

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

TSB-A-99(1)R
Real Estate Transfer Tax
March 1, 1999

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. M990106A

On January 6, 1999, the Department of Taxation and Finance received a Petition for Advisory Opinion from Waldbaum, Inc., c/o The Great Atlantic & Pacific Tea Company, Inc., 90 Delaware Street, Paterson, NJ 07503.

The issue raised by Petitioner, Waldbaum, Inc., is whether the period of an "interim term" of a lease for real property, during which the lessee is conducting due diligence investigations of the property and is neither paying rent nor otherwise occupying the premises, is deemed part of the lease term for purposes of determining whether or not the term of the lease is 49 years or more and taxable for purposes of the Real Estate Transfer Tax imposed pursuant to Article 31 of the Tax Law.

Petitioner presents the following facts. Petitioner, as "Lessee," entered into a ground lease with Sears, Roebuck & Company ("Sears"), as "Lessor," dated April 8, 1996, for premises located in Hicksville, New York. The ground lease provided for an "interim term," which was initially defined in section 1(e) of the ground lease, in part, as:

The period commencing on the date of this Lease and ending on the earlier of: (i) twelve (12) months thereafter; or (ii) upon the issuance of a building permit for Lessee's proposed initial Improvements on the Premises by the municipality having jurisdiction with respect to the Shopping Center and expiration of any time period within which any appeal therefrom may be taken or challenge thereto may be asserted. . . .

This definition further provided that in the event that Petitioner was unable to obtain the requisite permits and approvals prior to the end of the initial interim term, then the Petitioner could extend the interim term for additional periods by notifying Sears and, in certain instances, making specified payments to Sears for such extensions. If the interim term were extended, the ground lease provides that any such extension "shall be deemed to be included within the definition of 'Interim Term' for all purposes under this Lease."

Construction of the initial improvements to the Premises cannot begin until after Petitioner has obtained the requisite permits and approvals and the interim term ends.

Section (1)(g) of the ground lease defines the "lease term" of the premises, in part, as follows:

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The Term shall commence ("Commencement Date") on the earlier of: (i) the date 180 days after expiration of the Interim Term; or (ii) the date Lessee opens for business on the Premises. The Term shall terminate as of the last day of the month which is twenty-five (25) Lease Years after the Commencement Date . . . Lessee shall have the right to extend the Term . . . for two (2) ten-year periods. . . .

Section (2) of the ground lease, entitled "Granting Clause," provides, in part:

In consideration of the obligation of Lessee to pay rent as herein provided, and in consideration of other terms, covenants and conditions hereof, Lessor hereby demises and leases to Lessee, and Lessee hereby takes from Lessor, the Premises and any and all rights and privileges appurtenant thereto, TO HAVE AND TO HOLD such Premises for the Lease Term, all upon the terms and conditions set forth in this Lease. . . . (emphasis added)

Section (26) of the ground lease provides, in part:

During the Interim Term, Lessee shall have access to the Premises for conducting engineering and other feasibility studies, including the obtaining of any and all necessary consents or approvals, subject to Lessee not interfering with Lessor's day-to-day business operation on the Shopping Center. . . .

During the interim term, Petitioner, in accordance with section (26) of the ground lease, has been conducting due diligence investigations regarding the Premises and has been attempting to obtain the requisite governmental approvals needed to construct the building on the site. However, because Petitioner was unable to obtain all such approvals within the initial twelve month period of the interim term, Petitioner and Sears have entered into a series of amendments to the ground lease extending the interim term. Presently, pursuant to the "Third Amendment to Ground Lease," the interim term will expire no later than June 8, 1999. In consideration for this extension of the interim term through June 8, 1999, Petitioner paid Sears \$150,000 (the "extension payment"). Pursuant to the "Third Amendment to Ground Lease," the extension payment is non-refundable unless the lease term commences on or before to December 8, 1999, and Petitioner thereby becomes obligated to begin paying rent. If the lease term does commence on or before December 8, 1999, the extension payment will then be credited against the rent due from Petitioner until the extension payment is depleted.

Petitioner and Sears would now like to enter into a further amendment to the ground lease to extend the interim term to a date no later than December 31, 2000, pursuant to a "Fifth Amendment to Ground Lease." The proposed "Fifth Amendment to Ground Lease" does not require a payment from Petitioner to Sears in consideration for the further extension of the interim period.

Applicable Law

Section 1402 of the Tax Law imposes the real estate transfer tax on each conveyance of real property or interest therein when the consideration exceeds five hundred dollars. The term "conveyance" is defined in section 1401(e) of the Tax Law. Included in the definition of conveyance is the transfer or transfers of any interest in real property by any method.

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. . . .

Section 575.7 of the Real Estate Transfer Tax regulations provides, in part:

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.

Section 1405 of the Tax Law provides, in part:

(a) The following shall be exempt from payment of the real estate transfer tax:

* * *

9. Conveyances of real property which consist of the execution of a contract to sell real property without the use or occupancy of such property or the granting of an option to purchase real property without with the use or occupancy of such property. . . .

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Conclusions

The period of the interim term of the ground lease is not deemed to be part of the lease term for purposes of determining whether or not the term of the lease is 49 years or more.

The interim term of the ground lease can be characterized, pursuant to section 1405(a)(9) of the Tax Law, as a contract to sell real property without the granting of the use or occupancy of such property. The fact that Petitioner has access to the property during the interim term, in order to conduct engineering and feasibility studies for the purpose of securing building permits and approvals, does not rise to the level of having the "use or occupancy" of the property.

At the time Petitioner is able to obtain all the requisite permits and approvals for the construction of the initial improvements on the Premises, the interim term would end. Petitioner would then be able to begin construction on the Premises. If Petitioner were to begin such construction, it would then be deemed to have the "use and occupancy" of the property and the time period during which construction was taking place would be deemed to be part of the lease term for purposes of determining whether or not the term of the lease is 49 years or more.

However, pursuant to section (2) of the ground lease, the "Lease Term" itself commences on the earlier of: "(i) the date 180 days after expiration of the Interim Term; or (ii) the date Lessee opens for business on the Premises" (ground lease, section (1)(g)). Consequently, the maximum amount of time during which construction was taking place that could be included as part of the lease term — before the commencement of the actual lease term itself — is 180 days (*i.e.*, six months). Therefore, because the maximum possible term of the lease would be 45 years, six months (*i.e.*, a possible six months during construction, plus the 25-year initial term, plus two ten-year renewal options), the lease is not taxable for purposes of the Real Estate Transfer Tax.

DATED: March 1, 1999

/s/
John W. Bartlett
Deputy Director
Technical Services Bureau

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