STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition of **WILLIAM ISER AND TIMBERLINE ASSOCIATES, L.P.** for Revision of Determinations or for Refund of Tax on Gains Derived from Certain Real Property Transfers under Article 31-B of the Tax Law for the Year 1987.	DETERMINATION DTA NOS. 812176 AND 813258

Petitioners, William Iser, 7200 Radice Court, Lauderhill, Florida 33319, and Timberline Associates, L.P., 71 Smith Hill Road, Monsey, New York 10952, filed petitions for revision of determinations or for refund of tax on gains derived from certain real property transfers under Article 31-B of the Tax Law for the year 1987.

The Division of Taxation, by its representative, Steven U. Teitelbaum, Esq. (Kenneth J. Schultz, Esq., of counsel), and petitioner William Iser, appearing by Thomas D. Kearns, Esq., and petitioner Timberline Associates, L.P., appearing by Howard M. Koff, Esq., agreed to have the controversies determined on submission without a hearing and the Division of Taxation's representative and petitioners' representatives executed a consent form to this effect on the following dates: with respect to William Iser, the Division executed the consent on May 3, 1995 and petitioner's representative executed the form on April 27, 1995; with respect to Timberline Associates, L.P., the Division executed the consent on May 3, 1995 petitioner executed the consent on April 10, 1995. All briefs in the matters were received by November 20, 1995, which date began the six-month period for the issuance of this determination. After due consideration of the documents submitted bythe parties and the briefs submitted in support of the parties' positions, Joseph W. Pinto, Jr., Administrative Law Judge, renders the following determination.

ISSUE

I. Whether William Iser's withdrawal from Timberline Associates, L.P., resulting in Stephen Iser's acquisition of an additional 40% partnership interest, constituted a transfer of a controlling interest subject to the real property transfer gains tax.

II. Whether Timberline Associates, L.P. is entitled to a "step-up" in original purchase price if it is determined that the William Iser transaction mentioned in Issue "I" resulted in an acquisition of a controlling interest.

III. Whether petitioners have demonstrated that their failure to comply with the filing and payment provisions of Article 31-B of the Tax Law was attributable to reasonable cause and not willful neglect.

FINDINGS OF FACT

Prior to the findings of fact, it is necessary to mention that petitioner Timberline Associates, L.P. ("Timberline") notified the Division of Tax Appeals, by letter to Joseph W. Pinto, Jr., Administrative Law Judge, dated September 11, 1995, that it had reviewed the documents and briefs submitted in the Iser matter and concluded that since the legal issue and facts of its case were identical with those in Iser, that it could not advance any arguments to support its position that the acquisition of the William Iser interest was of a controlling interest so as to entitle it to a step-up in original purchase price, and that it supports the position of William Iser and conceded the validity of the assessment issued to it. Timberline claimed that if the Division was successful in proving that the transfer was of a controlling interest and therefore taxable, it was, as a matter of law, entitled to a step-up in original purchase price. This assertion will be addressed in this determination, as set forth in Issue "II" above.

Further, each petitioner entered into a stipulation of facts with the Division, both of which have been incorporated into the Findings of Fact below.

1. On or about January 10, 1985, Timberline, a New York corporation, purchased real property located in Town of Clarkstown, County of Rockland, New York. The property was acquired from Kingsgate Company, a New York partnership, having an office in New City,

New York. The property purchased was described as "Lot E-1 on a certain map entitled 'Plan of Kingsgate, Town of Clarkstown, County of Rockland, State of New York'."

Also on January 10, 1985, Timberline purchased a second parcel of real property from Rusten Enterprises, Inc., a New York corporation, having an office at 71 Smith Hill Road, Monsey, New York, which was described in the deed as "Lot E-2 on a certain map entitled 'Plan of Kingsgate, Town of Clarkstown, County of Rockland, State of New York'." These two parcels comprised the property in issue (the "property").

2. At the time of the acquisition of the property, Timberline was owned by two individuals, Stephen Iser, who owned 60% of the corporation, and William Iser, who owned 40% of the corporation.

3. On or about February 24, 1987, the corporation was liquidated and and the property was transferred to Timberline Associates, L.P., a Delaware limited partnership (the "Partnership"), which was organized to, among other objects and purposes, hold title to the property. Upon the transfer, the interests in the Partnership were held as follows:

Stephen Iser	59.5%
William Iser	39.5%
T.A. Group, Inc.	1.0%

The Partnership had one general partner, T.A. Group, Inc., 71 Smith Hill Road, Monsey, New York, and two limited partners, William Iser and Stephen Iser. Stephen Iser signed the Agreement of Limited Partnership of Timberline Associates, L.P. as president of T.A. Group, Inc.

4. The Partnership agreement stated in Paragraph "7. Term." that it would dissolve, and its affairs wind up, at such time as the partners unanimously determined, or earlier if the partnership disposed of its interest in all or substantially all of its property or if dissolution occurred under Delaware law or if the general partner was removed, withdrew or dissolved.

5. The capital contributions of the partners at the inception of the Agreement of Limited Partnership were as follows:

T.A. Group, Inc.	$ 500.00
Stephen Iser	3,000,000.00
William Iser	2,000,000.00

T.A. Group, Inc. contributed in cash, while the limited partners, Stephen and William Iser contributed their 60% and 40% interest in the property described in Finding of Fact "2" above, from the corporation. T.A. Group, Inc. was general partner, with a percentage of ownership generously described as 1% given its insignificant capital contribution. Important to note, however, is the fact that the First Amended and Restated Agreement of Limited Partnership, paragraph "13.4" provided that T.A. Group, Inc. was designated the "tax matters partner".

6. The partners to the Agreement of Limited Partnership of Timberline Associates, L.P. agreed that the fair market value of the property was $5,000,000.00.

7. The Agreement of Limited Partnership also provided for the withdrawal of limited partners from the partnership. In paragraph "14" of the agreement, it stated:

> "Any limited partner who wishes to withdraw from the Partnership is entitled to receive an amount equal to his capital account balance on such terms as the General Partner and the withdrawing Limited Partner agree, and the Partnership shall be bound by the terms of any such agreement."

8. Petitioners and the Division stipulated that the transfer of the property to the Partnership constituted a mere change in the form of ownership of the Property.

9. On or about February 26, 1987, William Iser withdrew from the Partnership and thereafter, on March 6, 1987, Axel Graf, an unrelated third-party, purchased a 29% interest in the Partnership. William Iser's withdrawal from the Partnership was a transfer by William Iser of a 40% interest in the Partnership.

An agreement, dated February 26, 1987, was executed by Stephen Iser on behalf of T.A. Group, Inc. for Timberline Associates, L.P., and William Iser, which provided that William Iser would withdraw from the partnership and receive his capital account balance in the amount of two million dollars ($2,000,000.00). The terms specified that Iser would receive $100,000.00 from Timberline Associates, L.P. and the balance within five years. However, the principal balance was to be reduced by payments to William Iser upon the sale of each condominium unit in accordance with the following schedule:

Amount per Unit	Number of Units
$7,000.00	First 10
$7,500.00	Next 10
$8,000.00	Next 10
$8,500.00	Next 10
$9,000.00	Next 10
$9,500.00	Next 10
$7,805.00	Next 179
$7,905.00	Last 1

The payments to William Iser were to be made in the above-stated amounts on the date of the closing of the sale of a unit and regardless of the amount Timberline received on any sale.

10. Petitioners did not submit gains tax transfer questionnaires for the withdrawal from the Partnership or the acquisition of a controlling interest to the New York State Department of Taxation and Finance.

11. On March 6, 1987, the approximate interests in the Partnership were then held as follows:

Stephen Iser	70.5%
Axel Graf	28.5%
T.A. Group, Inc.	1.0%

12. By letter, dated October 21, 1987, the firm of Dreyer and Traub, issued an opinion to T.A. Group, Inc., the general partner, with regard to the gains tax ramifications of the transactions set forth above. Specifically with regard to the liquidation of William Iser's interest in the partnership and the subsequent acquisition by Mr. Graf of an interest in the Partnership from the Partnership. The letter stated that it did not believe that the gains tax was applicable, saying that since at all times Stephen Iser owned 60% or more of the total interest in the Partnership, both directly and indirectly, there had not been a transfer of a controlling interest in the Partnership.

13. Sometime subsequent to 1987, the Partnership filed a gains tax return with the Division in connection with the sale of condominium units at the property which recited an original purchase price ("OPP") and a stepped-up OPP to reflect the consideration paid to William Iser upon the liquidation of his interest in the Partnership. The Division determined

that the Partnership was not allowed the step-up on the basis that its acquisition of William Iser's interest was not of a "controlling interest".

14. The Division issued a Notice of Determination to Timberline Associates LP, dated September 1, 1991, assessment number L-002662595-8, which assessed additional real property gains tax in the sum of $99,573.08 plus penalty and interest, for the tax periods ended January 28, 1988 and July 18, 1988. In addition, the Division issued another Notice of Determination to Timberline Associates LP, assessment number L-008352394-4, which assessed additional real property gains tax for the tax period ended October 2, 1992 in the sum of $17,928.02, plus interest. The second assessment was issued following an analysis of the 100% update figures provided by Timberline Associates, L.P. These two assessments were sustained in full in two separate conciliation orders, dated October 14, 1994.

15. As a result of the adjustments made with regard to Timberline Associates, L.P., the Division issued an assessment to William Iser, dated July 29, 1991, which set forth additional real property gains tax due of $180,200.00, plus penalty and interest, for the period ended February 26, 1987. Based on evidence provided by William Iser, this assessment was revised to $160,400.00, plus penalty and interest after the conciliation conference, by order dated May 21, 1993.

16. Both petitioners, Timberline Associates, L.P. and William Iser, have appealed from said orders, and present the issues now before this forum.

CONCLUSIONS OF LAW

A. Tax Law § 1441 imposes a 10% tax upon gains derived from the transfer of real property located within New York State. Tax Law § 1443(1) provides for an exemption from gains tax when the consideration is less than $1,000,000.00.

Tax Law § 1440(7) defines "transfer of real property," in part, as follows:

> "'Transfer of real property' means the transfer or transfers of any interest in real property by any method, including but not limited to sale, exchange, assignment, surrender, mortgage foreclosure, transfer in lieu of foreclosure, option, trust indenture, taking by eminent domain, conveyance upon liquidation or by a receiver, or transfer or <u>acquisition of a controlling interest</u> in any entity with an interest in real property . . . . Transfer of real property shall also include partial or

> successive transfers, unless the transferor or transferors furnish a sworn statement that such transfers are not pursuant to an agreement or plan to effectuate by partial or successive transfers a transfer which would otherwise be included in the coverage of this article . . . ." (Emphasis added.)

The term "controlling interest" is defined in Tax Law § 1440(2), in relevant part, to mean:

> "(ii) in the case of a partnership . . . fifty percent or more of the capital, profits or beneficial interest in such partnership . . . ."

Tax Law § 1443(5) exempts from gains tax a transfer of real property which involves "a mere change of identity or form of ownership or organization, where there is no change in beneficial ownership."

The central issue presented herein is whether William Iser's withdrawal of his approximately 40% partnership interest from the partnership and the resulting acquisition by Stephen Iser of William Iser's approximately 40% share in the partnership was taxable under Article 31-B of the Tax Law as an additional acquisition of a controlling interest by Stephen Iser, who, after the withdrawal, owned a beneficial interest in 99% of the partnership. The parties stipulated that William and Stephen Iser owned the same proportionate interests in the corporation and, initially, in the partnership. Their beneficial interests in the entities which had an interest in real property did not change between the corporation and the partnership. Further, the parties agree that the transfer of the property to the partnership constituted a mere change in the form of ownership of the property pursuant to Tax Law § 1443(5).

William and Stephen Iser transferred their interests in the property to the partnership in exchange for proportionate interests in the partnership as limited partners. The partners agreed that the market value of the property transferred was $5,000,000.00.

There is no dispute that a transfer occurred when the property was transferred from the corporation to the partnership. The consideration received on the transfer was the value of the partnership interest in the partnership, purportedly the market value of the property. Therefore, Stephen Iser's interest was worth the stated value of his capital contribution per the Agreement of Limited Partnership, $3,000,000.00, and William Iser's interest was valued at $2,000,000.00. The transfers of interests in real property valued in excess of $1,000,000.00 presumably would

be subject to gains tax and not exempt from tax pursuant to Tax Law § 1443(1), where the consideration is less than one million dollars. However, as agreed by the parties, the transfers of the real property interests to the Partnership consisted of mere changes of identity or form of ownership or organization where there was no change in beneficial interest and was an exempt transfer pursuant to Tax Law § 1443(5). Under the Division's regulations, the total consideration for a transfer is first determined before applying the mere change of identity exemption (20 NYCRR former 590.50[c]). In this case, it was the value of the property transferred to the Partnership. Since the transfer of the partnership interests was inextricably linked to the transfer by Stephen and William Iser of the real property to the Partnership, the value of the interests was dictated by the value of the real property (Matter of Jaffe, Tax Appeals Tribunal, March 28, 1996).

Tax Law § 1440(1)(a) defines "consideration" as follows:

> "'Consideration" means the price paid or required to be paid for real property or any interest therein . . . . Consideration includes any price paid or required to be paid, whether expressed in a deed and whether paid or required to be paid by money, property, or any other thing of value . . . ."

A partnership results from a contract between the parties (Rizika v. Potter, 72 NYS2d 372, 375 [Sup Ct, Oneida County 1947]). As with any contract, the agreement or agreements underlying the partnership must be supported by consideration (15 NY Jur 2d, Business Relationships, § 1305). Here, Stephen and William Iser agreed to transfer their respective interests to the Partnership in exchange for the Partnership's promise to transfer partnership interests to them. Thus, William and Stephen Iser each received consideration on the transfer (see, Levinsky v. Kraut, 121 AD2d 723, 724, 504 NYS2d 150, 151).

For the purpose of this case, the focus must be on Stephen Iser's transfer of his interest in the real property to the Partnership and his simultaneous acquisition of a controlling interest in that entity. But for the exemption provided for in Tax Law § 1443(5), his acquisition of a controlling interest in the Partnership would have been subject to tax. His subsequent acquisition of an additional 40% interest in the Partnership upon the withdrawal of William Iser from the Partnership was aggregable with his prior acquisition, regardless of whether tax

actually was imposed, and taxable pursuant to Tax Law § 1440(7) and 20 NYCRR former 590.45(d).

The regulation at 20 NYCRR former 590.45(d) stated as follows:

> "(d) Question: If a shareholder acquires a 50-percent interest in a corporation and gains tax is paid on the transfer, and one year later the same shareholder acquires an additional 20 percent, is there a second acquisition of a controlling interest?
>
> "Answer: Yes. The interests acquired after March 28, 1983 are added together in determining whether an acquisition of a controlling interest has occurred. No acquisition of stock will be added to another acquisition of stock if they occur more than three years apart, unless the acquisitions were so timed as part of a plan to avoid the gains tax. An example of this would be if T acquired 80 percent of the stock and simultaneously contracted for the purchase of the remaining 20 percent in three years and one day."

Petitioners argued that the language of 20 NYCRR former 590.45(d) provides that tax must be paid on all acquisitions of controlling interests which are aggregated with subsequent acquisitions. This argument must fail because its interpretation is too narrow. The section, 20 NYCRR former 590.45, concerns the aggregation of interests acquired and former subsection (d) addressed itself to the aggregation of a controlling interest with other interests acquired within three years. In the example given, the fact that gains tax was paid on the acquisition of the controlling interest is of no more significance than the fact that the interest was in a corporation and not some other entity. In fact, the answer to the hypothetical in the regulation never addresses the issue of tax paid on the acquisition of the controlling interest as a sine qua non for aggregation, yet it does address the issue of grandfathering, the three-year limitation on aggregation and an exception thereto.

The importance of 20 NYCRR former 590.45(d) vis-a-vis aggregation is that there can be more than one acquisition of a controlling interest subject to the real property gains tax and, as the Division pointed out, the regulations recognize that the first acquisition need not always be taxed, but may be exempt as a mere change of identity (see, 20 NYCRR former 590.49[b]). The mere change exemption only defers payment of tax on the portion of gain attributed to the mere change exemption (20 NYCRR former 590.50[c]). It was not intended to prevent aggregation with subsequent acquisitions of controlling interests.

Petitioners contend that Matter of Whiteface Limited Partnership (Tax Appeals Tribunal, November 3, 1994), is controlling herein. However, the facts of that case distinguish it from the instant matter. In Whiteface, two partners liquidated their interests in Whiteface Limited Partnership, and another entity, beneficially owned by the same family as the withdrawing partners, acquired an interest which was determined to represent a mere change in the form of ownership with no change in beneficial interest that was subject to tax. The Division argued in Whiteface that the withdrawal of the two partners and the acquisition of the interest by the entity beneficially owned by the same family were two separate transfers. The withdrawal left one remaining partner whose share increased on the withdrawal from 25% to 100%. The acquisition of a 50% interest then followed. This scheme was used to restructure the partnership. The Division argued that the two separate transfers did not qualify for the section 1443(5) exemption while petitioner said it did qualify because the statute applied to mere changes in form "however effected".

The Tribunal said that the two transfers should be seen as one because they were part of a single plan to restructure for the purpose of facilitating bank financing. It utilized the aggregation language of section 1440(7) to accomplish one transfer and then section 1443(5) to exempt that transfer from tax as a mere change.

Unlike the Whiteface matter, the parties herein agree that Stephen Iser's transfer of his 60% interest in the real property to the Partnership in exchange for a 60% interest in the Partnership was eligible for exemption under section 1443(5) as a mere change in identity. But, the subsequent withdrawal from the Partnership by William Iser which effectively transferred his 40% interest to Stephen Iser was clearly subject to aggregation pursuant to 20 NYCRR former 590.45(d).

Further, the total consideration on a transfer is first determined before applying the mere change of identity exemption (see, Matter of Jaffe, supra; 20 NYCRR former 590.50[c]). Stephen Iser received a 60% interest in the real property as stated in the contract. The receipt of

the partnership interest was the receipt of consideration from Timberline Associates, L.P. for the transfer of his interest in the property (Levinsky v. Kraut, supra).

Stephen Iser's beneficial interest in the property did not change, and he received the benefit of the section 1443(5) exemption for that fact. However, it is undeniable, given the discussion above, that an acquisition of a controlling interest supported by consideration occurred and that said transfer was properly aggregated with the subsequent acquisition which constituted a subsequent acquisition of a controlling interest.

B. Having determined that the acquisition of the 40% interest by Stephen Iser was subject to aggregation and taxable, it is now necessary to determine whether penalties were properly assessed herein.

Tax Law § 1446(2)(a) provides, in part, as follows:

> "Any transferor failing to file a return or to pay any tax within the time required by this article shall be subject to a penalty . . . . If the tax commission determines that such failure or delay was due to reasonable cause and not due to willful neglect, it shall remit, abate or waive all of such penalty and such interest penalty." (See also 20 NYCRR former 590.71.)

In the instant matter, petitioners contend that it was reasonable for them to rely on the advice they received from their counsel, Dreyer and Traub, as memorialized in the letter of October 21, 1987. Although the Division argues that the letter was issued months after the transfer and issued to the general partner, T.A. Group, Inc., not William or Stephen Iser, it is noted that Stephen Iser was the president of the general partner, and, both Stephen and William Iser, through paragraph 13.4 of the First Amended and Restated Agreement of Limited Partnership of Timberline Associates, L.P. designated the general partner as the "tax matters partner" of the Partnership, thus making it the proper party to receive the tax advice letter from Dreyer and Traub. Further, the firm of Dreyer and Traub represented the partnership throughout the transfers in issue, evidenced by reference to the firm in the Division's Exhibit I, the mortgage between Timberline Associates, L.P. and William Iser, dated February 26, 1987, eight months prior to the letter upon which reliance is claimed. Therefore, although the letter

was ex post facto, it merely restated the legal assumptions and advice rendered by the firm before and during the transactions.

Due to the standard prescribed by interpretive case law, in general, reliance upon the advice of counsel or a tax professional has met with little success before the Tax Appeals Tribunal. Reliance upon counsel does not, of itself, show reasonable cause (Matter of LT & B Realty Corp. v. New York State Tax Commn., 141 AD2d 185, 535 NYS2d 121). All of the actions of the taxpayer are relevant in determining whether reasonable cause is present (id.). Moreover, the actions must be evaluated in light of the information available at the time (Matter of 61 East 86th Street Equities Group, Tax Appeals Tribunal, January 21, 1993).

In addition, the Division argues herein that this matter is similar to the circumstances found in Matter of Norwest Bank International (Tax Appeals Tribunal, May 3, 1990), where the Tribunal said that the existence of reasonable cause or willful neglect must be determined on a case by case basis in light of all the circumstances specific to the taxpayer in question including such factors as the ability of the taxpayer to understand and carry out its obligations and whether the taxpayer exercised ordinary business care and prudence. Further, the Tribunal said that New York courts have specifically rejected the view that consulting with and following the advice of a tax professional will by itself constitute reasonable cause. It held that to justify a finding of reasonable cause the reliance must itself be reasonable. (See also, Matter of BAP Appliance Corp., Tax Appeals Tribunal, June 29, 1989.)

The Division argues that this matter, like Norwest Bank, presented circumstances where there were indications that the transactions were taxable, it received conflicting advice from its tax advisors, yet it chose not to file returns. In Norwest Bank, this conduct was found to be conscious and intentional.

It is determined that the facts of the instant matter are distinguishable and penalties should be abated. Petitioners' reliance on the advice of their tax professional, the firm of Dreyer and Traub, New York tax professionals, unlike counsel in Norwest Bank, was prudent. Petitioners relied upon their advice throughout the transactions in issue and also exercised

ordinary business care in structuring their transactions and tax filings given the available statutes, regulations and lack of interpretive case law in the area. Unlike the circumstances in Norwest Bank, the October 21, 1987 letter was unequivocal and specifically directed to the transactions in issue, with particular attention to the gains tax implications of the withdrawal of William Iser from the Partnership. Further, as stated above, there was no case law or other interpretive rulings upon which petitioners or their tax professional could rely and it was prudent for petitioners to proceed as if the transfer was not taxable. As the Dreyer and Traub letter reveals, that firm relied on the statutes and regulations as a basis of its opinion and without any other contrary indications. Therefore, neither petitioners nor the firm acted imprudently in not soliciting the advice of the Department of Taxation and Finance before deciding not to file returns in this matter. (See Norwest Bank International, supra.) The penalties assessed herein to William Iser are hereby cancelled.

C. With regard to the petition of Timberline Associates, L.P., it is determined that the Partnership is entitled to a step-up in basis consistent with the determination in Conclusion of Law "A" above, wherein it was determined that there was a second acquisition of a controlling interest upon the withdrawal of William Iser from the partnership (20 NYCRR former 590.49 [b]).

As stated by the Division, "[e]conomic justice demands that Article 31-B be interpreted in such a way that the petitioner pays the tax due on the gain he is realizing and the transferee is allowed a step-up for the consideration paid for the interest acquired (Matter of Cove Hollow Farms, 146 AD2d 49; 539 NYS2d 127)" (Division's brief, p. 12). The interests of economic justice are served by allowing the step-up in basis for Timberline Associates, L.P. as requested by it in its letters to the Division of Tax Appeals, dated September 11, 1995, and the Division is directed to make the necessary adjustments.

D. The petition of William Iser is granted to the extent set forth in Conclusion of Law "B" but in all other respects is denied and the Notice of Determination, issued to him, dated July 29, 1991 is sustained. The petition of Timberline Associates, L.P. is granted to the extent set forth in Conclusion of Law "C" but in all other respects is denied, and the two notices of determination, issued to it, dated August 2, 1991 and December 27, 1993, are sustained.

DATED: Troy, New York
May 9, 1996

/s/ Joseph W. Pinto, Jr.
ADMINISTRATIVE LAW JUDGE