NEW YORK CITY TAX APPEALS TRIBUNAL
ADMINISTRATIVE LAW JUDGE DIVISION

In the Matter of the Petition	:	**DETERMINATION**
of	:	**TAT(H)14-26(RP)**
VCP One Park REIT, LLC, VCP One Park Parallel REIT LLC, and One Park Avenue Mezz Partners LLC	:	

Bunning, A.L.J.:

The three Petitioners filed a petition for redetermination of a deficiency (Petition) of New York City (City) Real Property Transfer Tax (RPTT) with respect to transfers that occurred on or about March 1, 2011 under Title 11, Chapter 21, of the Administrative Code of the City of New York (Administrative Code) asserted in three Notices of Determination issued by Respondent City Department of Finance on July 18, 2014.

On September 1, 2015, the parties, having agreed pursuant to § 1-09(f) of the City Tax Appeals Tribunal (Tribunal) Rules of Practice and Procedure (20 RCNY) to have this case determined on submission without hearing, submitted a stipulation of facts, including exhibits (Stipulation). Petitioners and Respondent filed briefs, the last of which was filed on December 9, 2016. A telephone conference was held on December 19, 2016, and the parties submitted a second stipulation incorporating the language of 20 RCNY § 1-09(f), and additional exhibits, on January 6, 2017.

Joseph Lipari, Esq., Lary S. Wolf, Esq., and Libin Zhang, Esq. of Roberts & Holland LLP represented Petitioners, and Andrew G. Lipkin, Esq., Assistant Corporation Counsel of the City Law Department, represented Respondent.[1]

ISSUES

The ultimate issue is whether the transfers at issue qualify as REIT transfers within the meaning of Administrative Code § 11-2012.e (3). There are three sub-issues:

1. May estimated market value (EMV) be used to determine consideration in a REIT transfer of a controlling interest in an entity owning real estate?

2. Should EMV be used where the results of the 40% test of Administrative Code § 11-2102.e (2) (C) are $0 or less because the liens on the property are greater than the EMV?

3. Should the Grantees' payment of RPTT be included in determining consideration for a REIT transfer?

FINDINGS OF FACT

Petitioner One Park Avenue Mezz Partners LLC (Grantor) was the grantor of 100% of the membership interests in One Park Avenue Senior Mezz LLC (Senior Mezz LLC). The grantees were Petitioners VCP One Park REIT LLC (D-REIT) and VCP One Park

[1] Frances Henn, Esq., represented Respondent until she submitted a letter dated April 18, 2016 stating that the case would be reassigned to Mr. Lipkin.

Parallel REIT LLC (F-REIT)(collectively Grantees).[2] The Grantees are both Delaware limited liability companies formed on February 28, 2011. Each elected to be taxed as a real estate investment trust (REIT) pursuant to Internal Revenue Code section 856.[3] D-REIT was funded with contributions of approximately $71.8 million of cash and F-REIT was funded with contributions of cash of approximately $73.8 million.

Before the transactions at issue, Grantor was owned 80% by BA One Park Avenue LLC and 20% by MH One Park Member LLC. Grantor owned 100% of Senior Mezz LLC, which owned 100% of One Park Avenue Partners, LLC, which owned a fee interest in the commercial real property located at One Park Avenue in the City (Borough of Manhattan, Block 888, Lot 1)(the Property).

On February 28, 2007, Grantor borrowed $32.6 million from Bank of America (the Junior Mezz Loan). On the same date, Senior Mezz LLC borrowed $75.45 million from Bank of America, Citicorp North America, Inc. and RXR 1 Park Mezz Investor LLC (the Senior Mezz Loan).

One Park Avenue Partners LLC was the borrower on a mortgage loan dated as of February 28, 2007, from Bank of America, of $375 million, secured by the Property.

On or about March 1, 2011, Grantor transferred 49% of the membership interest in Senior Mezz LLC to D-REIT, and the remaining 51% to F-REIT. Grantor received $2,250,000 in cash

---

[2] The D-REIT and F-REIT terminology is used by Petitioners and will be used in this determination for ease of reference.

[3] Internal Revenue Administrative Code § 856 is incorporated by reference into Administrative Code § 11-2102(e), which provides special rules and a lower tax rate for qualifying transfers to REITs.

($1,110,245 from D-REIT and $1,139,755 from F-REIT), $2,250,000 in REIT Preferred Membership Units (worth $1,110,245 from D-REIT and worth $1,139,755 from F-REIT), and $1,125,000 in REIT Profits Units ($555,123 from D-REIT and $569,877 from F-REIT), for a total of $5.625 million, from the two Grantees.

The Grantees' operating agreements establish four types of ownership interests: Series A and B shares, Preferred Membership Units, and a Profits Unit. The Grantor acquired the Preferred Membership Units and the Profits Units. Additional capital contributions, if any, were to be made by holders of Series A shares. The Preferred Membership Units entitled the bearer to a 7% return, which was to be paid from available cash until August 31, 2013 (two and one-half years after the transaction) and thereafter without restriction. Any additional available cash was to be paid to holders of Series A and B shares up to a 13% internal rate of return, and then 10% to the Profits Unit and 90% to Series A and B holders. Any proceeds from the sale of assets or refinancing was to be distributed in the same fashion until August 31, 2013, and thereafter to the holder of the Preferred Membership Units until the 7% return was achieved and the par value amount was returned to the holder. On August 31, 2013, the Grantees were to pay the full amount of all accrued and unpaid preferred return. The holder of the Preferred Membership Units was to be redeemed once the preferred return and the par amount of the interest were received.

Immediately after the transfers to the Grantees, MH One Park Member LLC (the 20% owner of the Grantor) contributed $6 million of cash and assets to Senior Mezz LLC in exchange for a 5% interest. Senior Mezz LLC was thereafter owned 47% and 48% by the two grantees, and 5% by MH One Park Member LLC.

After the transaction, Senior Mezz LLC continued to own 100% of the interests in One Park Avenue Partners LLC, which continued to own 100% of the Property.[4]

The two REIT Petitioners used $104.92 million of the cash, and $250 million from a new mortgage loan from Morgan Stanley, to repay the $375 million mortgage loan owed to Bank of America. They paid $2.4 million as a guaranty or reserve for the new mortgage loan. They paid $850,000 to Bank of America to discharge the Junior Mezz Loan. They paid $15.13 million to Bank of America to discharge the Senior Mezz Loan.

Respondent's real property tax assessment for the Property, dated as of January 15, 2011, showed an EMV of $240,568,000.

Petitioners timely filed the RPTT return with Respondent,[5] claiming the transaction met the requirements of a REIT transfer. They computed tax due of $2,999,582.25, based on an exemption for mere change of form without a change in beneficial ownership of 5%, and using the RPTT tax rate for REIT transfers of 1.3125% of the remaining 95% of $240,568,000.

---

[4] One Park Avenue Partners LLC subsequently contributed the Property to a new wholly-owned limited liability company in a transaction exempt from RPTT as a mere change in form without a change in beneficial ownership.

[5] The parties stipulated to the RPTT return, attached as Exhibit B to the Stipulation. The parties also submitted Respondent's audit file as Exhibit V to the Stipulation. This contains a copy of the same RPTT return (pp. 14-24), and a copy of another return with a different REIT worksheet (pp. 6-13). The REIT worksheet said to have been filed lists total consideration of $5,625,000; the other lists it as $240,568,000. The differences in the returns were not explained and the parties' stipulation that the RPTT return marked as Exhibit B was filed will govern.

Schedule 1 of the RPTT return, which reports "Details of Consideration," reported $240,568,000 on line 10 ("Other [describe]") with the notation "Real estate investment trust transfer - see rider"), and reports the same number on line 11 ("total consideration"); every other line reported "0.00."

On the "Worksheet for Conditions 1(a) and 1(b)," (REIT worksheet) Petitioners reported $5,625,000 on line 1[6] (which is to be the sum of lines 1, 2, 7, 8, 9, and 10 from schedule 1, which reported all consideration received for the transfers). It reported $3,375,000.00 on lines 2.e and 2.g as the value of REIT shares received, and reported $2,250,000 on line 3, which is line 1 multiplied by 40%. Line 2.d was marked "N/A" and every other line was filled in with a "0."

Respondent conducted an examination of the RPTT return. On September 25, 2013, Petitioners submitted a revised "Schedule 1 - Details of Consideration" on which it reported cash of $2,250,000 at line 1, the $375,000,000 mortgage at line 3, $15,977,000 as the value of other liens on property at line 6, $3,375,000 as the value of shares of stock or partnership interest received at line 7, and total consideration of $240,568,000 on line 11, explaining that line 11 was EMV.[7] It computed net equity in the worksheet

---

[6] $5,625,000 is the total consideration received of the $2,250,000 in cash, $2,250,000 in Preferred Membership Units, and $1,125,000 in Profit Units.

[7] Line 11 is to be the total of lines 1, 2, 7, 8, 9, and 10, and in this case would be $5,625,000. The Schedule 1 ("Details of Consideration") on the RPTT returns listed $240,568,000 on line 10 ("Other") and left the other lines blank.

for conditions 1(a) and 1(b) (the sum of lines 1,2,7,8,9, and 10) as $5,625,000.

Respondent determined that the transaction did not qualify as a REIT transfer. It computed tax due using the commercial tax rate of 2.625%. Respondent requested an appraisal of the Property and did not receive one. It computed taxable consideration of $525,349,603.14, based on the sale of the Property on March 1, 2007 for $550 million plus RPTT paid by the Grantees of $2,999,582, less 5% exemption for a mere change in form without a change in beneficial ownership, resulting in tax at 2.625% of $13,790,427.08.[8]

Respondent computed the 40% test by using Petitioners' value for consideration, $5,625,000, and adding the RPTT paid by the Grantees of $2,999,582 for a total of $8,624,582. It compared this with the value of REIT shares received ($3,375,000), resulting in a ratio of 39.13%, so that the 40% test was not met.

After crediting Petitioners' payment of $2,999,582.25, it determined that additional tax of $10,790,844.83 was due, together with interest of $3,143,116.06 computed to August 15, 2014, for a total of $13,933,960.89. On July 18, 2014, Respondent issued three Notices of Determination for this amount, one to each of the Petitioners. They state that "The lower tax rates for the REIT Transfers is being denied since there was not full compliance with all of the requirements as reflected in the Code Section 11-2103-e."

[8] The Notices of Determination acknowledge that a 5% mere change in form exemption applied; therefore, the taxable consideration used was computed "for the 95% interest conveyed."

The Petition protesting the three Notices of Determination was received on October 14, 2014. Respondent filed its Answer on December 15, 2014.

POSITIONS OF THE PARTIES

Petitioners contend that all requirements for a REIT transfer have been met and that the tax should be based on the EMV rather than the actual fair market value or the consideration received.

Respondent contends that the transfers do not qualify as REIT transfers because the 40% test was not met. The 40% test does not apply to transfers of economic interests in real property. Even if it does, using the EMV leads to an absurd result here because it is less than the amount of liens on the Property, so the equity in the Property is $0. Even if EMV were permitted to be used here, the Grantees' payment of the RPTT requires that the amount of RPTT paid be added to the EMV, which causes the Grantor's interest to be less than 40% of the consideration.

CONCLUSIONS OF LAW

1. Overview of the RPTT

Administrative Code § 11-2102 (b) imposes RPTT on the transfer of an economic interest in real property located in the City, where the consideration exceeds $25,000. "Transfer" is defined to include the transfer of an interest in an entity owning real property when it is a "controlling interest,"

meaning, in the case of an entity taxed as a partnership, that there was a transfer of 50% or more of the capital, profits, or beneficial interest. Administrative Code §§ 11-2101.7 and 11-2101.8. Accordingly, these transfers of economic interests were subject to RPTT.

Administrative Code § 11-2102.a (9)(ii) imposes RPTT at a rate of 2.625% where the consideration is greater than $500,000, and the property conveyed is something other than a one-, two-, or three-family house or an individual residential condominium.

"Consideration" is defined in Administrative Code § 11-2101.9 as:

> "[t]he price actually paid or required to be paid for the real property or economic interest therein, without deduction for mortgages, liens and encumbrances, whether or not expressed in the deed or the instrument and whether paid or required to be paid by money, property, or any other thing of value. It shall include the cancellation or discharge of an indebtedness or obligation. It shall also include the amount of any mortgage, lien or other encumbrance, whether or not the underlying indebtedness is assumed."

The Real Property Transfer Tax Rules of the City of New York (RPTT Rules; 19 RCNY) provide at § 23-02 that where the grantee agrees to pay RPTT due on a conveyance, the assumed obligation is included in computing the RPTT.[9] In such case, the amount of the RPTT is added to consideration and the RPTT is re-computed on this amount.

---

[9] RPTT is deemed to be the grantor's obligation, so the grantee's payment is viewed as additional consideration paid to the grantor.

The RPTT statute and rules contain special provisions for qualified REIT transfers. They reduce RPTT in two ways. First, RPTT is imposed at 50% of the otherwise applicable tax rate. Second, consideration, which is the base for computing RPTT, is the EMV shown in the Department's most recent real property tax assessment rather than the actual consideration paid (Administrative Code 11-2102.e[3]). This section provides:

> "For purposes of determining the consideration for a real estate investment transfer taxable under this subdivision e the value of the real property or interest therein shall be equal to the estimated market value as determined by the commissioner of finance for real property tax purposes as reflected on the most recent notice of assessment issued by such commissioner, or such other value as the taxpayer may establish to the satisfaction of such commissioner."

This case illustrates the benefits of these provisions. Petitioners contend that the tax base is 95% of $240,568,000 and the tax rate is 1.3125%. Respondent contends that the tax base is $525,349,603.14 and the tax rate is 2.625%. The difference between these positions is $10,790,844.83, plus interest.

A qualified REIT transfer must meet certain requirements. The one at issue here is the "40% test," which requires that the "value of the ownership interests in the REIT . . . received by the grantor as consideration for such conveyance or transfer must be equal to an amount not less than forty percent of the equity interests in the real property or economic interest therein conveyed or transferred by the grantor to the grantee . . . ." Administrative Code § 11-2102.e (2). The value of the equity interest "is to be computed by subtracting from the consideration for the conveyance or transfer of the real property or economic interest therein the unpaid balance of any loans or other

encumbrances that are liens on the real property or economic interest therein . . . ."[10] *Id.* The grantor must retain the equity interest for two years.

2. The EMV Provision of Administrative Code § 11-2103.e(3)

Respondent contends that in using EMV, Petitioners used an incorrect measure of consideration for purposes of the 40% test. Respondent first argues that EMV may not be used in valuing the transfer of a controlling interest, but applies only to the transfer of real property or an interest in real property. Respondent points to the language of Administrative Code § 11-2101.e (3), and to the legislative history which provides that EMV is to be used to value real property and makes no mention of economic interests in real property. Respondent argues that the general rule of Administrative Code § 11-2101.9 therefore prevails and the consideration is the "price actually paid or required to be paid for the real property or economic interest therein, without deduction for mortgages, liens and encumbrances . . . ."

When construing a statute, courts are to discern and give effect to the Legislature's intent. The starting point is the statute's language. The statute must be construed as a whole and its various sections must be considered together with reference to one another (*Matter of Shannon*, 25 NY3d 345, 351 [2015]). Courts are to "give the statute a sensible and practical over-all construction, which is consistent with and furthers its scheme and purpose and harmonizes all its interlocking provisions" (*Matter of Long v Adirondack Park Agency*, 76 NY2d 416, 420

[10] There is an exception for liens or encumbrances created in contemplation of the transaction but this is not relevant here.

[1990]). A statutory exception "should be the product of Legislative action, not administrative or judicial construction (McKinneys Cons Laws of NY, Book 1, Statutes § 114);" (*Buffalo Columbus Hosp. v Axelrod*, 165 AD2d 605, 608 [4th Dept 1991]).

Respondent is correct that, in every other instance in Administrative Code § 11-2102.e, reference is made to "real property or economic interest therein," but in subsection (3), the reference is to the value of the "real property or interest therein." However, this does not create an exception from the EMV valuation rule for REIT transfers of economic interests.

Instead, § 11-2102.e (3) provides an exception for all REIT transfers from the normal rule for calculating consideration. Without § 11-2102.e (3), consideration is the price paid for the real property, interest in real property, or economic interest in property Administrative Code § 11-2101.9. In the case of a transfer of an economic interest in real property where the entity owns something other than real property located in the City, Administrative Code § 11-2102.d provides:

> " . . . the consideration subject to tax shall be deemed equal to the fair market value of the real property or interest therein apportioned based on the percentage of the ownership interest in the entity transferred."

Administrative Code § 11-2102.e (3) does not refer to "an economic interest" because valuation of an economic interest is determined either by the price paid or the fair market value of the real property within the entity (Administrative Code § 11-2102.d). Therefore the section addresses the value of property

or an interest in property, because this is how the value of the interest in the entity is determined.[11]

Further, as Petitioners point out, the REIT section contains numerous provisions indicating that transfers of economic interests are intended to fall within its scope. Administrative Code § 11-2102.e (2) defines a REIT transfer, in part, to mean "any deed or other instrument or transaction conveying or transferring real property or an economic interest therein . . . " to a REIT or corporation or partnership in which a REIT owns a controlling interest. Administrative Code § 11-2102.e (2) (C) phrases the 40% test in terms of "the value of the equity interest in the real property or economic interest therein conveyed or transferred by the grantor . . . " and contains other references to economic interests. Plainly, the Legislature intended to include transfers of economic interests within the REIT provisions.

Because the statute is not ambiguous, there is no reason to resort to legislative history, (*Shannon; Roberts v Tishman Speyer Props.*, L.P., 13 NY3d 270, 286 [2009]). However, there is nothing in the legislative history that supports Respondent's argument. Respondent relies on the June 9, 1994 letter of New York State Taxation and Finance Commissioner James W. Wetzler to the Governor (Wetzler Letter). The single sentence on point, at page 46, states, "For purposes of the New York City transfer tax, the value of the real property will be equal to the estimated market value determined for real property tax purposes, i.e., the

---

[11] RPTT Rule § 23-02 (3) provides an analysis and examples for computing consideration in the case of transfers of interests in entities that own real property. Because RPTT taxes only real property, the value of the economic interest for RPTT purposes is determined by the value of the real property it owns.

assessed value." For the reasons explained above, EMV is to be used to value the underlying real property, which is needed to determine the value of any transfer subject to RPTT, including transfers of economic interests. It does not evidence an intent to exclude transfers of economic interests from the EMV valuation rule.

Finally on this point, Respondent argues that to allow Petitioners to use EMV as consideration would "give Petitioners an undeserved double benefit - half the tax rate which would then be applied to the deemed consideration, which is less than half the consideration estimated by the auditor" (Resp. Br. at 11). This, however, is clearly what the Legislature intended in enacting § 11-2102.e (3).

3. The 40% Test

Respondent's second argument is that even if Petitioners could use the EMV measure for consideration, they do not meet the 40% test here, because the $375 million mortgage on the underlying real property is greater than EMV, leaving a negative equity, making the 40% test meaningless.

Petitioners argue that Administrative Code § 11-2102.e (3) defines consideration both for purposes of the 40% test and for the tax base upon which RPTT is paid. In this case, the debt is greater than the EMV of the property, so the equity is less than $0; Petitioners contend that the 40% test was nevertheless met, because the value of the ownership interests was not less than 40% of $0.

As noted, § 11-2102.e (3) defines "consideration for a real estate investment trust transfer taxable under this subdivision e . . . ." Consideration is relevant in two instances: applying the 40% test and determining what the tax base is, i.e., on what amount RPTT is paid. Section 2102.e (3) provides a definition of consideration to be used throughout the subdivision. If the application of the test results in no equity in the property, and the Petitioners have retained some interest, then by definition that interest is at least 40% of the equity, which is zero. Thus, the test is technically met, but the results are not particularly meaningful. But this is because EMV was selected as the measure of consideration. Because the EMV of a property is usually less than its fair market value, and sometimes significantly so, the situation here is neither unforeseen nor even unusual.[12]

Respondent correctly points out that the purpose of the 40% test is to "to ensure that the grantor maintains some continuity of ownership in the property after the transfer or conveyance and is not transferring the property to the REIT in order to 'cash out' the property" (Wetzler Letter, p. 45). But the statute is to be interpreted based on its words. "[V]ague notions of a statute's 'basic purpose' are ... inadequate to overcome the words of its text regarding the *specific* issue under consideration" *(Montinile v Bd of Trustees of the National Elevator Industry Health Plan*, - US - 136 S Ct 651, 661 [2016] quoting *Mertens v Hewitt Associates*, 508 U.S. 248, 261 [1993]

---

[12] Indeed, a review of Respondent's real property tax records on its website shows that in 2007, when the Property sold for $550,000,000, Respondent determined an EMV for real property tax purposes of $187,000,000 as of its tax status date of January 5, 2007, on its Final Assessment Role dated May 25, 2007. There is some irony in Respondent's criticism of the results of a test that uses EMV as a proxy for value, when it is Respondent that annually determines the EMV of real property.

[emphasis in original] [noting that statutory text was "certainly not nonsensical"]). A court's role is limited to interpreting and applying statutes even where doing so may "lead to a harsh outcome" or "will supposedly undercut a basic objective of the statute" (*Baker Botts, LLP v Asarco LLC*, 576 US ____, 135 S Ct 2158, 2169 [2015]) (*see also*, Sotomayor, J., concurring in the judgement, "Given the clarity of the statutory language, it would be improper to allow policy considerations to undermine the American Rule in this case"). "If the wording of the statute has caused an unintended consequence, it is up to the legislature to correct it" (*People v Golo*, 26 NY3d 358 [2015]).

In reply, Respondent cites several cases for the proposition that statutes must not be construed so as to produce results that are absurd or that would frustrate the statutory purpose. Only one of these, *Matter of Long v Adirondack Park Agency*, is helpful here.[13] There, the statute gave the Adirondack Park Agency (APA) 30 days from the date a local zoning board granted a variance to reverse that decision, during which time the local zoning board's decision was suspended. Although the local zoning board was to provide the APA with timely notice of the application and a copy of it, together with the materials considered by the local board,

---

[13] *Matter of Schmidt v Roberts*, 74 NY2d 513 (1976) strictly interpreted New York's double jeopardy statute to hold that "another state" does not include the United States. *Matter of State of New York [Abrams] v Ford Motor Co.*, 74 NY2d 495 (1989) holds that where the statute is clear and unambiguous, the court should construe it so as to give effect to the plain meaning of the words used. *Doctors Council v New York City Employees' Retirement Sys.*, 71 NY2d 669 (1988) held that the statute clearly entitled part-time employees to membership in New York City Employees Retirement System). *New York Bankers Assn. v Albright*, 38 NY2d 430 (1975) held that even where a statute is unambiguous, its legislative history and context should be examined. (This approach is not found in more recent cases; for example, it was relied on by the Appellate Division's opinion in *Doctors Council*, which was reversed by the Court of Appeals, which noted, "The reasoning of *New York Bankers Assn.* . . . is inapplicable to the unqualified statutory definition in this case" 71 NY2d at 675.)

the statute did not explicitly tie the 30-day period to receipt by the APA of all of these items. Instead, it required the APA to act within 30 days of the local zoning board's grant of the variance. The Court interpreted the 30-day period to commence "no later than the receipt by the APA of notice of a variance grant, along with necessary materials promptly and reasonably requested by the APA which are pertinent to a meaningful review," (76 NY2d at 423). On those facts, starting the running of the 30-day period only when the local zoning board had complied with its statutory obligations under the APA was consistent with the language and apparent goal of the statute.

It is unclear how the principles of *Long* can be applied to this case. Here, the Legislature carved out an exception to the definition of consideration for REIT transfers. It rejected fair market value in favor of the artificial metric of EMV. The Legislature must be presumed to be aware of that fact that EMV is usually less than fair market value, and often greatly so (*see., e.g., In re Northwest Airlines Corp.*, 483 F3d 160, 169 [2d Cir. 2007] ["We also assume that Congress passed each subsequent law with full knowledge of the existing legal landscape"]). It adopted the measure of EMV to reduce RPTT and thereby encourage transfers to REITs.[14] The 40% test requires that the actual amount of debt be subtracted from this artificially low consideration value, skewing the 40% test in the taxpayer's favor, by reducing the minimum test for equity below what it would be if fair market value were used. Where an artificial value meets the real world, the results cannot be expected to

[14] "The purpose of sections 300 through 310 of the bill is to encourage the formation of real estate investment trusts (REITs) in New York State and New York City by reducing the tax liability that would accrue on real estate transactions that occur in connection with the initial formation of a REIT" (Wetzler Letter, p. 44).

make perfect sense. But that is clearly the test that the Legislature enacted. It is beyond the authority of this Tribunal to re-write the statute or substitute a different test.

Respondent argues that the Grantor "received REIT shares which were significantly different from the common equity that the other owners retained" (Resp Br at p. 13). In exchange for the economic interests in the real estate, the Grantor received cash, Preferred Membership Units, and the Profits Units. These preferred units entitled the grantor to a 7% return from available cash and refinancing or sales proceeds until August 31, 2013, thereafter to be paid unconditionally. After August 31, 2013, the 7% return was not limited to these sources and the par value could be repaid. The Series A and B investors enjoyed a 13% return, but only from available cash. The Grantor also had 10% residual profits interest which was paid after 13% return to the other Series A and B investors. Respondent argues that the 7% preferred return "resembles debt more than an equity interest" and argues that the 10% profits interest "is speculative because the property has to generate enough revenues to first satisfy the other investors' 13% IRR " (Resp Br at p. 13).

Rather than develop this argument further, however, Respondent uses it to make another one, which is that the RPTT return filed here "confirms the difficulty in applying the relevant REIT tests under the facts of the present transaction" and concludes that "[t]herefore, as explained below, the RPTT the grantees paid should have been included on line 1, and also caused the Transfer to fail the 40% test" (Resp Br at p. 14).

The difficulty in completing the worksheet does not result from the application of the 40% test, but rather because Schedule

R of the RPTT return does not appear to contemplate use of EMV instead of fair market value in REIT transactions. Line 1 of the worksheet is the summary of the consideration from Schedule 1, where consideration for the transaction is listed. Schedule 1 does not contain a line for use of EMV; instead, it lists the various components of consideration that would be examined in a non-REIT case such as cash, mortgage, etc. If EMV is used, the data must be force-fit into Schedules 1 and R, as occurred here.

Courts have wrestled with the distinction between debt and equity in countless opinions and contexts. Various tests have been used, including multi-factor tests found in *Estate of Mixon, 464 F.2d 394 (5th Cir., 1972)* and other cases. Respondent does not cite authority for its position. Petitioners argue that the Grantor's interests have the indicia of equity. Even if the preferred interests were disregarded, the 10% profits interest is indisputably equity. Therefore, the 40% test is met and the Tribunal has no authority on these facts to disregard the results. Respondent's remedy appears to rest with the Legislature.

4. Consequences of Grantee's Payment of the RPTT

The Grantees paid the RPTT. Respondent argues that the consideration ($5,625,000 - the cash and REIT interests which the Grantor received) should be increased by the tax the grantee paid ($2,999,582), for a total of $8,626,582. 40% of this is $3,449,823.80, which is greater than the retained ownership interests of $3,375,000, so it is argued that the 40% test is not met.

The issue is whether consideration in a REIT transfer is limited to the EMV of the underlying property, or is a component to which other amounts are to be added.

In the ordinary (non-REIT transfer) case, consideration is defined by Administrative Code § 11-2101.9 to include "the price paid or required to be paid for the real property or economic interest therein . . . . . It shall include the cancellation or discharge of an indebtedness or obligation." RPTT is imposed in the first instance on the grantor. Therefore, the grantee's payment of it is viewed as a discharge of the grantor's obligation and additional consideration. As Respondent notes, RPTT Rules § 23-02(2) provides the general rule that, "Where a grantee agrees to pay the City and State transfer taxes due on a conveyance, as part of the consideration for the conveyance, the obligations so assumed are included in computing the tax . . . ." These provisions are designed to determine the fair market value of the property or property interest, by aggregating each component of the consideration paid for the transfer.

However, in the case of a REIT transfer, the special rule of Administrative Code § 11-2102.e (3) applies, defining consideration as the EMV of the underlying property. Unlike the definition of consideration in non-REIT cases, the language of that provision does not suggest that EMV is a component of consideration to which other amounts may be added to determine fair market value. Instead, it states that, "the value of the real property or interest therein shall be equal to the estimated market value . . . ."

This language is unequivocal. Consideration is the EMV of the property or interest in property (unless the taxpayer establishes a different, presumably lower, value). There is no

basis to add anything else to it, because the statute mentions only EMV, and because it does not attempt to compute fair market value, as it does in non-REIT transfers. This is further demonstrated by the legislative history: "For purposes of the New York City transfer tax, the value of the real property will be equal to the estimated market value for real property tax purposes, i.e., the assessed value" (Wetzler Letter, p. 46.)

Respondent's argument is premised in part on an analysis of the RPTT return, NYC-RPT, but review of this document supports Petitioners' position. The worksheet to determine whether the 40% test is met begins with the sum of all consideration paid with the transfer, which includes on line 9 of Schedule 1 "Amount of Real Property Transfer Tax and/or other taxes or expenses of the grantor which are paid by the grantee." This amount would be included in taxable consideration in the a non-REIT transfer.

But the instructions for line 1 of the worksheet (which determines consideration in a REIT transfer) state, "Where the value of the underlying property transferred or interest therein is used in determining the consideration for a REIT Transfer, you may, but are not required to, report as the value of the real property or interest therein . . . the estimated market value as determined by the Department of Finance as reflected on the most recent Notice of Assessment issued by the Department." Thus, in the case of REIT transfers, Respondent's instructions state that EMV is the only measure of consideration, rather than merely one component of it.

Respondent's reliance on *Matter of Zeckendorf Columbus Co.*, DTA No. 812021, TSB-D-97(6)R (1997) is misplaced. That case,

involving the State gains tax and real estate transfer tax, does not involve a transfer to a REIT.

ACCORDINGLY, IT IS CONCLUDED THAT Petitioners paid the correct amount of RPTT. The Petition is therefore granted and the Notices of Determination are cancelled.

DATED: January 24, 2017
New York, New York

/s/
David Bunning
Administrative Law Judge