that the Annuity represents consideration for the transfer.

We thus conclude that the Annuity payments and the amount of the mortgages on the Property will be included in the consideration for the transfer of the LP Interest to the Trust.

Transfer to the discretionary trust. At the end of the Trust Term, the principal of the Trust, including the LP Interest, will be transferred to a discretionary trust for the benefit of the Subsequent Beneficiaries. Thus, the Subsequent Beneficiaries will be the beneficial owners of the LP Interest while it is part of the principal of that trust. We concluded above that the Subsequent Beneficiaries will be the beneficial owners of the LP Interest during the Trust Term. As a result, when the LP Interest is transferred to the discretionary trust following the Trust Term, there will be no change in its beneficial ownership and the transfer will be exempt from the RPTT under Code section 11-2106(b)(8).

Sincerely,

/s/ Devora B. Cohn  
Associate Commissioner  
for Legal Affairs

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