STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
KEVIN KELLY	:	DETERMINATION DTA NO. 819863
for Revision of a Determination or for Refund of Real Estate Transfer Tax under Article 31 of the Tax Law for the Period March 29, 2001.	:	

Petitioner, Kevin Kelly, 512 Sweet Bay Circle, Jupiter, Florida 33458, 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 March 29, 2001.

A hearing was held before Catherine M. Bennett, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on August 30, 2004 at 1:30 P.M., with all briefs submitted by June 9, 2005, which date began the six-month period for the issuance of this determination. Petitioner appeared by Victoria A. Ramundo, Esq. The Division of Taxation appeared by Christopher C. O'Brien, Esq. (Barbara J. Russo, Esq., of counsel).

ISSUE

Whether the Division of Taxation erroneously assessed additional tax on the conveyance of residential property, pursuant to Tax Law § 1402-a.

FINDINGS OF FACT[1]

1. Petitioner, Kevin Kelly, entered into a construction and purchase contract with J & B Builders ("the contract") on March 23, 2001, for the purchase of a building lot and home "built or to be built" on lots 88 and 89 in the subdivision known as Spruce Ridge, in the Town of Pompey, Onondaga County, State of New York. The contract provided that:

a. Petitioner would pay the builder $1,700,000.00 for the home and the lots with the following schedule of payments to be made:

1) $10,000.00 deposited with the contract, and held by the builder or broker pending acceptance of the contract;

2) An additional sum of $300,000.00 payable to the builder upon the purchaser's delivering to the builder a commitment of a mortgage, or waiver thereof;

3) The balance of $1,390,000.00 payable in cash or its equivalent upon closing or passing of the deed.

b. The transaction was to include the lot, the house constructed or to be constructed by the builder and any appliances, fixtures and other personal property as described by the contract;

c. There were no agreements other than those provided in the contract;

d. A lending institution was to issue to petitioner a written commitment to make a construction first mortgage loan on the home in the amount of $1,100,000.00.

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[1] The parties submitted a stipulation of facts, which was incorporated into the Findings of Fact except where such stipulation was an assertion of the position of one party, or a statement of authenticity of documents and incorporation by reference. The Division of Taxation submitted proposed findings of fact which have been incorporated into the Findings of Fact except where modified to more accurately reflect the record. Petitioner's objections to the proposed findings of fact have been fully considered and incorporated in the Findings of Fact as supported by the record and as relevant herein.

2. A Combined Real Estate Transfer Tax Return, Form TP-584, signed by J & B Builders as the grantor and petitioner as the grantee, was filed by petitioner's former attorney on March 30, 2001 ("the original TP-584"). The original Form TP-584 reported: a "conveyance in fee interest" of a "1-3 family house" in the box for the "Type of Property conveyed"; the "amount of consideration for the conveyance" of $1.7 million dollars on line 1 of Part I of Schedule B; that 100% of the real property is residential real property and real estate transfer tax due in the amount of $6,800.00. The parties acknowledge that the entire Part II of Schedule B of the original Form TP-584 for the "Computation of Additional Tax Due on the Conveyance of Residential Real Property for $1 Million or More" was left blank by the grantor, the grantee and their former attorneys. The reported real estate transfer tax in the amount of $6,800.00 was paid.

3. The only deed in this matter is a warranty deed ("deed") dated March 21, 2001, representing that it is for the transfer of "Lot No. 88 and 89 as shown on a map entitled Final Plan Spruce Ridge, Section #9, made by Alfred N. Ianuzi, L.L.S. dated February 4, 2000" from J & B Builders, Inc. to petitioner. The original Form TP-584 concerns an underlying transfer of two lots of real property ("the lots") that are described in this deed, and is the same real property reported on a later filed amended Form TP-584. The deed was signed by both parties on March 21, 2001 and recorded with the Onondaga County Clerk's office on March 30, 2001. The deed is subject to the trust provisions of section 13 of the Lien Law.

4. Neither the building contract nor the deed to the lots contained any provision for reversion of title to the lots to the builder upon any default. The builder, by affidavit, acknowledged that petitioner eventually defaulted in paying him under the building contract, and although the builder would have been entitled to file a mechanic's lien for amounts due under the

building contract, the builder was not entitled to regain title to the lots pursuant to the terms of the contract.

5. A survey of the lots in issue, dated March 13, 2001, prepared "for conveyance and/or mortgage purposes only," shows a house and utilities on the lots.

6. The lots were assessed as "residential vacant land" before the following transactions:

a) the deed was dated and recorded,
b) the original Form TP-584 was filed,
c) the building contract was signed,
d) petitioner closed on the Chase Construction Loan, and
e) the builder's attorney prepared the Statement of Sale.

7. On March 29, 2001, petitioner obtained a construction loan convertible into a mortgage from Chase Manhattan Bank ("Chase") in the amount of $1,100,000.00 to finance construction of the residence on the lots ("Petitioner's Construction Loan"). Chase filed a UCC lien on the lots.

8. The following documents relating to petitioner's construction loan were submitted into evidence:

a. The Mortgagor's Closing Affidavit, indicating that petitioner had unencumbered ownership of the lots, executed to induce Chase to lend petitioner $1,100,000.00 as a construction loan;

b. The Building Loan Contract between petitioner and Chase for the improvement of a single family residence to be constructed on the real property, with construction to begin within 30 days following the recording of the mortgage and any applicable UCC Financing Statements; and

c. The Construction Loan Addendum which further indicates that the proceeds of the loan were to finance the construction of a single-family detached dwelling, and that the property securing the loan would include the dwelling during and after construction.

9. The builder's former attorney prepared a Statement of Sale, signed by a paralegal for the firm and by petitioner stating that the closing on the builder's contract occurred on March 29, 2001 for a total sale of $1.7 million dollars. The statement reflects a down payment of $310,000.00 with additional down payments of $250,000.00 and $40,000.00 and recording fees and taxes as credits to the purchaser in the amount of $7,538.00, for a net due the builder of $1,092,462.00. The Statement of Sale shows J&B Builders as seller, petitioner as purchaser and the premises which are the subject of the sale as 4494 Spruce Ridge Drive, Manlius, New York, a/k/a Lots #88 and #89, Spruce Ridge, Section 9.

10. A certificate of occupancy was issued by the Town of Pompey on April 15, 2002 for the residence constructed on the lots.

11. The Division of Taxation ("Division") conducted a desk audit upon receipt of the original TP-684. Thereafter, the Division issued a Statement of Proposed Audit Changes dated June 12, 2003, stating the following:

> Section 1402(a) of the Tax Law provides in part that in addition to the tax imposed by Section 1402 of Article 31, a tax is hereby imposed on each conveyance of residential real property or interest therein when the consideration for the entire conveyance is one million dollars or more. For purposes of this section, residential real property shall include any premises that is or may be used in whole or in part as a personal residence, and shall include a one, two or three-family house, an individual condominium unit, or a cooperative apartment unit. The rate of such tax shall be one percent (1%) of the consideration or part thereof attributable to the residential real property.
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> A review of the information submitted concerning the conveyance of real property located at SPRUCE RIDGE DRIVE [sic].

> We have information that indicated a conveyance of real property occurred on 03/29/01, and the tax of $17,000.00 was not paid.

12. Petitioner telephoned the Division in response to the Statement of Audit Changes and submitted a letter requesting abatement of penalties. The Division requested petitioner to provide documentation to support his position.

13. The testimony in this case revealed that the parties initially intended for the builder to construct the home and for petitioner to buy the land and the home as a package. When the builder was unable to qualify for financing for the entire project, petitioner sought qualification for the construction financing. In order to approve petitioner's financing, Chase Manhattan Bank required petitioner to own the land outright, unencumbered by any builder or other liens, to enable the bank to perfect a first priority lien on the land. Thus, a deed to transfer the property was prepared on March 21, 2001, the contract for the purchase of the lots and the home to be built thereafter executed on March 23, 2001 a construction loan with Chase closed on March 29, 2001, and the building commenced.

14. Petitioner's former attorney who had filed the original Form TP-584 stated in correspondence dated September 2, 2003, that he and the builder's former attorney had erred in preparing and filing the original Form TP-584. The correspondence confirms that petitioner obtained title to the land from the builder pursuant to a deed dated March 21, 2001, at which time no single family residence existed on the property. At the time the single family residence was completed the following year, petitioner already owned the land upon which the house was constructed.

15. Petitioner's current attorney filed an amended TP-584 on September 22, 2003, signed by J & B Builders's former attorney as grantor and petitioner as grantee ("the amended Form TP-584"). The amended Form TP-584, concerning the same property in issue, reported: a

"Conveyance in fee interest" of "vacant land" for the "Type of Property conveyed"; the "amount of consideration for the conveyance"of $300,000 on line 1 of Part I of Schedule B; the date of conveyance as March 29, 2001; that 100% of the real property is residential real property; and total real estate transfer tax due recomputed to be $1,200.00.

16. Copies of two checks were submitted into the record. One is a bank check in the amount of $250,000.00, dated March 23, 2001, payable to J& B Builders, Inc. It was drawn on petitioner's account at Chase, bears check no. 0729100255, and includes petitioner's name and address. The second check is in the amount of $62,476.50, dated March 29, 2001, payable to Shulman Curtin Grundner & Regan. It was drawn on petitioner's account with The Prudential Bank as Check No. 104. Petitioner's signature appears on the second check.

17. There are three disbursement draw schedules in the record relating to the disbursement of construction funds. The only one on Chase letterhead indicates the following disbursements: $560,000.00, $300,000.00, $420,000.00, $280,000.00 and $140,000.00 for a total of $1,700,000.00. The two other draw schedules in the record are on the builder's letterhead. One lists the draw schedule breakdown in an undated document as: $650,000.00, $450,000.00, $400,000.00 and $200,000.00, for a total of $1,700,000.00. The other indicates the draw as: $560,000.00 (which was adjusted manually to $310,000.00 without explanation), $420,000.00, $280,000.00, and $140,000.00, for a total of $1,400,000.00. Attached to this last draw schedule is a fax cover sheet from petitioner's former attorney stating that he believed this to be the draw schedule under which the builder and petitioner were operating, since petitioner had already paid the builder $600,000.00.

18. The Division issued to petitioner a Notice of Determination in this matter dated August 7, 2003, assessing additional tax in the amount of $17,000.00, plus penalty and interest, for a total of $25,738.82, in accordance with the Division's desk audit conclusions.

19. A conciliation conference was held in this matter, and the conciliation conferee cancelled the penalties, but otherwise sustained the tax in the amount of $17,000.00, plus interest computed at the applicable rate.

SUMMARY OF THE PARTIES' POSITIONS

20. Petitioner argues that the real property transferred by deed to him in March 2001 was vacant land. Petitioner further argues that the tax in issue applies only to conveyances of residential real property, and since vacant land does not constitute the same, the assessment should be canceled in its entirety.

21. The Division contends that the tax is properly applied here to a conveyance of an interest in residential real property defined by the lots and the home to be built, since an "interest in real property" includes a "contract to purchase real property" under Article 31 of the Tax Law.

CONCLUSIONS OF LAW

A. In pertinent part, Tax Law § 1402-a(a), also known as the "mansion tax," states:

> In addition to the tax imposed by section fourteen hundred two of this article, a tax is hereby imposed on each conveyance of residential real property or interest therein when the consideration for the entire conveyance is one million dollars or more. For purposes of this section, residential real property shall include any premises that is or may be used in whole or in part as a personal residence, and shall include a one, two, or three-family house, an individual condominium unit, or a cooperative apartment unit. The rate of such tax shall be one percent of the consideration or part thereof attributable to the residential real property.

Tax Law § 1401 defines the terms used in Article 31 (and thus Tax Law § 1402-a), in pertinent part, as follows:

> (e) 'Conveyance' means the transfer or transfers of any interest in real property by any method, including but not limited to sale, exchange, assignment, surrender, mortgage foreclosure, transfer in lieu of foreclosure, option, trust indenture, taking by eminent domain, conveyance upon liquidation or by a receiver, or transfer or acquisition of a controlling interest in any entity with an interest in real property. . . .
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> (f) 'Interest in the real property' includes title in fee, a leasehold interest, a beneficial interest, an encumbrance, development rights, air space and air rights, or any other interest with the right to use or occupancy of real property or the right to receive rents, profits or other income derived from real property. It shall also include an option or contract to purchase real property.

B. Petitioner asserts that since the conveyance in issue was one of vacant land, with no residential real property thereon, the tax simply does not apply. The form which this transaction ultimately took began with the purported conveyance of the vacant land by deed on March 21, 2001. Petitioner asserts that this conveyance, as a separate transaction, controls the ultimate application of the mansion tax to this case. Although this transaction had the potential of being structured to control the taxation result, petitioner's contention that the mansion tax should not apply to this set of facts is not supported by the documents executed with regard to the entire transaction. First, under Real Property Law § 461(6), the transfer of title takes place upon delivery of a properly executed instrument conveying title to residential real property. Although the deed purportedly conveyed the property in question on March 21, 2001, there is no evidence of delivery in the record. The only manner in which delivery can be supported is by inference, since Chase required petitioner to own the property before it would close on the construction loan. There are, however, other conflicting facts. Petitioner claims to have paid $300,000.00 for the property alone. The contract with J&B Builders sets forth a commitment for the purchase by petitioner of the land and the house to be built for $1.7 million, as described in Finding of Fact "1." A statement of sale accompanied the closing on the Chase construction loan on March 29, 2001. It reflected a down payment of $310,000.00, consistent with the contract, additional

deposits of $250,000.00 and $40,000.00, with a net due the builder of $1,092,462.00 after credits. The only checks submitted into evidence that were allegedly payment for the land were not dated March 21, 2001, but rather March 23 and March 29, 2001, respectively, for $250,000.00 and $62,476.50, the dates which correspond to the purchase contract date and the date of the Chase construction loan closing. The first check for $250,000.00 was drawn on an account with Chase. It appears these funds were drawn on an account owned by petitioner, and not from the construction loan proceeds, though it remains questionable. Petitioner's attorney claims the second check is reimbursement to petitioner's former attorney for the additional amount owed for the purchase of the lots, plus $10,000.00 toward the down payment on the builder's contract, and expenses paid by the former attorney. However, there is no additional documentation to substantiate petitioner's assertion.

Another fact which does not support the division of this matter into separate transactions is the sequence of payments set forth by the construction loan disbursement draw schedules. There are three draw schedules in the record. The only one on Chase letterhead indicates the following disbursements: $560,000.00, $300,000.00, $420,000.00, $280,000.00 and $140,000.00 for a total of $1,700,000.00. The two other draw schedules in the file are on the builder's letterhead, as described in Finding of Fact "17." The two builder draw schedules are not consistent and no explanation was provided as to why different schedules were prepared showing different disbursements, or which more closely follows the actual pattern of disbursement. Since the funds were disbursed from Chase, it seems as though it is more likely that the disbursements followed that schedule, which does not support any separate payment for the lots.

C. Petitioner ignores certain inconsistencies or explains away as sloppy errors with no significance to this matter the following alleged facts: the builder's former attorney improperly prepared the construction contract by using a contract with standard language that was left unchanged to include the lots; he improperly prepared the statement of sale by including the lots and the home to be built as part of the same sale; and he erred in the preparation of the original TP-584. However accurate some of those allegations are, the fact remains that the documents do not support the claim that petitioner makes: the only thing conveyed was vacant land. What was conveyed in this matter was an interest in residential real property, consisting of the lots and the contract for the purchase of a home to be built. Petitioner responds that he did not have a contract to purchase residential real property, since no residence existed on the lots at the time of the conveyance, or at the time of the execution of the contract. At best, petitioner argues, he had executed a contract to construct a residence. While I do not disagree that petitioner's wording can be used to describe the facts of this case, I believe that what was conveyed in this case was an interest in residential real property properly subjected to the mansion tax imposed by Tax Law § 1402-a.

D. Several facts are certain: the land was vacant when the deed was prepared; the primary reason for altering the form of the transaction from its original form was not to avoid the mansion tax, but to accommodate the financing needs of the parties to see their way through the transaction; and the ultimate goal of all the parties was for petitioner to have a home built by this builder on the land in issue. In order to ensure proper tax treatment of a series of transactions, the courts often apply the principle of substance over form. In this case, examining the substance of this transaction lends further support for a finding that the steps of this transaction should not be viewed separately. The Supreme Court has expressly sanctioned the step

transaction doctrine, noting that "interrelated yet formally distinct steps in an integrated transaction may not be considered independently of the overall transaction" (***Commr v. Clark***, 489 US 726, 738, 89-1 US Tax Cas ¶ 9230; ***see also, Commr v. Court Holding Co.***, 324 US 331, 334 45-1 US Tax Cas ¶9215). The U.S. Circuit Court of Appeals in ***True v. U.S.*** (190 F3d 1165, 99-2 US Tax Cas ¶ 50872) thoroughly reviewed these judicial doctrines, and insofar as the analysis of the step transaction doctrine is applicable to this matter, the Court stated the following:

> Deciding 'whether to accord the separate steps of a complex transaction independent significance, or to treat them as related steps in a unified transaction, is a recurring problem in the field of tax law.' ***King Enters., Inc. v. United States,*** 418 F.2d 511, 516 (Ct. C1. 1969). In search of an answer to this problem, courts utilize a variety of approaches, including a particular incarnation of the basic substance over form principle known as the step transaction doctrine. Simply stated, the step transaction doctrine provides that 'interrelated yet formally distinct steps in an integrated transaction may not be considered independently of the overall transaction.' ***Commissioner v. Clark,*** 489 U.S. 726, 738 (1989). . . .
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> Courts have developed three tests for determining when the step transaction doctrine should operate to collapse the individual steps of a complex transaction into a single integrated transaction for tax purposes: (1) end result, (2) interdependence, and (3) binding commitment. ***See Associated Wholesale Grocers, Inc. v. United States*** 927 F.2d 1517, 1522 (10th Cir. 1991). More than one test might be appropriate under any given set of circumstances; however, the circumstances need only satisfy one of the tests in order for the step transaction doctrine to operate. ***See id.*** at 1527-28. . . .
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> The end result test combines 'into a single transaction separate events which appear to be component parts of something undertaken to reach a particular result.' ***Kornfeld,*** 137 F.3d at 1235; ***Associated Wholesale Grocers,*** 927 F.2d at 1523. Under this test, if we find the series of closely related steps in a transaction are merely the means to reach a particular result, we will not separate those steps, but instead treat them as a single transaction. ***Kanawha Gas & Utils. Co. v. Commissioner,*** 214 F.2d 685, 691 (5th Cir. 1954). The taxpayer's subjective intent is especially relevant under this test because it allows us to determine

> whether the taxpayer directed a series of transactions to an intended purpose. ***See, Brown v. United States***, 782 F.2d 559, 563 (6th Cir. 1986). . . . The intent we focus on under the end result test is not whether the taxpayer intended to avoid taxes. Prior case law clearly instructs that tax reduction and avoidance motives are permissible and do not alone invalidate a transaction. ***Gregory***, 293 U.S. at 469. Instead, the end result test focuses on whether the taxpayer intended to reach a particular result by structuring a series of transactions in a certain way. ***See King Enters.***, 418 F.2d at 516.

Given the type of transactions involved in this case, only the end result test is relevant to the analysis and applied herein.

Acknowledging that conveyance of property by deed may have its own business purpose and economic effect does not preclude application of the step transaction doctrine in this instance. Similarly, the Court in ***True*** (***supra***) further stated:

> To ratify a step transaction that exalts form over substance merely because the taxpayer can either (1) articulate some business purpose allegedly motivating the indirect nature of the transaction or (2) point to an economic effect resulting from the series of steps, would frequently defeat the purpose of the substance over form principle. Events such as the actual payment of money, legal transfer of property, adjustment of company books, and execution of a contract all produce economic effects and accompany almost any business dealing. Thus, we do not rely on the occurrence of these events alone to determine whether the step transaction doctrine applies. Likewise, a taxpayer may proffer some non-tax business purpose for engaging in a series of transactional steps to accomplish a result he could have achieved by more direct means, but that business purpose by itself does not preclude application of the step transaction doctrine. ***Associated Wholesale Grocers***, 927 F.2d at 1527. Although the absence of economic effects or business purposes may be fatal to a taxpayer's step transaction refund suit, the presence of those factors is not dispositive. ***See id.*** at 1526-27. We must still examine the objective realities of the multi-step transactions to determine their tax status, and proceed to do so under the end result . . . test[].

E. From the outset, petitioner intended to contract with J&B to build a home on this parcel of land. The documents taken in their entirety support a view that the entire transaction should be viewed as one. This was not tax avoidance, or even good tax planning. It was a transaction whose structure was altered to attain the business purpose associated with the financing of petitioner's deal. The individual tax significance of each step of a multi-step transaction is

irrelevant when, considered as a whole, the steps accomplish but a single intended result, which in actual purpose and effect is subject to the given tax consequence (***see, Crenshaw v. U.S.***, 450 F2d at 472, 71-2 US Tax Cas ¶ 9698). The reality is that petitioner intended to reach the particular end result of having J&B build his home on the lots in issue. Had the builder obtained financing as originally planned, then the builder would have transferred the property when the home was completed, and the conveyance would have been subject to tax as a transfer of residential real estate in excess of $1,000,000.00. The severing of the transaction into the steps necessary to secure financing should not be afforded a different tax treatment when the documentary evidence does not support separating the transaction into independent steps. This result is consistent with the statutory provisions of Tax Law Article 31.

F. Accordingly, on the basis of the application of Tax Law § 1402-a to the facts of this case, and the consideration given to the support supplied by the step transaction doctrine, the mansion tax was properly assessed in this case.

G. The petition of Kevin Kelly is hereby denied, and the Notice of Determination dated August 7, 2003, reduced to eliminate penalties (***see, Finding of Fact*** "19"), is sustained.

DATED: Troy, New York
December 8, 2005

/s/ Catherine M. Bennett
ADMINISTRATIVE LAW JUDGE