

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

TSB-A-91 (3) R
Real Property
Transfer Gains Tax
March 22, 1991

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. M910115A

On January 15, 1991, a Petition for Advisory Opinion was received from Phillips, Nizer, Benjamin, Krim and Ballon, 40 West 57th Street, New York, NY 10019.

The issue raised by Petitioner, Phillips, Nizer, Benjamin, Krim and Ballon, is whether a lease modification agreement (hereinafter the "LMA") entered into by Petitioner's client (the "Tenant") modifying a right of first refusal constitutes a transfer of real property under the Real Property Transfer Gains Tax (the "gains tax").

On November 12, 1990, Tenant entered into a lease for a term of 48 years 11 months which contained a conventional right of first refusal. Pursuant to a proposed LMA, the landlord and Tenant propose amending the lease so that the right of first refusal will contain the following terms:

(1) In the event that the Landlord receives a bona fide third party offer it desires to accept, the Landlord must notify the Tenant of such offer and the Tenant shall have the right of exercising its right of first refusal at a price which is equal to the lesser of: (a) the price offered by the third party or (b) a base price of \$2,250,000 (which the Landlord and Tenant believe is the property's current fair market value) subject to annual increases based on the percentage increase in the Consumer Price Index but limited to annual percentage increases of 6%.

(2) Upon Landlord's receipt of an all cash, bona fide, third party offer to purchase the property at or above a fixed price of \$5,000,000, which amount is also subject to annual adjustments based on the percentage increase in the Consumer Price Index, the Landlord must notify the Tenant and thus trigger the Tenant's right to exercise the right of first refusal, even if the Landlord does not wish to accept such third party offer.

Section 590.5 of the Gains Tax Regulations, provides, in part, as follows:

"(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.

* * *

(b) Question: Is the creation of a leasehold for a term of less than 49 years every 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. (emphasis added)

Moreover, pursuant to Section 1440.7 of the Tax Law, the granting of an option with use and occupancy is a transfer of an interest in real property which is subject to the gains tax, regardless of whether or not the granting of the option to purchase occurs simultaneously with the creation of the lease.

Section 590.30 of the Gains Tax Regulations provides, in part, as follows:

"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 optionor to convey the real property upon the exercise of the option. (emphasis added)

Further, 77 Am Jur 2d, §49 states, in part, as follows:

The distinction between an option and a pre-emptive right to purchase in the event the landlord should decide to sell is well recognized. Unlike an option, a pre-emptive right does not give the pre-emptioner the power to compel an unwilling owner to sell; it merely requires the owner, when and if he decides to sell, to offer the property first to the person entitled to the pre-emptive right at a stipulated price. There is no doubt that an agreement based on a consideration to give the promisee the refusal or first right to purchase in case the landowner wishes to sell at a fixed price or at a price

which may be made certain, while of less value than an ordinary option to purchase, is valid and binding on the landowner. (emphases added)

Accordingly, pursuant to Section 590.30 of the Gains Tax Regulations and 77 Am Jur. 2d, §49 there's a definite distinction between an option to purchase and a right of first refusal in that an option gives the lessee the power to compel an unwilling lessor to sell the property being leased, Paragraph one of the LMA constitutes a right of first refusal since the Tenant has no power to compel the landlord to sell the property. Therefore, if the lease is modified to only include paragraph "1", pursuant to Section 590.30 of the Gains Tax Regulations the lease is not a transfer of real property subject to the gains tax. However, Section 590.5(b) of the Gains Tax Regulations and Section 1440.7 of the Tax Law provide that a leasehold when coupled with the granting of an option to purchase is the transfer of an interest in real property. Since paragraph "2" of the LMA gives the Tenant the power to compel the landlord to sell the property upon the landlord's receipt of a third party offer, such amendment constitutes the grant of an option to purchase and is, therefore, a transfer of real property subject to the gains tax.

DATED: March 22, 1991

s/PAUL B. COBURN
Deputy Director
Taxpayer Services Division

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