

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
HOWARD SCHRIER, MARVIN SCHRIER AND SIDNEY SCHRIER	:	DECISION DTA No. 806270
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	:	

Petitioners Howard Schrier, Marvin Schrier and Sidney Schrier, c/o Hartley J. Chazen, Esq., 777 Third Avenue, New York, New York 10017 filed an exception to the determination of the Administrative Law Judge issued on October 31, 1991 with respect to their 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. Petitioners appeared by Howard M. Koff, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Kenneth J. Schultz, Esq., of counsel).

Petitioners filed a brief on exception. The Division of Taxation filed a letter in lieu of a brief. Oral argument, requested by petitioners, was heard on February 13, 1992.

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

ISSUE

Whether petitioners' original purchase price, for real property transfer gains tax purposes, should be the fair market value of the real property on the date it was transferred to petitioners in a liquidating dividend, or rather, the liquidating corporation's carry-over original purchase price of the property.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

In 1986, petitioners, Howard Schrier, Marvin Schrier and Sidney Schrier, each owned one-third of the outstanding stock of H. Schrier & Co., Inc. ("the corporation"). The corporation operated a wholesale food distribution business from its warehouse at 363 Bond Street, Brooklyn, New York.

During 1986, after negotiations extending over a period of more than one year, the corporation sold its operating business assets and good will to a former competitor, Irving Liebertoff, Inc., of Brooklyn, New York. As part of the agreement, petitioners agreed to provide full-time services to the purchaser. The purchaser, however, already owned an under-utilized warehouse and had no use for the corporation's land and building at 363 Bond Street. Consequently, the corporation retained title to the real property.

Petitioners were advised by counsel that, for Federal tax purposes, the corporation had to be liquidated and its real property distributed to petitioners by the end of December 1986.

It was petitioners' intention that they were to act unanimously in disposing of the property. Petitioners were advised by counsel that, in order to provide for unanimity of action, they would have to take title either as joint tenants with rights of survivorship, or under a partnership agreement. Petitioners elected to take title as joint tenants, as they were advised that the drafting of a partnership agreement would be expensive and also that such an agreement could raise Federal income tax problems.

Accordingly, the corporation distributed the land and warehouse building at 363 Bond Street to petitioners, as joint tenants with rights of survivorship, solely in exchange for petitioners' shares of stock in the corporation.

The distribution was accomplished by deed dated December 27, 1986, between SMH Liquidating Corp., formerly known as H. Schrier & Co., Inc., as grantor, and petitioners, as

grantees. Petitioners took title as joint tenants with rights of survivorship. The deed was not recorded until December 18, 1987.

The transaction constituted a liquidation which was taxable for Federal income tax purposes.

The fair market value of the property on the date of the transfer was \$975,000.00.

The sum of \$325,000.00 (representing one-third of the total fair market value) was used as the selling price in the computation of the long term capital gain on the sale of the corporation's stock, as reported on each petitioner's 1986 Federal income tax return.

The transfer from the corporation to petitioners was exempt from real property gains tax and no tax was assessed or paid with respect to said transfer.

At the time of the liquidation, the corporation's basis for the property was \$212,413.00.

The following New York State real property transfer gains tax questionnaires were filed with respect to the transaction:

(a) Transferor questionnaire. A transferor questionnaire dated December 27, 1986 was executed by H. Schrier & Co., Inc. showing gross consideration paid of \$975,000.00, said sum representing the fair market value of the land and building at the date of the transfer to petitioners upon dissolution of the corporation. The purchase price paid to acquire the property was stated to be \$226,735.00, with capital improvements of \$238,625.00, for a total original purchase price of \$465,360.00. The gain subject to tax was stated as zero.

(b) Transferee questionnaire. A transferee questionnaire also dated December 27, 1986 was executed by petitioners showing consideration of \$975,000.00, again representing the fair market value of the land and building at the date of transfer upon dissolution.

It appears that petitioners contracted to sell the premises to Cosmos Forms Ltd., pursuant to a contract of sale dated November 16, 1987, and further, that on November 23, 1987, Cosmos Forms Ltd. assigned its rights under the contract to Fali Realty Corp.

The following New York State real property gains tax questionnaires were filed with respect to petitioners' sale of the property:

(a) Transferor questionnaire. Petitioners executed a transferor questionnaire showing a transfer to Fali Realty Corp., as transferee. The questionnaire, dated November 16, 1987, showed an anticipated transfer date of December 30, 1987. Gross consideration was reported to be \$1,300,000.00 and the purchase price paid to acquire the property was stated as \$975,000.00. The sum of \$10,000.00 was shown as an allowable selling expense, resulting in a total original purchase price of \$985,000.00. The gain subject to tax was shown as \$315,000.00, with anticipated tax due of \$31,500.00.

(b) Transferee questionnaire. A transferee questionnaire, also dated November 16, 1987, was submitted showing Cosmos Forms, Ltd., as transferee and petitioners, as transferor. The anticipated date of transaction was shown as December 30, 1987 and the consideration was stated to be \$1,300,000.00.

(c) Transferee questionnaire. A transferee questionnaire dated November 23, 1987 was submitted showing the transferee as Fali Realty Corp. and the transferor as Cosmos Forms, Ltd. The consideration paid was shown as zero.

Petitioners paid \$101,758.70 in New York State real property transfer gains tax on or about February 12, 1988.

On or about September 8, 1988, petitioners filed a claim for refund of \$70,258.70, asserting that proper tax due was only \$31,300.00,¹ as their purchase price paid to acquire the property should be \$975,000.00, rather than the corporation's original purchase price of \$465,360.00.

OPINION

Initially, we provide a brief synopsis of the statute and regulations applicable to the issues in this case to provide a framework for our discussion of the Administrative Law Judge's determination and the positions of the parties.

Tax Law § 1441 imposes a ten percent tax on gains derived from the transfer of real property in New York State. The "gain" which is taxed is the difference between the "original

¹As found above, the transferor questionnaire for the transaction indicates anticipated tax due of \$31,500.00.

purchase price" for the property and the "consideration" received for the property (Tax Law § 1440[3]). Original purchase price is defined, generally, as the price paid or required to be paid to acquire the interest in the property, the cost of capital improvements, and certain selling expenses (Tax Law § 1440[5][a]).

The law exempts certain transfers from the tax, including transfers where the consideration is less than one million dollars and transfers which consist of "a mere change of identity or form of ownership or organization where there is no change in beneficial interest" (Tax Law § 1443[5]).

The regulations of the Division of Taxation (hereinafter the "Division") provide that the transfer of real property by a corporation to its shareholders, who will hold the property as "tenants-in-common" in the same pro rata share as they own the corporation, is a mere change of identity or form of ownership or organization. In such situations, the shareholders have a carry-over original purchase price (20 NYCRR 590.50[a]).

In this case, the Administrative Law Judge rejected petitioners' assertion that the transfer was not a mere change in the form of ownership because they took the property as joint tenants and not tenants-in-common. The Administrative Law Judge determined, in effect, that the use of "tenants-in-common" in the regulation was not intended to exclude other forms of ownership from the mere change exemption but was merely illustrative of one type of transfer of real property from a corporation to its shareholders which is an exemption from the tax as a "mere change in ownership." The Administrative Law Judge also determined that the Division's regulation on carryover original purchase price was valid and properly applicable to the transfer of the property from the corporation to petitioners.

On exception, petitioners assert that there are substantial differences between a joint tenancy and a tenancy in common, and that these differences contradict a finding that a shift from corporate form to a joint tenancy constitutes a mere change. Petitioners further assert that 20 NYCRR 590.50(a)(3) is contradicted by Tax Law § 1440(5)(a) and is, therefore, invalid.

In response, the Division states that the question is whether, as a result of the corporate liquidation, the interest of any one of the petitioners had changed relative to the interests of the other petitioners. As each petitioner held an equal interest both before and after the liquidation, the Division asserts that this is only a change in form, not a change in beneficial interest. Further, the Division asserts that the original purchase price was that price paid by the corporation to acquire the property. The Division states that the value of the stock exchanged for the property is not the original purchase price because petitioners did not acquire an interest in the real property at the time of the liquidation -- they held an interest through the corporate form which continued after the liquidation.

We affirm the determination of the Administrative Law Judge for the reasons that follow.

The facts of this case present an unusual situation: petitioners are arguing that they are outside the scope of an exemption to the gains tax, while the Division is asserting that the transaction qualified for an exemption. This scenario contradicts the usual situation where the Division challenges a taxpayer's claim of entitlement to an exemption under Tax Law § 1443. Petitioners find themselves in this position because (1) the transfer from the corporation to petitioners was for less than \$1 million and exempt from tax for that reason (see, Tax Law § 1443[1]) and (2) the gains tax ultimately due on the transfer from petitioners to Fali Realty Corp. would be substantially less if the mere change in form exemption is found to be inapplicable to the first transfer since petitioners would not have a carryover purchase price.

We deal first with the fundamental issue of whether the transfer of real property from a corporation, as a liquidating dividend, to the shareholders as joint tenants constitutes a change in the beneficial ownership of the property, or simply a mere change of identity or form of ownership or organization under the Division's regulations. Petitioners have not challenged the validity of the regulations as written on this point, but argue that the regulations do not intend to exempt the instant transfer.

In Matter of 307 McKibbin St., this Tribunal stated that the structure of the gains tax is to:

"[look] 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" (Matter of 307 McKibbin St. Realty Corp., Tax Appeals Tribunal, October 14, 1988).

This structure is also evident in the regulations which convey the underlying theme of the tax through a series of examples of the mere change in form exemption provided by Tax Law § 1443(5) (see, 20 NYCRR 590.50[a][2]-[5]). In these examples, various types of changes in business form are addressed. Provided the owners of the property retain the same proportion of beneficial ownership, the end result of each change in business form is the same -- the change is deemed a mere change. Any variation in the rights and obligations imposed by the new business form is not addressed by the regulation; the only concern articulated in the examples is whether the proportion of beneficial interest of each owner has varied. Thus, the transfer of property from a tenancy in common to a partnership, where each owner's percentage of beneficial interest in the property is preserved, is considered a mere change in form despite any change in the parties' legal relationship under the new business form (see, 20 NYCRR 590.50[a][2]). Likewise, the transfer of property from a corporation to its shareholders, who will take the property as tenants in common with the same proportion of beneficial ownership as they had as shareholders, is considered a mere change in form (see, 20 NYCRR 590.50[a][3]). From this we conclude that the primary concern of the examples is whether the economic interests in the real property have been changed (see, Matter of Bredero Vast Goed, N. V. v. Tax Commn. of the State of New York, 146 AD2d 155, 539 NYS2d 823, 825 [where the court recognizes and upholds economic reality as the key principle underlying the interpretation of the imposition section of the gains tax]).

Based on this discussion, we determine that the transfer of property as a liquidating dividend from the corporation to the shareholders as joint tenants constitutes a mere change in form under the regulations.

We acknowledge that there are substantive legal differences between joint tenants and tenants in common. However, given that the primary focus of the mere change in form exemption is on economic ownership, we conclude that the legal differences between joint and common tenancies do not warrant different treatment under the exemption.

Regarding the absence of a specific example addressing joint tenancy, the examples in the regulations are just that -- examples. They are not meant to be a comprehensive analysis of the results of every possible change in business form. Rather, they serve as a sample of the more common transactions in order to demonstrate the focus of the gains tax which is on the percentage of beneficial interest.

On exception, petitioners rely on Publication 588 and a November 1, 1983 opinion letter in support of their position that the exemption applies only to tenancies in common (Oral Arg. Tr., pp. 7-8). This reliance is misplaced. The subject matter of Publication 588 and the November 1, 1983 opinion letter were superseded by the modification of Publication 588 in TSB-M-83(3)-R and the promulgation of the regulations in 1985. Since petitioners' transactions did not occur until December 1986, it is the regulations which govern the transaction.

We will now address the validity of the carry-over original purchase price rule of 20 NYCRR 590.50(a)(3). Tax Law § 1440(5) states that:

"(b) In the case of a transfer of real property by a gift, devise, bequest or inheritance, the original purchase price of the real property in the hands of the transferee immediately after the transfer shall be the same as the original purchase price of such property in the hands of the transferor immediately before the transfer.

"(c) The transferee of every transfer of real property for which exemption is granted, pursuant to subdivision one of section fourteen hundred forty-three of this article on the basis that no consideration was paid for such transfer, shall be bound by a

determination of original purchase price as determined under paragraph (b) of this subdivision, if such transferee participated in filing the forms upon which such exemption was granted" (Tax Law § 1440[5][b] and [c]).

20 NYCRR 590.50 states that:

"(a) Question: Section 1443(5) of the Tax Law exempts a transfer from the gains tax 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.' Does this exempt:

* * *

"(3) The transfer of real property by a corporation to its shareholders, who will hold the real property as tenants-in-common in the same pro rata share as they own the corporation?

"Answer: Yes. This is a mere change of identity or form of ownership or organization. The shareholders will have a carry-over original purchase price in the real property" (20 NYCRR 590.50[a][3], emphasis added).

The cited portions of Tax Law § 1440(5) address situations where the carry-over original purchase price rule applies because a transfer of ownership was made but no consideration was paid for the transfer. Further, the carry-over purchase price rule is also applicable to situations where consideration is paid for a transfer of ownership, but the ownership is found to be a mere change, i.e., the form of ownership changed, but the holders of the ownership interest and their proportional interests remained the same (see, 20 NYCRR 590.50[a][3]).

Petitioners contend that because 20 NYCRR 590.50(a)(3) goes beyond Tax Law § 1440(5) by applying the carry-over purchase price rule to exchanges for consideration, the regulation is invalid. We disagree. Preliminarily, we note that, pursuant to Tax Law § 2006(7), the Tribunal has "the authority to rule on the validity of the regulations of the commissioner of taxation and finance where such regulations are at issue."

We determine that the regulation represents a proper, practical method for implementing the gains tax and is not inconsistent with any statutory provision. To provide otherwise would undermine the imposition of the gains tax. Without 20 NYCRR 590.50(a)(3), a taxpayer

intending to sell real property could raise the original purchase price of the real property through an intermediate transaction to a dummy corporation wholly owned by the taxpayer. This transaction would be exempt from tax pursuant to Tax Law § 1443(5) as a mere change in form. The corporation could then make a transfer of the real property to a third party. Although this transfer would be subject to the imposition of the gains tax, the amount of tax due would be greatly diminished since the intermediate transaction inflated the original purchase price through a transfer that was not taxed. The carry-over original purchase price rule, applied to the mere change in form transfer, acts to preserve the gain for taxation at the time of a subsequent taxable transfer. Therefore, we conclude that the regulation is a valid interpretation of the Tax Law.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Howard Schrier, Marvin Schrier and Sidney Schrier is denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petition of Howard Schrier, Marvin Schrier and Sidney Schrier is denied; and
4. The denial of petitioners' claim for refund is sustained.

DATED: Troy, New York
July 16, 1992

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

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

/s/Maria T. Jones
Maria T. Jones
Commissioner