REPORT #551-1

TAX SECTION

New York State Bar Association

Statement of Richard G. Cohen

Table of Contents

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My name is Richard G. Cohen. I am here in my capacity as the Chairman of the Tax Section of the New York State Bar Association. I wish to address the proposal to extend the New York City Real Property Transfer Tax to certain transfers of controlling interests in corporations, partnerships, trusts and other entities, and to certain transfers of stock in cooperative housing corporations.

This amendment is, to all intents and purposes, identical to Local Law No. 23 first enacted at the meeting of the City Council on June 29, 1986, and approved by the Mayor on July 8, 1986. Because of the decision of the Appellate Division of the New York Supreme Court, Second Department, in 41 Kew Gar-s Road Associates v. Tybursk, the validity of all tax ordinances approved by the Mayor on that date has been brought into question. The current amendment would be retroactive to the same effective date as the original ordinance, that is, July 13, 1986.

On behalf of the Tax Section of the New York State Bar Association, we do not oppose efforts to correct the effects of technical errors of this type, even though somewhat retroactive. We have not had sufficient opportunity to consider the extent of the

City's power to make this correction with retroactive effect and, accordingly, take no position on that legal question. We do note that the retroactive imposition of federal and state income taxes is generally upheld if the public has had reasonable advance notice.* We agree that retroactivity in this particular case does not seem to be unreasonable or otherwise especially onerous.

On the other hand, we do wish to express continuing concern over the practice of adopting significant changes in taxing statutes without giving the affected parties adequate time to review, consider and comment on them. Taxation is a complex matter, and the drafting of statutory language to reflect properly the legislative policy and intent is a difficult, often strenuous process. We respectfully submit that all City tax statutes would benefit from the input of responsible professional organizations like the New York State Bar Association prior to enactment. We recognize

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* Historically, the courts have not viewed attempts to impose retroactive excise taxes as liberally as they have viewed retroactive income taxes. See, e.g., Untermyer v. Anderson, 276 U.S. 440 (1928); Chrysler Properties. Inc. v. Morris, 23 N.Y.2d 515 (1969); Roosevelt Raceway. Inc. v. Monaghan 9 N.Y.2d 293, 310 (1961); Laciden Realty Corp. v. Graves, 288 N.Y. 354, 357 (1942); McKnight v. Union Baa and Paper Co., 63 Misc. 132 (Sup. Ct. Saratoga Co. 1909).

that political exigencies do not always permit the City the luxury of prolonged review and debate, but where the opportunities exist, it is extremely important that the City avail itself of them.

Accordingly, we urge that, where not inconsistent with otherwise overriding concerns, the Tax Section of the New York State Bar Association and similar professional organizations be given more meaningful opportunities to submit their views on the technical aspects of any proposed tax legislation prior to enactment. By meaningful, we mean one that is not merely a pro forma process, but one in which there is a significant dialogue with the City. That process would help the City adopt fairer, more easily administrable and, therefore, more effective tax laws.

City taxation has often been regarded as a relatively minor aspect of the subject of taxes. As a result, little analytic attention has been given to it in the past. However, state and city income tax rates on individuals now equal as much as 17.8% combined, as compared to federal tax brackets of only 15% and 28% by 1988. The city's real property transfer tax, at a rate of 2% of gross value, would equal 20% of the equity of property subject to a 90% mortgage. Indeed, in some cases, a 2% gross tax rate can result in tax liabilities exceeding the net worth of the taxpayer. This could easily occur if, as suggested in one of the position papers described below, a simple corporate reorganization can result in multiple impositions of the tax.

The New York City real property transfer tax has become a major factor in many commercial transactions involving the City. It extends to foreign corporations with leased office space in the City. It affects testamentary transactions and intra-family gifts. And it affects persons having no direct interest in real property in the City, and who are unlikely to realize the wide-ranging scope of the claim of jurisdiction. Accordingly, it deserves serious attention as to how it works: whether it is fair in application; whether it is sufficiently understandable to be administrable; whether, in the long run, it drives commercial activity away from the City and results in greater tax losses than gains. Failure to give each of these aspects reasonable consideration can result in serious injury to the city's economy and its ability to provide needed services.

The recent amendments to the City transfer tax represent a situation where it is particularly clear that the input of the bar associations and other informed professionals would improve the tax. The language of this statute was originally drawn more than five years ago. Since that time, legislators, administrators and professionals have learned much about the issues involved in applying a real property transfer tax to entity transactions, the New York State Gains Tax being the most complete development to date of the law in this area. Despite the available body of law on which an expanded transfer tax could have been based, however, and despite the fairly broad authority given to the City under the

enabling legislation to adapt the transfer tax and respond to reasonable business and commercial concerns, the legislation enacted earlier this year and under consideration here today is in many respects a throwback to an era when our understanding of the issues and appreciation of the complexities of this kind of tax were just beginning to develop. We recognize that the City's immediate fiscal needs sometimes require prompt legislative action, but they should not require the perpetuation of provisions that apply to a broad range of complex commercial transactions in an outmoded, haphazard, and often surprising manner.

In connection with the particular tax before us, we had been in the process of preparing several papers on various technical difficulties. The papers were not addressed to whether the tax was politically advisable as an overall matter of policy, but to the proper interpretation of the statute as enacted. In several cases, we had concluded that statutory clarification, either of the City's ordinance or of the underlying state enabling act, might well be advisable to make the statute more understandable, fairer, and, hence, more effective. We wish to submit two of those memoranda now for your consideration, and we may have one or two more we would like to have the opportunity to submit subsequently.

The reports we submit to you today cover two aspects of the tax: (1) the rules respecting the kinds of transfers that are added together in determining whether a 50% controlling interest has been transferred, and (2) the appropriate application of the tax in the context of related entities. With respect to the 50% aggregation rule, we recommend that transactions involving less than 50% of the economic interest in an entity be aggregated only if they are part of a plan to convey 50% or more, and that for certain small transactions, the parties be exempted from reporting requirements. For example, persons buying and selling a relatively small quantity of publicly traded stock in a routine manner should not be required to obtain appraisals of the corporation's interests in City property or file information returns with respect to the purchase and sale unless there is reason to believe that the acquisition may be part of an attempt to transfer control (e.g., as the result of a tender offer for 50% or more of the stock). With respect to transfers involving related entities, we recommend that the new tax be applied by looking to the substance of a transaction rather than its form. Specifically, we recommend (1) that no tax be imposed on a transfer of stock or partnership interest that constitutes a change in the form of ownership, to the extent there is no change in beneficial ownership, and (2) that a major loophole, which allows controlling interests in entities which own real property indirectly through intermediate entities to be sold without tax, be closed. All of these changes would serve the purposes of making the tax more

rational, easier to administer and, ultimately, more effective.

We recognize that it might be difficult to take our comments into account prior to this afternoon's City Council meeting -- which, of course, is one more reason why we urge more time between notice and enactment. We also recognize that since we had expected to submit these papers to the administrative agencies, most of our comments may properly be addressed administratively. However, some of the comments do seem to require legislative responses, and we suggest that they be considered at another City Council meeting in the near future -- preferably within the next six months -- and, to the extent bona fide problems have been identified and not resolved administratively by then, appropriate action in this body or elsewhere be taken (including, if necessary, requesting the state legislature to make appropriate changes in the underlying enabling act). In summary, we wish to emphasize the need for better communication between Government and taxpayers, in a way that benefits both. We stand ready to do our part in making the system better. We request the opportunity to be of service.

Thank you for your time.