STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
VIACOM, INC.	:	DETERMINATION DTA NO. 819591
for Revision of a Determination or for Refund of Real Estate Transfer Tax under Article 31 of the Tax Law for the Period May 4, 2000.	:	

Petitioner, Viacom, Inc., 1515 Broadway, New York, New York 10036, filed a petition for revision of a determination or for refund of real estate transfer tax under Article 31 of the Tax Law for the period May 4, 2000.

On July 20, 2004 and July 22, 2004, respectively, petitioner by its representative, Roberts & Holland LLP (Carolyn Joy Lee, Esq., of counsel) and the Division of Taxation by Christopher C. O'Brien, Esq. (Barbara J. Russo, Esq., of counsel), waived a hearing and agreed to submit the matter for determination based on documents and briefs to be submitted by December 14, 2004, which commenced the six-month period for the issuance of this determination. After review of the evidence and arguments presented, Thomas C. Sacca, Administrative Law Judge, renders the following determination.

ISSUES

I. Whether a conveyance of real property was properly excluded from the real estate transfer tax pursuant to Tax Law § 1405(b)(6) as a "mere change of identity or form of ownership or organization where there is no change in beneficial ownership."

II. Whether penalty imposed under Tax Law § 1416(b) should be sustained.

FINDINGS OF FACT

The parties entered into a Stipulation of Facts which has been incorporated into the Finding of Facts herein. Petitioner's proposed finding of fact 7 has been rejected as not being reflective of the Stipulation of Facts. Petitioner's proposed finding of fact 8 has been rejected as not being reflective of the stipulation of facts and being in the nature of a legal conclusion. Petitioner's proposed finding of fact 13 has been rejected as being in the nature of a conclusion. Petitioner's proposed finding of fact 14 has been rejected as not being supported by the facts. Petitioner's proposed finding of fact 15 has been rejected as being in the nature of a legal conclusion.

1. On May 4, 2000, the CBS Corporation ("CBS") merged into Viacom, Inc. ("Viacom") (the "Merger"). CBS had been a Pennsylvania corporation; Viacom is a Delaware corporation. The Joint Proxy Statement describes CBS, Viacom, and the terms and conditions of the Merger.

2. The Merger was a statutory merger effected under the Delaware General Corporation Law ("Delaware Corporate Law") by filing a Certificate of Merger with the Secretary of State of the State of Delaware. A Restated Certificate of Incorporation of Viacom became effective upon the Merger.

3. At the time of the Merger, Viacom had two outstanding classes of common stock, Viacom Class A voting common stock ("Class A Stock") and Viacom Class B nonvoting common stock ("Class B Stock"). In the Merger, the holders of CBS voting common stock received Viacom Class B nonvoting common stock.

4. In the Merger, the CBS shareholders received Viacom Class B Stock equal in the aggregate to a 54.88% ownership interest in Viacom.

5. The terms of the Class B Stock are set forth in the Restated Certificate of Incorporation of Viacom. As set forth therein, (i) the holders of Class A Stock and Class B Stock receive dividends ratably; (ii) upon a dissolution or liquidation of Viacom, the holders of Class A Stock and Class B Stock divide the net assets of Viacom available to common stockholders ratably; and (iii) any split, subdivision or combination of the outstanding Class A Stock or Class B Stock is to be matched by a proportionate split, subdivision or combination of the other Class's stock. The Certificate of Merger states that each share of Class B Stock has rights, privileges, limitations, restrictions and qualifications identical to a share of Class A Stock, except that shares of Class B Stock have no voting rights other than those required by the Delaware Corporate Law.

6. The Restated Certificate of Incorporation provided that, contemporaneous with the Merger, the Board of Directors of Viacom was expanded from 10 to 18 directors. In addition, the Stockholders Agreement was entered into by National Amusements, Inc., which owned 68% of Viacom's Class A Stock at the time of the Merger, and CBS. In the Stockholders Agreement it was agreed that, subject to fiduciary limitations, for a three-year period subsequent to the Merger, 8 of the 18 members of Viacom's board of directors would be individuals who had been directors of the former CBS ("CBS Directors"), or replacements those CBS Directors might designate. The remaining ten directors of the combined company were the individuals who were the Viacom Board members prior to the Merger ("Viacom Directors"). Of these ten Viacom Directors, two were required to be either current independent directors of Viacom or other disinterested independent persons who are chief executive officers of a Fortune 500 company or a non-U.S. company of comparable size. Except with respect to matters delineated in Annex 1 of Viacom's Restated Certificate of Incorporation, all actions of the board of directors for the

three-year period subsequent to the Merger required the approval of 14 directors. The expanded board size could not be changed without the approval of at least 14 directors for the three-year period subsequent to the Merger. The actions of the board, other than those stated in Annex 1 of Viacom's Restated Certificate of Incorporation, including any change in board size, thus would require the approval of at least 50% of the former CBS board members.

7. Mr. Karmazin, then current CEO and President of CBS, was named the President and Chief Operating Officer ("COO") of Viacom at the time of the Merger. During the three-year period following the Merger, Mr. Karmazin could not be terminated or demoted, nor could his operational responsibilities be curtailed, except on the approval of at least 14 directors.

8. Prior to the Merger, the stock of CBS and the Viacom Class A Stock and Class B Stock were publicly traded on the New York Stock Exchange ("NYSE"). Following the Merger, the Viacom Class A Stock and Class B Stock continued to be publicly traded on the NYSE.

9. Since the Merger, Viacom has made two dividend payments to holders of Class A Stock and Class B Stock, which dividends were paid ratably as specified in the Restated Certificate of Incorporation of Viacom. On October 14, 2003, Viacom announced the payment of a dividend of $0.06 per share for each share of Class A Stock and Class B Stock. On January 28, 2004, Viacom announced the payment of a dividend of $0.06 per share for each share of Class A Stock and Class B Stock.

10. The Merger effected a transfer of a controlling economic interest in CBS within the meaning of Tax Law Article 31. The interests in real property in New York State owned by CBS at the time of the Merger (collectively the "CBS Real Estate") were reported on Forms TP-584, combined real estate transfer tax returns, filed on May 22, 2000 (collectively the "Returns").

11. The fair market value of the CBS New York Real Estate at the time of the Merger was $222,505,992.00 in the aggregate, as indicated on the Returns.

12. The Returns claimed exemptions aggregating 70.44% under Tax Law § 1405(b)(6). Real estate transfer tax ("RETT") in the amount of $258,106.92 was paid to the New York State Department of Taxation and Finance on May 22, 2000.

13. The Commissioner of Taxation and Finance issued a Notice of Determination ("Notice") dated May 2, 2003 to Viacom.

14. The Commissioner accepted the exemption claimed under Tax Law § 1405(b)(6) as to 15.56% of the transfer, but disallowed the claim for exemption for the 54.88% (rounded in the Notice to 54.9%) ownership interest that CBS shareholders received in Viacom as a result of the Merger, on the basis that the Class B Stock was nonvoting stock.

15. The Commissioner has asserted a RETT deficiency of $493,965.08.

16. The Commissioner has asserted interest as of May 2, 2003 in the amount of $117,908.11 and a penalty of $172,887.75 with respect to the RETT deficiency.

17. On July 30, 2003, Viacom filed a timely petition for review of the notice with the Division of Tax Appeals.

18. On October 1, 2003, the Division of Taxation filed a timely answer to the petition.

CONCLUSIONS OF LAW

A. The real estate transfer tax is "imposed on each conveyance of real property or interest therein" (Tax Law § 1402[a]). All conveyances are presumed subject to the tax (Tax Law § 1404[b]). While the grantor in the transaction is generally responsible for the payment of the transfer tax, where the grantor has failed to pay the tax, the grantee has the duty to pay the tax (Tax Law § 1404[a]).

The term “conveyance” is defined as “[t]he transfer or transfers of any interest in real property . . . including . . . [a] transfer or acquisition of a controlling interest in any entity with an interest in real property” (Tax Law § 1401[e]). Section 1401(b)(i) of the Tax Law defines a “controlling interest” as “in the case of a corporation, either fifty percent or more of the total combined voting power of all classes of stock of such corporation, or fifty percent or more of the capital, profits or beneficial interest in such voting stock of such corporation.” Finally, in the case of a controlling interest in any entity that owns real property, “consideration” means “the fair market value of the real property or interest therein, apportioned based on the percentage of the ownership interest transferred or acquired in the entity” (Tax Law § 1401[d][iii]).

B. Tax Law § 1405(b)(6) excludes from the real estate transfer tax “[c]onveyances to effectuate a mere change of identity or form of ownership or organization where there is no change in beneficial ownership.” Petitioner states that the issue to be addressed in this matter is whether, following the Merger, the CBS shareholders had an *ongoing* “beneficial interest” in the CBS Real Estate thus entitling the Merger to the 54.88% change-in-form exemption claimed. However, the statute provides an exclusion for real estate transfers which effectuate a mere change of identity or form of ownership where there is *no change* in “beneficial ownership.” Thus, although the shareholders may have maintained an ongoing beneficial ownership, the question to be addressed is whether there was a consistency in that ownership.

C. In May 2000, CBS merged with Viacom with Viacom surviving the merger as the new corporate entity. Shareholders of CBS exchanged their voting common stock for shares of Viacom Class B nonvoting common stock. Viacom acquired a controlling interest in CBS, which at the time of the Merger had an interest in real property, as indicated on the real estate transfer tax returns. Pursuant to Tax Law § 1401(b)(i) and (e), the Merger between CBS and Viacom resulted in a taxable conveyance of an interest in real property by CBS to Viacom.

D. Petitioner contends that the change-in-form exemption contained in section 1405(b)(6) is to be read independently of the definition of "controlling interest" provided in section 1401(b)(i) so as to determine the issue of "beneficial ownership" without resort to the definition of "control." However, McKinney's Consolidated Laws of NY, Book 1, Statutes § 97 provides, in pertinent part:

> It is a fundamental rule of statutory construction that a statute or legislative act is to be construed as a whole, and that all parts of an act are to be read and construed together to determine the legislative intent. . . . A general expression or a single sentence detached from its context does not reveal the purpose of the statute as a whole, and particular provisions, therefore, should not be torn from their places and, so isolated, be given a special meaning at variance with the general purpose and spirit of the enactment.

When construing a statute the primary focus is on the intent of the Legislature in enacting the statute (McKinney's Cons Laws of NY, Book 1, Statutes § 92[a]; ***see***, ***Matter of Sutka v. Connors***, 73 NY2d 395, 541 NYS2d 191; ***Matter of American Communications Technology v. State of New York Tax Appeals Tribunal***, 185 AD2d 79, 592 NYS2d 147, ***affd*** 83 NY2d 773, 611 NYS2d 125). When that intent is clear from the wording of the statute itself, the inquiry ends (McKinney's Cons Laws of NY, Book 1, Statutes § 76; ***see***, ***Matter of American Communications Technology v. State of New York Tax Appeals Tribunal***, ***supra***). However, when there is an ambiguity in the words of the statute, the inquiry extends to other methods of ascertaining legislative intent (***see***, McKinney's Cons Laws of NY, Book 1, Statutes §§ 76, 92; ***Matter of American Communications Technology v. State of New York Tax Appeals Tribunal***, ***supra***). In a case such as this where it is presumed that the determination of the Division is correct in subjecting the transaction at issue to RETT and petitioner is arguing that the transfer of the CBS Real Estate resulted in a mere change in the form of ownership, petitioner is required to prove that its interpretation of the statute is the only reasonable interpretation, or that the Division's interpretation is unreasonable (***Matter of Marriott Family Rests. v. Tax Appeals Tribunal of State of New York***, 174 AD2d 805, 570 NYS2d 741, ***lv denied*** 78 NY2d 863, 578 NYS2d 877; ***Matter of Aetna Casualty & Surety Co. v. Tax Appeals Tribunal***, 214 AD2d 238, 633 NYS2d 226, ***lv denied*** 87 NY2d 811, 644 NYS2d 144; ***see also***, ***Matter of Grace v. State Tax Comm.***, 37 NY2d 193, 371 NYS2d 715; ***Matter of Federal Insurance Co. v. State Tax Comm.***, 146 AD2d 888, 536 NYS2d 595). These principles of statutory construction also apply to the interpretation of regulations (***see***, ***Matter of Cortland-Clinton v. NYS Dept. Of Health,*** 59 AD2d 229, 399 NYS2d 492).

E. The meaning and purpose of the term "beneficial ownership" as it is used in the context of Article 31 of the Tax Law relating to corporations must be determined by considering the exemption together with the definitions of "conveyance" and "controlling interest," since the exemption provides that "the tax shall not apply to conveyances to effectuate a mere change . . ." (Tax Law § 1405 [b][6]). When used in this context, "conveyance" means a "transfer or acquisition of a controlling interest in any entity with an interest in real property . . ." (Tax Law § 1401[e]). In defining "controlling interest," the statute refers only to voting stock (Tax Law § 1401[b]). Therefore, when reading Article 31 as a whole, the exemption states that the tax will not apply to a transfer or acquisition of 50% or more of the total combined voting power of all classes of stock of the corporation, or 50% or more of the capital, profits or beneficial interest in such voting stock which effectuates a mere change of identity or form of ownership where there is no change in beneficial ownership. It is clear that the definition of "controlling interest" is an important and integral part of the change-in-form exemption. When a change in the controlling interest occurs, it follows that there is a change in the beneficial ownership. In that voting power is an aspect required for purposes of a controlling interest, where there occurs an exchange of voting stock for nonvoting stock, there must necessarily occur a change from a controlling interest, and therefore a change of beneficial ownership for purposes of Article 31.

F. As the Division notes, if petitioner's position were accepted, it would create an opportunity for tax avoidance in transfers structured as in the Merger between CBS and Viacom, Inc. Since a taxable conveyance of a controlling interest means the transfer of 50% or more of total combined voting power or voting stock, by converting the interest from voting shares to nonvoting shares, petitioner would escape any future taxability of the interest. As Tax Law § 1404(b) provides, "for purposes of the proper administration of this article and to prevent evasion of the tax hereby imposed, it shall be presumed that all conveyances are taxable."

G. Although the term "beneficial ownership" is not defined in the statutory or regulatory scheme, it has commonly been defined by both the courts and the Tax Appeals Tribunal in other areas of the law as dominion and control over the property (***Matter of Racal Corporation and Decca Electronics, Inc.***, Tax Appeals Tribunal, May 13, 1993; ***Matter of Schechter***, Tax Appeals Tribunal, October 13, 1994; ***see also***, ***Yelencsis v. Commissioner***, 74 TC 1513 [holding that in the matter of Federal income tax questions, the term "beneficial ownership" is "marked by command over property or enjoyment of its economic benefit"]; ***Macan, Dublin, & Savannah Railroad Co. V. Commissioner***, 40 BTA 1266 [in determining an issue regarding whether a subsidiary was properly included in a consolidated income tax return, the court stated that "[t]he direct ownership required by the statute is not merely possession of the naked legal title but beneficial ownership, which carried with it dominion over the property" and "taxation is not so much concerned with the refinements of title as it is with the actual command over the property taxed . . . that is the beneficial interest”]).

In ***Matter of Racal (supra)***, the Tribunal affirmed the holding of the Administrative Law Judge that petitioners were the beneficial owners of stock of the subsidiaries, because they “had dominion and command over the subsidiaries and received the economic benefit of the stock . . . .” The issue in ***Racal*** concerned the entitlement of petitioners to exclude from entire net income interest received from second tier subsidiaries. Dominion and command were found to exist because petitioners had absolute control over the election and removal of officers and directors, and of operational, tax and financial matters. Petitioners also had the absolute power to cause dividends to be declared and paid and the right to sell or pledge all of the stock.

In ***Matter of Shecter (supra)***, the Tribunal addressed the issue of whether a beneficial interest had changed in a transaction subject to the gains tax. The Tribunal, noting that the United States Supreme Court in ***Commissioner v. Sunnen***, (333 US 591) looked beyond the change in formal legal title to determine if the transferor continued to retain significant control over the transferred property, stated that it was necessary to look at the circumstances both before and after completion of the transaction in making this determination. In its decision, the Tribunal found that because petitioner relinquished control over his stock in the corporation having an interest in real property to a partnership in which he had no partnership interest, he failed to meet the criteria for a mere change exemption provided under the former Gains Tax Law. There is nothing in the Tribunal’s decision, contrary to petitioner’s claim, which limits its analysis to factual circumstances when ownership is ambiguous.

As with the taxpayer in ***Matter of Schecter (supra)***, the CBS shareholders involved in the exchange of voting stock for nonvoting stock did not retain dominion and control of the property transferred from CBS to Viacom as a result of the Merger. Their interest in the real property after the Merger differed from their interest in the real property before the Merger. The voting rights influence and control the disposition of the property, and here the CBS shareholders transferred their controlling interest in CBS by way of voting stock for a noncontrolling interest in Viacom in receipt of nonvoting stock.

H. Petitioner's reliance on the "look-through-principle" as the basis for its position that the economic reality of the transaction controls in determining whether the transfer of real property qualified for the mere change-in-form exemption is misplaced. Initially, it is noted that the economic reality in the present case, contrary to petitioner's claim, is that petitioner's interest in the real estate transferred changed in the Merger; the CBS shareholders owned voting stock and thus a controlling interest in CBS prior to the transfer, and owned Viacom nonvoting stock and therefore a noncontrolling interest in Viacom after the transfer. In addition, using the Tribunal's inquiry into economic reality does not support petitioner's position. Petitioner incorrectly concludes that applying the economic reality theory to the interpretation of the RETT's change-in-form exemption results in the conclusion that the beneficial ownership of real estate is determined by disregarding the entity and looking to the economic reality, that is, the economic ownership of the real estate. What the Tribunal stated was that in looking at the economic reality of a transaction, in order to determine if there has been a change in beneficial interest, one must examine the circumstances surrounding the entire transaction, including a showing of control by the transferor of the entities involved. In order to determine control, the Tribunal stated that it is necessary to look at the parties' "post-transfer conduct." Thus, in determining the economic reality of the transaction, the Tribunal directed an examination of both whether the transferor maintained control of the entities involved and whether the transferor retained a financial interest similar to the ownership interest possessed before the transfer (***see***, ***Matter of Schecter***, ***supra***).

I. Petitioner's claim that a determination of change in beneficial ownership depends on whether the transferor maintains the same "pro rata share" is misleading as it focuses upon the amount of the real estate owned by the shareholders after the transfer. This is only the initial inquiry, as the present matter is concerned with a transfer of a controlling interest, not merely a transfer of real property. To analyze the transfer at issue only by examining the economic interests in the real property before and after the conveyance fails to take into account the fact that the interest transferred involves a controlling interest. That a controlling interest is involved cannot be ignored in applying the mere change-in-form exemption. The CBS shareholders' interest in the real property has changed from a controlling interest in CBS (voting stock) prior to the Merger to a noncontrolling interest in Viacom (nonvoting stock) after the Merger.

J. Petitioner's reliance on a gains tax exemption contained in Tax Law former § 1443(4) in support of its position is misplaced. Although it may be useful to look to gains tax decisions for discussions of common law meanings of undefined terms, the actual provisions of a separate and distinct tax may not be used to interpret another tax (***Matter of Ziegleman***, Tax Appeals Tribunal, August 18, 1994).

K. Petitioner unsuccessfully argues that the provisions of the Stockholders Agreement provided the CBS shareholders with a level of control after the Merger equivalent to the control they possessed as holders of voting stock of CBS. Initially it is noted that these provisions of the Shareholders Agreement were limited to the three years after the Merger. More importantly, by exchanging voting stock for nonvoting stock, the CBS shareholders no longer had the right to vote for any directors after the Merger. Although the rights arising from owner's equity are conveyed by both voting and nonvoting shares, such as the right to receive dividends and liquidation distributions, the Division correctly points out that the rights conveyed by voting stock carry additional benefits. As a general rule, directors are elected by shareholders who own voting shares (Business Corporation Law § 614[a]). In addition, absent contrary language in the bylaws, certificate of incorporation or other sections of the Business Corporation Law, whenever any corporate action, other than the election of directors, is to be taken by a vote of the shareholders, the issues will be decided by the majority of those shareholders holding voting stock (Business Corporation Law § 614[b]). Issues subject to a vote often include the right to approve the issuance of additional capital stock, the right to approve mergers and consolidations, the right to sell, lease, exchange or otherwise dispose of assets (such as real estate) not in the regular course of business and the right to dissolve the corporation.

It is clear that those shareholders holding nonvoting stock do not have the same dominion and control over the corporation and its assets as those holding voting stock. Thus, the economic interest of the CBS shareholders in the real property was altered by the Merger, and the mere change-in-form exemption does not apply to the conveyance at issue.

L. Tax Law § 1416(b) provides that any grantor or grantee failing to pay any tax within the time required by Article 31 shall be subject to a penalty. Such section further provides that where such failure was due to reasonable cause and not due to willful neglect, penalty shall be waived. In determining whether reasonable cause and the absence of willful neglect exist, the most important factor to be considered is the extent of the taxpayer's efforts to ascertain the proper tax liability (***LT & B Realty v. State Tax Commn.***, 141 AD2d 185, 535 NYS2d 121).

Petitioner's claim that the penalty imposed be waived is based upon the premise that the phrase "beneficial ownership," which it is at the heart of the dispute in this matter, is not defined in either the statute or regulations. Petitioner also asserts that the Division's position in this matter is "novel" and without precedent. However, as has been previously noted with respect to gains tax penalties, "the failure to pay a tax due to a different legal interpretation of a statute need not be considered 'reasonable cause.' In fact, if it were so considered, [the Commissioner] would rarely if ever be entitled to levy such penalties." (***Matter of Auerbach v. State Tax Commn.***, 142 AD2d 390, 536 NYS2d 557.) In addition, there has been no showing as to the extent of petitioner's efforts to ascertain the proper tax liability. Therefore, it is concluded that petitioner's failure to pay the applicable RETT on the transfer at issue was not due to reasonable cause.

M. The petition of Viacom, Inc. is denied, and the Notice of Determination dated May 2, 2003 is sustained.

DATED: Troy, New York
May 26, 2005

/s/ Thomas C. Sacca
ADMINISTRATIVE LAW JUDGE