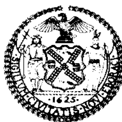

FINANCE
NEW • YORK
THE CITY OF NEW YORK
DEPARTMENT OF FINANCE

March 13, 2003

Re: Request for Ruling
Real Property Transfer Tax

FLR-024795-021

Dear :

This is in response to your request for a ruling dated September 4, 2002 regarding the application of New York City Real Property Transfer Tax ("RPTT") to the conveyance of real property in connection with a "reverse" like-kind exchange under Internal Revenue Code ("IRC") section 1031.[1] Additional information was received on October 30 and December 16, 2002 and January 7 and 13, 2003.

BACKGROUND

IRC section 1031 provides for nonrecognition of gain and loss on exchanges of like-kind properties. In a like-kind exchange, a taxpayer transfers one property (the "relinquished property") to a third party, and receives in exchange a like-kind property (the "replacement property"). In 2000, the Internal Revenue Service promulgated Revenue Procedure 2000-37, 2002-2 C.B. 308 (Sept. 18, 2000) ("Rev . Proc. 2000-37") setting forth criteria for a type of like-kind exchange, known as a "reverse exchange". In a reverse exchange, the taxpayer identifies and arranges for the acquisition of the replacement property by an accommodation titleholder before it has disposed of the relinquished property. To meet the requirements of Rev. Proc. 2000-37, the

[1] For purposes of this ruling request, it is assumed that the transactions described below fall within the safe-harbor of Rev. Proc. 2000-37. The Department is not opining as to whether the transactions, do in fact, meet those requirements.

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accommodation titleholder must have enough of the benefits and burdens of ownership with respect to the replacement property that the accommodation titleholder is treated as the owner for federal income tax purposes. The replacement property is then transferred either directly or indirectly through a qualified intermediary (as defined in Treas. Reg. 1.1031(k)-1(g)(4)) to the taxpayer. A qualified intermediary is a person who is not the taxpayer or a disqualified party (defined at Treas. Reg. §1.1031(k)-1(k)) and who enters into a written agreement with the taxpayer (called the exchange agreement) under which the intermediary acquires the relinquished property from the taxpayer, transfers the relinquished property to a third party (the "Purchaser"), acquires the replacement property, and transfers the replacement property to the taxpayer. Treas. Reg. § 1.1031(k)-1(g)(4)(iii). The applicable Treasury Regulations provide that for the limited purposes of the like-kind exchange rules with respect to the relinquished property, the qualified intermediary is not considered the agent of the taxpayer. Treas. Reg. § 1.1031(k)-1(g)(4)(i).

FACTS

The facts presented are as follows:

Inc., an corporation ("Parent"), is in the business of serving as an accommodation titleholder for purposes of "reverse" like-kind exchanges under IRC section 1031. Parent intends to perform this service through one or more single member limited liability companies, each serving as an accommodation titleholder ("AT").

A sample reverse like-kind exchange within the scope of this ruling request would involve the transfer by the seller of the replacement property (the "Seller") of legal title to and federal tax ownership of the replacement property to the AT on day 1. Within 180 days thereafter:

(a) the AT would transfer federal tax ownership of the replacement property to the qualified intermediary (The qualified intermediary will be Corporation ("QI"), an entity related to the accommodation titleholder.);
(b) the QI would transfer federal tax ownership of the replacement property to the taxpayer in exchange for the taxpayer's transfer of federal tax ownership of the relinquished property to the QI;
(c) the AT would convey legal title to the replacement property directly to the taxpayer;
(d) the QI would transfer federal tax ownership of the relinquished property to the Purchaser; and
(e) The taxpayer would convey title to the relinquished property directly to the Purchaser.

In support of your application for a letter ruling, you have submitted a sample Qualified Exchange Accommodation Agreement ("QEAA") intended to be used during the acquisition of the replacement property. The QEAA is designed and intended to be a QEAA as defined in Rev. Proc. 2000-37. Pursuant to Article 1.A of the QEAA, the AT will be assigned a contract for the acquisition of the replacement property pursuant to

which it will acquire as quickly as practicable "qualified indicia of ownership" with respect to the replacement property. "Qualified indicia of ownership" are defined by the QEAA to mean (a) legal title, (b) other indicia of ownership that are treated as beneficial ownership under applicable principles of commercial law (*e.g.,* a contract for deed), or (c) interests in an entity that is disregarded as an entity separate from its owner for federal income tax purposes (*e.g.*, a single member limited liability company) and that holds either legal title to the property or such other indicia of ownership. QEAA, Art. 1.B. Pursuant to the QEAA, all funds needed to acquire the property are to be provided to the AT as one or more nonrecourse loans secured by the replacement property. QEAA, Art.1.B.2. The AT will not be required or expected to advance or expend any of its own funds. *Id.* The QEAA requires that the AT and the taxpayer report the acquisition, holding and disposition of the replacement property as provided in Rev. Proc. 2000-37. The AT will be treated as the beneficial owner of all property that it holds pursuant to the QEAA for all federal income tax purposes and the taxpayer and the AT will report the federal income tax attributes of all property involved in the QEAA in a manner consistent with Rev. Proc. 2000-37. QEAA, Art. 2.C. In your letter dated December 13, 2002, you have also represented that the QEAA will be amended to specifically provide that the AT will receive only the fee set forth in Article 4D and reimbursement or indemnification in respect of costs and expenses incurred with respect to its legal ownership of the property and that the AT will transfer the property to the taxpayer at no profit or loss to the AT, other than the fee.

The QEAA provides further that the taxpayer is solely responsible for any and all activities, actions and decisions relating to the preservation and enhancement of the replacement property, including but not limited to, management, repairs, construction and payment of taxes, mortgage payments and similar items and the AT shall follow all reasonable written requests from the taxpayer and act as a conduit for payments and other matters. QEAA, Art. 3.A. Under the QEAA, the taxpayer wholly indemnifies the AT against any loss or liability arising directly or indirectly from the QEAA or the replacement property. QEAA, Art. 4.A. The taxpayer also indemnifies the AT and any related entities against any state and local taxes imposed or asserted with respect to the transactions, except that the AT will be solely responsible for all state and local taxes imposed on it with respect to the fees and interest income earned by the AT for its own account under the QEAA. QEAA, Art. 4.E.1. To the extent any state and local taxes require the AT to conform to the federal income tax treatment of the transactions, the taxpayer must fully indemnify the AT and Parent for all state and local taxes incurred as result of the conformity. QEAA, Art. 4.E. 2. Article 6.S of the QEAA provides that the AT is acting solely as the taxpayer's agent for all purposes except for federal income tax purposes.

In accordance with Rev. Proc. 2000-37, within 180 days after the transfer of the "qualified indicia of ownership" of the replacement property to the AT, the replacement property will be transferred to the taxpayer through the QI. QEAA, Art. 2.D.

If for any reason, the AT is holding the "qualified indicia of ownership" of the replacement property at the end of the 180 day period, the AT shall have the immediate

right to require the taxpayer to purchase the property (the "Put") and the taxpayer shall have the immediate right to require the AT to sell the property (the "Call"). However, pursuant to Rev. Proc. 2000-37, the Put and Call will not be effective for a period in excess of 185 days from the date on which the qualified indicia of ownership were acquired by the AT. QEAA, Art. 4.B. Attached to the QEAA will be a lease (the "Lease") executed contemporaneously with the QEAA, with the AT as lessor and the taxpayer as lessee with respect to the replacement property during the time that the AT is holding the property. QEAA, Art. 4C. The Lease is a net lease with the amount of the rent equal to the outstanding monthly obligation on the note and the mortgage on the property, payable in arrears. Lease §§3.1 and 3.2. As "additional rent", the taxpayer is also responsible for all taxes, fees and other charges, including all utilities with respect to the property. Lease §4. Under the Lease, the taxpayer has the right to construct any improvements on the leased premises without the consent of or notice to the AT. Lease §5.1. You also have submitted a sample flow chart demonstrating that the AT's cash flow with respect to the replacement property is designed to be a wash with the income equaling the expenses.

You have submitted a sample Exchange Agreement ("Exchange Agreement") in support of your application, subject to the modifications to Article 2D as proposed in your letter dated January 10, 2003. Under the Exchange Agreement, the relinquished property will be transferred from the taxpayer to the QI subject to the relinquished property contract between the taxpayer and the Purchaser of the relinquished property. Exchange Agreement, Art. 1A. You have represented that the Exchange Agreement will provide that the taxpayer will assign its rights (but not its obligations) under the QEAA with respect to the acquisition of the replacement property to the QI. The QI will be indemnified for any costs associated with the implementation of the Exchange Agreement. Exchange Agreement, Art. 5. The Exchange Agreement specifically provides that the QI is not liable for the debts or obligations of the taxpayer as a result of the provisions of the Exchange Agreement and the QI is acting solely as the taxpayer's agent for all purposes, except for federal and, as appropriate, state income tax purposes. Exchange Agreement, Art. 7F. In your letter dated January 10, 2003, you have represented that in the reverse exchange, the only profit derived by the QI is the Exchangor Fee prescribed under Article 2I of the Exchange Agreement.

ISSUES

You have requested the following rulings:

1. The transfer of the replacement property to the taxpayer from the Seller of the replacement property pursuant to the Exchange Agreement and the QEAA constitutes a single transfer of that property and is subject to the RPTT only once.
2. The transfer of the replacement property by the AT to the QI for the purpose of completing the Section 1031 exchange is not subject to the RPTT.
3. The transfer of the relinquished property by the taxpayer to the Purchaser of that property in accordance with the terms of Exchange Agreement constitutes a single transfer of that property and is subject to the RPTT only once.

DISCUSSION

In general the RPTT is imposed on each deed at the time of delivery by a grantor to a grantee when consideration for the real property and any improvement thereon exceeds $25,000. §11-2102.a of the Administrative Code of the City of New York (the "Code"). The RPTT does not apply to a deed, instrument, or transaction conveying real property from a principal to an agent or a deed, instrument, or transaction conveying real property from an agent to a principal. Code §11-2106.b(7).

Pursuant to Title 19 of the Rules of the City of New York section 23-05(b)(7)(i), a conveyance between a principal and an agent is exempt from tax provided:

- a written agreement is entered into at the time of the transaction establishing such a relationship with respect to the realty or economic interest therein,
- the purported agent functions as an agent with respect to the realty or economic interest therein for all purposes, and
- the purported agent is held out as the agent and not the principal in all dealings with third parties relating to the realty or economic interest therein.

In re Goldman, Sachs & Co. v. Michael, 113 A.D.2d 326, 330 (1st Dept. 1985), the court stated that a transfer qualified for the exemption when "there was [a] prior agreement that the agent-entity would be created for a limited period and would serve a definite stated purpose and where the agent purchased the transferred property with funds provided by the principal".

Section 4.02(5) of Rev. Proc. 2000-37 requires that no later than 180 days after the transfer of qualified indicia of ownership to the accommodation titleholder the property must be transferred either directly or indirectly through a qualified intermediary to the taxpayer as replacement property; or (b) the property must be transferred to a person who is not the taxpayer or a disqualified person as relinquished property. Treas. Reg. section 1.1031(k)-1(g)(4) provides that in the case of a taxpayer's transfer of relinquished property involving a qualified intermediary, the qualified intermediary is not considered the agent of the taxpayer for the limited purposes of IRC section 1031(a). Under section 4.02(6) of Rev. Proc. 2000-37, the combined time period that the relinquished property and the replacement property are held in a "qualified exchange accommodation arrangement" may not exceed 180 days.

Notwithstanding the requirements of Rev. Proc. 2000-37, you argue that for purposes of the RPTT, the substance of the transaction is a single transfer of the replacement property from the seller to the taxpayer, with the AT and QI acting as the taxpayer's agents, and a single transfer of the relinquished property, with the QI functioning as the taxpayer's agent. Therefore, you contend, based on the substance of the transactions, the RPTT should be due only once on the transfer of the replacement property to the taxpayer and

the RPTT should be due only once on the transfer of the relinquished property to the Purchaser.

Because a taxpayer selects the form of a transaction, it generally can not disavow that form for tax purposes. *See, e.g.,* Commissioner v. National Alfalfa Dehydrating & Milling Co., 417 U.S. 134, 148-49 (1974) and Sverdlow v. Bates, 283 A.D. 487, 491 (3rd Dept. 1954). The form of a transaction is particularly important in the like-kind exchange area under IRC section 1031. As stated in Barker v. Commissioner, 74 T.C. 555, 560-561(1980).

> The "exchange" requirement poses an analytical problem because it runs head-long into the familiar tax maxim that the substance of a transaction controls over form. In a sense, the substance of a transaction in which the taxpayer sells property and immediately reinvests the proceeds in like-kind property is not much different from the substance of a transaction in which two parcels are exchanged without cash.…Yet, if the exchange requirement is to have any significance at all, the perhaps formalistic difference between the two types of transactions, must, at least on occasion, engender different results…. (citations omitted.)

Where the taxpayer seeks to avoid the form of his own agreement, a higher level of proof, known as "the strong proof standard" is required. Coleman v. Commissioner, 87 T.C. 178, 201-203 (1986), *aff'd, per curiam,* 833 F.2d 303 (3rd Cir. 1987).

Recognizing that the form of the transaction in this case is particularly important for federal income tax purposes does not preclude an analysis of the substance of the transaction for purposes of applying the RPTT. Under general tax principles, the determination of ownership of an asset for tax purposes is to be based on an analysis of many different factors indicative of ownership, not always on the bare legal title. Bailey v. CIR., 912 F. 2d 44, 47 (2nd Cir.1990). *See, e.g.,* Helvering v. Clifford, 309 U.S. 331 (1940); Helvering v. F.& R. Lazarus Co., 308 U.S. 252 (1939). "[T]axation is not so much concerned with the refinements of title as it is with actual command over the property taxed—the actual benefit for which the tax is paid." Corliss v. Bowers, 281 U.S. 376, 378 (1930).

In this case, in addition to holding legal title to the replacement property prior to its transfer to the taxpayer, the AT will also be reporting the income and expenses with respect to the property for federal income tax purposes. This federal tax treatment would normally indicate that the AT is the owner of the property. However, other factors militate strongly in favor a determination that, for purposes of the RPTT, the AT is an agent of the taxpayer with respect to the property. For instance, the cash flow that the AT will be receiving as a result of the transaction is designed to be a wash, with the income equaling the expenses. Furthermore, the taxpayer will have provided the funds to purchase the replacement property and will have indemnified the AT for all possible expenses associated with the property. You have also represented that the QEAA will be amended to specifically provide that the AT will receive only the fee set forth in Article

4D and reimbursement or indemnification in respect of costs and expenses incurred with respect to its legal ownership of the property and that the AT will transfer the property to the taxpayer at no profit or loss to the AT, other than the fee. The Lease between the taxpayer and the AT is a net lease with the amount of the rent equal to the payments due on the note and mortgage secured by the property. Thus, the AT cannot profit or lose from the Lease. Furthermore, under the Lease, the taxpayer has the right to construct any improvements on the leased premises without the consent of or notice to the AT. The QEAA provides that the taxpayer is solely responsible for any and all activities, actions and decisions relating to the preservation and enhancement of the replacement property, including but not limited to, management, repairs, construction and payment of taxes, mortgage payments and similar items and the AT shall follow all reasonable written requests from the taxpayer and act as a conduit for payments and similar items.

The AT also will be holding the property for a limited time period. It is intended that the AT hold the replacement property for no more than 180 days. If at the end of 180 days, the AT is still holding the qualified indicia of ownership, the Put and Call will operate to terminate the AT's involvement with the property. Finally, Article 6.S of the QEAA provides that the AT is acting solely as taxpayer's agent for all purposes except for federal income tax purposes.

Based on all the facts, including the fact that the transaction was intended to meet the formalistic requirements of Rev. Proc. 2000-37, we have concluded that the AT is holding the replacement property as an agent for the taxpayer. Thus, only one RPTT will be due upon the transfer of the replacement property from the seller to the AT. The transfer of legal title to the replacement property from the AT to the QI and from the QI to the taxpayer will be exempt from the RPTT as transfers between agents and their principal.

Once the AT has acquired the replacement property, it will hold the property until the exchange for the relinquished property is effected. Prior to transferring legal title to the replacement property to the taxpayer, the AT will transfer federal tax ownership of the replacement property to the QI. The QI will hold the federal tax ownership for a brief time and then transfer it to the taxpayer. The QI will be completely indemnified for all costs associated with holding the replacement property. Article 7F or the Exchange Agreement provides that the QI is acting solely as the taxpayer's agent for all purposes, except for federal and as, appropriate, state income tax purposes. You have represented that the only profit that the QI will derive from the transactions is the Exchangor Fee. Because of the brief time and limited purpose that the QI will be holding the replacement property and the fact that the transaction is intended to meet the criteria of Rev. Proc. 2000-37, we have determined that the QI also is functioning as the taxpayer's agent for purposes of the RPTT. Consequently, any transfer of interests in the replacement property to the QI from the AT and from the QI to the taxpayer will not be subject to the RPTT. Similarly, the transfer to and the holding by the QI of the federal tax ownership of the relinquished property prior to its transfer to the Purchaser is of a limited purpose and duration and solely for the purpose of fulfilling the requirements of Rev. Proc. 2000-37.

Based on these facts, the transfer of these interests from the taxpayer to the QI will be exempt from the RPTT as a transfer from a principal to an agent.

The Department reserves the right to verify the facts submitted.

Very truly yours,

Devora B. Cohn
Associate Commissioner for Legal Affairs

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