

New York State Department of Taxation and Finance
Office of Tax Policy Analysis
Technical Services Division

TSB-A-01(8)R
Real Estate Transfer Tax
December 6, 2001

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. M010809B

On August 8, 2001, the Department of Taxation and Finance received a Petition for Advisory Opinion from the New York Times Company and Forest City Ratner on behalf of themselves and The New York Times Building LLC (LLC) and its members, which will be New York limited liability companies formed by Petitioners. The members of LLC (each a "Member" and collectively "the Members") will be FC Lion, LLC (FC Member) and NYT Real Estate Company LLC (NYT Member). Additional information related to the Petition was received on September 5, 2001, November 15, 2001 and November 28, 2001.

The issues raised by Petitioners, based on the facts described in this Petition, are:

1. Whether the real estate transfer tax is due upon transfer of vacant possession of the Land from the State Parties to LLC when the rights and obligations of LLC with respect to the Land as ground lessee under the Ground Lease commence.
2. Whether the real estate transfer tax due upon the conveyance of the Land by the State Parties to LLC is to be computed based upon \$85,560,000 ("the Initial Land Acquisition Amount") and the value of the limited percentage rent due for the first twenty-nine years of the term of the Ground Lease.
3. Whether real estate transfer tax will be due upon the execution of the Ground Lease and other documents and the recording of the Memorandum of the Ground Lease and other related documents, as described below.
4. Whether the transfers of condominium units from LLC to its respective members are exempt from the real estate transfer tax.

Petitioners present the following facts as the basis for this Advisory Opinion.

Petitioners, through LLC, will develop a real estate project (the "Project") on property (the "Land") located on the east side of Eighth Avenue between 40th and 41st Streets, which is situated in an area of midtown Manhattan that is being rehabilitated and renewed by the State of New York. It is intended that the Project, when constructed, will be converted to condominium ownership and

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will comprise a number of condominium units, the FC Units¹ (referred to herein as the "FC Member Space"), the NYT Unit and the Special Purpose Unit² or "SPU", and common elements including core mechanical facilities, lobbies, etc. The NYT Unit and SPU are both to be owned by NYT Member (the NYT Unit and the SPU, collectively, are referred to as the "NYT Member Space"). The Members intend to construct upon the Land an office building (the "Building") of approximately 1,430,000 gross square feet of above grade space, additional below grade space and additional roof top and mechanical space, which shall include retail space and subway improvements. The New York Times Company, an affiliate of NYT Member, intends to locate its world headquarters in the NYT Member Space; FC Member intends to create commercial office space and retail space in the FC Member Space.

The Land

In furtherance of the Project development plan, 42nd St. Development Project, Inc. ("42DP"), a subsidiary of New York State Urban Development Corporation d/b/a Empire State Development Corporation, and which is a corporate governmental agency of the State of New York constituting an instrumentality of the State of New York and public benefit corporation (collectively referred to as the "State Parties"), will obtain fee title to the Land through condemnation proceedings. The Land is being acquired by the State Parties pursuant to the Land Acquisition and Development Agreement (the "LADA") by and among the State Parties and LLC. Pursuant to the LADA, LLC will post with the State Parties one or more letters of credit in an amount equal to 120% of the aggregate amount of the appraised value of the Land to be taken by condemnation and the estimated costs to relocate existing tenants and occupants. The amount of the letters of credit will be at least \$106 million (consisting of \$85,560,000 and additional assurance funds of \$21 million) for such initial land acquisition fund (\$85,560,000 is hereinafter called the "Initial Land Acquisition Amount"). The State Parties will draw upon the letters of credit to obtain the funds necessary to acquire the Land through condemnation proceedings. Upon completion of condemnation, title to the Land will be held by 42DP and will be leased to LLC pursuant to a ground lease (the "Ground Lease"), but LLC will not have the rights of a tenant under the Ground Lease until vacant possession of the Land has been delivered to LLC, as described below. It is anticipated that upon execution of the necessary

¹The "FC Units" shall consist of a FC Retail Unit and FC Individual Office Units. Each FC Individual Office Unit will be its own separate condominium unit, with each such Unit comprising a floor of the Building. The FC Retail Unit and FC Individual Office Units will be leased to one or more space tenants under separate unit subleases as set forth in the declaration of condominium to be finalized by the Members following the Land acquisition and substantial completion of the improvements (the "Condominium Declaration") for the Project.

²The Special Purpose Unit shall contain public amenities, including an auditorium and exhibition space, which will be used by NYT Member, not-for-profit entities, and other third parties.

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documents with the State Parties, including the Ground Lease, a Memorandum of Ground Lease and other related documents will be recorded.³

In the event that the State Parties expend more than the Initial Land Acquisition Amount to acquire vacant possession of the Land, the State Parties will draw upon the \$21 million additional assurance funds available under the letters of credit, and if additional funds are required, LLC will pay such amounts to the State Parties. To the extent such funds in excess of the Initial Land Acquisition Amount are expended, LLC will be entitled to a reimbursement of such excess by means of a credit against 85% of future Payments in Lieu of Real Estate Taxes ("PILOT payments") otherwise due from LLC to 42DP as occupancy payments under the Ground Lease. In the event that the State Parties expend less than the Initial Land Acquisition Amount to acquire title to and vacant possession of the Land, LLC will nevertheless be obligated to pay the Initial Land Acquisition Amount for the Land.

The Ground Lease will take effect and the letters of credit will be posted upon execution of the Ground Lease and the LADA. However, the rights and obligations of LLC with respect to the Land as ground lessee under the Ground Lease will not commence until title has been acquired by the State Parties through condemnation proceedings (which has not yet occurred) and vacant possession of the Land has been delivered to LLC. (It is anticipated that it may take approximately one year for the State Parties to obtain vacant possession of the Land once title has been acquired). Although entitled a "Lease", for tax purposes, the LADA and Ground Lease result in a sale between the State Parties and LLC of the Land. Pursuant to the terms of the LADA, the LLC and State Parties have agreed that the transaction price for the Land is \$85,560,000 (the Initial Land Acquisition Amount). While the Ground Lease is for a term of 99 years, the LLC as ground lessee has an option to purchase the Land pursuant to the Ground Lease after 29 years following delivery of possession for a purchase price of \$10. Payments under the Ground Lease for the first 29 years will be limited to PILOT payments, a theater surcharge, which relates to real estate taxes for the Times Square District, and limited percentage rent. If the Ground Lease continues after 29 years, the only occupancy payments required then will be actual real estate taxes instead of PILOT payments. The Ground Lease is a "triple net lease," as a result of which, LLC bears all the costs and burdens of ownership throughout the term of the Ground Lease.

Simultaneously with entering into the Ground Lease, LLC will enter into subleases with FC Member (the "FC Sublease") for the FC Member Space and a sublease with NYT Member (the "NYT Sublease") for the NYT Member Space (the FC Sublease and the NYT Sublease, collectively, the "Members' Subleases"), which will allocate all financial obligations under the Ground Lease between the two Members' subleases.

³The related documents include the Members' Subleases, discussed *infra*, the LADA, and a Declaration and Agreement of Design, Use and Operation.

The Building

The Building will be developed, beneficially owned from the outset, and operated, by FC Member and NYT Member. However, the State Parties have insisted on a single lease and a unified (or cross collateralized) set of obligations covering all project components during the development and construction phase. In addition, it is anticipated that the construction lender will prefer that title be held by a single entity during construction. To this end, NYT Member and FC Member will form LLC which will lease the Land from 42DP pursuant to the Ground Lease and develop the Project. LLC will enter into the construction loan and construction agreements for the core and shell of the Building but permanent financing will be separately obtained by each Member for its Member Space. Following substantial completion of the improvements, LLC will submit its leasehold interest in the Project to condominium ownership pursuant to a Declaration of Leasehold Condominium ("Condominium Declaration"), in accordance with New York law, and the Condominium Declaration will be recorded. After completion of the improvements, LLC will assign to 42DP all of its interest in the Project and the Ground Lease pursuant to an Assignment and Assumption of Ground Lease (the "Lease Assignment"). The Ground Lease contains a non-merger clause and the Lease Assignment will contain a non-merger provision, which ensure that 42DP remains as lessor under the Ground Lease and that 42DP becomes lessee under the Ground Lease and sublessor under the Members' Subleases, such that the Members' Subleases remain in existence as direct ground leases between 42DP as lessor and FC Member and NYT Member as lessees, (collectively, the "Unit Leases"). The Unit Leases shall contain the same terms as the Members' Subleases contained with LLC, except that such Unit Leases will be amended to more accurately describe the Members' Spaces as constructed.

LLC's Operating Agreement (the "Operating Agreement") provides that, from inception and at all times thereafter, each Member is the sole beneficial owner of such Member's Space. In the case of the FC Units, the Operating Agreement makes clear that FC Member is the sole beneficial owner of the FC Member Space from the inception of the Project. FC Member also is the beneficial owner of the FC Membership Interest in LLC from the inception of the Project. Likewise, NYT Member is the beneficial owner of the NYT Member Space from the inception of the Project, as well as, the beneficial owner of the NYT Membership Interest in LLC. The Operating Agreement further provides that each Member will receive all benefits, and bear all obligations, attributable to its respective space and the common elements of the condominium. All items of profit and loss, tax deductions and credits, and cash flow, attributable to a Member's Space, will be fully allocated to that Member. No Member will have any beneficial interest in any other Member's Space. Liquidating distributions will also be based on separate ownership by each Member of its respective Member Space.

The project will be financed through a combination of Member investments and one or more construction loans. The Operating Agreement apportions the construction financing between the

Members pursuant to a formula based on the relative share of the total costs of construction allocable to each Member's Space. Upon conveyance by LLC of the Units to the Members, it is anticipated that each Member will arrange its own permanent financing.

Applicable Law and Regulations

Section 1402 of the Tax Law imposes the real estate transfer tax on each conveyance of real property or interest therein when the consideration exceeds five hundred dollars.

Subdivision (d) of Section 1401 of the Tax Law provides, in part:

“Consideration” means the price actually paid or required to be paid for the real property or interest therein, including payment for an option or contract to purchase real property, whether or not expressed in the deed and whether paid or required to be paid by money, property, or any other thing of value. It shall include the cancellation or discharge of an indebtedness or obligation. It shall also include the amount of any mortgage, purchase money mortgage, lien or other encumbrance, whether or not the underlying indebtedness is assumed or taken subject to.

Subdivision (e) of Section 1401 of the Tax Law provides:

“Conveyance” means the transfer or transfers of any interest in real property by any method, including but not limited to sale, exchange, assignment, surrender, mortgage foreclosure, transfer in lieu of foreclosure, option, trust indenture, taking by eminent domain, conveyance upon liquidation or by a receiver, or transfer or acquisition of a controlling interest in any entity with an interest in real property. Transfer of an interest in real property shall include the creation of a leasehold or sublease only where (i) the sum of the term of the lease or sublease and any options for renewal exceeds forty-nine years, (ii) substantial capital improvements are or may be made by or for the benefit of the lessee or sublessee, and (iii) the lease or sublease is for substantially all of the premises constituting the real property. Notwithstanding the foregoing, conveyance of real property shall not include a conveyance pursuant to devise, bequest or inheritance; the creation, modification, extension, spreading, severance, consolidation, assignment, transfer, release or satisfaction of a mortgage; a mortgage subordination agreement, a mortgage severance agreement, an instrument given to perfect or correct a recorded mortgage; or a release of lien of tax pursuant to this chapter or the internal revenue code.

Subdivision (f) of Section 1401 of the Tax Law provides, in part:

“Interest in the real property” includes title in fee, a leasehold interest , a beneficial interest, an encumbrance, development rights, air space and air rights, or any other interest with the right to use or occupancy of real property or the right to receive rents, profits or other income derived from real property....

Subdivision (b) of Section 1405 of the Tax Law provides, in part:

The tax shall not apply to the following conveyances:

6. Conveyances to effectuate a mere change of identity or form of ownership or organization where there is no change in beneficial ownership....

* * *

9. Conveyances of real property which consist of the execution of a contract to sell real property without the use or occupancy of such property or the granting of an option to purchase real property without the use or occupancy of such property;

Subdivision (a) of Section 1410 of the Tax Law provides, in part:

The tax imposed hereunder shall be paid to the commissioner, or to any agent of the commissioner appointed pursuant to section fourteen hundred seven of this article, no later than the fifteenth day after the delivery of the instrument effecting the conveyance by the grantor to the grantee....

Opinion

Under the LADA, LLC has the obligation to fund the State Parties’ acquisition costs of the land. To that end, LLC will advance an amount currently estimated to be not less than \$106 million to the State Parties; \$85,560,000 as consideration for the acquisition of the land, and additional amounts (currently estimated to be a minimum of \$21,000,000) representing assurance funds for possible additional acquisition costs for the Land which may be incurred by the State Parties. Any acquisition costs in excess of \$85,560,000 million will be credited against future PILOT payments under the Ground Lease. Once the State Parties have obtained the Land, the LADA provides that the State Parties shall remove all occupants and deliver possession of the Land to LLC. At this point in time, the rights and obligations of LLC with respect to the Land as ground lessee under the Ground Lease shall commence.

Although entitled a “lease,” for tax purposes, the LADA and Ground Lease result in a sale between the State Parties and LLC of the Land. The Ground Lease is a “triple net lease,” as a result

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of which, LLC bears all the costs and burdens of ownership throughout the term of the Ground Lease. While the Ground Lease is for a term of ninety-nine years, the Ground Lease contains a purchase option that allows LLC to acquire the property 29 years after delivery of vacant possession for the nominal amount of \$10. The annual payments required under the Ground Lease for the first 29 years of the term of the lease are limited to PILOT payments, a theater surcharge (which relates to real estate taxes for the Times Square District), and limited percentage rent. No other occupancy charges are payable under the Ground Lease. The combined effect of the purchase option and payments under the Ground Lease and LLC's obligations under the LADA is to transfer beneficial ownership of the Land to LLC and its Members upon delivery of possession.

As noted above, Section 1402 of the Tax Law imposes the real estate transfer tax on each conveyance of real property or interest therein when the consideration exceeds five hundred dollars. Section 1401(e) of the Tax Law defines the term "conveyance" as the transfer or transfers of any interest in real property by any method. Section 1401(f) of the Tax Law states that an interest in real property "includes title in fee, a leasehold interest, a beneficial interest, an encumbrance, development rights, air space and air rights, or any other interest with the right to use or occupancy of real property or the right to receive rents, profits or other income derived from real property." As defined in Section 1401(d) of the Tax Law, consideration "means the price actually paid or required to be paid for the real property or interest therein, including payment for an option or contract to purchase real property . . . whether paid or required to be paid by money, property, or any other thing of value. . . ."

Thus, with respect to Issues 1 and 2, the conveyance of beneficial ownership of the Land to LLC and its members under the Ground Lease and LADA is subject to the real estate transfer tax as a conveyance of an interest in real property. The date of delivery of vacant possession of the Land is deemed to be the date that the conveyance is effected. Moreover, the real estate transfer tax is due fifteen days following this date. As any funds advanced by LLC to the State Parties in excess of the Initial Land Acquisition Amount of \$85,560,000 will be repaid to LLC through a reduction in the PILOT payments under the terms of the Ground Lease, such excess amounts do not constitute consideration for purposes of the real estate transfer tax. It is noted, however, that in addition to the Initial Land Acquisition Amount of \$85,560,000, the Ground Lease requires payment of a limited percentage rent. Therefore, the consideration for the conveyance is equal to the sum of \$85,560,000 plus the value of the limited percentage rent.

With respect to Issue 3, Section 1405(b)(9) of the Tax Law provides an exemption from real estate transfer tax for conveyances of real property which consist of the execution of a contract to sell real property without the use or occupancy of such property or the granting of an option to purchase real property without the use or occupancy of such property. Thus, the mere execution of the necessary documents and recording of the Memorandum of the Ground Lease and other related documents effect an exempt conveyance pursuant to Section 1405(b)(9) of the Tax Law.

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As noted above, Section 1405 (b)(6) of the Tax Law provides an exemption from the real estate transfer tax for conveyances that effectuate a mere change of identity or form of ownership or organization where there is no change in beneficial ownership.

In 115 Spring Street Company, Adv Op Comm T&F, March 30, 1994, TSB-94(3)-R, where each partner, pursuant to a partnership agreement, held a beneficial interest solely in the unit the partner occupied and had no interest in the other partners' units, it was recognized that the beneficial ownership of each unit vested with each individual partner without regard to ownership of the property being held by the petitioner, a cooperative housing corporation. Thus, the transfer of the shares allocated to the units from petitioner to each partner whereby each partner received shares allocated to the unit occupied by such partner constituted a mere change of identity or form of ownership or organization, since there was no change in the beneficial ownership of each unit.

In Vacation Village Homeowners Association, Inc., Adv Op Comm T&F, May 24, 1994, TSB-A-94(6)-R, where each participant in the conversion of a homeowners association into condominium units held a beneficial interest solely in the lot and home he or she occupied as his or her residence and held no interest in the other homeowner's lots or homes, it was recognized that the beneficial ownership of each lot and home had continuously vested with each individual homeowner, without regard to the homeowner being a member of a homeowners association. Thus, the conversion of the lots and homes within a homeowners association into condominium units and the resulting exchange by the homeowners of their lot deeds for condominium deeds constituted a mere change of identity or form of ownership or organization, since there was no change in the beneficial ownership of each lot and home.

In Armory Place LLC, Adv Op Comm T&F, May 19, 1999, TSB-A-99(3(-R) and in Columbus Centre LLC and its Members, Adv Op Comm, April 18, 2001, TSB-A-(3)-R, where each member of an LLC held a beneficial interest in its own unit of the real property and held no interest in the units of the other members, it was recognized that the beneficial ownership of each unit had continuously vested with each unit owner. Thus, the conversion of the units within the LLC into condominium units and the resulting conveyance to each unit owner of its respective unit constituted a mere change of identity or form of ownership or organization, since there was no change in the beneficial ownership of each unit.

As set forth above, LLC will beneficially own the Land and the Building during the Project's construction for the benefit of its members. The LLC Operating Agreement clearly provides that the interest of each Member is limited to its interest in its respective Member Space and the common elements of the condominium. All benefits and obligations regarding a particular Member's Space will be attributed to that Member, and all items of profit and loss, tax credits and deductions, and cash flow derived from such Members' Space will be allocated to that Member.

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Following substantial completion of the project, LLC will submit its leasehold interest under the Ground Lease to condominium ownership pursuant to a Condominium Declaration and cause the Condominium Declaration to be recorded. Upon completion of the Project, LLC will effectuate the transfer of the Units to its Members by assigning to 42DP all of its interests in the Ground Lease pursuant to the Lease Assignment. As a result of a non-merger provision in the Ground Lease, 42DP will remain ground lessor, as well as ground lessee, under the Ground Lease. Additionally, as a result of a non-merger provision in the Lease Assignment, the terms of the Members' Subleases continue to apply as direct leases with 42DP as lessor. The direct leases incorporate the same terms as those found in the Members' Subleases.

LLC is being used by its Members as a vehicle to address the practical realities of constructing and financing a complex real estate project. Use of LLC during construction is a solution that enables the Members to complete the Project while preserving their agreement that each Member be the beneficial owner of its units or Member Space from the outset. This beneficial ownership is explicitly set forth in the Operating Agreement. In the case of the FC Units, the Operating Agreement makes clear that FC Member is the beneficial owner of the FC Member Space from the inception of the Project. FC Member also is the beneficial owner of the FC Membership Interest in LLC from the inception of the Project. Likewise, NYT Member is the beneficial owner of the NYT Membership Space from the inception of the Project, as well as the beneficial owner of the NYT Membership Interest in LLC.

Thus, with respect to Issue 4 and, consistent with the rationale set forth in 115 Spring Street Company, supra, Vacation Village Homeowners Association, Inc., supra, Armory Place LLC, supra, and Columbus Centre LLC and its Members, supra, it is concluded that the conversion of the Building by LLC into condominium units and the resulting conveyances of legal title of the units to the respective Members of the LLC will constitute a mere change of identity or form of ownership or organization, and such conveyances will be exempt from the real estate transfer tax.

DATED: December 6, 2001

/s/
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NOTE: The opinions expressed in Advisory Opinions are limited to the facts set forth therein.