



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

July 11, 2003

RE: Ruling Request

Real Property Transfer Tax
FLR 034803-021

Dear _____ :

This letter responds to your request, received April 21, 2003, on behalf of (the " ") and (the "Taxpayer") for a ruling regarding the application of the New York City Real Property Transfer Tax (the "RPTT") to the proposed conveyances described below. This office received additional information concerning this request on April 30 and June 13, 2003.

FACTS

The facts presented are as follows:

The _____ is a public corporation established to promote economic development in the City. The Taxpayer is a privately owned _____. The proposed conveyances addressed in this ruling arise in connection with the _____ (the "Project").

The Project. In _____, the City entered into a memorandum of understanding with the (the " ") for the redevelopment of the Project area, which is located in the _____ area. The redevelopment was conceived as a joint effort, to be implemented by public

agencies and private developers designated by the City and (collectively, the "Public Parties"). A comprehensive study and plan of the Project area, aimed at turning into a safe, lively center for entertainment, shopping, commuting, and business, was commissioned and completed in . That plan (the "Project Plan") was approved by the City's Board of Estimate in .

In , pursuant to section 402 of the Business Corporation Law and section of the New York State Urban Development Corporation Act (the "UDC Act"), created (" ") as a wholly-owned subsidiary corporation of for the purpose of implementing the Project, in conjunction with the City. The Project involves the development of new office towers, entertainment/retail facilities, hotels, and other improvements in the Project area, which the Public Parties have divided into various sites.

Pursuant to the Project Plan, has acquired or is currently in the process of acquiring, generally through exercise of 's condemnation powers, fee title to approximately acres of land in . Upon acquisition of the respective sites, it has been the practice of to convey title to the land and all buildings and improvements then or thereafter located thereon to as a fee-on-limitations, subject to reversionary rights in such property simultaneously conveyed by to the City. Such reversionary rights are triggered following substantial completion of new improvements on the site or upon the occurrence of certain other events. Also upon acquisition of a site, enters into a long-term ground lease for such site with a designated developer that is responsible for developing the site, funding certain acquisition costs, and undertaking certain improvements on and in connection with the site. Upon the exercise of its reversionary rights, the City succeeds to the interest of as the lessor under the respective ground lease. The ground leases generally grant a purchase option to the lessee thereunder.

The development of the Site. The Taxpayer owns property located at block , lots in (the "Site"). The Site has a parking lot and billboard sign, but no buildings or other improvements. The Public Parties have designated the Taxpayer as the developer of the Site.

However, because the Taxpayer owns the Site, certain aspects of 's typical acquisition and conveyance process for the Project (e.g., condemnation) are inappropriate. As a result, the Taxpayer, , and (acting on behalf of the City) have entered into a letter agreement dated (the "Letter of Intent"). Under the terms of the letter, the Taxpayer would voluntarily convey, by one or more deeds, for no consideration, a fee-on-limitation (the "Fee-on-Limitation") to , and, simultaneously, a reversionary interest (the "Reversionary Interest") to the City. Simultaneously, with such conveyances, and the Taxpayer would enter into a lease of the Site (the "Ground Lease").

Under section of the UDC Act, the conveyance of fee title to would bring the Site within the provisions of the Project Plan. Among other things, that would exempt the Site from provisions of the City's zoning resolution and instead impose certain design, use and operating guidelines applicable to the Project. It is anticipated that, because would hold record title to the Site, that it would be exempt from real property and certain other taxes.

Under the Ground Lease, the Taxpayer would develop, construct, and operate a new building (the "Improvements") at the Site. would hold title to the Improvements. (The Improvements and the Site together are referred to herein as the "Property.")

The Ground Lease. The Ground Lease would have a term of years. The Ground Lease would require the Taxpayer to pay a fixed rent of \$10.00 per year. The Taxpayer would also be required to make payments in lieu of taxes (the "PILOTs"). The amount of those payments would be the same as the amount that otherwise would be payable if the Property were not exempt from taxes. The Taxpayer would also pay a surcharge relating to the rehabilitation of .

The Ground Lease would be a triple net lease. Under the Ground Lease, the Taxpayer would be required to make all payments in connection with the Improvements, including all costs of maintenance and repair, and all required insurance premiums. The Taxpayer would be solely responsible for any damage to the Improvements during the Ground Lease's term. The Taxpayer also would indemnify the Public Parties for any losses resulting from non-compliance with the operative documents and the use, operation, and maintenance of the Improvements, with certain limited exceptions, such as gross negligence or willful misconduct by a Public Party.

The Taxpayer would the have the option to purchase the Property at any time following the 20th anniversary of substantial completion of the Improvements for \$10 (the "Purchase Option"). In an event of default (the "Early Termination"), the Purchase Option would be exercised, and the Taxpayer would be liable for any damages resulting from its default. The Property would also revert to the Taxpayer at the end of the lease term by virtue of the Fee on Limitation.

The Taxpayer would have the right to lease space within the Property to third parties and retain all rent and other income resulting from those leases. The Taxpayer would also have the right to place leasehold mortgages on its interest in the Property and would retain the resulting proceeds. In addition, the Taxpayer could sell or otherwise transfer its interest in the Property, provided that its transferee is not a "Prohibited Person" under certain City guidelines and met certain financial and experience criteria.

If the Property is damaged during the term of the Ground Lease, the Taxpayer would be primarily responsible to seek recovery for any damages. In addition, the Taxpayer would generally have to rebuild, replace, or restore the Property to substantially the same condition and value as existed before, although, under certain circumstances, the Public Parties would permit a smaller or otherwise different Improvements instead of those in substantially the same condition and value as existed before. The Taxpayer also would be entitled to receive any insurance recoveries or damages recovered from third parties. The Ground Lease would remain in effect.

If all or substantially all of the Property were to be taken by condemnation proceeding, then the Ground Lease would terminate and the Purchase Option would be automatically exercised, even if the 20th anniversary has not been reached. Any resulting condemnation award would be paid to the Taxpayer. For those purposes, the standard for "substantially all of the Property" would look to a determination by the Tenant as to the economic potential of

the Property. The Tenant would also have the right to exercise the Purchase Option if the value of any portion of the Property taken in a condemnation proceeding exceeds \$.

If less than substantially all the Property were to be condemned, the Taxpayer can exercise the Purchase Option if it is permitted to under the terms of the Purchase Option (e.g., the 20th anniversary must have been reached). If the Taxpayer were not so permitted to exercise the Purchase Option, the Ground Lease would remain in effect, with a proportionate abatement of the Taxpayer's obligations under the Ground Lease. In that case the Taxpayer would receive any condemnation award and would be required to restore the Property.

The Public Parties would have no obligation to improve, repair, or maintain any of the Property. They have no right to receive any condemnation award or proceeds from insurance maintained by the Taxpayer. Because the Taxpayer would eventually have record title to the Property, they would be unaffected by the Property's appreciation or depreciation in value. Although the Ground Lease would provide the Public Parties with certain monetary remedies in the event of the Taxpayer's default (e.g. liquidated damages and the right to place liens on the Property with respect to unpaid PILOTs and other unpaid amounts), such remedies are intended to be analogous to rights the Public Parties would have in their governmental capacity against private owners for similar defaults (e.g., levying fines and imposing tax liens).

Financial and tax reporting. You have represented that, for financial reporting and federal, state, and City income tax purposes, the Taxpayer would be treated as the owner of the Property.

ISSUES

You have requested a ruling that the following proposed transactions would be exempt from the RPTT:

1. the conveyance by the Taxpayer of the Fee on Limitation on the Site to , and, simultaneously, of the Reversionary Interest to the City, and the Creation of the Ground Lease between and the Taxpayer (the "Sale and Leaseback"), and
2. the reconveyance of the Site to the Taxpayer by virtue of (i) the Fee on Limitation, (ii) the Taxpayer's exercise of the Purchase Option, or (iii) an Early Termination as a result of a default under the Ground Lease (the "Reconveyance").

CONCLUSIONS

Based upon the facts presented and the representations submitted, we conclude that the Sale and Leaseback and the Reconveyance would be exempt from the RPTT under section 11-2106(b)(8) of the New York City Administrative Code (the "Code").

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. Code section 11-2102(a). 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.

Code section 11-2106(b) exempts from tax certain transactions that would otherwise be subject to the RPTT. Under paragraph (8) of that subdivision, a deed conveying an 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 real property 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 Sale and Leaseback. In this case, before the proposed transactions set out above, the Taxpayer beneficially owns the Site because it owns a fee interest in that real property. The Taxpayer would convey the Fee on Limitation on the Site to , and, simultaneously, the Reversionary Interest to the City, and would lease the Property to the Taxpayer under the Ground Lease. Following those transactions, would be record owner of the Site, and the Taxpayer would be a lessee under the Ground Lease.

For federal income tax and New York State tax purposes, a taxpayer can be the beneficial owner of property if it enjoys the benefits and bears the burdens of ownership, despite not having title to the property. See, Frank Lyon Co. v. United States, 435 U.S. 561 (1978); Helvering v. F & R Lazarus & Co., 308 U.S. 252 (1939); Rev. Rul. 68-590, 1968-2 C. B. 66; FSA Memo 199920003 (May 21, 1999); Matter of Sherwood Diversified Services, Inc., 382 F. Supp. 1359 (interpreting New York State sales tax law); General Electric Co., Inc., TSB-A-96 (5)R (June 25, 1996) (synthetic lease situation); Eastman Kodak Co., TSB-A-90(8)S (March 12, 1990). See also, Matter of Erie County Industrial Development Agency v. Roberts, 63 N.Y.2d 810 (1984) *aff'd for reasons stated at* 94 A.D.2d 532 (4th Dept. 1983) (applying "benefits and burdens" analysis to lease transaction to determine if project financed by Industrial Development Agency is a "public works" project for purposes of the Labor Law). In our opinion, based upon the facts presented, is appropriate to apply the above "benefits and burdens of ownership" analysis for purposes of Code section 11-2106(b)(8).

The factors relevant to determining whether a party enjoys the benefits and bears the burden of owning property include: (1) which party exercises control over the property during the lease term; (2) who bears the risk of loss from a casualty or condemnation; and (3) which party has the potential to obtain profit or incur loss from the holding of the property. See, Sun Oil Co. v. Commissioner, 562 F.2d 258, 268-269 (3rd Cir. 1977); Illinois Power, supra, 1437-1440; Pacific Gamble Robinson and Affiliated Companies v. Commissioner, T.C. Memo 1987-533; Eastman Kodak, TSB-A-90(8)S; FLR-93-110. See also, Levy v. Commissioner, 91 T.C. 838, 860 (1988); Larsen v. Commissioner, 89 T.C. 1229, 1267 (1987), *aff'd in part and reversed in part sub nom Casebeer v.*

Commissioner, 909 F.2d 1360 (9th Cir. 1990); Torres v. Commissioner, 88 T.C. 702, 720-722 (1987); Coleman, 87 T.C. 178, 205; Grodt & McKay Realty Inc. v. Commissioner, 77 T.C. 1221 (1981).

Addressing the first factor, the facts showing that the Taxpayer would exercise control over the property include: (i) the Taxpayer would direct and pay for the construction of the Improvements; (ii) the Taxpayer would have the right to possess and use the Improvements; (iii) the Taxpayer would have the obligation to repair and maintain the Property; (iv) the Taxpayer would have the right to sublease the Property and retain all rent and other income from those leases; (v) the Taxpayer would have the right to place leasehold mortgages on its interest in the Property and retain the proceeds; (vi) the Taxpayer would have the right to sell its interest in the Property, provided it is not to a "Prohibited Person;" and (vii) the Taxpayer would pay PILOTs in an amount equal the real estate taxes it would pay if it were the Property's record owner.

Addressing the second factor, the facts showing that the Taxpayer bears the risk of loss from a casualty or condemnation include: (i) the Taxpayer would be required to insure the Property against any loss or liability; (ii) if the Property were to be damaged during the term of the Ground Lease, the Ground Lease would remain in effect, and the Taxpayer would be primarily responsible for seeking recovery for any damages and would have to rebuild, replace, or restore the Property to substantially the same condition and value as existed before, and would also be entitled to receive any insurance recoveries or damages recovered from third parties; (iii) if all or substantially all of the Property were to be taken by condemnation, the Ground Lease would terminate and the Purchase Option would be automatically exercised, even if the 20th anniversary of substantial completion of the Improvements has not been reached, and any resulting condemnation award would be paid to the Taxpayer; (iv) if less than substantially all the Property were to be condemned, the Taxpayer can exercise the Purchase option if permitted to under its terms, and, if the Taxpayer is not so permitted, the Ground Lease would remain in effect, with a proportionate abatement of the Taxpayer's obligations under the Ground Lease, and the Taxpayer would receive any condemnation award and would undertake to restore the Property; and (v) the Taxpayer would indemnify the Public Parties for any losses resulting from non-compliance with the operative documents and the use, operation, and maintenance of the Improvements.

Addressing the third factor, the facts show that the Taxpayer would have the potential to benefit from appreciation and to lose from depreciation in the value of the Improvements. The Ground Lease would end in one of three ways: First, if at any time following the 20th anniversary of substantial completion of the Improvements, the Taxpayer exercises the Purchase Option for \$10; second, in case of an "Early Termination" by an event of default, the Purchase Option would be exercised, and the Taxpayer would be liable for any damages resulting from its default; and third, the Property would also revert to the Taxpayer at the end of the 40-year lease term by virtue of the Fee-on-Limitation. Because the Property would eventually hold title to the Property in all circumstances, it alone stands to gain or lose from changes in the Property's value.

In addition, you have represented that, for financial reporting and federal, state, and City income tax purposes, the Taxpayer would be treated as the owner of the Site while it is the lessee under the Ground Lease.

We conclude that the facts and circumstances presented show that the Taxpayer would be the beneficial owner of the Property when it is the lessee under the Ground Lease. 19 RCNY section 23-05(b)(8)(iv). Because the Taxpayer currently is the beneficial owner, there would be no change in beneficial ownership as a result of the Sale and Leaseback. As a result, the proposed transactions that compose the Sale and Leaseback would be exempt from the RPTT under Code section 11-2106(b)(8).

The Reconveyance. The Taxpayer would reacquire record title to the Property by virtue of (i) the Fee on Limitation, (ii) the Taxpayer's exercise of the Purchase Option, or (iii) an Early Termination as a result of a default under the Ground Lease. As owner of the fee, the Taxpayer would beneficially own the Property. Because the Taxpayer would have beneficially owned the Property under the Ground Lease, the Reconveyance would result in no change of beneficial ownership and would be exempt from the RPTT under Code section 11-2106(b)(8).

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The Department reserves the right to verify the information submitted.

Sincerely,

Devora B. Cohn
Associate Commissioner
Office of Legal Affairs

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