

**New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau**

TSB-A-83(1)M
Gains Tax
November 14, 1983

STATE OF NEW YORK
STATE TAX COMMISSION

ADVISORY OPINION

PETITION NO. M831011A

On October 14, 1983 a Petition for Advisory Opinion was received from The Edgewater Company of Ulster, Marine Midland Towers, 360 S. Warren Street, Syracuse, New York 13202.

The issue raised is whether the beneficiary of an industrial revenue bond financing (the "Company") is able to include as part of the "original purchase price" as defined in Article 31-B of the Tax Law (the "Gains Tax Law") the cost of capital improvements to real property constructed by the Company as agent for the industrial development agency (the "IDA"), which capital improvements were financed with the proceeds of an industrial revenue bond financing, when the company later obtains fee ownership of the capital improvements and then transfers the building together with the land.

Petitioner describes the transactions involved as follows:

"In the presently proposed structure of this transaction the Company would own fee simple title to a parcel of vacant land (the "Land"). The Company would enter into a ground lease (the "Ground Lease") with the IDA. The IDA in turn would enter into a sublease (the "Sublease") with the Company pursuant to which the IDA would appoint the Company its agent in connection with the construction of a building on the IDA's leasehold estate in and to the Land, said construction to be financed with the proceeds of an industrial revenue bond issued by the IDA. Pursuant to the terms of the Sublease the Company will pay to the IDA rent equal to the debt service payments due on the IDA's bond. Such rental payments will be the IDA's only source of revenue to cover the debt service on the bond, and upon any default by the Company in making such payments, the holder of the bond would be able to foreclose on the IDA's leasehold estate under the Ground Lease and on the Company's fee estate (which would be subjected to the lien of the Mortgage).

"The Ground Lease and the Sublease will both have terms, including options for renewals which shall be less than 49 years and neither the IDA Under the Ground Lease nor the Company under the Sublease will have an option to purchase either the Land or any of the improvements.

"The Ground Lease shall provide that title to any improvements constructed on the Land shall automatically vest in the landlord upon the termination of the Ground Lease."

The agreements provide that the IDA is to "construct" the project with financing from an industrial revenue bond. Repayment of the bond is contingent upon the payment of the "rent" by the Company. If the Company fails to make the "rental" payments when due, the bondholders may declare the repayment of the bond to be in default and foreclose on the Company's fee estate as well

as the IDA's leasehold estate under the Ground Lease. The effect of the agreements is that the Company makes all the payments on the bonds and assumes all the risk of loss.

Section 856 of the General Municipal Law authorizes local jurisdictions to create industrial development agencies. An IDA is declared a corporate governmental agency, constituting a public benefit corporation. The IDA is authorized by law to issue bonds to raise the required capital for projects it has determined to be for the public benefit. Subsection (1) of section 864 of the General Municipal Law states, in part that "the bonds of every issue shall be special obligations of the agency payable solely from revenues derived from the leasing, sale, or other disposition of a project, . . ."

Thus, the IDA's involvement in a project is to provide low-cost financing for such project by issuing bonds and structuring the agreement with the Company's rental or lease payments equal the debt service payments due on the bonds. The IDA does not have any opportunity for gain, nor any risk of loss. As a public corporation, the IDA is considered an exempt organization; it does not enter into a project for the purpose of obtaining tax benefits for itself, although certain tax benefits flow by virtue of its being an exempt organization or are statutorily conferred in subsection 1 of section 864 of the General Municipal Law. The substance of the agreements between the IDA and the Company, when viewed in their entirety and in light of the statutory authorization for IDA's, indicate that the true nature of the transaction is that of a financing arrangement, and it will be viewed as such for gains tax purposes.

Accordingly, in the transaction described herein, the Company will be considered the owner of the project, such that there will not be a taxable event for gains tax purposes until the Company transfers its interest in the land or building to a party other than the IDA. When such transfer occurs, the original purchase price of the fee interest in the land and building to the company-transferor will be its cost of acquisition of the land plus the cost of the capital improvements.

DATED: November 4, 1983

s/FRANK J. PUCCIA
Director
Technical Services Bureau