

**NEW YORK CITY TAX APPEALS TRIBUNAL
ADMINISTRATIVE LAW JUDGE DIVISION**

In the Matter of the Petition
of
1 World Trade Center LLC, et al.

:
: **DETERMINATION**
:
:
: **TAT(H) 07-34 (CR), et al.**
:
:

Schwartz, A.L.J.:

Petitioners, 1 World Trade Center LLC, 2 World Trade Center LLC, 4 World Trade Center LLC and 5 World Trade Center LLC (now known as 3 World Trade Center LLC) ("Petitioners" or the "Silverstein Lessees") filed Petitions for Hearing with the New York City ("City") Tax Appeals Tribunal ("Tribunal") seeking redeterminations of deficiencies of City Commercial Rent Tax ("CRT") under Chapter 7 of Title 11 of the City Administrative Code ("Code") for the five tax years beginning June 1, 2001 and ending May 31, 2006 ("Tax Years").

A hearing was held and various documents were admitted into evidence. Petitioners were represented by Elliot Pisem, Esq. and Joseph Lipari, Esq. of Roberts & Holland LLP. The Commissioner of Finance ("Respondent" or "Commissioner") was represented by Frances J. Henn, Esq., Senior Counsel of the City's Law Department. Joshua M. Wolf, Esq., Assistant Corporation Counsel, participated on Respondent's briefs. Both parties filed briefs and reply briefs.

CONCLUSIONS

The payments made by Silverstein Lessees to the Port Authority after September 11, 2001 did not constitute base rent paid for taxable premises because the Silverstein Lessees no longer had the right to occupy specific space after the government takeover of the World Trade Center site on September 11, 2001. Thus, the Commercial Rent Tax does not apply to those payments.

FINDINGS OF FACT

The Silverstein Lessees and the Port Authority of New York and New Jersey (the "Port Authority") executed four Agreements of Lease (the "Leases"), dated as of July 16, 2001, each for a term of 99 years. The Leases related to the buildings ("Buildings") which were known as "One World Trade Center,"¹ "Two World Trade Center,"² "Four World Trade Center" and "Five World Trade Center." One World Trade Center and Two World Trade Center were collectively known as the "Twin Towers."

Each of the Buildings was located on a portion of the World Trade Center site in Lower Manhattan that is owned by the Port Authority (the "WTC Site"). The WTC Site consisted of 16-acres (roughly four north-south city blocks long by two cross-town city blocks wide) that was bounded on the north by Vesey Street, on the south by Liberty Street, on the east by Church Street and on the west by West Street.³ At the time the Leases were entered into, the WTC Site contained the four Buildings leased by the Silverstein

¹ One World Trade Center was also known as "Tower A" or the "North Tower."

² Two World Trade Center was also known as "Tower B" or the "South Tower."

³ See, Taxpayers' Exhibit ("T. Ex.") 1, Exhibit T and Tr. pp. 49-50.

Lessees, and also contained a Marriott Hotel, a Customs House, retail space leased to an unrelated party and a PATH train⁴ terminal.

Each of the Leases was identical in all material respects relevant to this Determination other than with regard to the Building to which each one related. Each of the Leases was amended, in part, by an agreement effective as of July 24, 2001.

The Leases did not provide for the lease of the land underlying the Buildings to the Petitioners. Instead, as indicated by the language of the Lease for One World Trade Center (the "Lease"), they provided,⁵ in pertinent part, that:

The Port Authority hereby lets to the Lessee and the Lessee hereby hires and takes from the Port Authority at the World Trade Center:

(a) all that certain volume of space occupied by the Building (as hereinafter defined) and any replacements thereof, known and designated as One World Trade Center, also known as Tower A, situate, lying and being in the Borough of Manhattan, County, City and State of New York, the exterior limits of any horizontal plane which lies within said volume of space being more particularly bounded and described on "Exhibit A" attached hereto

. . . .

(b) together with all buildings now or hereafter occupying such volume of space demised under Section 2.1.(a) above and all other improvements, fixtures,

⁴ "PATH" is the Port Authority's Trans-Hudson commuter rail line that connects Manhattan with various locations in New Jersey. See, McKinney's Unconsol L. §6861.

⁵ T. Ex. 1, Sections 2.1(a) and (b).

The Lease also provided for certain rights which effectively served as easements over certain common areas.⁶ In addition, the Lease included certain sub-grade space under One World Trade Center.⁷ The Leases between the Port Authority and the other Petitioners contain substantially identical provisions, other than with respect to the subgrade space.⁸

Michael Levy, Petitioners' Vice President at the time the Leases were negotiated with the Port Authority, was actively involved in negotiating the Leases and structuring the transactions.⁹ Mr. Levy credibly testified that it was his understanding that the Port Authority refused to lease the land under the Buildings to Petitioners because they were prohibited by statute from doing so, and that the properties covered by the Leases ("Premises") were described in the manner set out in the Leases at the Port Authority's insistence.¹⁰

Petitioners intended to operate the Buildings and, for a short time did operate the Buildings, by subleasing the leased space to subtenants and receiving subtenant rent. Petitioners anticipated that the subtenant rents would greatly exceed the amounts payable to the Port Authority under the Leases.

However, the Buildings were totally destroyed in the terrorist attacks on the World Trade Center on September 11, 2001. As a result of the destruction of the Buildings, the subtenants that had

⁶ T. Ex. 1, Section 2.1(c).

⁷ T. Ex. 1, Exhibit A.

⁸ This distinction is not material to these proceedings.

⁹ Tr. pp. 21-2.

¹⁰ Tr. p. 26.

previously occupied space in the Buildings stopped paying rent to Petitioners. While some of the subleases technically continued after the Buildings were destroyed, Petitioners' property insurer did not let Petitioners terminate the leases. However, Petitioners did not pursue these subtenants to continue to collect rent.¹¹

The Leases contained the following obligation to rebuild (the "Rebuilding Obligation"):

If the Premises . . . shall be damaged or destroyed . . ., the Lessee, at its sole cost and expense, and whether or not such damage or destruction is covered by insurance proceeds sufficient for the purpose, shall remove all debris resulting from such damage or destruction, and shall rebuild, restore, repair and replace the Premises . . ., substantially in accordance, to the extent feasible, prudent and commercially reasonable, with the plans and specifications for the same as they existed prior to such damage or destruction or with the consent in writing of the Port Authority, which consent shall not be unreasonably withheld, conditioned or delayed, make such other repairs, replacements, changes or alterations as is mutually agreed to by the Port Authority and the Lessee. Such rebuilding, restoration, repairs, replacements, or alterations shall be commenced promptly and shall proceed with all due diligence . . .¹²

Under the Rebuilding Obligation, even if the Buildings were destroyed, the Leases could not be surrendered or terminated and Petitioners continued to be liable for the payments under the Leases.¹³

¹¹ Tr. pp. 28-9.

¹² T. Ex. 1, Section 15.1.

¹³ T. Ex. 1, Section 15.1.4.

After September 11, 2001, Mr. Levy was involved with the Port Authority, other governmental entities and the insurers to address the various issues that arose after the destruction of the World Trade Center in the terrorist attacks. Mr. Levy credibly testified¹⁴ that shortly after September 11, 2001, Petitioners understood, as a result of statements on behalf of various government entities including the State of New York (the "State"), the City, the Lower Manhattan Development Corporation ("LMDC") and the Port Authority, that office towers could not be rebuilt on the portion of the WTC Site that became known as the Twin Towers Footprints.¹⁵ Because of the huge loss of life on those locations, that area had attained the status of hallowed ground which had to be preserved for a memorial to the victims of the attacks.

In the aggregate, the Silverstein Lessees had leased approximately ten million square feet of rentable office space in the four Buildings. Because of their height, the volume of space occupied by the Twin Towers accounted for ninety percent of the total area that had been leased to Petitioners and that is at issue here.¹⁶

Immediately following the September 11, 2001 terrorist attacks, the City took control of the entire WTC Site to conduct activities relating to rescuing any survivors, recovering human remains,

¹⁴ Tr. pp. 31-2.

¹⁵ The portion of the WTC Site on which the Twin Towers stood prior to their destruction on September 11, 2001 came to be known as the "Twin Towers Footprints." That term is also used to describe the portion of the concrete slab on which the Twin Towers stood prior to 9/11. See, *Coalition of 9/11 Families, Inc. v. Lower Manhattan Development Corp.*, 820 N.Y.S.2d 842 (Table), 2006 N.Y. Slip Op. 51212 (U) (unreported disposition), WL 1789056 (N.Y. Sup.).

¹⁶ This includes the sub-grade space in the net leased premises for One World Trade Center (the North Tower).

cleaning up the debris and shoring up the "bathtub."¹⁷ From September 11, 2001 until approximately July 1, 2002, neither the Petitioners nor the Port Authority had control over the WTC Site, and no work could be performed by Petitioners, the Port Authority, or any private party anywhere on the WTC Site. On approximately July 1, 2002, the City returned control over the WTC Site to the Port Authority. From that time through the remainder of the Tax Years, the Port Authority managed and controlled the entire WTC Site and controlled access to the WTC Site.¹⁸

As of July 18, 2002, Petitioners and the Port Authority entered into an "Interim Access Agreement"¹⁹ under which they acknowledged that the Port Authority and the Metropolitan Transit Authority ("MTA") would be performing work on the WTC Site needed to expedite construction of the temporary PATH facilities and repair subway lines. Petitioners entered into this agreement at the Port Authority's request to enable the Port Authority and the MTA to perform essential work on the transit facilities, a portion of which was to be constructed on space that comprised a portion of the Premises covered by the Leases. Petitioners understood that because it was a national emergency, the government was going to do this work in any event. By entering into the agreement at a time when Petitioners could not otherwise obtain liability insurance, Petitioners received protections from the Port Authority against claims by persons injured while working on the WTC Site.²⁰ In addition, under this agreement, the Port Authority was responsible

¹⁷ The "bathtub" is the concrete barrier surrounding the WTC Site that keeps the Hudson River out.

¹⁸ T. Ex. 31, ¶7; Tr. pp. 31, 41-2.

¹⁹ T. Ex. 16.

²⁰ Tr. p. 54.

for providing a construction fence around the WTC Site and providing a security force. The Port Authority controlled access to the WTC Site and Petitioners or their agents had to receive permission from the Port Authority to enter any portion of the WTC Site.²¹ This agreement was extended five times and remained in effect until May 31, 2004.²²

The Port Authority, which is a governmental body, has its own police and buildings departments that are not under the jurisdiction of the City. The Port Authority has the jurisdiction to grant building permits on the WTC Site.²³ Although Petitioners had the Rebuilding Obligation under the Leases, Petitioners could not rebuild until a comprehensive redevelopment plan was adopted by the relevant government entities, designating specific locations where Petitioners could construct new buildings. They also could not rebuild until the Port Authority issued building permits for the new construction. After recovery and clean-up efforts were underway at the WTC Site, discussions and consultations began among various governmental entities concerning exactly how the process of rebuilding would be conducted. These discussions extended over a number of years. It was expected that a successful site plan would need to provide for a memorial and museum to be built on the Twin Towers Footprints. On the remainder of the site, approximately ten million square feet of rentable office space (which was the amount of office space previously contained in the Buildings), a performing arts center, a retail component and a new PATH terminal would be built. Thus, although it was expected that Petitioners would eventually be allowed to construct office towers somewhere on the WTC Site, the decisions

²¹ Tr. pp. 30-1.

²² T. Exs. 17, 18, 19, 20 and 21.

²³ Tr. p. 43.

as to the location and size of such towers and the time at which they would be built remained subject to negotiation with the Port Authority.

In the Spring of 2002, the Port Authority and the LMDC requested design proposals for the WTC Site. They held a design competition, including a public referendum at the Javits Center, and reviewed various proposed site plans. The Port Authority and the LMDC did not even seek Petitioners' consent to carry out the site plan design in this manner.

In February 2003, when the design competition was completed, the Governor of the State and the Mayor of the City joined the Port Authority and the LMDC in announcing the selection of a design concept proposed by Daniel Libeskind for the redevelopment of the WTC Site. The Libeskind proposal located office towers on the perimeter of the site. The interior of the site would contain a memorial located on the Twin Towers Footprints and a museum. There would also be a performing arts center on the WTC Site. Daniel Libeskind was chosen to be the site planner. Petitioners were not asked to consent to the selection of the design plan.

As of December 15, 2003, the Petitioners and the Port Authority entered into an amendment to the Leases ("December 2003 Amendment") formally removing the Twin Towers Footprints and certain other spaces from the Premises leased by Petitioners and providing that the parties agreed to "include in the Premises" leased by Petitioners other space on which Petitioners could build five office towers containing at least ten million square feet of office space (as well as related space),²⁴ rather than the four office towers that

²⁴ T. Ex. 10, Section 1.(a)(ii), and (c).

had been destroyed. The December 2003 Amendment provided that such new towers were to be built "generally in the locations shown on [the attached site diagram] (or in other locations mutually acceptable to [Petitioners] and the Port Authority.)" The fifth tower ("Tower 5") was to be located south of Liberty Street in an area that was outside the original WTC Site. The descriptions and space allocated to the Petitioners in that amendment were extremely rudimentary, lacking among other things, metes and bounds for the descriptions of Petitioners' new space or dimensions for the buildings to be constructed. These space allocations were considered interim in nature.

As of November 24, 2004, Petitioners, the Port Authority and others agreed to the World Trade Center Design and Site Plan²⁵ (the "November 2004 Site Plan"). Under that agreement, the signatories approved the locations of buildings, streets, and other facilities and agreed that they would cooperate with respect to any refinements or changes to the plan, recognizing that environmental analyses had not yet been done. Although this agreement was materially more detailed than the December 2003 Amendment, it was still tentative, failed to contain sufficient information to allow Petitioners to rebuild and did not require the Port Authority to turn over access to any portion of the WTC Site to the Petitioners.²⁶

The first building to be constructed on the WTC Site was to be the Freedom Tower, which is designated "One World Trade Center." It was intended to be the symbol that the World Trade Center would be rebuilt bigger and higher. The elevation was planned to be 1,776 feet and it was planned to be the tallest building in the world.

²⁵ T. Ex. 11.

²⁶ T. Ex. 11, Tr. pp. 38-9.

However, its location was not to be on the Footprint of the former One World Trade Center but elsewhere on the WTC Site. Petitioners were given limited access to the WTC Site beginning in 2004 for the purpose of designing the Freedom Tower. After Petitioners released a complete design of the Freedom Tower to the public, the City Police Department raised security concerns and the Port Authority would not give Petitioners a building permit. After a substantial redesign of the Freedom Tower to address the security concerns raised by the Police, Petitioners and the Port Authority agreed that the Freedom Tower would be built by an entity owned by the Port Authority.

In 2006, after the close of the Tax Years, the process of redesigning the WTC Site which began in 2002 ended. In November, 2006, Petitioners and the Port Authority entered into the Master Development Agreement for Towers 2/3/4 of the World Trade Center ("November 2006 Master Development Agreement.")²⁷ In connection with the execution of the November 2006 Master Development Agreement, the ownership of 1 World Trade Center LLC, the former lessee of One World Trade Center was assigned to the Port Authority and this Port Authority newly-owned entity was to build both the Freedom Tower and Tower 5, both of which, were to have been built by one or more of the Silverstein Lessees under the December 2003 Amendment. The remaining three Silverstein Lessees were given the rights to build three buildings (Towers 2, 3 and 4) with an aggregate of 6.2 million square feet of office space. None of these buildings was to be located on the Twin Towers Footprint, where ninety percent of the rentable space had been located prior to 9/11.²⁸ At the same time,

²⁷ T. Ex. 12.

²⁸ To the extent that the location eventually designated for one of the buildings to be constructed by one of the Petitioners overlaps somewhat with the location of one of the Buildings that had been destroyed, that overlap is coincidental. Tr. p. 60.

the remaining three Silverstein Lessees executed amended leases containing adjustments to the monthly payments to be made thereafter by them to the Port Authority for the replacement space. The portion of the WTC Site that was set aside for a memorial and memorial museum included the Twin Towers Footprints and also the area surrounding the Twin Towers Footprints.²⁹

The November 2006 Master Development Agreement established a development schedule under which, beginning in 2008, the Port Authority was required to deliver portions of the WTC Site to the remaining Silverstein Lessees so that they could commence rebuilding. The Port Authority was required to pay liquidated damages to the remaining Silverstein Lessees if it failed to do so. None of the prior interim agreements provided specific dates by which the Port Authority was required to deliver portions of the WTC Site to Petitioners or contained any penalty provisions if the Port Authority failed to do so.

Each of the Leases originally entered into in July 2001 required an initial rent payment ("Lump Sum Payments") aggregating approximately \$491,000,000 for the four Buildings. The Lump Sum Payments were to be paid at the commencement of the Leases and were "for the letting of the Premises."³⁰ Additional monthly payments were required to be made throughout the 99-year term of the Leases. The Lump Sum Payments were made in July 2001. Petitioners also made the monthly payments required under the Leases throughout the Tax Years even though the Buildings had been destroyed and could not be rebuilt during those years.

²⁹ See, T. Ex. 12, Exhibit I.

³⁰ T. Ex. 1, Section 5.1.

The Leases provided that the Lump Sum Payments should be allocated to specific monthly periods over the term of the Leases for Federal Income Tax purposes.³¹ Mr. Levy credibly testified that the Lump Sum Payments were viewed by the parties to the Leases as consideration for the entire 99-year term of the Leases.³²

The Leases required Petitioners to maintain casualty insurance³³ and to name the Port Authority as an additional insured. Petitioners' insurance also included "business interruption" coverage under which each Petitioner received payments for lost subtenant rents. On or about April 11, 2002, Petitioners, the lessee of the retail space, their mortgagees and the Port Authority entered into an agreement regarding the allocation of the insurance proceeds which had been held in escrow. Additional terms relating to the insurance proceeds were reduced to writing on December 1, 2003.³⁴ This agreement provided that the insurance proceeds could be used to pay at least \$1,500,000,000 to the Port Authority, repay Petitioners' mortgagee and the retail lessee's mortgagee, and pay any remainder to Petitioners and the retail lessee. Petitioners made the periodic payments due to the Port Authority under the Leases after September 11, 2001 from their business interruption insurance proceeds. Petitioners were required under the Leases to continue to make the periodic payments. Petitioners believed that if they stopped making the payments, the Port Authority would most likely commence litigation. Petitioners were concerned that if they were held to be in default under the Leases they could lose any

³¹ T. Ex. 1, Section 5.5. This is required under Internal Revenue Code "IRC" §467.

³² Tr. p. 27.

³³ T. Ex. 1, Section 14.1.

³⁴ T. Ex. 9.

rights to build on alternative locations at the WTC Site once an agreement was reached regarding rebuilding.³⁵

For the 2001/2002 tax year, Petitioners filed CRT returns and paid CRT in the total amount of \$11,710,289 on all initial Lump Sum Payments and several periodic payments of rent. For the 2002/2003, 2003/2004 and 2004/2005 Tax Years, each Petitioner filed CRT returns on which that Petitioner reported as "rent" all of the payments it made to the Port Authority during that Tax Year. Petitioners also filed CRT Quarterly returns for the period June 1, 2005 through August 31, 2005 in which they claimed an exemption from the CRT based on new Code §11-704(a)6 which repealed the CRT with respect to the WTC Site.³⁶

Each Petitioner computed its "base rent" subject to CRT by deducting all the rents received from subtenants in the same tax period. Some of the Petitioners reported relatively small amounts of subtenant rent from actual subtenants on the CRT returns for periods after the 2001/2002 year. However, there is nothing in the Department of Finance's audit files³⁷ to indicate that these payments of rent (that were apparently received after the 2001/2002 Tax Year) related to periods subsequent to September 11, 2001.

On their CRT returns for the 2002/2003, 2003/2004 and 2004/2005 Tax Years, Petitioners also treated the business interruption insurance proceeds that covered lost rent payments as payments from subtenants for purposes of computing base rent. As a result, they showed no CRT liability and paid no CRT for those Tax Years.

³⁵ T. Ex. 31, ¶11; Tr. pp. 52-3.

³⁶ L. 2005, ch. 2, § A 4, eff. Aug. 30, 2005.

³⁷ City's Exs. A, B, C, and D.

Following an audit of Petitioners' CRT Returns, the Commissioner issued a Notice of Determination, dated May 27, 2007, to each of the four Petitioners asserting proposed deficiencies including substantial understatement penalties and interest,³⁸ as follows:

1 World Trade Center LLC:

Tax Year	Principal	Interest	Penalty	Total
2001/2002	\$ 4,521,322.56	\$2,073,131.28	\$ 452,132.26	\$ 7,046,586.10
2002/2003	2,181,901.68	815,141.50	218,190.17	3,215,233.35
2003/2004	2,037,455.28	585,036.48	203,745.53	2,826,237.29
2004/2005	2,048,576.83	411,427.05	204,857.68	2,664,861.56
2005/2006	512,087.04	52,919.43	51,208.70	616,215.17
Total	\$11,301,343.39	\$3,937,655.74	\$1,130,134.34	\$16,369,133.47

2 World Trade Center LLC:

Tax Year	Principal	Interest	Penalty	Total
2001/2002	\$ 4,354,221.41	\$1,996,511.53	\$ 435,422.14	\$ 6,786,155.08
2002/2003	2,163,361.32	808,214.96	216,336.13	3,187,912.41
2003/2004	1,949,127.38	559,673.94	194,912.74	2,703,714.06
2004/2005	1,959,779.76	393,593.44	195,977.98	2,549,351.18
2005/2006	489,855.42	50,621.99	48,985.54	589,462.95
Total	\$10,916,345.29	\$3,808,615.86	\$1,091,634.53	\$15,816,595.68

³⁸ Computed to June 15, 2007.

5 World Trade Center LLC (now known as 3 World Trade Center LLC):

Tax Year	Principal	Interest	Penalty	Total
2001/2002	\$ 478,253.92	\$219,290.49	\$ 47,825.39	\$ 745,369.80
2002/2003	253,893.74	94,852.74	25,289.37	374,035.85
2003/2004	216,376.64	62,130.56	21,637.66	300,144.86
2004/2005	216,385.65	43,457.93	21,638.57	281,482.15
2005/2006	54,223.56	5,603.50	5,422.36	65,249.42
Total	\$1,219,133.51	\$425,335.22	\$121,813.35	\$1,766,282.08

4 World Trade Center LLC:

Tax Year	Principal	Interest	Penalty	Total
2001/2002	\$249,690.55	\$114,488.92	\$24,969.06	\$389,148.53
2002/2003	127,484.33	47,627.14	12,748.43	187,859.90
2003/2004	112,767.21	32,380.07	11,276.72	156,424.00
2004/2005	113,140.29	22,722.60	11,314.03	147,176.92
2005/2006	28,196.22	2,913.82	2,819.62	33,929.66
Total	\$631,278.60	\$220,132.55	\$63,127.86	\$914,539.01

The stated reason for the proposed deficiencies was Respondent's disallowance of the amount of the business interruption insurance payments as subtenant deductions.

None of the Petitioners requested a Conciliation Conference. On August 22, 2007, Petitioners filed Petitions for Hearing with the Tribunal. After the Tribunal's pre-hearing conference process was completed, a Hearing was held on November 24, 2008. The First Supplemental Stipulation of Facts was filed on March 9, 2009. The Second Supplemental Stipulation of Facts and accompanying exhibits were filed on November 30, 2009. Pursuant to that Second Supplemental Stipulation of Facts, the record of the Hearing was

reopened with the consent of the parties for the limited purpose of entering into the record Taxpayers' Exhibits 32, 33, 34, 35, and 36. The record is now closed.

POSITIONS OF PARTIES

Petitioners contend that the CRT does not apply to the payments they made to the Port Authority after September 11, 2001. They note that the Leases gave Petitioners rights to the volume of space occupied by the Buildings. They assert that once the Buildings were destroyed, the leased "volume of space occupied by the Buildings" no longer existed and, therefore, there were no taxable premises. Petitioners note that the Leases required Petitioners to rebuild the Buildings on the original locations only if that was "feasible, prudent and commercially reasonable." However, Petitioners contend that various government entities deprived Petitioners of access to the WTC Site and made it clear, even before the Leases were initially amended in December, 2003, that Petitioners would never be permitted to rebuild on the Twin Towers Footprints. In any event, Petitioners assert that the Leases were not amended with sufficient specificity to permit Petitioners to rebuild until after the close of the Tax Years. Therefore, Petitioners assert, there were no premises that they had the right to use or occupy during the Tax Years other than for the brief period prior to September 11, 2001.

Respondent agrees that "premises" must exist for the CRT to apply. However, in Respondent's view, all that is necessary is identification of a "space" subject to a landlord-tenant relationship. Respondent contends that Petitioners had the right, under the Leases, throughout the Tax Years, to rebuild in the same locations and those locations still existed during the Tax Years. The Commissioner asserts that the Leases were not amended with

specificity to remove that right until after the close of the Tax Years.

Petitioners alternatively argue that even if the amounts paid to the Port Authority were properly included in base rent, the amounts received from business interruption insurance to replace lost subtenant rents should be deducted from base rent under the provision permitting the deduction of "amounts received . . . from any tenant."³⁹ Respondent counters that the amounts paid by the insurance company would not be entitled to the subtenant deduction because the insurance company was not Petitioners' subtenant.

Additionally, Petitioners assert that the Lump Sum Payments made in July, 2001, which they reported in full on the CRT returns for that period and on which they fully paid CRT either were not taxable at all because they were not rent allocable to any period or they should have been amortized over the entire 99-year term of the lease. Petitioners assert that, in either case, Petitioners overpaid CRT for the 2001/2002 Tax Year. While Petitioners are not claiming refunds, they assert that these alleged overpayments should be used to offset any CRT due for subsequent years under the doctrine of equitable recoupment. Respondent counters that the CRT is due in the tax period when the payment is made regardless of the tax period to which the payment relates. Respondent also notes that there is no language in the Code or Rules that would permit Petitioners to amortize the payments for CRT purposes over the term of the Leases.

Finally, Petitioners claim that the substantial understatement penalty should not apply because the statutory language of the CRT

³⁹ Code §11-701.7.

supports their position and there was no unfavorable authority. They assert that they had both substantial authority and reasonable cause for taking the position that no CRT was due on the payments to the Port Authority after the Buildings were destroyed. The Commissioner contends that there is no substantial authority for Petitioners' position. As a result, the Commissioner asserts that there was no reasonable cause for Petitioners' reporting position and that he cannot use his discretion to waive the penalty.

DISCUSSION AND ANALYSIS

Code §11-702 imposes the CRT on the "base rent" paid by a tenant to a landlord for "taxable premises." "Base rent" is "rent" paid for each "taxable premises" with certain adjustments. Code §11-701.7. "Rent" is the "consideration paid or required to be paid by a tenant for the use or occupancy of premises" Code §11-701.6. "Taxable premises" means "[a]ny premises in the city occupied, used or intended to be used for the purpose of carrying on or exercising any . . . commercial activity, including any premises so used even though it is used solely for the purpose of renting, or granting the right to occupy or use" Code §11-701.5. "Premises" means "[a]ny real property or part thereof, and any structure thereon or space therein." Code §11-701.4. The applicable Rules merely restate the statutory language. 19 RCNY §7-01.

By their terms, the Leases could not be terminated by Petitioners even if the Buildings were destroyed. In such instance, Petitioners remained liable for payments due under the Leases. The Leases further provided that Petitioners would be responsible for rebuilding or replacing any such destroyed Building. Petitioners obtained insurance to cover any such costs. After 9/11, the

payments Petitioners made to the Port Authority were from the proceeds of that insurance. The Commissioner seeks to impose the CRT on these payments.

The CRT would apply to the post-9/11 payments if the amounts Petitioners paid the Port Authority constituted "rent" (that is, consideration for use or occupancy of premises) and if Petitioners used or intended to use those premises for a taxable purpose (such as subletting those premises) during the period for which Respondent seeks to impose the tax. Petitioners contend that the CRT does not apply because there were no "premises" to which they had rights of use or occupancy after 9/11. The Commissioner acknowledges that some form of "premises" must exist prior to a finding of taxability, but claims that all the CRT requires is mere identification of a space subject to a landlord/tenant relationship. The Commissioner asserts that the airspace that had been surrounded by the Buildings prior to 9/11 still existed and contends that because the Leases were not amended with enough detail to permit Petitioners to rebuild elsewhere during the Tax Years, Petitioners still had the rights granted to them under the Leases to rebuild in that airspace.

The Department has a published position that a tenant is subject to the CRT where the liability to pay rent continues after the premises have been destroyed by fire.⁴⁰ However, this position, does not address a case such as the one here where, post 9/11, there was an effective takeover by the government of the Premises and a *defacto* modification of the Leases which prohibited the Silverstein Lessees from rebuilding in the same airspace that had been covered by the Leases. In addition, Petitioners were not provided with

⁴⁰ See, e.g., NYC Finance Admin. Bulletin, March, 1972.

alternative space on which they could begin to rebuild during the Tax Years.

Clearly, the Leases gave Petitioners the responsibility to remove debris at their expense, to rebuild the Buildings as they had existed before the destruction, to the extent feasible, and to make changes in the building plans, if necessary, with the consent of the Port Authority. Yet, the government exercised its police power to effectively strip Petitioners of all of those rights.

Within minutes of the first plane crashing into One World Trade Center at 8:40 a.m. on September 11, 2001, the City had taken control of the WTC Site. On that day, the Mayor of the City issued a Mayoral Order proclaiming a local state of emergency. This Proclamation of Emergency was renewed every five days until the end of June 2002. The City Office of Emergency Management ("OEM") took control of the WTC Site and controlled access to the WTC Site. Petitioners were excluded from the WTC Site and were granted access only upon express authorization from the City.⁴¹ Notwithstanding that the Leases made Petitioners responsible for debris removal, the City hired the contractors who performed the debris removal activities and Petitioners had no control over this activity nor did

⁴¹ See, *In Re World Trade Center Disaster Site Litigation*, 456 F. Supp.2d 520 (S.D.N.Y., 2006), *aff'd in part and appeal dismissed in part*, 521 F.3d 169 (2d Cir. 2008). This case dealt with liability for injuries to workers involved in cleaning up the WTC Site. The court held that Petitioners [the "Silverstein Defendants"] were not liable for these injuries because they had been "divested of control over their leasehold interests immediately following the September 11 attacks, reentering the site only with the City's permission and for limited purposes." 456 F. Supp.2d at 572.

they bear its cost.⁴² Thus Petitioners were deprived of the right to fulfill this debris removal obligation under the Leases.

Almost 3,000 people died in the attack on the Twin Towers and public sentiment made it impossible to rebuild in the same location.⁴³ Petitioners' witness, Mr. Levy, testified that shortly after 9/11, based on the statements of various governmental officials, it was clear that Petitioners would not be permitted to rebuild on the Twin Towers Footprints. Not only is this testimony credible, but it would stretch credulity to believe otherwise, especially since the Port Authority was not only Petitioners' landlord but was also the government entity with the power to make any necessary changes in the use of the WTC Site.

The Port Authority is a public authority created by a compact between the State and the State of New Jersey.⁴⁴ In 1962, the Port Authority was given the power to plan, construct and operate the World Trade Center.⁴⁵ It has complete control over the land that

⁴² *Diversified Carting, Inc. v. The City of New York*, 2006 WL 147584 (S.D.N.Y., 2006). This was a suit in quasi-contract by certain subcontractors relating to payment for clean-up work done at the WTC Site. The City had hired the contractors who, in turn, hired the subcontractors. The subcontractors argued that they were performing a duty owed by Petitioners [the "Silverstein Entities"] as the lessees and that they provided a benefit to Petitioners for which Petitioners should compensate them. The court held that Petitioners were not liable to these subcontractors because the City took over the WTC Site and Petitioners did not participate in or fund the clean-up efforts.

⁴³ For example, the *New York Times* reported that some family members of those who died vowed to chain themselves to bulldozers if any effort was made to build anything on the site where their loved ones had died. *NY Times* July 28, 2002. See, also, *Coalition of 9/11 Families, Inc.*, *supra* n. 16 for an indication of how strong the feelings of the 9/11 Families were with respect to the Twin Towers Footprints.

⁴⁴ The State laws relating to the Port Authority are contained in McKinneys Unconsol. L. §6401 *et seq.*

⁴⁵ See, McKinneys Unconsol. L. §6601 *et seq.*

constitutes the WTC Site.⁴⁶ It has extremely broad land use powers over the WTC Site including the power of condemnation.⁴⁷

The LMDC was formed as a public benefit corporation which was created in the aftermath of 9/11 to coordinate the remembrance, rebuilding and revitalization efforts in Lower Manhattan. It is a subsidiary of the State Urban Development Corporation ("NYSUDC") doing business as the Empire State Development Corporation.⁴⁸ The LMDC has the statutory authority of the NYSUDC and broad land use powers with respect to lower Manhattan.⁴⁹ It is the agency responsible for conducting the environmental and historic preservation reviews of the WTC Site.⁵⁰

The State and City governments, the Port Authority, the LMDC and Petitioners, faced with a crisis of historic proportions, endeavored in good faith to find a way to redevelop the WTC Site while addressing the concerns of the public and the families of the victims of the attacks, as well as the challenging financial requirements of an economically viable redevelopment. In the spring of 2002, while the City still controlled the WTC Site, the Port Authority and the LMDC requested design proposals for the WTC Site. They held a design competition and announced the winning design concept in February 2003. During this planning and design phase, Petitioners were not asked to consent to the decision to redesign

⁴⁶ *Coalition of 9/11 Families, Inc., supra*, n.15

⁴⁷ *Courtesy Sandwich Shop, Inc. v. Port of New York Authority*, 12 N.Y. 2d 379 appeal dismissed, 375 U.S. 78, reh'g denied, 375 U.S. 960 (1963).

⁴⁸ *See, Coalition of 9/11 Families, Inc., supra*, n. 15.

⁴⁹ *See, Wall Street Garage Park Corp. v. LMDC*, 799 N.Y.S. 2d 165 (Sup. Ct. N.Y. Cty 2004).

⁵⁰ *Coalition of 9/11 Families, supra*, n. 15.

the WTC Site in this manner nor were they asked to consent to the selection of the winner of the competition. Thus, Petitioners were deprived of their right under the Leases to rebuild the Buildings following the previous plans, or to initiate changes to those plans with the consent of the Port Authority.

Mr. Levy's credible testimony that Petitioners were told shortly after 9/11 that they would not be able to rebuild on the Twin Towers Footprints is also supported by the December 2003 Amendment to the Leases which first formally memorialized the actions of various government entities over the preceding 27 months during which those government entities deprived Petitioners of the right under the Leases to rebuild new buildings on the locations of the destroyed Buildings. The December 2003 Amendment contained a broad outline of the new design for the WTC Site as it affected the Lessees. In that design, the Twin Towers Footprints and certain other spaces were removed from the Premises leased to Petitioners and the parties agreed to "include in the Premises" other space on which Petitioners could build five office towers containing at least ten million square feet of office space.

In the December 2003 Amendment, the broad scope of the business deal had changed. The Silverstein Lessees had originally leased four Buildings containing an aggregate of ten million square feet of office space in particular locations. Now, it was contemplated that they would be given the same amount of space in five buildings in different locations, and one of these buildings was even outside the original WTC Site. However, this document did not provide enough detail to enable Petitioners to begin rebuilding. The Leases were not amended with sufficient detail to actually begin the rebuilding process until 2006, after the close of the Tax Years. At that point, 1 World Trade Center LLC was acquired by the Port

Authority and the remaining three Silverstein Lessees were given the right to build three buildings containing 6.2 million square feet of office space, most of which was not in the locations of any of the original four Buildings. This was a business arrangement very different from both the one entered into in 2001 and the one contemplated in 2003.

The Commissioner also claims that throughout the Tax Years Petitioners always had rights to "premises" covered by the Leases because the Port Authority leased to Petitioners the volumes of space and "any replacements thereof."⁵¹ Under Respondent's reading of the Leases, throughout the Tax Years, Petitioners always had the rights to either the original locations, or replacement locations within the WTC Site, either of which would constitute the "Premises" covered by the Leases.

The language to which the Commissioner refers reads as follows:

The Port Authority hereby lets to the Lessee and the Lessee hereby hires and takes from the Port Authority at the World Trade Center: (a) all that certain volume of space occupied by the Building (as hereinafter defined) and any replacements thereof [emphasis added]⁵²

However, Respondent's analysis rests on a misreading of this provision. The phrase "any replacements thereof" clearly refers to the possible future replacement of the Building during the ninety-nine year term of the Lease, a possible need for which was foreseen and addressed in the Rebuilding Obligation.⁵³ Respondent points to

⁵¹ Respondent's Brief, p. 21.

⁵² T. Ex. 1 Sections 2.1(a).

⁵³ See, text accompanying n. 12, *supra*.

nothing in the Leases to indicate that the parties ever contemplated a replacement of the location of the volume of space occupied by the Building covered by that Lease.

It is clear that beginning immediately after 9/11, the Port Authority was in breach of its obligation to Petitioners under the Leases to provide premises to which Petitioners had rights of use or occupancy. There was, of course, no malice in this breach. It was caused by necessary government action taken in response to a tragedy of massive proportions. Where performance becomes impossible because of action taken by government, performance is excused. *Metpath Inc. v. Birmingham Fire Insurance Co.*, 86 A.D.2d 407, 411 (1st Dept. 1982), citing 10 N.Y. Jurisprudence, Contracts §373 and the cases cited therein.

Nevertheless, while Petitioners were deprived by government action of their rights under the Leases, they continued to make the payments due under those Leases. Respondent, citing *Conboy, Hewitt, O'Brien & Boardman*, TAT No. 92-1121 (City Tax Appeals Tribunal, December 31, 1996), *aff'd*, 249 A.D.2d 235 (1st Dep't 1998), contends that the rent must be for "premises" because "[n]o commercial enterprise can be viewed as making payments without any reason therefor." However, businesses do make payments for a variety of reasons that may be deductible as business expenses for federal income tax purposes but which are not necessarily subject to the CRT. See, e.g., *Peat Marwick Main & Co. v. NYC Dept. of Finance*, 76 N.Y.2d 527 (1990) [payments for use of a luxury skybox in Madison Square Garden where the taxpayer entertained business clients were not subject to CRT].

Petitioners bore the risk of loss from the destruction of the premises and bore the risk of lost income from their subtenants.

Petitioners insured against such losses and made payments to the Port Authority from the proceeds of this insurance. After 9/11, Petitioners had the expectation that they would eventually be able to rebuild somewhere on the WTC Site and continued to make the payments due under the Leases because they were contractually obligated to do so and they did not want to be in default and risk losing those rights once the WTC Site plans were finalized. Therefore, the payments made were for the expectation of the right to occupy in the future as yet unidentified premises and not for the use and occupancy of the specific premises described in the Leases.

It is not surprising that there is no direct authority regarding the applicability of the CRT to payments for the possibility in the future of obtaining premises yet to be designated. There is some authority, however, that is tangentially relevant on the issue of when the CRT applies where a tenant makes payments under a lease but no longer occupies the premises.

In *Conboy, Hewitt, supra*, a lessee entered into an agreement with its landlord to surrender possession of the premises and terminate the lease a year early. The agreement required the tenant to continue to pay rent unless and until the landlord relet the premises, at which time the landlord and vacating tenant would split any "net profits" from reletting at a higher rent to a new tenant. The Tribunal held that the CRT applied to these payments because the payments related back to the original lease and were for "taxable premises." The landlord never released the tenant from the lease and the tenant "used" the premises by leaving it in a condition that would facilitate its re-rental in order to terminate the lessee's obligations.

In contrast, the Department previously opined that a lump sum payment in consideration for the landlord's cancellation of a lease is not subject to CRT. FLR(111)-CR-10/85. See, also, *Ted Bates Worldwide, Inc.*, TAT(H) 93-274(CR) (City Tribunal, ALJ Division, March 31, 1994) (a non-precedential ALJ determination). The Department's view appears to be that this payment terminates the tenant's interest in the future disposition of the premises and the tenant can no longer be said to be "using" those premises.

Conboy, Hewitt, the Department's ruling and *Ted Bates* all dealt with specifically identified physical locations that the tenants no longer wished to occupy, but which they could have continued to occupy had they not voluntarily surrendered possession of those premises. Nevertheless, this limited authority indicates that taxability depends on the reason for a payment and whether the tenant has any continuing rights to use the specific premises covered by the lease and for which the payment at issue is being made. The record is abundantly clear that the payments at issue were made because Petitioners had assumed the risk of loss under the Leases and hoped that they would be permitted to rebuild in some unspecified location on the WTC Site in the future. Such payments were not for the use or occupancy of the Premises defined in the Leases, since by governmental action, Petitioners no longer had any continuing rights to build on any specific spaces covered by the Leases.

The Department's own interpretation of the CRT supports Petitioners' position that the CRT does not apply when the taxpayer has no rights to a specific space. The Department stated that the CRT is applicable where "the storer rents a specific portion of a warehouse, and . . . where goods are assigned to a particular space" By contrast, "[t]he tax is not applicable when particular

space in a warehouse is not assigned to the goods deposited by the storer.”⁵⁴ Thus, the Department’s own interpretation of the CRT indicates that it cannot impose the CRT on payments for the right to some premises yet to be determined in the future. For the tax to be imposed, there must be a right to occupy specific premises.

The Commissioner asserts that the enactment of Code §11-704(a)6 in 2005,⁵⁵ which repealed the CRT with respect to the WTC Site effective August 30, 2005, indicates that the CRT applied to Petitioners during the Tax Years because the Legislature would not have engaged in a meaningless or redundant act. However, this legislation was part of broader legislation that provided both CRT and sales tax exemptions as well as various other incentives to businesses that located in Lower Manhattan.⁵⁶ It provides a permanent CRT exemption, even after the Buildings are rebuilt. It applies not only to Petitioners, but also to any of their future tenants and to tenants of other buildings on the WTC Site that are leased to parties other than Petitioners. In addition, the legislation provides various incentives applicable to parts of Lower Manhattan that are outside the WTC Site to aid in redevelopment of this area. There is nothing in the legislative history of this exemption to indicate that the Legislature considered the applicability of the CRT to Petitioners during the Tax Years.⁵⁷

⁵⁴ NYC Finance Dep’t Bulletin 1965-1, April 7, 1965 interpreting the former (but substantially identical) CRT Former Code §§ L46-1.0 and L46-2.0.

⁵⁵ See, n. 36, *supra*.

⁵⁶ Memorandum in Support of S5930, New York State Senate, 2005 McKinney’s Session Laws of NY at 1897-98.

⁵⁷ See, generally, Bill Jacket, L. 2005, ch. 2.

The Commissioner also contends that this forum must give deference to his interpretation of statutory terms unless that interpretation is irrational or unreasonable. He is in error. The Tribunal was created under the City Charter for the express purpose of reviewing petitions contesting notices issued by the Commissioner and it has the "same power and authority as the commissioner of finance to impose, modify or waive any taxes within its jurisdiction. . . ." City Charter §168(a).⁵⁸

As Petitioners did not pay rent for taxable premises after September 11, 2001, it is not necessary to address Petitioners' alternative arguments regarding the applicability of the subtenant deduction to the insurance payments or the proper treatment of the Lump Sum Payments.⁵⁹

ACCORDINGLY, IT IS CONCLUDED THAT:

The payments made by Petitioners to the Port Authority after September 11, 2001 did not constitute base rent paid for taxable premises because Petitioners no longer had the right to occupy specific space after the government takeover of the World Trade Center site on September 11, 2001. Thus, the CRT does not apply to those payments.

For the reasons set out above, the Petitions of 1 World Trade Center LLC, 2 World Trade Center LLC, 4 World Trade Center LLC and 5 World Trade Center LLC (now known as 3 World Trade Center LLC) are

⁵⁸ See, also *In re Cord Meyer Development Company*, TAT No. 90-0614 (City Tribunal, January 9, 1992) in which the Commissioner's deference argument was specifically rejected.

⁵⁹ I have considered all other arguments and do not find them persuasive.

granted and the Notices of Determination dated May 27, 2007 are cancelled.

DATED: December 3, 2009
New York, New York

MARLENE F. SCHWARTZ
Administrative Law Judge