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May 25, 1995

Beth A. Kaswan, Esq.  
Deputy Commissioner for Legal Affairs  
New York City Department of Finance  
345 Adams Street  
Brooklyn, New York 11201

Re: Proposed Amendment to Rules Relating to the  
New York City Real Property Transfer Tax

Dear Ms. Kaswan:

This letter comments on the proposed amendment to the rules relating to the New York City Real Property Transfer Tax (the "NYC Transfer Tax"), which would amend paragraph (2) of the definition of "economic interest in real property" contained in Rule 23-02 of Title 19 of the Rules of the City of New York (Rules Relating to the Real Property Transfer Tax) (the "Rules"). For the reasons stated below, we support the adoption of the proposed amendment, with some minor modifications.

### Background

The proposed amendment modifies the definition of an "economic interest in real property" contained in the Rules. The Commissioner of Finance's statement regarding the basis and purpose of the proposed amendment includes the following, fairly complete description of the nature of the proposed amendment:

"The definition [of economic interest in real property] has been modified to provide that the ownership of a beneficial interest in a corporation, partnership, trust or other unincorporated

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entity owning an economic interest in real property located in New York City will be treated as an economic interest in New York City real property in all events. This amendment is necessitated by the amendment of section 11-2106 of the Administrative Code of the City of New York by section 308 of Ch. 170 of the Laws of New York 1994 to add a new paragraph 8 to subdivision b thereof providing for an exemption from the tax for transfers that effect a mere change of identity or form of ownership or organization to the extent the beneficial ownership of the real property remains the same. That amendment was effective for transfers occurring on or after June 9, 1994.

"Under the current rules, the transfer of a controlling economic interest in an entity owning New York City real property is taxable, whereas a transfer of a controlling interest in an operating entity that owns an economic interest in an entity owning New York City real property generally is not considered a transfer of an economic interest in real property. The rules under the New York State Real Property Transfer Tax and Real Property Transfer Gains Tax do not contain a similar limitation. With the enactment of the mere change exemption, an operating entity owning real property in New York City could transfer that property tax free to a wholly owned entity and, thereby avoid the transfer tax on the transfer of a controlling economic interest in the operating entity. The purpose of the proposed amendment is to eliminate this opportunity for tax avoidance by bringing the New York City rules

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into conformity with the comparable rules under the New York State Real Property Transfer Tax and Real Property Transfer Gains Tax."

#### Comments

The Tax Section supports this amendment to the regulations, and particularly supports this conforming of the treatment of transfers of an economic interest in real property under the NYC Transfer Tax to the treatment of the same transactions under the State Transfer Tax and the State Gains Tax.

This issue was discussed by the Tax Section in a report by the Committee on Income from Real Property, dated November 20, 1986, entitled "Application of the New York City Real Property Transfer Tax to Transfers of Economic Interests in Real Property in the Context of Related Entities." This report stated that in order to avoid the emasculation of the so-called "Pan Am" amendments to the statute, it was necessary to look through tiers of entities and either treat an upper-tier entity as the indirect owner of the real property held by its subsidiary, or treat the shareholders or partners of the upper-tier entity as transferring indirectly the economic interests in the lower-tier entity that owns the real property. The 1986 report noted that the requisite statutory language necessary for such an interpretation did not specifically appear in the NYC Transfer Tax statute. Nevertheless, the report recommended the adoption of a regulation substantially the same as the amendment now proposed.

We continue to believe that the definition of "transfer" in the NYC Transfer Tax statute is broad enough to support a regulation that treats the transfer of the upper-tier entity as effecting an indirect transfer of the lower-tier entity.<sup>1</sup> We also believe

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<sup>1</sup> Code §11-2101 defines "transfer" or "transferred" as follows: "[w]hen used in relation to an economic interest in real property, the terms "transfer" or "transferred" shall include the transfer or transfers or issuance of shares of stock in a corporation, interest or interests constitute a controlling interest  
(continued...)

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that any doubt as to this conclusion should be eliminated by the 1994 amendment to the NYC Transfer Tax. That amendment introduced a change-in-form exemption to the statute (Code §11-2106), which both (i) made this interpretative change necessary to the rational application of the tax, and (ii) provided a clear basis for applying concepts of beneficial, rather than formal, ownership in interpreting the statute. The proposed regulation gives effect to the substance of the transaction, and eliminates the tax avoidance otherwise possible given the enactment of the mere change exemption. As outlined in our prior report, the amendment is consistent with the original legislative intent to close loopholes in the taxation of transfers of real property by elevating substance over form.

We note that the amendment is proposed to apply to transfers effected on or after the date the proposed regulation was promulgated. We believe, however, that since the proposal represents a clear change in the Commissioner's interpretation of the law, taxpayers who entered into binding contracts to transfer controlling interests prior to the promulgation of the proposed regulation should be entitled to continue to rely on the interpretation set forth in the existing regulation.

We also believe that Illustration (ii) in the proposed rule should be clarified to include the reasons why the described transaction is exempt from tax. We recommend that Illustration (ii) state that the transfer of 100 percent of the stock of a corporation that owns 49 percent of the stock of another corporation (the "second tier corporation") is not subject to tax because there is not a transfer of a controlling interest in the second tier corporation. It also would be helpful to include illustrations of transfers of less than 100% interests in entities that, in turn, own less than 100% of the lower-tier entity. For example, if X corporation owns 80% of the stock of Y corporation (which owns real property), we assume that a transfer of 80% of the stock of X should be subject to tax ( $80\% \times 80\% = 64\%$ ), but that a transfer

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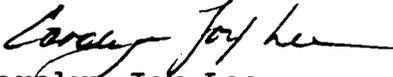
<sup>1</sup>(...continued)  
in such corporation, partnership, association, trust or other entity.

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of 60% of X would not give rise to tax (60% x 80% = 48%).

Please do not hesitate to call me if we can be of any further assistance to you.

Very truly yours,

  
Carolyn Joy Lee  
Chair