

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

TSB-A-85 (3) R
Real Property Transfer
Gains Tax
August 8, 1985

STATE OF NEW YORK
STATE TAX COMMISSION

MODIFIED ADVISORY OPINION PETITION NO. M850305A

On March 7, 1985, a Petition for an Advisory Opinion was received from 52 Habitat Co. c/o Jack Resnick & Sons, Inc., 110 East 59th Street, New York, New York 10022.

The issues raised concern the application of the Real Property Transfer Gains Tax imposed by Article 31-B of the Tax Law (hereinafter the "gains tax") to the following factual situation.

Petitioner is the owner of certain real property (hereinafter the "Property") and the building located thereon (hereinafter the "Building") in New York City (the Property and the Building being hereinafter collectively referred to as the "Premises"). Petitioner, as landlord, and Morgan Guaranty Trust Company of New York (hereinafter "Morgan"), as tenant, are parties to a certain lease, dated as of June 30, 1982 (hereinafter the "Net Lease"), the term of which is to commence the day after the existing tenant (hereinafter the "Existing Tenant") completely vacates the Building, and a companion lease, dated as of June 30, 1982 (hereinafter the "Interim Lease"), the term of which began in 1982 and which takes effect in stages as spaces in the Building are vacated by the Existing Tenant. Both the Net Lease and the Interim Lease contain options in favor of Morgan to purchase the Premises, exercisable with respect to the Interim Lease during the period of January 1, 2001 through December 31, 2003 (provided the Interim Lease is still in effect), and with respect to the Net Lease, during the 15th, 16th and 17th years of the term of the Net Lease.

A memorandum of the Net Lease and a memorandum of the Interim Lease were recorded in the Office of the Register of the City of New York on July 6, 1982. The recorded memoranda of both the Net Lease and the Interim Lease refer to the option to purchase.

Both leases have been amended at various times by agreements. The Interim Lease was amended by agreements dated as of June 30, 1982, December 21, 1982, as of February 28, 1983, April 21, 1983, May 6, 1983, January 12, 1984, December 28, 1984, and January 31, 1985. The Net Lease was amended by the above mentioned agreements dated as of June 30, 1982, May 6, 1983 and December 28, 1984.

The principal amendment made to the Net Lease by the agreement dated May 6, 1983 was to allow the total annual payment of principal and interest due under the mortgage referred to therein to exceed the fixed rent due under the Net Lease for the same annual period. This change was made to enable the Petitioner to consummate a mortgage for which the Petitioner had received a commitment from a particular lender. The principal amendment made by the December 28, 1984 agreement to the Net Lease was to provide that the foregoing amendment made by the May 6 agreement became null and void upon the consummation of a subsequent mortgage, which mortgage has been consummated.

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Petitioner and Morgan propose to further amend the Interim Lease pursuant to a modification agreement (hereinafter the "Modification Agreement") which will incorporate, (with certain exceptions including the option to purchase contained in the Net Lease) all of the terms, covenants and conditions of the Net Lease. The Modification Agreement will amend the Interim Lease for the period from August 1, 1985 to December 31, 1986 (hereinafter the "Modification Period"). Further, the Modification Agreement will terminate the option to purchase contained in the Interim Lease. In addition to converting the Interim Lease into a net lease effective August 1, 1985, the Modification Agreement will act to lease the entire Building to Morgan subject to the Existing Tenant's occupancy of certain space, and assign to Morgan Petitioner's right, title and interest under the lease between Petitioner and the Existing Tenant covering those specified areas of the Building still occupied by the Existing Tenant, and several service contracts applicable to the Building and which obligations Morgan will assume. The Modification Agreement also contains various representations by Petitioner in favor of Morgan with respect to the lease with the Existing Tenant and sets forth an agreement between Petitioner and Morgan in connection with the assumption by Morgan of the management of the Building. As consideration for Morgan assuming certain responsibilities for the operation of the Premises prior to the commencement of the Net Lease (such as payment of real estate taxes and operating expenses) which otherwise would have been Petitioner's obligation, Petitioner will pay Morgan the amount of \$985,000 (assuming the effective date of the Modification Agreement is August 1, 1985). This amount is a discounted advance reimbursement to Morgan for the costs and expenses to be so incurred by Morgan, discounted at a rate of 1 percent per month, and is designed to put Morgan and Petitioner in the same financial position in which they would have been had the Modification Agreement not been executed.

Finally, Petitioner and Morgan propose to enter into a Commencement Date Agreement pursuant to which the commencement date of the term of the Net Lease will be fixed as January 1, 1987, notwithstanding that all of the space occupied by the Existing Tenant may not yet have been vacated. January 1, 1987 was a possible commencement date for the Net Lease prior to its amendment by the Commencement Date Agreement.

The principal amendment made by the Commencement Date Agreement to the Net Lease is to fix the commencement of the Net Lease and, thus, to fix all other time periods in the Net Lease which are measured from such date, including the option period, the rent adjustment periods and the renewal periods.

The specific gains tax issues raised by Petitioner with respect to this transaction, and the issues which this opinion is intended to address are as follows:

1. Would the amendments made by the Commencement Date Agreement to the Net Lease cause the Net Lease and the option contained therein to lose their identity as contracts entered into on or before March 28, 1983 within the meaning of 1443.6 of the Tax Law (hereinafter the "grandfather exemption")?

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2. Would the amendment of the Interim Lease by the Modification Agreement (including the cancellation of the option contained therein) result in a transfer of real property, as defined at 1440.7 of the Tax Law, from the Petitioner to Morgan?

3. Is the \$985,000 payment by Petitioner to Morgan payment for an interest in real property?

4. Did the amendments made to the Net Lease by the prior agreements dated as of June 30, 1982, May 6, 1983 and December 28, 1984 modify the option contained therein to the extent that a new option was granted?

Section 1443.6 of the Tax Law exempts transfers of real property that occur after the effective date of the gains tax if the transfer is made pursuant to a contract entered into on or before March 28, 1983. The Department of Taxation and Finance has ruled that a contract entered into on or before March 28, 1983, which is amended after such date will continue to benefit from the grandfather exemption as long as the amendments are of a non-substantial nature (Publication 588 Q&A #21A).

The amendments made by the Commencement Date Agreement to the Net Lease and the option contained therein do not constitute a substantial amendment of the Net Lease or the option. Accordingly, the Commencement Date Agreement would not cause the Net Lease nor the eventual transfer of the Premises pursuant to the option in the Net Lease to lose the benefit of the grandfather exemption.

The amendments made to the Interim Lease by the Modification Agreement are of a substantial nature. Of the transfers from the Petitioner to Morgan resulting from the Modification Agreement, only the assignment of Petitioner's interest in the Existing Tenant's lease is a transfer of real property within the meaning of 1440.7 of the Tax Law. Accordingly, the appropriate gains tax forms must be filed for this transfer of real property.

The \$985,000 payment provided for in the Modification Agreement, as a discounted advance reimbursement to Morgan for certain costs and expenses related to the operation of the Premises, is not payment for an interest in real property within the meaning of 1440.4 of the Tax Law.

Finally, the amendments made to the Net Lease by the agreements dated as of June 30, 1982, May 6, 1983 and December 28, 1984 do not substantially modify the option to purchase contained in the Net Lease. Accordingly, these agreements do not grant a new option with respect to the Net Lease.

DATED: July 31, 1985

s/ANDREW F. MARCHESE
Chief of Advisory Opinions

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