

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

TSB-A-02(1)R
Real Estate Transfer Tax
April 3, 2002

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. M000629A

On June 29, 2000, the Department of Taxation and Finance received a Petition for Advisory Opinion from Manda Muller Kalimian, P.O. Box 645, Locust Valley, NY 11560.

The issues raised by Petitioner, Manda Muller Kalimian, are:

- (1) Whether the transfer by Petitioner of an interest in an entity that owns real property to a grantor retained annuity trust would be subject to the Real Estate Transfer Tax imposed pursuant to Article 31 of the Tax Law (the "transfer tax").
- (2) Whether the subsequent transfer from a grantor retained annuity trust, at the end of the term of such trust, of the principal of the trust to a discretionary trust for the benefit of Petitioner's husband and children would be subject to the transfer tax.

Petitioner presents the following facts as the basis for this Advisory Opinion.

Petitioner is a 99% limited partner in a limited partnership. The general partner of the limited partnership is a corporation owned by Petitioner. The limited partnership owns only one asset, commercial real property located in the City of New York. The fair market value of the real property is \$51 million. The real property is subject to mortgages of approximately \$41 million.

Petitioner is considering transferring her entire limited partnership interest to an irrevocable grantor retained annuity trust ("GRAT"). The limited partnership interest is the only asset being transferred to the GRAT. Pursuant to the terms of the GRAT, the GRAT will pay Petitioner an annuity payment of approximately \$2 million (20% of the net value of the real property) per year for a term of seven years. The annuity will be paid from income derived from the GRAT, and, should that income be insufficient in any year, from the GRAT principal. If the GRAT income exceeds the amount of the annuity, the excess income will be added to the GRAT principal. Petitioner is both the grantor and the initial trustee of the GRAT. The GRAT further provides that after a term of seven years (or upon the death of Petitioner, whichever is earlier) payment of the annuity will cease, the GRAT will terminate, and the GRAT principal will be transferred to a discretionary trust for the benefit of Petitioner's husband and children. No beneficiary will assume any liability for the indebtedness on the property.

Under the provisions of the Internal Revenue Code ("IRC"), Petitioner will be making a taxable gift equal to the difference between the net value of the assets transferred to the GRAT (\$10,000,000) and the present value of the annuity stream retained by Petitioner, which Petitioner

has computed to be \$9,927,392. During the term of the GRAT, Petitioner would be deemed to be the owner of the trust and would be taxed on all income of the GRAT for federal tax purposes (IRC section 671 and 677). Furthermore, 100% of the GRAT principal would be included in Petitioner's gross estate were she to die during the trust term (IRC section 2036). Due to this possible reversion, Petitioner is also deemed to be the owner of the GRAT principal under IRC section 673.

Applicable Law

Section 1402(a) of Article 31 of the Tax Law imposes a tax on each conveyance of real property, or interest therein, where the consideration for such conveyance exceeds five hundred dollars.

Subdivision (e) of section 1401 of the Tax Law provides, in part:

(e) "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. . . .

Subdivision (b) of section 1401 of the Tax Law provides:

(b) "Controlling interest" means (i) in the case of a corporation, either fifty percent or more of the total combined voting power of all classes of stock of such corporation, or fifty percent or more of the capital, profits or beneficial interest in such voting stock of such corporation, and (ii) in the case of a partnership, association, trust or other entity, fifty percent or more of the capital, profits or beneficial interest in such partnership, association, trust or other entity.

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

(d) "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.

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(iii) In the case of a controlling interest in any entity that owns real property, consideration shall mean the fair market value of the real property or interest therein, apportioned based on the percentage of the ownership interest transferred or acquired in the entity. . . .

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

(f) "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. . . .

Finally, section 1405(b)(6) of the Tax Law sets forth that conveyances are exempt from the real estate transfer tax to the extent that they "effectuate a mere change of identity or form of ownership or organization where there is no change in beneficial ownership. . . ."

Opinion

With respect to Issue (1) raised by Petitioner, the transfer of Petitioner's 99% limited partnership interest to the GRAT would be a transfer of a controlling interest in an entity owning real property and, therefore, a taxable conveyance pursuant to section 1401(e) of the Tax Law. Pursuant to section 1401(d)(iii) of such law, the consideration for such conveyance is measured by the fair market value of the real property apportioned to the percentage of the ownership interest transferred, or \$50.49 million (\$51 million multiplied by 99%).

Petitioner will irrevocably transfer her limited partnership interest to the GRAT. Upon termination of the GRAT, the trust principal will be transferred to a discretionary trust for the benefit of Petitioner's husband and children. While Petitioner will receive payments from the GRAT for the duration of the annuity term, she assumes no risk of loss during the term. In fact, the annuity payment of \$2 million is guaranteed under the provisions of the GRAT, such that it must be paid, even where the income realized by the trust is insufficient to pay the annuity. In that instance, the annuity must be paid from the GRAT's principal. Income that exceeds the required annuity payment must be added to the GRAT's principal.

Currently, a limited partnership owns the real property of which Petitioner is a 99% limited partner and the sole shareholder of a corporation which is the 1% general partner. After the 99% limited partnership interest is conveyed to the GRAT, Petitioner will be entitled to an annuity payment of \$2 million per year for the next seven years for a total of \$14 million. The present value of the annuity (\$9,927,392) as set forth in the Petition is approximately equal to the value of the equity of the limited partnership interest (\$10 million). After the conveyance, Petitioner's interest

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in the real property will be comparable to that of a seller of an interest in real property who takes back a seven-year purchase money note in the approximate amount of \$10 million.

Therefore, it is concluded that the exemption from the transfer tax under Section 1405(b)(6) of the Tax Law for conveyances that effectuate a mere change of identity or form of ownership does not apply to any part of the conveyance to the GRAT. The conveyance by Petitioner of her limited partnership interest to the GRAT would be subject to the transfer tax to the full extent of the consideration (\$50.49 million).

With respect to Issue (2) raised by Petitioner, Petitioner's husband and children would be the beneficial owners of the limited partnership interest held by the GRAT and will continue to be the beneficial owners of this interest after it is conveyed by the GRAT to the discretionary trust. Therefore, pursuant to section 1405(b)(6) of the Tax Law, the conveyance of the limited partnership interest from the GRAT to the discretionary trust, upon termination of the GRAT, will be exempt from the transfer tax as a mere change of identity or form of ownership or organization since, under the facts presented, there is no change in beneficial ownership.

DATED: April 3, 2002

/s/
Jonathan Pessen
Tax Regulations Specialist IV
Technical Services Division

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