

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petition :
of :
SKS ASSOCIATES : **DECISION**
T/A FARDALE GARDENS : **DTA No. 804517**
: :
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 SKS Associates T/A Fardale Gardens, 100 Clinton Avenue, Mineola, New York 11501, filed an exception to the determination of the Administrative Law Judge issued on February 22, 1991 with respect to its 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.

Petitioner appeared by Kestenbaum & Mark (Richard S. Kestenbaum, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Paul A. Lefebvre, Esq., of counsel).

Neither party filed a brief on exception. Petitioner's request for oral argument was denied.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUES

I. Whether the original purchase price of real property held by a partnership may be stepped-up to reflect the consideration paid for the acquisition of interests in such partnership.

II. Whether, if it is determined that a controlling interest was not acquired, petitioner is entitled to a stepped-up value of the original purchase price pursuant to the regulation at 20 NYCRR 590.49(c).

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

Sometime in 1985, petitioner, SKS Associates ("SKS"), filed a gains tax return with the Division of Taxation indicating an original purchase price for certain property owned by SKS known as Fardale Gardens which further indicated the use by petitioner of a stepped-up original purchase price. The Division disallowed the stepped-up original purchase price and SKS made a payment in full of the tax calculated by the Division.¹

On November 5, 1986, SKS filed a Claim for Refund of Real Property Gains Tax in the sum of \$3,250.56. The explanation provided by petitioner on the claim for refund was as follows:

"The taxpayer requests this refund because it feels the disallowance of additional basis was incorrect. The additional basis was the result of the 2 partners of the taxpayer purchasing (for cash) part of the property from a third party (who was originally a partner of this taxpayer). This transaction was reported on the taxpayer's return (Federal) as a Section 754 adjustment. Enclosed is an article explaining the rationale for this adjustment which taxpayer feels is also appropriate for inclusion as basis for New York State gains tax purposes."

On January 30, 1987, the Department of Taxation and Finance, Central Miscellaneous Tax Section, responded to the claim for refund by SKS and denied same in full. The explanation offered by the Department was as follows:

"The basis of the claim is that in June, 1983, Fred Seidenfeld, a one-third owner in a cooperative, sold his interest to the two remaining partners. As a result, you contend that the two remaining partners acquired a controlling interest in the property, and should, therefore, be allowed the amount paid as part of the partnership's original purchase price.

Section 590.44 of the New York State Transfer Gains Tax Regulations defines controlling interest, in part, as '...(ii) in the case of a partnership, association, trust,

¹It is noted that the original assessment and all documents filed with regard to the ultimate sale of Fardale Gardens in 1985, 1986 and 1987 were not provided to this forum. The information stated above is inferred from the documents which have been entered into evidence.

or other entity, fifty percent or more of the capital, profits, or beneficial interest in such partnership, association, trust, or other entity.'

Section 590.45(c) states, 'For purposes of determining whether a controlling interest is acquired, only acquisitions of interest occurring after March 28, 1983 are added together.'

In addition, Section 590.49(b) states, 'If less than a controlling interest were acquired, the entity may not step-up its original purchase price in the property.'

In this case, as the two remaining partners acquired less than a controlling interest after March 28, 1983, then the stepped-up basis is not allowed."

It is not disputed that in June 1983, Fred Seidenfeld, a partner in SKS, sold his one-third interest in said New York partnership to the remaining partners, Aaron Sokol and Michael Kluger.² In consideration for his one-third interest, Mr. Seidenfeld received \$1,306,317.00 in cash and was relieved of mortgage liabilities of \$827,908.00. Mr. Seidenfeld's one-third portion of the original purchase price of the underlying realty was \$1,264,792.00. Mr. Seidenfeld's gross profit was \$869,433.00 on the transaction. This gain was determined to be taxable to Mr. Seidenfeld, the transferor in the transaction, pursuant to Tax Law §§ 1441 and 1443(1). On November 3, 1983, the Division of Taxation issued a Statement of No Tax Due on the transaction.³

SKS Associates filed a United States Partnership Return of Income for calendar year 1983 which listed its principal business activity as real estate and its principal product as rentals. Attached to said return was an Election of Special Basis Adjustment pursuant to Internal Revenue Code § 754. The election stated, in part, as follows:

"SKS Associates hereby elects under Code Sec. 754 to apply the provisions of Code Secs. 734(b) and 743(b) beginning with the calendar year 1983 to the return for which year this statement is attached."

Internal Revenue Code § 754 states, in part, as follows:

²SKS Associates operated as a partnership without a written partnership agreement.

³This fact was alleged in the answer filed by the Division but the actual Statement of No Tax Due was not entered into evidence.

"If a partnership files an election, in accordance with regulations prescribed by the Secretary, the basis of partnership property shall be adjusted, in the case of a distribution of property, in the manner provided in section 734 and, in the case of a transfer of a partnership interest, in the manner provided in section 743."

Since the instant case deals with a transfer of partnership interest, IRC § 743 applies. That section provides, in part, as follows:

"(a) GENERAL RULE. -- The basis of partnership property shall not be adjusted as the result of a transfer of an interest in a partnership by sale or exchange or on the death of a partner unless the election provided by section 754 (relating to optional adjustment to basis of partnership property) is in effect with respect to such partnership.

(b) ADJUSTMENT TO BASIS OF PARTNERSHIP PROPERTY. -- In the case of a transfer of an interest in a partnership by sale or exchange or upon the death of a partner, a partnership with respect to which the election provided in section 754 is in effect, shall -- (1) increase the adjusted basis of the partnership property by the excess of the basis to the transferee partner of his interest in the partnership over his proportionate share of the adjusted basis of the partnership property."

OPINION

In the determination below, the Administrative Law Judge held that it was improper to allow a step-up in basis in the original purchase price with respect to the transfer of real property for the purposes of computing the real property transfer gains tax (hereinafter "gains tax"). Specifically, it was ruled that 20 NYCRR 590.49 requires the acquisition of a controlling interest as a prerequisite for stepping up the original purchase price of the property in question. Since petitioner did not acquire a controlling interest, the Administrative Law Judge concluded that it was not entitled to a step-up in the original purchase price. The Administrative Law Judge also rejected petitioner's argument that 20 NYCRR 590.49(c) authorized an upward adjustment in the original purchase price even when petitioner failed to acquire a controlling interest. The Administrative Law Judge pointed out that the provision stated therein relates only to the interest that was being resold.

On exception, petitioner asserted: (1) the original purchase price of real property held by a partnership may be stepped-up to reflect the consideration paid for the acquisition of a controlling interest in such partnership; (2) petitioner is entitled to a step-up in basis for purposes of computing its gain derived from the transfer of real property; (3) the intent of the gains tax enacted as Tax Law Article 31-B is to tax the actual economic gain realized by a taxpayer upon certain transfers of real property; (4) petitioner had acquired a controlling interest as provided in 20 NYCRR 590.44; and (5) alternatively, petitioner is entitled to a step-up in the original purchase price pursuant to the regulation in 20 NYCRR 590.49(c).

In response, the Division of Taxation relies on the determination of the Administrative Law Judge and the arguments it presented to the Administrative Law Judge.

Tax Law § 1441 imposes a tax on gains derived from the transfer of real property within the State. In the case of a business entity, the "transfer of real property" is defined as encompassing only the acquisitions of a controlling interest in such entity (former Tax Law § 1440[7]). With respect to a partnership, a "controlling interest" means fifty percent or more of the capital, profits or beneficial interest in such partnership (Tax Law § 1440[2][ii]; 20 NYCRR 590.44[a]). The regulation in 20 NYCRR 590.49 and the accompanying example indicate that for purposes of determining whether a controlling interest is acquired, only acquisitions of interest occurring after March 28, 1983 are added together. In the instant case, the two remaining partners jointly acquired only one-third of the interest in the partnership after that date. Since the acquired interest was less than fifty percent of the total interest in the partnership, the remaining partners did not acquire a controlling interest in the partnership for purposes of computing the gains tax. Thus, the purchase of the one-third interest by the remaining partners was not subject to any gains tax. In the absence of a taxable event (i.e., acquisition of a controlling interest), the regulation in 20 NYCRR 590.49(b) explicitly disallows the entity a step-up in its original purchase price in the real property. The obvious purpose of this regulation is to ensure that the entire gain is subjected to tax when there is a subsequent taxable event.

Drawing from Federal law on partnership taxation (i.e., IRC §§ 734, 743, 751), petitioner contends that the remaining partners are entitled to a step-up in basis upon the acquisition of the outgoing partner's interest. Petitioner argues that to the extent that the purchase price (fair market value) for the acquired interest exceeded its basis, the remaining partners paid for unrealized gain. By disallowing an upward basis adjustment in the interest transferred, the argument runs, the partners will be forced to recognize gain on appreciation for which they already paid and pay tax on a gain from which they received no economic benefit. This argument is without merit.

Preliminarily, we note that the Federal partnership taxation scheme is fundamentally distinguishable from the statutory framework of the New York State gains tax. The Federal Code sections cited by petitioner constitute parts of a very technically precise body of law governing transactions involving partnerships. They provide for the recognition of both gains and losses in the event that partnership property is distributed to the partners or partnership interests are transferred. There are no minimum thresholds in the level of gains or losses for recognition purposes. Lastly, a critical component of the partnership taxation scheme is the allowance for depreciation deductions. By contrast, the New York State gains tax is just that, a gains tax; thus, the concepts of losses and depreciation deductions are not recognized in the gains tax statutes because neither has any relevance in that context. Additionally, the gains tax is imposed only when real property is being transferred and only when the consideration paid for the transfer is one million dollars or more (Tax Law §§ 1441, 1443[1]). In the case of a transfer of partnership interests, the gains tax is not triggered unless the transfer constitutes a controlling interest (former Tax Law 1440[7]). Given the differences in the intent and scope of the two taxation schemes, we reject petitioner's argument that its original purchase price in the property sold should receive the same step-up treatment as provided under the Federal tax law.

Alternatively, petitioner argues that it is still entitled to claim a step-up in basis in the original purchase price pursuant to 20 NYCRR 590.49(c). That regulation enables a transferee who acquired a certain percentage of partnership interest to claim a step-up in basis upon resale of that interest, regardless of whether it constitutes a controlling interest. The language of 20 NYCRR 590.49(c) explicitly conditions the step-up in basis upon the resale of partnership interests, rather than a sale of the real property by the partnership. In this case, petitioner offered no evidence to show that the subsequent transfer which triggered the gains tax involved a resale of partnership interests. Hence, we agree with the Administrative Law Judge's conclusion that petitioner erred in relying on 20 NYCRR 590.49(c) as an alternative ground for claiming an upward adjustment in the original purchase price.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of SKS Associates T/A Fardale Gardens, is denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petition of SKS Associates T/A Fardale Gardens is denied; and
4. The claim for refund of real property transfer gains tax is denied.

DATED: Troy, New York
January 12, 1991

/s/John P. Dugan
John P. Dugan
President

/s/Francis R. Koenig
Francis R. Koenig
Commissioner

/s/Maria T. Jones
Maria T. Jones
Commissioner