



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

May 4, 2004

Re: Ruling Request
Real Property Transfer Tax

FLR No.: 034818-021

Dear _____ :

This is in response to your request for a ruling dated December 11, 2003 on behalf of (the "Company") regarding the application of the New York City Real Property Transfer Tax ("RPTT") to the following transaction. This office received additional information and documentation on January 29, February 12, March 9, March 18, April 8 and April 21, 2004.

FACTS

The facts presented are as follows:

In 1996, the United States Congress, through Subtitle A – Military Housing Privatization Initiative of the 1996 Defense Authorization Act, P.L. 104-106 110 Stat. 186 (the "Privatization Initiative"), provided alternative authorities for the acquisition and improvement of military housing. Specifically, the Privatization Initiative encourages the ownership, operation, and maintenance of military housing by private entities and authorizes the Department of Defense to engage in various activities to promote private sector involvement, such as providing or guaranteeing loans to private companies, leasing or conveying existing property and facilities to private entities, and investing in private companies through limited partnerships or other ownership interests.

Pursuant to the Privatization Initiative, the Army and _____, a Delaware limited liability company (the "Managing Member"), have agreed to form the Company and become the sole members therein. The Company is a Delaware limited liability company organized for the purposes of designing, financing, constructing, renovating, managing, operating and maintaining military residential housing units at the _____ Military Base in _____, New York (the "Installation"). The land portion of the Installation is going to be leased to the Company pursuant to a ground lease (the "Ground Lease").

Under the Ground Lease, the Army will convey certain housing and related facilities existing at the Installation (“Existing Housing”) to the Company for the term of the Ground Lease. Upon expiration of the Ground Lease, all right, title, and interest in the real property and improvements will revert to the Army. Buildings used to house displaced residents during the Initial Development Period, anticipated to be a period of approximately three years, will be returned to the Army after the residents return to their normal housing units and the buildings are no longer needed. The Company will have no right or obligation to remove any of the improvements upon expiration or termination of the Ground Lease.

After the Ground Lease goes into effect, the Company will contract for all necessary services, including architectural, engineering, and construction services, obtain financing for the Project, and supervise demolition or renovation of the Existing Housing and construction of new housing and ancillary facilities in accordance with plans approved by the Army. For the remaining term of the Ground Lease, the Company will operate, manage and maintain the residential units and related ancillary facilities in cooperation with the Army and subject to rules and regulations specified by the Army.

The initial term of the Ground Lease is 50 years. The Ground Lease does not provide for any payment of rent. The Ground Lease may be extended for up to 25 additional years at the sole option of the Army and upon 12 months advance written notice to the Company. Pursuant to the Ground Lease, the Installation will be under the general supervision of the Army at all times. Pursuant to the terms of the Municipal Services Agreement, the Company is required to purchase municipal services normally provided by a municipality, including police, fire, utility services, solid waste and telecommunications, directly from the Army or the Army’s designee during the term of the Ground Lease.

Prospective tenants will be selected for occupancy of the housing based on a priority sequence set forth in the Ground Lease. It is anticipated that most of the tenants will be military personnel and their families. All tenants will enter into a standard form lease for occupancy approved by the Army. The Army will limit the rental rates the Company is allowed to charge for military personnel residing in the Housing.

The rights and obligations of the parties in the project are set forth in the Company’s Limited Liability Company Agreement (the “Operating Agreement”) and the Ground Lease. The Army is obligated to make an initial capital contribution of \$. The Managing Member is obligated to make an initial contribution of \$ million with no obligation to make any additional contributions. However, the Managing Member will not be obligated to make its initial capital contribution until the Company has spent all of the Army’s capital contribution and fully drawn down all of the proceeds available from the financing of the project and the net operating income is insufficient to implement the Initial Development Plan, as set forth as an exhibit to the Operating Agreement. The Managing Member is not expected to have to make its contribution until about three years after the start of the project. In addition to the contributions by the Army and the Managing Member, the project will be financed through the issuance of \$ of bonds by

Until the Managing Member makes its capital contribution, it will not be entitled to any amount of income, gain, loss, deduction or distribution from the Company. Until that time, the Army is entitled to all of the income and distributions from the Company. After the Managing Member makes its capital contribution, the Army will be entitled to receive approximately percent and the Managing Member will be entitled to percent of all items of income, gain, loss and deduction of the Company each year. After the Managing Member makes its capital contribution, distributions to the Managing Member will be subject to an annual return cap equal to percent of its capital investment although the cap may not be applicable to all payments under the Operating Agreement.

Separately, and as compensation for management services rendered with respect to the project, an affiliate of the Managing Member will receive a monthly management fee for 50 years.

In the event that the Installation is closed, the Managing Member has the option to purchase a portion of the Installation pursuant to the terms of a Purchase Option Agreement. The Company may terminate all or part of the Ground Lease if there is a base closure. But if the Ground Lease is not terminated, it will remain in effect and any sale of the Installation would be subject to the Ground Lease.

The facts presented are derived from drafts of the applicable documents provided and, therefore, any material changes to the transaction as set forth in the final documents may render the ruling inapplicable.

ISSUE

You have requested a ruling as to whether the transaction described above is subject to the RPTT.

CONCLUSION

The conveyance of the Installation by the Army to the Company is subject to the RPTT. As more fully explained below, the consideration for the transfer is deemed to be equal to the greater of the fair market value of the interest in the Installation conveyed or the amount of any mortgage, lien, or other encumbrance on that interest. The transfer is exempt to the extent the Army retains an interest in the Company but is taxable to the extent of the value of the Managing Member's interest in the Company. A valuation of the Managing Member's interest is a factual question that is not an appropriate subject of a ruling request.

The granting of the option to purchase a portion of the Installation in the event the Installation is closed is not subject to the RPTT.

DISCUSSION

A. Ground Lease

The RPTT is imposed on each deed at the time of delivery by the grantor to a grantee when the consideration for the real property or any improvement thereon exceeds \$25,000. Section 11-2102.a of the Administrative Code of the City of New York (the “Code”). A deed is defined as “any document or writing... whereby any real property or interest therein is created, vested, granted...or otherwise conveyed including any such document or writing whereby any leasehold interest in real property is granted assigned or surrendered.” Code §11-2101.2.

Consideration is defined as the price actually paid or required to be paid for the real property, without deduction for mortgages, liens and encumbrances, whether or not expressed in the deed or instrument and whether paid or required to be paid by money, property, or any other thing of value. Code §11-2101.9. It shall also include the amount of any mortgage, lien or other encumbrance, whether or not the underlying indebtedness is assumed. Id.

Section 23-03(e)(3) of Title 19 of the Rules of the City of New York (“RCNY”) describes the application of the RPTT in the case of conveyances of real property to partnerships. In the case of an existing partnership organized by the grantors for the purpose of holding or holding and operating the real property, a conveyance of the real property to the partnership is subject to tax, even where the conveyance is made some time after the acquisition of the partnership interest. 19 RCNY §23-03(e)(3)(iii). In such event, the acquisition of the partnership interest and the conveyance of the realty are considered elements of a single transaction. Id. Title 19 RCNY section 23-03(e)(3) provides that the consideration in the case of a taxable conveyance to a partnership is the greater of the fair market value of the property conveyed or the amount of any mortgage, lien or other encumbrance on the property.

Code section 11-2106(b) exempts from tax certain transactions that would otherwise be subject to the RPTT.¹ 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. Title 19 RCNY section 23-05(b)(8)(iv) 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 facts and circumstances.

Pursuant to the Ground Lease, the Army is conveying an interest in the Installation to the Company in return for an interest in the Company. Thus, the transaction is subject to the RPTT. The Company was formed for the purpose of holding and operating the Installation. Because the conveyance of the Installation to the Company pursuant to the Ground Lease is deemed to be in exchange for the interest in the Company, the consideration is deemed to be equal to the greater of the fair market value of the interest in the Installation transferred or the amount of any mortgage, lien or other encumbrance on the interest in the Installation transferred. 19 RCNY §23-03(e)(3)(iii).

Under Code section 11-2106(b)(8), the transfer is exempt to the extent that it effects a mere change of form of ownership whereby the beneficial ownership of the property remains the

¹ Code section 11-2106(a)(2) exempts the United States and its agencies and instrumentalities from the tax but does not exempt a grantee from the United States from liability for the tax on a transaction with the United States. Thus, while the Army is exempt from liability for any tax in this transaction, the transaction itself is not exempt.

same. Thus, to the extent the Army retains an interest in the Company, the transfer is not subject to the RPTT. However, to the extent the Managing Member is granted an interest in the Company, the transaction is subject to the RPTT. Because of the contingent nature of the timing of the Managing Member's contribution to the Company, a factual determination of the value of the interest granted the Managing Member is not an appropriate subject for a ruling request.

B. Purchase Option

The RPTT is not applicable to an option for the purchase of real property if it does not vest legal or equitable title. 19 RCNY §23-03(j)(3). For this purpose, equitable title will be deemed to vest where the benefits and burdens of ownership have shifted to the optionee, for example where possession or the right to receive rent or depreciate the realty is given to the optionee. Id. In the present case, the Managing Member cannot be said to have equitable title to the Installation merely because it is a member of the LLC that is the lessee of the Installation. Therefore it is our opinion that the purchase option granted to the Managing Member does not vest legal or equitable title in the Managing Member and thus is not subject to the RPTT.

The Department reserves the right to verify the facts submitted.

Very truly yours,

Ellen E. Hoffman
Assistant Commissioner, Tax Law and Conciliations

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