STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
NET REALTY HOLDING TRUST	:	DECISION DTA No. 812217
for Revision of a Determination or for Refund of Real Estate Transfer Tax under Article 31 of the Tax Law.	: :	

Petitioner Net Realty Holding Trust, 535 Boylston Street, Boston, Massachusetts 02116, filed exceptions to the order of the Administrative Law Judge issued on August 4, 1994 and the determination of the Administrative Law Judge issued on May 25, 1995. Petitioner appeared by Gleich, Siegel & Farkas (Stephan B. Gleich, Esq., of counsel). The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Paul A. Lefebvre, Esq., of counsel).

Petitioner filed a brief in support of its exceptions and in reply to the Division of Taxation's brief in opposition. Oral argument was heard on February 8, 1996.

The Tax Appeals Tribunal renders the following decision per curiam. Commissioner DeWitt took no part in the consideration of this decision.

ISSUES

I. Whether the real estate transfer tax is preempted by the preemption provisions of the Federal Employee Retirement Income Security Act of 1974.

II. Whether the Division of Taxation properly calculated the consideration given by petitioner for real property acquired in a foreclosure sale for purposes of computing petitioner's real estate transfer tax liability.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge in her order and determination. These facts are set forth below.

ORDER

The New England Teamsters and Trucking Industry and Pension Fund (the "Pension Fund") was organized pursuant to section 302(c) of the Labor Management Relations Act of 1947, as amended (29 USC 186[c]). The Pension Fund was, at all relevant times, a qualified employee benefit plan under the Federal Employee Retirement Income Security Act of 1974 ("ERISA").

Petitioner, Net Realty Holding Trust ("NET"), is the nominee of, and is wholly-owned by its beneficiary, the Pension Fund. It was organized to hold title to and manage properties on behalf of the Pension Fund.

Letters of determination issued by the Internal Revenue Service establish that as of 1970 NET was determined to be a qualified trust under section 401(a) of the Internal Revenue Code and thus exempt from Federal income taxes under section 501(a) of the Internal Revenue Code.

NET was the second mortgagee on certain real property known as 400 Columbus Avenue, Mt. Pleasant, New York. As of December 13, 1991, the defaulting mortgagor owed NET $15,818,094.19; and NET brought a motion in Supreme Court, Westchester County, to foreclose the mortgage. A Judgment of Foreclosure and Sale was issued on April 7, 1992 which, among other things, ordered the sale of the subject real property at public auction. The judgment order contained the following relevant provisions:

> "[I]t is further
>
> "**ORDERED, ADJUDGED AND DECREED** that, the Referee make a Report of Sale and file it with the Clerk of the County of Westchester with all convenient speed; the purchaser or purchasers at such sale shall be let into possession upon production of the Referee's deed or deeds; if the proceeds of such sale be insufficient to pay the amount so reported due to the plaintiff with interest, costs and allowances as aforesaid, the Referee shall specify the amount of such deficiency in his Report of Sale; and it is further

> "**ORDERED, ADJUDGED AND DECREED** that, in the event that plaintiff shall become the purchaser of the premises directed to be sold, or that the rights of the purchaser at said sale, and the terms of sale under this judgment shall be assigned to or acquired by the plaintiff and a duly executed assignment in writing be filed with the Referee, the Referee shall not require the plaintiff to pay in cash the entire amount bid at said sale, but shall execute and deliver to the plaintiff a deed or deeds of the premises sold upon payment to the Referee of the amounts specified above in the paragraphs marked 'FIRST', 'SECOND', and 'THIRD', or in lieu of such payments, upon filing with said Referee receipts of the proper municipal authorities showing such payments. The balance of the amount bid, if any, shall be allowed to the plaintiff, and applied pursuant to paragraph 'FOURTH' above. If thereafter there shall be a surplus over and above the amounts due to the plaintiff, the plaintiff shall pay the same to said Referee upon delivery to it of the Referee's deed, and the Referee shall then deposit such amount with the aforesaid depository . . . ."

NET was the highest bidder at the foreclosure sale, purchasing the property for the sum of $8,000,000.00. Petitioner obtained the subject real property with a pre-existing mortgage of $1,958,785.00.

On or about June 2, 1992, NET filed a Combined Real Property Transfer Gains Tax Affidavit and Real Estate Transfer Tax Return (Form TP-584), reporting the conveyance of the real property pursuant to the foreclosure sale. Schedule E of Form TP-584 instructs the taxpayer to calculate the consideration by adding "[t]he amount of foreclosure judgment or bid price by grantee whichever is higher" to the amount of any pre-existing mortgage or lien. In accordance with this instruction, NET added the amount of the foreclosure judgment, $15,818,094.19, to the amount of the pre-existing mortgage remaining on the property, $1,958,785.00, arriving at a total of $17,776,879.19. It paid real estate transfer tax on the conveyance of $71,108.00.

NET filed a claim for refund of tax dated March 22, 1993, advancing two arguments to support its claim for refund. First, it claimed that as an ERISA trust it was exempt from payment of the real estate transfer tax. Second, it took the position that if any tax must be paid, the tax should be imposed on the total of the bid price ($8,000,000.00) plus the amount of the first mortgage, a total of $9,958,785.00.

The Division of Taxation ("Division") denied NET's claim for refund in a letter dated June 9, 1993, giving the following explanation for its determination:

> "There is no provision stated under Article 31, New York State Real Estate Transfer Tax Law for the exemption of the payment of tax by an Erisa trust.
>
> "In addition, if real property is being conveyed pursuant to a mortgage foreclosure, the consideration is the amount of judgement in foreclosure or the bid price, which ever is higher, plus the amount of any other pre-existing mortgages, liens or other encumbrances remaining on the property after the transfer."

NET filed a petition protesting the denial of its refund claim on September 2, 1993.

In its petition, NET stated:

> "If NET must pay any transfer tax, it should pay a transfer tax on $9,958,785.00, the total of the bid price ($8,000,000.00) <u>which reflected the fair market value of the property at the time of the sale</u>, plus the first mortgage ($1,958,785.00). NET is, therefore, entitled to a refund of $31,273.00 ($71,108.00 less $39,835.00)." (Emphasis added.)

The Division filed an answer on or about October 19, 1993, denying the above statement (among others), and stating that the consideration paid for the subject property properly included the entire amount of the foreclosure judgment.

The Division submitted the following documents as exhibits: NET's petition with attachments, including a copy of the Division's letter denying NET's refund claim; a copy of the Form TP-584 filed by petitioner; a copy of NET's refund claim; and a copy of the Division's answer. The Division offered no evidence of its own to controvert the factual claims made by NET's attorney in an affirmation.[1] However, in his affirmation, the Division's attorney states:

> "[P]etitioner alleges numerous times that the petitioner 'obtained property less than the judgment amount' and obtained such property for a bid price that, 'reflected the fair market value of the property at the time of the sale.' These factual allegations are material elements to the arguments the petitioner makes with respect to its claim for a partial refund of the real estate transfer tax imposed by Article 31 of the Tax Law. The taxpayer's failure to offer any evidence with respect to these issues requires the dismissal of the instant motion."

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[1]Mr. Gleich acted as NET's attorney in the foreclosure proceeding and, therefore, had personal knowledge of the facts stated in his affirmation.

In response to the Division's statements, NET filed: a reply affirmation; a copy of a deed which established that NET acquired the subject property at a bid price of $8,000,000.00; and two appraisal letters. The first appraisal letter establishes that as of November 13, 1991 the property was appraised at a value of $8,500,000.00. A second appraisal letter establishes that as of July 15, 1993 the subject property was appraised at a value of $3,500,000.00.

DETERMINATION

Many of the findings of fact found in the Administrative Law Judge's order were restated in the determination, except for the facts set forth below.

The following language in the judgment order was struck out by the judge before he signed the order:

> "**ORDERED, ADJUDGED AND DECREED** that the plaintiff may apply at the foot of this judgment, after sale, pursuant to the provisions of Section 1371 of the Real Property Actions and Proceeding Law for judgment against
>
> the defendants for such deficiency, if any, to which the Court shall deem the plaintiff to be entitled."

The loan to the defaulting debtor was nonrecourse in nature which means that NET could not seek a deficiency judgment after sale of the subject real property. The order of the court reflected the terms of the mortgage note.

In November 1991, Leggat McCall & Werner Appraisal and Consulting Co. conducted an appraisal of the subject property and concluded that at that time the property's fair market value was $8,500,000.00. Ernst and Young conducted an update of an appraisal of the subject property conducted in 1992 and concluded that as of July 15, 1993 the property had a fair market value of $3,500,000.00.

On February 4, 1994, NET brought a motion for summary determination with respect to both issues raised in its petition. On August 4, 1994, this Administrative Law Judge issued an order granting summary determination to the Division on the question of NET's claimed exemption from the real estate transfer tax. With respect to the consideration given for the real property, this Administrative Law Judge found that there were triable issues of fact and denied summary determination. On September 21, 1994 and September 28, 1994, respectively, NET and the Division executed a consent to have this second issue determined by submission of documents without hearing.

OPINION

In the order below, the Administrative Law Judge addressed two claims made by petitioner in a motion for summary determination. First, the Administrative Law Judge, analyzing petitioner's claim that the real estate transfer tax was preempted by ERISA, held that, under the principles espoused in Matter of Morgan Guar. Trust Co. v. Tax Appeals Tribunal (80 NY2d 44, 587 NYS2d 252), such tax was not preempted by ERISA. In doing so, the Administrative Law Judge granted summary determination to the Division on this issue in accordance with 20 NYCRR former 3000.5(c).

Second, the Administrative Law Judge denied that part of the summary determination motion on the issue of whether the Division properly calculated the consideration for the real property acquired in the foreclosure sale for purposes of computing petitioner's real estate transfer tax liability because she found that there was a material issue of fact concerning whether the full amount of mortgage indebtedness was discharged in the foreclosure proceeding. Upon submission for determination in lieu of a hearing, the Administrative Law Judge concluded that the Division had properly calculated the consideration and she sustained the refund denial.

We will first address the issue of ERISA preemption of the real estate transfer tax. The Employee Retirement Income Security Act of 1974, as amended (29 USC § 1001 et seq.), is the Federal law that regulates employee benefit plans. ERISA contains a preemption provision with respect to state laws relating to employee benefit plans. 29 USC § 1144(a) provides that:

> "the provisions of [ERISA] shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan described in [29 USC § 1003(a)] and not exempt under [29 USC § 1003(b)]."

The term "State laws," for purposes of preemption, "includes all laws, decisions, rules, regulations, or other State action having the effect of law, of any State" (29 USC § 1144[c][1]). The phrase "relate to" is given its broadest common sense meaning such that a state law "relate[s] to" a benefit plan "in the normal sense of the phrase, if it has a connection with or references such a plan" (Shaw v. Delta Air Lines, 463 US 85; Metropolitan Life Ins. Co. v. Massachusetts, 471 US 724).

While explicitly exempting state laws of general application (e.g., insurance, banking or securities, as well as state criminal statutes), ERISA made no mention of tax law in the original preemption provision (see, 29 USC § 1144[b][2][A], [4]). In 1983, Congress amended the statute to affirm more specifically that "any State tax law relating to employee benefit plans" is preempted by ERISA (29 USC § 1144[b][5][B][i]). ERISA preempts not only laws specifically designed to affect employee benefit plans, but also laws of general application if they "relate to" employee benefit plans (Mackey v. Lanier Collection Agency & Serv., 486 US 825).

In Matter of Morgan Guar. Trust Co. v. Tax Appeals Tribunal (supra), the Court of Appeals held that the real property gains tax was preempted by ERISA because the "tax has more than a tenuous, remote or peripheral connection to employee benefit plans . . ." (Matter of Morgan Guar. Trust Co. v. Tax Appeals Tribunal, supra, 587 NYS2d 252, 256). The Court based its result on three factors: the gains tax impacts on the structure and administration of the plan by imposing recordkeeping and reporting requirements; the tax would influence the plan's investment strategy by making certain assets less attractive investments or requiring the retention of an asset that would otherwise have been liquidated; and preemption is consistent with the favorable tax treatment given to benefit plans under the Internal Revenue Code.

More recently, a court, distinguishing Morgan Guaranty, held that the real property tax of the City of New York was not preempted by ERISA (Matter of American Fedn. of Musicians' & Empls.' Pension Fund v. Tax Commn. of the City of New York, NYLJ, March 10, 1993, at 21, col 5, affd 203 AD2d 205, 612 NYS2d 857, lv denied 84 NY2d 803, 617 NYS2d 136). The court found that the tax was merely peripheral to the plan and not preempted because it was a cost of doing business in New York and not a direct tax on plan profits like the gains tax.

In the order below, the Administrative Law Judge applied the three factors set forth by the Court in Morgan Guaranty and found that they yielded a different result when applied to the transfer tax. First, there are no recordkeeping or filing requirements for the transfer tax similar to those required by the gains tax law. Second, the transfer tax, which is less than 1%, would not have a significant influence on a plan's investment strategy because there is no direct relationship between earnings from the asset transferred and the amount of the tax. Third, the transfer tax has no counterpart in the Internal Revenue Code. Therefore, the income tax advantages given to benefit plans cannot be applied to the transfer tax because it is not based on plan income, earnings or profitability. The Administrative Law Judge summed up petitioner's arguments and concluded as follows:

> "since the tax must be paid from Plan income, the amounts available for distribution to Plan beneficiaries will be reduced. I conclude that this is not a direct enough relationship to trigger preemption under ERISA" (Order, conclusion of law "C").

On exception, petitioner maintains that the Administrative Law Judge erred by oversimplifying its argument to be that simply because the tax must be paid from plan income, the amounts available for distribution to plan beneficiaries will be reduced and, thus, preemption should apply. It argues that there is more to the analysis, including the requirement that the plan maintain "actuarial soundness" which is threatened because the plan must pay significant amounts of plan benefits for the transfer tax. Petitioner also argues that the tax would impinge on investment strategy because:

> "The imposition of a $71,108.00 transfer tax expense upon the Plan, to acquire a piece of property worth far less than the loan it secured, certainly impacts upon fiduciary decision making" (Petitioner's brief, p. 7).

Finally, petitioner notes that, in the event of plan termination and liquidation, the reduction caused by the expenditure for transfer tax "would be felt, pro rata, by all Plan beneficiaries.

How much more can a state law effect or 'relate to' the Plan in the event of Plan termination?" (Petitioner's brief, p. 8).

The Division, on the other hand, argues that the real estate transfer tax is more like the real property tax held in American Federation not to be preempted by ERISA. The Division also points out that petitioner failed to acknowledge that the Court in Morgan Guaranty clearly distinguished stamp and excise taxes from the gains tax which was found to be preempted in that case. When comparing the real property tax to the transfer tax, the Division argues that the transfer tax is "either equal to or more remote and tenuous than the real property tax" (Division's brief, p. 8).

We affirm the Administrative Law Judge on this issue. Although petitioner argues on exception that the Administrative Law Judge oversimplified its position, the arguments presented, albeit with more elaboration, are still the same ones raised below. Petitioner asserts that the transfer tax relates to the plan because the funds necessary to pay the tax must come from plan assets and, thus, the plan's assets will be diminished. Each of the instances which petitioner has raised to show that the tax relates to the plan, e.g., the actuarial soundness requirement and the impact on termination and liquidation, are variations on the same theme: that paying the tax will necessarily deplete plan assets. Petitioner has failed to show that any of the three factors relied on by the Court of Appeals in Morgan Guaranty apply to the transfer tax in issue herein. The Administrative Law Judge in her determination thoroughly analyzed the three factors and noted that they do not apply to the transfer tax and we agree with that analysis.

Petitioner has also failed to demonstrate that the transfer tax is not a stamp or excise tax or a cost-of-doing-business tax. The Court of Appeals specifically distinguished these types of taxes from the gains tax it found to be preempted in Matter of Morgan Guar. Trust Co. v. Tax Appeals Tribunal (supra, 587 NYS2d 252, 257). The court in American Federation found the real property tax to be a cost of doing business and, as such, not preempted by ERISA. This was later upheld on appeal. The transfer tax, even more than the real property tax, represents a cost of doing business not unlike the fee charged for recording a deed or mortgage. Following petitioner's argument would lead to an ultimate finding that any law of any state that imposed any type of fee, charge or tax would be preempted because it would necessarily deplete plan funds. This is not what Congress had in mind. Moreover, if Congress had intended to preempt all state taxes, it could have made that clear in 1983 when it amended ERISA. Instead, it put the qualifying language "relating to employee benefit plans" into the amendment. We, therefore, agree with the conclusion of the Administrative Law Judge that petitioner has not demonstrated that "the real estate transfer tax relates to the Plan in more than a tenuous or remote manner" (Order, conclusion of law "C").

Turning to the issue of the calculation of consideration for transfer tax purposes, in the determination below, the Administrative Law Judge held that Tax Law § 1401(d), which defines the term "consideration" for purposes of the real estate transfer tax, supports the Division's calculation of the consideration given by petitioner for the property acquired in the foreclosure sale. The Administrative Law Judge found that, there being no evidence of petitioner's obtaining a deficiency judgment for the amount remaining outstanding on the mortgage, the amount of the indebtedness cancelled was $15,818,094.19, and the Division correctly determined that the consideration subject to transfer tax was the amount of the judgment in foreclosure of $15,818,094.19, plus the amount of the preexisting mortgage of $1,958,785.00, which totals $17,776,879.19.

On exception, petitioner continues to argue that there is no statutory basis for the Division's interpretation of Tax Law § 1401(d) to mean that, in a foreclosure sale, consideration is measured by the higher of the bid price or the amount of the judgment in foreclosure. Petitioner maintains that the correct measure to use is the fair market value of the property at the time of the foreclosure. In support of this position, it cites to the definition of consideration contained in Tax Law § 1440(1), which relates to the gains tax, and also to a gains tax advisory opinion. The use of the gains tax definition of consideration is proper in this situation, petitioner argues, because, in the absence of statutory language to support the Division's interpretation, resort to this alternate definition is a logical and realistic approach.

The Division, on the other hand, maintains that in this case there was a mortgage foreclosure which resulted in the cancellation of an indebtedness totalling $15,818,094.19. Applying the statute to this set of facts should result in a finding that the Division properly determined the correct consideration.

Tax Law § 1401(e) defines a conveyance for purposes of the real estate transfer tax, in pertinent part, as "the transfer or transfers of any interest in real property by any method, including but not limited to . . . mortgage foreclosure . . . ." Tax Law § 1402(a) imposes the transfer tax on each conveyance of real property when the consideration exceeds $500.00. Tax Law § 1401(d) defines "consideration," in part, as follows:

> "the price actually paid or required to be paid for the real property . . . whether paid or required to be paid by money, property, or any other thing of value. It shall include the cancellation or discharge of an indebtedness or obligation. It shall also include the amount of any mortgage, purchase money mortgage, lien or other encumbrance, whether or not the underlying indebtedness is assumed or taken subject to" (emphasis added).

We affirm the determination of the Administrative Law Judge on this issue. There is no dispute that the transaction in issue was subject to the transfer tax. The only question is whether the Division's calculation of the consideration upon which the tax was based was proper. As the Administrative Law Judge pointed out, a plain reading of the statute supports the Division's calculation. Reducing this case to its essentials, there was a mortgage foreclosure which resulted in the cancellation of an indebtedness of $15,818,094.19. Tax Law § 1401(d) provides that consideration "shall include the cancellation or discharge of an indebtedness or obligation." Thus, directly applying the statute to this factual context leads to the result that the proper measure of the consideration is the amount of the indebtedness cancelled ($15,818,094.19) plus the amount of the preexisting mortgage ($1,958,785.00 [which amount is not in dispute]).

Petitioner's arguments for using the fair market value of the property at the time of the sale as the measure of consideration are completely without merit. Nowhere in the transfer tax statutes is there any support for the use of fair market value as a valid means of measurement.

Petitioner's argument that the gains tax statutes should be used to arrive at a means of measurement of consideration is equally unavailing. This Tribunal has previously held, in Matter of 61 East 86th St. Equities Group (Tax Appeals Tribunal, January 21, 1993) that:

> "We disagree with petitioner's contention that the structure of the transfer tax may be relied on to interpret the structure of the gains tax. First, the two taxes are set out in different parts of the Tax Law -- Article 31 contains the real estate transfer tax and Article 31-B contains the gains tax. Thus, we find it inappropriate to imply any correlation between the two Articles absent an express statement by the Legislature that the two are related."

There is, therefore, no basis to rely on the gains tax definition of consideration in this case. Moreover, as explained above, the transfer tax statute provides a definition of consideration which is directly applicable to the facts present in the instant matter (see, Tax Law § 1401[d]).

There was some discussion both below and on exception about the impact of the presence or absence of a deficiency judgment in this case. Since the facts show that there was no deficiency judgment obtained, the question of what the impact would have been had there been one is irrelevant and beyond the scope of this analysis. For the same reason, any discussion of the impact of an unrelated third party's purchase of the property at the foreclosure auction rather than the mortgagee is also irrelevant. The Division has now promulgated regulations covering both of these situations and a wide variety of other circumstances applicable to foreclosure sales (see, 20 NYCRR 575.11[a][3]). Again, none of these circumstances is present in the factual context of this case, and any discussion of them would be irrelevant.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Net Realty Holding Trust is denied;

2. The order and the determination of the Administrative Law Judge are affirmed; and

3. The petition of Net Realty Holding Trust is denied.

DATED: Troy, New York

December 26, 1996

/s/Carroll R. Jenkins
Carroll R. Jenkins
Commissioner

/s/Joseph W. Pinto, Jr.
Joseph W. Pinto, Jr.
Commissioner