STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :

of :

CAFCOR TRUST REG. VADUZ :

for Revision of a Determination or for Refund of Real Estate Transfer Tax under Article 31 of the Tax Law. :

DETERMINATION
DTA NOS.812682 AND 812683

In the Matter of the Petition :

of :

CAFCOR TRUST REG. VADUZ :

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, Cafcor Trust Reg. Vaduz, Brunschvig, Badel, Lindenfeld et Grumbach, 78 Rue Du Rhone, 1204 Geneva, Switzerland, filed petitions for revision of a determination or for refund of real estate transfer tax under Article 31 of the Tax Law and 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.

A hearing was held before Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York on December 13, 1994 at 9:15 A.M., with all briefs to be filed by April 7, 1995 which commenced the six-month period for issuing this determination. Petitioner filed briefs on February 13, 1995 and April 7, 1995.

The Division of Taxation filed a brief on March 6, 1995. Petitioner appeared by Roberts & Holland (Carolyn J. Lee, Esq. and Carlton M. Smith,Esq., of counsel). The Division of Taxation appeared by Terrence M. Boyle, Esq. (Andrew J. Zalewski, Esq., of counsel, at the hearing and Susan Hutchison, Esq., of counsel on the brief).

ISSUE

Whether New York State may impose real estate transfer tax and real property gains tax on a nonresident trust arising from its transfer of stock of a nonresident corporation to another nonresident corporation when, by such transfer of stock, the corporations have transferred controlling interest in an entity with an interest in real property in New York.

FINDINGS OF FACT

Albert Elias was born in Baghdad, Iraq in 1921. In 1926, he moved to India, where he became successful in the paper trade. In 1976 he became a citizen of the United Kingdom. He currently holds a United Kingdom passport.

In 1984, Albert Elias became a resident of the State of Israel. As of the date of the hearing, he continued to reside in Israel.

Albert Elias has never resided in or engaged in the conduct of any trade or business in the United States. He has never owned any United States real property or been a partner of any partnership engaged in the conduct of any trade or business in the United States or owning United States real property.

Albert Elias believes he was not required to file, and he

has never filed, United States income tax returns.

On November 23, 1962, Albert Elias created a Liechtenstein trust, Cafcor Trust Reg. Vaduz ("Cafcor") to hold most of his investment assets and to invest those assets throughout the world. The trust was created in accordance with the Statute of April 10, 1928, Law Gazette of Liechtenstein No. 6 of June 18, 1928, and was registered number H. 621/100 with the Public Register of Liechtenstein. Initially, Albert Elias capitalized Cafcor with 10,000 Swiss Franks. He subsequently contributed additional cash and property to Cafcor.

Albert Elias retains the power to dissolve Cafcor at any time and does not require the consent of any trustee, beneficiary or any other person to do so. If he dissolves Cafcor during his lifetime, all of Cafcor's income and assets revert to his ownership.

In the 1980's and through 1991, Cafcor had bank accounts in Switzerland, Israel, the United Kingdom and the United States. In this period, Cafcor also owned stocks and bonds of corporations located throughout the world, including stocks and bonds of United States corporations and stocks and bonds of corporations with United States investments.

Cafcor had investments in countries other than the United States. For example, Cafcor indirectly owned three hotels in Israel.

The trustees of Cafcor managed the trust in Switzerland, at Albert Elias's direction. Albert Elias always controlled the investment decisions regarding Cafcor's assets. The trustees

met with Albert Elias, generally in Switzerland, or corresponded or communicated telephonically with Albert Elias from the trustees' offices in Switzerland to review the status of the trust's investments and receive direction from Albert Elias. From their offices in Switzerland, the trustees take such actions as are necessary to implement decisions regarding management and investment of the trust's assets.

Since 1985, Albert Elias has conducted his business activities and managed his personal investments and the investments of Cafcor from his offices in Tel Aviv, Israel. Prior to 1985, he conducted his business and investment activities from offices in London.

Cafcor is purely an investor. It has never had any employees and has never engaged in an active trade or business. It has never had an office in the United States, owned United States real property, or conducted any business in the United States. It has never been a partner in a partnership that was engaged in a trade or business in the United States or that owned United States real property. Cafcor has used United States brokerage firms to effect purchases and sales of stocks and bonds in United States companies, and has appointed an attorney-in-fact to perform certain acts for Cafcor, but Cafcor has not otherwise had any agent or representative in the United States. Cafcor has never filed income tax returns in the United States.

In the late 1970's, Albert Elias became aware of the possibility of acquiring a lease on the Lancaster Hotel (later

known as the Madison Towers Hotel), located at 22 East 28th Street in Manhattan, together with an option to buy the hotel. The hotel contains approximately 300 rooms and has commercial and retail space on the street level.

For various reasons, including the insulation of other trust assets from potential liabilities, privacy, and income tax planning, Albert Elias was advised that any acquisition of the hotel property should be made by a corporation. A Netherlands Antilles limited liability company was chosen as the vehicle for acquiring the hotel.

Accordingly, on February 5, 1979, Cafcor incorporated, and became the sole shareholder of, a limited liability company (a Naamloze Vennootschap) created under the laws of Curacao, Netherlands Antilles. The company was originally named Bedford N.V., though later in 1979 its name was changed to Migdal Madison N.V. ("Migdal"). None of the activities relating to the formation of Migdal or Cafcor's exercise of its rights as Migdal's shareholder took place in the United States. Migdal was formed in Curacao, and shareholder meetings took place in Curacao or Switzerland. The certificates evidencing Cafcor's ownership of Migdal were maintained in Israel.

On September 12, 1979, Migdal purchased the lessee's position in an existing lease relating to the Lancaster Hotel, and under the lease's purchase option, on May 4, 1980, Migdal purchased the hotel itself. Migdal's negotiations and consummation of these acquisitions were effected by its officers; Cafcor's trustees did not participate in these

activities.

After the acquisition of the hotel, Migdal commenced a renovation of the property. During the renovation, Migdal became short of funds and, as a result, sold the hotel to a newly created New York limited partnership, Manhattan Hospitality Associates, in 1982 in a transaction that raised approximately $4.5 million for Migdal. Migdal leased the property back from the partnership to continue operating the hotel and used the additional funds to complete the renovation. Manhattan Hospitality Associates was owned by third parties, and neither Cafcor nor Albert Elias was a partner in Manhattan Hospitality Associates.

In 1986, Migdal and Simon Elias (Albert Elias's son) acquired all of the partnership interests of Manhattan Hospitality Associates from the original partners in a transaction under which the original partners received approximately $7.5 million. After this 1986 transaction, Migdal owned a 99% general partnership interest in Manhattan Hospitality Associates and Simon Elias owned a 1% limited partnership interest in Manhattan Hospitality Associates.

On February 1, 1991, Cafcor sold all of its stock in Migdal to Jolly Hotels S.P.A., an Italian corporation owning a chain of hotels primarily in Italy and other parts of Europe. Simultaneous with this sale, Simon Elias sold his 1% interest in Manhattan Hospitality Associates to Jolly Hotels U.S.A., Inc., a New York corporation. Neither Albert Elias nor his family nor Cafcor owned any stock in Jolly Hotels S.P.A.

In negotiating this sale, Albert Elias met with representatives of Jolly Hotels S.P.A. in Geneva, where the principal terms of the transaction were agreed upon. Subsequently, as the negotiations were finalized and the documentation completed, Albert Elias conferred with various parties from his offices in Israel. The final decision to sell the Migdal stock was made by Cafcor's trustees in Switzerland. Said decision was based upon their discussions with Albert Elias, who conferred with the trustees in Switzerland from his home and office in Israel. Neither Albert Elias nor the trustees traveled to New York to negotiate the terms of the stock sale or to effect the sale.

Neither Albert Elias nor Cafcor's trustees attended the closing of the sale of Migdal's stock. Simon Elias attended the closing. He was authorized under a power of attorney from the trust to act on the trust's behalf in signing the necessary documents and making all necessary New York State real property gains tax and real estate transfer tax filings. Simon Elias signed the closing documents on behalf of Cafcor.

During the period Cafcor owned Migdal, the trustees of Cafcor were not involved and did not engage in the management of the hotel or of Migdal. During that period, Albert Elias visited the United States approximately once a year to monitor and observe the investment, but he had no legal role and no practical involvement in the management of Migdal or in its management of the hotel.

When Migdal first leased the hotel in 1979, it hired an

unrelated management company, First Hospitality Services, to manage the hotel.

In 1979, Simon Elias, then a citizen of the United Kingdom, came to the United States to obtain a graduate degree at Tulane University in New Orleans. Shortly after his graduation, in 1982, Simon Elias became one of the Managing Directors of Migdal and began managing the hotel in the place of First Hospitality Services.

Simon Elias worked for Migdal as a salaried employee. He received no compensation for his work from Cafcor or his father. His duties in managing the hotel as Migdal's employee included performing accounting procedures, increasing business sales, overseeing the hotel's renovation and maintenance, and, generally, maximizing its revenues and profits. In the period Simon Elias worked at Migdal, Migdal employed approximately 60 other people to work on the hotel staff.

When it first began operation in New York, Migdal applied for authority to do business in New York as a foreign corporation under Business Corporation Law § 1304. It became authorized to do business in New York under that section on September 19, 1979 (though, originally under the name Bedford, N.V.).

During the period that Cafcor owned Migdal, Migdal filed United States Federal income tax returns as a corporation on Form 1120F and New York State franchise tax returns as a corporation on Form CT-3.

In connection with Cafcor's sale of Migdal stock and

Simon Elias's sale of his interest in Manhattan Hospitality Associates, in 1991, filings were made with respect to the real property transfer gains tax and real estate transfer tax. On the filings, Cafcor and Simon Elias reported the sales as subject to real property transfer gains tax and real estate transfer tax. Simon Elias signed Cafcor's filings under his power of attorney from Cafcor.

On February 13, 1991, Cafcor paid real estate transfer tax in the amount of $109,296.00 on its sale of the Migdal stock.

On February 14, 1991, Cafcor paid real property transfer gains tax in the amount of $534,529.60 on its sale of the Migdal stock.

As a result of an audit, on February 15, 1991, Cafcor paid additional real property transfer gains tax in the amount of $881,100 on its sale of the Migdal stock.

On February 2, 1993, Cafcor filed a claim for refund of real estate transfer tax of $109,296.00 paid with respect to the sale of the Migdal stock on the grounds that the tax as applied to this transaction violated the Due Process Clauses of the United States and New York Constitutions, the Commerce Clause of the United States Constitution, and article XVI, § 3 of the New York Constitution.

On February 3, 1993, Cafcor filed a claim for refund of real property transfer gains tax of $1,424,530.00 paid with respect to the sale of the Migdal stock on the grounds that the tax as applied to this transaction violated the Due Process Clauses of the United States and New York Constitutions, the

Commerce Clause of the United States Constitution, and article XVI, § 3 of the New York Constitution. Petitioner concedes that if a refund is due, the tax to be refunded is $1,415,629.60, rather than $1,424,530.00.

In a letter dated December 17, 1993, the Division of Taxation ("Division") denied the claim for refund of real property transfer gains tax, contending that the tax was constitutional as applied to the transaction.

In a letter dated December 24, 1993, the Division denied the claim for refund of real estate transfer tax, contending that the tax was constitutional as applied to the transaction.

The Division asserts that New York has nexus to Cafcor based upon the attribution to Cafcor of the assets owned by Migdal.

On March 17, 1994, Cafcor timely filed separate petitions with the Division of Tax Appeals contesting the denials of the two refund claims on the same grounds as those set forth in the refund claims.

In accordance with State Administrative Procedure Act § 306(1), petitioner's proposed findings of fact have generally been accepted and included herein. It is noted that proposed findings of fact "8", "9" and "23" were changed to reflect the record. Proposed finding of fact "37" was rejected because it was in the nature of a conclusion of law.

CONCLUSIONS OF LAW

A. Initially, petitioner argues that the Federal and New York Constitutions impose nexus requirements that limit the

power of New York to impose real property gains tax and real estate transfer tax on foreign persons. It is submitted that these limitations prohibit the taxation of Cafcor because Cafcor does not have sufficient presence in New York.

Relying upon Quill Corporation v. North Dakota (504 US 298, 119 LEd 2d 91), it is petitioner's position that it does not have a sufficient nexus to New York to permit the imposition of a tax on a stock sale. After explaining that "transactional" nexus is not at issue in this case, petitioner contends that Cafcor did not have a sufficient presence in New York to satisfy the Federal constitutional standard for nexus to tax with respect to either the Federal Due Process Clause or the Commerce Clause. Petitioner further submits that the New York Constitution also imposes a nexus requirement and it is clear that Cafcor's presence in New York is insufficient to give New York jurisdiction to tax Cafcor.

On the basis of Rhode Island Hospital Trust Company v. Doughton (270 US 69, 46 Sup Ct 256, 70 L Ed 475) and In re Gates' Estate (243 NY 193), petitioner next argues that the United States Supreme Court and the New York Court of Appeals have held that a state cannot tax a corporation's shareholder on the basis of the presence of corporate assets in the state. Further, petitioner maintains that the cases relied upon by the Division, Matter of Bredero Vast Goed, N.V. v. Tax Commn. of the State of N.Y. (146 AD2d 155, 539 NYS2d 823, appeal dismissed 74 NY2d 791, 545 NYS2d 105) and 595 Investors Ltd. Partnership v. Biderman (140 Misc 2d 441, 531 NYS2d 714), are distinguishable

and inapplicable to this case.

Lastly, petitioner submits that the imposition of real property gains tax and real estate transfer tax on the sale of stock by a person not domiciled in New York is precluded by article XVI, § 3 of the New York State Constitution.

B. In response to the foregoing, the Division first argues that Cafcor's physical presence in New York is not required under the United States Constitution to satisfy the due process requirement for nexus to tax. It is submitted that there is no question that New York has a "minimum connection" with the transaction it seeks to tax. According to the Division, there is also no question that the income attributed to the State is rationally related to values connected to New York. The Division maintains that Cafcor derived an economic benefit from its ownership of Migdal, which was formed for the purpose of acquiring real property. Further, there is no question that Cafcor derived an economic benefit from the transfer to Jolly. The Division posits that New York's taxation of the transaction is not fundamentally unfair to petitioner.

With respect to the Commerce Clause, the Division first notes that the Court in Quill did not address the issue of whether the physical presence of a foreign corporation in the state was a necessary element of nexus in order to permit the state to impose taxes other than sales and use taxes. It is maintained that Quill represents a narrow and limited decision with respect to issues of nexus and the application of the Commerce Clause.

Relying upon Allied-Signal v. Commr. of Finance (79 NY2d 73, 580 NYS2d 696), the Division maintains that New York may tax Cafcor's gain or the consideration from the transfer of real property located within New York because it is evident that New York has afforded privileges to Migdal which contributed to the appreciation of the real property which thereby benefited Migdal's sole shareholder, Cafcor. Citing International Harvester Co. v. Dept. of Taxation (322 US 435, 88 L Ed 1373) and Geoffrey, Inc. v. South Carolina Tax Commn. (437 SE2d 13, cert denied ___ US ___, 114 S Ct 550, 126 L Ed 451), the Division posits that:

> "Indisputably, in this case, Cafcor, through its sole ownership of Migdal, owned real property in New York and derived an economic gain from that real property ownership. Thus, there can be no question that Cafcor has a 'substantial nexus' with New York State and that New York's imposition of RETT and gains tax in this matter does not violate the commerce clause of the United State [sic] Constitution" (Division's brief, p. 13).

The Division next argues that American Ins. Assn. v. Lewis (50 NY2d 617, 431 NYS2d 350) does not support petitioner's position that the imposition of the taxes at issue herein violates the Due Process Clause of the New York Constitution.

The Division submits that the decisions in Rhode Island Hospital Trust Co. v. Doughton (supra) and In re Gates' Estate (supra) are not controlling for purposes of the constitutional standard for nexus. According to the Division, New York is not seeking to impose tax on the transfer of stock but on the transfer of real property located within New York. It is also argued that while a corporation is a distinct legal entity

separate from a shareholder, a taxing authority can, under some circumstances, look through the corporate structure and view the corporation and shareholder as one. Lastly, it is argued that the Rhode Island case does not consider the minimum contacts analysis of International Shoe v. Washington (326 US 310, 90 L Ed 95) as to when jurisdiction is obtainable.

Finally, the Division maintains that the New York Constitution does not prohibit the imposition of tax in this case. It is submitted that petitioner's analysis of In re Williams (173 Bankr 459) is incorrect. It is also contended that neither the real estate transfer tax nor the real property gains tax impose an ad valorem tax on intangible personal property in contravention of article XVI, § 3 of the New York State Constitution.

C. In its reply brief, petitioner argues that neither the statutes nor the case law support the Division's conception of nexus. According to petitioner, the gains tax statutes and the transfer tax statutes recognize a distinction between direct ownership of real property and the ownership of interests in corporations and other entities. Petitioner submits that the case law does not support the conclusion that a shareholder's contacts with a state are tested by characterizing the shareholder as owning and transferring corporate property.

Petitioner next maintains that the system of statutory interpretation and extrapolation which looks through entities is irrelevant to the question of whether a foreign shareholder with no New York contacts can be subjected to New York tax based on

the attribution of the corporation's assets to the shareholder. Petitioner proceeds to argue that the cases cited by the Division fail to support the Division's theory for attributing to Cafcor nexus to New York, and clearly do nothing to undercut the conclusion of Rhode Island Hospital Trust and In re Gates that a shareholder is not the owner of corporate property for purposes of establishing a nexus to tax.

Petitioner contends that Cafcor did not purposefully avail itself of the benefits or protections of New York. Further, it is argued that the Division's approach ignores the difference between owning real property and owning stock. Petitioner submits that the fundamental fairness at issue herein concerns whether a person has sufficient contact with the state to be held accountable for taxes. It is argued that, by this standard, Cafcor's ties to New York are not sufficient to permit New York to impose tax on Cafcor. According to petitioner, Rhode Island Hospital Trust and In re Gates retain their validity. Further, Rhode Island Hospital Trust and In re Gates are neither inconsistent with nor outdated by International Shoe.

After distinguishing Geoffrey, petitioner contends that while New York has afforded privileges and opportunities to Migdal, this does not entitle New York to tax Cafcor. Similarly, petitioner posits that it did not avail itself of the privilege of transacting business within the State within the meaning of American Ins. Assn. Lastly, petitioner points out that it agreed with the comments by the court in In re Williams

to the effect that most courts have concluded that the gains tax is different from an income tax.

D. In order to analyze the issues presented, it is necessary to characterize the transaction at issue. In effect, petitioner has presented this case as one in which New York has attempted to impose tax upon a foreign trust which transferred shares of stock in a foreign corporation to another foreign corporation. In contrast, the Division views the transaction in issue as a tax imposed on the transfer of real property in New York.

The case of Bredero Vast Goed, N.V. v. Tax Commn. of the State of N.Y. (supra) presents an analogous situation to that involved herein. In Bredero, three Netherlands public corporations jointly owned a New York corporation which was an 85% general partner in a partnership which held title to real property in New York City. The stock of the New York corporation was conveyed to another corporation. Following the denial of a refund and the denial of its petition by the Tax Appeals Tribunal, petitioner commenced a proceeding and argued, among other things, that the two-tiered transaction was one-step removed from the transfer of real property because the corporation did not directly own the property. Thereafter, the Appellate Division affirmed the denial of the petition. In its decision, the court noted that the term "transfer of real property" is broadly defined by Tax Law § 1440(7) as:

> "the transfer or transfers of any interest in real property by any method, including but not limited to * * * acquisition of a controlling interest in any entity with an interest in real property" (emphasis in

original). (Id., 539 NYS2d at 825.)

The court also noted that pursuant to Tax Law § 1440(2), a "controlling interest" is defined as a 50% or more beneficial interest in an entity. The Appellate Division then concluded that there was a transfer of real property with the meaning of Tax Law § 1440(7) stating:

> "Here, respondent looked beyond the two-tiered nature of the conveyance and determined that petitioners 'effectively' transferred an interest in the 342 Madison Avenue building. This construction keys into the economic reality that the partnership's sole asset consisted of the Madison Avenue property, and that the new 85% general partner, RPBLC, acquired a controlling interest in the real estate. In our view, respondent's interpretation is entirely rational and we defer to that construction (citation omitted)" (id., 539 NYS2d at 825).

On the basis of Bredero, it is concluded that there was a transfer of real property within the meaning of Tax Law § 1440(7). It is also determined that similar reasoning supports the conclusion that it is proper to analyze the legal issues raised by petitioner on the premise that there was a transfer of real property in New York because this was the gravamen of the transaction. Any other approach would ignore the economic reality of the transaction at issue herein.

E. Petitioner's arguments do not compel a different result. Petitioner is correct that if Cafcor had sold less than 50% of the stock of Migdal, or any amount of nonvoting stock, the Division could not have argued that Cafcor transferred New York real property (see, Tax Law § 1440[2]). However, this does not mean that there is no statutory basis for treating persons transferring stock as if they transferred real property.

Rather, the statutory definition of a controlling interest merely recognizes the economic reality that when a person transfers 50% or more of the voting stock of a corporation which owns real property, there has effectively been a transfer of real property.

Petitioner's argument that case law does not support the conclusion that a shareholder's contacts with a state are tested by characterizing the shareholder as owning and transferring corporate property misstates the point. Namely, when there is a transfer of real property in New York, the connection to New York is evident. When there is a transfer of a controlling interest in a corporation that owns real estate, the real estate has also been conveyed. Petitioner's focus upon the transfer of stock overlooks the fact that the only taxes in issue are those which arise from the transfer of real estate in New York.

F. Petitioner's first argument is that, on the basis of Quill, New York does not have a sufficient nexus to either Cafcor or the transaction to impose a tax.

In Quill, North Dakota filed an action to require Quill Corporation to collect and pay a use tax on goods purchased for use within the State. Quill Corporation was an out-of-state mail-order house that did not have outlets or sales representatives in North Dakota. It did not have any employees that worked within the State and it owned little or no tangible personal property in North Dakota. Quill sold office equipment and supplies through catalogues, flyers, advertisements in national periodicals and telephone calls. Its annual national

sales were over $200,000,000.00 of which close to $1,000,000.00 were made to about 3,000 customers in North Dakota. Quill was the sixth largest seller of office supplies in North Dakota. The corporation's North Dakota customers received their merchandise by mail or common carrier from out-of-state locations.

With respect to the Due Process Clause, the Court in Quill stated:

> "The Due Process Clause 'requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax', Miller Bros. Co. v. Maryland, 347 US 340, 344-345, 98 L Ed 744, 74 S Ct 535 (1954), and that the 'income attributed to the State for tax purposes must be rationally related to "values connected with the taxing State."' Moorman Mfg. Co. v Bair, 437 US 267, 273, 57 L Ed 2d 197, 98 S Ct 2340 (1978) (citation omitted).

* * *

> "Our due process jurisprudence has evolved substantially in the 25 years since Bellas Hess, particularly in the area of judicial jurisdiction. Building on the seminal case of International Shoe Co. v. Washington, 326 US 310, 90 L Ed 95, 66 S Ct 154, 161 ALR 1057 (1945), we have framed the relevant inquiry as whether a defendant had minimum contacts with the jurisdiction 'such that the maintenance of the suit does not offend "traditional notions of fair play and substantial justice."' Id., at 316, 90 L Ed 95, 66 S Ct 154, 161 ALR 1057 (quoting Milliken v Meyer, 311 US 457, 463, 85 L Ed 278, 61 S Ct 339, 132 ALR 1357 (1940)). In that spirit, we have abandoned more formalistic tests that focused on a defendant's 'presence' within a State in favor of a more flexible inquiry into whether a defendant's contacts with the forum made it reasonable, in the context of our federal system of government, to require it to defend the suit in that State. In Shaffer v Heitner, 433 US 186, 212, 53 L Ed 2d 683, 97 S Ct 2569 (1977), the Court extended the flexible approach that International Shoe had prescribed for purposes of in personam jurisdiction to in rem jurisdiction, concluding that 'all assertions of state-court jurisdiction must be evaluated according to the standards set forth in International Shoe and its progeny.'

> "Applying these principles, we have held that if a foreign corporation purposefully avails itself of the benefits of an economic market in the forum State, it may subject itself to the State's in personam jurisdiction even if it has no physical presence in the State.
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> * * *
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> "Comparable reasoning justifies the imposition of the collection duty on a mail-order house that is engaged in continuous and widespread solicitation of business within a State. Such a corporation clearly has 'fair warning that [its] activity may subject [it] to the jurisdiction of a foreign sovereign.' Shaffer v Heitner, 433 US, at 218, 53 L Ed 2d 683, 97 S Ct 2569 (Stevens, J., concurring in judgment).
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> "In this case, there is no question that Quill has purposefully directed its activities at North Dakota residents, that the magnitude of those contacts is more than sufficient for due process purposes, and that the use tax is related to the benefits Quill receives from access to the State. We therefore agree with the North Dakota Supreme Court's conclusion that the Due Process Clause does not bar enforcement of that State's use tax against Quill" (Quill Corp. v. North Dakota, supra, 119 L Ed 2d at 102-104).

G. Judged by the foregoing standards, it is clear that New York has "some minimum connection" with the transaction it seeks to tax. As noted by the Division, the transaction which New York seeks to tax is the transfer of real property located within the State of New York.[1] The transfer of the real estate was accomplished through the transfer of a controlling interest in Migdal.

The record also establishes that the income attributed to

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[1]Tax Law § 1402 imposes a real estate transfer tax on each conveyance of real property when the consideration exceeds $500.00. Real property, in turn, is defined as every estate or right, except sepulcher, located in whole or in part within the state of New York (Tax Law § 1401[c]). Real property gains tax is imposed by Tax Law § 1441 on gains derived from the transfer of property within New York.

New York is rationally related to values connected to New York (id., 119 L Ed 2d at 102). The real estate transfer tax is based on the consideration for the conveyance (Tax Law § 1402). The real property gains tax is based on gain derived from the transfer of real property (Tax Law § 1441). Since the property is situated in New York, the relationship to New York is evident.

The record shows that a Netherlands Antilles limited liability company was chosen by Cafcor as a vehicle for acquiring a particular hotel in New York City. Cafcor was the sole shareholder of the limited liability company which accomplished Cafcor's goal of acquiring the desired hotel. Under these circumstances, there is no question that Cafcor purposefully directed its activities at New York State and the magnitude of this effort was sufficient for due process purposes. Further, it is noted that petitioner has not argued that it did not have "notice" or "fair warning" that its transactions would be subject to tax (see, Quill Corp. v. North Dakota, supra, 119 L Ed 2d at 102).

H. It is petitioner's position that Cafcor did not have a sufficient presence in New York to satisfy the Federal constitutional standard for nexus to tax under the Commerce Clause as interpreted by Quill.

A four-part test, which was set forth in Complete Auto Transit v. Brady (430 US 274, 97 S Ct 1076, 51 L Ed 2d 326), currently governs the validity of state taxes under the Commerce

Clause.

Under the Complete Auto four-part test, a tax will be sustained against a Commerce Clause challenge provided the tax:

> "[1] is applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State" (Complete Auto Transit v. Brady, supra, at 279, 51 L Ed 2d 326, 97 S Ct 1076).

Here, the only issue presented concerns the first criteria, i.e., nexus. In Quill, the Court noted that although the Due Process and Commerce Clauses have a nexus test, the standards are not the same because they are driven by different concerns (Quill Corp. v. North Dakota, supra, 119 L Ed 2d at 106). In Quill, the Court explained the differences as follows:

> "Due process centrally concerns the fundamental fairness of governmental activity. Thus, at the most general level, the due process nexus analysis requires that we ask whether an individual's connections with a State are substantial enough to legitimate the State's exercise of power over him. We have, therefore, often identified 'notice' or 'fair warning' as the analytic touchstone of due process nexus analysis. In contrast, the Commerce Clause, and its nexus requirement, are informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy." (Id., 119 L Ed 2d at 106.)

On the basis of the difference in considerations, the Court concluded in Quill that physical presence in the taxing state was not required to support jurisdiction under the Due Process Clause (id., 119 L Ed 2d at 104; see, Matter of Orvis Co. v. Tax Appeals Tribunal, ___ NY2d ___ [June 14, 1995]). However, in order to support jurisdiction to tax under the Commerce Clause, the Court in Quill adhered to the precedent it established in National Bellas Hess v. Dept. of Revenue of Illinois (386 US

753, 18 L Ed 2d 505) and held there must be some physical presence of an interstate mail-order vendor in the taxing state. The Court presented two reasons for requiring the physical presence of the vendor -- (1) it established a "bright line" test and created a "discrete realm of commercial activity that is free from interstate taxation" (Quill Corp. v. North Dakota, supra, 119 L Ed 2d at 108) and (2) it satisfies the demands of stare decisis (id., 119 L Ed 2d at 110).

As subsequently interpreted by the Court of Appeals in Orvis, while physical presence of a mail-order vendor is required, it need not be substantial. However, it must be clearly greater than a "slightest presence".

I. Petitioner's reliance upon Quill to establish the lack of nexus is troubling since Quill involved an attempt by a state to impose on obligation to collect and remit use tax on a nonresident mail-order vendor. In contrast, the instant matter concerns a foreign trust which, through the transfer of stock, effectively conveyed real estate in New York. On its face, the factual situations are readily distinguishable. The difference in the situations is highlighted by the fact that in Quill the Court specifically noted that it had not articulated the same physical presence requirements for taxes other than sales and use taxes (id., 119 L Ed 2d at 108).

Guidance on the issue of whether physical presence is required may be found in Matter of Allied-Signal v. Commr. of

Finance (supra).[2] In this case, the Court of Appeals addressed the question of "whether New York City may constitutionally tax any portion of the dividend and capital gain income that a non-domiciliary corporation receives [Bendix] by reason of its investment in another corporation conducting business within the City [ASARCO] in the absence of a unitary business relationship between the two corporations" (id., 500 NYS2d at 697; emphasis in original). The Court concluded that such a tax would be acceptable over both Due Process Clause and Commerce Clause objections. The Court explained its position as follows:

> "In determining whether a sufficient nexus exists between a taxing jurisdiction and the income it seeks to tax, the Supreme Court has emphasized that the inquiry should focus upon whether 'the taxing power exerted * * * bears fiscal relation to protection, opportunities and benefits given by the state. The simple but controlling question is whether the state has given anything for which it can ask return' (Wisconsin v. Penney Co., 311 US 435, 444, 61 S Ct 246, 250, 85 L Ed 267; see, Norfolk & W. Ry. Co. v. Tax Commn., 390 US 317, 325, n. 5, 88 S Ct 995, 1001, 19 L Ed 2d 1201. Here, it is undisputed that New York City has afforded privileges and opportunities to ASARCO. That these privileges and opportunities have contributed to ASARCO's capital appreciation and thus also inured to the benefit of all its shareholders, including Bendix, is also beyond question. Thus, we agree with the City that it has given Bendix something 'for which it can ask return,' and that consequently a sufficient nexus existed to support the City's tax.
>
> "Indeed, it would be difficult to reconcile a contrary conclusion with the Supreme Court's decision in Harvester Co. v. Department of Taxation, 322 US 435, 64 S Ct 1060, supra. There, the Court upheld the Wisconsin Privilege Dividend Tax which--in its practical operation--worked very similarly to the tax at issue here. Both were imposed on nondomiciliary

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[2] As argued by petitioner, it is recognized that the issue in Allied-Signal is not identical to that presented herein. However, it is concluded that the case is instructive for the general principles espoused.

shareholders based on the presence in the taxing jurisdiction of the corporation which generated the investment income sought to be taxed. Significantly, in upholding the Wisconsin tax against constitutional challenge, the Supreme Court expressly rejected the notion that the taxing power exerted by a State had to be premised on the taxpayer's own activities within the State:

> '[A state] may impose the burden of the tax * * * upon the stockholders who derive the ultimate benefit from the corporation's [state] activities. Personal presence within the state of the stockholder-taxpayers is not essential to the constitutional levy of a tax taken out of so much of the corporation's [state] earnings as is distributed to them. A state may tax such part of the income of a non-resident as is fairly attributable either to property located in the state or to events or transactions which, occurring there, are * * * within the protection of the state and entitled to the numerous other benefits which it confers. * * *And the privilege of receiving dividends derived from corporate activities within the state can have no greater immunity than the privilege of receiving any other income from sources located there' (id., at 441-442, 64 S Ct, at 1063-1064 [emphasis supplied]; see also, Shaffer v. Carter, 252 US 37, 40 S Ct 221, 64 L Ed 445)." (Id., 580 NYS2d at 701-702.)

On the basis of Allied-Signal it is concluded that Cafcor's presence within New York is unnecessary to establish nexus.[3] (See also, Geoffrey v. South Carolina Tax Commn., 437 SE 2d 13, supra.) Further, it is undisputed that New York has afforded privileges and opportunities to Migdal. These privileges and opportunities contributed to Migdal's capital appreciation and thus inured to the benefit of Cafcor. Therefore, New York has given Cafcor something for which it can ask return.

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[3] In its reply brief, petitioner declined to assert that a physical presence in New York was required. However, petitioner contended that some minimal contact between the state and the would-be taxpayer was required.

Consequently, it is found that there is a sufficient nexus to support the real property gains

tax and the real property transfer tax over the objection that such taxes are barred by the Commerce Clause.

J. Citing American Insurance Assn. v. Lewis (supra), petitioner argues that the New York Constitution also imposes a nexus requirement and that Cafcor's presence in New York is insufficient to give New York jurisdiction to tax Cafcor.

Petitioner's reliance upon the American Insurance case is misplaced. In that case there was a challenge to an amendment to a law which sought to make fire and extended coverage available to persons who otherwise would be unable to obtain adequate private insurance protection. Under the amendment, those companies with a greater net worth had to pay more. The amendment did not have a method for determining how much of the tax could be ascribed to the insurance companies' business in New York and how much to the insurance companies' business in other states. In concluding that the provision violated due process, the Court stated:

> "However, it is obvious that, absent a methodology by which to allocate an insurer's net worth to business activity or to property located in New York--and the statutory formula is bare of such a provision--the 'capping' inevitably must reach an arbitrary, unapportioned percentage of out-of-State property. Patently, no means by which to assure that the tax is one focused on an intrastate measure of value is discernible." (Id., 431 NYS2d at 356.)

K. As noted by the Division, the facts presented herein are readily distinguishable from these presented in American

Insurance. The real estate transfer tax and the real property gains tax are imposed on the consideration or the gain arising from transfers of real property in the state of New York. Unlike the situation in American Insurance, the taxing power is not being extended "to tangible or intangible property having no connection or relationship to the taxing State" (id., 431 NYS2d at 354).

L. Petitioner cites Rhode Island Hospital Trust (supra) and In re Gates' Estate (supra) for the proposition that the United States Supreme Court and the New York Court of Appeals have held that a state cannot tax a corporation's shareholder based on the presence of corporate assets within the state.

In the Rhode Island case, North Carolina attempted to impose a transfer or inheritance tax upon shares of stock which were owned by a resident of Rhode Island in R.J. Reynolds Tobacco Company ("Reynolds Tobacco"). Reynolds Tobacco was incorporated in the State of New Jersey and was authorized to do business in the State of North Carolina. Two-thirds of Reynolds Tobacco's property was located in North Carolina.

The Supreme Court concluded that the North Carolina tax was unconstitutional utilizing the following reasoning:

> "It goes without saying that a state may not tax property which is not within its territorial jurisdiction . . . . A state has no power to tax the devolution of the property of a non-resident unless it has jurisdiction of the property devolved or transferred. In the matter of intangibles, like choses in action, shares of stock, and bonds, the situs of which is with the owner, a transfer tax of course may be properly levied by the state in which he resides. So, too, it is well established that the state in which a corporation is organized may provide in creating it for the taxation in that state of all its shares,

> whether owned by residents or non-residents . . . . In this case the jurisdiction of North Carolina rests on the claim that, because the New Jersey corporation has two-thirds of its property in North Carolina, the state may treat shares of its stock as having a situs in North Carolina to the extent of the ratio in value of its property in North Carolina to all of its property. This is on the theory that the stockholder is the owner of the property of the corporation, and the state which has jurisdiction of any of the corporate property has pro tanto jurisdiction of his shares of stock. We can not concur in this view. The owner of the shares of stock in a company is not the owner of the corporation's property. He has a right to his share in the earnings of the corporation, as they may be declared in dividends, arising from the use of all of its property. In the dissolution of the corporation he may take his proportionate share in what is left, after all the debts of the corporation have been paid and the assets are divided in accordance with the law of its creation. But he does not own the corporate property." (Id.)

The Court proceeded to note that since the stockholder does not own the corporate property, jurisdiction over the shares of stock could not be based on the location of the corporate property. The Court further noted that North Carolina could not control the devolution of the New Jersey shares. However, this could be determined by Rhode Island where the decedent lived or by the laws of New Jersey which was the state of incorporation. (Id.)

In the case of In re Gates' Estate (supra), the Court of Appeals reviewed a provision which taxed the transfer by a nonresident of intangible property evidenced by or consisting of shares of stock or bonds when "the property represented by such shares of stock, bonds, * * * consists of real property which is located, wholly or partly, within the state of New York" (id., at 195). The Court concluded that the foregoing tax was void. In reaching this conclusion the Court noted that the stocks and

bonds only represent the intangible rights of a stockholder or bondholder. Neither the stock nor the bonds consist of real property. After quoting the Rhode Island Hospital Trust case, the Court determined that "[t]he state of New York might not tax the transfer of shares in foreign corporations owned by a nonresident" (id., at 197).

M. The foregoing cases are readily distinguishable from the current matter. Unlike the Rhode Island Hospital Trust or In re Gates cases, New York is not seeking to impose tax on the transfer of stock. Rather, New York is imposing a tax on the consideration or gain arising from the transfer of real property in New York. This point was recognized by the Court in Bredero which found that for purposes of the gains tax the conveyance of the controlling interest in a corporation was "effectively" a transfer of real property. A similar conclusion was reached by the Court in 595 Investors Ltd. Partnership v. Biderman (supra) with respect to the real estate transfer tax. Since New York is asserting tax on the consideration or gain derived from the transfer of property in New York, New York has jurisdiction to impose the taxes in issue.

N. In reaching the foregoing conclusion, petitioner's attempt to distinguish Bredero and 595 Investors has been considered and rejected. Contrary to petitioner's suggestion, the critical fact in Bredero was not that a New York corporation was transferred. Rather, the crux of the decision was that petitioners had "effectively" transferred real property (id., 539 NYS2d at 825). Similarly, the taxpayer was found liable for

real property transfer tax in 595 Investors because the court gave effect to the purpose of the legislation which was "to tax transactions which effectively, but indirectly, convey real property" (id., 531 NYS2d at 717). Petitioner's attempt to limit 595 Investors to those instances where the real property was held by a passive or sham corporation is rejected.

O. Several additional points warrant attention. There is no reason to believe that the Division's interpretation of the real property gains tax would create "structural concerns about the effects of state regulation on the national economy" (Quill Corp. v. North Dakota, supra, 119 L Ed 2d at 106). To the extent pertinent herein, the real property gains tax is imposed only if there is a transfer of a "controlling interest in any entity with an interest in real property" (Tax Law § 1440[7]). The real estate transfer tax defines a conveyance, in part, as a "transfer or acquisition of a controlling interest in an entity with an interest in real property" (Tax Law § 1401[e]). Therefore, petitioner's concern about a hypothetical farmer in Iowa or pensioner in Florida who has a small percentage interest in a corporation acquired by another is misplaced.

Further, contrary to petitioner's argument, this is not a case where the corporate form is being ignored. Rather, it recognizes, as the Court of Appeals did in Allied-Signal, that New York afforded privileges and opportunities to Migdal which inured to the benefit of Cafcor. Under these circumstances the imposition of tax does not offend the Due Process Clause or Commerce Clause.

Petitioner has taken issue with the Division's assertion that the law has changed since the decision in Rhode Island Hospital Trust and In re Gates. The Division's argument has merit to the extent that it recognizes, as the Supreme Court did in Quill, that due process analysis has changed substantially since National Bellas Hess (see, Conclusion of Law "F"). However, since, as noted, this is not considered a case where the corporate form is being ignored, further discussion of this point is unnecessary.

P. Petitioner argues that the New York Constitution, article XVI, § 3 specifically eschews any nexus over intangibles owned by a nondomiciliary. According to petitioner, article XVI bars New York from imposing any tax other than a tax "measured by income generally" on intangible personal property. Citing In re Williams (supra), petitioner contends that neither the real property gains tax nor the real estate transfer tax is a tax measured by income generally.

In its reply brief, petitioner quotes the portion of the decision in Williams which notes that:

> "[w]hen discussing whether the Gains Tax is an 'income tax', most courts have concluded that the nature of the Gains Tax is sufficiently different from an income tax as we know it when filing Federal or State income tax returns to preclude such comparison" (In re Williams, supra, at 462).

Petitioner also directs attention to Publication 588, "Question and Answers - Gains Tax on Real Property Transfer" (November 1984), which concluded in question and answer number 75 that the gains tax was a transfer tax which is deductible from Federal and State income tax.

Q. The New York Constitution, article XVI, § 3 provides:

> "Moneys, credits, securities and other intangible personal property within the state not employed in carrying on any business therein by the owner shall be deemed to be located at the domicile of the owner for purposes of taxation, and, if held in trust, shall not be deemed to be located in this state for purposes of taxation because of the trustee being domiciled in this state, provided that if no other state has jurisdiction to subject such property held in trust to death taxation, it may be deemed property having a taxable situs within this state for purposes of death taxation. Intangible personal property shall not be taxed ad valorem nor shall any excise tax be levied solely because of the ownership or possession thereof, except that the income therefrom may be taken into consideration in computing any excise tax measured by income generally. Undistributed profits shall not be taxed."

R. As noted by the Division, petitioner's analysis is not supported by the case it cited. In In re Williams the Court concluded that, for purposes of section 507(a)(7)(A) of the United States Code, the gains tax is "a tax on or measured by income or gross receipts" with regard to granting priority status on a claim. In reaching this conclusion, the Court stated:

> "Unfortunately, whether the payment of this Gains Tax results in financial loss to the taxpayer, the Gains Tax is a tax measured by the 'gain' of a specific transaction, as recognized by the Second Circuit in In re 995 5th Avenue Associates, L.P., 963 F 2d 503, 513 (2nd Cir. 1992):
>
>> 'First . . . New York gains tax liability is always contingent on the profitability of the underlying transaction. If the transaction yields no gain, there is no tax due. The fact that "gain", as calculated under the gains tax, does not take into account certain development costs in no way alters this core attribute of the gains tax . . .
>>
>> 'Second, under the gains tax, the consideration for the sale . . . is not determinative of the amount due under the gains tax. Instead, the

> consideration is used only as a means to measure the gain accruing to the transferor as a result of the transfer. It is the gain, albeit as defined by the provisions of the gains tax, that provides the key figure for determination of the amount owed under the tax.'

"This analysis is bolstered by a plain reading of Section 507(a)(7)(A) of the Code, which covers all taxes on or measured by income, not just 'income taxes' which would encompass a more narrow group. [Emphasis in original.] The question of whether the Gains Tax is an income tax is not before the Court, although this is the most common interpretation of the Code section. Based on the measurement of the Gains Tax, the conclusion becomes inescapable that this is a tax measured by income or gain from a sales transaction, taking into consideration certain adjustments. [Emphasis added.]

"To be consistent with the characteristics of the New York State Gains Tax, the language of the Code, legislative history and the judicial interpretation afforded priorities under Section 507, this Court holds that the Gains Tax is a tax 'on or measured by income or gross receipts', pursuant to Section 507(a)(7)(A) of the Code."

As shown by the foregoing quotation, there is substantial authority for the proposition that the gains tax is a tax measured by income (see also, Matter of Morgan Guaranty Trust Company of New York v. Tax Appeals Tribunal, 80 NY2d 44, 587 NYS2d 252, 257). Therefore, it does not violate the provisions of the New York constitution.

It is noted that petitioner's focus on the quotation from In re Williams that the gains tax is not an income tax misstates the point. In order to satisfy constitutional requirements, it is sufficient that it is a tax measured by income. Further, the question addressed in Publication 588 was whether the gains tax was deductible from Federal and State income tax. There was no consideration of whether the gains tax was on ad valorem tax or

a tax for mere possession or ownership. Therefore, it is concluded that the portion of Publication 588 cited by petitioner does not support petitioner's position.

S. The Division has also accurately noted that it has been held that the real estate transfer tax does not impose an ad valorem tax on intangible personal property in contravention of article XVI (§ 3) of the New York State Constitution. In 595 Investors, the Court stated:

> "In Franklin Society for Building and Savings v. Bennett, 282 N.Y. 79, 24 N.E. 2d 854 (1939), app. dism. 309 U.S. 640, 60 S. Ct. 894, 84 L. Ed. 995, the court discussed the essential characteristics of an ad valorem property tax in relation to Article 16, Section 3 of the New York State Constitution. That section provides, in pertinent part, that 'intangible personal property shall not be taxed ad valorem nor shall any excise tax be levied solely because of the ownership or possession thereof.' The two salient features of the mortgage recording tax at issue there which prevented it from coming within the constitutional prohibition were that it was levied not for mere ownership or possession of a mortgage, but rather for the right to record the mortgage, and because the tax was imposed only once, at the time of recording. Similarly, the RPTT is also not levied for mere ownership or possession nor imposed at any regular interval, but only upon the occurrence of a single event: to wit, a transfer. Therefore taxation of the transfers of the limited partnership interests does not violate the ad valorem constitutional prohibition" (595 Investors Ltd. Partnership v. Biderman, supra, 531 NYS2d at 718).

Similar reasoning supports the conclusion that the gains tax does not violate the New York Constitution, article XVI, § 3. It is not imposed for mere ownership or possession of stock. Rather, it is imposed only upon the transfer of a controlling interest in an entity owning real property in New York.

T. The petitions of Cafcor Trust Reg. Vaduz are denied.

DATED: Troy, New York
October 5, 1995

/s/ Arthur S. Bray

ADMINISTRATIVE LAW JUDGE