

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

TSB-A-96 (2) R
Real Property Transfer
Gains Tax
Real Estate Transfer Tax
March 21, 1996

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. M960122D

On January 22, 1996, a Petition for Advisory Opinion was received from Tarrytown Corporate Center III, L.P., 580 White Plains Road, Tarrytown, New York 10591.

The Petitioner, Tarrytown Corporate Center III, L.P., (the "Transferor") proposes to transfer its fee simple interest in real property located at 520 White Plains Road, Tarrytown, New York (the "Property"). The Petitioner, a partnership, would transfer this Property to a special purpose limited liability company (the "Transferee") to be formed by Reckson Associates Realty Corp., a corporation that qualifies and has elected to be treated as a real estate investment trust for Federal and New York State tax purposes (the "REIT"), and by Reckson Operating Partnership, L.P., a New York limited partnership that is greater than 70% owned by the REIT (the "OP"). The Property will be the sole asset of the Transferee following the transaction. This transfer would occur pursuant to an agreement dated December 1, 1995 by and among the Transferor, the REIT, and the OP (the "Agreement"). The REIT and the OP on the one hand, and the Transferor and its partners on the other hand, are independent and unaffiliated with respect to each other. In connection with this transfer the Petitioner raises the following issues:

(1) Provided that the closing and the sale of the Property occur within a reasonable period of time following the execution of the Agreement (which occurred on December 1, 1995), whether the sale of the Property to the Transferee will constitute a real estate investment trust transfer (a "REIT transfer") made within six months of the date of the initial offering of the REIT shares (June 2, 1995) for purposes of the real estate transfer tax imposed by Article 31 of the Tax Law (the "transfer tax") and the real property transfer gains tax (the "gains tax") imposed by Article 31-B of the Tax Law.

(2) Also, in connection with issue #1, if the sale of the Property will be deemed to have occurred within a reasonable period of time following the execution of the Agreement if the closing occurs not later than the later of (a) 90 days after the date the Agreement is executed (i.e., by February 29, 1996) or (b) 10 business days following the receipt of this advisory opinion. In this regard, if, despite their best efforts to close the sale of the Property by February 29, 1996 or within 10 business days following the receipt of this advisory opinion, the parties are unable to do so, and the closing and sale of the Property takes place at some point thereafter, whether this inability to close within the time frames described above will cause the transfer of the Property to be considered as not having occurred within a reasonable period of time following the execution of the Agreement.

(3) If the Transferor liquidates or otherwise distributes to its partners the Consideration received for the Property within two years following the date of the transfer of the Property to the Transferee, will the consideration and ownership requirements of sections 1402(b) and 1441.2 of the Tax Law be satisfied on a partner-by-partner basis by any partner of the Transferor who continues

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to retain, for the remainder of the two-year period from the date of transfer of the Property to the Transferee, ownership interests in the Transferee having a value of at least 40% of that partner's pro-rata portion of the equity value of the Property transferred to the Transferee (determined as of the date of the transfer of the Property to the Transferee). Also, whether the failure of any one partner to meet the consideration and ownership requirements will affect the gains tax or transfer tax liability of any other partner.

(4) Whether the consideration for the transfer of the Property to the Transferee will be equal to the amount of Consideration negotiated for and contained in the Agreement if this amount is equal to the cash received plus the value of interests in the Transferee to be paid for the Property, plus the amount of any indebtedness that the Transferee assumes or takes the Property subject to.

The REIT was formed using a structure commonly known as an UPREIT, in which the real property assets of the REIT are owned indirectly by the REIT through the OP and other partnerships. Shares of the REIT are publicly traded on the New York Stock Exchange. The REIT and the OP were formed in September of 1994. At that time, and until June 2, 1995, the REIT had no assets or operations and did not qualify or elect to be treated as a REIT. On June 2, 1995, a series of transactions occurred, including an initial public offering of REIT shares, in which REIT shares and interests in the OP were issued in exchange for cash, real property interests, and controlling interests in entities that own New York real property. Upon this initial issuance and public offering, REIT shares began trading on the New York Stock exchange on June 2, 1995. The REIT shares were offered to the public in a prospectus dated May 25, 1995. As is customary with public offerings of securities, in order to permit the maximum degree of liquidity for the newly issued shares, the New York Stock Exchange began to list the prices for orders for the shares beginning on May 25, 1995, and investors' orders for the shares were permitted to begin to be traded on a "when issued" basis. Under the rules of the stock exchange, all such orders (and any trades based on the orders) were contingent upon and subject to the actual sale and issuance of the REIT shares by the REIT, which occurred on June 2, 1995. From and after this date, the price listing of REIT shares on the stock exchange reflected the actual price for the shares themselves.

Under the terms of the Agreement, the Transferee would acquire the Property subject to the mortgage of Connecticut General Life Insurance securing an amount not in excess of \$15,400,000 (the "Cigna Loan"), and any lien or encumbrance of the Town of Greenburgh securing payments in lieu of taxes. The Transferor would transfer the Property to the Transferee in exchange for (I) a 40% interest in the Transferee, (ii) \$4,560,000 in cash, and (iii) 60% of the amount by which \$15,400,000 exceeds the outstanding balance of the Cigna Loan (other than current interest, which would be adjusted at closing) prior to taking into account the reduction in the Cigna Loan contemplated by Paragraph 5.3.d of the Agreement (collectively, the Consideration"). The Transferor may distribute to its partners their proportionate shares of the Consideration. Following these transactions, the REIT would retain a 50% ownership interest in the Transferee, and the OP would retain a 10% ownership interest in the Transferee.

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Analysis

In 1994, the Tax Law was amended by Chapter 170 to provide special tax treatment under the gains tax and the transfer tax for certain transfers or conveyances made in connection with the initial formation of a REIT. The special provisions include a reduced rate of tax under the gains tax of 2.5% of the gain (as opposed to the otherwise applicable rate of 10%) and under the transfer tax of \$1 for each \$500 of consideration or fractional part thereof (as opposed to the otherwise applicable rate of \$2 for each \$500 of consideration or fractional part thereof). The amendments made by Chapter 170 to Tax Law section 1402 with regard to the transfer tax are identical in substance to the amendments made to Tax Law section 1441 with regard to the gains tax. We will reference section 1441 in this opinion. No regulations have been promulgated which interpret the provisions of section 1441.2. However, the New York State Department of Taxation and Finance (the "Department") issued memorandum TSB-M-94(4)-R on December 2, 1994 to provide guidance to taxpayers with respect to the new REIT provisions. We will make references in this opinion to the memorandum as "the TSB-M".

In order to be eligible for the reduced tax rate, a transfer must qualify as a real estate investment trust transfer. This term is defined in section 1441.2(b)(ii) as "any transfer of real property to a REIT, or to a partnership or corporation in which a REIT owns a controlling interest immediately following the transfer, which transfer occurs in connection with the initial formation of the REIT, provided that the conditions set forth in clauses (A) and (B) [§1441.2(b)(ii)(A) and (B)] of this subparagraph are satisfied."

Issues #1 and #2

The Department, through its issuance of the TSB-M, has provided that REIT transfers made within six months after the date of the initial offering of REIT shares qualify as transfers made in connection with the initial formation of a REIT.

The date of the initial offering of REIT shares is the date when the shares are actually issued. In this case, the REIT shares were issued on June 2, 1995. Although the New York Stock Exchange began to list prices for orders for shares, and investors' orders for the shares were permitted to begin to be traded on a "when issued" basis, on May 25, 1995, all of the orders (and any trades based on the orders) were contingent upon and subject to the actual sale and issuance of the REIT shares by the REIT, which did not occur until June 2, 1995. Accordingly, based on the policy set forth in the TSB-M, the transfer of the Property must have occurred on or before December 2, 1995 in order for it to qualify as a transfer in connection with the initial formation of the REIT.

The phrase "transfer of real property" is defined in section 1440.7(a) of the Tax Law as the transfer of any interest in real property by any method. The term "interest", as defined in section 1440.4 of the Tax Law, includes a contract to purchase real property. Tax Law section 1443.7 provides an exemption from the gains tax transfers of real property consisting of the execution of a contract to sell real property without the use or occupancy of the property. When these provisions are read together, it is clear that the execution of a contract to sell real property is in itself a "transfer of real property" under the gains tax.

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Accordingly, although in this case the only "transfer of real property" that took place within six months of the initial offering is the execution of the Agreement, a "transfer" which is not taxable, it is reasonable to couple that "transfer" with the actual transfer of the fee simple interest which occurs within a reasonable time thereafter. Once the two transfers are coupled, then the actual transfer of title will be eligible for the lower tax rate afforded to REIT transfers, provided the other requirements of section 1441.2 are satisfied.

Thus, the transfer of the fee title of the Property shall be deemed to have occurred within a reasonable period of time following the execution of the Agreement if such transfer occurs not later than the later of (a) 90 days after the date the Agreement is executed, that is, by February 29, 1996 or (b) 10 business days following the receipt of this advisory opinion. Further, even if the transfer of the fee title takes place beyond these time frames, the transfer may still be considered to have occurred within a reasonable time after the execution of the Agreement. The exact length of time beyond these periods cannot be specifically stated here. That will be determined on a case-by-case basis. Notwithstanding the foregoing, if despite their best efforts to transfer the fee of the Property by February 29, 1996 or within 10 business days of the receipt of this advisory opinion the parties are unable to do so, and then the transfer takes place at some point thereafter, this inability to transfer the Property within this period shall not necessarily cause the transfer of the Property to be considered as not having occurred within a reasonable period of time following the execution of the Agreement.

Issue #3

Section 1441.2(b)(ii) sets forth three requirements that must be met in order for a transfer to constitute a REIT transfer. First, the value of the ownership interests in the Transferee received by the Transferor as consideration for the transfer of the Property must be equal to an amount not less than 40% of the value of the Transferor's equity interest in its Property. Second, the ownership interests in the Transferee that are received by the Transferor must be retained by the Transferor or by the owners of the Transferor (i.e., its partners) for a period of not less than two years following the date of transfer. Third, section 1441.2(b)(ii) sets forth a requirement concerning the use of the cash proceeds from the sale of ownership interests in the REIT upon its initial formation. For purposes of this advisory opinion, it is assumed that the third requirement of section 1441.2(b)(ii) was satisfied.

The first two requirements of section 1441.2(b)(ii) will be applied on a partner-by-partner basis if the Transferor liquidates, or otherwise distributes to its partners the Consideration received for the transfer of the Property, within two years following the date of the transfer of the Property. In this event, the consideration and ownership retention requirements will continue to be satisfied for each partner who continues to retain, for the remainder of the two year period from the date of the transfer of the Property to the Transferee, the required ownership interests in the Transferee. These ownership interests must have a value of at least 40% of the partner's pro-rata portion of the equity value of the Property transferred to the Transferee (determined as of the date of the transfer of the Property to the Transferee).

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Issue #4

Paragraph (c) of section 1441.2 of the Tax Law sets forth a general rule regarding the calculation of consideration. The law provides that the consideration is to be determined by reference to the fair market value of the real property being transferred. Generally, under the statute, the fair market value is calculated by dividing (i) the net cash flow from operations with respect to such real property for the 12-month period ending on the last day of the second month preceding the date of the transfer, by (ii) the sum of (A) the federal long-term rate compounded semi-annually that is determined by the United States Secretary of the Treasury determined under Internal Revenue Code section 1274(d) in effect 30 days prior to the transfer and (B) two percentage points. However, paragraph (c) authorizes the taxpayer to utilize any other method for determining fair market value which the Commissioner has prescribed in rules or otherwise. In essence, this provision gives the Department the authority to review a taxpayer's proposed alternative calculation of consideration and determine whether it is reasonable.

Based on the forgoing, the method of calculating the consideration proposed by the Petitioner based upon the agreed amount of Consideration set forth in the Agreement is reasonable in light of the fact that it represents the values negotiated for and contained in the Agreement between the Transferor and the entities that control the Transferee.

DATED: March 21, 1996

/s/
DORIS S. BAUMAN
Director
Technical Services Bureau

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