

person or persons to whom an economic interest in real property is transferred. The definitions of "Grantor" and "Grantee" in existing Rule § 23-02 merely repeat the statutory language. Tax Law § 1401(g), relating to the real estate transfer tax, is more explicit in defining "grantor," where there is a transfer of a controlling interest, to include not only "an entity with an interest in real property" but also "a shareholder or partner transferring stock or partnership interest " in such entity. Example E treats Shareholders B, C, D, and E as the grantors and apparently treats Shareholder A and the other Corporation Y shareholders as the grantees, which seems consistent with the statutory definitions. However, it would add clarity if the definition of "grantor" in Rule § 23-02 were expanded to include language referring explicitly to shareholders or partners similar to that in Tax Law §1401(g), above.⁶

(e) In the case of a tax on the transfer of an economic interest in real property, the real property transfer tax must be paid by the grantor (or the grantee if the grantor does not pay) within thirty days after the transfer, to the Commissioner of Finance at the Department of Finance, Operations Division, Real Property Transfer Tax Group. Adm. Code § 11-2104; Rule § 23.08. "In the case of a transfer of an economic interest in real property, a joint return shall be filed by both the grantor and the grantee for each instrument or transaction by which such transfer is effected, whether or not a tax is due thereon. . . . The return shall be signed under oath by both the grantor or his agent and the grantee or agent". Adm. Code § 11-2105.a. Such return must be filed at the above office at the time the tax is paid, or if no tax is due, within 30 days after the transfer. Rule § 23-09(a). "Where a deed, or instrument or transaction has more than one grantor or more than one grantee, the return may be signed by any one of the grantors and by any one of the grantees, provided, however, that those not signing shall not be relieved of any liability for the tax imposed by this chapter". Adm. Code § 11-2105.e. Neither the existing nor proposed Rules shed any light on how these provisions will apply to transactions involving publicly traded corporations. If Example E involved a merger of two public corporations and the shareholders of X and Y are the grantors and grantees, respectively, can Corporations X and Y sign the return as agents for their shareholders? If it is the shareholders who owe tax as the grantors (or grantees), assuming that the City would require aggregation in such a case, how would this tax be collected? Any payment by one of the corporate parties on behalf of their shareholders would have to be carefully structured to avoid jeopardizing the income tax-free status of the reorganization. Since, as in Example E, not every shareholder's burden is proportionate to his stock ownership, there would be considerable administrative problems in auditing the transaction, and in collecting any additional tax if any were found due from the shareholders. We believe that these are issues which should be addressed by clarifying who the "grantee" is for all purposes in a situation like Example E, unless the problem can be avoided by the City's adopting the reasoning of the Crossland Savings opinion for both the grantor and the grantee where they are publicly traded corporations, so that there would be no tax in such a case.

⁶ The treatment of Shareholder A and the Y Shareholders as the grantees is stated indirectly in Example E by describing beneficial interests in Corporation X's real property as having been "transferred" to them, leaving some question as to whether it was the intent of the Example to infer that they will be "grantees" for all purposes, such as return filing and tax liability (see paragraph 4(c) below).

Many of the problems discussed in (e) above would be eliminated if the City either identified Y as the grantee of the X shares for purposes like return filing and tax liability (on facts like those in Example E) or deleted the existing exemption of transfers made pursuant to statutory mergers from tax at the corporate level in Rule § 23-03(e)(2). This rule predates the adoption in the statute both of the controlling interest rule in 1986 and the mere change exemption in 1994. The retention of the merger rule following the 1986 amendments was important to avoid a double transfer tax on a corporate merger. However, with the enactment of a change-in-form exemption for the City, this no longer seems necessary.

In the State real estate transfer tax, Tax Law § 1405(b).6 originally contained an exemption for deeds given pursuant to mergers, etc., which was repealed in the 1989 legislation enacting both the controlling interest and mere change rules. Currently, the State's position is that, in a corporate reorganization resulting in the acquisition of a controlling interest in Company X, an entity with an interest in real property, by Company Y, both widely held and publicly traded, Company X and its shareholders are the grantors and are equally liable for the entire transfer tax due, and if they fail to pay, then Company Y is liable as grantee. See Coopers & Lybrand, LLP, Advisory Opinion, February 21, 1997, TSB-A-97(2)R (CCH New York State Tax Reporter ¶ 402-671), relating to a reverse triangular merger. With the adoption by the City of both the controlling interest and mere change rules, we suggest that the City consider whether the statutory merger exemption in the rules could be seen as having become obsolete to the same extent that the similar exemption in the Tax Law was deemed expendable when corresponding changes were adopted at the State level. Bear in mind, however, that the Coopers opinion relies in part on definitions of "Grantor" and "Grantee" in Tax Law § 1401(g) and (h) which differ from the corresponding definitions in Adm. Code § 11-2101.14 and 15. See paragraph 4(d) above. With particular reference to the difference in the definitions of "grantor," the City must consider whether the suggested change in regulatory interpretation would be consistent with the statute.

5. We recommend addition of examples of the following:

- A. A transfer to or from an LLC.
- B. An actual cash sale that is nevertheless exempt to some extent as a mere change in form.

6. The proposed Rules include a step-transaction rule, Rule § 23-05(b)(8)(iii), under which the analysis of the application of the change-in-form exemption would include examinations of transactions occurring before and after the apparent mere change-in-form transfer, to determine "the extent to which the beneficial interest therein remains the same following the transaction." While we understand the theoretical justification for applying such principles in determining the extent to which a transfer effects a change in beneficial ownership, we do have some concerns with this proposal.

The transfer tax has long been applied in a formalistic manner, and has not heretofore employed broadly applicable recharacterization provisions. It is true that, since the enactment of the controlling interest provisions, the rules have included provisions for aggregating transfers of interests in entities for purposes of determining whether there has been a transfer of a controlling interest, with a rebuttable presumption that transfers within a 3-year period are aggregated. Rule § 23-02, definition of Controlling Interest, paragraph (2). These are, however,

rules for determining whether actual transfers of minority interests in entities were in fact made "pursuant to a plan to either transfer or acquire a controlling economic interest in real property" such that there was in fact a transfer of a controlling interest. (Under § 23-02, transfers aggregated with respect to whether a controlling interest has been transferred are also aggregated with respect to the \$25,000 threshold for tax and the applicable tax rate.)

The proposed "step-transaction" rule addresses a different kind of question—whether transfers made in some particular form or order can be recharacterized in order to create a different taxable event. Thus, the proposed example concludes that a transfer of real property to a wholly-owned corporation, followed by a sale of a 49% interest in the corporation, results in the imposition of tax on 49% of the consideration for the transfer of the property. Exactly how the two transfers are to be recharacterized is not clear, but the proposed treatment of the first transfer as partially taxable, notwithstanding its formal qualification for a full exemption is, in our view, a qualitatively different application of the concept of "plan" than that heretofore applied to minority entity interests.

The proposed rule is in some respects analogous to the existing rule for multi-step transactions completed within 30 days, set forth in Rule § 23-03(f). We note, however, that that rule is specifically limited in scope, suggesting in turn that the ability to recharacterize a series of planned transactions and compute tax without regard to intervening, planned steps, has heretofore been quite limited. See also Department of Finance Bulletin, December, 1981 (transfer of property in a three-way exchange is taxable twice, notwithstanding parties' plan that the first transfer be immediately followed by the second).

Similarly, while the statute has long included an exemption for transfers involving "a mere agent, dummy, straw man or conduit," Adm. Code § 11-2106(b)(7), this exemption has been narrowly construed to require essentially the income-tax equivalent of a nominee relationship, and has not been available based solely on parties' ability to demonstrate a plan. See, e.g., Petition of The 35-37 West 23rd Street Partnership, New York City Tax Appeals Tribunal, ALJ Division, October 31, 1995 (CCH New York State Tax Reporter ¶600-223). The existing statutory credit provisions, which collapse certain transfers and permit the overall tax liability to be determined in a manner that could be said to reflect a step-transaction analysis, also are narrowly drawn. See Adm. Code §§ 11-2102 (b) (2) and (c) (2), both of which are limited to specific types of related transactions, and include explicit 24-month time limitations.

In addition, it is not clear from the proposed rule what standards will be applied in determining whether different transfers will be considered to be made "pursuant to a plan." For example, do the concepts underlying the aggregation rules of Rule § 23-02 also inform the application of the step transaction doctrine, or is the proposed rule a more limited inquiry into the actual beneficial ownership of property following its transfer? While the application of a step-transaction concept may be appropriate in measuring the change in beneficial interest, we do not believe it is appropriate to apply, for example, a presumption of relatedness to all transactions occurring within three years before or after a transfer. The substance-over-form principles that underlie a step-transaction theory have a long history in the income tax laws, where there is abundant, if not always clear, authority regarding the application of this concept. If this concept is now imported into the City transfer tax, we recommend that it be applied by reference to the

income tax concepts of step transactions, and not by reference to the different concepts that underlie the aggregation rules of Rule § 23-02.

It also should be made clear that, since the basis for the application of such a doctrine here is to arrive at an accurate representation of the true beneficial interest in property following its transfer, taxpayers likewise are entitled to invoke this rule, so that two transfers which, in form, would not qualify for the change-in-form exemption might nonetheless be shown to be sufficiently related to be exempt from tax.

The administration of such a rule must also be addressed. If the ministerial process of recording deeds for actual conveyances becomes a forum for inquiries into the possibility of related transfers, there will be serious transactional problems raised by the application of this rule. In the illustration in proposed § 23-05(b)(8)(iii), is the tax on the 49% said not to be exempt as a mere change of form due at the time the building is transferred to X Corporation, or at the time the sale of stock to B, C, D and E takes place?

We also believe that the application of a step-transaction rule in applying the change-in-form exemption is directly contrary to the State's interpretation of its transfer tax and, prior to that, the State's interpretation of the gains tax. Compare, e.g., Peter S. Kalikow, Advisory Opinion, January 18, 1991, TSB-A-91(1)(R) (CCH New York State Tax Reporter ¶ 253-751) (transfer of property to 100% owned corporation, followed by sale of 20% stock interest, is not subject to the gains tax). We are concerned about the development of different State and City interpretations of the same statutory exemption. Such nonconformity in the administrative interpretations of essentially identical statutory provisions increases the burdens of complying with New York's taxes, and ought generally to be avoided. We urge the City to coordinate with the State to consider whether the policy reasons for their position might also be applicable to the City tax, and to endeavor to avoid the complexities created by differing interpretations.

Finally, given the fact that this interpretation differs from the limited step-transaction analysis heretofore applied under the City transfer tax statute and rules, and from the interpretation (as we understand it) of the change-in-form exemptions by the State, we believe this rule should be applied prospectively only.

7. The following are recommended stylistic or grammatical corrections:

A. In Illustrations (ii) and (iii) of Rule § 23-03(e).2, added by § 3 of the proposals, we suggest replacing "would be meaningless" with "would not affect X's beneficial interest in Y's real property".

B. In Example B of Rule § 23-05(b)(8)(i), added by § 4 of the proposals, we recommend that "gets" in the 6th and 7th sentences be replaced with "receives".

C. In § 1, amending Examples (i) and (ii) in Rule § 23-03(d), in the first sentence of Example (ii) add "in 1990" (or some other pre-effective date), as in Example (i).

D. In §§ 2 and 4, amending Rule § 23-03(e)(1) and (3), put new subparagraphs (iv) at the beginning of their respective paragraphs as new subparagraphs (i), so that the reader

does not have to wade through three subparagraphs before being told that they are no longer applicable.

E. In § 2, above, add the following at the end of the first sentence of subparagraph (iv) as proposed: "whether or not shares of stock are issued in exchange."

F. On page 4 of the proposals, 7 lines from the bottom, "retains" should be "retain."