

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
GKK 2 HERALD LLC	:	DETERMINATION
for Revision of a Determination or for Refund of Real	:	DTA NO. 826402
Estate Transfer Tax under Article 31 of the Tax Law for	:	
the Period December 22, 2010.	:	

Petitioner, GKK 2 Herald LLC, filed a petition for redetermination of a deficiency or for refund of real estate transfer tax under Article 31 of the Tax Law for the period December 22, 2010.

On August 25, 2010 and August 26, 2015, respectively, petitioner, appearing by Morrison & Foerster, LLP (Irwin M. Slomka, Esq., of counsel), and the Division of Taxation, appearing by Amanda Hiller, Esq. (Tobias A. Lake, Esq., of counsel), waived a hearing and submitted this matter for determination based on documents and briefs to be submitted by December 23, 2015, which date commenced the six-month period for issuance of this determination. After due consideration of the documents and arguments submitted, Barbara J. Russo, Administrative Law Judge, renders the following determination.

ISSUE

Whether the Division of Taxation properly asserted real estate transfer tax against GKK 2 Herald LLC for a transaction occurring on December 22, 2010.

FINDINGS OF FACT¹

1. On December 21, 2012, the New York City Department of Finance issued a Notice of Determination (the NYC Notice) to GKK 2 Herald LLC (petitioner), asserting liability for New York City real property transfer tax in the amount of \$2,923,593.75, and interest in the amount of \$469,033.37, for a total amount due of \$3,392,627.12.

2. As a result of the conclusions reached by the New York City Department of Finance, as reflected in the NYC Notice, the Division of Taxation (Division) performed an audit of petitioner relating to the real estate transactions and the transfer of an interest in an entity that owns real property that occurred in the year 2010.

3. On February 11, 2013, the Division issued a Statement of Proposed Audit Changes to petitioner (Statement). The Statement asserts liability for New York State real estate transfer tax (RETT) in the amount of \$445,500.00, interest in the amount of \$77,240.21, and penalty in the amount of \$155,925.00, for a total amount due of \$678,665.21.

4. On April 1, 2013, the Division mailed a Notice of Determination (Notice) to petitioner. The Notice asserts liability for RETT in the amount of \$445,500.00, interest in the amount of \$82,529.45 as of April 1, 2013, and penalty in the amount of \$155,925.00, for a total amount due of \$683,954.45.

5. On May 10, 2013, petitioner filed a Request for Conciliation Conference with the Bureau of Conciliation and Mediation Services (BCMS).

¹ The parties executed and submitted a Stipulation of Facts setting forth 22 numbered stipulated facts and including 11 exhibits of which the parties agreed to the admissibility. The stipulated facts are generally incorporated herein. Additional Findings of Fact have been made.

6. On April 25, 2014, BCMS issued a conciliation order that upheld the assessment of RETT in the amount of \$445,500.00 and interest computed at the applicable rate, but cancelled the penalty in the amount of \$155,925.00.

7. On July 21, 2014, petitioner filed a petition in connection with the notice.

8. On October 1, 2014, the Division filed its answer in response to the petition.

9. On October 20, 2014, petitioner filed a reply to the Division's answer.

Description of Transaction at Issue

10. Pursuant to an Agreement of Sale, dated April 9, 2007, petitioner and SLG 2 Herald LLC (SLG) acquired real property located at 2 Herald Square, New York, New York a/k/a 1302-28 Broadway, New York, New York (the Property), as tenants-in-common.

11. Upon acquisition, petitioner held an undivided 45% tenant-in-common fee interest in the Property and SLG held an undivided 55% tenant-in-common fee interest in the Property.

12. RETT was paid in connection with petitioner's and SLG's acquisition of the Property as tenants-in-common on April 9, 2007.

13. On or about December 14, 2010, petitioner and SLG formed 2 Herald Owner LLC, a Delaware limited liability company (Owner LLC).

14. On December 22, 2010, petitioner and SLG contributed their respective 45% and 55% interests in the property to Owner LLC. As consideration for such contributions, petitioner received a 45% membership interest in Owner LLC and SLG received a 55% membership interest in Owner LLC.

15. On December 22, 2010, petitioner executed and delivered to Owner LLC a Bargain and Sale Deed Without Covenants (the GKK deed) with respect to its 45% tenant-in-common fee interest in the Property.

16. On December 22, 2010, SLG executed and delivered to Owner LLC a Bargain and Sale Deed Without Covenants (the SLG deed) with respect to its 55% tenant-in-common fee interest in the Property.

17. On December 22, 2010, petitioner sold its 45% membership interest in Owner LLC to SLG. In exchange for the conveyance of its 45% membership interest in Owner LLC to SLG, petitioner received consideration of \$111,375,000.00, which was based on the purchase price of \$25,312,500.00 and the prorated mortgage amount of \$86,062,500.00. On the New York State Combined Real Estate Transfer Tax Return for the conveyance between petitioner and SLG, petitioner and SLG reported no consideration for the amount of the conveyance and checked the box stating "exemption claimed."

18. Petitioner and SLG timely filed a New York State Combined Real Estate Transfer Tax Return (Form TP-584) reporting the contribution of petitioner's fee interest to Owner LLC and the sale to SLG of petitioner's membership interest in Owner LLC (Joint RETT return). On the return for the conveyance between petitioner and SLG, under the section for "condition of conveyance," boxes are checked stating, "conveyance for which exemption from transfer tax claimed . . ." and "other" wherein the description is stated as "transfer of 45% interest." The Joint RETT return includes form TP-584.1, New York State Real Estate Transfer Tax Return Supplement Schedules, reporting the contribution of petitioner's fee interest to Owner LLC as a conveyance that consists of a mere change of identity or form of ownership or organization.

19. SLG timely filed a New York State Combined Real Estate Transfer Tax Return (Form TP-584) reporting the contribution of its fee interest to Owner LLC (SLG RETT return). The SLG RETT return reports the condition of the conveyance as a “conveyance which consists of a mere change of identity or form of ownership or organization.”

20. Since December 22, 2010, through the date of the petition filed by petitioner in this matter, Owner LLC continued to own the Property.

SUMMARY OF THE PARTIES' POSITIONS

21. Petitioner contends that the Division erred in issuing the notice because petitioner's and SLG's contributions of their respective interests in the Property to Owner LLC are exempt from RETT as a “mere change in form” pursuant to Tax Law § 1405(b)(6). Petitioner contends that its subsequent sale of its 45% membership interest in Owner LLC to SLG is also not subject to RETT because it does not constitute a transfer of a controlling interest in an entity that owns real property under Tax Law § 1401(b).

22. The Division contends that, by transferring petitioner's 45% interest in Owner LLC to SLG, SLG obtained a 100% controlling economic interest in the Property, which resulted in a 55% nontaxable mere change in ownership and a 45% taxable change in beneficial ownership.

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 until the contrary is proven, and the burden of proving the contrary is on the person liable for payment of the tax (Tax Law § 1404[b]).

The term “conveyance” is defined, to the extent relevant here, as “the transfer or transfers of any interest in real property by any method, including but not limited to sale, exchange, assignment . . . or transfer or acquisition of a controlling interest in any entity with an interest in real property” (Tax Law § 1401[e]). The term “controlling interest” has the following definition:

“‘Controlling interest’ means (i) 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, and (ii) in the case of a partnership, association, trust or other entity, fifty percent or more of the capital, profits or beneficial interest in such partnership, association, trust or other entity” (Tax Law § 1401[b]).

The Tax Law further provides that the real property transfer tax shall not apply to “[c]onveyances to effectuate a mere change of identity or form of ownership or organization where there is no change in beneficial ownership . . .” (Tax Law § 1405[b][6]).

B. The Division concedes that petitioner’s contribution of its 45% tenant-in-common interest to Owner LLC in exchange for a 45% interest in Owner LLC, and SLG’s contribution of its 55% tenant-in-common interest to Owner LLC in exchange for a 55% interest in Owner LLC, standing alone, are exempt from the RETT as a mere change in form of ownership. Indeed, the Division’s own regulations provide that the RETT does not apply to “[t]he conveyance by tenants-in-common of their interest in real property to a partnership or a corporation, the partnership or corporation interests being in the same pro rata shares as the tenants-in-common held prior to the conveyance. Such conveyance is not taxable as there is no change in beneficial ownership” (20 NYCRR 575.10[a]).

The Division argues, however, that because of the subsequent transfer of petitioner's 45% interest in Owner LLC to SLG, the combined transactions became subject to the RETT. According to the Division, "[i]t is Petitioner's sale of its 45% interest in Owner LLC to SLG, in aggregation with Petitioner and SLG's conveyances of their interests in the property to Owner LLC, and the RETT implications of aggregating those transactions, that are at issue in this case."

The Division attempts to "aggregate" three nontaxable transactions, namely (1) the transaction between SLG and Owner LLC, which effectuated a mere change in form of ownership, (2) the transaction between petitioner and Owner LLC, which effectuated a mere change in form of ownership, and (3) the transaction whereby petitioner transferred its 45% interest in Owner LLC to SLG, in order to impose tax under the RETT on the transfer of a minority interest. However, the third transaction does not meet the definition of a transfer of a "controlling interest" because petitioner did not own more than 50% of Owner LLC. As such, that transaction, by definition, cannot be considered a transfer or acquisition of a controlling interest in an entity with an interest in real property.

The Division contends that adding the transfer of petitioner's 45% interest in Owner LLC with SLG's 55% interest in Owner LLC results in SLG's "acquisition" of a controlling interest in Owner LLC. In support of its position, the Division points to section 575.6(d) of the real estate transfer tax regulations, which provides:

"Where there is a transfer or acquisition of an interest in an entity that has an interest in real property, on or after July 1, 1989, and subsequently there is a transfer or acquisition of an additional interest or interests in the same entity, the transfers or acquisitions will be added together to determine if a transfer or acquisition of a controlling interest has occurred. Where there is a transfer or acquisition or a controlling interest in an entity on or after July 1, 1989, and the real estate transfer tax is paid on that transfer or acquisition and there is a subsequent transfer or

acquisition of an additional interest in the same entity, it is considered that a second transfer or acquisition of a controlling interest has occurred which is subject to the real estate transfer tax. No transfer or acquisition of an interest in an entity that has an interest in real property will be added to another transfer or acquisition of an interest in the same entity if they occur more than three years apart” (20 NYCRR 575.6[d]).

While the regulation provides for adding together multiple transfers or acquisitions of interests in an entity with an interest in real property to determine if a transfer or acquisition of a controlling interest has occurred, the regulation does not provide for adding such a transfer or acquisition together with a nontaxable mere change in form of ownership conveyance. Contrary to the Division’s argument, the regulation does not authorize adding a nontaxable mere change in form of ownership transaction with a transfer of a minority, noncontrolling interest in order to achieve a taxable transaction.

The plain language of the regulation provides that aggregation applies to multiple transfers or acquisitions of interests in an entity with an interest in real property that occur within a three-year period. The fallacy of the Division’s argument for aggregation in this case is that the initial transaction between SLG and Owner LLC wherein SLG exchanged its 55% tenant-in-common interest in the property for a pro rata 55% interest in Owner LLC was not a “transfer or acquisition of an interest in an entity with an interest in real property.” Rather, it was a mere change in the form of ownership of the property. SLG held the same beneficial ownership in the property both before and after the “mere change” transaction with Owner LLC, its interest in Owner LLC “being in the same pro rata shares as the tenants-in-common held prior to conveyance” (20 NYCRR 575.10[a]). Since the transaction between SLG and Owner LLC was not a transfer or acquisition of an interest in an entity with an interest in real property, that transaction cannot, under the plain

language of the statute and regulations, be aggregated with petitioner's subsequent transfer of a noncontrolling interest.

Moreover, the plain language of the regulation further provides that where there is a transfer or acquisition of a controlling interest in an entity with an interest in real property, "*and the real estate transfer tax is paid on that transfer or acquisition*" followed by a subsequent transfer or acquisition of an additional interest in the same entity within three years, "it is considered that a second transfer or acquisition of a controlling interest has occurred which is subject to the real estate transfer tax" (20 NYCRR 575.6[d]; emphasis added). As noted above, the initial transfer between SLG and Owner LLC was not a transfer or acquisition of a controlling interest, but merely a change in form of ownership. As such, no real estate transfer tax was paid, nor was it required to be paid on the "mere change" transaction. The Division's argument that the subsequent transfer of petitioner's 45% interest to SLG is considered a second transfer or acquisition of a controlling interest that is subject to the RETT ignores the plain language of the regulation requiring that RETT was paid on the initial transaction for aggregation to apply. Similar to the language of the regulation, the Division's Publication 576 states that, "If there is a transfer or acquisition of a controlling interest in an entity *on which the real estate transfer tax must be paid* and there is a subsequent transfer or acquisition of an additional interest in the same entity within three years, the second transfer or acquisition is also subject to the real estate transfer tax" (emphasis added). There is no dispute that the real estate transfer tax did not apply to the initial transaction between SLG and Owner LLC wherein SLG exchanged its 55% tenant-in-common interest in the property for a pro rata 55% interest in Owner LLC. As such, the regulation relied

upon by the Division is inapplicable. The position espoused by the Division here is inconsistent with its own regulations and publication and accordingly must be rejected.

C. The Division further relies on the provision of the repealed gains tax under Tax Law former Article 31-B and the regulations and case law thereunder in support of its position. The Division contends that it is appropriate to use the provisions of the gains tax in interpreting the RETT, noting that the definition of “controlling interest” is the same for the RETT under Tax Law § 1401(b) as it was for gains tax under Tax Law former § 1440(2), and that the regulations for both the RETT and gains tax provide for aggregation. However, a significant difference in the language of the gains tax compared to the RETT is evident in the difference between the definition of “transfer of real property” under former Article 31-B and “conveyance” under the RETT.

“Transfer of real property” is defined, in part, under the former gains tax as “the transfer or transfers of any interest in real property by any method, including but not limited to sale, exchange, assignment . . . or acquisition of a controlling interest in any entity with an interest in real property. . . *Transfer of real property shall also include partial or successive transfers pursuant to an agreement or plan to effectuate by partial or successive transfers a transfer which would otherwise be included in the coverage of this article . . .*” (Tax Law former § 1440[7]; emphasis added).

In contrast, as noted above, for purposes of the RETT, “conveyance” is defined, in relevant part, as “the transfer or transfers of any interest in real property by any method, including but not limited to sale, exchange, assignment . . . or transfer or acquisition of a controlling interest in any entity with an interest in real property” (Tax Law § 1401[e]). The definition of conveyance under the RETT, unlike the definition of “transfer of real property” under the gains tax, is silent in regard

to partial or successive transfers. As such, unlike the gains tax, the statutory provisions for the RETT upon which the RETT regulations must be based, does not specifically authorize the aggregation of successive transfers.² The Division's reliance on the gains tax regulations and case law is thus misconceived (*cf. Matter of Iser*, Tax Appeals Tribunal, May 8, 1997).

D. The Division argues that deference should be given to its interpretation. In *Kurcsics v. Merchants Mut. Ins. Co.* (49 NY2d 451 [1980]) the Court stated:

“Where the interpretation of a statute or its application involves knowledge and understanding of underlying operational practices or entails an evaluation of factual data and inferences to be drawn therefrom, the courts regularly defer to the governmental agency charged with the responsibility for administration of the statute. If its interpretation is not irrational or unreasonable, it will be upheld [citations omitted]. Where, however, the question is one of pure statutory reading and analysis, dependent only on accurate apprehension of legislative intent, there is little basis to rely on any special competence or expertise of the administrative agency and its interpretive regulations are therefore to be accorded much less weight. And, of course, if the regulation runs counter to the clear wording of a statutory provision, it should not be accorded any weight (*Kurcsics v. Merchants Mut. Ins. Co.*, 49 NY2d at 459).

The issue in the present case does not involve an understanding of the physical or social sciences, obscure regulatory practices, complex markets or industries, expert analysis of voluminous factual data, or subtle policy determinations outside the competence of ordinary persons. Indeed, the issues are so purely legal in nature that the parties stipulated the facts and submitted the case without a hearing. The Division's interpretation herein is inconsistent with the plain language of the statute, regulations, and its own publication and as such is not entitled to deference.

² Whether the Division exceeded its authority in promulgating section 575.6(d) of the real estate transfer tax regulations is unnecessary to address herein, because, as stated above, it is determined that this regulation does not apply to the transaction at issue.

E. The petition of GKK 2 Herald LLC is granted and the Notice of Determination dated April 1, 2013 is cancelled.

DATED: Albany, New York
May 26, 2016

/s/ Barbara J. Russo
ADMINISTRATIVE LAW JUDGE