STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petitions	:	
of	:	
ARCADE BROADWAY PLAZA RENTALS, INC. **ARCADE RENTAL INVESTMENTS, INC.** **ASCOT DEVELOPMENT, INC.** **COSMOS RENTAL INVESTMENTS, INC.** **MARATHON RENTAL INVESTMENTS, INC.** **MRI-888 RENTAL INVESTMENTS, INC.**	: : : :	DETERMINATION DTA NOS. 816027, 816028, 816029, 816030, 816031 AND 816032
for Redetermination of Deficiencies or for Refunds of Corporation Franchise Tax under Article 9-A of the Tax Law for the Period January 1, 1991 through December 31, 1993.	: :	

Petitioners, Arcade Broadway Plaza Rentals, Inc., Arcade Rental Investments, Inc., Ascot Development, Inc., Cosmos Rental Investments, Inc., Marathon Rental Investments, Inc. and MRI-888 Rental Investments, Inc., 1633 Broadway, New York, New York 10019, filed petitions for redetermination of deficiencies or for refunds of corporation franchise tax under Article 9-A of the Tax Law for the period January 1, 1991 through December 31, 1993.

A hearing was held before Timothy J. Alston, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on March 27, 1998 at 10:15 A.M., with all briefs to be submitted by July 28, 1998, which date began the six-month period for the issuance of this determination. Petitioners appeared by Robert A.N. Cudd, Esq., and Eric T. Klein, Esq. The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Kenneth J. Schultz, Esq., at hearing and Kevin R. Law, Esq., and James P. Connolly, Esq., on brief, of counsel).

ISSUE

Whether, in computing franchise tax liability measured by the capital base pursuant to Tax Law § 210(1)(b) and (2), a corporation's interest in a partnership holding title to real property is properly valued at fair market value (thereby treating the corporation as if it held an interest in the real property directly) or at the value shown on the corporation's books and records in accordance with generally accepted accounting principles (thereby treating the partnership interest as personal property).

FINDINGS OF FACT

1. Petitioners, Arcade Broadway Plaza Rentals, Inc., Arcade Rental Investments, Inc., Ascot Development, Inc., Cosmos Rental Investments, Inc., Marathon Rental Investments, Inc. and MRI-888 Rental Investments, Inc. are Delaware corporations subject to corporation franchise tax under Article 9-A of the Tax Law for each of the years at issue.

2. During the years at issue, each petitioner's primary asset was an interest in one or more partnerships or limited partnerships. Each such partnership or limited partnership held title to real property either directly or through other partnerships. The real property owned by the partnerships was located in various states, including New York.

3. Petitioners timely filed general business corporation franchise tax returns (Form CT-3) and metropolitan transportation business tax surcharge returns (Form CT-3M) for the years 1991, 1992 and 1993. In calculating its tax liability using the capital base method, each petitioner valued its partnership interests based on the fair market value of the real property held by the partnerships.

4. Petitioners subsequently filed amended CT-3's and CT-3M's for the years at issue. In calculating their tax liability under the capital base on their amended returns petitioners valued

their partnership interests by using the book value of such interests. As a result of this change in the valuation of their partnership interests, petitioners' amended returns claimed refunds in the following amounts:

Arcade Broadway Plaza Rentals, Inc.

Year	CT-3	CT-3M	Total
1991	$ 19,803	$ 2,928	$ 22,731
1992	19,819	2,930	22,749
1993	16,211	2,396	18,607
Total	$ 55,833	$ 8,254	$ 64,087

Arcade Rental Investments, Inc.

Year	CT-3	CT-3M	Total
1991	$ 12,847	$ 1,891	$ 14,738
1992	18,927	2,805	21,732
1993	18,454	2,728	21,182
Total	$ 50,228	$ 7,424	$ 57,652

Ascot Development, Inc.

Year	CT-3	CT-3M	Total
1991	$ 10,053	$ 378	$ 10,431
1992	10,569	1,562	12,131
1993	7,563	1,117	8,680
Total	$ 28,185	$ 3,057	$ 31,242

Cosmos Rental Investments, Inc.

Year	CT-3	CT-3M	Total
1991	$ 72,628	$ 9,999	$ 82,627
1992	63,843	9,438	73,281

1993	62,858	9,248	72,106
Total	$ 199,329	$ 28,685	$ 228,014

Marathon Rental Investments, Inc.

Year[1]	CT-3	CT-3M	Total
1992	$ 6,181	$ 1,011	$ 7,192
1993	7,242	1,070	8,312
Total	$ 13,423	$ 2,081	$ 15,504

MRI-888 Rental Investments, Inc.

Year	CT-3	CT-3M	Total
1991	$ 37,300	$ 5,514	$ 42,814
1992	35,821	5,295	41,116
1993	28,934	4,277	33,211
Total	$ 102,055	$ 15,086	$ 117,141

5. On both their original franchise tax returns and their amended returns, petitioners treated their respective partnership interests as business capital. The Division did not dispute this classification.

6. The Division subsequently issued letters to petitioners denying each of the claims for refund listed above.

SUMMARY OF THE PARTIES' POSITIONS

7. Petitioners note that, for purposes of computing franchise tax liability under the capital base, Tax Law § 210(2) requires the valuation of personal property (except marketable securities)

[1] Petitioner Marathon Rental Investments, Inc. did not claim a refund for the 1991 tax year.

at book value according to generally accepted accounting principles ("GAAP"). Petitioners assert that partnership interests are treated as personal property under New York and Delaware law. Petitioners thus contend that they properly valued their respective partnership interests at book value according to GAAP in computing their franchise tax liability under the capital base on their amended returns. Accordingly, petitioners assert that their refund claims should be granted.

8. The Division asserts that valuation of partnership interests in computing franchise tax liability under the capital base is properly determined by analysis of the underlying partnership assets. In this case, since the primary assets of the partnerships in question consisted of real property, and since Tax Law § 210(2) requires valuation of real property at average fair market value in computing the capital base, petitioners' amended returns were incorrect and the refund claims must be denied. The Division argues that this aggregate or conduit approach to its interpretation of Tax Law § 210(2) as applied to corporate partners is rational, is consistent with the "fabric" of the Tax Law and is good public policy.

CONCLUSIONS OF LAW

A. Article 9-A of the Tax Law imposes a franchise tax on any corporation "[f]or the privilege of exercising its corporate franchise, or of doing business, or of owning or leasing property in this state in a corporate or organized capacity, or of maintaining an office in this state" (Tax Law § 209[1]). The franchise tax imposed under Article 9-A equals the the sum of (i) the greater of (a) the entire net income base, (b) the capital base, (c) the minimum taxable income base, or (d) the fixed dollar minimum, plus (ii) the subsidiary capital base.

Petitioners were also subject to the temporary metropolitan transportation business tax surcharge imposed under Tax Law § 209-B and were required to file metropolitan transportation business tax surcharge returns (Form CT-3M) along with their general business corporation franchise tax returns (Form CT-3). The MTA surcharge during the years at issue was equal to 17 percent of the taxpayer's franchise tax liability attributable to its business activity carried on within the metropolitan commuter transportation district.

B. At issue in this matter is petitioners' computation of their franchise tax liability under the capital base (Tax Law § 210[1][b]). This base imposes a tax upon the total of a taxpayer's business and investment capital allocated within New York (***id.***). As relevant herein, "investment capital" means "investments in stocks, bonds and other securities, corporate and governmental, not held for sale to customers in the regular course of business" (***see***, Tax Law § 208[5]), and "business capital" means "all assets, other than subsidiary capital, investment capital and stock issued by the taxpayer" (***see***, Tax Law § 208[7]). The allocation of business and investment capital is made by multiplying the taxpayer's total business capital by its business allocation percentage ("BAP") and its total investment capital by its investment allocation percentage ("IAP") (***see***, Tax Law § 210[1][b]; [4], [5]). The BAP represents the arithmetic mean of the ratios of the taxpayer's receipts, payroll and property values within New York to those of the taxpayer as a whole (***see***, Tax Law § 210[3][a]). The IAP reflects the degree of New York State presence of the issuers of the securities in which the taxpayer has invested (i.e., the entities which have generated the taxpayer's investment income) (***see***, Tax Law § 210[3][b]).

C. Tax Law § 210(2) provides rules for the valuation of subsidiary capital, investment capital and business capital for the purpose of computing the tax under the capital base and states, in relevant part, the following:

> The amount of subsidiary capital, investment capital and business capital shall be determined by taking the average value of the assets included therein . . . *For purposes of this subdivision, real property and marketable securities shall be*

> *valued at fair market value and the value of personal property other than marketable securities shall be the value thereof shown on the books and records of the taxpayer in accordance with generally accepted accounting principles.* (Emphasis added.)

D. As noted previously, the specific point of dispute between petitioners and the Division involves the proper valuation of petitioners' partnership interests (***see***, paragraphs "7" and "8"). Petitioners contend that the term "personal property" as used in Tax Law § 210(2) includes partnership interests and that their partnership interests were properly valued at book value in accordance with GAAP for purposes of computing franchise tax liability under the capital base. The Division asserts that partnership interests are not personal property for purposes of Tax Law § 210(2) and that, for the purpose of determining liability under the capital base, such interests are properly valued based on the partner's proportionate interest in the underlying partnership assets. The Division thus asserts that the partnership must be treated as a conduit to determine liability under the capital base.

Resolution of the instant matter turns on the meaning of "personal property" as used in Tax Law § 210(2). This is a matter of statutory construction, the fundamental rule of which is to effectuate the intent of the Legislature (***Matter of 1605 Book Center, Inc. v. Tax Appeals Tribunal***, 83 NY2d 240, 244, 609 NYS2d 144, 146, ***cert denied*** 513 US 811, 130 L Ed 2d 19). Where the statutory language is clear and unambiguous it should be construed so as to give effect to the plain meaning of the words used (***Patrolmen's Benevolent Assn. v. City of New York***, 41 NY2d 205, 208, 391 NYS2d 544, 546). Regarding tax statutes in particular, it is axiomatic that ambiguity therein must be "construed in favor of the taxpayer and against the taxing authority, and the burdens they impose are not to be extended by implication" (***Matter of American Cyanamid & Chem. Corp. v. Joseph***, 308 NY 259, 263). On the other hand, tax statutes should be construed to insure the collection of all designated taxes where a supportable theory can be found (***see***, ***County of Nassau v. Lincer***, 254 App Div 760, 4 NYS2d 77, 78, ***affd*** 280 NY 662; ***see also***, McKinney's Cons Laws of NY, Book 1, Statutes § 313).

E. It is well established that the term "personal property" generally includes partnership interests. Specifically, the New York Revised Limited Partnership Act states that "an interest in a limited partnership is personal property and a partner has no interest in specific partnership property" (Partnership Law § 121-701). In addition, section 107 of the Partnership Law states that "a partner's interest in the partnership is his share of the profits and surplus and the same is personal property." Also, section 107 of the Partnership Law states that "a limited partner's interest in the partnership is personal property." The courts have also consistently held that a partnership interest is personal property (***see***, ***e.g.***, ***Blodgett v. Silverman,*** 277 US 1, 72 L Ed 749, ***Reiter v. Greenberg***, 21 NY2d 388, 288 NYS2d 57). Additionally, New York courts have held that specific partnership real estate becomes personal property at least as concerns the interests of the partners (***see***, ***Estate of Havemeyer***, 17 NY2d 216, 270 NYS2d 197, ***General Property Corp. v. Diamond***, 29 AD2d 173, 286 NYS2d 553). Moreover, in ***Matter of Finkelstein*** (40 Misc 2d 910, 245 NYS2d 225), a New York estate tax case, the court held that a deceased partner's interests in partnerships which owned real property in other states was taxable in New York because the partner's interests were intangible personal property and not real property.

F. There is no indication in Article 9-A that the Legislature intended to deviate from the plain meaning of the term "personal property" as used in Tax Law § 210(2). Neither Article 9-A nor the regulations promulgated thereunder contain any special definition of "personal property" as used therein. Additionally, there are no provisions in the regulations directing a conduit approach to the valuation of assets under the capital base for corporate partners (thereby implying a departure from the plain meaning of "personal property"). The term "personal property" as used in Tax Law § 210(2) must therefore be given its plain meaning. Since this term generally includes partnership interests, petitioners properly valued their partnership interests at the value shown on their books and records according to GAAP pursuant to Tax Law § 210(2). Petitioners' amended franchise tax returns thus properly calculated tax due under the capital base.

G. Before addressing the specific arguments raised by the Division, it is necessary to consider the Division's assertion that its interpretation of the statute in question is entitled to deference. Reviewing courts have stated that the interpretation of a statute by an agency charged with its enforcement is entitled to great weight (***Howard v. Wyman***, 28 NY2d 434, 438, 322 NYS2d 683, 686). This deferential standard has been applied by courts on appellate review generally where an agency has promulgated a regulation interpreting a statute (***see***, ***e.g.***, ***Matter of Blue Spruce Farms v. State Tax Commn.***, 99 AD2d 867, 472 NYS2d 744). The instant matter is distinguishable from such cases because the Division has not enacted a regulation defining "personal property" for purposes of Tax Law § 210(2). Additionally, while the Tax Appeals Tribunal has adopted a deferential standard in ruling on the validity of a Division regulation (***see***, ***e.g.***, ***Matter of Shorter***, Tax Appeals Tribunal, July 31, 1997), it has not adopted such a standard where, as here, the issue presented is simply one of statutory construction. Furthermore, as a matter of "pure statutory construction" (***Debevoise & Plimpton v. New York State Department of Taxation & Fin.***, 80 NY2d 657, 664, 593 NYS2d 974, 977), "there is little basis to rely on any special competence or expertise of the administrative agency" (***Kurcsics v. Merchants Mut. Ins. Co.***, 49 NY2d 458, 459, 426 NYS2d 451, 458). Accordingly, the Division's interpretation of Tax Law § 210(2) is not entitled to deference.

H. The Division acknowledges that partnership interests are properly treated as personal property in many areas of the law. The Division asserts, however, that a deviation from the plain meaning of "personal property" as used in section 210(2) is necessary here because Article 9-A generally follows conduit principles in its treatment of corporate partners and that such conduit principles should also apply in valuing the partnership interests of corporate partners for capital base purposes. The Division asserts that this conduit approach is set forth in the following regulation related to corporate partners:

> **Source and character of partnership items.** Each item of income, capital, gain, loss or deduction has the same source and character in the hands of a partner for article 9-A purposes as it has in its hands for Federal income tax purposes. Where an item is not characterized for Federal income tax purposes, the source and character of the item shall be determined as if such item were realized by the partner directly from the source from which realized by the partnership, or incurred by the partner in the same manner as incurred by the partnership. (20 NYCRR 3-13.2.)

Section 3-13.2 of the franchise tax regulations (20 NYCRR 3-13.2) underscores the requirement that Federal partnership income tax principles be followed in computing the entire net income and minimum taxable income bases. The regulation also addresses situations involving items not characterized or taken into account for Federal income tax purposes. However, as petitioners correctly note in their brief, this regulation has no application in determining liability for a corporate partner under the capital base, for it contains no language related to the valuation of corporate assets.

I. The Division also notes, correctly, that both the entire net income ("ENI") and minimum taxable income bases treat partnerships as conduits in the calculation of tax due. Specifically, the starting point for calculating tax liability under the entire net income and minimum taxable income bases is Federal taxable income (***see***, Tax Law § 208[8-B], [9]). Federal income taxation of partnerships is premised on a conduit principle (***see***, Internal Revenue Code § 701). Franchise tax liability under these bases, which is generally based on Federal taxable income with certain modifications, thus also treats the partnership as a conduit.

Contrary to the Division's assertion, however, the fact that the ENI and minimum taxable income bases follow a conduit approach with respect to partnerships does not support the proposition that the capital base should also treat the partnership as a conduit for purposes of the valuation of assets under the capital base. As noted above, the ENI and minimum taxable income bases calculate tax based on income. Following Federal partnership income tax principles, once the income of the partnership is determined, the partnership acts as a conduit through which partnership income flows through to the partners. The statutory language thus directs a conduit approach for the ENI and minimum taxable income bases. In contrast, as discussed above, there is no statutory language directing a conduit approach for purposes of valuing assets of corporate partners under the capital base. Certainly, it is the statutory language that is controlling and not a particular theoretical approach to the taxation of partnerships. Moreover, as petitioners correctly note in their brief, the capital base values and taxes assets, not income, and is therefore fundamentally different in character from a tax measured by corporate income. Petitioners' primary assets are partnership interests. Petitioners' partnership interests are therefore the assets subject to tax under the capital base; not the underlying partnership assets. Since partnership interests are personal property, such interests should be valued at book value according to GAAP for purpose of computing liability under the capital base.

J. The Division also notes that its regulations provide rules for calculating a corporate partner's BAP and IAP based on the corporate partner's proportionate interest in the partnership's assets (***see***, 20 NYCRR 4-6.5).[2] The regulations thus expressly require a corporation to treat a partnership as a conduit by looking through to the underlying partnership assets to determine the appropriate rate of allocation. Tellingly, however, there are no similar regulations requiring a conduit approach to the valuation of partnership assets under Tax Law § 210(2). Under these circumstances, the plain meaning of the statutory language must prevail and petitioners' partnership interests must be treated as personal property valued at book value according to GAAP.

K. The Division also asserts that its interpretation of Tax Law § 210(2) is good tax policy. The Division argues that under the interpretation of the statute espoused herein, taxpayers who own real property would have an incentive to form a partnership and to transfer the real property to the partnership. Such taxpayers could thus lower their franchise tax liability under the capital base through transactions lacking in business purpose and economic substance. In contrast, the Division's interpretation would put those corporations owning real property on equal footing for franchise tax purposes with those corporations owning interests in partnerships owning real property.

The Division's policy argument likewise fails to justify a departure from the plain meaning of the language of Tax Law § 210(2). As petitioners note in their reply brief, "taxpayers are, of course, generally free to structure their business affairs as they consider to be in their best

---

[2]Specifically, the regulations state, in relevant part:

> . . . a taxpayer which is a partner of a partnership must include its proportionate part of the partnership's property, receipts and payroll within and without New York State in computing its business allocation percentage and alternative business allocation percentage and must include its proportionate part of the assets and liabilities of the partnership which are used in the computation of investment capital in computing its investment allocation percentage. The term *proportionate part* as used in this section means the percentage which the partnership used to distribute to the partner, its distributive share of partnership ordinary income in an income year, or partnership ordinary loss in a loss year. (20 NYCRR 4-6.5[a][1]; emphasis in original.)

interests, including lawful structuring to minimize taxes" (***Commr. v. First Security Bank of Utah, N.A.***, 405 US 394, 398, n. 4, 31 L Ed 2d 318). Moreover, the transfer of an asset to a partnership has legal ramifications. As noted previously, a partner has no ownership interest in the partnership assets (Partnership Law §§ 107, 121-701) and cannot, therefore, dispose of a fractional interest in such assets. Accordingly, any disparity in tax liability under the capital base between the corporation owning real estate and the corporation owning an interest in a partnership owning real estate may be justified because, as petitioners note in their reply brief, these two corporations "do not own the same type of asset" (Petitioners' reply brief p. 6).

L. The Division also argues that its interpretation of the statute herein is consistent with the general rule that tax legislation should be implemented in a manner that gives effect to the economic substance of a transaction. This general rule does not suffice to overcome the plain meaning of Tax Law § 210(2), however, and the Division's assertion must be rejected. Moreover, the cases cited by the Division as examples of the application of this rule involve whether particular transactions are subject to sales and use tax and are therefore distinguishable from the instant matter (***Petrolane Northeast Gas Serv. v. State Tax Commn.***, 79 AD2d 1043, 435 NYS2d 187, ***lv denied*** 53 NY2d 601, 438 NYS2d 1027; ***Credit Bur. of Cent. N.Y. v. State Tax Commn.***, 105 AD2d 1042, 483 NYS2d 480; ***Chemical Bank v. Tully***, 94 AD2d 1, 464 NYS2d 228). Indeed, ***Chemical Bank v. Tully (supra)*** may be viewed as supportive of petitioners' position in this matter. Specifically, that case involved the interpretation of the statutory definition of "sale" for purposes of the Sales and Use Tax Law. The definition of this word, as set forth in Tax Law § 1101(b)(5), is much more expansive than the common understanding of sale. The court noted that the statutory definition of sale is not guided by the common understanding of the word, but by the Legislature's taxing policies; therefore, a transaction which, in common parlance, might not be regarded as a sale would properly be treated as a sale for sales tax purposes (***id.***, 464 NYS2d at 229). In contrast, there is no broadly inclusive statutory definition of personal property in Article 9-A; indeed, there is no definition at all. Accordingly, there is no basis upon which to depart from the common understanding of that term in the instant matter.

M. The petitions of Arcade Broadway Plaza Rentals, Inc., Arcade Rental Investments, Inc., Ascot Development, Inc., Cosmos Rental Investments, Inc., Marathon Rental Investments, Inc., and MRI-888 Rental Investments, Inc. are granted. Accordingly, petitioners' claims for refund of corporation franchise tax as claimed on their amended franchise tax returns for the years at issue are likewise granted.

DATED: Troy, New York
December 31, 1998

/s/ Timothy J. Alston
ADMINISTRATIVE LAW JUDGE