STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
PURCHASE CORPORATE PARK ASSOCIATES II	:	DECISION DTA No. 813819
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 December 11, 1996 with respect to the petition of Purchase Corporate Park Associates II, c/o The Related Companies, 625 Madison Avenue, New York, New York 10022. Petitioner appeared by Battle Fowler, LLP (Richard L. O'Toole, Esq., of counsel). The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (David C. Gannon, Esq., of counsel).

The Division of Taxation filed a brief in support of its exception. Petitioner filed a brief in opposition. Oral argument was not requested.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision. Commissioner Pinto took no part in the consideration of this decision.

ISSUE

Whether the amount received by petitioner for a lease surrender should be added to the amount received by petitioner for the sale of essentially the same property as consideration under Tax Law former § 1440(1)(a)[1] where the transactions occurred simultaneously and were dependent.

[1]The real property transfer gains tax imposed by Tax Law Article 31-B was repealed on July 13, 1996.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.

A stipulation was received into evidence in this matter and the Division of Taxation requested two findings of fact pursuant to 20 NYCRR 3000.15(d). The facts as set forth in the stipulation and the requested facts have been substantially adopted in this determination with only slight changes in the wording.

There are several different and related companies that were involved with petitioner in the transactions that are the subject of this proceeding. The names of such companies and the various relationships between the companies and with petitioner during the time period in question are as follows:

- Nestle USA, Inc. and Nestle Chocolate and Confection Company, Inc. (hereinafter "NCCC") were affiliates (Exhibit P, ¶ 7);

- Nestle USA, Inc. and NCCC were wholly-owned subsidiaries of "Nestle"[2] (Exhibit K ¶ 26.01, Exhibit L ¶ 17.01);

- Nestle USA, Inc. and NCCC were limited partners in petitioner (Exhibit K ¶ 26.01, Exhibit L ¶ 17.01), and;

- Nestle USA, Inc. and NCCC were limited partners in Purchase Corporate Park Associates VI[3] (Exhibit G, footnote 2).

In July 1982, petitioner agreed to lease a 35-acre parcel of unimproved land located at 1000 Manhattanville Road, Town/Village of Harrison (Purchase), New York (hereinafter "Land"), from Manhattanville College, as ground lessor, pursuant to a 99-year ground lease (hereinafter "Ground Lease") to be executed upon obtaining site plan and other required governmental approvals. The Ground Lease with Manhattanville College was executed on July

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[2]The term "Nestle" is used since the exhibits refer to the parent company only as Nestle.

[3]While Purchase Park Associates VI is not involved in the present matter, it was involved in the separate issue explained in footnote 4, infra.

1, 1984. Construction of an office building and ancillary facilities (hereinafter "Building") on the site was completed in 1986. (Exhibit P, ¶ 3.)

On July 2, 1985, petitioner entered into a lease (the "Lease") with Nestle Foods Company, subsequently known as Nestle Chocolate and Confection Company, Inc. (NCCC), pursuant to which NCCC leased the Building and subleased the Land.[4] (Exhibit P, ¶ 4.)

Due to a decline during the late 1980's in market conditions for rental office buildings in Westchester County, by late 1991 the Lease constituted an above-market obligation for NCCC. Accordingly, the Lease had a negative economic value to NCCC, and a positive economic value to petitioner. (Exhibit 2, ¶ 2.) In an effort to get out of the above-market Lease, NCCC proposed to buy itself out of the Lease, vacate the Building and relocate its operations. Petitioner was unwilling to assume the risk of an empty building in a bleak market and would not agree to NCCC's buyout proposal without a replacement tenant. Petitioner's mortgagee also would not agree. Negotiations continued and it was ultimately agreed that NCCC would pay petitioner to surrender its lease (the buyout it had originally requested), and, simultaneously, Nestle USA, Inc. would buy the building and petitioner's interest in the Ground Lease (alleviating petitioner and petitioner's mortgagee's concerns about holding a vacant building during a real estate slump). (Exhibit 2, ¶¶ 4, 5.)

On December 28, 1991 NCCC paid $16,409,000.00 to petitioner to surrender the Lease (hereinafter "Lease Surrender").

On December 16, 1991, NCCC and petitioner filed a New York State Combined Real Property Gains Tax Affidavit and Real Estate Transfer Tax Return in connection with the Lease Surrender. This return states that no consideration was paid to the transferor, NCCC. (Stipulation, ¶¶ 5, 6.)

On December 23, 1991, Nestle USA, Inc. acquired fee title to the Land from Manhattanville College. (Exhibit P, ¶ 7.) On December 28, 1991 Nestle USA, Inc. entered into a contract to purchase the Building from petitioner, together with petitioner's interest as lessee

[4]NCCC merged with and into Nestle Food Company effective December 28, 1991. (Exhibit G, footnote 1.)

under the Ground Lease, for a total purchase price of $49,000,000.00. Petitioner filed a gains tax transferor questionnaire dated December 16, 1991 that reflected the gross consideration of $49,000,000.00. Likewise Nestle USA, Inc. filed a gains tax transferee questionnaire stating that the consideration to be paid to acquire the Building together with the tenant's interest under the Ground Lease, was $49,000,000.00. (Stipulation ¶ 7.)

The Division issued a tentative assessment dated March 6, 1992 increasing the consideration reported by petitioner regarding the above two transactions by including the $16,409,000.00 reported by petitioner as a lease surrender fee in the consideration petitioner received for the sale of the building. (Exhibit G, ¶ II.) On March 9, 1992, petitioner paid the additional gains tax due as shown on the tentative assessment. (Exhibit G, caption.) On August 11, 1993, the Division received a claim for refund from petitioner. By letter dated March 18, 1994, the Division denied the claim for refund (Exhibit F).[5]

The amount of $49,000,000.00 was an accurate reflection of the fair market value of the Building and petitioner's interest in the Ground Lease at the time of the transfer of these assets from petitioner to Nestle USA, Inc. The amount of $16,409,000.00 was an accurate reflection of the fair market value of the Lease Surrender (i.e., what a lessee would be willing to pay and a lessor would be willing to accept to allow the lessee to get out of an above-market long-term lease). In its brief petitioner avers that the Division has not questioned the values assigned to either the Lease Surrender or the purchase of the Building. In its responding brief the Division states:

> "Petitioner asserts that the Division does not contest petitioner's valuation of the building and the lease. This is not accurate. The Division considers the appraisal irrelevant because the question presented in this matter is a legal one: how does the definition of consideration at section 1440 apply to the facts of this case. Therefore, the appraisal is immaterial." (Division's brief, footnote 1.)

In its reply brief, petitioner responds as follows:

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[5]Petitioner's original claim was for a refund in the amount of $1,823,572.00. On March 18, 1994, the Division granted a partial refund in the amount of $182,671.40 for an issue unrelated to the present matter. Therefore, the amount remaining at issue in the present matter is $1,640,900.60. These amounts represent tax only, exclusive of interest. (Exhibit G, refund form, Exhibit P, footnote 1.)

> "Petitioner believes (a) the Division has not introduced any evidence concerning valuation, (b) the valuation of $49 million for the building and $16.41 million for the lease surrender was negotiated by unrelated parties, was confirmed by an appraisal, and was accurate, and (c) the correctness of these valuations is extremely relevant, because they demonstrate that, when the parties engaged in two transactions involving separate interests in real estate (the sale of the building and the surrender of the lease), they applied arm's length, bona fide consideration to each property interest." (Petitioner's reply brief, p. 1.)

During the hearing held on this matter Administrative Law Judge Pinto specifically asked the Division's representative if there was any issue with regard to the numbers. The Division responded with:

> "No. From our position we are working with the number, 49 million, for the sale of the building, 16.41 million for the lease hold surrender, and its the treatment of those numbers based on the facts and the gains tax, so the evaluation -- I think the appraisal comes in and says the lease was above market by about 25.8 million. We are not -- There is no dispute as to what the appraisal concludes. We are basically accepting the 49 million and 16.4 million dollar amounts that were exchanged. The numbers are not at issue. It's the application of the gains tax as to how this transaction flowed." (Tr., pp. 26,27; emphasis added.)

The appraisal submitted was entitled "REAL PROPERTY VALUATION OF 100 MANHATTANVILLE ROAD PURCHASE NEW YORK FOR PURCHASE CORPORATE PARK ASSOCIATES II" and was submitted to petitioner in June of 1993 by Peter F. Korpacz & Associates, Inc., Real Estate Appraisers & Counselors. It is a retrospective analysis providing a valuation as of December 30, 1990. The value of the property to petitioner, excluding the ground lessor's interest and subject to the NCCC lease, was $41,000,000.00. The value of the property to petitioner without the NCCC lease was $15,200,000.00. The appraisal explains that the fair market value of the NCCC lease to petitioner in December of 1991 was calculated by estimating the market value of the leasehold estate subject to the NCCC lease, estimating the market value of the leasehold estate free and clear of the NCCC lease, and attributing the difference between the two values as the value of the NCCC lease. Therefore the value of the lease to petitioner was $25,800,000.00. (Exhibit O.)

The values as submitted in the appraisal and the amounts actually paid for the Lease Surrender and the sale of the Building, including the remaining interest in the Ground Lease, do

not exactly match. However, petitioner has proven that the value of the Lease Surrender was at the least the $16,409,000.00 paid (appraisal value - $25,800,000.00), and that the value of the Building together with petitioner's interest in the Ground Lease was not more than the $49,000,000.00 petitioner received and reported to the Division (appraisal value - $41,000,000.00). The Division, while expressing the opinion that these amounts are not relevant to the issue in this case, did not contest the amounts at any time during these proceedings.

The Lease Surrender and the transfer of the Building were two separate transactions. Although they were tied together in that both transactions had to close in order for either of them to close, the amounts paid by NCCC to get out of its lease and the amount paid by Nestle USA, Inc. to acquire the building were the result of independent negotiations and were based on the real cost to NCCC of the above-market lease and the true value of the building. (Exhibit 2, ¶ 5.)

Petitioner treated the $16,409,000.00 paid by NCCC as a lease termination fee and not part of the consideration paid by Nestle USA, Inc. for the Building for gains tax, and Federal and State income tax purposes. For Federal and State income tax purposes that meant petitioner listed the $16,409,000.00 as ordinary income rather than as a capital gain. In 1991 the maximum Federal income tax rates on ordinary income and capital gain income were 31% and 28%, respectively. Treating this transaction as a lease surrender payment and therefore ordinary income meant that petitioner's partners paid approximately $492,270.00 more in Federal income taxes than if they had treated the income as a capital gain and part of the consideration for the building.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge concluded that the Lease Surrender and the sale of the Building and any rights under the Ground Lease were two separate and distinct transactions for gains tax purposes. The Administrative Law Judge rejected the Division's argument that because the sale of the property would not have taken place without the surrender of the lease

required the finding that only one transaction occurred. The Administrative Law Judge also rejected the Division's argument that it was necessary to look through the entities to determine beneficial ownership with respect to the transfers.

The Administrative Law Judge stated that under the facts presented to her, the focus is on the economic reality of the transfers themselves and not whether the same entities controlled both transfers. In citing to ***Matter of Cheltoncort Co. v. Tax Appeals Tribunal*** (185 AD2d 49, 592 NYS2d 121), ***Matter of Perry Thompson Third Co. v. Tax Appeals Tribunal*** (185 AD2d 49, 592 NYS2d 121) and ***Matter of Loren Crossroads Assocs.*** (Tax Appeals Tribunal, August 1, 1991), the Administrative Law Judge analogized the facts in those cases, which dealt with the sale of property and simultaneous lease-back to the transferor of certain commercial space, to demonstrate that merely because two transactions are interdependent does not transform two separate and distinct transactions into one transaction.

The Administrative Law Judge also pointed out that another indication of the two transfers being characterized as two separate transactions was the income tax treatment by petitioner of the payment received for the Lease Surrender. Although noting that petitioner's Federal income tax treatment of the transactions is not controlling, the Administrative Law Judge stated that she found that such treatment was indicative of a separate transaction.

The Administrative Law Judge also concluded that the surrender of a lease has been recognized as a transaction subject to tax pursuant to Tax Law former § 1440(7)(a) (***Matter of Indeck Energy Serv. of Oswego***, Tax Appeals Tribunal, August 14, 1997; ***see also, Matter of 52 Fulton St. Distribs., Ltd. v. New York State Tax Commn.***, Sup Ct, Albany County, Sept. 14, 1987, Williams, J.).

Since the Administrative Law Judge determined that there were two separate transactions, she next considered whether it was proper for the Division to include the amount paid for the Lease Surrender as a part of the consideration received by petitioner for the sale of the Building and its remaining rights in the Ground Lease. The Administrative Law Judge found that a separate value was attributed to the Lease Surrender by the parties in the amount of

$16,409,000.00. Since the amount received for the Lease Surrender was not "the price paid or required to be paid" for the sale of the Building, the $16,409,000.00 is not treated as consideration for the sale of the Building. Lastly, the Administrative Law Judge failed to apply Tax Law § 1448(1) to these transactions since she had determined that there were, in fact, two separate transactions and that the Lease Surrender transaction may not be added to the consideration received for the sale of the Building; thus, petitioner did not structure these transactions in order to avoid the gains tax. Accordingly, the Administrative Law Judge granted the refund requested by petitioner.

ARGUMENTS ON EXCEPTION

The Division continues to argue that the Lease Surrender and the sale of the Building are not separate transactions, but rather, are two parts of a single transaction. The Division states that petitioner would not agree to sell the Building, and any rights thereunder, without the surrender of the lease. Moreover, the lease had value to petitioner. Accordingly, the Lease Surrender falls within the definition of consideration as "any other thing of value" as set forth in Tax Law former § 1440(1)(a). Additionally, the Division argues that Tax Law former § 1448 applies in this case.

Petitioner argues that the Administrative Law Judge properly treated the two transfers as separate and distinct transactions. Petitioner asserts that the $16.41 million paid by NCCC accurately reflected the value of the Lease Surrender and that the Lease Surrender and transfer of the Building were the result of independent negotiations and were based on bona fide values. The Leasehold Surrender payment was an arm's-length payment and the value of such payment was supported by an appraisal and such appraisal was not disputed by the Division.

With respect to the Division's argument that Tax Law former § 1448(1) applies to this transaction, petitioner argues that the Division cannot reformulate a transaction unless the primary purpose of the form of the transaction is the avoidance or evasion of the gains tax, rather than for a business purpose. Accordingly, since the Lease Surrender had a business purpose and reflected economic reality, former section 1448(1) may not be used to

recharacterize the $16.41 million paid for the Lease Surrender as consideration for the transfer of the building.

OPINION

The Division argues on exception, as it did below, that the focus of the gains tax is to look through entities to determine beneficial ownership and economic reality (Division's brief, p. 4). In this case, the Division is urging us to apply the look-through principle to the transferees and not the transferor. The Division argues that since Nestle USA and NCCC were wholly-owned subsidiaries of parent Nestle, it should be found that by looking through the entities, it is clear that parent Nestle was the transferee of both transfers which requires petitioner, as transferor, to combine the payments received in both transfers as a single consideration received for the sale of the Building and the remaining interests in the Ground Lease. We disagree.

In ***Matter of Von-Mar Realty Co***. (Tax Appeals Tribunal, December 19, 1991, ***confirmed Matter of Von-Mar Realty Co. v. Tax Appeals Tribunal***, 191 AD2d 753, 594 NYS2d 414, ***lv denied*** 82 NY2d 655, 602 NYS2d 803), we summarized the application of the "look-through principle" by stating as follows:

> "[t]he 'look-through principle,' i.e., looking through an entity which owns real property to determine the beneficial owners of the real property, has been applied to the gains tax statutory scheme where adjacent or contiguous properties are transferred by two or more entities under common ownership to determine whether a taxable 'transfer of real property' has occurred (***Matter of 307 McKibbon St. Realty Corp., Tax Appeals Tribunal***, October 14, 1988). The 'look through principle' was also applied where a taxpayer and an entity in which it owns a 'controlling interest' [footnote omitted] transfer their interests in a single building with the result that the sales are aggregated to determine whether the $ 1 million exemption has been exceeded (***Matter of Howes***, Tax Appeals Tribunal, September 22, 1988, ***confirmed Matter of Howes v. Tax Appeals Tribunal***, 159 AD2d 813, 552 NYS2d 972). As we noted in these earlier decisions, the focus of the gains tax through entities pervades the entire statutory scheme imposing the tax (***Matter of Howes***, ***supra; Matter of 307 McKibbon St. Realty Corp.***, ***supra***; ***see also***, ***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 [where the court sustained looking through two tiers of entities to find a transfer of real property])."

Clearly, we have applied the look-through principle in determining who the beneficial owners of the real property are in order to ascertain whether a taxable transfer has occurred. In this case, the transferor of the Lease Surrender was NCCC and the transferor of the Building was petitioner. However, the Division is arguing that we should look through NCCC and Nestle USA, the transferee of the Building, to determine the beneficial owners of these entities. The Division asserts that it is parent Nestle who controlled the transaction and it is parent Nestle who had ownership of the Building at the end of the day. This argument is without merit. Since there has been no proof to show that there is a common ownership between NCCC and petitioner, we conclude that the look-through principle is not applicable to the facts of this case.

We agree with the Administrative Law Judge that there were two separate and distinct transactions that took place. As she adequately dealt with the issue presented to her, we affirm the determination of the Administrative Law Judge for the reasoning set forth therein.

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 Purchase Corporate Park Associates II is granted; and

4. The remainder of petitioner's refund claim dated August 4, 1993 in the amount of $1,640,900.60, plus interest, is granted.

DATED: Troy, New York
November 13, 1997

_____
Donald C. DeWitt
President

_____
Carroll R. Jenkins
Commissioner