STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
FOREIGN HOLDINGS, INC.	:	DETERMINATION DTA NO. 813064
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, Foreign Holdings, Inc., 675 Fifth Avenue, New York, New York 10022, filed a petition for revision of a determination or for refund of tax on gains derived from certain real property transfers under Article 31-B of the Tax Law.

On October 25, 1995 and November 3, 1995, respectively, petitioner, by its representative, Richards & O'Neil, LLP (Anthony J. Carbone, Esq., of counsel), and the Division of Taxation, by its representative, Steven U. Teitelbaum, Esq. (Herbert M. Friedman, Jr., Esq., of counsel), consented to have the controversy determined on submission without hearing, with all briefs to be submitted by March 18, 1996, which date began the six-month period for the issuance of this determination.[1] After due

consideration of the record, Brian L. Friedman, Administrative Law Judge, renders the following determination.

ISSUE

Whether the Division of Taxation properly included a fee of $1,000,000.00 paid by The May Department Stores Company (the transferee) to Kingsville Investments, Inc. as additional

[1]Petitioner's reply brief, submitted on March 18, 1996, had three exhibits annexed thereto. By letter dated March 20, 1996, the Division objected to the inclusion of these exhibits in the record since there existed a deadline of January 15, 1996 for the filing of petitioner's exhibits. The Division's assertions are correct; accordingly, while the reply brief has been reviewed and considered in the rendering of this determination, the exhibits attached thereto have not.

consideration received by petitioner (the transferor) and, accordingly, denied petitioner's claim for refund of gains tax paid on such amount.

FINDINGS OF FACT

1. On December 16, 1991, The May Department Stores Company ("May") entered into a written agreement (the "letter agreement") with Kingsville Investments, Inc. ("Kingsville") whereby Kingsville agreed to act on May's behalf to facilitate May's purchase of real property at 436-438 Fifth Avenue in New York City from Foreign Holdings, Inc. ("petitioner").

Pursuant to the terms of the letter agreement, May agreed to pay Kingsville a fee of $1,000,000.00 which was due upon (i) the closing of a sale between petitioner and May or (ii) default by May under the terms of an agreement to purchase the property.

The letter agreement stated that Kingsville was aware that, "over the course of the last several years", May and its predecessor had failed in their efforts to acquire title to the subject property. Kingsville acknowledged in the letter agreement that it had access to the principals of petitioner. It agreed that May would conduct all negotiations with petitioner and that Kingsville would have no authority to accept, reject or make any offer on behalf of May. The $1,000,000.00 fee specified in the letter agreement was not identified therein as a "broker's" or "finder's" fee or commission. The letter agreement also stated, in part, as follows:

> "Kingsville represents and warrants to May that Kingsville has not dealt with any broker, agent, finder or other intermediary in connection with the possible purchase by May of the Property from Foreign such that any broker, agent, finder or other intermediary would be entitled to a broker's or agent's commission or finder's or similar fee or any other compensation or reimbursement of any kind or a share of the Fee. Kingsville covenants that it shall not have any dealings, negotiations or consultations with respect to possible or actual purchase by May of the Property from Foreign with any broker, agent, finder or other intermediary."

2. On April 17, 1992, petitioner and May entered into a Purchase and Sale Agreement in which May agreed to purchase the Fifth Avenue property for the sum of $14,350,000.00. The Purchase and Sale Agreement required May to pay a deposit of $1,435,000.00 which was to be held in escrow.

3. Petitioner and Kingsville are both wholly owned by Yeung Chi Shing Holding, Inc., a Delaware corporation. The Purchase and Sale Agreement (see, Division's Exhibit "L") indicates

that petitioner's address is 675 Fifth Avenue, New York, New York. The letter agreement (see, Division's Exhibit "L"), written on Kingsville's letterhead lists Kingsville's address as 675 Fifth Avenue, New York, New York. The Purchase and Sale Agreement was signed on behalf of petitioner by Lilian Leong, Assistant Secretary. The letter agreement was signed on behalf of Kingsville by Lilian Leong, Assistant Secretary.

4. The affidavit of Kawai Fong, general manager of Kingsville (see, Petitioner's Exhibit "1"), states that Kingsville was duly organized under the laws of Hawaii and is qualified to do business in New York. Prior to entering into the letter agreement with May, Kingsville had been conducting an active real estate business which included real property managerial services for its corporate parent, Yeung Chi Shing Holding, Inc. Included among its services was managing the Fifth Avenue property subsequently sold by petitioner to May. As of the date of the affidavit (January 12, 1996), Kingsville continued to perform a variety of real estate managerial services. Kingsville files its own separate New York State and New York City franchise tax returns.

Petitioner was created solely to own the Fifth Avenue property. Since the date of sale of the property to May, petitioner has been dormant.

5. May did not contest Kingsville's commission. At the closing of the sale of the Fifth Avenue property on June 2, 1992, payment of the commission was made by wire transfer to Kingsville's account at Citibank, N.A. (see, Petitioner's Exhibit "6").

6. Paragraph (l) of section 4.1(k) of the Purchase and Sale Agreement stated as follows:

> "Seller has received a copy of that certain separate agreement (the 'Separate Agreement') dated December 16, 1991 by and between Purchaser and Kingsville Investments, Inc."

7. Section 4.3 of the Purchase and Sale Agreement stated as follows:

> "Seller and Purchaser each represent to the other that it has had no dealings, negotiations or consultations with any broker or agent, in connection with this Agreement or the sale of the Property and that it shall indemnify, defend, protect and hold harmless the other and its respective directors, officers, employees and agents from and against any and all claims (whether meritorious or not), losses, expenses, damages, and costs (including, without limitation, reasonable attorney's fees) arising out of or related to any and all brokers or agents claiming to have

represented it in connection with this Agreement or in connection with the sale of the Property."

8. On May 8, 1992, the Division of Taxation received a Transferor Questionnaire (Form TP-580) from petitioner (see, Division's Exhibit "H") which indicated gains tax due in the amount of $1,277,434.90 (gross consideration paid by the transferee was listed thereon as $14,350,000.00). On the same date, a Transferee Questionnaire (Form TP-581) was received from May (see, Division's Exhibit "I") on which consideration paid to transferor was stated to be $14,350,000.00. On the questionnaire, May indicated that brokerage fees paid by the transferee were in the amount of $1,000,000.00.

9. On May 27, 1992, the Division of Taxation issued a Tentative Assessment and Return (see, Division's Exhibits "J" and "N"; Petitioner's Exhibit "4") on which total tax due was computed to be $1,377,434.90, an increase of $100,000.00 from the amount computed by petitioner. The basis for this increase was the holding by the Division that the fee paid to Kingsville was part of the consideration to petitioner since both Kingsville and petitioner were owned by Yeung Chi Shing Holding, Inc.

10. Petitioner paid the disputed $100,000.00 at closing and, on January 4, 1993, filed a claim for refund therefor (see, Division's Exhibit "D"). By letter dated February 5, 1993, the Division denied petitioner's refund claim in its entirety. A Conciliation Order (CMS No. 130401), dated May 20, 1994, sustained the Division's denial of petitioner's claim for refund.

SUMMARY OF THE PARTIES' POSITIONS

11. The position of petitioner may be summarized as follows:

a. The letter agreement of December 16, 1991 established a brokerage arrangement between May and Kingsville. The Tax Law does not subject brokerage commissions to gains tax. This is true regardless of the relationship between the broker and a party to the sale.

b. The broker's commission paid by May to Kingsville was not a part of the price paid or required to be paid for the property.

c. Even if deemed to be additional consideration, petitioner is entitled to deduct the commission from its taxable gain on the transfer of the property pursuant to Tax Law § 1440(1)(a).

d. The "look-through" principle, referred to by the Division in its brief, is not applicable in the present matter. May could have compelled specific performance of its purchase contract with petitioner regardless of whether or not it paid the broker's commission to Kingsville. The agreement between May and Kingsville was a bona fide, arms length transaction which was fully enforceable by Kingsville.

e. Despite the Division's contentions to the contrary, the services of Kingsville were specifically referred to in the purchase agreement. There was a valid purpose to the language in section 4.3 of the purchase agreement, i.e., to protect the parties from claims of other (than Kingsville) brokers.

f. The implication by the Division is that May was helping petitioner to reduce its gains tax burden by agreeing to divert $1,000,000.00 to a related entity. Petitioner contends, however, that May would have been foolish to do so because, by the terms of the letter agreement and the purchase agreement, it was exposing itself to an additional $1,000,000.00 liability. As is customary upon execution of a contract of sale, May deposited 10%, or $1,435,000.00 toward the purchase price. If the actual purchase price had been $15,350,000.00, May could have made a downpayment of $1,535,000.00 which would have been forfeited upon its default. Under the facts herein, May, upon default would have forfeited its $1,435,000.00 downpayment and, in addition, would have been obligated to pay Kingsville an additional $1,000,000.00 per the letter agreement, a potential additional liability of $900,000.00. This, petitioner maintains, is unlikely in light of May's experience in the commercial real estate market.

12. The Division of Taxation maintains as follows:

a. May's payment of $1,000,000.00 to Kingsville was, in reality, additional consideration paid to petitioner and was not "customary brokerage fees" paid to a third party. For gains tax purposes, petitioner is the same entity as Kingsville. They are wholly owned by the same

entity, they have the same principal place of business and the letter agreement and Purchase and Sale Agreement were signed by the same individual. Therefore, May's payment of $1,000,000.00 to Kingsville was nothing more than an attempt to circumvent the gains tax statutes.

b. The fee paid to Kingsville was illusory, i.e., Kingsville performed no service at all. In essence, Kingsville was paid a fee for contacting itself concerning a purchase of property. The Division points to the language in section 4.3 of the Purchase and Sale Agreement which states that the seller and purchaser represent to each other that neither has had any dealings, negotiations or consultations with any broker or agent in connection with the agreement. The Division notes that it is unusual for an agreement to call for a fixed commission since it is customary for a commission to be based upon a percentage of the selling price. It could, therefore, be assumed that the selling price had already been determined at the time the letter agreement was entered into. If so, then Kingsville performed no service at all.

c. Petitioner is not entitled to deduct the $1,000,000.00 paid to Kingsville because it did not pay the fee. Even if deemed to have been paid by petitioner, it is not deductible since, as previously noted, it is not a "customary brokerage fee" nor is it a customary, reasonable and necessary legal, engineering or architectural fee incurred to sell the property.

CONCLUSIONS OF LAW

A. Tax Law § 1441 imposes a 10 percent tax on the gain derived from the transfer of real property located within the State of New York, where the consideration for the transfer is $1,000,000.00 or more.

B. Tax Law § 1440(1)(a) provides as follows:

> "'Consideration' means the price paid or required to be paid for real property or any interest therein, less any customary brokerage fees related to the transfer if paid by the transferor, including payment for an option or contract to purchase or use real property."

20 NYCRR 590.10(b), relating to payment of brokerage fees by the transferee when the broker was retained by the transferor, states:

> "Question: Does the payment of brokerage fees by the transferee constitute additional consideration if the broker was retained by the transferor, but it is agreed that the fees are to be paid by the transferee?
>
> "Answer: Yes. However, such brokerage fees may also be subtracted from the amount of gross consideration to arrive at the consideration for purposes of determining whether the $1 million exemption applies and in computing the transferor's gain. For example, a purchaser agrees to pay $1,030,000 for the real property with $980,000 to be paid directly to seller and $50,000 to be paid to seller's broker. The amount of consideration used for the $1 million test is $980,000 ($980,000 to seller plus $50,000 extinguishment of a debt of seller minus seller's paid brokerage fee of $50,000).

The Division contends that, inasmuch as petitioner and Kingsville were both wholly owned by the same entity (Yeung Chi Shing Holding, Inc.), the $1,000,000.00 paid by May to Kingsville should be construed to be a payment of additional consideration and, therefore, the actual consideration subject to the gains tax was $15,350,000.00 and not $14,350,000.00 as set forth in the Purchase and Sale Agreement. The Division further maintains that the fee paid to Kingsville was illusory, i.e., Kingsville really performed no service at all since, in essence, it was paid a fee for contacting itself about a proposed purchase because the principals of Kingsville were also the principals of petitioner. It is imperative, therefore, to first determine whether or not the $1,000,000.00 fee paid to Kingsville by May could properly be considered to be "customary brokerage fees."

C. The letter agreement, entered into between May and Kingsville, does not refer to the services to be performed by Kingsville as brokerage services. In brief, the letter agreement states that, because Kingsville had access to the principals of petitioner and because May was interested in acquiring the property, Kingsville would, in consideration of the payment of the $1,000,000.00 fee, pursue the principals of petitioner with respect to a sale thereof.

The term "broker" is defined as a "person dealing with another for sale of property. A person whose business it is to bring buyer and seller together." (Black's Law Dictionary 174, 175 [5th ed 1979]). From the evidence presented, it appears that Kingsville did precisely that, i.e., it brought together May and petitioner with the result being that a contract was entered into and a sale of the property occurred. The Division maintains, however, that since Kingsville and

petitioner were wholly owned by the same entity, Kingsville really performed no services at all since it was paid a fee for contacting itself about the proposed sale.

In response, petitioner has introduced the affidavit of Kawai Fong, general manager of Kingsville (see, Petitioner's Exhibit "1"). This affidavit stated, in part, that Kingsville had been conducting an active real estate business prior to, during and subsequent to its dealings with May. May's representatives had indicated to Kingsville that it wished to retain the services of a party which had contacts with petitioner as well as a familiarity with the property and with the New York City marketplace, both of which Kingsville had. While Kingsville continues to engage in an active real estate business (it also files its own separate State and City corporate franchise tax returns), petitioner was created solely to own the subject real property and, since the sale, has been dormant. As to the Division's contention that, by virtue of the fact that both petitioner and Kingsville were owned by the same entity and the payment of the fee to Kingsville was, therefore, additional consideration, petitioner points to certain private letter rulings issued by the Division.

D. In a Private Letter Ruling issued on September 4, 1985 (see, Petitioner's Exhibit "8"), the Division's Technical Services Bureau stated that, in its opinion, as long as brokerage fees were reasonable in amount, they would be deductible from consideration subject to the gains tax even though the seller was the 99 percent owner of the partnership to which the brokerage fees were being paid.

Similarly, in Priv Ltr Rul 131 (April 25, 1985), despite the fact that one-half of the brokerage fee was to be paid to a co-executor and one-third residuary legatee of the estate/seller, the Division's Technical Services Bureau held that the brokerage fee was deductible from gross consideration. In that particular case, however, it should be noted that both of the brokers were fully licensed as real estate brokers.

Another Private Letter Ruling, issued June 19, 1989, dealt with the issue of the deductibility of brokerage fees paid by a developer to a related company which held a broker's license. The Technical Services Bureau held that as long as the fees were reasonable in amount

and nature, were related to the transfer and were paid by the transferor, they would be deductible in computing total consideration subject to the gains tax.

As to the issue of whether or not the broker must be licensed, in a Private Letter Ruling issued on August 20, 1990, it was stated as follows:

> "With respect to the deduction from gross consideration for commissions paid to a non licensed person for structuring the sale of real estate, it is our opinion that if a transferor pays a fee to a person who performs the services of a broker in a particular transaction, such fee or commission if reasonable, should be deductible for gains tax purposes, whether or not the person is licensed. The transferor must submit a copy of the brokerage agreement or affidavit setting forth the amounts paid as broker fees in order to be allowed the deduction."

E. In the present matter, the fees were paid by May, the transferee, and not by petitioner, the transferor. Clearly, brokerage fees paid by the transferor are deductible from consideration whether the fees were paid to the broker of the transferor or transferee (see, Tax Law § 1440[1][a]). While the regulations (20 NYCRR 590.10[b]) address an instance where the transferee pays the brokerage fees of a broker retained by the transferor, in this case, the fees were paid by May, the transferee, to Kingsville pursuant to the letter agreement between those two entities. Therein lies the real point of controversy in this matter, i.e., there is no provision in the Tax Law or in the regulations which addresses such a situation. This is not, as the Division contends, a case where the taxpayer is claiming entitlement to a tax exemption and, therefore, bears the burden of demonstrating that his is the only reasonable interpretation of the applicable statute (see, Division's Brief, pp. 8, 9). Neither the Tax Law nor the regulations impose tax upon fees paid by a transferee for services performed for the transferee. Instead, the Division is claiming that the $1,000,000.00 fee paid by the transferee, May, to Kingsville was additional consideration to petitioner, the transferor, and is, therefore, subject to tax.

Initially (see, Petitioner's Exhibit "9"), to support its position, the Division relied upon the "look through" principle as discussed in Matter of 307 McKibbon Street Realty Corp. (Tax Appeals Tribunal, October 14, 1988). In that case, it should be pointed out, the Tribunal "looked through" entity ownership of real property to ascertain the beneficial ownership of real

property in order to determine whether the consideration received from contiguous properties should be aggregated.

In Matter of Von-Mar Realty Co. (Tax Appeals Tribunal, December 19, 1991), the Tribunal concluded that "the 'look through' principle applies to determine the exception to aggregation based on use, as well as to require aggregation based on ownership." Subsequently, in Matter of Von-Mar Realty Co. v. Tax Appeals Tribunal (191 AD2d 753, 594 NYS2d 414, lv denied 82 NY2d 655, 602 NYS2d 803), the Appellate Division, Third Department, defined the "look through" principle as "looking through an entity which owns real property to determine the beneficial owners of the real property." In the present matter, the Division has chosen to "look through" two separate entities (petitioner and Kingsville) which are commonly owned by Yeung Chi Shing Holding, Inc. and, as a result of such common ownership, has deemed fees received by Kingsville to be consideration received by petitioner. Because of the common ownership, the Division has somehow imputed ownership of the Fifth Avenue property to Kingsville by virtue of its decision to combine the fee received by Kingsville with the proceeds of the sale received by petitioner. This certainly appears to be an extension of the look through principle and one which is absent authority therefor.

Later, in its brief, the Division, citing Matter of Shecter (Tax Appeals Tribunal, October 13, 1994) and Matter of R.A.F. General Partnership (Tax Appeals Tribunal, November 9, 1995), contended that the analysis must be focused on the "economic reality" of the transaction to determine whether the transaction was subject to the gains tax. The "economic reality", the Division maintains, is that the total consideration received by petitioner was $15,350,000.00 because, for gains tax purposes, petitioner was the same entity as Kingsville. While it is true that petitioner and Kingsville are owned by the same entity and, therefore, have certain characteristics in common, the evidence, when taken as a whole, does not support the Division's position.

While petitioner and Kingsville are commonly owned, have the same business address and have at least one common officer (see, Finding of Fact "3"), there are other facts which

indicate that they are separate entities. According to the affidavit of Kawai Fong (see, Finding of Fact "4"), Kingsville conducted an active real estate business for the parent corporation which included managing the Fifth Avenue property which is the subject of this proceeding. Petitioner, on the other hand, was formed solely to own this property and became dormant after its sale. Petitioner and Kingsville file their own separate State and City franchise tax returns.

Although the Division maintains that its private letter rulings are "fact specific" and are not binding precedent (see, Division's Brief at pg. 4), such rulings are, in fact, statements of Division policy. Thus, the private letter rulings cited by petitioner (see, Conclusion of Law "D") stand for the proposition that the interrelationship of the broker and the seller does not preclude the deductibility of the brokerage fees from gross consideration subject to tax. In the present matter, there is no issue of deductibility. Rather, the Division has sought to impose tax on the brokerage fees paid by the transferee to its broker. Other than the interrelationship of the broker and the seller, there is no evidence that petitioner ever received the fee paid to Kingsville or that the fees and sale proceeds were subsequently comingled. More importantly, there is no authority, in statutes or regulations, for imposing tax upon brokerage fees paid by a transferee to its own broker.

It should also be noted that the Tentative Assessment and Return, assessing additional tax due based upon the $1,000,000.00 fee paid to Kingsville was issued by the Division to petitioner, the transferor. Other than one common officer, Lillian Leong, and the same principal place of business, the "beneficial interest" argument of the Division rests upon the ownership of both petitioner and Kingsville by Yeung Chi Shing Holding, Inc. As stated above, there is no evidence (or even an allegation) that petitioner received the fee paid to Kingsville. What the Division is really implying is that the parent, Yeung Chi Shing Holding, Inc., received the sale proceeds from petitioner and the fee from Kingsville based upon its ownership of both. Yet, clearly, the Division, despite its "beneficial interest" and "economic reality" arguments has not chosen to assess the one entity which, if any at all, would appear to have been the potential beneficiary of both sums paid by May.

F. As indicated in Conclusion of Law "C", supra, it cannot be found that the services performed by Kingsville for May were not brokerage services. It brought together the buyer and the seller. This conclusion is not altered by the fact that the broker and the seller were related entities since the definition of "broker" does not differentiate between services performed for entities related and unrelated to the broker.

G. The Division also points to language in section 4.3 of the Purchase and Sale Agreement (see, Finding of Fact "7") which, in essence, states that the seller and purchaser each represents to the other that neither has had any dealings with any broker or agent. The Division contends that this constitutes an admission by both that Kingsville was not involved and, therefore, had not earned a fee. However, as petitioner points out, section 4.1(1) of the Purchase and Sale Agreement states that petitioner has received a copy of the letter agreement between May and Kingsville. While, the language in section 4.3 is somewhat confusing in light of the fact that section 4.1(1) evidences knowledge of the existence of the letter agreement, petitioner's explanation therefore (see, Petitioner's Reply Brief, pp. 9-11) is reasonable, i.e., that section 4.3 is a boilerplate provision common to real estate contracts and was included to protect the parties from claims of undisclosed brokers which, after having dealt with one party, could then seek a commission from the other. It should be noted that a similar provision was included in the letter agreement (see, Finding of Fact "1").

H. Finally, the Division disputes that the fee to Kingsville was a brokerage fee on the basis that the letter agreement provided for the payment of a fixed sum ($1,000,000.00), since it contends that the customary brokerage commission is a fixed percentage of the purchase price. The Division concludes, from the fixed sum, that the purchase price must have been determined prior to the execution of the letter agreement and, therefore, Kingsville did not perform the service of a broker. The $1,000,000.00 fee, ultimately, amounted to approximately 7 percent of the purchase price ($1,000,000/$14,350,000 = .0697). The letter agreement acknowledges that May and its predecessor had been trying, for several years to acquire the Fifth Avenue real property. Although speculative, it would not then be unreasonable to assume that the parties

were able to arrive at a "ballpark" figure upon which a broker's commission could be calculated or, in the alternative, it is possible that May informed Kingsville of its "ceiling" price. The record does not disclose the basis for the arrival at the $1,000,000.00 amount, but absent additional evidence, the fact that the amount of the fee was apparently determined prior to the execution of the Purchase and Sale Agreement does not alone support a finding that Kingsville performed no service for May.

I. The petition of Foreign Holdings, Inc. is granted and the Division of Taxation is hereby directed to issue a refund of gains tax to petitioner in the amount of $100,000.00, together with appropriate interest.

DATED: Troy, New York
August 15, 1996

/s/ Brian L. Friedman
ADMINISTRATIVE LAW JUDGE