STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
FOREIGN HOLDINGS, INC.	:	DECISION DTA No. 813064
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.	:	

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on August 15, 1996 with respect to the petition of Foreign Holdings, Inc., 673 Fifth Avenue, 6th floor, New York, New York 10022. Petitioner appeared by Richards & O'Neil, LLP (Anthony J. Carbone, Esq., of counsel). The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Herbert M. Friedman, Jr., Esq., of counsel).

The Division of Taxation filed a brief in support of its exception and a reply brief. Petitioner filed a brief in opposition to the Division of Taxation's exception. Oral argument, at the request of both parties, was heard on July 8, 1997 in Troy, New York.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision. Commissioner Pinto concurs but for the reasons set forth in a separate opinion.

ISSUES

I. Whether a fee of $1,000,000.00 paid by the transferee was additional consideration received by petitioner, the transferor, forpurposes of the real property transfer gains tax imposed by former Article 31-B of the Tax Law.[1]

II. Whether petitioner bears the burden of proof to establish that the $1,000,000.00 fee was not additional consideration for the transfer of real property.

[1]The real property transfer gains tax imposed by Tax Law Article 31-B was repealed on July 13, 1996. The repeal applies to transfers of real property that occur on or after June 15, 1996 (L 1996, ch 309, §§ 171-180).

FINDINGS OF FACT

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

On December 16, 1991, The May Department Stores Company ("May") entered into a written agreement (the "letter agreement") with Kingsville Investments, Inc. ("Kingsville") whereby Kingsville agreed to act on May's behalf to facilitate May's purchase of real property at 436-438 Fifth Avenue in New York City from Foreign Holdings, Inc. ("petitioner").

Pursuant to the terms of the letter agreement, May agreed to pay Kingsville a fee of $1,000,000.00 which was due upon (i) the closing of a sale between petitioner and May or (ii) default by May under the terms of an agreement to purchase the property.

The letter agreement stated that Kingsville was aware that, "over the course of the last several years", May and its predecessor had failed in their efforts to acquire title to the subject property. Kingsville acknowledged in the letter agreement that it had access to the principals of petitioner. It agreed that May would conduct all negotiations with petitioner and that Kingsville would have no authority to accept, reject or make any offer on behalf of May. The $1,000,000.00 fee specified in the letter agreement was not identified therein as a "broker's" or "finder's" fee or commission. The letter agreement also stated, in part, as follows:

> "Kingsville represents and warrants to May that Kingsville has not dealt with any broker, agent, finder or other intermediary in connection with the possible purchase by May of the Property from Foreign such that any broker, agent, finder or other intermediary would be entitled to a broker's or agent's commission or finder's or similar fee or any other compensation or reimbursement of any kind or a share of the Fee. Kingsville covenants that it shall not have any dealings, negotiations or consultations with respect to possible or actual purchase by May of the Property from Foreign with any broker, agent, finder or other intermediary."

On April 17, 1992, petitioner and May entered into a Purchase and Sale Agreement in which May agreed to purchase the Fifth Avenue property for the sum of $14,350,000.00. The Purchase and Sale Agreement required May to pay a deposit of $1,435,000.00 which was to be held in escrow.

Petitioner and Kingsville are both wholly owned by Yeung Chi Shing Holding, Inc., a Delaware corporation. The Purchase and Sale Agreement (see, Division's Exhibit "L") indicates

that petitioner's address is 675 Fifth Avenue, New York, New York. The letter agreement (see, Division's Exhibit "L"), written on Kingsville's letterhead lists Kingsville's address as 675 Fifth Avenue, New York, New York. The Purchase and Sale Agreement was signed on behalf of petitioner by Lilian Leong, Assistant Secretary. The letter agreement was signed on behalf of Kingsville by Lilian Leong, Assistant Secretary.

The affidavit of Kawai Fong, general manager of Kingsville (see, Petitioner's Exhibit "1"), states that Kingsville was duly organized under the laws of Hawaii and is qualified to do business in New York. Prior to entering into the letter agreement with May, Kingsville had been conducting an active real estate business which included real property managerial services for its corporate parent, Yeung Chi Shing Holding, Inc. Included among its services was managing the Fifth Avenue property subsequently sold by petitioner to May. As of the date of the affidavit (January 12, 1996), Kingsville continued to perform a variety of real estate managerial services. Kingsville files its own separate New York State and New York City franchise tax returns.

Petitioner was created solely to own the Fifth Avenue property. Since the date of sale of the property to May, petitioner has been dormant.

May did not contest Kingsville's commission. At the closing of the sale of the Fifth Avenue property on June 2, 1992, payment of the commission was made by wire transfer to Kingsville's account at Citibank, N.A. (***see***, Petitioner's Exhibit "6").

Paragraph (l) of section 4.1(k) of the Purchase and Sale Agreement stated as follows:

> "Seller has received a copy of that certain separate agreement (the 'Separate Agreement') dated December 16, 1991 by and between Purchaser and Kingsville Investments, Inc."

Section 4.3 of the Purchase and Sale Agreement stated as follows:

> "Seller and Purchaser each represent to the other that it has had no dealings, negotiations or consultations with any broker or agent, in connection with this Agreement or the sale of the Property and that it shall indemnify, defend, protect and hold harmless the other and its respective directors, officers, employees and agents from and against any and all claims (whether meritorious or not), losses, expenses, damages, and costs (including, without limitation, reasonable attorney's fees) arising out of or related to any and all brokers or agents claiming to have

represented it in connection with this Agreement or in connection with the sale of the Property."

On May 8, 1992, the Division of Taxation received a Transferor Questionnaire (Form TP-580) from petitioner (***see***, Division's Exhibit "H") which indicated gains tax due in the amount of $1,277,434.90 (gross consideration paid by the transferee was listed thereon as $14,350,000.00). On the same date, a Transferee Questionnaire (Form TP-581) was received from May (***see***, Division's Exhibit "I") on which consideration paid to transferor was stated to be $14,350,000.00. On the questionnaire, May indicated that brokerage fees paid by the transferee were in the amount of $1,000,000.00.

On May 27, 1992, the Division of Taxation issued a Tentative Assessment and Return (see, Division's Exhibits "J" and "N"; Petitioner's Exhibit "4") on which total tax due was computed to be $1,377,434.90, an increase of $100,000.00 from the amount computed by petitioner. The basis for this increase was the holding by the Division that the fee paid to Kingsville was part of the consideration to petitioner since both Kingsville and petitioner were owned by Yeung Chi Shing Holding, Inc.

Petitioner paid the disputed $100,000.00 at closing and, on January 4, 1993, filed a claim for refund therefor (***see***, Division's Exhibit "D"). By letter dated February 5, 1993, the Division denied petitioner's refund claim in its entirety. A Conciliation Order (CMS No. 130401), dated May 20, 1994, sustained the Division's denial of petitioner's claim for refund.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge determined that Kingsville acted as a broker in relation to the transaction of sale because "it brought together May and petitioner with the result being that a contract was entered into and a sale of the property occurred" (Determination, conclusion of law "C"). His conclusion was "not altered by the fact that the broker and the seller were related entities since the definition of 'broker' does not differentiate between services performed for entities related and unrelated to the broker" (Determination, conclusion of law "F"). The Administrative Law Judge also found support for his conclusion in four private letter rulings

issued by the Division on April 25, 1985, September 4, 1985, June 19, 1989 and August 20, 1990, respectively.

The Administrative Law Judge noted that the fees at issue were paid by May, the transferee, to Kingsville pursuant to a letter agreement between those two entities and were not paid by petitioner, the transferor. The Division's regulations (20 NYCRR 590.10[b]) only address the situation where the transferee pays the brokerage fees of a broker retained by the transferor. The Administrative Law Judge concluded that: "[n]either the Tax Law nor the regulations impose tax upon fees paid by a transferee for services performed for the transferee" (Determination, conclusion of law "E").

The Administrative Law Judge rejected the Division's theory concerning the "look-through" principle, which essentially looks through an entity to determine who is the beneficial owner of real property, and its conclusion that the $1,000,000.00 fee paid by May to Kingsville was additional consideration to petitioner. The Administrative Law Judge stated that the Division was looking through two separate entities which are commonly owned by Yeung Chi Shing Holding, Inc. and, as a result of such common ownership, deemed fees received by Kingsville to be consideration received by petitioner. The Administrative Law Judge rejected the Division's attempt to impute ownership of the Fifth Avenue property to Kingsville by virtue of its decision to combine the fee received by Kingsville with the consideration received by petitioner as an unauthorized extension of the "look-through" principle.

Although the Administrative Law Judge noted that petitioner and Kingsville were commonly owned, have the same business address and have at least one common officer, he determined that the entities were, in fact, separate. The Administrative Law Judge stated that, according to the affidavit of Kawai Fong, Kingsville conducted an active real estate business for the parent corporation which included managing the Fifth Avenue property. The Administrative Law Judge also pointed to the fact that petitioner was formed solely to own the Fifth Avenue property and petitioner became dormant after the sale of the property. Lastly, the

Administrative Law Judge noted that petitioner and Kingsville filed their own separate State and City franchise tax returns.

Finally, the Administrative Law Judge rejected the Division's argument that since brokerage commissions are customarily a fixed percentage of the purchase price, Kingsville did not perform the service of a broker because the letter agreement provided for the payment of a fixed sum.

ARGUMENTS ON EXCEPTION

On exception, the Division argues that the Administrative Law Judge erred by not recognizing that Kingsville failed to perform any services in return for the $1,000,000.00 payment by May. In focusing on the letter agreement, the Division argues that the agreement requires Kingsville to contact the principals of petitioner concerning the potential sale of the Fifth Avenue property. The Division asserts that since the principals of Kingsville are the principals of petitioner, Kingsville was paid $1,000,000.00 to contact itself which is "a ludicrous proposition" (Division's brief in support, p. 4).

Next, the Division asserts that the Administrative Law Judge erred by relying on parol evidence and disregarding the plain language in the Purchase and Sale Agreement. The Division points to section 4.3 of the Purchase and Sale Agreement wherein it states, in pertinent part, that:

> "Seller and Purchaser each represent to the other that it has had no dealings, negotiations or consultations with <u>any</u> broker or agent, in connection with this Agreement or the sale of the Property . . . " (emphasis added).

The Division argues that the language contained in the contract is clear on its face. It states that neither party to the contract has dealt with any broker. Since the language is unambiguous, the Division asserts that the Administrative Law Judge erred by considering parol evidence in interpreting the language of the letter agreement.

The Division also argues that the Administrative Law Judge failed to apply the "look-through" principle in this case. The Division argues that the "economic reality" of this transaction is that petitioner received a total consideration of $15,350,000.00, which sum

includes the $1,000,000.00 payment at issue. The Division argues that petitioner and Kingsville are the same entity for gains tax purposes, having the same officers and shareholders. As a result, it was the burden of petitioner to demonstrate the separate identity of petitioner and Kingsville which it failed to do.

Lastly, the Division asserts that the Administrative Law Judge erred by relying on non-binding private letter rulings to support his determination. The Division argues that while such letter rulings may be used as research material, a taxpayer may not rely on or be bound by a Private Letter Ruling issued to another taxpayer. Therefore, such correspondence cannot be considered as having any precedential value by the Administrative Law Judge.

Petitioner argues, in opposition, that the $1,000,000.00 commission was not part of the price paid or required to be paid for the property. Rather, the commission was paid to Kingsville, a separate and distinct corporate entity from petitioner. The commission was not part of the contract price for the property and petitioner was unable to enforce payment of it. Further, the commission paid by the purchaser of real property to its broker is not subject to gains tax under the Tax Law. Under former Article 31-B of the Tax Law, a commission is clearly deductible from the consideration received on a transfer. Thus, even if the Division were correct in its argument as to the nature of the $1,000,000.00 payment, petitioner states that it would not be subject to taxation. Petitioner asserts that the "look-through" principle is not applicable herein since this case does not involve the aggregation of partial or successive transfers or transfers of contiguous parcels of property. Petitioner also argues that the commission was paid in exchange for the rendition of bona fide brokerage services as a result of an arms-length transaction which was fully enforceable by Kingsville. Petitioner states that the terms of the letter agreement were performed by Kingsville and were fully enforceable by Kingsville. Further, petitioner asserts that the services of Kingsville were fully recognized in the Purchase Agreement.

OPINION

While the Division argues that petitioner bears the burden of proof to show that the $1,000,000.00 payment was not additional consideration, the Division has cited no authority to support its proposition. We note that in general, a petitioner bears the burden of proof in matters asserted before the Division of Tax Appeals (***see***, 20 NYCRR 3000.15[d][5]) except as may otherwise be provided by law. In ***Matter of Grace v. New York State Tax Commn***. (37 NY2d 193, 371 NYS2d 715, ***lv denied*** 37 NY2d 708, 375 NYS2d 1027), the Court of Appeals held that a statute or regulation authorizing an exemption is construed against the taxpayer. However, as to an assertion of tax liability, the government takes nothing except what is given by the clear import of the statute. In this instance, the Division has asserted that the $1,000,000.00 payment by May to Kingsville was subject to tax because it was consideration received by petitioner. It was incumbent on the Division to provide sufficient evidence to support its claim that this amount was, in fact, part of the consideration given on the transfer and, thus, subject to tax under former Article 31-B of the Tax Law. As the Administrative Law Judge concluded, this is not a situation where petitioner is claiming entitlement to a tax exemption (Determination, conclusion of law "E"). We agree with the Administrative Law Judge that the evidence adduced at the hearing was not sufficient to demonstrate that the fee paid to Kingsville was received by petitioner or that the fee and the sale proceeds were ever comingled (Determination, conclusion of law "E"). As a result, we affirm that portion of the determination of the Administrative Law Judge which concludes that the $1,000,000.00 fee paid by May to Kingsville was not taxable as additional consideration to petitioner as a result of the transfer.

Since our decision on this issue is dispositive of this matter, there is no need to address the remaining issues raised by the parties.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the Division of Taxation is denied;

2. The determination of the Administrative Law Judge is affirmed;

3. The petition of Foreign Holdings, Inc. is granted; and

4. The Division of Taxation is hereby directed to issue a refund of gains tax to petitioner in the amount of $100,000.00, together with appropriate interest thereon.

DATED: Troy, New York
January 8, 1998

_____
Donald C. DeWitt
President

_____
Carroll R. Jenkins
Commissioner

Commissioner Pinto concurring:

Although I agree with the decision of the majority in this matter, I feel it is necessary to address myself to the issue of the "look-through" principle raised by the Division of Taxation. The Division correctly notes that we have in the past focused our analysis on the economic reality of transactions and elevated the substance of the transaction over the form in gains tax cases (***citing Matter of Bredero Vast Goed, N.V. v. Tax Commn***. of the State of New York, 146 AD2d 155, 539 NYS2d 823, ***appeal dismissed*** 74 NY2d 791, 545 NYS2d 105 and ***Matter of Shechter***, Tax Appeals Tribunal, October 13, 1994).

In my dissent in ***Matter of Barn Acquisition Corp***. (Tax Appeals Tribunal, September 22, 1997), I stated that I believed the majority had interpreted the statutory provisions too narrowly in light of the broad discretion given to the Division by the courts in cases like ***Bredero*** and ***Matter of Howes v. Tax Appeals Tribunal*** (159 AD2d 813, 552 NYS2d 972) and that the focus of the gains tax through entities pervades the entire statutory scheme imposing tax.

However, the facts of ***Barn Acquisition*** are very different and, thus, distinguishable from those of the instant matter. Most notably, the linear structure existent in ***Barn Acquisition*** is not present herein, i.e., the transferor corporation was wholly owned by a second tier subsidiary

which was wholly owned by the parent. In that case, the Division sought to impose liability on the grandparent, which had actually negotiated the sale of the real property, created the transferor corporation to hold the property, used another subsidiary to finance the transaction and accepted the proceeds of the sale without regard for any of the other entities. The economic reality of that case was apparent.

In the instant matter, the economic reality was not apparent. The $1,000,000.00 payment was made to a sister corporation with no apparent connection to the transaction. The fee received by Kingsville was negotiated and paid pursuant to a separate contract with the transferee, May, and the Division sought to include the fee as additional consideration. The Division did not seek to impose liability on the parent or on the sister corporation. More succinctly, the Division has not established what the payment was nor its relationship to the transaction. Without some basis for linking the payment to the consideration received by petitioner, it has not demonstrated an "economic reality" which warrants imposition of the gains tax.

DATED: Troy, New York
January 8, 1998

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Joseph W. Pinto, Jr.
Commissioner