STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
VON-MAR REALTY CO.	:	DECISION DTA No. 808098
for a Refund of Real Property Transfer Gains Tax under Article 31-B of the Tax Law for the Year 1989.	:	

Petitioner Von-Mar Realty Co., c/o Ronald J. DeVito, Esq., 1205 Franklin Avenue, Garden City, New York 11530 filed an exception to the determination of the Administrative Law Judge issued on April 4, 1991 with respect to its petition for a refund of real property transfer gains tax under Article 31-B of the Tax Law for the year 1989. Petitioner appeared by Howard M. Koff, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Kenneth J. Schultz, Esq., of counsel).

Both parties filed briefs 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.

ISSUE

Whether the Division properly treated the transfer of two contiguous properties sold by petitioner to one transferee on the same date as a single transfer of real property for purposes of applying the one million dollar exemption provided for by Tax Law § 1443(1).

FINDINGS OF FACT

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

On June 25, 1984, two contiguous parcels of improved real property, 5 Sydney Court, North Lindenhurst, New York and 7 Sydney Court, North Lindenhurst, New York a/k/a 1130

Route 109, North Lindenhurst, New York, were conveyed to John Marin and Walter Von Rauchhaupt by Sidney S. Simowitz, Florence Bernbaum and Jean Schumer.

On October 10, 1984, John Marin and Walter Von Rauchhaupt conveyed each of the aforesaid parcels of real property to Von-Mar Realty Co. ("Von-Mar"), a New York general partnership in which the general partners were John Marin and Walter Von Rauchhaupt.

At the time of its acquisition by Mr. Marin and Mr. Rauchhaupt, 5 Sydney Court, which was improved by an industrial building, was occupied by Cee-Jay Extruders, Inc., a steel extruding business, pursuant to a lease dated October 13, 1977 between Pagus Realty Corp., as landlord, and Cee-Jay Extruders, Inc., as tenant. During the period in which Von-Mar owned the 5 Sydney Court property, Cee-Jay Extruders, Inc. continued to occupy the property and paid rent to Von-Mar.

At the time of its acquisition by Mr. Marin and Mr. Rauchhaupt, the real property at 7 Sydney Court was also improved by an industrial building. On October 12, 1990, the parties herein, executed a written stipulation, the terms of which, in pertinent part, were as follows:

a. At the time in which 5 Sydney Court and 7 Sydney Court were purchased, John Marin, Walter Von Rauchhaupt and Martin Weisenfeld were principals in several affiliated corporate entities which sold discounted merchandise to consumers. The corporate affiliates were Albro Supplies, Ltd., The County Dump, Inc. and County Liquidators, Inc. Mr. Von Rauchhaupt and Mr. Marin who were the sole partners of Von-Mar were the owners of 90 percent of the shares of stock in all of these corporate affiliates. Mr. Weisenfeld was the owner of 10 percent of the stock of these companies;

b. 7 Sydney Court was leased by Von-Mar to Albro Supplies, Ltd. to serve as the headquarters for the operation of these companies. The County Dump, Inc. and County Liquidators, Inc. also utilized space at 7 Sydney Court;

c. Between the time of purchase (by Mr. Marin and Mr. Von Rauchhaupt) and sale (by Von-Mar) of these properties, the companies conducted business only at 7 Sydney Court;

d. The lease between Von-Mar and Albro Supplies, Ltd. was oral. On occasions when the business operation was unable to pay Von-Mar the full amount of the rent, Von-Mar forgave the portion which could not be paid;

e. When the properties were sold by Von-Mar on January 5, 1989, the aforesaid businesses continued in possession of the 7 Sydney Court property pursuant to a new lease which was entered into between these business entities and the purchaser (L.B. Realty Co.) of the properties.

On September 9, 1988, Von-Mar entered into two contracts of sale (the provisions of which were substantially the same) by which Von-Mar agreed to sell each of the properties located at 5 Sydney Court and 7 Sydney Court to L.B. Realty Co. The selling price of the 5 Sydney Court parcel was $975,000.00 while the selling price of 7 Sydney Court was $1,530,000.00. Both properties were actually sold by Von-Mar to L.B. Realty Co. on January 5, 1989.

The Division of Taxation treated the transfers of these parcels of real estate as a single transfer for purposes of the real property transfer gains tax and aggregated the selling price of both parcels for purposes of imposing such tax. Von-Mar paid the tax, as assessed by the Division of Taxation, under protest and, on March 3, 1989, Von-Mar filed a claim for refund of real property transfer gains tax in the amount of $37,082.50. By letter dated April 19, 1989, the Division of Taxation denied Von-Mar's refund claim in its entirety.

The parties herein agreed, at the argument of this motion, that there are no material and triable issues of fact and that, upon the motion papers of the Division, Von-Mar's memorandum in opposition (which seeks summary determination in favor of Von-Mar), a stipulation of facts and such oral argument, no further hearing is necessary and that summary determination, in favor of one party or the other, should be granted.

OPINION

In the determination below, the Administrative Law Judge held that petitioner's sale of two contiguous parcels of land were properly aggregated for purposes of applying the real property transfer gains tax (hereinafter "gains tax"), as the parcels were used for a common or related purpose, i.e., to generate rental income. The Administrative Law Judge held that the "look-through" principle is not applicable in determining whether there was a common use. In short, the fact that 7 Sydney Place was leased to affiliate corporations which were 90 percent owned by the two sole partners of Von-Mar did not alter the conclusion that the properties were used by petitioner for a common purpose, i.e., rental income. In addition, the Administrative Law Judge abated the penalties imposed upon petitioner.[1]

On exception, petitioner argues that the "look-through" principle which has been employed by the Division of Taxation (hereinafter the "Division") to aggregate transfers of real property cannot be ignored merely because it would prevent aggregation in this case. Accordingly, petitioner asserts that the Administrative Law Judge erred in stating that the beneficial ownership of 7 Sydney Court should not be considered in this determination. Petitioner objects to the conclusion of the Administrative Law Judge that the properties were used for a common or related purpose.

In response, the Division, relying on case law and Tribunal decisions, asserts that the regulation contains a two-fold test which petitioner must meet: first, to show that the only correlation between the properties is contiguity or adjacency; second, to show that the properties were not used for a common or related purpose. The Division contends that petitioner has failed to show that the only correlation between the two properties is the contiguity itself, and that the properties were not used for a "common or related purpose" as required by 20 NYCRR 590.42. Moreover, the Division asserts that the "look-through" principle should be used only when it is required that beneficial ownership be determined. Thus, it contends that the

[1]This issue was not raised on exception by the Division.

Administrative Law Judge was correct in finding this principle inapplicable when determining "use" under 20 NYCRR 590.42.

Although we reach the same result as the Administrative Law Judge, we decide this case on a different basis which is set forth below.

Tax Law § 1441 imposes a ten percent tax upon gains derived from the transfer of real property located within New York State where the consideration received for such transfer is one million dollars or more (Tax Law §§ 1441; 1443[1]).

The first sentence of Tax Law § 1440(7) states, in relevant part, that the "[t]ransfer of real property" means the transfer or transfers of any interest in real property by any method, including . . . [transfers by] sale."

The regulation at 20 NYCRR 590.42 codifies the Division's interpretation of this first sentence of section 1440(7) (Matter of Iveli v. Tax Appeals Tribunal, 145 AD2d 691, 535 NYS2d 234, lv denied 73 NY2d 708, 540 NYS2d 1003). This regulation states, in relevant part:

> "the separate deed transfers of contiguous or adjacent properties to one transferee are, for purposes of the gains tax, a single transfer of real property . . . . However, if the transferor establishes that the only correlation between the properties is the contiguity or adjacency itself, and that the properties were not used for a common or related purpose, the consideration will not be aggregated" (20 NYCRR 590.42 [emphasis added]).

As the 5 Sydney Court and 7 Sydney Court properties transferred by petitioner to L.B. Realty were contiguous, the regulation at 20 NYCRR 590.42 is clearly applicable, as the parties acknowledge, with the burden on petitioner to prove the negative requirements set forth therein (20 NYCRR 590.42).

This first requirement of 20 NYCRR 590.42, i.e., that "the only correlation between the properties is their contiguity or adjacency itself," poses a significant hurdle to taxpayers in light of its broad language.[2] The use of such language is consistent with the expansive definition of

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[2]Previous cases and decisions have supported the conclusion that two separate showings are required under 20 NYCRR 590.42 by a taxpayer seeking to defeat the aggregation of contiguous or adjacent properties (Matter of Sanjaylyn Co. v. State Tax Commn., 141 AD2d 916, 528 NYS2d 948, appeal dismissed 72 NY2d 950, 533 NYS2d 55; Matter of Bombart v. Tax Commn. of the State of New York, 132 AD2d 745, 516 NYS2d 989 [whether the

"transfer of real property" which was designed to maximize revenues (Tax Law § 1440[7]; Matter of Bombart v. Tax Commn. of the State of New York, supra; Matter of Iveli v. Tax Appeals Tribunal, supra). We read this requirement in a manner consistent with this legislative intent - to comprehensively tax real property transfers - to allow separate gains tax treatment of contiguous properties only in the rare instance that the nature of the properties at issue had no kinship whatsoever, except their physical proximity.

The facts stipulated to by the parties indicate that both parcels of land were improved by industrial buildings. The building at 5 Sydney Court housed a steel extruding business, while 7 Sydney Court served as headquarters for discount merchandising firms which were 90 percent owned by petitioner. Further, the two properties were acquired by petitioner at the same time from the same grantors and were transferred by petitioner at the same time to the same purchaser. Petitioner offers nothing to distinguish the nature or characteristics of these properties. In our opinion, these facts, without more, do not establish that the only correlation between these properties was the contiguity itself (Matter of 307 McKibbon St. Realty Corp., supra).

Although the foregoing disposes of petitioner's refund claim, in our effort to fully respond to each of the arguments set forth by the parties, we will also address petitioner's contention that the properties were not used for a common or related purpose. Petitioner asserts that the "look-through" principle, which pervades the application of the gains tax, requires that the use of the properties by their beneficial owner be the controlling factor in making this determination.

The "look-through" principle, i.e., looking through an entity which owns real property to determine the beneficial owners of the real property, has been applied to the gains tax statutory

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properties were used for a common or related purpose]; Matter of 307 McKibbon St. Realty Corp., Tax Appeals Tribunal, October 14, 1988 [whether the only correlation between the properties is their contiguity or adjacency itself]).

scheme where adjacent or contiguous properties are transferred by two or more entities under common ownership to determine whether a taxable "transfer of real property" has occurred (Matter of 307 McKibbon St. Realty Corp., supra). The "look through principle" was also applied where a taxpayer and an entity in which it owns a "controlling interest"[3] transfer their interests in a single building with the result that the sales are aggregated to determine whether the $1 million exemption has been exceeded (Matter of Howes, Tax Appeals Tribunal, September 22, 1988, affd 159 AD2d 813, 552 NYS2d 972). As we noted in these earlier decisions, the focus of the gains tax through entities pervades the entire statutory scheme imposing the tax (Matter of Howes, supra; Matter of 307 McKibbon St. Realty Corp., supra; see also, Bredero Vast Goed, N.V. v. Tax Commn. of the State of New York, 146 AD2d 155, 539 NYS2d 823, appeal dismissed 74 NY2d 791, 545 NYS2d 105
[where the court sustained looking through two tiers of entities to find a transfer of real property]).

The Division correctly states that the question of whether to apply the "look-through" principle to characterize "use" of real property under 20 NYCRR 590.42, rather than to determine ownership, is one of first impression. If the lease transactions between petitioner and its controlled corporations are recognized for purposes of this analysis, the case law clearly indicates that use of contiguous or adjacent properties to generate rental income constitutes a "common or related purpose" within the meaning of 20 NYCRR 590.42 (Matter of Sanjaylyn Co. v. State Tax Commn., supra; Matter of Bombart v. Tax Commn. of the State of New York, supra). Thus, such a determination would require that the sale prices of the properties be aggregated for purposes of applying the gains tax.

Petitioner argues that because the 7 Sydney Court property was rented to corporations controlled by the owners of petitioner, these transactions should be ignored. This argument states that because such "controlled entities" are disregarded in determining ownership, the Division should not be allowed to recognize transactions between a taxpayer and its "controlled

[3]A "controlling interest" means a 50% or more interest in an entity that owns an interest in real property (Tax Law § 1440[2]).

entities" when characterizing "use" under 20 NYCRR 590.42. Accordingly, petitioner argues that upon applying the "look-through" principle in this context, the 7 Sydney Court property should be classified not as rental property, but as property being used by the owners of petitioner to carry on the operations of their controlled corporations.

Thus, the issue we are faced with may be phrased as follows: whether the gains tax, under which contiguous parcels of real property transferred by "controlled entities" of a taxpayer are deemed to be owned by the taxpayer, requires the taxpayer to recognize transactions between itself and its controlled entities when characterizing the use of such properties.

At the core of this issue is a frequent source of debate in taxation: whether the substance of petitioner's transactions in a certain instance should govern the tax consequences rather than the form it has chosen. The general rule in Federal taxation is that a corporation is a taxable entity even if it has only one shareholder who exercises control over it (see, Moline Props. v. Commissioner, 319 US 436). The substance over form analysis is a distinct and limited exception to this general rule that separate entities must be respected for tax purposes (see, Humana, Inc. v. Commissioner, 881 F2d 247, 89-2 USTC ¶ 9453). This doctrine may be used to disregard the separate corporate entity only where the Legislature has evinced an intent to do so (see, Clougherty Packing Co. v. Commissioner, 811 F2d 1297, 87-1 USTC ¶ 9204). In this case, the State Legislature, by defining an "interest in property" to include a controlling interest in an entity and making the beneficial ownership of real property a basic tenet of the taxing scheme, has manifested such an intent to disregard the controlled entity in determining ownership of the property (Tax Law § 1440[2]; see, Matter of Howes, supra). Consistent with this approach, it would appear to follow that transactions between commonly owned entities should also be ignored when determining how the property is used.

The Division contends that the "look-through" approach should be applied only when determining ownership, yet it wishes to eschew this approach when characterizing the properties' use. This selective application of this principle would effectively collapse controlled

entities holding legal title in determining ownership, aggregation and taxability, then reconstruct them in determining the possible exception to aggregation based on a property's use. Neither the Division, nor the Administrative Law Judge, offered any rationale for this selective application. We ourselves see no justification for this different treatment and conclude that the "look through" principle applies to determine the exception to aggregation based on use, as well as to require aggregation based on ownership. However, since we have resolved the first issue against petitioner, i.e., that it did not establish that the only relationship between the properties was their contiguity, this matter is resolved against petitioner.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Von-Mar Realty Co. is denied;

2. The determination of the Administrative Law Judge is affirmed;

3. The petition of Von-Mar Realty Co. is denied; and

4. The Division's denial of Von-Mar Realty Co.'s claim for refund is sustained.

DATED: Troy, New York
December 19, 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