

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

TSB-A-93 (2)R  
Real Property  
Transfer Gains Tax  
Real Estate Transfer Tax  
January 12, 1993

STATE OF NEW YORK  
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. M921216A

On December 16, 1992, a Petition for Advisory Opinion was received from Resnick Water St. Development Co., 110 East 59th, Street, New York, New York 10022.

By letter dated December 16, 1992, Prudential Insurance Company of America joined in the Petition for its additional benefit, the benefit of its affiliate, nominee or assigns should Prudential become a successor in interest to Resnick Water St. Development Co.

The issues raised by Petitioner, Resnick Water St. Development Co. and Prudential Insurance Company of America, are:

(1) Whether any aspects of the IDA Conveyance-Leaseback, including, but not limited to, the conveyance to the IDA of the PSI Units and or any Additional Units conveyed in connection with the exercise by PSI of any of its Expansion Space Options and reconveyance of all of such Units (or reversion, as the case may be) to Resnick Water St. Development Co., (the "Development Co.") its successors and assigns, and the creation of the overlease constitute taxable transfers for purposes of the New York State Real Property Transfer Gains Tax (the "gains tax") and the New York State Real Estate Transfer Tax (the "transfer tax").

(2) Whether the creation of (a) the Amended and Restated Lease (which includes the Expansion Space Options, Right of First Offer and the Building Offer) and (b) the IDA Lease constitute taxable transfers for purposes of the gains tax or the transfer tax.

The New York City Industrial Development Agency (the "IDA") has agreed to participate in a financing transaction to induce Prudential Securities, Inc. (formerly known as Prudential-Bache Securities, Inc.), a Delaware corporation, ("PSI") to retain its offices in New York City.

PSI presently occupies approximately 50% of the total rentable space in 199 Water Street (also known as One Seaport Plaza) under an existing lease entered into with Development Co., a New York limited partnership and fee owner of One Seaport Plaza and the RMJ Lease. The existing lease is dated November 15, 1983 and was amended by four agreements dated November 15, 1983, by agreement dated May 31, 1984 and by amendments dated May 18, 1984, April 11, 1986, June 5, 1986 and August (no date), 1986 (all, collectively, the "Existing Lease"). The Existing Lease is scheduled to expire on December 31, 1994. Under Article VI of the Existing Lease, PSI has the option to extend the term of the Lease to December 31, 2024 by exercising six consecutive five-year renewal options.

TSB-A-93 (2)R  
Real Property  
Transfer Gains Tax  
Real Estate Transfer Tax  
January 12, 1993

Under a separate lease (the "RMJ Lease"), Development Co. leased to RMJ Securities Corp. certain other space in the building (the "RMJ Space"). PSI is the present lessee of the RMJ space as a result of series of assignments. PSI presently occupies 16 full floors and 1 partial floor of the building's 34 floors, pursuant to the Existing Lease and the RMJ Lease.

PSI is also a limited partner in Development Co. and has a 13% equity interest and a 15% interest in Development Co.'s profits and losses.

One Seaport Plaza is presently encumbered by a \$195,000,000 mortgage held by The Prudential Insurance Company of America ("Prudential"), the ultimate parent company of PSI. In connection with the IDA financing, Prudential and Development Co. will enter into an agreement modifying the terms and conditions of the Mortgage (the "Amended Mortgage").

The IDA has agreed to participate in the transaction described herein. Pursuant to an agreement between the City of New York (the "City") and PSI, the IDA's participation will confer tax benefits to PSI to reduce PSI's cost of operating and maintaining its office in the City, and help finance the cost of equipment and leasehold improvements necessary for its operations (hereinafter the "IDA Benefits"). Under the proposed IDA financing arrangement the Existing Lease and the RMJ Lease will be modified as follow:

(1) PSI will exercise four of its six renewal options extending the expiration date of the Existing Lease to December 31, 2014. Immediately thereafter, Development Co. and PSI or its affiliate will amend the Existing Lease to consolidate the RMJ Lease with the Existing Lease and amend and restate such lease as consolidated, (hereinafter referred to as the "Amended and Restated Lease"). The Amended and Restated Lease will commence effective January 1, 1993 and shall run for approximately 22 years, with four mutually exclusive sets of renewal options. Simultaneously with the execution of the Amended and Restated Lease, PSI may also lease approximately, an additional 60,000 square feet of space (2 floors). The terms of each renewal option and annual rent are determined by a formula in the Amended and Restated Lease. In no event, however, will the total term of the Amended and Restated Lease extend beyond December 21, 2039.

(2) Pursuant to the Amended and Restated Lease, Development Co. will grant to PSI six options (the "Expansion Space Options") to lease additional full floors in One Seaport Plaza (the "Expansion Space") among the then available floors. PSI will also receive a right of first offer (the "Right of First Offer") to lease any space becoming available in the building. The Amended and Restated Lease will expressly provide that under no circumstances will PSI lease 90% or more of the total rentable space in One Seaport Plaza even if all options were to be exercised by PSI. In addition, the Amended and Restated Lease will provide that in no case will any lease entered into extend the term of the Amended and Restated Lease so that the total period of such lease equals or exceeds 49 years.

TSB-A-93 (2)R  
Real Property  
Transfer Gains Tax  
Real Estate Transfer Tax  
January 12, 1993

(3) The Amended and Restated Lease will also provide that Development Co. will grant to PSI a right of first offer in the event Development Co. decides to sell the building (the "Building Offer") during the term of the Amended and Restated Lease. The Building Offer does not grant PSI the right to compel Development Co. to sell the building to PSI or to a party related to PSI.

(4) The parties have also made modifications to the Existing Lease including: (1) several changes necessary to reflect the creation of the condominium units in the IDA conveyance - leaseback transaction and (2) changes in the tax escalation clause.

To accomplish securing the IDA Benefits, the following will take place:

(a) Development Co. will convert One Seaport Plaza into condominium units. Each floor of the building will comprise a separate condominium unit and separate tax parcel with the exception of the 22nd floor, which will constitute condominium units, and the garage, retail space and lobby space in the building, which will constitute two condominium units. All of the condominium units will be owned initially by Development Co. At the closing of the IDA financing, Development Co. will convey to the IDA title to the condominium units leased by PSI (the "PSI Units") under the Amended and Restated Lease. The IDA will take title to the PSI Units subject to the Amended and Restated Lease and the Amended Mortgage. The deed to the PSI Units and any additional units ultimately leased to PSI receiving IDA Benefits (the "Additional Units") will either (i) contain a reversion to Development Co. upon the expiration of, or earlier termination of, the IDA Lease referred to below or upon certain other events or, (ii) be an estate for 22 years with the possibility of earlier reversion.

(b) The IDA will then enter into an overlease with Development Co. (the "Overlease"), pursuant to which the IDA will lease the PSI Units back to Development Co. for a term co-extensive with the duration of the IDA Benefits (a period of approximately 22 years) at nominal rent. For purposes of this petition, all steps contemplated by this subparagraph and subparagraph (a) will be referred to as the "IDA Conveyance-Leaseback."

(c) Development Co. and PSI will consummate the transaction creating the Amended and Restated Lease.

(d) PSI will enter into a sub-sublease with the IDA for nominal rent, pursuant to which PSI will sub-sublet the PSI Unit to the IDA.

(e) The IDA will enter into a sub-sub-sublease with PSI and certain of its affiliates, pursuant to which the IDA will sub-sub-sublet the PSI Units together with certain leasehold equipment and the leasehold improvements in the PSI Units to PSI and its affiliates (the "IDA Lease").

(f) PSI and IDA will each enter into financing agreements.

TSB-A-93 (2)R  
Real Property  
Transfer Gains Tax  
Real Estate Transfer Tax  
January 12, 1993

The Overlease and the Amended and Restated Lease will contemplate the potential conveyance to the IDA of the Additional Units in connection with the exercise by PSI of its Expansion Space Options, and will cover such Units upon the conveyance thereof to the IDA.

The Amended and Restated Lease will, among other things, require PSI to pay rent with respect to the PSI Units. In addition, the IDA-PSI documents will require PSI to make PILOT payments (payments in lieu of real estate taxes) imposed against the PSI Units. A separate agreement between Development Co. and the IDA will require Development Co. to make certain payments (the "Payments") if PSI fails to perform some of its obligations to IDA. Development Co.'s obligations to make the Payments will be secured by a mortgage from Development Co. to the IDA covering Development Co.'s interest in the PSI Units (the "IDA Mortgage"). The IDA Mortgage will be subject and subordinate to the Amended Mortgage. Upon reversion of the PSI Units to Development Co., Development Co. will not assume or take subject to any mortgages placed on the PSI Units by the IDA for the benefit of PSI.

In the event that Prudential forecloses on the Amended Mortgage or accepts an assignment of the Overlease and/or a conveyance in lieu of foreclosure or otherwise acquires Development Co.'s interest, Prudential, its affiliate, nominee or assigns will also become the tenant under the Overlease and the sublandlord under the Amended and Restated Lease and may become obligated under the Overlease to convey Additional Units to the IDA. In addition, Prudential, its affiliate, nominee or assigns may obtain title to the PSI Units by operation of the reversions. Although PSI is presently a wholly-owned subsidiary of Prudential it may not be such at the time of such conveyance or reversion.

The gains tax is a ten percent tax on the gain derived from the transfer of real property, which includes the transfer or acquisition of a controlling interest in an entity with an interest in real property, where the real property is located in New York State and where the consideration for the transfer is \$1 million or more.

Section 590.5 of the Gains Tax Regulations provides as follows:

590.5 Lease/sublease as a transfer of real property. [Tax Law, § 1440(7)]

(a) Question: Is the creation of a leasehold or sublease a transfer of real property?

Answer: Yes. The creation of a leasehold or sublease is a transfer of an interest in real property, but only where:

(1) the sum of the term of the lease or sublease and any options for renewal exceeds 49 years;

(2) substantial capital improvements are or may be made by or for the benefit of the lessee or sublessee; and

(3) the lease or sublease is for substantially all of the premises constituting the real property. Substantially all is defined to mean 90 percent of the total rentable space of the premises, exclusive of common areas. (See section 590.56 of this Part, relating to an assignment of a lease.)

For the purpose of determining whether a lease or sublease is for substantially all of the premises constituting the real property, premises shall include, but not be limited to the following:

(1) an individual building, except for space which constitutes an individual condominium or cooperative unit;

(2) an individual condominium or cooperative unit; or

(3) where a lease or sublease is of vacant land only, any portion of such vacant land.

(b) Question: Is the creation of a leasehold for a term of less than 49 years ever taxable?

Answer: Yes. If a leasehold is coupled with the granting of an option to purchase the property, the transfer is taxable regardless of the term of the lease.

Section 590.30 of the Gains Tax Regulations provides as follows:

590.30 Right of first refusal. [Tax Law, S 1440]

Question: Is the term "right of first refusal", contained in a lease agreement, considered an option?

Answer: No. A right of first refusal grants the recipient the right to buy the real property at the same price that has been offered to the seller and the seller accepts or proposes to accept from a third-party buyer. The right of first refusal does not grant the lessee the ability to compel an unwilling owner of the real property to sell. In contrast, an option gives the optionee the right to purchase property at an agreed-upon price from the optionor, if he chooses, at any time within the option period. The optionee may compel an unwilling option or to convey the real property upon the exercise of the option.

TSB-A-93 (2)R  
Real Property  
Transfer Gains Tax  
Real Estate Transfer Tax  
January 12, 1993

Consequently, a lease for less than 49 years containing a right of first refusal is not a transfer of real property and is not taxable under the gains tax. Accordingly, a purchase of real property pursuant to the exercise of a right of first refusal is not exempt under the grandfather exemption. (emphasis added)

Where an existing lease is modified, such modifications will result in the creation of a new lease for Gains Tax purposes if the modifications are determined to be substantial in nature. Beakman C. Cannon Adv Op Comm T & F, May 29, 1990, TSB-A-88(1)-R; Syosset Shopping Center Associates Adv Op, Comm T & F, September 14, 1987, TSB-A-87(8)-R. The determination of what is a substantial modification in an existing lease must be made on a case by case basis. If the modifications made to an existing lease are determined to be substantial in nature, a new lease is deemed to be created for gains tax purposes, the term of which would start on the effective date of such modifications.

Section 590.67(a) of the Gains Tax Regulations provides, in part, as follows:

590.67 Transfers pursuant to industrial development agency projects. [Tax Law, 1440]

(a) Question: How are transfers of interests in real property to and from an industrial development agency (IDA) treated for purposes of the gains tax?

Answer: When the company (the beneficiary of an industrial revenue bond financing) transfers fee title to the real property to the IDA solely for the purpose of receiving tax-exempt financing, and simultaneously leases such property back, upon which the company will construct an improvement, the company will be considered the owner of the project and there will not be a taxable event for gains tax purposes until the company transfers an interest in the land or building to a party other than the IDA. This is also true for ground leases/subleases or other similar transactions which are designed to facilitate industrial revenue bond financings.

Section 575.5 of the Transfer Tax Regulations states as follows:

575.7 Leases and subleases. (Tax Law, §1401(d)(e), (f)) (a) Creation of a taxable lease or sublease not coupled with an option to purchase. The creation of a lease or sublease is a conveyance subject to tax only where:

(1) the sum of the term of the lease or sublease and any options for renewal exceeds 49 years; and

(2) substantial capital improvements are or may be made by or for the benefit of the lessee or sublessee; and

(3) the lease or sublease is for substantially all of the premises constituting the real property. "Substantially all" means ninety percent or more of the total rentable space of the premises, exclusive of common areas.

For the purpose of determining whether a lease or sublease is for substantially all of the premises constituting the real property, premises shall include, but not be limited to the following:

(1) an individual building, except for space which constitutes an individual condominium or cooperative unit;

(2) an individual condominium or cooperative unit; or

(3) where a lease or sublease is of vacant land only, any portion of such vacant land.

Moreover, Section 575.11(a) of the Transfer Tax Regulations provides, in part, as follows:

(a) The following are examples of conveyances which are subject to the real estate transfer tax.

\* \* \*

(13) A conveyance of real property to an industrial development agency (IDA) by a person who is not the beneficiary of the IDA financing, at the direction of such beneficiary, with such beneficiary subsequently leasing the property from the IDA, is subject to tax. In such a conveyance, the beneficiary of the IDA financing and not the IDA is deemed to be the grantee, and therefore the exemption described at paragraph (1) of subdivision (c) of section 575.9 of this Part does not apply.

(14) A conveyance of real property by an IDA to a person who is not the beneficiary of the IDA financing where such conveyance is made at the direction of such beneficiary is subject to tax. In such a conveyance, the beneficiary of the IDA financing is deemed to be the grantor of the conveyance.

Section 575.11(b) of the Transfer Tax Regulations provides as follows:

"(b) The following are examples of conveyances which are not subject to the real estate transfer tax.

(1) A conveyance of real property by the beneficiary of the industrial development agency (IDA) financing to the IDA, in connection with the receipt of such financing is not subject to tax.

(2) A conveyance of real property by the IDA, as grantor, to the beneficiary of the IDA financing, as grantee is not subject to tax."

With respect to issue "1", the focus of Section 590.67 of the Gains Tax Regulations and Section 575.11 of the Transfer Tax Regulations is to exclude from gains tax and transfer tax respectively the transfer of title to real property to an IDA for the purpose of obtaining IDA financing and the subsequent leaseback to the beneficiary of the financing, where the grantor remains the beneficial owner of the property. In the instant case, while Development Co. is not the beneficiary of the IDA financing, the transfer by Development Co. to the IDA of title to the PSI Units, will not result in a change in beneficial ownership since Development Co. retains all the benefits and burdens of ownership of the PSI Units. Accordingly, in keeping with the intent of Section 590.67 of the Gains Tax Regulations and Section 575.11 of the Transfer Tax Regulations, the transfer of title to the PSI Units by Development Co. to the IDA, the leaseback by the IDA to Development Co. of the PSI Units and the reconveyance of all such units back to Development Co., its successors and assigns will not be subject to either the gains tax or the transfer tax.

Concerning issue "2", pursuant to Section 590.5 of the Gains Tax Regulations and Section 575.7 of the Transfer Tax Regulations the creation of a lease for a term of less than 49 years, including renewal periods and not coupled with an option to purchase is not a transfer or a conveyance of real property and, therefore, is not subject to gains tax and transfer tax respectively. In addition, pursuant to Section 590.30 of the Gains Tax Regulations a lease for a term of less than 49 years containing a right of first refusal is not a transfer of real property and therefore, is not subject to gains tax. While the Transfer Tax Regulations are silent as to the taxability of a lease coupled with a right to first refusal, the same policy adopted for gains tax purposes would apply for transfer tax and, as such, a lease coupled with a right to first refusal is not subject to transfer tax.

Moreover, pursuant to Beakman C. Cannon, supra, and Syosset Shopping Center Associates, supra, where an existing lease is modified, such modifications will result in the creation of a new lease for gains tax purposes if the modifications are determined to be substantial in nature. The same principle would hold true to determine the transfer tax consequences where an existing lease is modified.

TSB-A-93 (2)R  
Real Property  
Transfer Gains Tax  
Real Estate Transfer Tax  
January 12, 1993

Accordingly, pursuant to Sections 590.5 and 590.30 of the Gains Tax Regulations, Section 575.7 of the Transfer Tax Regulations, Beakman C. Cannon, supra, and Syosset Shopping Center Associates, supra, while substantial modifications will be made to the Existing Lease, so that the consolidation and restatement of the RMJ Lease and the Existing Lease into the Amended and Restated Lease will constitute a new lease, such Amended and Restated Lease will not be subject to either the gains tax or the transfer tax since the term of the lease, including renewal periods, is less than 49 and the lease contains no option to purchase. Further, the IDA Lease will not be subject to either the gains tax or the transfer tax since the term of the lease is less than 49 years and the lease contains no options to purchase.

DATED: January 12, 1993

/s/  
PAUL B. COBURN  
Deputy Director  
Taxpayer Services Division

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