STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
LOREN CROSSROADS ASSOCIATES	:	DETERMINATION
for Revision of a Determination or for Refund of Tax on Gains Derived from Certain Real Property Transfers under Article 31-B of the Tax Law.	:	

Petitioner, Loren Crossroads Associates, 237 Mamaroneck Avenue, White Plains, New York 10605, filed a petition for revision of a determination or for refund of tax on gains derived from certain real property transfers under Article 31-B of the Tax Law (File No. 806641).

A hearing was held before Thomas C. Sacca, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on May 3, 1990 at 1:15 P.M., with all briefs submitted by June 15, 1990. Petitioner appeared by Alfred H. Mattikow, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Paul A. Lefebvre, Esq., of counsel).

ISSUE

Whether the consideration required to be paid to petitioner on its transfer of certain real property should be reduced by the amount of rent paid by petitioner to the purchaser in a concurrently executed lease agreement.

FINDINGS OF FACT

Petitioner, Loren Crossroads Associates ("Loren"), is a partnership consisting of three individuals. The partnership owned amulti-tenanted office building at 33 West Main Street, Elmsford, New York. The building was purchased by the partnership in April 1983.

On or about December 6, 1985, petitioner entered into a contract of sale whereby petitioner agreed to sell to Piccadilly Hotel Company the building located in Elmsford, New York. The selling price for the property was $7,250,000.00. The contract of sale contained a

provision which provided that simultaneously with the closing of title, and as a condition precedent to the purchaser's obligations under the contract of sale, petitioner was to enter into a lease with the purchaser. The contract provided that petitioner, as lessee, was to enter into a lease to rent from the purchaser, as lessor, 19,554 rentable square feet of unrented space in the building as of the date of the contract of sale. The lease was referred to as the "Master Lease-Back". Petitioner transferred the property to the seller on December 27, 1985.

On December 27, 1985, petitioner, as lessee, and the Piccadilly Hotel Company, as lessor, entered into an agreement of lease for a two-year period commencing on the 27th day of December, 1985 and ending on the 26th day of December, 1987. The agreement provided that petitioner would lease 19,554 square feet of vacant space in the building located at 33 West Main Street for an annual rental rate of $351,972.00, to be paid in monthly installments of $29,331.00. In addition, petitioner was obligated to pay an additional $2.00 per square foot of rental space to cover the cost of electricity consumed in the demised premises. Under the lease, petitioner had the right to use and occupy the rented space as general business offices.

The lease agreement provided petitioner with the right to find other tenants to lease the vacant rental space. If an appropriate tenant was found, the landlord, Piccadilly Hotel Company, was required to execute a substitute lease with the new tenants. Petitioner was responsible for the costs of any alterations to the rental space required by the substitute lease. The substitute lease with the new tenants relieved petitioner of all remaining payments relating to the space covered by such lease. Rental payments made by the new tenants were paid directly to the landlord. During the two-year period of the lease, neither petitioner nor the individual partners occupied the rented space.

On the closing date of the sale of the building, $900,000.00 of the selling price was placed into an escrow account. As to the amount escrowed, $700,000.00 was for rental payments and $200,000.00 was for electricity payments required to be made under the lease agreement. In order to release funds from this account, authorized signatures of both petitioner and Piccadilly Hotel Company were required. During 1986 and 1987, actual expenditures paid

out of the escrow account were as follows:

	1986	1987	Total
Rent		$314,871	$190,314	$505,185
Utilities		34,867	17,890	52,757
Tenants Improvements	--	19,229	19,229	
Advertising		5,723	--	5,723	
Insurance		1,938	--	1,938	
Repairs		24,256	--	24,256	
Totals		~~$381,655~~	~~$227,433~~	~~$609,088~~

The full amount of the escrow account was not used during the rental period as petitioner was able to rent portions of the demised premises to new tenants. At the conclusion of the rental period, the balance remaining in the escrow account was given to petitioner.

For the tax year 1985, the Federal and State income tax returns of the petitioner and the partners showed a selling price for the property at issue of $7,250,000.00. The amount escrowed was treated on the books and records as an amount due petitioner from the purchaser of the property. During the tax years 1986 and 1987, the payments made from the escrow account were treated as expenses on the Federal and State income tax returns of the partnership and the individual partners. The accountant for petitioner testified that the returns were filed in such a manner because the selling price of $7,250,000.00 was ascertainable when the 1985 returns were completed, but the expenses under the lease were unknown at such time. The accountant further testified that had the purchase price been reduced in 1986 and 1987 to reflect the expenses paid out of the escrow account, amended returns for the year 1985 would have had to have been filed in 1986 and 1987 to reflect the lower purchase price and reduced capital gains for the partnership and each individual partner. According to the accountant, it is not proper to continuously amend returns to give effect to subsequent events.

On December 23, 1985, the Division of Taxation ("Division") issued to petitioner a Real Property Transfer Gains Tax Tentative Assessment and Return showing the gain subject to tax of $2,699,449.94 and total tax due of $269,945.00. Petitioner paid the total tax due on the date of transfer. On or about December 1, 1987, petitioner filed with the Division a claim for refund of real property transfer gains tax requesting a refund of $60,903.81. The claim for refund was

based on the premise that the amount of $609,088.00 expended by petitioner pursuant to the lease agreement reduced the $7,250,000.00 selling price to $6,640,912.00, the amount of gain to $2,090,036.94 and the amount of total tax due to $209,041.19. As a result of the reduction of the selling price, petitioner claimed a refund in the amount of $60,903.81. On February 29, 1988, the Division denied petitioner's claim for refund, stating that a leaseback is not considered a reduction to the consideration received.

SUMMARY OF THE PARTIES' POSITIONS

Petitioner contends that the purchase price shown in the contract of sale was, in effect, a conditional purchase price. The final purchase price was determined only at the conclusion of the two-year lease agreement, when the total amount paid under the lease could be computed. The "price required to be paid" pursuant to the contract of sale was the listed selling price of $7,250,000.00 less the amount of $609,088.00 paid under the lease agreement. Since petitioner never occupied the vacant space as a tenant, the rent payments made by petitioner pursuant to the lease should be considered an expense of selling the property. Therefore, petitioner argues, it is entitled to a refund of the gains tax paid on the $609,088.00 of expenses.

It is the position of the Division that there are two transactions involved in this matter: the sale of the real property and the leasing back of a portion of such property. Therefore, the Division argues, the amounts paid under the leaseback should not be used to reduce the consideration received for the sale of the real property. The Division further contends that as petitioner treated the transactions as a sale and leaseback for income tax purposes, they should be treated the same way for real property transfer gains tax purposes.

CONCLUSIONS OF LAW

A. Tax Law § 1441 imposes a tax, at the rate of 10%, on the gain derived from the transfer of real property within New York State. The gain on a transfer is the difference between the consideration and the original price of the property (Tax Law § 1440.3). Consideration, for purposes of calculating the taxable gain, is defined at Tax Law § 1440.1 as the price paid or required to be paid for real property or any interest therein. At issue here is

whether the amount "required to be paid" by the purchaser for the real property should take into account the payments made by petitioner under the lease agreement.

B. The transfer of real property includes the transfer or transfers of any interest in real property by any method, including a transfer by sale. A transfer of an interest in real property also includes the creation of a leasehold or sublease 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 (Tax Law § 1440.7).

Thus, in a sale-leaseback transaction, the gains tax is imposed on the initial transfer (sale) from the grantor-lessee to the grantee-lessor as well as on the leaseback if the three conditions precedent to the taxability of leases and subleases are present (20 NYCRR 590.32).

C. The arrangement between petitioner and the purchaser is properly classified as a sale-leaseback transaction. The contract of sale contains a provision which required petitioner to simultaneously enter into a lease with the purchaser to rent the vacant space in the building transferred from petitioner to the purchaser. On December 27, 1985, petitioner and purchaser closed on the agreement to sell the property and, at the same time, entered into the agreement to lease a portion of the building. In addition, the contract itself refers to the rental arrangement as the "Master Lease-Back". Finally, petitioner's own books and records treated the transactions as a sale-leaseback arrangement. Although the arrangement constitutes a sale lease-back transaction, the leaseback is not a taxable event as the three conditions precedent to the taxability of a lease are not present (see, Conclusion of Law "B").

D. Petitioner's argument that the selling price should be reduced by the amount of expenses incurred under the lease arrangement because it was a condition of the sale is incompatible with the substance of the transactions at issue. Such position is also in direct

conflict with the way petitioner handled the transactions for income tax purposes, Tax Law § 1440.7, and the regulations promulgated thereunder.

As a sale-leaseback arrangement, there exist two independent transactions between petitioner and the purchaser: the sale of the building from petitioner to the purchaser and the rental of office space from the purchaser to petitioner. Each transaction could stand alone and apart from the other as adequate consideration was received by the respective parties in each of the exchanges. In the contract of sale, there was an exchange of the purchase price for ownership of the building, with the purchase price being $7,250,000.00. The obligation to pay the purchase price existed at the date of closing, irrespective of whether petitioner or substitute tenants were leasing the vacant space in the building. Such obligation was not altered by the terms of the lease arrangement. In the agreement to lease, there was an exchange of rental payments for the right to use the demised premises. Although neither petitioner nor the individual partners occupied the vacant space, they had the right, under the agreement of lease, to do so. The fact that the demised premises were not occupied by petitioner or the partners does not change the lessor-lessee relationship between the parties to the lease agreement. With regard to the expenses incurred by petitioner for new tenant work, petitioner, by obtaining substitute tenants, was relieved of its obligations under the lease for the space rented to the new tenants. Thus, petitioner received value for both the sale of the building and the expenses it incurred pursuant to the lease. Under these circumstances, the lease payments cannot simultaneously perform the function of paying for the rental space and the function of reducing the purchase price.

Viewing the sale-leaseback transaction as two distinct transactions is consistent with petitioner's treatment of the transactions on its books and records, with Tax Law § 1440.7, and the Real Property Transfer Gains Tax Regulations (20 NYCRR 590.5; 590.32), which treat a sale-leaseback transaction as two taxable events. Furthermore, petitioner's income tax returns treated the transactions separately, with the sale of the building considered a sale for $7,250,000.00 and the amounts paid pursuant to the lease agreement considered expenses of the partnership in the ensuing years. Petitioner received certain tax benefits by structuring the

transactions as a sale-leaseback and must now bear the gains tax responsibilities of such an arrangement.

E. The consideration required to be paid by the purchaser to petitioner for the transfer of the real property was $7,250,000.00. That the parties entered into a separate agreement that placed a portion of the selling price in an escrow account to insure petitioner's compliance under the lease does not alter the selling price. The money placed in escrow belonged to petitioner as evidenced by the return to petitioner of the unused escrowed amount at the completion of the lease term. In addition, petitioner considered itself the owner of the money in escrow as the amount was reflected on its books and records as an amount due petitioner from the purchaser.

Under all the facts and circumstances, it is determined that the selling price of the building was $7,250,000.00 and petitioner is not entitled to its refund claim.

F. The petition of Loren Crossroads Associates is denied and the Division of Taxation's denial of petitioner's refund claim is sustained.

DATED: Troy, New York

_____

ADMINISTRATIVE LAW JUDGE