How New York City and State Transfer Taxes Apply to Ground Leases

By Joshua Stein

When a developer finds a suitable development site, the owner of that site often refuses to sell, but instead will only enter into a long-term lease—a "ground lease"—to the developer. With a ground lease the developer can achieve possession and control of the site,[1] almost as if the developer owned it,[2] typically for 99 years, in exchange for paying ground rent.[3] The developer can use a well-written ground lease to obtain financing and develop a substantial project. Ground lease transactions raise far more issues, many of them more interesting, than the issues that arise in an ordinary purchase and sale of a development site. A ground lease often works very well for the owner and, to a lesser degree, the developer. But developers often have to live with that, as part of the cost of doing business.

A ground lease in New York will incur lower transfer taxes than an outright sale at a similar valuation. Lower transfer taxes come at the cost of increased complexity in the issues surrounding those transfer taxes, although that complexity does not in itself justify switching to an outright sale.[4]

As the starting point for discussion, New York City (the "City") and New York State (the "State") both impose a transfer tax on most conveyances of real property. The City and State taxes have many similarities, but also some important differences,[5] particularly as they relate to ground leases.[6]

NY Tax Law Section 1402(a) imposes the State's real estate transfer tax ("NYS RETT") "on each conveyance of real property or interest therein when the consideration exceeds five hundred dollars."[7] An interest in real property includes "a leasehold interest, a beneficial interest...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."[8] This definition seems to capture any ground lease. It is not that simple, though.

The State tax law defines a conveyance as "the transfer or transfers of any interest in real property by any method."[9] Thus, almost any sale, exchange, assignment, [10] or surrender of any lease, even if only an hour remains in its term, attracts NYS RETT. A lease coupled with a purchase option always attracts NYS RETT, regardless of the remaining term of the lease.[11]

Absent an option to purchase, when a landlord and a tenant enter into a long-term lease, such as the typical ground lease, it will not always constitute a conveyance under the State tax law. Instead, the NYS RETT treats a lease without a purchase option as a conveyance only if it meets this three-prong test:

1) the sum of the term...and any options for renewal exceeds forty-nine years,
2) substantial capital improvements are or may be made by or for the benefit of the lessee..., and
3) the lease...is for substantially all of the premises constituting the real property.[12]

The first prong of the test leads some landlords and tenants to limit the term of a ground lease to 49 years precisely to avoid NYS RETT. That seems rather extreme, given the relatively favorable transfer tax treatment of ground leases, as described in this article, and the relatively low rate of the NYS RETT.

The second prong for taxability will be met by almost every ground lease that contemplates a development project.[13]

The third prong raises some odd issues. Regulations issued by the New York State Department of Taxation and Finance ("DTF") define "substantially all of the premises constituting the real property" to mean "ninety percent (90%) or more of the total rentable space of the premises, exclusive of common areas."[14] DTF regulations then define "premises" to mean, in relevant part: "where a lease...is of vacant land, any portion of such vacant land."[15] In other words, if a property owner owns a single large vacant lot and leases only a small corner of that land to a developer for 50 years, that corner will be deemed "substantially all of the premises constituting the real property."[16] That result seems somewhat counterintuitive, especially if one starts from and believes the words of the statute. Intuition is, however, rarely a good guide to New York real estate transfer taxes. If intuition were a good guide, one would intuitively not expect leases demising less than "substantially all of the premises" to qualify for any special treatment at all in the first place.[17]

For any taxable conveyance, the NYS RETT will equal "two dollars ($2) for each five hundred dollars ($500) of consideration or fractional part thereof."[18] In other words, the NYS RETT is 40 basis points, rounded up to the next even number of whole dollars.

In general, 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."[19] For creation of a leasehold interest, State tax law provides:

consideration shall include but not be limited to the value of the rental and other payments attributable to the use and occupancy of the real property or interest therein, the value of any amount paid for an option to purchase or renew and the value of rental or other payments attributable to the exercise of any option to renew.[20]

For a taxable ground lease, consideration includes any payment the tenant makes to obtain the ground lease (so-called "key money") and the present value of the right to receive rental payments or other payments for use and occupancy,[21] for the base term and any possible renewal term.[22] In other words, State tax law assumes the tenant will exercise all renewal options. That assumption seems reasonable.[23]

To calculate the present value of the incoming rental stream,[24] the taxpayer[25] (the landlord) must, at least as a starting point, use "a discount rate equal to 110 percent of the federal long-term rate, compounded semiannually."[26] This article calls that the "default discount rate." Given today's interest rates, the default discount rate is less than 4%, very low, likely to produce unrealistically high taxable consideration for any long-term ground lease.

The DTF regulations do, however, acknowledge that using the default discount rate may produce taxable "consideration" in excess of the leased property's fair market value as if sold.[27] If the taxpayer establishes that this is so, then DTF allows the taxpayer to use a higher discount rate, to derive consideration for the lease that more accurately reflects the fair market value of the property as if sold.[28] This example, based on a DTF regulation, will help explain.[29]

Assume A, as landlord, creates a lease with B as tenant. The lease is for a term of 60 years and covers an entire plot of undeveloped land A owns. The lease allows B to make substantial capital improvements to the land. A will receive $6,000,000 in rent over the lease term. The applicable federal long-term rate for December 2014 is 2.72% compounded semi-annually. The default discount rate used to calculate present value equals 2.99% (i.e., 2.72% multiplied by 110%). That brings the present value of the rent to $1,623,500.

Because all three conditions in Section 1401(e) are met, creation of the lease constitutes a conveyance subject to NYS RETT. The taxable consideration is the present value of the rent based on the default discount rate—i.e., $1,623,500.[30] Therefore, the landlord owes NYS RETT, at a rate of $2 for each $500 (or part thereof) of consideration, in the amount of $6,494 ($1,623,500 divided by 500 is $3,247).

If the taxpayer can show that $1,623,500 does not reasonably approximate the leased property's fair market value, as if sold, the taxpayer may use a discount rate that would produce consideration equal to that fair market value. For example, suppose A has recently received many offers to purchase for only $1,000,000. A may then use a discount rate of 4.99%, instead of the default discount rate, in calculating the taxable consideration. The taxable consideration would then equal about $1,000,000 as opposed to $1,623,500. A would ultimately save $2,494 (nearly 40%) in NYS RETT, perhaps exceeding the legal fees required to reach this favorable result.

Turning from the NYS RETT to the New York City real property transfer tax ("NYC RPTT"), one encounters a pleasant surprise, an exception to the common assumption that the City's taxes are more burdensome than the State's. The analysis begins with New York City Administrative Code ("Admin Code") Section 11-2102: "A tax is hereby imposed on each deed at the time of delivery by grantor to grantee when the consideration for the real property and any improvements thereon (whether or not included in the same deed) exceed twenty-five thousand dollars."[31] Section 11-2101 defines several terms, including "deed," "real property," and "consideration." The City's definitions of these terms generally match the State's, except as this article notes.[32] As one very important difference, the NYC RPTT applies to the creation of any lease, regardless of term.[33] This avoids some philosophical nuances discussed earlier. But it means any "consideration" at all for any lease in the City will attract a tax.

Section 11-2102(a)(10) sets the NYC RPTT rates for "a grant, assignment, or surrender of a leasehold interest in real property."[34] A typical ground lease falls in the category taxed "at the rate of 1.425% of the consideration...where the consideration is $500,000 or less, and at the rate of 2.625% of the consideration where the consideration...is more than $500,000."[35] Thus in New York City the tax rate on a ground lease is typically 2.625%—more than six times the State's tax rate.

Although City transfer tax rates are high, the NYC RPTT excludes from taxable "consideration" for a ground lease any payment that constitutes "rent" for purposes of the City's commercial rent or occupancy tax (the "CRT").[36] This exclusion is unique to the City, because CRT is unique to the City.

The City imposes CRT on "rent" paid to occupy or use certain premises in the City "for carrying on or exercising any trade, business, profession, vocation, or commercial activity including any premises so used even though it is used solely for the purpose of renting, or granting the right to occupy or use, the same premises in whole or in part to tenants."[37] In other words, CRT is a tax on commercial tenants, including ground lease tenants – anyone who conducts any form of business in leased premises.

The CRT defines "rent" as:

> The consideration paid or required to be paid by a tenant for the use or occupancy of premises, valued in money, whether received in money or otherwise, including all credits and property or services of any kind and including any payment required to be made by a tenant on behalf of his or her landlord for real estate taxes, water rents or charges, sewer rents or any other expenses (including insurance) normally payable by a landlord who owns the realty other than expenses for the improvement, repair or maintenance of the tenant's premises.[38]

A "tenant" means: "[a] person paying or required to pay rent for premises as lessee, sublessee, licensee or concessionaire."[39] A ground tenant thus constitutes a "tenant" who pays "rent" within the meaning of the CRT.

For NYC RPTT purposes, Admin Code Section 11-2102(a)(10)(iii) states generically that "the amount subject to tax…shall be only such amount as is not considered rent for purposes of [CRT]."[40] This exclusion makes a huge difference. It means that, under City tax law, the only consideration paid for the grant of a ground lease consists of whatever "key money" or other consideration the tenant pays to obtain the lease. The rent itself is not taxable consideration, as it would be under State tax law.

One might think the "rent" exclusion would apply only to leases that are actually subject to CRT, but the Admin Code does not suggest that reading. City tax officials have not interpreted the "rent" exclusion that way, either. The NYC RPTT's exclusion of "rent" from "consideration" seems to apply whether or not the ground tenant actually owes CRT on that rent, after taking into account the CRT's limits and scope. Some of those limits are geographic. Others impose threshold values on untaxed rent.

Taxpayers should proceed with care, though. Little written authority beyond the Admin Code itself supports this favorable definition of "consideration." The Admin Code simply excludes "rent" as defined in the CRT. At one point, the City issued a tax ruling that can, with close scrutiny, be interpreted to support the favorable reading the City has historically applied to ground rent. In that ruling, City tax officials passed up an opportunity to limit the "rent exclusion" so it applies only to leases actually subject to CRT.[41] The author has found no other City tax ruling to confirm that analysis. According to industry lore, though, the City has consistently disregarded any "rent" (as defined in the CRT) in calculating NYC RPTT anywhere in the City. Even if a ground lease attracts no NYC RPTT—because it requires only payment of "rent" and no other consideration—the parties still need to file a NYC RPTT tax return. For the privilege of doing that, the City charges a fee.

Regardless of the measure of the NYS RETT and the NYC RPTT, the parties to a ground lease also need to think about when the obligation to pay either transfer tax actually arises. Transfer tax does not attach to every ground lease when the parties sign it. Occasionally, the parties will sign a ground lease and it will never attract any transfer tax.

The parties to a ground lease sometimes negotiate a due diligence period, which starts from signing of documents and gives the tenant an option (e.g., for 90 days or six months) to proceed, usually without paying an option fee.[42] A tenant can use that period to finish its homework on the transaction. With comfort that the due diligence period (free option) gives it site control, the tenant can safely invest more money in evaluating the development project. The lease term would not begin and the landlord would not deliver possession of the leased premises until the due diligence period expires. If the tenant likes what it learns in due diligence, the tenant goes ahead with the transaction by giving a notice to proceed. If the tenant doesn't like what it learns, the transaction ends and the tenant never takes possession. As a practical matter, due diligence periods also give prospective tenants an opportunity to find debt and equity financing sufficient to close the transaction and proceed with development—perhaps the most important piece of information a developer needs to learn in the due diligence period for any development project.

Instead of entering into a lease that doesn't become effective until the tenant decides to proceed, landlord and tenant might enter into an "agreement to lease" with an expiration date by which the "agreement to lease" will become a lease (or not). If the tenant decides to proceed, then the parties would sign a lease, equivalent to delivering a deed at a purchase and sale closing. Until the tenant's option period ("due diligence" period) expires, and the parties sign a lease, the tenant can complete its due diligence and decide whether to proceed.

Whether the parties sign a lease subject to a possible future "notice to proceed" or an agreement to lease with a possible lease closing later,[43] conveyance would not occur, consideration would not be deemed delivered, and transfer tax would not attach until the landlord actually delivers possession. Until that time, a taxable event will not have occurred.[44]

The taxable event in either of these structures turns on the definition of "interest" in real property, which appears in NY Tax Law Section 1401(f), particularly the statutory reference to transactions "with the right to use or occupancy of real property."[45] The exemptions to taxable conveyances listed in NY Tax Law

Section 1405(b) state: "The tax shall not apply to the following conveyances:...(9) Conveyances of real property...without the use or occupancy of such property or the granting of an option to purchase real property without the use or occupancy of such property."[46]

In an advisory opinion issued to Waldbaum, Inc. (the "Waldbaum Advisory Opinion"), DTF opined that interim lease periods during which a tenant conducts due diligence investigations, but does not pay rent or occupy the premises, do not count as part of the lease term or trigger RETT. DTF concluded that "the interim term of the ground lease can be characterized, pursuant to section 1405(a)(9) of the [State] Tax Law, as a contract to sell real property without the granting of the use or occupancy of such property."[47]

DTF further opined:

> 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 [sufficient to constitute an interest in real property under Section 1401].[48]

In sum, if the parties sign a lease that unambiguously limits the tenant's allowable use of the property (so the tenant can do nothing more than conduct due diligence) in the due diligence period, then that lease is not in and of itself (yet) a conveyance of an interest in real property. Therefore, it does not (yet) trigger the NYS RETT.

If the signing of a lease with a due diligence period does not start the lease term or trigger NYS RETT, then at what moment in time will such a lease attract NYS RETT? Generally, in these transactions the lease term will begin at the end of the due diligence period, once all commencement contingencies are met. Often the tenant will need to give formal notice to proceed, effectively an option exercise notice. Whatever the lease requires for the tenant to take possession, once that happens the landlord owes NYS RETT.

In the Waldbaum Advisory Opinion, the lease term began (i.e., the tenant obtained use and occupancy of the property)—and the landlord owed NYS RETT—as soon as the tenant obtained all the approvals it needed to start its initial improvements on the premises.[49]

If a lease provides for a due diligence period, but allows the tenant to start preliminary work on site, that may give the tenant enough "use and occupancy" to start the lease term and trigger NYS RETT.[50] It matters, though, who does the work. If the lease requires the landlord to do preliminary work, the lease term would still begin only when the tenant takes possession.[51] According to DTF, "if Tenant is responsible for...construction...the lease term would begin with the Tenant's use or occupancy upon the commencement of the Construction Period."[52]

If a ground lease allows the ground tenant to receive rent from subtenants in the due diligence period, it could well be taxable from inception. The right to receive that rent could constitute constructive leasehold possession by the ground tenant.

To summarize all of this, the NYS RETT applies to "consideration" given in exchange for the "conveyance" of a leasehold under a ground lease (an "interest in real property") in the State, if the lease meets certain requirements. Consideration for the NYS RETT includes any payments made to obtain the lease. It also includes the present value of future rent payments discounted at 110% of the applicable federal long-term rate compounded semi-annually. If the taxpayer can show the default discount rate produces consideration beyond the property's fair market value as if sold, the taxpayer can use a higher discount rate.

The City imposes NYC RPTT on each "deed" (including creation of any lease) when "consideration" exceeds $25,000.[53] But consideration excludes payments constituting "rent" for CRT purposes, even if no one owes CRT on that "rent." Because ground lease payments typically qualify as "rent," they do not attract NYC RPTT.

If a lease contemplates a due diligence period, the parties can defer transfer tax until the landlord delivers possession, but the lease must limit the tenant's possessory rights in the meantime.

The transfer taxes on creation of a ground lease in the City are relatively low when compared with the usual transfer tax burden on City real estate transactions. Even if a ground lease triggers a NYS RETT, which it usually will, that tax will remain relatively low—sort of like the transfer taxes that apply to real estate transactions almost anywhere else in the United States. The NYS RETT on a ground lease hardly gives the parties a reason to limit the term of a ground lease just to avoid tax.

Endnotes

1. The archetypal transaction involves vacant land. Sometimes the leased premises consist of land plus an existing building, which the developer will redevelop or demolish and replace with a new structure. Sometimes a "ground lease" will even refer to a long-term lease of part of a building, if it has the basic attributes of a ground lease: a very long term with flexibility almost equivalent to ownership, and creating an "investment"-type asset rather than a mere "occupancy" arrangement. Others, including Black's Law Dictionary and prominent members of the New York City real estate bar, believe a lease cannot be a "ground lease" unless it includes some ground.
2. The landlord will want comfort that the developer will: (a) complete and pay for a reasonable development project; (b) operate the project in a reasonable and responsible way; and (c) at the end of the lease term, return a building in reasonable condition. The more

comfort—and the more detail—the landlord seeks on these issues, the more difficult the ground lease negotiations will be.

3. Determination and future adjustment of that rent over many decades becomes crucially important, of course. *See, e.g.*, Joshua Stein, "The Most Important Issue in Every Ground Lease," New York Real Property Law Journal, Winter 2014, at 17.

4. The transfer tax issues in a ground lease are not nearly as interesting as the issues that arise within the ground lease itself, though.

5. Many regard the City tax as more burdensome than the State's. That is often a good rule of thumb. The City tax certainly has a higher rate. But, even before considering the differences flagged in this article, the City tax is not always more burdensome. For example, the State taxes a transfer to or from a charitable organization, whereas the City sometimes does not.

6. The principles discussed here generally also apply to subleases, but this article does not consider subleases. Also, the various transfer taxes have numerous inconsistent exceptions and counterintuitive traps, and a few opportunities, any of which can potentially apply to ground lease transactions. This article disregards those generic matters. It also does not consider real estate transfer taxes imposed in a few municipalities other than New York City. Those taxes look very much like the State transfer tax, but one cannot assume they always match. One should instead research any municipal tax that might apply. The State transfer tax exempts leases to certain new businesses that participate in the START-UP NY program under NY Econ. Dev't Law Article 21; *see* N.Y. Tax Law § 1405(b)(11) (McKinney 2013). This exemption is one of many examples in which New York promotes economic development by exempting favored businesses from the burdens that apply to everyone else, rather than lessening those burdens for all. This in turn maximizes the importance of government agencies and officials and often requires any developer to seek help in navigating the paperwork and procedures.

7. NY Tax Law § 1402 (McKinney 2014).

8. NY Tax Law § 1401(f) (McKinney 2014).

9. NY Tax Law § 1401(e) (McKinney 2014).

10. A collateral assignment is not a conveyance within the meaning of Section 1401 and does not attract transfer tax. *See* N.Y. St. Dept. of Taxation & Fin. Advisory Op. No. TSB-A-97(4)R. It may, however, attract a mortgage recording tax under some circumstances.

11. 20 NYCRR § 575.7(c)(1) ("An option to purchase real property is an interest in real property. Where an option to purchase real property is coupled with the granting of the right to use and occupancy of the real property, a conveyance subject to the transfer tax has occurred."). Ground lessors generally try to avoid granting purchase options. In most cases, a ground lessor enters into a ground lease precisely because the ground lessor does not want to sell. The ground lessor assumes any purchase option will be exercised at the earliest possible opportunity, usually a good guess. Most ground lessees unhappily live without purchase options.

12. NY Tax Law § 1401(e) (paragraph breaks added).

13. The State tax law offers no guidance on when capital improvements will be substantial enough to satisfy the second prong of the test in NY Tax Law § 1401(e).

14. 20 NYCRR § 575.7(a)(3).

15. 20 NYCRR § 575.7(a)(3)(iii).

16. 20 NYCRR § 575.7(a)(1-3).

17. In N.Y. St. Dept. of Taxation & Fin. Advisory Op. No. TSB-A-07(2)R, DTF interpreted the term "substantially all of the premises," in the context of a long-term lease demising part of an existing shopping center. In determining that such a lease is not for substantially all of the premises and thus not subject to transfer tax, DTF applied a broad definition of premises. DTF stated that "it is important to view the matter with an eye on the unique nature of the shopping center enterprise from a business and legal perspective and look beyond the examples given in [Section 575.7(a)(3)]." DTF cited an earlier advisory opinion, Adv Op Comm T&F, September 27, 2005, Harter, Secrest & Emery, LLP, 604-2711, Adv Op Comm TSB-A-05(1)R, 2005 (the "Harter Secrest Advisory Opinion") and then observed: "because a shopping center is operated by the landlord and tenants as a closely integrated retail enterprise, the relevant premises must include all of the real property constituting the shopping center." Concluding that because the lease affected "less than 90% of the total rentable space available to all tenants in the entire shopping center, exclusive of common areas," DTF said the transaction does not incur NYS RETT. In contrast, an equivalent lease of vacant land elsewhere in the same tax lot might be deemed "substantially all of the premises," as noted above. Any logical or "tax policy" reason for that distinction is not readily apparent.

18. NY Tax Law § 1402(a) (McKinney 2014).

19. NY Tax Law § 1401(d) (McKinney 2014).

20. *Id.* If the tenant agrees to build a building on the site, would that building, or the promise to build it, constitute "consideration" for the ground lease? Historically it never has. To treat the building as "consideration," one would first need to predict the value of the building at the end of the lease term, then discount it back to present value. If the assumed discount rate even slightly exceeds the assumed appreciation rate, the present value will approach zero. Even if one can reasonably predict those rates, how can one predict the likely condition or value of the building at the end or premature termination of the lease? One should often assume the building will, at the end of the lease term, be obsolete and in need of major capital expenditures, the result of deferred maintenance in the last decade or so of the lease term. What value will such a building have? And if the "promise to build" constitutes consideration, what about the "promise to insure" and the "promise to maintain" and the "promise to pay taxes" and all the other promises in the lease? Don't all those benefit the landlord somehow? Shouldn't all these other promises also constitute consideration? Instead, it probably makes more sense to treat the "promise to build" as part of the internal workings of the lease—part of the reason the transaction makes sense, sort of like a very large security deposit—rather than consideration for the lease. That doesn't mean DTF won't try to tax the "promise to build" as part of the response to some future budget crisis. On the other hand, in 2005, DTF did issue the quite extensive Harter Secrest Advisory Opinion on taxation of ground leases. That opinion explored a variety of hypothetical cases, including some where the tenant would construct substantial capital improvements. Nothing in that advisory opinion suggested at any point that "consideration" running to the landlord might include the tenant's promise to build. On the other hand, if the tenant induced the landlord to sign a ground lease by immediately conveying to the landlord some existing building somewhere else, then the value of that building would presumably constitute consideration, the transfer of which would attract at least one transfer tax and very likely two.

21. *See* 20 NYCRR § 575.7 (b)(2)(ii) (2014). Actually the NYS RETT considers only the landlord's "net rents," meaning gross rents less estimated operating costs the landlord pays. "Such operating costs include amounts paid for heat and gas, electricity, furnishings, insurance, maintenance, management and real estate taxes[.]" A ground lease will, however, almost always pass all those costs through to the tenant, eliminating any savings opportunity. And if the landlord offered to pay those costs to reduce tax, the rent would rise accordingly, defeating the purpose.

22. *See* 20 NYCRR § 575.7(b)(1). Both for the threshold determination of taxability and for calculating the tax, the statute assumes the tenant will exercise all renewal options, treating them as part of the lease term. That sometimes comes as a surprise to smart and creative real estate people. They often think, but only briefly, that they can outwit the tax by having a short initial term followed by many renewal options.

23. In a properly negotiated and typical development ground lease for vacant land, the rent should reflect just the value of the vacant land. Once the tenant has built a building on that land, the burden of paying rent should always fall far below the benefit of continuing to effectively "own" the building and having a place to put it. So the tenant should always want to continue the lease as long as possible, implying the tenant should exercise all renewal options (unless, of course, for some reason they have become uneconomic). To avoid issues about forgetting to exercise extension options, it will usually make sense to eliminate them and just extend the lease term, perhaps with termination options along the way. If no credit (and no collateral beyond the building) backs the tenant's leasehold obligations, then the tenant in effect has a termination option at all times.

24. If the actual rental payments are "tied to unknown factors," DTF regulations require the taxpayer to make "a reasonable estimate" of how those payments will turn out. 20 NYCRR § 575.7(b)(3). This would presumably cover CPI adjustments, land value rent resets, and the like, which often appear in ground leases. The taxpayer may need a crystal ball. But it's not too different from the crystal ball used by any ground lease appraiser.

25. *See* N.Y. Tax Law § 1404(a). The law requires a landlord, as the transferor, to pay NYS RETT. If the landlord (transferor) fails to pay, or is exempt, the tenant (transferee) must pay. If the landlord must pay it, but the tenant agrees to do so instead, then that payment constitutes additional consideration, itself taxable under the NYC RPTT and NYS RETT. If the tenant pays that second iteration of tax, however, that payment does not attract a third iteration of tax. In a substantial outright sale, the parties can actually save a few pennies by having the purchaser pay the seller's transfer tax and repricing the deal accordingly. Do the math. That small tax-saving opportunity doesn't work for ground leases, though, because of how the NYC RPTT works, as described later in this article.

26. 20 NYCRR § 575.7(b)(2). The calculation will use the rate in effect 30 days before the date of transfer. The federal long-term rate is announced every month, *available at* http://apps.irs.gov/app/picklist/list/federalRates.html (last visited December 25, 2014).

27. 20 NYCRR § 575.7(b)(2)(ii).

28. *See* 20 NYCRR § 575.7(b)(2). The regulations do not say how the taxpayer would go about "establish[ing]" that the "consideration" exceeds fair market value. Presumably, current appraisals from reputable appraisers would be the gold standard. If the taxpayer has received offers to purchase, those would help. Presumably whatever the taxpayer offers, if anything, DTF will respond by asking for more. It will become a typical valuation dispute, of the type well known in tax and other law. The taxpayer should plan for that possibility.

29. The example comes from 20 NYCRR § 575.7(b)(5) example 1 (2014), after filtering out a "red herring" discussion about the landlord's paying some operating costs.

30. This assumes the tenant pays no up-front "key money" or other inducement payment.

31. New York, N.Y., Admin Code § 11-2102(a) (West, Westlaw through L. 2013, ch. 517 and Local Law 113 of 2013).

32. New York, N.Y., Admin Code § 11-2101.2, 5, & 9 (West, Westlaw through L. 2013, ch. 517 and Local Law 113 of 2013).

33. New York, N.Y., Admin Code § 11-2101.2 (defining "deed"); § 11-2102(a)(10) (West, Westlaw through L. 2013, ch. 517 and Local Law 113 of 2013).

34. New York, N.Y., Admin Code § 11-2102(a)(10) (West, Westlaw through L. 2013, ch. 517 and Local Law 113 of 2013).

35. New York, N.Y., Admin Code § 11-2102(a)(10)(ii) (West, Westlaw through L. 2013, ch. 517 and Local Law 113 of 2013).

36. *See Id.* The net rate of CRT equals about 4% of rent paid by substantial commercial tenants in Manhattan south of 96th Street, subject to many exemptions and exclusions irrelevant to the present discussion. Almost no other jurisdiction in the United States imposes such a tax. CRT payors also typically pay, among other taxes and charges, the following extraordinary collection of City and State taxes, generally mitigated by their deductibility (a) City income tax of up to almost 4%; (b) City general corporation or unincorporated business tax of up to 8.85%, in some cases credited against "a" or vice versa; (c) through their rent, a contribution to City property taxes, often around $10 a square foot, at least in prime areas of Manhattan; (d) sales tax of 8.875% on purchases of goods and services except for resale; (e) a metropolitan commuter transportation mobility tax of 0.34%; (f) taxes on electricity and telecommunications (including a significant chunk of the total bill for any cellphone number with a New York mailing address); (g) separate charges for water, sewer and commercial garbage collection (taxes don't cover them); (h) directly or indirectly, the cost of sidewalk sweeping, snow removal, maintenance, repair and often reconstruction (taxes don't cover them either); and (i) State income taxes at some of the highest rates in the nation.

37. New York, N.Y., Admin Code § 11-701.5 (West, Westlaw through L. 2013, ch. 517 and Local Law 113 of 2013).

38. New York, N.Y., Admin Code § 11-701.6 (West, Westlaw through L. 2013, ch. 517 and Local Law 113 of 2013).

39. New York, N.Y., Admin Code § 11-701.3 (West, Westlaw through L. 2013, ch. 517 and Local Law 113 of 2013).

40. New York, N.Y., Admin Code § 11-2102(a)(10)(iii) (West, Westlaw through L. 2013, ch. 517 and Local Law 113 of 2013).

41. N.Y.C. Dep't Fin. Ltr. Rul., FLR 96-4666 (Feb. 24, 1997), 1997 WL 168624. In relevant part, a taxpayer deeded property to the New York City Industrial Development Agency and leased it back under a "Prime Lease." The City concluded that no RPTT was due on that rent, as the Prime Lease was a "true lease" under which the tenant will "pay rent for the use and occupancy" of the premises. The City quoted Admin Code § 11-2101.1 and § 11-2101.2, with their blanket exclusion from RPTT of any amount constituting rent under the CRT; hence the parties owed no RPTT on the rent under the Prime Lease. The ruling nowhere suggested that the blanket exclusion of "rent" under the CRT applies only in areas of the City subject to CRT. To the contrary, the ruling said nothing at all about the location of the leased premises. This suggests location is irrelevant, hence whether the property is located in an area subject to CRT is irrelevant. In other words, the City seems to suggest the same principles apply anywhere in the City. It is a suggestion inferred from silence. It thus lacks the clarity and certainty a taxpayer might prefer. Taxpayers should note that, while it may not attract RPTT, a sale and leaseback transaction may be considered a financing arrangement subject to the State's mortgage recording tax.

42. The tenant may agree to pay carrying costs during the due diligence period. If the tenant also receives the benefit of rental income in that time, that may interfere with the favorable treatment of due diligence periods as described in the next few paragraphs of this article.

43. The parties may have psychological reasons to resist a two-step process, even if it leads to the exact same sequence of possible events, i.e., one party or

the other may feel better knowing that something called a "lease" is in place rather than something that feels more like an option.

44. *See* Harter, Secrest & Emery, LLP, N.Y. Dep't Tax & Fin. Tech. Servs. Div. Adv. Op., TSB-A-05(1) R (Sept. 27, 2005), 2005 N.Y. Tax LEXIS 231. Scenario 5 discussed in that opinion suggests that any payments in the due diligence period would not constitute taxable rent under NYS RETT. *Id.*
45. NY Tax Law § 1401(f) (McKinney 2014).
46. NY Tax Law § 1405(b)(9) (McKinney 2014).
47. Waldbaum, Inc., N.Y. Dep't Tax & Fin. Tech. Servs. Bur. Adv. Op., TSB-A-99(1) R (Mar. 1, 1999), 1999 N.Y. Tax LEXIS 68.
48. *Id.*
49. *See id.*
50. *Id.*
51. *See* Harter, Secrest & Emery, LLP, N.Y. Dep't Tax & Fin. Tech. Servs. Div. Adv. Op., TSB-A-05(1) R (Sept. 27, 2005), 2005 N.Y. Tax LEXIS 231.
52. *See id.*
53. New York, N.Y., Admin Code § 11-2102 (West, Westlaw through L. 2013, ch. 517 and Local Law 113 of 2013).

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