

STATE OF NEW YORK  
TAX APPEALS TRIBUNAL

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In the Matter of the Petition	:	
of	:	
<b>RELIANCE CAPITAL HOTELS CORPORATION</b>	:	DECISION
or Revision of a Determination or for Refund	:	DTA No. 813647
of Tax on Gains Derived from Certain Real	:	
Property Transfers under Article 31-B of the	:	
Tax Law.	:	

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Petitioner Reliance Capital Hotels Corporation, c/o Reliance Group Holdings, Inc., 55 East 52nd Street, New York, New York 10055, filed an exception to the determination of the Administrative Law Judge issued on October 31, 1996. Petitioner appeared by Gregory P. Candela, Esq. The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Susan Hutchison, Esq., of counsel).

Petitioner filed a brief in support of its exception. The Division of Taxation filed a brief in opposition and petitioner filed a reply brief. Oral argument, at petitioner's request, 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.

***ISSUE***

Whether petitioner transferred an interest in real property as defined in Tax Law § 1440(4).

***FINDINGS OF FACT***

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

On May 4, 1982, a joint venture comprised of petitioner, Reliance Capital Hotels Corporation, and Taxfinco, Inc. ("Taxfinco") (an unrelated entity) entered into a purchase and sale agreement (the "Contract") with Providence Capital Realty Group, Inc. ("PCRG"), pursuant

to which PCRG agreed to sell approximately 7.78 acres of land ("the Land") in Westbury, New York to petitioner and Taxfinco.

On July 30, 1982, PCRG assigned its interest in the Land to a related entity, F.O. Building Associates ("FOB").

On December 28, 1983, FOB gave a mortgage on the Land to The Capitol Life Insurance Company ("Capitol Life"), another entity related to PCRG.

By letter dated June 17, 1985, PCRG and FOB (as assignee) gave notice to petitioner and Taxfinco that it was terminating the Contract and tendered a check representing the buyers' \$130,000.00 deposit plus interest thereon.

On August 16, 1985, FOB, Westbury Properties Group and Capitol Life, as sellers, entered into a contract ("the Westbury Contract") to sell the Land and certain other parcels of property<sup>1</sup> to Westbury Property Sales Associates and Westbury Property Investment Company (collectively, "Westbury").

The Westbury Contract specifically provided that Westbury had been advised of the existence of the Contract and that Westbury had agreed to accept title to the Land "subject to the rights, if any, of [petitioner and Taxfinco]".

By letter dated August 26, 1985, Taxfinco rejected the termination of the Contract by PCRG and FOB and returned the check representing the buyers' deposit plus interest which had been tendered with the proposed termination.

On October 9, 1985, petitioner and Taxfinco commenced an action in the Supreme Court of the State of New York, County of Nassau, against PCRG and FOB alleging breach of the Contract ("the Action"). In its complaint petitioner alleged that PCRG had not validly terminated the Contract. Also on October 9, 1985, petitioner and Taxfinco caused a notice of pendency to be filed in the office of the County Clerk of Nassau County.

By deed dated October 22, 1985, FOB transferred the Land to Westbury.

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<sup>1</sup>Westbury Properties Group, a limited partnership, apparently had an ownership interest in the other parcels which were the subject of the Westbury Contract. It did not have an ownership interest in the Land.

In a supplemental complaint dated March 31, 1986, petitioner and Taxfinco added Westbury as a defendant in the Action. The supplemental complaint alleged that Westbury had actual or constructive notice of the Action prior to its purchase of the Land and sought specific performance of the Contract or money damages.

The plaintiffs and the defendants in the Action brought motions and cross-motions for summary judgment. By order dated March 13, 1987, the court denied the motions for summary judgment brought by both the plaintiffs and the defendants. With respect to the defendants' motion, the court noted that, by personally delivering the June 17, 1985 letter to the buyers (see, above), the defendants had failed to comply with the notice provisions of the Contract, thereby rendering the notice of termination of the Contract a "nullity". The court therefore denied the defendants' motion.

On or about October 23, 1987, an agreement was reached to settle the Action. Under the terms of the settlement, general releases were exchanged among the parties and Westbury paid the joint venture a total of \$1,175,000.00, attributable as follows: \$500,000.00 to Taxfinco and \$675,000.00 to petitioner.

In a letter addressed to the attorneys for petitioner and Taxfinco and dated October 23, 1987, the attorney for Westbury set forth his understanding of the settlement agreement as follows:

"[T]his is to confirm that defendant [Westbury] has offered payment of \$1,175,000 in settlement of the [Action] and that you [i.e., the joint venture] have accepted same.

You have agreed that in connection therewith (i) the [A]ction shall be discontinued as to all defendants with prejudice, (ii) the related lis pendens shall be lifted promptly upon payment, and (iii) there shall be an exchange of releases between plaintiffs and defendants from all claims related to the subject matter of the [A]ction . . .

You have stated that you recognize too that this payment is in full satisfaction of all such claims . . ."

On April 14, 1988, a Certificate of Dissolution of petitioner dated March 31, 1988 by written consent of its sole shareholder, Reliance Capital Corporation, was filed in the office of the Secretary of State of Delaware.

Except to the extent that the \$100.00 of capital of petitioner was to have been distributed to its sole shareholder upon dissolution, no dividends or other monies were distributed to petitioner's parent by petitioner at the time of or as part of its dissolution.

The Division of Taxation ("Division") subsequently undertook an audit of petitioner. Following the audit, the Division concluded that the exchange of the general release and the \$1,175,000.00 payment constituted a transfer of an interest in real property subject to the gains tax, and on August 23, 1993, the Division issued to petitioner a Notice of Determination which assessed real property transfer gains tax in the amount of \$117,500.00, plus penalty and interest.

Pursuant to a Conciliation Order dated December 9, 1994, the gains tax deficiency was reduced to \$58,501.00, plus interest. Penalty on the assessment was cancelled.

The gains tax assessment as revised by the Conciliation Order was calculated based upon consideration of \$675,000.00 (i.e., the settlement payment by Westbury to petitioner) less an original purchase price allowance of \$89,990.00, for a gain subject to tax (at a 10 percent rate) of \$585,010.00.

#### ***THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE***

The Administrative Law Judge reasoned that petitioner had transferred an interest in real property that was subject to the real property transfer gains tax (hereinafter the "gains tax").<sup>2</sup> The Administrative Law Judge determined that "whether a settlement payment is properly subject to gains tax depends upon the 'origin and character' of the underlying claim" (Determination, conclusion of law "B") (*see, Matter of Preferred Rentals, Stockton Bldg.*, Tax Appeals Tribunal, March 21, 1996). The Administrative Law Judge decided that, because the joint venture rejected the proposed termination of the contract and commenced the Action alleging the validity of the contract and, in turn, sought specific performance under the contract, these factors outweighed petitioner's argument that the contract was properly terminated on June 17, 1985. Therefore, the Administrative Law Judge concluded that petitioner and

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<sup>2</sup>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).

Taxfinco had a valid contract to purchase real property until the settlement payment was made in October of 1987. Thus, the Administrative Law Judge determined that since the joint venture claimed an interest in real property, the payment in settlement of the claim constituted consideration for the surrender of an interest in real property. Accordingly, such payment to petitioner was properly subject to gains tax.

Alternatively, the Administrative Law Judge rejected petitioner's contention that the transfer of the interest in property was exempt from taxation pursuant to Tax Law § 1443(6) since petitioner failed to establish entitlement to the grandfathered contract exemption. Petitioner did not take exception to this conclusion of the Administrative Law Judge.

Lastly, the Administrative Law Judge addressed petitioner's argument that, even if it were responsible for the gains tax, it could not pay such tax because it had been dissolved. Petitioner urged that the relevant issue was whether its former stockholder could be liable for any gains tax. The Administrative Law Judge noted that the Division of Tax Appeals is charged with determining tax liability and not the issue of collecting any tax determined to be due. Therefore, the Administrative Law Judge stated that the Division of Tax Appeals had no jurisdiction to consider the liability of such former stockholder (*see*, Tax Law §§ 1444[1], 2008) where such former stockholder had not filed a petition with the Division of Tax Appeals. Petitioner did not take an exception to this conclusion of the Administrative Law Judge.

#### ***ARGUMENTS ON EXCEPTION***

In its exception, petitioner argues that the \$675,000.00 payment to it was not a payment for a transfer of an interest in real property. Petitioner asserts that the money it received was a settlement payment. Although the underlying lawsuit involved real property, petitioner alleges that it never transferred any interest in real property.

Additionally, petitioner alleges that only PCRG, FOB and/or Westbury can be liable for any gains tax due. Petitioner states that PCRG assigned its interest in the property at issue to FOB. Petitioner also mentions that FOB sold the property to Westbury and, thus, if any gains

tax is owing, petitioner claims that it would be due from either PCRG, FOB and/or Westbury since they were the three entities who were involved in transferring interests in real property.

In response, the Division argues that petitioner, as a contract vendee, had an interest in real property pursuant to Tax Law § 1440(4). The Division states that Westbury paid \$1,175,000.00 to petitioner and Taxfinco in exchange for the release and/or assignment by petitioner and Taxfinco of their rights under the purchase contract. For support of this proposition, the Division points to exhibit 7 of Exhibit M and Exhibit K which are letters outlining the settlement agreement between the parties.

With respect to petitioner's argument concerning the liability of others for the gains tax, the Division emphasizes that the transfer at issue herein between petitioner and Taxfinco and Westbury is a separate and distinct taxable transaction from the October 22, 1985 transfer of the fee interest in the real property from FOB, as transferor, to Westbury, as transferee. Thus, regardless of any other taxable transaction, the transfer at issue is properly subject to gains tax.

In its reply brief, petitioner relies on this Tribunal's decision in *Matter of Preferred Rentals, Stockton Bldg.* (*supra*) and states that this case established that a litigation settlement payment does not constitute consideration for an interest in real property.

### ***OPINION***

Petitioner argues that our decision in the *Matter of Preferred Rentals, Stockton Bldg.* (*supra*) is controlling in this case. In *Preferred Rentals*, the petitioner owned certain property which it operated as rental property. The petitioner entered into a Lease and Purchase Option Agreement with lessee granting lessee a 21-year lease with an option to purchase after the 164th month of the lease term. However, prior to the execution of this Lease and Purchase Option Agreement, the petitioner was named in a lawsuit by complainants seeking specific performance of an alleged 49-year lease term already negotiated between the petitioner and complainants. Complainants alleged that the petitioner breached their lease agreement when the petitioner received a better offer from lessee. Complainants also filed in court a notice of pendency with respect to the property.

Thereafter, the petitioner commenced proceedings to remove the lis pendens filed on the property. After negotiations, the petitioner and complainants entered into a settlement whereby the petitioner paid complainants \$560,000.00 in exchange for their release of the claim of a leasehold interest in the property and removal of the lis pendens. The petitioner then added the cost of the settlement payment to its original purchase price on the transfer of the property to lessee arguing that the settlement payment was made to remove the lis pendens from the property so that the property could be transferred free and clear of all encumbrances. We held that the settlement payment was not made to remove an encumbrance, but rather, a potential encumbrance. The lawsuit against the petitioner for specific performance of an alleged lease agreement or for money damages for breach of such agreement did not act to create an encumbrance on the property. Rather, the settlement payment represented a cost of protecting title to the property which is not properly included in original purchase price for purposes of the gains tax.

The Division states that *Preferred Rentals* is a different situation than the case before us. The Division argues, in pertinent part, as follows:

"in *Preferred Rentals*, the Tribunal carefully reiterated a very important factual element in that case which was that the division had asked the tax payer [sic] in *Preferred Rentals* for a copy of the lease. That was the nature of that lawsuit, the alleged breach of the lease and filing of the notice of pendency.

"And in the decision the Tribunal says that the tax payer [sic] simply could not provide a copy of the lease to the division because it didn't exist. Clearly there was no transfer of an interest in real property in that case. And that case is about someone filing a claim and filing a notice of pendency and the settlement monies being strictly to clear the title on that property.

"This case is completely and dramatically different. Here we have a contract vendee who has a clear interest in real property as defined in the tax law. We have that contract vendee going to a global settlement with all of the defendants. We have that contract vendee stating that it has a valid contract purchase agreement.

"And if you look at the global settlement it does provide that part of it will be for the clearing of the cloud on the title of the property, for clearing the notice of pendency, but also for release of all the parties' rights under the action and to the purchase agreement" (Oral Argument Tr., pp. 16-17).

The Division's argument in this case is that, pursuant to the settlement agreement, petitioner and Taxfinco gave Westbury a release and/or surrender of their rights under the purchase contract. Therefore, the Division argues that, pursuant to Tax Law § 1440(4), petitioner transferred an interest in real property, to wit, its rights under the purchase contract. As such, the Division asserts that the payment received for such transfer was properly subject to gains tax. However, as in *Preferred Rentals*, petitioner herein received a settlement payment in which it relinquished its claim of rights under the purchase contract. Therefore, we reverse the determination of the Administrative Law Judge on this issue and find *Preferred Rentals* is controlling in this case.

The Division argues that Westbury paid for more than just the quieting of title to the property. The Division asserted in its brief (*see*, p. 7), as well as at oral argument, that petitioner gave a release of its rights under the purchase contract. We disagree.

A letter from Marc S. Dreier, Esq. to Frank Geller, Esq., dated October 23, 1987, outlined the agreement between the parties to the settlement. There is nothing in this letter that states that either petitioner or Taxfinco released their rights under the purchase contract. Rather, the language contained in subparagraph (ii) states as follows:

"In connection therewith, the Seller and Purchaser [as both terms are defined in subparagraph (i)] shall exchange mutual releases, and Westbury shall further obtain from Taxfinco, Inc., Reliance Capital Hotels Corporation and Providence Capitol Realty Group, Inc. releases of the Seller from all claims related to the subject matter of the action captioned Taxfinco, Inc. et al. v. Providence Capitol, et al., Index # 18578/85 (Sup. Ct. Nass. Co.) ('the related action')" (Exhibit "M," exhibit 7 attached thereto).

The settlement agreement states that petitioner relinquished its claim of any rights under the purchase contract. In this case, the property was already transferred to Westbury who took the property subject to the rights of petitioner and Taxfinco. We find, as we did in *Preferred Rentals*, that Westbury's payment to petitioner and Taxfinco was to quiet title to the property and not for a transfer of an interest in real property.

The Division tries to distinguish *Preferred Rentals* on the facts by stating that in that case, the lease at issue did not exist, whereas, in petitioner's case herein, there existed a valid



contract under which petitioner had rights to purchase certain property. However, this distinction unnecessarily focuses on the merits of each of the lawsuits brought in the respective cases. Since each lawsuit settled, there was no decision made as to the merits of the respective parties' positions. Accordingly, the distinction is irrelevant due to the fact that settlement payments were made to resolve all claims made pursuant to the lawsuits.

With respect to the second issue raised by petitioner on exception, we agree with the Division that the transfers that took place between PCRG and FOB and FOB and Westbury are separate and distinct transactions from the one at issue herein. Thus, the taxability of those transactions are not properly before us for review.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Reliance Capital Hotels Corporation is granted to the extent that the settlement payment received by it did not constitute consideration for the transfer of an interest in real property, but is otherwise denied;
2. The determination of the Administrative Law Judge is reversed in accordance with paragraph "1" above, but is otherwise sustained;
3. The petition of Reliance Capital Hotels Corporation is granted to the extent indicated in paragraph "1" above, but is otherwise denied; and
4. The Notice of Determination (L-007837927-8) is cancelled.

DATED: Troy, New York  
December 31, 1997

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Donald C. DeWitt  
President

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Carroll R. Jenkins  
Commissioner

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Joseph W. Pinto, Jr.  
Commissioner

