Finance

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March 28, 2014

Re: Request for Ruling
Real Property Transfer Tax
XXX
FLR: 13-4947

Dear XXX:

This letter responds to your request, received August 19, 2013, for a ruling on behalf of XXX (the "Taxpayer") regarding the application of the New York City Real Property Transfer Tax (the "RPTT") to the proposed conveyance described below. This office received additional information concerning this request on November 14 and December 5 and 10, 2013 and January 16, 2014.

FACTS

The facts presented are as follows:

The Taxpayer owns condominium unit XXX (the "Property"). The Taxpayer is seeking to transfer the Property to her son.

Under federal tax laws in effect before 2011, taxpayers were permitted unified estate and gift tax lifetime credit (the "Unified Credit") of $1 million. As part of a political compromise, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "Act") increased the amount of Unified Credit to $5 million. The Act provided that increased amount of the Unified Credit would expire in two years, ending on December 31, 2012. After December 31, 2012, the estate tax laws were to sunset, or expire, and therefore the gift and estate tax laws that were in effect 10 years earlier were to be automatically reinstated. As a result, there was a concern among those in the estate tax community that the Unified Credit would be reduced from $5 million to $1 million or perhaps even less.[1] This lead to taxpayers seeking to avail themselves of the more favorable laws, which, in turn, caused a shortage of available appraisal services.

Against that background, in 2012, the Taxpayer met with her tax advisor to discuss gifting her son the Property. On XXX, 2012, the Taxpayer set up a trust (the "Trust") with her son as the beneficiary, and contributed XXX to the

[1] It was not until late on December 31.2012 that a compromise was reached in the federal government extending the $5 million Unified Credit.

Trust. Among other provisions, the trust provided that: the Taxpayer, as grantor, retained no powers to change the beneficial disposition of the Trust; the Trust's assets are not owned by the Taxpayer and the Taxpayer retained no rights that would cause the assets to be included in the grantor's gross estate; and the Taxpayer retained the power to acquire or reacquire any assets of the Trust by substituting property of equivalent power (a "Power of Substitution").

The Trust was set up this way to permit the Taxpayer's to make the gift while the Unified Credit remained at $5 million, and to compensate for the inability to obtain a timely appraisal. As explained further below, by including the Power of Substitution in the Trust, the Taxpayer could contribute to the corpus of the Trust in 2012 and take advantage of the $5 million Unified Credit, and, at later time, obtain an appraisal of the Property and substitute the Property for amount of cash equal to the Property's appraised value. Consistent with the structure of the Trust, the Taxpayer reported the XXX contribution to the Trust on a 2012 federal form 709, Gift Tax Return, and has also reported income earned on the Trust's assets on her personal income tax returns.

The Taxpayer now proposes, using the Power of Substitution, to transfer the Property to the Trust and take an amount of cash equal to the value of the Property, XXX, established by an appraisal, from the Trust. You have represented that that is not a taxable event for federal income, estate, or gift tax purposes.

The Property is not encumbered by a mortgage and was not so encumbered at the time the Trust was created or any time since it has been owned by the Taxpayer.

ISSUE

You have requested a ruling that the proposed the transfer of the Property from the Taxpayer to the Trust and the withdrawal of an amount of cash equal to the appraised value of the Property, XXX, from the Trust, would be a transfer without consideration and thus not subject to the RPTT.

CONCLUSION

Based upon the facts presented and the representations submitted, we conclude that the proposed transfer of the Property from the Taxpayer to the Trust and the withdrawal of an amount of cash equal to the appraised value of the Property, XXX, from the Trust, would be a transfer without consideration and thus not subject to the RPTT.

DISCUSSION

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The RPTT applies to each deed conveying an interest in New York City real property when the consideration for the real property interest exceeds $25,000. Section 11-2102(a) of the Administrative Code of the City of New York (the "Code"). The term "consideration" is defined as the price actually paid or required to be paid for real property and includes the amount of any mortgage, lien or other encumbrance, regardless of whether the underlying indebtedness is assumed. Code § 11-2101.9. Section 23-03(j)(1) of title 19 of the Rules of the City of New York ("RCNY") provides as an example of situation where the RPTT does not apply:

> A conveyance of realty without consideration, as defined in § 23-02 "Consideration," and otherwise than in connection with a liquidation. This includes a deed conveying realty as a bona fide gift. A conveyance of realty subject to any indebtedness is not a gift to the extent of the indebtedness.

You have requested we rule that the Taxpayer's transfer of the Property to the Trust would be a gift to her son and not subject to the RPTT. You have represented that the Property is not encumbered by a mortgage and was not so encumbered at the time the Trust was created. At the time of the transfer to the Trust, the Taxpayer will withdraw an amount of cash equal to the appraised value of the Property, XXX, from the Trust. You suggest that the cash the Taxpayer would receive from the Trust would not be consideration, but would be a gift set up as a two-part structure using the Power of Substitution to compensate for the inability to obtain a timely appraisal before an anticipated possible change in federal tax law.

<u>Tax law relating to trusts.</u> As a general matter, under federal, state, and city tax law a trust is a separate entity. It is treated as owning the assets composing its corpus and must file an income tax return with respect to any income derived from its assets. Different considerations, however, may result in a trust being treated differently for different tax purposes.

If a trust meets certain requirements relating to the grantor's ability to exercise dominion and control over the trust, it is treated as a grantor trust under Sections 671 through 679 of the Internal Revenue Code (the "IRC"). In that case, the grantor is treated as owning the assets composing its corpus and must file an income tax return with respect to any income derived from its assets. In certain situations, a trust may be treated as a grantor trust for income tax purposes, even though the corpus is treated as owned by the trust for gift and trust tax purposes. For example, under IRC section 675(4)(C), where the grantor retains a Power of Substitution, the grantor will be treated as owning the trust for income tax purposes, even if it is not treated that way for gift and estate tax purposes. That type of trust is known an Intentionally Defective Grantor Trust ("IDGT") because, like a grantor trust, the income generated by assets held in the trust is taxed to the grantor, while, because it is "defective," the assets are considered the property of the trust for estate and gift tax purposes.

New York tax law follows the federal grantor trust classification. See N.Y. Tax Law §§611(a), 612(a); Instructions to 2012 N.Y. Form IT-205 at 6. New York estate tax law generally follows federal estate tax law in the determination of the taxable estate. New York Tax Law § 954(a). New York imposes no gift tax.

When property is transferred under a Power of Substitution, there are no federal income, estate, or gift tax consequences. See Revenue Ruling 85-13, 1985-1 CB 184 (income tax); Revenue Ruling 2008-22, 2008-1 CB 796 (estate tax); Treas. Reg. § 25.2511-1(g)(1) (gift tax does not apply to transfers for full and adequate consideration). Because New York State and City personal income use federal income as a starting point (N.Y. Tax Law § 612(a); Code § 11-1711(a)), there would also be no consequences under those taxes.

The Trust. You have represented that the Trust is structured as an IDGT. For gift and estate tax purposes, the Taxpayer's has completed her gift and no longer owns the Trust's assets: for gift tax purposes, the assets are considered the property of the Trust because the Taxpayer has retained no powers to change the beneficial disposition of the Trust, Treas. Reg. §25.2511-2(b); and for estate tax purposes, the Trust assets will be excluded from the Taxpayer's gross estate because the assets are not owned by the Taxpayer (see IRC §2033) and the Taxpayer has retained no rights or powers described in IRC Sections 2036, 2037, 2038, and 2042 that would cause the assets to be included in the her gross estate. The Taxpayer has filed a gift tax return reporting the completed transaction for estate and gift tax purposes. For income tax purposes, because the Power of Substitution causes her to be treated as owning the Trust's assets, the Taxpayer has filed personal income tax returns reporting the income derived from the Trust's assets.

Under those circumstances, as explained above, if the Property were to be transferred under the Power of Substitution as proposed, there would be no income, estate, or gift tax consequences.

RPTT consequences. In this case, if the Property had been transferred to the Trust at the time the Trust was established, it would have been considered a gift from the Taxpayer, and with the Property unencumbered by a mortgage, there would have been no consideration and no tax. The substance of the transaction as it has been proposed would be the same; the difference would be a matter of timing as result of the IDGT with a Power of Substitution structure.

While we have found no authority addressing the RPTT consequences of a transfer under a Power of Substitution, the RPTT will often follow the result in other taxes. Here, for estate and gift tax purposes, the Taxpayer's cash contribution to the Trust was considered made in 2012, and the proposed transfer under the Power of Substitution would have no federal, state, or City income, estate, or gift tax consequences. In addition, the result of the transfer as proposed is not substantively different from the result if the Property had been transferred at the time the Trust was set up. It is also apparent from the facts as presented that it has been the Taxpayer's intention, since at least 2012, has been to make a gift of her apartment to her son. A gift was made in 2012, and the Taxpayer filed a 2012 federal form 709, Gift Tax Return, reporting that gift. The delayed structure using the Power of Substitution came to pass as a result of the inability to obtain a timely appraisal before an anticipated change in federal tax law. But for that inability, the Property would have been transferred to the Trust at the time the Trust was set up and it would not have been subject to tax.

As a result, based upon your representations, we conclude that the proposed transfer of the Property would be without consideration and not subject to the RPTT under Code sections 11-2102(a) and 11-2101.9 and 19 RCNY section 23-03(j)(1). It should be noted that this result applies only to the facts in this ruling and does not suggest that the result would be the same under any transfer made pursuant to a Power of Substitution in a trust.

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This opinion is based on the facts as presented. The Department of Finance reserves the right to modify its opinion in the event that the facts upon which this opinion is based are other than as described above.

Very truly yours,

Dara Jaffee
Acting General Counsel
Office of Legal Affairs

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