

New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB-A-97(6)R
Real Estate Transfer Tax

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. M970214C

On February 14, 1997, the Department of Taxation and Finance received a Petition for Advisory Opinion from American Management Association, 1601 Broadway, New York, New York. Petitioner submitted additional information pertaining to the petition on March 12, 1997 and April 30, 1997.

The issue raised by Petitioner, American Management Association, is whether Real Estate Transfer Tax imposed by Article 31 of the Tax Law (the "transfer tax") would be imposed with respect to the transaction described herein.

Petitioner submits the following facts as the basis for this Advisory Opinion. Petitioner is a not-for-profit educational entity chartered by the New York Board of Regents. Petitioner has leased from Broadway 48th-49th Street Associates ("Broadway") approximately 178,944 square feet of space in the office portion of a multi-use building located at 1601 Broadway in New York City (the "Building"). Petitioner's space constitutes 23% of the rentable square feet of the Building. The balance of the Building is a hotel with some retail uses on the ground level. Petitioner uses its space for student instruction and for administrative functions in support of its educational programs.

It has been determined that in order to keep Petitioner's educational programs in New York current occupancy costs must be reduced. Discussions have been held with the New York City Economic Development Corporation ("EDC") to formulate options to achieve such relief. EDC suggested that if real property tax exemption could be obtained, with the savings passed to Petitioner, the goal of reducing Petitioner's occupancy costs to the appropriate level could be met. (It is noted that the question of whether the real property tax applies is outside the province of this Department; the opinion only addresses the real estate transfer tax consequences of the described transaction.)

Petitioner indicates that to obtain the real property tax exemption the following three-part test must be met:

- (1) the user of the real property must be exempt from real property tax;
- (2) the nature of the use must be exempt; and
- (3) the owner of the real property must be exempt.

Petitioner states that it meets the first two requirements, but absent a transfer of title to Petitioner, the third requirement would not be satisfied. During lease negotiations, Broadway agreed to help Petitioner meet the third requirement. Therefore, a plan has been devised under which Broadway would transfer to Petitioner the space now leased to Petitioner by Broadway. Under this plan, Broadway would convey title of the air envelope enclosing the space

that Petitioner currently occupies to Petitioner. The value of the proposed transaction to Broadway is that if real property tax exemption can be obtained by Petitioner, Petitioner becomes a more viable tenant as a result of its reduced occupancy expenses.

The conveyance would be by deed. The deed would convey only the volume of space enclosing the area occupied by Petitioner. The estate conveyed would exist only for so long as the lease between Petitioner and Broadway (the "Lease") remains in effect. Title of the estate which would be the subject of the conveyance will revert automatically to Broadway at the expiration of the Lease, or at any earlier termination.

The estate to be conveyed is fee simple determinable, or estate on limitation. The conveyance will be subject to all existing title exceptions, ground leases, present and future mortgages, and the existing Lease between Broadway and Petitioner. The deed that would effectuate the conveyance specifically states there is to be no merger of leasehold and fee estates. Also, since the interest in real property being conveyed will remain subject to the Lease, Petitioner contends that no economic interest will be conveyed; that is, Broadway will retain the right to receive all rent and other income required to be paid by Petitioner under the Lease. Only "raw" title, subject to automatic reverter and devoid of economic interest, will be transferred. Broadway will continue to be treated as owner of the demised premises for Federal, State and local income tax purposes. No monetary consideration is being paid and no monetary obligation is being undertaken. In addition, Petitioner and Broadway anticipated in their negotiations prior to execution of the Lease an application by Petitioner for real property tax exemption based on Petitioner's exempt status. The relevant provisions of Section 4.1(f) of the Lease state:

If Taxes are reduced and such reduction is directly attributable to Tenant's tax exempt status, which reduction is obtained at Tenant's sole cost and expense, Owner shall, upon submission of proof of such reduction by Tenant or the City, apply the entire amount of such reduction as a credit against the Fixed Annual Rent. Owner shall cooperate with Tenant, at no cost or expense to Owner, if Tenant seeks a reduction in Taxes as a result of Tenant's tax exempt status.

Therefore, Broadway, which is referred to in the Lease as the "Owner", will not receive any part of the real property tax exemption savings under provisions of the Lease. Petitioner states that no other agreement exists that entitles Broadway to any consideration in consequence of real property tax savings achieved as a result of Petitioner's exempt status.

The conveyance will be subject to the Lease and to present and future Building mortgages and other matters now of record. Broadway's counsel has advised that the consolidated mortgage now on the Building has an outstanding balance of approximately \$165,000,000. Broadway would retain the right to increase the existing mortgage or add new mortgages, and keep the proceeds of any additional financing. Petitioner will not be obligated in any way with respect to existing or future mortgages. Petitioner has obtained from the mortgagee a non-disturbance agreement in connection with its Lease. The non-disturbance

agreement provides, in essence, that so long as Petitioner is not in uncured default under its Lease, it will not be disturbed in its possession even if there is a foreclosure of the Building mortgage. Consequently, there is no real or imputed obligation of Petitioner, the grantee/transferee, with respect to the mortgage now on the Building or any future mortgage. Broadway retains the right to receive all rents as well as the proceeds of all mortgage financing and refinancing. Petitioner's title remains subject to forfeiture if Broadway becomes bankrupt or defaults under its mortgage. Petitioner has no right to cure a default by Broadway under its mortgage.

In the event of condemnation, the proceeds from the condemnation belong to Broadway, except as provided in the lease between Broadway and Petitioner. The terms of the Lease, which will remain superior to the conveyance of title and not be subject to merger, provide, in essence, that Petitioner will have no condemnation claim for the value of the unexpired portion of the term of the Lease. Petitioner would only be entitled to compensation for its fixtures and relocation expenses, provided such award does not diminish the award made to Broadway.

Petitioner is without authority to encumber the demised premises without the express written consent of Broadway. The Lease between Broadway and Petitioner provides that Petitioner has no authority or power to cause or permit a lien or encumbrance of any kind whatsoever to attach to the Building or the demised premises.

Analysis

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

Section 1405(b)(6) of the Tax Law provides an exemption from the transfer tax to the extent that a conveyance effectuates a mere change of identity or form of ownership or organization where there is no change in beneficial ownership.

The transfer of title to real property to an Industrial Development Agency (IDA) for the purpose of a tenant obtaining IDA financing did not result in a change in beneficial ownership since the grantor of the conveyance to the IDA retained all the benefits and burdens of ownership of the real property which was the subject of the conveyance. (See Resnick Water St. Development Co., Adv Op Comm T&F, January 12, 1993, TSB-A-93(2)R and Midtown Realty Company, Adv Op Comm T&F, October 28, 1993, TSB-A-93(18)R.)

Conclusion

As described in Petitioner's facts, subsequent to the proposed conveyance of the "raw" legal title to the space occupied by Petitioner, Broadway, the grantor will continue to possess the same economic and beneficial ownership interest in the space that it had prior to the conveyance. The fact that the grantor will continue to possess the same economic and beneficial ownership interest is represented by the following: (1) there will be non-merger language in the deed so that the leasehold estate will continue to exist; (2) Broadway will retain the right to receive all rent and other income required to be paid

by Petitioner under the Lease; (3) Broadway's retention of rights with respect to existing and new mortgages (4) the non-disturbance agreement regarding Petitioner's leasehold interest in the event of a foreclosure of the Building mortgage; (5) Broadway will continue to be treated as owner of the demised premises for income tax purposes; (6) the provisions relative to the distribution of condemnation proceeds; (7) the limitations placed on Petitioner with respect to the authority to encumber the demised premises; and (8) the interest in real property conveyed will revert automatically to Broadway at the expiration of the Lease or at any earlier termination.

Therefore, the conveyance to Broadway of the air envelope enclosing the space that Petitioner currently occupies is exempt from the transfer tax as a conveyance which results in a mere change of identity or form of ownership or organization where there is no change in beneficial ownership, pursuant to section 1405(b)(6) of the Tax Law.

DATED: May 21, 1997

/s/
John W. Bartlett
Deputy Director
Technical Services Bureau

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