

Transfer Tax Rules for Qualifying REIT Transfers

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In this installment of Real Assessment, the authors explore New York state and New York City real property transfer taxes.

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New York state and New York City real property transfer taxes (TTs) are among the most complex and nuanced in the country. These taxes may apply in instances that might not be obvious or straightforward, including transfer of a controlling interest in an entity that owns real property in the state or city. Properly paying the TT took on even greater importance after the state revised its statute last year to include some responsible person liability provisions for the TT

for conveyances occurring on or after July 1, 2021.¹ This means that there can now be personal liability on a responsible person under the state's TT. No corresponding changes were made to the city's statute.

Both the state and city provide preferential tax treatment for specific qualifying real estate investment trust transfers.² Both impose their transfer taxes for qualifying REIT transfers at a reduced rate.³ This article focuses on a recent determination by an administrative law judge of the New York City Tax Appeals Tribunal, Administrative Law Judge Division, which focuses on the second type of preferential tax treatment for qualifying REIT transfers under the city's TT, measuring the taxable consideration.⁴

A REIT is an entity as defined in IRC section 856. REITs are tax-driven structures popular in some types of investment classes. Typically, a REIT is a company that owns, operates, or otherwise finances income-generating real estate. In general, to qualify as a REIT, the company must invest at least 75 percent of its total assets in real estate; derive at least 75 percent of its gross income from rents from real property, interest on mortgages financing real property, or from sales of real estate; distribute at least 90 percent of its

¹ N.Y. Tax Law section 1401(a)(2).

² See N.Y.C. Admin. Code section 11-2102.e; and N.Y. Tax Law section 1402(b).

³ For New York City TT purposes, qualifying REIT transfers are taxed at half the otherwise applicable rate. See N.Y.C. Admin. Code section 11-2102.e(1). For New York state REIT purposes, qualifying REIT transfers are taxed at the rate of \$1 for each \$500 or fractional part thereof of consideration, which results in qualifying REIT transfers being taxed at half the base rate of \$2 for every \$500 of consideration or fractional part thereof of consideration for transfer. N.Y. Tax Law section 1402 (b)(1). (Note that legislation generally applicable to conveyances made after July 1, 2019, increases the rate of the base state TT from 0.4 percent to 0.65 percent in the case of transfers of some property located in New York City.)

⁴ Note that ALJ determinations are not considered precedential, in contrast to New York City Tax Appeals Tribunal decisions.

taxable income to its shareholders; and be an entity that is taxable as a corporation. Other requirements include being managed by a board of directors or trustees, having a minimum of 100 shareholders, and having no more than 50 percent of its shares held by five or fewer individuals.

In *Matter of Park Central Hotel*,⁵ the ALJ ruled that the measure of consideration upon which the city TT is based, on a qualified REIT transfer, is the estimated market value (EMV) as determined by the commissioner of finance for real property tax purposes as reflected on the most recent notice of assessment issued by the commissioner. The ALJ rejected the commissioner's argument that the consideration for the transfer should be on the actual total consideration.

In late 2011 Park Central Hotel (DE) LLC and PCH TIC Owner LLC (Grantors), transferred 100 percent of the tenancy-in-common interests in a condominium unit to PC Festivus LLC (Grantee), which is wholly owned by LaSalle Hotel Operating Partnership LP. LaSalle's general partner, LaSalle Hotel Properties, was a REIT as defined in the IRC. On the date of the transfer, LaSalle issued class A partnership units of ownership to the Grantors, which were admitted as limited partners of LaSalle. In exchange for the real property interests, the Grantors received the following consideration: (1) \$382,792,818 in cash, which was used to pay off the balances of the remaining indebtedness encumbering the condo unit, and (2) \$13,441,833 for the equity in the property (\$8,000,100 in class A partnership units in LaSalle and \$5,441,733 in cash). Thus, more than 40 percent of the equity consideration received by the Grantors was in the form of an interest in an entity controlled by a REIT, which resulted in the transfer constituting a qualified REIT transfer under the real property TT.

To qualify as a REIT transfer under the city TT, the grantor must receive, as part of the consideration for the transfer, an ownership interest in the REIT that is both held by the grantor for at least two years from the date of transfer and worth at least 40 percent of the value of the equity interest in the realty or economic interest conveyed by the grantor to the grantee,

among other requirements. In this case, since approximately 61 percent of the equity consideration received by the Grantors (that is, \$8,000,100 out of \$13,441,833) was in the form of an interest in an entity controlled by a REIT, the parties stipulated that the transaction was a qualified REIT transfer. At issue, however, was the consideration on which the TT would be computed.

Shortly after the transfer, the Grantors filed TT returns stating the consideration for the transfer was \$105,808,170, which was the EMV of the property, based on the most recent notice of property value issued by the commissioner. On audit, the commissioner rejected that consideration, however, and issued two notices of proposed tax adjustments, which stated:

Although the requirements were met to qualify as a REIT Transfer and the lower REIT tax rate of 1.3125 [percent] as per NYC Administrative Code Section 11-2102, the consideration for the REIT transfer was deemed to be based on the actual total consideration for the property as per the 12/29/11 Closing Statement and the 1/4/12 Purchase Price Allocation Report of \$396,234,651.

The Grantors appealed and sought an ALJ determination of the alleged TT deficiency.

The ALJ determination began by noting that the parties stipulated that the transaction qualified as a REIT transaction, so the specific TT statutory rules applicable to REIT transfers would apply. The ALJ quoted the following statutory provision (Admin. Code section 11-2102.e.(3)) governing consideration, which was at issue in the case:

For purposes of determining the consideration for a real estate investment trust 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 purposes as reflected on the most recent notice of assessment issued by such commissioner, or such other value as the taxpayer may

⁵TAT(H)15-33(RP) (Oct. 29, 2021).

establish to the satisfaction of such commissioner.

Rejecting the commissioner of finance's argument, the ALJ made clear that "the statutory scheme does not impose other prerequisites to using EMV as the measure of consideration for REIT transfers. Nothing in the statute indicates that EMV is to be used only in particular circumstances, such as when the value of the property cannot otherwise be established. No language exists limiting EMV to a fallback position when the general rules for computing consideration do not yield a result." Finally, since the taxpayers did not attempt to establish a value other than EMV, the ALJ determined that EMV is the measure of consideration upon which the city TT is computed.

This ALJ determination highlights the specific statutory rules, and thus distinctions, set forth in New York City's TT for particular types of transactions. Compared with the city's law, New York state's TT law⁶ also provides a specific statutory method for the calculation of consideration for qualifying REIT transfers:

For purposes of measuring consideration . . . the fair market value of the real property or interest therein being conveyed shall be calculated by dividing (i) the net cash flow from operations with respect to such real property for the 12-month period ending on the last day of the second month preceding the date of conveyance by (ii) the sum of (A) the federal long term rate compounded semi-annually that is determined by the United States secretary of the treasury under section 1274(d) of the internal revenue code in effect thirty days prior to the date of the conveyance and (B) two percentage points.

The law also states:

Provided however, if the commissioner of taxation and finance determines that either the amount in clause (i) of this paragraph or clause (ii) of this paragraph

does not result in an accurate representation of the fair market value of such real property or interest therein as such value is to be determined under this paragraph, the commissioner may adjust either of such amounts.

Furthermore, the law provides:

In lieu of utilizing the method prescribed in this paragraph for determining fair market value, the taxpayer may utilize any method for determining fair market value that the commissioner of taxation and finance has prescribed in rules or regulations or otherwise.

If we have made your head spin, we apologize. While we love addressing New York state's and New York City's thorny transfer taxes, we acknowledge that we may be in the minority. Often the relevant transfer tax issues are whether there is a taxable conveyance, what is the applicable tax rate, and how is consideration measured for the transfer. On top of that, the state's and city's transfer tax treatment of a transaction may differ. Accordingly, it is important for taxpayers to carefully consider the applicability of New York state's and New York City's transfer taxes when transferring real property located in the state or city and on conveyances of a controlling interest in an entity that owns real property in the state or city. ■

⁶N.Y. Tax Law section 1402(b)(3).