

April 9, 2002

RE: Ruling Request

Real Property Transfer Tax
FLR-024790-021

Dear :

This letter responds to your request, dated 2002, on behalf of (the "Lender"), for a ruling regarding the application of the New York City Real Property Transfer Tax (the "RPTT") to the transaction described below.

FACTS

The facts presented are as follows:

The Lender is a wholly owned subsidiary of (the "Parent"), and a member of the , which engage in financial operations throughout the world. The Lender has substantial lending operations in New York State. The Lender is developing a new form of transaction that will permit individuals in New York to finance purchases of residences in a manner that conforms with Islamic religious principles, known as "Shariah."

Some observant Muslims believe that Shariah prohibits them from charging or paying interest for the use of money ("riba"). They believe, however, that it is permissible to earn profits from the productive investment of money in commercial transactions. That has led to different financing arrangements, one of which is known as a "murabaha." In a common murabaha, a seller sells an asset to third party financier. The financier then resells the asset to a buyer for the price he paid plus an agreed-upon profit amount. The buyer then pays the financier the amount the financier paid the seller and the profit amount in installment payments over time or as a lump sum at a later time. In a murabaha, the financier is considered to be earning a profit on the transaction and not riba.

The Lender proposes to adopt a structure similar to the murabaha to provide financing for residential purchases. The murabaha transaction structure will provide financing to a home purchaser on the same economic terms as a conventional mortgage loan. Under the Lender's murabaha home financing program, the following transactions (collectively, the "Overall Transaction") will occur:

(1) A home buyer (the "Purchaser") will enter into a contract (the "Contract") to buy a home (the "Premises") from a seller (the "Original Seller") for an agreed-upon price (the "Original Purchase Price"). For purposes of illustration, assume that the Original Purchase Price is \$100,000.

(2) In accordance with usual practices, upon entering into the Contract, the Purchaser will pay the Original Seller a deposit (the "Earnest Money Amount I"). For purposes of illustration, the Earnest Money Amount I is \$5,000.

(3) The Contract between Purchaser and the Original Seller will provide, and the Original Seller will separately agree by executing an "Assignment Rider", that the Purchaser may assign its right under the Contract to the Lender.

(4) Purchaser will apply to the Lender for financing under its murabaha home finance program. If the Lender approves the application, it will issue a commitment letter to Purchaser specifying the terms of the financing. For purposes of illustration, assume the Lender's commitment is to provide financing in the amount of \$80,000 (the "Base Amount") under a financing structured as a murabaha transaction.

(5) At a single closing involving the Original Seller, the Purchaser, and the Lender, the Original Seller will "sell" the Premises to the Lender, which will then resell the Premises to the Purchaser. Those transactions will proceed at the closing as follows:

(a) Purchaser issues to the Lender a "Promises to Purchase," which represents an undertaking to purchase the Premises from the Lender once it has purchased the Premises from the Original Seller.

(b) Purchaser then assigns the Contract to the Lender and the Lender accepts the assignment.

(c) Purchaser makes a payment to the Lender ("Earnest Money Amount II") in an amount equal to the Original Purchase Price under the Contract, less the Earnest Money Amount I previously paid by the Purchaser and less the Base Amount. Under the illustration, the amount of this additional payment would be \$15,000. (Any purchase price adjustments under the Contract in favor of the Purchaser would reduce this amount; any purchase price adjustments in favor of the Original Seller would increase this amount. For purposes of the illustration, it is assumed that there are no purchase price adjustments.

(d) The Lender makes a payment to the Original Seller equal to the Earnest money Amount II plus the Base Amount being financed by the Lender. Under the illustration, this payment would equal \$95,000. At the Lender's request, the Original Seller executes a deed in favor of the Purchaser.

(e) The Purchaser and the Lender sign a Purchase and Financing Agreement (the "PFA") providing for the resale of the Premises from the Lender to the Purchaser.

(f) The Lender delivers to the Purchaser the deed to the Premises issued by the Original Seller.

(g) Purchaser executes and delivers to the Lender a Mortgage securing payment obligations under the PFA.

(h) Purchaser and the Lender execute a "Tax Matters Agreement" under which the Lender and the Purchaser agree on federal, state, and local tax treatment of the Overall Transaction.

Under the PFA, the Purchaser will buy the Premises from the Lender for the sum of the "Base Amount," any additional miscellaneous amounts that may be due from Purchaser to the Lender, plus a "Profit Amount." The Profit Amount is a stated amount reflecting a return to the Lender on the Base Amount, over the term of the PFA, at an agreed rate of profit. For example, assuming a 15-year term (*i.e.*, 180 monthly payments) and an eight percent profit rate (*i.e.*, 0.67 percent per month), the Profit Amount on a Base Amount of \$80,000 would be \$57,613.90. The total purchase price the Purchaser will agree to pay to the Lender under the PFA would, in this example, be \$137,613.90. As with a conventional mortgage loan, this amount would be paid in 180 monthly installments of \$764.52 each.

The PFA would also provide for a "rebate" of the Profit Amount in the event of a full or partial prepayment of the Base Amount (for example, upon the Purchaser's sale of the Premises). The Purchaser would effectively be required to pay only the unamortized balance of the Base Amount and any accrued and unpaid Profit Amount to the date of prepayment. In the event of a partial prepayment, the Purchaser would be entitled to a contemporaneous rebate equal to the portion of the Profit Amount that would have otherwise accrued on the amount prepaid after the date of prepayment. In effect, the Purchaser's payment of the Profit Amount would be identical to its payment of interest on a conventional mortgage loan.

The Mortgage will secure the Purchaser's obligations (i) to pay the Base Amount; (ii) to pay the Profit Amount as it is earned in accordance with the PFA; (iii) to pay any incidental amount owed to the Lender (*e.g.*, late charges and unpaid escrow amounts); and (iv) to otherwise perform the Purchaser's obligations under the Mortgage and the PFA. The Mortgage will specifically state that for purposes of the New York State and City mortgage recording taxes ("MRT") the maximum amount of principal indebtedness secured by the Mortgage is the Base Amount.

The Tax Matters Agreement will recite that: "At Purchaser's request [the Lender] is providing financing for the purchase of the Premises by accepting an assignment of the Contract from the Purchaser, purchasing the Premises from Original Seller and then immediately reselling the Premises on a deferred payment basis." The Tax Matters Agreement will set forth the express agreement of the Lender and Purchaser that the Overall Transaction is to be characterized as the purchase of the Premises by the Purchaser from the Original Seller for the Original Purchase Price (*i.e.*, \$100,000), financed in part by a mortgage loan from the Lender to the Purchaser in the principal amount of the Base Amount (*i.e.*, \$80,000).

The Tax Matters Agreement will further describe specific federal, state, and local tax returns and filings the parties will make consistent with their agreement. These will include an agreement

that, for RPTT purposes, the parties will treat the Overall Transaction as a purchase of the Premises by the Purchaser from the Original Seller for the Original Purchase Price, financed in part by the Lender, and accordingly Original Seller and Purchaser will file a single RPTT return reflecting the sale of the Premises by Original Seller to the Purchaser for the Original Purchase Price (*i.e.*, \$100,000). The Tax Matters Agreement will also state that for MRT purposes the Mortgage secures a maximum principal amount of indebtedness equal to the Base Amount (*i.e.*, \$80,000).

ISSUES

You have requested the following rulings:

1. The RPTT will be imposed on the sale of the Premises as a transfer by the Original Seller to Purchaser, for a consideration equal to the Original Purchase Price payable to the Original Seller under the Contract; and
2. The RPTT will not be imposed on any other aspects of the Overall Transaction, including the assignment of the Contract by the Purchaser to the Lender, the Lender's receipt of the Earnest Money Amount II from the Seller, and its payment to the Original Seller, and the Lender's receipt of the deed from the Original Seller and its delivery to the Purchaser.

CONCLUSIONS

Based upon the facts presented and the representations submitted, we conclude that:

1. The RPTT will be imposed on the sale of the Premises as a transfer by the Original Seller to Purchaser, for a consideration equal to the Original Purchase Price payable to the Original Seller under the Contract; and
2. The Lender's participation in the other aspects of the Overall Transaction, including the assignment of the Contract by the Purchaser to the Lender, the Lender's receipt of the Earnest Money Amount II from the Seller, and its payment to the Original Seller, and the Lender's receipt of the deed from the Original Seller and its delivery to the Purchaser, is as a mere conduit and, as a result, the other aspects of the Overall Transaction are exempt from the RPTT.

DISCUSSION

The RPTT applies to each deed conveying an interest in New York City real property when the consideration for the real property interest exceeds \$25,000. Section 11-2102(a) of the New York City Administrative Code (the "Code"). Code section 11-2101.9 defines "consideration" as the price paid or required to be paid for the property in money, property, or anything of value. It includes the amount of any indebtedness on the property, whether or not that indebtedness is assumed by the grantee.

Code section 11-2106(b) provides that the RPTT will not apply to certain deeds, instruments, and transactions. Paragraph 7 of section provides that the RPTT does not apply to:

A deed, instrument or transaction conveying or transferring real property or an economic interest therein from a mere agent, dummy, straw man or conduit to his principal or a deed, instrument or transaction conveying or transferring real property or an economic interest therein from the principal to his or her agent, dummy, straw man or conduit.

Section 23-05(b)(7) of Title 19 of the Rules of the City of New York (the "RCNY"), similarly provides that the RPTT will not apply to:

A deed, instrument, or transaction conveying or transferring real property or an economic interest therein from a mere agent, dummy, straw man or conduit to a principal, or a deed, instrument or transaction conveying or transferring real property or an economic interest therein from the principal to his agent, dummy, straw man or conduit.

The following are examples of deeds, instruments, and transactions in which this exemption applies:

(a) The conveyance of realty by an individual to a corporation solely for the purpose of obtaining mortgage financing, followed by the immediate reconveyance of the realty by the corporation to the individual after such mortgage financing is obtained.

...

In this case, the Overall Transaction begins when a purchaser and Original Seller enter into the Contract, providing for the sale of the Premises at an agreed price. As in other residential purchases, the Purchaser leaves a deposit, the Earnest Money Amount I, and agrees to arrange for financing.

In a typical residential sale, a bank or other financing entity will agree to provide financing of a portion of the purchase price (the same as the Base Amount). At the closing, the seller receives the non-financed portion of the purchase price, less the deposit, (the same as the Earnest Money Amount II), from the purchaser, and the financed portion from the bank, and the seller provides a deed conveying the Premises to the purchaser. The Purchaser agrees to pay the bank interest and principal on the financed portion over a fixed time and provides the bank with a mortgage on the Premises to secure the loan.

The process in the Overall Transaction, as you have represented it, involves certain different steps at the closing. The Purchaser assigns the Contract to the Lender and gives the Lender the Earnest Money Amount II. The Lender then provides the Original Purchaser with the total of the Base Amount and the Earnest Money Amount II. The Lender and the Purchaser assign a PFA providing the resale of the Premises from the Lender to the Purchaser. The Lender delivers the deed issued by the Original Seller to the Purchaser and the Purchaser provides a mortgage on the Premises securing its obligations under the PFA.

Under the PFA, the Purchaser is required to pay the Lender the Base Amount and the Profit Amount in fixed payments over a period of time. The amount of each installment and the periods of time over which they would be repaid, are identical to what they would be in a typical mortgage loan for the same principal amount.

When compared to a typical mortgage, the only difference in the Overall Transaction is that the Earnest Money Amount II goes from the Purchaser to the Lender and then to the Original Seller, rather than directly from the Purchaser to the Original Seller, and similarly, the deed goes from the Original Seller to the Lender and then to the Purchaser, rather than directly from the Original Seller to the Purchaser. Because these transactions taken place at single closing, those difference are without consequence, and in all respects the substance of the transaction, in terms of the rights and obligations of the parties, is identical to a typical purchase financed by mortgage loan. In addition, under the Tax Matters Agreement, the Lender and Purchaser agree to treat the Overall Transaction for MRT and other tax purposes as the purchase of the Premises by the Purchaser from the Original Seller for the Original Purchase Price financed in part by a mortgage loan from the Lender to the Purchaser in the principal amount of the Base Amount.

The substance of the Overall Transaction is a sale of the Premises by the Original Seller to the Purchaser. The Lender's participation in the transaction is to provide financing. Its additional involvement, as an intermediary between the Original Seller and the Purchaser, has no legal consequence and amounts to nothing more than that of a mere conduit.

Based upon on the above, and the information and representations submitted, we have determined that the RPTT will be imposed on the sale of the Premises as a transfer by the Original Seller to Purchaser, for a consideration equal to the Original Purchase Price payable to the Original Seller under the Contract. Other aspects of the Overall Transaction, including the

assignment of the Contract by the Purchaser to the Lender, the Lender's receipt of the Earnest Money Amount II from the Seller and its payment to the Original Seller; the Lender's receipt of the deed from the Original Seller and its delivery to the Purchaser, are exempt from the RPTT under Code section 11-2106(b)(7) and 19 RCNY section 23-05(b)(7).

* * *

The Department of Finance reserves the right to verify the information submitted.

Sincerely,

Devora B. Cohn
Associate Commissioner
for Legal Affairs

LED: ld