The New York Transfer Tax Implications of Renewable Energy Projects

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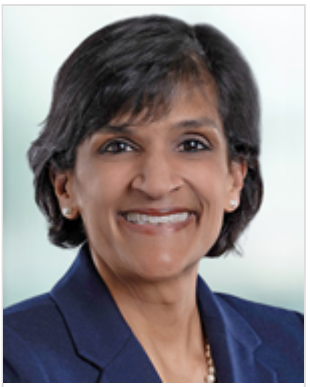
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In this installment of Real Assessment, the authors examine how New York state transfer taxes can apply to renewable energy projects in certain scenarios.

In New York state, real estate transfer taxes sometimes provide unwelcome surprises for developers. When structuring transactions involving real estate, lawyers and other real estate professionals should understand the potential impact of these types of taxes because New York imposes a transfer tax on many transactions that might catch parties off guard, possibly creating unintended tax exposure. Renewable energy projects are particularly susceptible to these tax traps because they use structuring techniques designed to address unique renewable industry issues, such as the need for site control during extensive due diligence periods and the manner of financing renewable projects.

Renewable energy transactions often require the developer to acquire site control long before construction of the project begins, during the time that engineering analysis, permitting, and other due diligence takes place. Renewable developers may use different techniques to obtain site control, including purchase options, options for easements, or options to lease — all of which provide the developer with some site control while the engineering and other aspects of the project take shape. Renewable projects also often involve the sale of equity interests in entities that hold these rights, such as through the acquisition of the membership interests of the single-purpose development entity. Finally, renewable projects may include certain transfers of real estate or equity interests for financing, such as tax equity financing or sale-leaseback transactions.

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In New York, these structuring techniques can run into transfer tax issues. This article examines whether the state transfer tax might apply in the following situations, and if so, gives drafting and structuring tips for renewable projects: (1) options to lease; (2) purchase options coupled with access rights, easements, or licenses; and (3) the sale of a controlling interest in an entity that holds one or more of these rights.

What the Tax Covers

The New York state transfer tax (NYTT) applies to conveyances of real property or interests in real property that exceed $500.[1] In most counties, the tax equals $2 for each $500 of consideration.[2] For nonresidential conveyances exceeding $2 million, the state imposes an additional tax of $1.25 per $500 of consideration.[3]

Options to Lease

An option to lease is a popular structure in renewable energy projects since it secures future rights to lease a property while the developer seeks permits and approvals and determines whether a particular site will be needed. A property owner may like options to lease since they provide immediate compensation without disrupting the owner's use of the property. Renewable developers often record a memo of option to lease in the local property records to protect their interests. So the question of whether an option to lease is subject to NYTT may arise as soon as the memo of option to lease is presented for recording.

An option to lease is likely not subject to the NYTT. The tax applies to conveyances of real property and conveyances of interests in real property.[4] Under the NYTT statute, leases and options are treated as interests in real property, not real property.[5] Interests in real property include:

- the creation of a leasehold only when the term — including any options to renew — exceeds 49 years, substantial capital improvements are or may be made by or for the benefit of the tenant, and the lease is for all or substantially all of the premises constituting the real property;[6] and
- an option or contract to purchase real property with the right to use or occupancy of the real property.[7]

An option is subject to the NYTT only if it applies to real property. Since the statute treats leases as interests in real property and not real property, an option to lease is not an option to acquire real property. Instead, it is an option to acquire an interest in real property. The statute applies to options to purchase real property and not to an option to acquire an interest in real property, meaning that options to lease are likely not subject to the NYTT. There are no state advisory opinions directly addressing options to lease. Options to lease do not typically provide developers or project companies with use and occupancy rights (which are relevant in the transfer tax analysis, as discussed later), which provides additional support that these options are not subject to the NYTT. In practice, county clerk offices also do not seem to expect payment of transfer tax when recording these agreements.

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Purchase Options Coupled With the Right to Use and Occupancy

Another technique sometimes used by developers of renewable energy projects is to seek access or license rights from a property owner, along with a purchase option, particularly during long permitting or diligence periods. The access right or license provides current rights to enter the property for inspection and other purposes, in advance of a decision on whether to purchase the property.

The NYTT expressly applies to options to purchase real property, coupled with the right to use and right of occupancy of real property.[8] This right to use and to occupancy has long been understood to apply to a leasehold interest that includes a purchase option. But could other rights constitute the right to use and occupancy of real property that could trigger the NYTT? For example, could the right to access property or a short-term license constitute the right to use and occupancy of real property, and trigger the NYTT, when coupled with a purchase option?

There is little direction in New York on this issue. Although no NYTT regulations or advisory opinions address it, there are strong arguments that the NYTT does not apply in these cases. First, access agreements or licenses typically permit entry onto the property but do not permit the holder to operate at the property. Also, access agreements and licenses may not provide exclusive rights. For example, the property owner may continue to have full rights to use the property despite an access agreement or license held by a developer of a renewable energy project. Use or occupancy arguably requires operating at the property and the ability to exclude others, similar to leasehold rights. So until more guidance arrives, it is likely that options to purchase coupled with an access agreement or license are not subject to NYTT.

The Controlling Interest Rule

The NYTT covers a broad range of transactions in addition to straightforward buying and selling of real property. For example, under the controlling interest rule, the transfer of a controlling interest in an entity owning land triggers the tax. Conveyances covered by the NYTT include instances when a person or group of persons acting in concert transfers or acquires a controlling interest in a partnership, corporation, or other entity with an interest in real property.[9]

Under the controlling interest rule, the transfer tax applies even though the real estate itself remains with the same owner: the entity. The purpose of this rule is to prevent tax avoidance and to equalize treatment of sales of real property and sales of interests in entities owning interests in real property. For example, if A sells land to B, the transfer tax applies. The tax applies in the exact same way when A owns a limited liability company that owns land and A sells her interest in the LLC to B. Although the parties did not file a deed, they owe the transfer tax. The tax equalizes outcomes and treats the sale of interest in the LLC as though the LLC has sold the interest in the land to B directly.

For a corporation, a controlling interest means 50 percent or more of total combined voting power of stock or 50 percent or more of capital, profits, or beneficial interest in the voting stock.[10] For a partnership, association, trust, or other entity, a controlling interest means 50 percent or more of the

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capital, profits, or beneficial interest in the entity.[11] These definitions are important since they indicate there are multiple ways in which the controlling interest NYTT can be triggered.

Most renewable energy projects are developed through a project-specific LLC. The LLC is typically a single-member entity, although it could be a multimember entity with different classes of equity holders. Once a project is further along in development, a typical renewable energy entity structure might include different classes of equity holders so that one class holds operating control and the other class holds most of the capital interest, for purposes of allocating tax credits or other economic benefits to the noncontrolling equity holders. On the surface, it appears the entity that controls the operations holds a controlling interest. However, under the NYTT rules, the sale of passive equity interests may trigger the NYTT controlling interest rule if those interests represent a majority of the capital, profits, or beneficial interest of the voting stock.

Another potential trigger for renewable energy projects is the three-year aggregation rule. Under that rule, transfers that occur within three years of each other will be added together to determine whether there is a controlling interest.[12] For example, if A acquires 30 percent of the interest in an entity owning real property in year 1 and acquires another 25 percent of the interest in that entity in year 2, those interests add together to reach a 55 percent controlling interest that triggers the tax. Although no single transaction involved the sale of a controlling interest, the two sales of interests occurred within three years of each other, and the tax adds each sale together.

Application to Renewable Deals

For renewable energy projects, the first time developers typically encounter the controlling interest question is when the site control agreement is assigned from the parent company into a project-specific LLC. Because developers secure site control quickly — often before they know whether the site will actually be developed — site control agreements are typically entered into between a parent company and a landowner. Once the developer completes enough diligence to know whether a project is likely to advance, it typically forms a project-specific LLC that will ultimately apply for project permits, develop, and construct the project. When the parent company assigns the site control agreement to the project-specific LLC, developers must perform the controlling interest analysis for NYTT purposes. If the project-specific LLC is created as a single-member LLC with the sole member as the parent company that signed the site control agreement, the assignment of the site control agreement does not trigger NYTT because the controlling interest in the entity that holds the real estate interest has not changed.

Another common scenario involving a controlling interest transfer in renewable energy projects involves the sale of a project to another company. Renewable energy projects may be structured as investment opportunities in which one company secures site control, diligences the project, and obtains all permits, and then markets the project for sale to another company that will construct and operate the project. This typically involves the sale of the membership interests in the project-specific LLC to the company that will construct and operate the project. For example, and using the structure discussed in the paragraph above, Company A may enter into a lease agreement with a landowner. Company A will diligence the project and then form the project-specific LLC. Company B

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may wish to purchase the renewable energy project once it's ready to start construction, and it will typically do so by purchasing the membership interests in the project-specific LLC, as all the permits and approvals are tied to that specific entity. When Company B purchases 100 percent of the membership interests in the project-specific LLC from Company A, a controlling interest transfer occurs, and transfer tax may be due on the conveyance.

Finally, many renewable energy projects use tax equity financing. Those transactions may also create transfer tax issues and should be carefully reviewed with a lawyer or tax adviser early in the process so they can be structured to address any NYTT implications.

FOOTNOTES

[1] N.Y. Tax Law section 1402(a).

[2] *Id.*

[3] *Id.*

[4] *Id.*

[5] *See* N.Y. Tax Law section 1401(f) (defining "interest in the real property" as including leaseholds and options to purchase real property).

[6] *See* N.Y. Tax Law section 1401(e) (defining conveyance as including leases exceeding 49 years, involving substantial improvement of the property, and involving substantially all of the premises constituting real property).

[7] *See* N.Y. Tax Law section 1401(f) (defining "interest in the real property" as including options to purchase real property).

[8] *See* New York State Department of Taxation and Finance, Instructions for Form TP-584-I (2025), 6a (defining the consideration calculation for leasehold interests or options including the use and occupancy of real property).

[9] N.Y. Comp. Codes R. & Regs. tit. 20, section 575.6(a).

[10] N.Y. Tax Law section 1401(b).

[11] *Id.*

[12] N.Y. Comp. Codes R. & Regs. tit. 20, section 575.6(d).

END FOOTNOTES

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