STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition of **307 McKIBBON STREET REALTY CORP.** for Revision of a Determination or for Refund of Tax on Gains Derived from Certain Real Property Transfers under Article 31-B of the Tax Law.	:	DECISION DTA NO. 803226

Petitioner, 307 McKibbon Street Realty Corp., 44 East 32nd Street, New York, New York 10016, filed an exception to the determination of the Administrative Law Judge issued on October 22, 1987 with respect to its petition for revision of a determination or for refund of tax on gains derived from certain real property transfers under Article 31-B of the Tax Law (File No. 803226). Petitioner appeared by Schonwald, Schaffzin & Mullman, Esqs. (Edmund A. Schaffzin, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Paul A. Lefebvre, Esq., of counsel).

The petitioner did not file a brief on exception; the Division of Taxation filed a letter in opposition to the exception. Oral argument was heard at the request of the petitioner on April 14, 1988.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUE

Whether the Division of Taxation properly aggregated the consideration received by petitioner with the consideration received by another corporation upon the simultaneous transfer by petitioner and such other corporation of two contiguous properties, thereby subjecting petitioner's transfer to tax under Tax Law Article 31-B.

FINDINGS OF FACT

We find the facts as stated in the Administrative Law Judge's determination and such facts are incorporated herein by this reference except that finding of fact "7" is modified as set forth below.

On August 9, 1983, Mr. Richard Penzer, pursuant to previously executed contracts, purchased four properties located in Brooklyn, New York. The four properties were known as 79 Bogart Street, 304 Boerum Street, 307 McKibbon Street, and 328 Boerum Street.

Mr. Penzer's custom in purchasing realty was to purchase properties in corporate form and, more specifically, if the purchase involved more than one property, to purchase by the use of more than one corporate entity (i.e., to purchase each property through a separate corporation). The reason advanced for such practice was to gain the advantage, in the event of a disaster at one property, of limiting potential liability to the individual corporation's assets, thus protecting Mr. Penzer from exposure to financial liability as an individual. Mr. Penzer was entitled to and did consolidate his corporate holdings for income tax purposes. Accordingly, the property known as 79 Bogart Street was purchased by and in the name of 100 White Street Realty Corp., and the property known as 328 Boerum Street was purchased by and in the name of petitioner, 307 McKibbon Street Realty Corp. Mr. Penzer was the sole shareholder and officer of both of these corporations.

The two noted properties which are relevant to this proceeding, being 79 Bogart Street and 328 Boerum Street, are physically contiguous parcels of real property upon which are situated 100,000 square-foot commercial factory buildings. Although physically contiguous, each property had its own separate tax lot designation, separate boiler system, separate certificate of occupancy, separate electrical service and meter, and separate water meter. There were no party walls or passageways between or connecting the two premises.

Each of the properties was, to some extent, renovated (the specific nature of the renovations made is not relevant to the issue presented herein). The cost of such renovations was allocated equally to each of the buildings. This equal allocation was made as a matter of convenience, in that it was not feasible to allocate exact amounts to each parcel.

Prior to the transfers in question herein, the properties had not been put on the market or otherwise offered for sale. Rather, Mr. Penzer was approached by a real estate broker representing an interested purchaser, one John Rashti, in need of an empty factory building in order to relocate a manufacturing business out of Manhattan. In addition, Mr. Rashti was interested in additional space for potential future manufacturing needs. At the time, one of the subject properties was vacant, while the other was occupied by a tenant under a ten-year lease.

Negotiations were held between Mr. Penzer and Mr. Rashti, at the commencement of which the asking price for each of the premises individually was in excess of one million dollars. However, Mr. Rashti was able to negotiate the initial price for each building downward in view of the buildings' then-poor condition. Ultimately, the selling prices for the individual properties were agreed to as $1,255,000.00 for 79 Bogart Street and $995,000.00 for 328 Boerum Street. In view of the buyer's need to relocate his existing work force from Manhattan to Brooklyn, the vacant building (79 Bogart Street) was more valuable to the buyer than the premises (328 Boerum Street) which were encumbered by the ten-year lease, with such circumstance being a consideration in the individual selling prices as ultimately agreed to.

Finding of Fact "7" of the Administrative Law Judge's determination is modified at the request of the petitioner to read as follows:

> Separate contracts were entered into between 100 White Street Realty Corp. (for 79 Bogart Street) and John Rashti, as the contract vendee, and 307 McKibbon Street Realty Corp. (328 Boerum Street) and John Rashti, as the contract vendee. Both contracts were subsequently assigned and the transfers were made to an Industrial Development Agency which then leased both properties to Harry J. Rashti & Co., Ltd.

On December 18, 1984, simultaneous closings were held wherein the two properties were transferred to the contract assignee. A negotiated lump-sum amount of $150,000.00 was paid to Robert W. Romano as the broker for the transactions. The brokerage agreement states that the two corporations, 307 McKibbon Street Realty Corp. and 100 White Street Realty Corp., were to pay the brokerage amount to the broker, with such agreement signed by Richard Penzer, as president, on behalf of both corporations. There is no language in the agreement specifying any allocation of the

fee between the two properties, or indicating anything other than that the two corporations were jointly responsible for payment of the full brokerage fee.

In connection with the transfers, requisite transferor and transferee questionnaires were filed with the Division. With respect to the transfer of 79 Bogart Street, gains tax (Tax Law Article 31-B) in the amount of $85,062.31 was paid. With respect to 328 Boerum Street, the Division took the position that the consideration received should be aggregated with the consideration received in the transfer of 79 Bogart Street, and thus the consideration for the transfer of 328 Boerum Street, for gains tax purposes, was deemed to have exceeded the one million dollar gains tax threshold. Accordingly, gains tax of $55,806.51 was computed, and was paid under protest by petitioner.

On December 18, 1984, petitioner filed a claim for refund of the aforementioned tax paid under protest. By a letter dated January 31, 1986, the Division denied petitioner's claim for refund, and the instant proceeding ensued.

OPINION

The Administrative Law Judge held that the consideration for the two contiguous properties used for the common purpose of investment was properly aggregated notwithstanding that two separate corporate entities were the transferors. The Administrative Law Judge determined that the transaction was in essence a single transfer either because the corporate transferors were acting in concert or because the common sole shareholder of both corporations held the beneficial interest in both properties.

The petitioner took exception to the Administrative Law Judge's conclusion that the consideration should be aggregated arguing that this conclusion erroneously denies the legal existence of the corporations, ignores the affidavit offered by petitioner to the Division of Taxation that the transfers were not pursuant to a plan or agreement and was based on the erroneous assumption that the properties were used for a common or related purpose.

We affirm the determination of the Administrative Law Judge for the reasons set forth below.

Petitioner's first contention is that the Division may not ignore the existence of the two separate corporations as the transferors of the property involved. Petitioner's argument assumes that

the application of the gains tax is determined simply upon a finding that a corporation or other entity owns real property. This assumption runs counter to the entire structure of the gains tax which looks through entity ownership of real property to determine the beneficial ownership of the property. This beneficial ownership is determined based on the identity of the owners of the entity that owns the real property.

The focus of the gains tax through entities to determine the beneficial ownership of real property is evidenced both by the imposition provisions of the statute and by its exemptions.

The tax is imposed on transfers of real property (Tax Law {1441) which are defined to include an "acquisition of a controlling interest in any entity with an interest in real property." (Tax Law {1440.) The tax is imposed based on the percentage interest, if 50% or more, acquired in a corporation, partnership or other entity (Tax Law {1440.1[c]). This imposition on acquisitions of controlling interests in entities that own real property expresses the theory of the tax to look down through entities and to equate ownership of real property through an entity, beneficial ownership, with direct ownership of real property. The focus of the tax through two tiers of entities was recently upheld in the decision of Bredero Vast Goed, N.V., et al. (Sup Ct Albany County, Jan. 7, 1988, Travers, J.). (See also, 595 Investors Limited Partnership v. Biderman, Sup Ct, NY County, July 6, 1988, Lehner, Jr. applying the New York City Real Estate Transfer Tax through two tiers of entities.)

Further, "'Interest' when used in connection with real property includes, but is not limited to, title in fee, a leasehold interest, a beneficial interest . . ." (Tax Law {1440.4, emphasis added).

The focus of the gains tax through entities is also expressed in the exemption of Tax Law section 1443.5 which exempts a transfer to the extent it "consists of a mere change of identity or form of ownership or organization where there is no change in beneficial interest." (Tax Law {1443.5, emphasis supplied.)

The Division's regulations illustrate this mere change in form exemption with a series of examples indicating that a transfer to an entity is exempt from tax to the extent that the transferor owns an interest in the transferee and, thus, retains a beneficial interest in the real property (20

NYCRR 590.50). For example, a transfer of real property by an individual to a partnership in exchange for a partnership interest is said to be exempt to the extent of the individual's interest in the partnership (20 NYCRR 590.50[a][1]).

This exemption which looks through entities to exempt transfers based on beneficial ownership must necessarily be coupled with a similar look through the entity to determine beneficial ownership where, as here, an entity is selling real property. If not, the tax would be rendered a nullity through transactions structured in two steps, with the first step designed to benefit from the section 1443.5 exemption and the second from the less than $1 million exemption. For example, an individual or entity intending to sell a parcel of real property for more than $1 million to a third party could make intermediate transfers to entities it wholly owns. Such transfers would be entirely exempt from gains tax pursuant to the section 1443.5 exemption. If the commonly owned entities subsequently transferred to the intended transferee each for less than $l million, the entire transaction would escape gains tax. Such a result could not have been intended by the Legislature. Accordingly, we conclude that in the transaction at issue the beneficial ownership of the interests in real property being transferred must be determined.

To determine petitioner's ownership interest in the corporation, and thus his beneficial interest in the real property, the definition of controlling interest in the case of a corporation directs us to the percentage of ownership in the total combined voting power of all classes of stock in such corporation (Tax Law, {1440.2). Since this definition would control how the tax and mere change in form exemption would apply on the transfer of real property to a corporation in exchange for stock, it logically should apply to determine the taxability of a subsequent transfer by the corporation. In the instant case, since Mr. Penzer was the sole shareholder of both corporations, he held 100% of the beneficial interests in both pieces of real property.

As the owner of 100% of the beneficial interest in each property, Mr. Penzer cannot be treated differently than a person who directly holds title to two pieces of contiguous real property. To do otherwise would jeopardize the base of the tax by encouraging all future transferors of real property to segment their ownership of contiguous tracts of property among separate but commonly

owned entities. Therefore, we conclude that the Division properly treated the transfer of these contiguous parcels as it would if they had been transferred by a single individual or entity.

The Division's treatment of such transfers was set forth at question and answer number 42 of Publication 588 as follows (this interpretation was adopted as a regulation, 20 NYCRR 590.42, on September 24, 1985):

> "Q. Is the consideration received by a transferor for the transfer of contiguous or adjacent parcels of property to one transferee added together for purposes of applying the $1 million exemption?
>
> "A. Generally, yes. A 'transfer of real property' is defined in {1440.7 to mean 'the transfer or transfers of any interest in real property.' Thus, the separate deed transfers of contiguous or adjacent properties to one transferee is, for purposes of the gains tax, a single transfer of real property. It is the consideration for the interests in a single transfer, regardless of the number of deeds used to transfer the property, that is used to determine the application of the $1 million exemption.
>
> "However, if the transferor establishes that the only correlation between the properties is the contiguity or adjacency itself, and that the properties were not used for a common or related purpose, the consideration will not be aggregated.
>
> "When the transfer is to more than one transferee, whether the amount paid for each deed transfer is added together depends on whether the transferor is subject to the aggregation clause for partial or successive transfers. (See Q & A number 43)"

As we held in Matter of Thomas Iveli and Robert Sigmund (Tax Appeals Tribunal, February 23, 1988), this interpretation to treat as a single transfer the transfer by one transferor to one transferee the transfer of contiguous properties used for a common or related purpose is well within the first sentence of the statutory definition of transfer of real property at Tax Law section 1440.7. Applications of this interpretation have been upheld in Matter of Sanjalyn v. State Tax Commn. (App Div, 3d Dept, June 2, 1988, Mercure, J.) and Matter of Bombart v. State Tax Commn. (132 AD2d 745). The first sentence of section 1440.7 states, in pertinent part, that transfer of real property means "the transfer or transfers of any interest in real property . . ." (Tax Law {1440.7, emphasis added). "Real property" is in turn defined to mean "every estate or right, legal or equitable, present or future, vested or contingent, in lands, tenements or hereditaments, including buildings . . ." (Tax Law {1440.6). In combination, these two definitions result in a definition of

"transfer of real property" that includes transfers of any interest in lands. This is obviously very broad language, without limitation as to the number of transferors, transferees or deeds or the physical location of the property.

Since the instant properties are physically contiguous, the question that remains is whether the petitioner has established "that the only correlation between the properties is the contiguity or adjacency itself, and that the properties were not used for a common or related purpose." (Department of Taxation & Finance, Publication 588 Q & A #4; 20 NYCRR 590.42.) We conclude that petitioner has not established that the only relationship between the instant properties, which were each improved with a commercial factory building and which were purchased by a single purchaser for immediate and future manufacturing needs, was their contiguity or adjacency. Further, we conclude that such similarly improved properties were used for a common or related purpose, notwithstanding the fact that one of the properties was vacant at the time of sale. Accordingly, the Division of Taxation properly aggregated the consideration for the two properties.

The petitioner's argument with respect to an affidavit offered by petitioner that "the transfers were not 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 . . ." would only be relevant if this case involved the so-called "aggregation clause", set forth at the third sentence of the definition of transfer of real property at Tax Law section 1440.7. Since we decide this case under the first sentence of section 1440.7, the question of plan or agreement is not relevant.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the petitioner, 307 McKibbon Street Realty Corp., is granted to the extent that finding of fact "7" of the Administrative Law Judge's determination is modified, but except as so granted is in all other respects denied;

2. The determination of the Administrative Law Judge is modified as set forth in paragraph "1" but is in all other respect affirmed;

3. The petition of 307 McKibbon Street Realty Corp. is denied and the Division of Taxation's denial of petitioner's claim for refund is sustained.

Dated: Albany, New York
October 14, 1988

/s/John P. Dugan
John P. Dugan
President

/s/Francis R. Koenig
Francis R. Koenig
Commissioner