

Common Agreement dated April 9, 2007 governing their respective rights and obligations as owners of the Property (TIC Agreement). The TIC Agreement is not included in the Record, which is silent as to the terms of the TIC Agreement.

Petitioner and SLG as lessors also entered into a ground lease for the Property dated as of April 9, 2007 with Sitt 2 Herald LLC as lessee (Ground Lease).²

The events relevant to the case before this Tribunal occurred in December 2010 as follows:

On December 14, 2010, 2 Herald Owner LLC, (Herald), a Delaware LLC was formed.

On December 22, 2010 Petitioner and SLG took the following actions:

1. **TIC Contribution Agreement.** Petitioner and SLG entered into a TIC Contribution Agreement under which Petitioner and SLG agreed to contribute their respective undivided interests as tenant in common in the Property as well as their interests under the Ground Lease to Herald in exchange for membership interests in Herald.

The TIC Contribution Agreement contains a number of provisions describing Petitioner's rights and obligations in connection with the contribution of its tenant-in-common interest in the Property and its interest in the Ground Lease to Herald that have no counterpart with regard to SLG's contribution to Herald:

- i. Petitioner was released from all obligations under a \$191,250,000 mortgage loan (Mortgage Loan) secured by Herald's interest in the Property. SLG received no such release.
- ii. Petitioner was entitled to a return of a letter of credit and all other collateral related to the Mortgage Loan. By contrast, SLG was obligated to deliver a replacement letter of credit to the holder of the Mortgage Loan.
- iii. Petitioner made various representations relating to its title to its tenant-in-common interest in the Property that SLG did not make.

² The actions in April 2007 were part of a structure intended to qualify a series of transactions involving GKK, SLG and a number of other entities as like kind exchanges exempt from federal income tax. Those transactions and the federal tax treatment of them are not relevant to the issues before this Tribunal.

- iv. Petitioner agreed to pay “any and all” New York State Real Estate Transfer Tax (State RETT) and all RPTT due in connection with the transactions. Gramercy Capital Corp., Petitioner’s parent entity, joined in the execution of the TIC Contribution Agreement solely in connection with certain representations and warranties and to indemnify SLG and Herald against any New York State (State) and New York City (City) transfer taxes payable in connection with the transactions contemplated by the TIC Contribution Agreement.
- v. SLG had the right to terminate the TIC Contribution Agreement under certain circumstances in the event of a condemnation of the Property. Petitioner had no such right.
- vi. SLG’s obligation to close was conditioned on a title insurance policy being issued insuring Herald’s interest in the Property. Petitioner’s obligation to close included no comparable condition.

2. **Herald LLC Agreement.** Also on December 22, 2010, Petitioner and SLG executed the Limited Liability Agreement of Herald (Herald LLC Agreement).

The TIC Contribution Agreement provided that Petitioner and SLG intended to form Herald and would enter into a LLC agreement under which Petitioner would have a 45% membership interest and SLG would have a 55% membership interest in Herald. However, the Herald LLC Agreement does not specify the interests of Petitioner and SLG in Herald. The Herald LLC Agreement merely provides in Section 3.4.1 that the available cash flow of Herald “shall be distributed by [Herald] from time to time as the Members shall jointly determine in their sole discretion” and in Section 3.5 that “[Herald’s] profits and losses shall be allocated jointly to the Members.” There are no other provisions in the Herald LLC Agreement regarding the interests of Petitioner and SLG in Herald.

3. **Deeds.** Petitioner and SLG each executed a Bargain and Sale Deed Without Covenants conveying its respective undivided interest in the Property to Herald.

4. **Mortgage Loan Assumption.** Herald assumed the Mortgage Loan under a separate assumption agreement.

5. **Purchase Agreement.** Also on December 22, 2010, Petitioner and SLG entered into a Membership Interest Purchase Agreement (Purchase Agreement) under which Petitioner agreed to sell, and SLG agreed to purchase, Petitioner's membership interest in Herald.

The recitals in the Purchase Agreement read as follows:

“WHEREAS, [Petitioner] and [SLG] intend to form a Delaware limited liability company having the name [Herald]. . . and, immediately thereafter, enter into a limited liability company agreement of [Herald] in form satisfactory to [Petitioner] and [SLG] (the “**Operating Agreement**”);

“WHEREAS, the Operating Agreement will provide that [Petitioner] shall hold a 45% membership interest in [Herald] (the “**GKK Membership Interest**”), and [SLG] shall hold a 55% membership interest in [Herald];

“WHEREAS, immediately following the formation of [Herald] and the execution and delivery of the Operating Agreement, [Herald] intends to acquire the Land [as defined in the Purchase Agreement]; and

“WHEREAS, subject to the terms hereof, [Petitioner] desires to sell the GKK Membership Interest and [SLG] desires to purchase the GKK Membership Interest in accordance with the terms hereof.”

The Purchase Agreement provides for a purchase price of \$25,312,500.

Petitioner and SLG timely filed three RPTT Returns, two reporting the contributions of their respective tenant-in-common interests to Herald (TIC Contribution Returns) and one reporting the sale of Petitioner's membership interest in Herald to SLG (Membership Interest Return). Each return reported the transfers as occurring on December 22, 2010. SLG signed its TIC Contribution Return on December 21, 2010. Petitioner signed its TIC Contribution Return on December 22, 2010. The Membership Interest Return was signed by SLG on December 21, 2010 and by Petitioner on December 22, 2010. Each of the TIC Contribution Returns reported no RPTT due claiming an exemption under condition g “[t]ransfer wholly or partly exempt as a mere change of identity or form of ownership.” The amount of consideration reported on the Membership Interest Return was the amount of the purchase price to be paid by SLG for

Petitioner's interest in Herald under the Purchase Agreement. The Membership Interest Return reported no RPTT due claiming that the transfer was of a 45% interest in a LLC.

The Department audited the transactions (Audit). As a result of the Audit, the Department issued the Notice asserting RPTT due of \$2,923,593.75 plus interest of \$469,033.37 for a total amount due as of January 3, 2013 of \$3,392,627.12.³ The amount of RPTT asserted was based on including the \$25,312,500 in cash and 45% of the principal amount of the Mortgage Loan in the taxable consideration. The Explanation of Adjustments section of the Notice asserts that "The exemption asserted for a mere change is being adjusted to the extent that the beneficial interest of [sic] the real property or economic interest therein has not remained the same per [Administrative Code of the City of New York] Section 11-2106(b)(8)." A copy of a brochure included in the Department's Audit File entitled "An Explanation of the Audit Process" and identifying GKK as the "Taxpayer" (Audit Brochure) describes the issues to be addressed in the audit as "Valuation of Consideration – Controlling Economic Interest – Change in Beneficial Ownership."

Petitioner asserts that the contribution of Petitioner's tenant-in-common interest in the Property to Herald in exchange for a membership interest in Herald and the sale of that membership interest to SLG are separate, nontaxable transactions and that Respondent cannot apply the step transaction doctrine to treat them as part of a single transaction subject to RPTT. (Petitioner's Brief in Support of its Exception [Petitioner's Br] at 1.) Petitioner further asserts that the ALJ erroneously raised a new factual issue not raised by the Parties, whether the contribution by Petitioner of its tenant-in-common interest in the Property to Herald resulted in a change of beneficial ownership in the Property, and based her decision in part on that issue. (*Id* at 3, 7.)

Respondent asserts that the events that took place on December 22, 2010 were steps in a single transaction whereby Petitioner sold its 45% tenant-in-common interest in

³ A copy of a Notice of Determination to SLG in connection with the transaction is included in the Department's Audit File. As the copy of that notice in the Record is undated and is not mentioned in the Stipulation, it is unclear whether the Department ever issued that notice to SLG. However it is clear from the Record that SLG was contacted in connection with the Audit.

the Property to SLG.⁴ Respondent further asserts that the transaction was not exempt from RPTT either as a mere change in form of ownership or as a transfer of a non-controlling economic interest. Respondent's Brief in Opposition to Petitioner's Exception [Respondent's Br] at 1-2.)

The ALJ concluded that the step transaction doctrine applies to treat the transactions occurring on December 22, 2010 as steps in a single transaction not exempt from RPTT either as a mere change of form of ownership or as a transfer of a non-controlling economic interest in property and sustained the Notice.⁵

For the following reasons, we conclude that the events of December 22, 2010 represent a single, integrated transaction whereby Petitioner conveyed its tenant-in-common interest in the Property to Herald in a taxable transaction in exchange for cash and relief from liability under the Mortgage Loan and, therefore, affirm the ALJ Determination and sustain the Notice.

Administrative Code §11-2102.a imposes the RPTT on "each deed . . . by a grantor to a grantee" where the consideration exceeds \$25,000. Administrative Code §11-2102.b(1) also imposes the RPTT on "each instrument or transaction . . . whereby any economic interest in real property is transferred by a grantor to a grantee" where the consideration exceeds \$25,000. For purposes of the RPTT, a "Deed" is defined as any "document or writing . . . whereby any real property or interest therein is created, vested, granted, bargained, sold, transferred assigned or otherwise conveyed. . . ." (Administrative Code §11-2101.2.) An "Economic interest in real property" includes an interest "in a partnership . . . which owns real property" in the City. (Administrative Code §11-2101.6.) "Controlling interest" includes 50% "or more of the capital, profits or beneficial interest in" a "partnership, association, trust or other entity." (Administrative Code §11-2101.8.) Finally, "Transfer" is defined in connection with an economic interest in real property as including "the transfer or transfers . . . of . . . interest or

⁴ Although in its brief Respondent asserts that the transaction constituted a taxable sale by Petitioner of its 45% interest in the Property to SLG, it is clear that the Department raised the issue as to whether the mere change exemption applied to Petitioner's transfer to Herald (the only transaction in this case to which that exemption might have applied.) See discussion at 11-12, *infra*.

⁵ ALJ Determination at 24.

interests in a partnership . . . whether made by one or several persons, or in one or several related transactions, which . . . interest or interests constitute a controlling interest in such . . . partnership. . . .” (Administrative Code §11-2101.7.)

Thus, the RPTT applies to a deed of *any* interest in real property in the City but it applies to a transfer of an economic interest in an entity that owns real property in the City *only* if the economic interest represents a controlling (i.e., 50% or more) interest in the entity.

Administrative Code §11-2106 lists a number of persons and transactions that are “exempt from the payment of the” RPTT, including at paragraph b(8):

“A deed, instrument or transaction conveying or transferring real property or an economic interest therein that effects a mere change of identity or form of ownership or organization to the extent the beneficial ownership of such real property or economic interest remains the same.”

The exemption provided by Administrative Code §11-2106.b(8) is commonly referred to as the “mere change exemption.” The Real Property Transfer Tax Rules of the City of New York (RPTT Rules) provide at 19 RCNY §23-05(b)(8)(iv) that:

“[f]or purposes of determining whether and to what extent the mere change of identity or form of ownership or organization exemption applies, the determination of the beneficial ownership of the real property or economic interest therein prior to a transaction and the extent to which the beneficial interest therein remains the same following the transaction will be based on the facts and circumstances.”

We first address Petitioner’s assertion that the ALJ erred by raising the factual question of whether Petitioner’s contribution of its tenant-in-common interest to Herald qualified for the mere change exemption because that issue “was not raised by the Department at any time prior to the ALJ’s Determination.” (Petitioner’s Br at 7.) We note that the Explanation of Adjustments section of the Notice clearly stated that the Department was asserting the RPTT because the “beneficial interest of [sic] the real property or economic interest therein has not remained the same. . . .” Even before the

Notice was issued to Petitioner, the Audit Brochure described the issues to be examined as “Valuation of Consideration – Controlling Economic Interest – *Change in Beneficial Ownership*” (emphasis added). Finally we note that in its Petition filed with the Tribunal Administrative Law Judge Division protesting the Notice, Petitioner claimed that its contribution of its tenant-in-common interest in the Property to Herald was exempt from RPTT under the mere change exemption.

The Audit Brochure and the Notice made it clear that the Department was denying Petitioner the benefit of the mere change exemption in connection with Petitioner’s contribution of its tenant-in-common interest to Herald and Petitioner clearly was aware of the Department’s position when it filed its Petition.⁶ Thus Petitioner cannot now claim surprise that the ALJ examined the factual question of whether Petitioner was entitled to the mere change exemption.

Petitioner bears the burden of establishing its entitlement to the benefits of the mere change exemption. It is established law in the State that while generally taxing statutes are construed in favor of the taxpayer,

“if a statute or regulation authorizing an exemption is found, it will be ‘construed against the taxpayer’. . . [citations omitted]. This is because an exemption is not a matter of right, but is allowed only as a matter of legislative grace.”⁷

The ALJ invoked the step transaction doctrine in sustaining the Notice concluding that the contribution of Petitioner’s tenant-in-common interest in the Property and Petitioner’s sale of its interest in Herald to SLG on December 22, 2010 were steps in a single transaction not exempt from RPTT either as a mere change of form of ownership or as a transfer of a non-controlling economic interest in property.

Petitioner asserts that the step transaction doctrine does not apply to the transactions at issue in this case, first, because Respondent, in promulgating the RPTT Rules, intended to preclude the use of the step transaction doctrine in applying the mere

⁶ We do not view as significant Respondent’s characterization of the conveyance as a sale of Petitioner’s tenant-in-common interest to SLG rather than to Herald. See n 4, *supra* and the discussion at 11-12, *infra*.

⁷ *Matter of Grace v NY State Tax Commn*, 37 NY2d 193, 196 (1975).

change exemption, and second, because the requirements of the step transaction doctrine are not met.

When the RPTT Rules were published in proposed form, they contained a provision that if a transaction purporting to qualify for the mere change exemption is preceded or followed by one or more transactions all part of a single plan, all of the transactions pursuant to the plan would be taken into account in determining the extent to which the mere change exemption would apply. That provision was not included in the final RPTT Rules. Petitioner argues that the removal of the provision from the final RPTT Rules evidenced Respondent's intent not to apply the step transaction doctrine in interpreting the mere change exemption. However, Petitioner has not offered any evidence of any such intent. Petitioner also fails to note that in place of that provision, the final RPTT Rules contain the provision quoted above that, in applying the mere change exemption, "the determination of the beneficial ownership of the real property or economic interest therein prior to a transaction and the extent to which the beneficial interest therein remains the same following the transaction *will be based on the facts and circumstances.*" (Emphasis added.) (19 RCNY §23-05[b][8][iv].) That provision in the final RPTT Rules is clearly broad enough to include the application of the step transaction doctrine in examining the facts and circumstances of a transaction to determine the extent to which the mere change exemption applies, if at all.⁸ We further conclude that because the question of whether, and to what extent, a grantor retains a beneficial interest in real property is a factual question, it is appropriate for a court to apply the step transaction doctrine even in the absence of any rule or regulation authorizing it to do so.

⁸ The provision of the final RPTT Rules applying a "facts and circumstances" analysis in determining the extent to which the beneficial ownership of real property remains the same following the transaction arguably represents an independent basis for concluding that Petitioner's conveyance of its tenant-in-common interest was not eligible for the mere change exemption. It is clear from the recitals in the documents and the simultaneous occurrence of the various steps involved that neither SLG nor Petitioner had any intention or expectation that Petitioner would retain a beneficial ownership in the Property following the actions of December 22, 2010 and, thus, we could end our inquiry there. Nevertheless, we agree with the ALJ that under the step transaction doctrine, there is no basis to assign independent economic significance to any of the various steps in the single transaction, which constituted a taxable sale of Petitioner's tenant-in-common interest in the Property.

Petitioner further argues that the step transaction doctrine does not apply in this case because the requirements of that doctrine are not met. We disagree and find that under the facts and circumstances of the various events of December 22, 2010, it is clear that the actions on that date were wholly interrelated components of a single transaction whereby Petitioner conveyed its tenant-in-common interest in the Property to Herald in exchange for cash and relief from liability under the Mortgage Loan. All of the essential documents were executed on the same day, December 22, 2010.⁹ At the beginning of that day, Petitioner held a 45% tenant-in-common interest in the Property. At the end of that day, Petitioner had no interest in the Property either directly or through an interest in Herald. Instead, Petitioner had received \$25,312,500 in cash,¹⁰ had been relieved of any liability for the Mortgage Loan and had received the return of a letter of credit provided as collateral for the Mortgage Loan. The recitals in the Purchase Agreement make it clear that at the moment Herald was to be formed and Petitioner was contributing its tenant-in-common interest in the Property to Herald in exchange for a membership interest in Herald, Petitioner simultaneously was entering into a binding agreement to sell that same interest.

The step transaction doctrine is a widely recognized judicially-created concept applied in tax cases whereby a court, after reviewing the facts and circumstances surrounding a series of related actions or events, can determine that they should be treated as components of a single, integrated transaction and taxed accordingly. The United States Supreme Court has held:

“The incidence of taxation depends upon the substance of a transaction. The tax consequences which arise from gains from a sale of property are not finally to be determined solely by the means employed to transfer legal title. Rather, the transaction must be viewed as a whole, and each step, from

⁹ SLG signed its RPTT returns on December 21, 2010.

¹⁰ The Record is silent as to when the \$25,312,500 in cash was actually paid to Petitioner but the RPTT returns report the transaction as occurring on December 22, 2010.

the commencement of negotiations to the consummation of the sale, is relevant.”¹¹

Petitioner argues that the doctrine is almost exclusively limited to corporate income tax cases. Petitioner does not cite any authority limiting the doctrine to corporate income tax cases or precluding its use in transactions using partnerships or LLCs. We note that while the *Court Holding* case involved a transfer to a corporation, the property so transferred was real estate. Our conclusions are not dependent on the fact that the Property was transferred to a LLC and would be the same had Herald been a corporation.

The step transaction doctrine generally is viewed as involving two tests, although the doctrine will be applied if either test is satisfied.¹² The first test is referred to as the end result test: If it is evident that the various steps were undertaken to achieve a specific ultimate result, they will be taxed as a single transaction. The second test is called the interdependence test: Separate steps will be consolidated where it is clear that no single step would have been undertaken except as part of the whole transaction.

The ALJ concluded that the end result test was satisfied because the intended result was the sale by Petitioner of its tenant-in-common interest to SLG.¹³ Petitioner asserts that the ALJ erred in applying the step transaction doctrine because she recharacterized the steps and created a fictional transaction, a sale by Petitioner of its tenant-in-common interest to SLG. (Petitioner’s Br at 13.) We disagree with Petitioner’s assertion that the ALJ Determination depends on the creation of a fictitious sale by Petitioner of its tenant-in-common interest to SLG. The ALJ ultimately concluded that the step transaction doctrine applies to treat the series of events occurring on December 22, 2010 as a single transaction not exempt from RPTT either as a mere change of form

¹¹ *Commr. of Internal Revenue v Court Holding Co.*, 324 US 331, 334 (1945) (*Court Holding*). See also, *True v United States*, 190 F3d 1165 (10th Cir 1999) (*True*); *Kuper v Commr. of Internal Revenue*, 533 F.2d 152 (5th Cir 1976); *Crenshaw v United States*, 450 F2d 472 (5th Cir 1971); *King Enters., Inc. v United States*, 418 F2d 511 (Ct Cl 1969) (*King Enterprises*); *NovaCare, Inc. v United States*, 52 Fed Cl 165 (2002); *Matter of Waterman Inv. Co.*, 1997 WL 519543 (NY St Div of Tax Appeals DTA 813224). The doctrine is closely related to the substance-over-form doctrine under which transactions should be taxed according to the economic substance rather than the formalistic structure by which the transaction is effected.

¹² *King Enterprises* at 516. Other courts have identified three tests. *True, supra*, at 1174.

¹³ ALJ Determination at 20.

of ownership or as a transfer of a non-controlling economic interest in property.¹⁴ In any event this Tribunal is not bound by the ALJ's or Respondent's characterization of the transaction when all of the facts relevant to the application of the mere change exemption to this transaction are fully presented in the Record and the issue of the application of the mere change exemption was clearly raised by the Department during the Audit and in the Notice. *See also Matter of Small*, 1988 WL 188212 (NY St Div of Tax Appeals DTA 803077) ("The Tribunal has the authority to determine what issues are properly before it on exception and to take appropriate action to insure that a just decision is reached in all cases.")

Moreover, it is unnecessary to create fictional transactions to reach a conclusion that Petitioner's conveyance of its tenant-in-common interest in the Property did not qualify for the mere change exemption from RPTT. We conclude that the events occurring on December 22, 2010, all of which are provided for in the recitals to the documents, were interrelated steps in a single, taxable transaction whereby Petitioner sold its tenant-in-common interest in the Property to Herald in exchange for cash and relief from liabilities. In particular, the TIC Contribution Agreement contains several provisions that are more typical of a sale than of the formation of a joint venture of any kind. For example, Petitioner was released from all obligations under the Mortgage Loan and received back its collateral. SLG was not released and had to provide a replacement letter of credit. Petitioner made various representations relating to its title to its tenant-in-common interest in the Property that SLG did not make. The parties' rights to terminate the agreement were not fully reciprocal. SLG's obligation to close was conditioned on a title insurance policy being issued insuring Herald's interest in the Property. Petitioner's obligation to close included no comparable condition. Finally, Petitioner and its parent agreed to pay all State and City transfer taxes and to indemnify SLG and Herald against any such taxes.

The end result test is satisfied because after all of the steps were completed, Petitioner no longer held any interest in the Property directly or indirectly; had been

¹⁴ ALJ Determination at 24.

relieved of any liability under the Mortgage Loan; and either had received, or was entitled to receive, \$25,312,500 in cash.

The interdependence test is the easier to apply in this case because the recitals in the TIC Contribution Agreement, the Herald LLC Agreement and the Purchase Agreement describe each of the interrelated steps. The Supreme Court has ruled that under the step transaction doctrine “interrelated yet formally distinct steps in an integrated transaction may not be considered independently of the overall transaction.” (*Commr. of Internal Revenue v Clark*, 489 US 726, 738 [1989].) The interdependence test examines the steps to determine whether any of the steps would have been undertaken except as part of the whole. It is clear from the Record that this test is satisfied. All of the steps were completed within as little as one day.¹⁵ The recitals to the documents describe each of the steps in a “WHEREAS” clause. Nothing in the Record suggests that any of the steps would have been taken independent of the others.

Petitioner does not argue that the steps were not related, only that they each had “substance and independent significance.” (Petitioner’s Br at 18.) For the mere change exemption to apply to the actions taken on December 22, 2010, the pivotal step, the receipt by Petitioner of an interest in Herald, would have to withstand scrutiny as a transaction having substance and independent significance. However, Petitioner’s receipt of a transitory interest in Herald had the fewest indicia of substance or independent significance of any of the steps in the transaction. The Herald LLC Agreement did not identify the interests of Petitioner and SLG, merely that they would share profits, losses and cash flow “jointly” or as they would “jointly determine.” It is difficult to imagine that parties intending to form a lasting joint venture would fail to specify with any detail their respective interests in profits, losses or cash flow. That failure is logical only when viewed in conjunction with Petitioner’s entry into a binding contract to sell its interest in Herald simultaneously with its entry into the Herald LLC Agreement. To qualify for the mere change exemption, the one step in the entire series that had to have substance was

¹⁵ SLG signed its RPTT returns on December 21, 2010 while the various agreements were dated as of December 22, 2010. The Record is silent as to when the \$25,312,500 in cash was actually paid to Petitioner but the RPTT returns report the transaction as occurring on December 22, 2010.

the receipt by Petitioner of a beneficial interest in Herald in exchange for Petitioner's interest in the Property. That is the step that was the most ephemeral.

Petitioner asserts that the State courts have not sanctioned the use of the step transaction doctrine in RPTT cases or in cases under the State RETT or the former State Real Estate Transfer Gains Tax (Gains Tax). (Petitioner's Br at 12-13.) This Tribunal is authorized to issue decisions having precedential effect provided there is no contrary State precedent. (§170[d] of the New York City Charter.) The absence of State court precedent on the application of the step transaction doctrine to real estate transactions does not preclude either the State Tax Appeals Tribunal or this Tribunal from applying the doctrine in appropriate cases under the State transfer taxes or the RPTT. We note that the State Tax Appeals Tribunal has applied the step transaction doctrine under the former Gains Tax in *Matter of Waterman Inv. Co.*, 1997 WL 519543 (NY St Div of Tax Appeals DTA 813224).

Petitioner claims that the transactions at issue in the present case are comparable to Example C in the RPTT Rules governing the mere change exemption.¹⁶ In that example, two equal partners in a general partnership owning real property in the City convert the partnership "to a [LLC] through the filing of articles of organization under applicable state law." Following the conversion of the general partnership to a LLC, one partner sells a 49% interest to the other. The example concludes that the sale of the 49% interest is not taxable as a sale of a controlling economic interest in the LLC.

Example C in the RPTT Rules has no relevance to the transaction before us. In the example, the issue is whether there was any transfer resulting from the conversion of the partnership to a LLC that could be aggregated with the subsequent sale of a 49% interest in the LLC. The example expressly states that "the conversion will not be considered a transfer of real property or an economic interest in real property." Therefore, there was no transfer, exempt or otherwise, prior to the sale of the 49% interest that could be aggregated with it. Had the conversion constituted a transfer, even one qualifying under the mere change exemption, the subsequent sale of a 49% interest

¹⁶ 19 RCNY §23-05(b)(8)(ii) Example C.

might have been aggregated with that initial transaction and, therefore, taxable as a sale of a controlling economic interest in the entity.¹⁷

The present case is wholly distinguishable from Example C in the RPTT Rules. It is undisputed that the contributions by Petitioner and SLG of their undivided interests in the Property to Herald are conveyances by deed of interests in real property. The only issue is whether Petitioner's contribution is eligible for the mere change exemption. It is not a question of whether that contribution should be aggregated with the sale of Petitioner's interest in Herald to SLG to comprise a controlling economic interest transfer, but whether the facts and circumstances of that sale cause the initial contribution to be taxable.¹⁸

Finally Petitioner asserts that it has the legal right to structure its affairs to reduce or eliminate the amount of RPTT payable on a transaction. (Petitioner's Br at 3.) While this is true, as the Supreme Court stated in *Gregory v Helvering*, 293 US 465, 469 (1935):

“The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted. (Citations omitted.) But the question for determination is whether what was done, apart from the tax motive, was the thing which the statute intended.”

While taxpayers are able to structure their business transactions so as to minimize the tax due, that structure must have substance apart from the tax consequences.¹⁹ In the present case, the one step in the series of events on December 22, 2010 essential to the tax consequences sought by Petitioner had no substance; Petitioner's ownership of an interest

¹⁷ The RPTT Rules provide at 19 RCNY §23-05(b)(8)(ii) that, “the determination of whether a controlling economic interest has been transferred is made prior to the application of this exemption. Thus, the transfer of a controlling economic interest will be taxable to the extent the beneficial ownership does not remain the same, even though the portion of the interest subject to tax represents, . . . in the case of a partnership . . . less than 50 percent of the capital, profits, or beneficial interest in such partnership. . . .”

¹⁸ To the extent that the ALJ's statement “Respondent may not argue that Example C is inapplicable to this matter merely because a [tenant-in-common] interest is not the same [as] a partnership interest” is inconsistent with our conclusion on this point, we disagree with that statement.

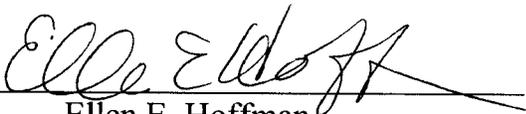
¹⁹ See *Court Holding*, 324 US 331, 334 (1945).

in Herald was too transient to be given effect so as to qualify Petitioner's contribution of its tenant-in-common interest in the Property to Herald for the mere change exemption.²⁰

For the above reasons, we conclude that the events occurring on December 22, 2010, all of which are provided for in the recitals to the documents, were interrelated steps in a single, taxable transaction whereby Petitioner conveyed its tenant-in-common interest in the Property to Herald in exchange for cash and relief from liabilities.

Therefore, the ALJ Determination is affirmed and the Notice sustained.²¹ Commissioner Frances J. Henn did not participate in this Decision.

Dated: July 15, 2016
New York, NY


Ellen E. Hoffman
President and Commissioner


Robert J. Firestone
Commissioner

²⁰ We note that an administrative law judge at the State Tax Appeals Tribunal (State ALJ) issued an opinion dated May 26, 2016 addressing the State RETT consequences of the transactions at issue in the case before us. (*Matter of GKK 2 Herald LLC*, 2016 WL 3131497 [NY St Div of Tax App DTA 826402] [State ALJ Determination].) Although determinations of State Tribunal administrative law judges have no precedential effect, because that determination involved the same transactions as are involved in the case before us, we feel it necessary to address that determination. (NY City Charter §170[d]; 20 NYCRR §3000.15[e][2].) We note that the issues addressed by the State ALJ differed from those before us. Most significantly, the Division of Taxation (Division) conceded that Petitioner's initial contribution of its tenant-in-common interest in the Property to Herald qualified for the mere change exemption under the State RETT. Thus, the State ALJ examined *only* the issue of whether SLG acquired a controlling economic interest in Herald and *not* whether the initial transfer by Petitioner qualified for the mere change exemption. The State ALJ concluded that in determining whether SLG had acquired a 100% controlling interest in Herald, the regulations under the State RETT do not authorize non-taxable transfers to be aggregated with taxable transfers. While not relevant to the case before us, the RPTT Rules expressly provide at 19 RCNY §23-05(b)(8)(ii) that the mere change exemption applies *after* a determination as to whether a controlling interest transfer has occurred. In any event, because the issue addressed by the State ALJ was whether SLG had acquired a 100% controlling economic interest in Herald and *not* whether the initial contribution by Petitioner was exempt to any degree, the State ALJ Determination has no relevance to the case before us.

²¹ We have considered all of the other arguments of the Parties and find them unpersuasive.