New York City Tax Appeals Tribunal

In the Matter of	:	
	:	DECISION
CORWOOD ENTERPRISES, INC., ET AL.	:	TAT (E) 00-39 (RP), ET AL.
Petitioners.	:	

Corwood Enterprises, Inc. ("Corwood"); Edgemont Enterprises, Inc. ("Edgemont"); Bosworth Enterprises, Inc. ("Bosworth"); Surrey Hill Enterprises, Inc. ("Surrey Hill"); and Milewood International, Inc. ("Milewood");[1] [collectively, "Petitioners"] filed an Exception to the Determination of an Administrative Law Judge ("ALJ") dated March 11, 2004. The ALJ's Determination denied the Petition filed by each of the Petitioners requesting a refund of New York City Real Property Transfer Tax ("RPTT") paid in connection with certain transfers of stock that occurred on March 12, 1999, described below, and sustained the Notices of Disallowance, dated August 1, 2000, issued by the New York City Department of Finance (the "Department") to each of the Petitioners.

Petitioners appeared by Herbert Teitelbaum, Esq. and David P. Kasakove, Esq. of Bryan Cave LLP and the Commissioner of Finance of the City of New York (the "Commissioner" or "Respondent") appeared by Robert F. Firestone, Esq, Senior Tax Counsel; and Martin Nussbaum, Esq., Assistant Corporation Counsel, New York City Law

[1]These matters have been designated, respectively, TAT(E) 00-39 (RP); TAT(E) 00-40 (RP); TAT(E) 00-41(RP); TAT(E) 00-42(RP); and TAT(E) 00-43(RP).

Department. Both parties filed briefs and/or letter briefs and oral argument was held by the Tribunal.

Corporate Structure [2]

Each Petitioner is an International Business Company ("IBC") incorporated in the British Virgin Islands ("BVI") in 1997 pursuant to the BVI International Business Companies Act. The registered office of each Petitioner was located in the BVI. Each Petitioner was listed on the BVI's register of IBCs as being in good legal standing and as having paid all fees, license fees, and penalties due and payable under the BVI International Business Companies Act.

Petitioners were the indirect owners, through two tiers of intervening entities, of Hotel 57 LLC ("LLC"), a limited liability company formed under the laws of the State of Delaware on June 11, 1996.[3] LLC had a registered office in Delaware and was in good

[2]For purposes of this decision, we have generally adopted all of the ALJ's Findings of Fact except as noted in footnote 5 of this decision. Only those findings germane to this decision have been restated above and, in some instances, those findings have been paraphrased. The remaining Findings of Fact of the ALJ can be found in the ALJ's Determination dated March 11, 2004. References to ownership status and activities are for all periods or dates pertinent to this Decision. Pursuant to a letter dated April 8, 2005 and the accompanying Amended Attachment to Notice of Exception, Petitioners took specific exception to four of the ALJ's Findings of Fact. Each of Petitioners' requested modifications to the ALJ's findings is addressed in this decision. *See* footnotes 3, 6, 7 and 8, *infra.*

[3]Petitioners take exception to the ALJ's Finding of Fact 2 to the extent that such finding stated that "Petitioners were the indirect owners, through two tiers of intervening entities, of Hotel 57 LLC ("LLC"), a limited liability company formed under the laws of the State of Delaware on June 11, 1996." Petitioners contend that this finding of the ALJ is not supported by the record and that it should be replaced by a finding setting forth the direct ownership interests of the five Delaware corporations in LLC. Petitioners also seek to amend the finding by adding the statement that LLC "was not Petitioners' agent." We decline to modify the ALJ's finding since Petitioners offer no support for their assertion that the ALJ's finding is not supported by the record. Furthermore, the ALJ's Findings of Fact clearly and concisely set forth the relationships of the various entities. Lastly, Petitioners' requested finding that LLC "was not Petitioners' agent" is clearly not supported by those paragraphs of the Parties' Stipulation of Facts cited by Petitioners.

standing and had a legal corporate existence under the laws of the State of Delaware, having filed its annual reports and having paid all applicable franchise taxes.

From August 1, 1996 to March 12, 1999, LLC owned the Four Seasons Hotel, including the underlying real property, located at 57 East 57th Street, New York, New York (the "Four Seasons"). LLC was engaged in no business other than in relation to its ownership of the Four Seasons.

Each Petitioner owned all of the stock of a BVI corporation (collectively the "Lower Tier BVI Subs") as follows: Corwood owned 100% of Kaywood Enterprises, Inc. ("Kaywood"); Edgemont owned 100% of Kilborn Trading Corp. ("Kilborn"); Bosworth owned 100% of Romney International Limited ("Romney"); Surrey Hill owned 100% of Expert Tips Limited ("Expert Tips"); and Milewood owned 100% of Brantwood Enterprises, Inc. ("Brantwood"). Each of the Lower Tier BVI Subs is also an IBC incorporated in the BVI pursuant to the BVI International Business Companies Act. The registered office of each of the Lower Tier BVI Subs was located in the BVI. Each of the Lower Tier BVI Subs was listed on the BVI's register of IBCs as being in good legal standing and as having paid all fees, license fees, and penalties due and payable under the BVI International Business Companies Act.

Each of the Lower Tier BVI Subs owned all of the stock of a Delaware corporation (collectively the "Delaware Subs") as follows: Kaywood owned 100% of Hotel 57 Corp. II, Inc. ("Hotel 57 Corp. II"); Kilborn owned 100% of Hotel 57 Corp. III, Inc. ("Hotel 57 Corp. III"); Romney owned 100% of Hotel 57 Corp. IV, Inc. ("Hotel 57 Corp. IV"); Expert Tips owned 100% of Hotel 57 Corp. V, Inc. ("Hotel 57 Corp. V"); and Brantwood owned 100% of Hotel 57 Corp. I, Inc. ("Hotel 57 Corp. I"). Each of the Delaware Subs was formed under the laws of the State of Delaware on June 11, 1996. Each of the Delaware Subs had a

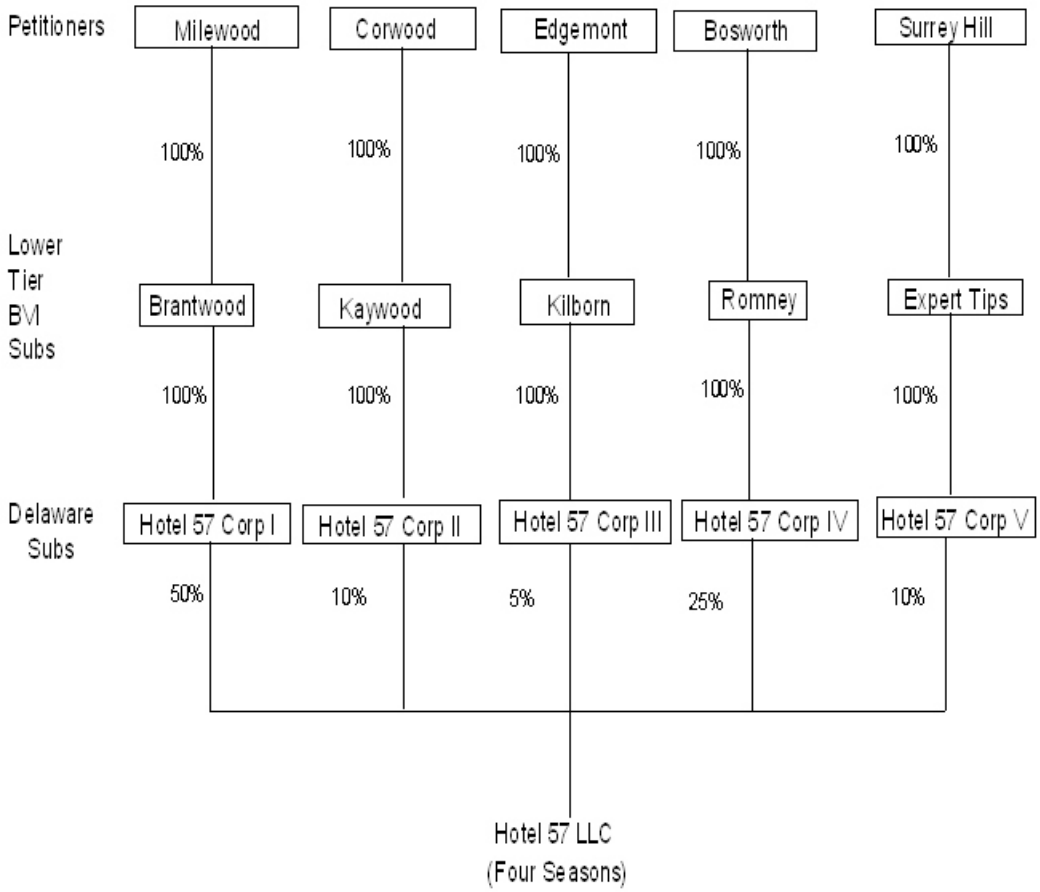
registered office in the State of Delaware and was in good standing and had a legal corporate existence under the laws of the State of Delaware, having filed its annual reports and having paid all applicable franchise taxes.

The Delaware Subs owned all of the interests in LLC. The Delaware Subs' ownership interests in LLC (which represented the value, vote and profits of LLC) were as follows:

Entity	Percent Ownership
Hotel 57 Corp. I	50
Hotel 57 Corp. II	10
Hotel 57 Corp. III	5
Hotel 57 Corp. IV	25
Hotel 57 Corp. V	10
Total	100%

LLC was treated for federal, state and local income tax purposes as a partnership, and annually filed federal Form 1065, U.S. Partnership Return of Income, Form IT-204, New York State Partnership Return, and Form NYC 204, Unincorporated Business Tax Return. Each Delaware Sub was treated as a partner in LLC for federal, state and local tax purposes in proportion to its respective percentage ownership interest in LLC.

The diagram below illustrates the corporate structure described above.



The Petitioners sold all of their shares in the Lower Tier BVI Subs (the "Transfers") for an aggregate of $275 million (the "Purchase Price") to 57 BB Property, L.L.C. ("Purchaser"), a Delaware limited liability company, pursuant to a Stock Sale and Purchase Agreement dated February 2, 1999 (the "Contract"). The closing of the Transfers took place on March 12, 1999 in Chicago, Illinois (the "Closing").

Operation of the Four Seasons

LLC purchased the Four Seasons pursuant to a purchase agreement dated June 18, 1996 ("Purchase Agreement") for $195 million.

LLC entered into a Second Amended and Restated Hotel Management Agreement, dated August 1, 1996, with Regent International Hotels, Inc. ("Regent") concerning the management of the Four Seasons (the "Hotel Management Agreement"). Regent managed the Four Seasons pursuant to this agreement. Milewood's director, Ambrose Cheung Wing Sum ("Mr. Cheung"), negotiated the Hotel Management Agreement with Regent. (Tr. 1[4] at 166.) Petitioners played no other role in the management of the Four Seasons.

None of the Petitioners engaged in any business other than in relation to its ownership of the stock of its Lower Tier BVI Sub, including, without limitation, taking all actions necessary to carry out the terms of the Transfers pursuant to the terms of the Contract.

[4]The transcript pagination for both the first and second day of the hearing began with page 1. Accordingly, transcript pages for the first day of the hearing are designated "Tr. 1" and transcript pages for the second day of the hearing are designated "Tr. 2".

Except for activities relating to the marketing of the Four Seasons and actions necessary to carry out the Transfers pursuant to the Contract that took place in New York City (the "City") as described below, each Petitioner conducted its only business, which was to hold the shares of its Lower Tier BVI Sub, in Hong Kong.[5] No Petitioner directly owned any real estate in the City. Apart from their respective indirect interests in LLC, no Petitioner ever held an ownership interest in any other kind of property or other business in the City. No Petitioner ever held a company meeting in the City.

None of the Petitioners ever filed an application for authority to do business in New York State (the "State") with the Department of State of New York.

None of Petitioners ever filed any income tax returns in the United States.

None of the Lower Tier BVI Subs engaged in any business other than in relationship to its ownership of its Delaware Sub, including, without limitation, taking all actions necessary, if any, to carry out the Transfers pursuant to the terms of the Contract.

None of the Delaware Subs engaged in any business other than in relation to its ownership interest in LLC, including, without limitation, taking all actions necessary, if any, to carry out the Transfers pursuant to the terms of the Contract.

All of the Petitioners, the Lower Tier BVI Subs and the Delaware Subs were single purpose entities in the above described corporate structure. This corporate structure was

[5]We have modified the ALJ's Finding of Fact 16 to include the fact that activities relating to the marketing of the Four Seasons as well those necessary to carry out, effectuate, and consummate all terms of the Transfers pursuant to the terms of the Contract took place in the City. The modification was necessary in order to accurately reflect the Record and in order for the ALJ's Finding of Fact 16 to be consistent with other Findings of Fact of the ALJ where these activities are considered to be part of the business of Petitioners. *See*, ALJ's Finding of Fact 15; *infra,* pp. 7-18 and; discussion, *infra*, pp. 41-43.

intended to confer tax benefits, to insulate the ultimate beneficial owners of the Four Seasons from liability and to make it possible for one Petitioner to dispose of its investment in the Four Seasons without disrupting the investments of the other Petitioners.

The Transfers

Vincent Kinson Ma ("Mr. Ma") was an officer of Corwood. During the period 1996 to 1999, Mr. Ma resided in Hong Kong. Mr. Ma executed the Contract on behalf of Corwood in Hong Kong.

Jane Chong ("Ms. Chong"), a Hong Kong resident, was an officer of Edgemont. Ms. Chong was also an officer of Kilburn, Edgemont's Lower Tier BVI Sub, and of Hotel 57 Corp. III, Kilburn's Delaware Sub. Ms. Chong executed the Contract on behalf of Edgemont in Hong Kong.

Pei Cheng Ming Michael a/k/a Michael C. Pei ("Mr. Pei") was secretary/treasurer of Bosworth. Mr. Pei was a resident of Hong Kong. Mr. Pei executed the Contract on behalf of Bosworth in Hong Kong.

James Pei Chun Tien ("Mr. Tien") was a Director and the President of Surrey Hill. Mr. Tien executed the Contract on behalf of Surrey Hill in Hong Kong.

Allan Yaf Wah Chung Li ("Mr. Li"), a Hong Kong resident, was Milewood's Assistant Secretary. Mr. Li was also an officer of Brantwood, Milewood's Lower Tier BVI Sub. Mr. Cheung, the director of Milewood, signed the Contract on behalf of

Milewood. Mr. Li testified at the hearing that he believed Mr. Cheung executed the Contract in Hong Kong.

Each Petitioner had one witness testify at the hearing: Mr. Ma for Corwood, Ms. Chong for Edgemont, Mr. Pei for Bosworth, Patrick Chow ("Mr. Chow"), a resident of Hong Kong, as vice-president of Surrey Hill for Surrey Hill, and Mr. Li for Milewood (collectively "Petitioners' Witnesses"). Each of Petitioners' Witnesses was an officer of his or her respective Petitioner and attended the Closing on behalf of that Petitioner. None of Petitioners' Witnesses was a director or shareholder of his or her respective Petitioner corporation. Each of Petitioners' Witnesses had a background in accounting, business, banking, and/or finance and was responsible for overseeing his or her respective Petitioner's investment in its Lower Tier BVI Sub. Each of Petitioners' Witnesses had a very limited knowledge of the Transfers. None of Petitioners' Witnesses purported to be knowledgeable about how the Transfers were marketed or provided a detailed explanation of what role the various "advisors" and "agents," discussed below, played in the Transfers.

The ALJ noted that as to certain of the factual matters that were most relevant to her factual conclusions, Petitioners, who have the burden of proof in this matter (*see*, New York City Charter §170.d), provided witnesses who lacked, or professed to lack, knowledge of the essential facts. According to the ALJ, this was particularly disconcerting with respect to Mr. Li, since the record indicates that Milewood, the Petitioner for which he served as an officer, owned an indirect 50% interest in the Four Seasons and was the dominant force in the decision-making regarding the Transfers.

Mr. Li testified that since "the hotel has international stature," Petitioners were advised to market the hotel internationally as this was the "proper way of selling this hotel

or selling our interest in the shares." Petitioners retained an agent, Morgan Stanley Dean Witter ("Morgan Stanley"), to assist in the marketing and to prepare a marketing brochure (the "Marketing Memorandum"). Petitioners sent the Marketing Memorandum to selected purchasers.[6] (Tr. 1 at 148.)

The first paragraph of the Marketing Memorandum states that it is based on:

> information provided by **Hotel 57 L.L.C. (together with its direct and indirect members and shareholders, the "Company" or "Hotel 57 L.L.C.")**, a Delaware limited liability company, the owner of the Four Seasons Hotel New York (the "Hotel"). It is being delivered on behalf of the Company by Morgan Stanley Dean Witter ("Morgan Stanley") upon receipt of a signed Confidentiality Agreement to a limited number of parties who may be interested in a transaction involving the Company and the Hotel. [Emphasis added.]

Page 00581 of the Marketing Memorandum states that:

> **Hotel 57 L.L.C.** . . . the owner of the Four Seasons Hotel New York, **has authorized Morgan Stanley to act as the Company's exclusive advisor and agent** in connection with the potential sale of the Company as described in this Memorandum. [Emphasis added.]

In a section entitled "Proposed Transaction," on page 00584 of the Marketing Memorandum, the proposed transaction is described as follows:

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[6]Petitioners also took exception to this Finding of Fact, ALJ's Finding of Fact 41, to the extent that it stated that "Petitioners retained an agent, Morgan Stanley, to assist in the marketing and to prepare a marketing brochure (the "Marketing Memorandum"). Petitioners sent the Marketing Memorandum to selected purchasers." This finding is clearly supported by the testimony of Mr. Li as referenced by the ALJ (Tr. 1 at 148). Petitioners have requested that Finding of Fact 41 be modified. The ALJ's Findings of Fact concerning the Marketing Memorandum accurately present the facts relevant to the Marketing Memorandum. Thus, we reject Petitioners' request to modify the ALJ's Findings of Fact as not supported by, and inconsistent with, the Record below.

> Morgan Stanley has been retained by **Hotel 57 L.L.C. as its exclusive financial advisor and agent** in the potential sale of the Company. The proposed transaction is to sell the stock of five off-shore entities incorporated in the British Virgin Islands that own individually the interests in five United States corporations that wholly own in the aggregate all of the membership interests in Hotel 57 L.L.C., the owner of the Hotel. See Section III - "Summary of the Ownership Structure".

The Marketing Memorandum is a thirty-three page marketing brochure. Most of the brochure consists of a detailed description and photographs of the Four Seasons including: rooms, meeting rooms and various amenities, extensive information about the financial condition of the hotel's operations, the Management Agreement and information about certain ground leases.

The Hong Kong office of Morgan Stanley prepared the Marketing Memorandum. However, all communications, inquiries and requests for information concerning the material in the Marketing Memorandum are directed to a Morgan Stanley address and telephone number in the City and to Morgan Stanley personnel at telephone numbers in the City. (Marketing Memorandum at 00577.) The Marketing Memorandum also states that a prospective purchaser wishing to proceed should submit a preliminary proposal to a Morgan Stanley address in the City. (Marketing Memorandum at 00581.) Mr. Li testified that Morgan Stanley initially attempted to market the deal but "I think they had no success, and thereafter [sic] a few months, we terminated the engagement." (Tr. 1 at 168-169.)

However, notwithstanding Mr. Li's testimony, Section 16.18 of the Contract states:

> . . . **Purchaser or its Affiliate dealt with Morgan Stanley Dean Witter with respect to entering into a confidentiality agreement for this transaction.** The parties agree that Purchaser is not responsible for any fees or commissions to Morgan Stanley Dean Witter. Sellers [defined as Petitioners herein] have retained PKF Consulting ["PKF"] and Polylinks International Ltd. ["Polylinks"] in connection with the transactions contemplated by the [Contract] . . . . [Emphasis added.]

The Closing Statement for the Transfers, dated March 12, 1999, in which the Petitioners are identified as the "Sellers," describes the "Sellers' Agent" as "PKF By: John Fox" and "Sellers' Advisors" as "Polylinks International Ltd. By: Margaret Lau, Daniel Yu, Beatrice Wen and Maureen Wong."

Polylinks was variously characterized by Petitioners' Witnesses as the "advisor," "broker," or "consultant" with respect to the Transfers. (Tr. 1 at 52, 102-103, Tr. 2 at 39-40.) Polylinks was compensated directly by the Petitioners for its services in marketing the Four Seasons and effectuating a sale of the shares of the Lower Tier BVI Subs.[7] (Tr. 1 at 55-56, 103, 136.)

[7]Petitioners took exception to the ALJ's Finding of Fact 50 to the extent that it stated that "Polylinks was compensated directly by the Petitioners for its services in marketing the Four Seasons and effectuating a sale of the shares of the Lower Tier BVI Subs." Petitioners want to replace this finding with the sentence that "Polylinks, with offices located exclusively in Hong Kong, served as an advisor/consultant to Petitioners, not as a real estate broker, and received a fee, not a commission, for services rendered with respect to the subject transactions." The ALJ's finding is supported by the testimony referenced on the transcript pages and such finding accurately reflects the combined testimony of the various witnesses whose testimony was not always consistent.

PKF was hired through Polylinks to assist with the marketing of the Four Seasons and to provide information to prospective purchasers.[8] (Tr. 1 at 52-55.) Ms. Chong explained that PKF was hired because "Polylinks was out of Hong Kong, and they couldn't possibly attend to all of the day-to-day or whatever, all of the myriad number of tasks that they needed to show the hotel." (Tr. 1 at 74.)

In a letter agreement, dated February 3, 1998, on the letterhead of PKF's San Francisco office to Daniel Yiu at Polylinks at a Hong Kong address (the "PKF Agreement"), the parties agreed that PKF would act as "confidential asset advisor" to LLC with respect to the Four Seasons. Mr. Yiu executed the PKF Agreement as "Polylinks International Limited on behalf of Hotel 57 LLC." Among the services PKF agreed to provide were:

> 1. Analyzing the Implications of Holding or Selling the Asset [the Four Seasons],
>
> 2. Assisting in Preparing the Property for Sale (if Appropriate),
>
> 3. Communicating that Decision to a Carefully Selected Market of Investors,
>
> 4. Monitoring the Sales/Bidding Process to Maximize the Value of the Asset, [and]

[8]Petitioners took exception to the ALJ's Finding of Fact 53 to the extent that such finding stated that "PKF was hired through Polylinks to assist with the marketing of the Four Seasons and to provide information to prospective purchasers." Petitioners request that this finding be replaced by the statement that "(a) PKF was retained by Hotel 57 L.L.C. not Petitioners; (b) PKF's principal offices were in San Francisco not New York City; and (c) PKF served as the 'confidential asset advisor' and did not act, and was not compensated, as a real estate agent or broker." Again, we decline to modify the ALJ's Findings of Fact as we find that her findings are reflective of the Record in this matter and especially the testimony referenced above.

5. Assisting in monitoring the due diligence exercises conducted by potential buyers.

The PKF Agreement provided that "[t]he Senior Vice President and Director of [PKF's] New York office, John Fox, will be assigned as the Four Seasons' on-site liaison with you and/or your designated representatives." PKF was to be compensated by a fixed fee for services rendered and not by a commission based on a sale.

The importance of having someone on site in the City to show the Four Seasons is illustrated by the following exchanges on cross examination of Mr. Li:

Q. (Mr. Nussbaum) Were you made aware of which particular prospective purchasers were visiting the hotel or inspecting the hotel?

A. (Mr. Li) I think any serious purchaser would look at the hotel and inspect the hotel.

Q. How would they get such permission to enter the premises?

A. They were qualified by the agents, because they came up with the price and the agents told us they were credible purchasers with the ability and capacity to buy these interests. (Tr. 1 at 170-171.)

. . .

Q. Did you help in any way facilitate or did you help facilitate any purchaser viewing the Four Seasons Hotel?

A. No, the agents do that.

Q. Did you provide the authorization to those agents? In other words, did you authorize the agent to act on your behalf to do that?

A. I am not sure whether I did personally.

Q. Did another officer or director of Milewood?

A. I am not sure. (Tr. 1 at 153-154.)

Ms. Chong, an officer of Edgemont, received marketing information from Polylinks and PKF. (Tr. 1 at 49.) She was also apprised by Polylinks and/or PKF that arrangements were made for prospective purchasers to be shown around the Four Seasons.

Ms. Chong was in the City on at least two occasions when she met with prospective purchasers. In one case she met the prospective purchaser at the office of Robinson Silverman Pearce Aronson & Berman ("Petitioners' Attorneys"). In the other case the location was at an airport hotel near J.F.K. Airport. (Tr. 1 at 50-51.)

Ms. Chong was also in the City for one day just prior to attending the Closing in Chicago, during which time an inventory of the Four Seasons was taken and certain closing adjustments were computed. She testified that she was in the City to receive the attorneys' advice and to give instructions as to how certain final adjustments such as inventory, receivables, taxes and other cut-off issues should be dealt with. (Tr. 1 at 45-46.)

In early 1999, Petitioners' Witnesses attended a meeting with Petitioners' Attorneys, at their offices in the City to discuss various issues relating to the Contract. The Purchaser was not present at that meeting. (Tr. 1 at 96, 123, 138.)

The parties stipulated that with respect to the Contract, Petitioners' Attorneys represented the Petitioners, and attorneys at the firms of Levenfeld Glassberg Tuchman & Goldstein and Kubasiak, Cremieux, Fylstra, Reizen & Rotunno, both located in Chicago, Illinois, represented the Purchaser. Negotiations concerning the terms of the Contract took place between parties' counsel by telephone and in one or more meetings in the City.

The Contract

The Contract is designated a "Stock Sale and Purchase Agreement" and provides for the sale by Petitioners of the shares in the Lower Tier BVI Subs. (Contract, section 2.1.) Petitioners are designated "Sellers." (Contract, opening paragraph.) The five Lower Tier BVI Subs, the shares of which constitute the property being sold, are defined as "Seller BVI Companies." (Contract, section 1.81.) The five Delaware Subs are defined as "Seller US Companies." (Contract, section 1.88.) LLC is defined as "Owner." (Contract, section 1.51.)

Article IV of the Contract states that:

> The parties hereto acknowledge and agree that although this transaction is a stock purchase, they wish the adjustments to the Cash Balance [the portion of the purchase price to be paid at the Closing] to be made as if the transaction were an acquisition of the Property [the Four Seasons, personal property, accounts receivable, etc.]

For example, real estate taxes were required to be prorated as if the real property, rather than the shares of the Lower Tier BVI Subs, had been sold. (Contract, section 4.1.)

In addition, Article V of the Contract, dealing with title and permitted exceptions, provides that Petitioners are required to provide Purchaser with good title to the real property.

> a. It is a condition to Purchaser's obligation to purchase the [shares of the BVI Subs] that on the Closing date the Title Insurer (or Title Insurers) would be prepared to issue to [LLC] a [title insurance policy] . . . (Contract, section 5.1);
>
> b. [Petitioners] shall discharge, or cause [LLC] to discharge, all Voluntary Title Exceptions on or prior to the Closing . . . (Contract, section 5.5); and
>
> c. [Petitioners] shall use a portion of the [sale proceeds] to [discharge any title exceptions] (Contract, section 5.3).

Various portions of the Contract provide that Petitioners were responsible for how the Four Seasons was managed up to the Closing. In numerous places, the Contract provides that the Petitioners are required to "cause Owner" [LLC] to take certain actions required by the Contract relating to the operation of the Four Seasons during the period up to and including the time of the Closing.

The Contract, by its terms, is governed by the substantive laws of New York State. (Contract, section 16.1(a).)

Contract, Section 16.1(b) provides that:

> [Petitioners] and Purchasers . . . irrevocably consent and submit to the jurisdiction of any Federal, state, county or municipal court sitting in the State of New York with respect to any action or proceeding brought therein by any party

> concerning any matters arising out of or in any way relating to [the Contract].

The Contract provides that each Seller shall pay "Transfer Taxes" and that each Seller shall "pay, indemnify, defend and save harmless Purchaser for the damages arising from Seller's failure to pay its Allocable Share of any Transfer Taxes . . . ." (Contract, Section 11.1(a) and (c)).[9]

Contract, Section 2.2(d) provides that the "Closing Location" is either "(i) the Sellers' counsel's offices in New York City or (ii) the offices of Purchaser's counsel in New York City." However, the Closing actually took place in Chicago.

Tax Payments and Refund Claims

In connection with the Transfers a portion of the consideration was apportioned to the real property as follows:

Petitioner	**Total Consideration**	**Amount Apportioned to Real Property**
Corwood	$ 27,500,000	$ 23,607,809.80
Edgemont	13,750,000	11,803,904.90
Bosworth	68,750,000	59,019,524.50
Surrey Hill	27,500,000	23,607,809.50
Milewood	137,500,000	118,039,049.00
Total	$275,000,000	$236,078,048.70

[9]We have added this finding of fact in order to more accurately reflect the Record.

Petitioners paid the RPTT, including applicable filing fees, on March 12, 1999, as follows:

Corwood	$ 619,730.00
Edgemont	309,877.50
Bosworth	1,548,287.51
Surrey Hill	619,730.00
Milewood	3,098,550.30
Total	$6,196,175.31

Under cover letters dated March 8, 2000, each Petitioner filed a claim for refund of the RPTT paid with respect to the Closing, plus interest. By Notices of Disallowance, dated August 1, 2000, the Department denied each Petitioner's refund claim. On October 26, 2000, each Petitioner timely filed a Petition seeking a refund of the RPTT that it had paid.

ALJ's Conclusions of Law

In denying Petitioners' refund claims, the ALJ made the following conclusions of law in her Determination:

1) The RPTT enabling legislation does not preclude the imposition of the RPTT on a transfer that closed outside the City since the provision in question merely limits the imposition of the tax to transfers where the property that is the subject of the transfer is located in the City.

2) The imposition of the RPTT on the Transfers does not violate Article XVI, section 3, of the New York State Constitution because the RPTT is not imposed on the presence in the City of the stock certificates and the RPTT is not an *ad valorem* tax.

3) The imposition of the RPTT on the Transfers does not violate the Due Process Clause of the United States Constitution because (1) the values subject to tax are attributable to the benefits given by the City and (2) Petitioners, through their officers and agents, had the minimum connections with the City necessary for *in personam* jurisdiction.

4) The imposition of the RPTT on the Transfers does not violate the Commerce Clause of the United States Constitution because Petitioners, through their officers and agents, had substantial nexus with the City.

Arguments on Exception

On appeal, Petitioners argue that the enabling legislation that authorizes the City to tax transfers of economic interests in real property expressly limits the taxing power to the transfer of economic interests within the City itself. Tax Law §1220 provides that "[a]ny tax imposed under the authority of this article shall apply only within the territorial limits of the city . . . imposing the tax." According to Petitioners, this limitation leads to the conclusion that the City does not have the power to tax Petitioners' transfer of their shares in the Lower Tier BVI Subs to Purchaser (a Delaware limited liability company) since the Closing occurred in Chicago, Illinois.

Petitioners also contend that the imposition of the RPTT on the transfer of stock of a foreign corporation by a foreign corporation is prohibited under Article XVI, Section 3,

of the New York State Constitution, which provides, in relevant part, "Moneys, credits, securities and other intangible personal property within the state not employed in carrying on any business therein by the owner shall be deemed to be located at the domicile of the owner for purposes of taxation . . . ."

In addition, Petitioners argue that the Transfers are not subject to the RPTT because they did not constitute transfers of economic interests in real property. According to Petitioners, the Transfers did not fit within the clear language of the definition of the term "economic interest in real property"[10] as they were not transfers of an ownership interest in an entity that owns real property. Although, the Transfers involved the sale of all of Petitioners' shares in the Lower Tier BVI Subs, the Lower Tier BVI Subs did not own any real property.

Petitioners further contend that the application of the RPTT to the sale of shares in foreign corporations, based on the location in the City of real property owned by the foreign corporations, violates the Due Process Clause of the United States Constitution. Petitioners argue that the record does not support the finding that Petitioners had minimum contacts with the City in order to meet constitutional due process requirements for jurisdiction.

Finally, Petitioners claim that the RPTT imposed herein improperly burdens interstate and international commerce, and violates the Commerce Clause of the United States Constitution. Petitioners argue that the record does not support a finding of substantial nexus between Petitioners and the City and the RPTT prevents the Federal Government from speaking with one voice when regulating commercial relations with foreign governments.

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[10]Section 11-2101.6 of the New York City Administrative Code.

Respondent contends that the ALJ's Determination should be affirmed as the ALJ correctly determined that the imposition of RPTT in the matter at bar was within the scope of the enabling law for the RPTT and did not violate the New York State Constitution or the Due Process or Commerce Clauses of the United States Constitution.

Based on the following, we find that the Transfers are subject to the RPTT and deny Petitioners' refund requests.

Section 11-2102.b of the New York City Administrative Code (the "Code") imposes the RPTT on "each instrument or transaction (unless evidenced by a deed subject to tax under subdivision a), at the time of the transfer, whereby any economic interest in real property is transferred by a grantor to a grantee, where the consideration exceeds twenty-five thousand dollars."

An "instrument" is defined in §11-2101.3 of the Code as "[a]ny document or writing (other than a deed or a will), **regardless of where made, executed or delivered,** whereby any economic interest in real property is transferred." [Emphasis added.]

Section 11-2101.4 of the Code defines "transaction" as "**[a]ny act or acts, regardless of where performed,** and whether or not reduced to writing, unless evidenced by a deed or instrument, whereby any economic interest in real property is transferred (other than a transfer pursuant to the laws of intestate succession)." [Emphasis added.]

An "economic interest in real property" is defined in §11-2101.6 of the Code as the "ownership of shares of stock in a corporation which owns real property; the ownership of an interest or interests in a partnership, association or other unincorporated entity

which owns real property; and the ownership of a beneficial interest or interests in a trust which owns real property."

Section 11-2107.7 of the Code states that the terms "transfer" or "transferred", when used in relation to an economic interest in real property, "shall include the transfer or transfers or issuance of shares of stock in a corporation, interest or interests in a partnership, association or other unincorporated entity, or beneficial interests in a trust, whether made by one or several persons, or in one or several related transactions, which shares of stock or interest or interests constitute a controlling interest in such corporation, partnership, association, trust or other entity."

A "controlling interest" is defined in §11-2101.8 of the Code as "[i]n the case of a corporation, fifty percent or more of the total combined voting power of all classes of stock of such corporation, or fifty percent or more of the total fair market value of all classes of stock of such corporation; and, in the case of a partnership, association, trust or other entity, fifty percent or more of the capital, profits or beneficial interest in such partnership, association, trust or other entity."

"Real property" is defined in §11-2101.5 of the Code, in relevant part, as "[e]very estate or right, legal or equitable, present or future, vested or contingent, in lands, tenements or hereditaments, which are located in whole or in part within the city of New York."

The RPTT Rules of the Department ("RPTT Rules") provide in the relevant part of 19 RCNY §23-02, containing the definition of controlling interest, that related transfers are aggregated in order to determine whether a controlling economic interest has been transferred, *i.e.,* whether the fifty percent threshold has been met. Related transfers

include "transfers made pursuant to a plan to either transfer or acquire a controlling economic interest in real property."

The basic facts in the matter at bar, while certainly complex, are not significantly disputed. Petitioners sold to Purchaser all of their shares in five BVI corporations (the Lower Tier BVI Subs); each of which owned one of five Delaware corporations (the Delaware Subs); which together held the total ownership interests in a Delaware limited liability company (LLC); which owned the Four Seasons in the City; to Purchaser for an aggregate price of $275 million. It is clear from the documents submitted into evidence as well as the testimony of Petitioners' Witnesses that the purpose in selling the shares of the Lower Tier BVI Subs was to bring about the sale of the Four Seasons.

Enabling Legislation

The authority of the City to impose the RPTT was originally derived from the enabling legislation set forth as an amendment to Tax Law Article 29 (Tax Law §§1201 *et seq.*) which was adopted in 1959.[11] Petitioners contend that the enabling legislation precludes the imposition of the RPTT on the Transfers because the Closing took place in Chicago, Illinois and the enabling legislation expressly limits the City's taxing power to the transfer of economic interests "within the" City itself. Petitioners assert that the limitation is contained in Tax Law §1220 which provides, in relevant part, that "[a]ny tax imposed under the authority of this article shall apply only within the territorial limits of the city, county, or school district imposing the tax."

Tax Law §1201(b)(i), in relevant part, permits the City to impose the RPTT on "each deed, other instrument or transaction . . . by which any real property or any

[11]Ch. 370, L. 1959.

economic interest therein is conveyed or transferred . . . ." In addition, Tax Law §1201(b)(i) also provides, with respect to the RPTT, that:

> . . . . Such taxes may be imposed on any conveyance or transfer of real property or interest therein where the real property is located in such city regardless of where transactions, negotiations, transfers of deeds or other actions with regard to the transfer or conveyance take place, subject only to the restrictions contained in section twelve hundred thirty. [providing exemptions for certain governmental and charitable organizations].

The above-referenced sentence was adopted as an amendment[12] to the enabling legislation in response to the decision in Realty Equities Corporation of New York v. Gerosa, 22 Misc.2d 817 (S. Ct. N.Y. Cty., 1959). Prior to the amendment, the enabling legislation contained the following relevant language:

> (3) A tax imposed hereunder shall have application only within the territorial limits of any such city . . . .
>
> . . .
>
> (6) This act shall not authorize the imposition of a tax on any transaction, originating and/or consummated outside of the territorial limits of any such city, notwithstanding that some act be necessarily performed with respect to such transaction within such limits.

Realty Equities, *supra,* involved a transfer of real property located in the City where the deed was delivered outside the City. The case held that the above-quoted subdivision (6) precluded the imposition of the RPTT on such a transfer. Following the

[12]Ch. 785, L. 1960.

1960 amendment to the enabling act, which specifically addressed subdivision (6) but not subdivision (3), transfers of real property located in the City were subject to the RPTT notwithstanding that the deeds were delivered outside the City. Samkoff v. Gersosa, 29 Misc.2d. 844 (S. Ct. N.Y. Cty., 1961). The decision in Samkoff, *supra* at 847-848, states that:

> The Legislature in 1959 added a provision to the enabling act granting the power to tax transfers of New York City real property. The court subsequently ruled that the general limitation of existing subdivision (6) rendered such tax invalid when applied to deeds delivered outside the city. The Legislature promptly enacted an act amending the enabling act for the purpose of 'clarifying the scope of the authority' to impose this [RPTT]. It added a sentence to the particular subparagraph dealing with such tax, thus making it clear that the authority to impose this tax, as distinguished from the other taxes provided for in the enabling act, was not intended to be limited to city transactions but rather to embrace all transfers of city real property regardless of the place of the making of the transaction therefor.

Thus, we find, as did the ALJ, that former subdivision 3 (now Tax Law §1220) merely limits the City's imposition of the RPTT to transfers of real property or economic interests in real property where the real property is located in the City. Former subdivision 3 (now Tax Law §1220) does not limit the City's imposition of the RPTT with respect to where the transfer takes place. Since the enabling legislation does not require that a closing occur in the City, the imposition of the RPTT to the Transfers is not outside the scope of the enabling legislation. Therefore, we reject Petitioners' argument that the City cannot tax the Transfers because the Closing occurred in Chicago, Illinois.

State Constitution

Petitioners also assert that Article XVI, section 3, of the State Constitution precludes the imposition of the RPTT on the Transfers. Petitioners rely on the language of the first sentence of the first clause of Article XVI, section 3, which provides that:

> Moneys, credits, securities and other intangible personal property within the state not employed in carrying on any business therein by the owner shall be deemed to be located at the domicile of the owner for purposes of taxation,[13] and if held in trust, shall not be deemed to be located in this state for purposes of taxation because of the trustee being domiciled in this state, provided that if no other state has jurisdiction to subject such property held in trust to death taxation, it may be deemed property having a taxable situs within this state for purposes of death taxation.

The legislative history of Article XVI, section 3, indicates "that it was designed to assure nonresidents that they could 'keep their money and securities [in New York] without any fear that the established legislative policy [of nontaxability] will be changed' (Journal and Documents, N.Y.S. Const. Conv., 1938, Doc. No. 2, p. 3)." Ampco Printing-Advertisers' Offset Corp. v. City of New York, 14 N.Y.2d 11, 23 (1964), *appeal dismissed*, 379 U.S. 5 (1964). In the matter at bar, the issue of whether the stock certificates were physically present in the City was never raised and was not argued as a basis for asserting the RPTT.

[13]As the ALJ noted, Petitioners quoted and relied only on the language of this provision up to this point.

The remainder of Article XVI, section 3, states:

> Intangible personal property shall not be taxed ad valorem nor shall any excise tax be levied solely because of the ownership or possession thereof, except that the income therefrom may be taken into consideration in computing any excise tax measured by income generally. Undistributed profits shall not be taxed.

595 Investors Limited Partnership, v. Biderman, 140 Misc.2d. 441, 446-447 (S. Ct. N.Y. Cty., 1988) held that:

> the RPTT amendment at issue does not impose an ad valorem tax on intangible personal property as it possesses none of the characteristics of such a tax. . . . Similarly, the RPTT is also not levied for mere ownership or possession nor imposed at any regular interval, but only upon the occurrence of a single event: to wit, a transfer.

Thus, we find, as did the ALJ, that Article XVI, section 3, of the State Constitution does not bar the imposition of the RPTT on the Transfers.

Multi-Tiered Structure

Section 11-2102.b of the Code imposes a tax on "each instrument or transaction . . . whereby any economic interest in real property is transferred . . . ." The term "economic interest in real property" is defined in §11-2101.6 of the Code as the "ownership of shares of stock in a corporation which owns real property; the ownership of an interest or interests in a partnership, association or other unincorporated entity which owns real property; and the ownership of a beneficial interest or interests in a trust which owns real property."

In her Determination, the ALJ concluded that, pursuant to the Code and the applicable RPTT Rules:

> by transferring the shares in the Lower Tier BVI Subs pursuant to the plan set forth in the Contract, notwithstanding the fact that the Closing, as well as many events leading up to the Transfers, took place outside the City, Petitioners have transferred a controlling economic interest in the Four Seasons and are subject [to] the RPTT. [Determination at 32.]

Furthermore, the ALJ stated that although Petitioners raised several arguments regarding the application of the RPTT to this matter, Petitioners did not dispute that the statutory and regulatory language resulted in the imposition of the RPTT to the Transfers. Determination at 32. On appeal, Petitioners, however, contend that under the clear language of the statute, the RPTT does not and cannot apply because the Transfers involved the sale of all of Petitioners' shares in the Lower Tier BVI Subs and the Lower Tier BVI Subs did not own any real property. Thus, Petitioners argue that, by definition, they did not transfer an economic interest in real property and, therefore, the Transfers were not subject to the RPTT.[14]

Petitioners also contend that to the extent the RPTT Rules provide for the taxation of the Transfers, the rules are not in conformity with the plain meaning of the relevant provisions in the Code. Specifically, the RPTT Rules provide in the relevant part of 19 RCNY §23-02, containing the definition of "Economic interest in real property," that:

[14]Petitioners do not otherwise dispute the existence of the necessary elements to render the Transfers subject to the RPTT (*e.g.;* that the Transfers constituted a conveyance of 50% or more of the stock of the Lower Tier BVI Subs).

(2) For transfers occurring prior to April 24, 1995, the ownership of shares of stock in a corporation that owns an economic interest in real property, the ownership of an interest or interests in a partnership, association, or other unincorporated entity which owns an economic interest in real property, and the ownership of a beneficial interest or interests in a trust which owns an economic interest in real property, may also constitute an economic interest in real property. The factors to be weighed in determining whether such ownership constitutes an economic interest in real property include the nature of the activities, assets, and purposes of the above-described entities.

To illustrate:

Illustration (i): X Corporation is a holding company whose sole asset is 100% of the stock of Y Corporation. Y owns real property located in New York City. Since X exists principally for the purpose of holding stock in a subsidiary which owns real property, the ownership of X stock constitutes an economic interest in real property and the sale prior to April 24, 1995, of all the stock of X Corporation is a transfer of a controlling economic interest in real property.

Illustration (ii): X Corporation is primarily engaged in manufacturing outside of New York City. X does not own real property in the City, but does own 100% of the stock of Y Corporation, which owns real property in the City. Since X does not exist principally for the purpose of holding stock in a subsidiary which owns real property, but rather is substantially engaged in other bona fide activities, the ownership of X stock does not constitute an economic interest in real property and the sale prior to April 24, 1995 of all the stock of X Corporation will not constitute a transfer of a controlling economic interest in real property.

(3) For transfers occurring on or after April 24, 1995, the ownership of shares of stock in a corporation that owns an economic interest in real property, the ownership of an

interest or interests in a partnership, association, or other unincorporated entity which owns an economic interest in real property, and the ownership of a beneficial interest or interests in a trust which owns an economic interest in real property, also constitutes an economic interest in real property.

To illustrate:

Illustration (iii): X Corporation is engaged in manufacturing outside New York City. X Corporation does not own real property in the City but owns 100% of the stock of Y Corporation, which owns real property located in New York City. The ownership of X Corporation stock constitutes an economic interest in real property and the sale on or after April 24, 1995 of all the stock of X corporation is a transfer of a controlling economic interest in real property. The result would be the same if, instead of owning the property directly, Y Corporation owns 100% of the stock of Z Corporation, which owns the property.

Illustration (iv): X Corporation is engaged in manufacturing outside New York City. X Corporation does not own real property in the City but owns 49% of the stock of Y Corporation which owns real property in the City. The ownership of X stock constitutes an economic interest in real property. However, a sale on or after April 24, 1995, of all the stock of X Corporation is not subject to tax as a transfer of a controlling economic interest in real property because there has been no transfer of a controlling interest in Y Corporation.

. . .

(5) In the case of a transfer of an ownership interest in an entity owning an economic interest in real property, where such ownership interest, itself, constitutes an economic interest in real property under these rules, the percentage of both interests must be considered to determine whether a

controlling economic interest in real property has been transferred.[15]

The RPTT Rules in effect on the date of the Transfers specifically provided that (except under certain circumstances not relevant to the matter at bar) ownership of an entity which owns an economic interest in real property also constitutes an economic interest in real property. Thus, the RPTT Rules treat as taxable a transfer of a controlling economic interest in real property where the entity owning the real property is more than one tier removed from the entity whose ownership interest is being transferred. In addition, under the RPTT Rules, a transfer is subject to RPTT regardless of whether the entity whose ownership interest is being transferred exists principally for the purpose of holding an ownership interest in an entity which owns real property or is substantially engaged in other bona fide activities.

Petitioners argue that the ALJ erroneously relied on the RPTT Rules and specifically on Illustration (iii) as set forth above. Petitioners assert that where the plain meaning of a statute does not impose a tax upon the Transfers, Respondent cannot do so simply by adopting a rule or regulation that imposes such a tax. Dun & Bradstreet, Inc. v. City of New York, 276 N.Y. 198, 204 (1937).

In order to determine whether a transfer of an economic interest in real property (§11-2101.6 of the Code) can include a multi-tiered transaction; *i.e.,* where there is more than one tier between the entity in which an ownership interest is being transferred and the entity that owns the real property, it is important to review the history of the RPTT.

[15]We have omitted that portion of the RPTT Rules which provides that, under certain circumstances, transfers occurring after April 24, 1995, of the ownership of an entity which owns an economic interest in real property may not constitute a transfer of an economic interest in real property since those circumstances are not relevant to the matter at bar; *e.g.;* a grandfathered contract.

The RPTT, when first enacted, only applied to transfers of real property by deed. Therefore, real property could be effectively transferred, without the imposition of the RPTT, by transferring an ownership interest in an entity that owned real property. Eventually the enabling legislation was amended to permit the imposition of RPTT on transfers of controlling economic interests.[16] "This bill closes that loophole by permitting the taxation of transfers of controlling interests in corporations, partnerships, associations, trusts and other entities which own real property. As a result, transactions which effectively, albeit indirectly, convey property will now be taxed." 595 Investors, *supra* at 444 *(citing* Governor Carey's approval letter, 1981 McKinney's Session Laws at 2636-2637). The impetus for the amendment to the enabling legislation is generally considered to have been the sale of stock of a corporation that owned what was then called the Pan Am Building. The transfer of 100% of the stock enabled the seller to avoid the RPTT that would have been payable had the building been sold directly. 595 Investors, *supra* at 444.

For transfers occurring prior to April 24, 1995, the Department treated the ownership of an interest in an entity that owned an economic interest in real property as an economic interest in real property only where the entity in which an ownership interest was being transferred existed principally for the purpose of holding an ownership interest in the entity owning real property and was not substantially engaged in other bona fide activities (the "Prior Rule"). *See* New York City RPTT Information Bulletin Number 2 (December 16, 1986), and subdivision 2 of the definition of "Economic interest in real property" as contained in the relevant part of the RPTT Rules at 19 RCNY §23-02.

For transfers occurring on or after April 24, 1995, the Department treats (with certain modifications not relevant to the matter at bar) the ownership of an interest in an

[16]Ch. 915, L. 1981.

entity that owns an economic interest in real property as an economic interest in real property regardless of the nature of the activities, assets and purposes of the entities (the "Current Rule"). *See* Subdivision 3 of the definition of "Economic interest in real property" as contained in the relevant part of the RPTT Rules at 19 RCNY §23-02. The change in the Department's position is generally related to an amendment to the RPTT in 1994 which provided an exemption from RPTT for transactions that effected a "mere change of identity or form of ownership . . . to the extent the beneficial ownership of such real property or economic interest therein remains the same . . ." (the "Mere Change Exemption"). (Section 11-2106.8 of the Code.)

Because the Prior Rule did not "look through" entities that were substantially engaged in other bona fide activities when determining whether there was an economic interest in real property, there were inconsistencies between the application of the Mere Change Exemption and the Prior Rule. For example, after enactment of the Mere Change Exemption an operating company that owned real property in the City could contribute that property to a wholly-owned subsidiary without incurring the RPTT.[17] However, pursuant to the Prior Rule, a subsequent transfer of the operating company's shares would not be subject to the RPTT because the entity was an operating company with other assets and activities. The Current Rule eliminates the difference in treatment between entities that existed principally for the purpose of holding an interest in an entity that owned real property and those that substantially engaged in other bona fide activities. Thus, under the above example, a subsequent transfer of the operating company's shares would be subject to the RPTT. The need to look through tiers is more compelling with the adoption of the Mere Change Exemption. Since an exemption from RPTT is provided where there is no change in ultimate beneficial ownership for transfers of property to one or more tiers

[17]Prior to the enactment of the Mere Change Exemption, such a transfer would have been subject to the RPTT.

of entities, it stands to reason that taxability must be determined without regard to the number of tiers of active or inactive entities existing between the real property and the entity in which ownership is transferred.[18]

Notwithstanding the change embodied in the Current Rule, a review of the facts in the matter before us indicates that none of the corporations had any activities or purpose other than to hold their respective ownership interests in the next lower tier entity including taking all actions necessary to carry out, effectuate and consummate the terms of the Transfers pursuant to the Contract. Therefore, under both the Prior Rule and the Current Rule, the Transfers constitute transfers of controlling economic interests in real property.

The State courts have previously considered the issue of whether a "look through" is permitted (within the definition of the term economic interest in real property) where the transaction in question involved multiple tiers of passive holding companies. In 595 Investors, *supra*, the tax applied with respect to the syndication of a Delaware limited partnership that owned another Delaware limited partnership that owned real property in the City. In finding that the RPTT applied, the decision states at 446 that:

> Here the sales of plaintiff's partnership interests were, in essence, the sales of interests in real property situated in New York City, and the economic value of such interests were derived solely from that parcel of realty. The purchasers of limited partnership interests will obtain their profits exclusively from revenues, capital appreciation and tax benefits attributable to that property. This is precisely the sort of transaction the RPTT amendment in question was intended

[18]Both the State Real Estate Transfer Tax ("RETT") and the State Gains Tax ("Gains Tax") always had exemptions for mere changes in form and rules that provided for looking through tiers. *See*, RETT Rules at 20 NYCRR §575.6(b), Example 3; and former Gains Tax Rules at 20 NYCRR §590.52.

> to reach, and these transactions would have come within the literal terms of the amendment but for the existence of plaintiff, a passive holding company which is engaged in no independent business activity. Accordingly, the court will disregard the passive shell entity, and permit the city to treat the transfers of partnership interests in plaintiff as if they were transfers of interests in the owning partnership.

In reaching this conclusion the court stated, at page 445, that:

> Clearly the statute would apply to a transfer of a controlling interest in a partnership that owned real property. To accept plaintiff's argument would ascribe to the Legislature an intent to permit the creation of shell entities to avoid taxation when the whole purpose of the legislation, as stated by the Governor and the Senate sponsor, is to tax transactions which effectively, but indirectly, convey real property.

The court also (at page 445) affirmed the concept that "[t]ax legislation should be implemented in a manner that gives effect to the economic substance of a transaction" and that the RPTT "would be rendered a nullity if it could be avoided simply by holding the real property through **passive corporations** or partnerships." [Emphasis added.]

Thus, we find that the RPTT applies to the Transfers at issue. The use of layers of passive, single-purpose entities for purposes of holding the Four Seasons should not take the Transfers outside the scope of the RPTT. In determining whether a transaction is a transfer of a controlling economic interest in an entity that owns real property, the Department must be permitted to look through multi-tier transactions to treat the transfer as a transfer of a controlling economic interest in an entity that owns real property because the transaction "effectively" conveyed the real property.[19]

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[19]Petitioners also contend that Illustration (iii) of the definition of "Economic interest in real property" as set forth in the RPTT Rules at 19 RCNY §23-02 can be distinguished from the Transfers

Our conclusion finds support in the New York State Tax Appeals Tribunal (the "State Tribunal") decision in Matter of Cafcor Trust Reg. Vaduz, DTA Nos. 812682 and 812683 (New York State Tax Appeals Tribunal, April 17, 1997). In Cafcor, *supra*, the State Tribunal addressed the constitutional issues raised by Petitioners in the context of the New York State Real Estate Transfer Tax ("RETT") and the now repealed New York State Real Property Gains Tax ("Gains Tax").[20] The decision dealt with the sale by a Liechtenstein trust, beneficially owned by a foreign individual, of the shares of an alien limited liability company created under the laws of Curacao, Netherlands Antilles. The alien limited liability company owned a controlling interest in a State limited partnership

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because the illustration does not have the same number of tiers as the Transfers. Petitioners argue that "Z Corporation" in the illustration would only correspond to the Delaware Subs and the Delaware Subs did not own the real property (Four Seasons). As we have found that it is appropriate to look through multi-tiered transactions for purposes of determining if a controlling economic interest has been transferred, the number of tiers between the entity in which an ownership interest is being transferred and the entity owning the real property is not relevant for purposes of determining if the transfer is a transfer of a controlling economic interest in real property. Moreover, we disagree with Petitioners' assertion that the illustration does not correspond to the number of tiers in the Transfers. The illustration refers to an "X Corporation" a "Y Corporation" and a "Z Corporation." In the situation where neither "X Corporation" nor "Y Corporation" own real property but all of the stock of "X Corporation" is sold and "X Corporation" owns 100% of the stock of "Y Corporation" which owns 100% of the stock of "Z Corporation" which owns real property in the City, "X Corporation" corresponds to the Lower Tier BVI Subs; "Y Corporation" corresponds to the Delaware Subs and "Z Corporation" is LLC, the entity that owned Four Seasons. Petitioners do not correspond to "X Corporation" in the illustration as it was not Petitioners' stock that was sold but that of the Lower Tier BVI Subs.

[20]The ALJ limited the applicability of Cafcor, *supra*, to the matter herein on the basis that the statutory language of the RPTT differed significantly from the language of the now repealed Gains Tax. The Gains Tax imposed the tax on "transfers of real property" and included a transfer of an interest in an entity that owned real property in the definition of a transfer of real property. The RPTT, specifically imposes the tax on transfers of shares without defining those transfers as transfers of real property. While we agree with the ALJ's statement as to the difference between the RPTT and the Gains Tax, we note that the State Tribunal in Cafcor, *supra*, addressed not only the Gains Tax but also the RETT, which uses different language. The RETT applies to the "conveyance of an interest in real property." Tax Law §1402(a). The Tax Law defines "conveyance" as a transfer of "any interest in real property by any method" including a transfer or acquisition of a controlling interest in any entity with an interest in real property. Thus the RETT treats a transfer of a controlling interest in an entity owning real property as a *method* for transferring an interest in real property. Similarly, the legislative history, discussed *supra*, of the application of the RPTT to transfers of controlling economic interests in real property recognizes that such a transfer is a *method* for transferring real property.

that owned a hotel in the City. All the activities of the trust connected with the sale took place outside the State. In denying the taxpayer's claims for refund of the Gains Tax and RETT, the State Tribunal stated that the taxpayer's "focus upon the transfer of stock overlooks the fact that the only taxes in issue are those which arise from the transfer of real estate in New York. No taxes have been imposed on the sale of the shares of stock."

Our conclusion is also supported by the Appellate Division's decision in Matter of Bredero Vast Goed, N.V. v. Tax Commission of the State of New York, 146 A.D.2d 155 (1989), *appeal dismissed*, 74 N.Y.2d 791 (1989) (a Gains Tax case). Bredero, *supra*, involved the sale by three Netherlands corporations of all the shares in a State corporation that owned an eighty-five percent interest in a State limited partnership that owned real property. The Gains Tax defined a "transfer of real property" to include the "acquisition of a controlling interest in any entity with an interest in real property."[21] At issue was whether the Gains Tax would apply to a two-tiered transaction where the entity in which a controlling interest was being transferred did not own the property directly. In affirming the State Tax Commission, the Appellate Division looked beyond the two-tiered transaction and determined that the taxpayers "effectively" transferred an interest in the building.

Due Process and Commerce Clauses

Petitioners assert that the imposition of the RPTT on the Transfers violates both the Due Process Clause and the Commerce Clause of the United States Constitution. Petitioners contend that they are challenging the constitutionality of the application of the RPTT to the Transfers and not the facial constitutionality of the statute. Petitioners argue

[21]Former Tax Law §1440[7], *repealed*, L. 1996, Ch. 309, section 171.

that a facial challenge is limited to situations where the statute could never be applied in a valid manner, which they do not contend.

This Tribunal has previously held that while it cannot determine whether a statute is unconstitutional on its face; *i.e.*, as written, it can determine whether a statute has been unconstitutionally applied to a particular set of facts. Siemens Corporation f/k/a Siemens Capital Corporation, TAT(E) 93-237 (GC), New York City Tax Appeals Tribunal (1999). In Moran Towing Corporation v. Urbach, 99 N.Y.2d 443, 448 (2003), the State Court of Appeals stated that "[a] party mounting a facial constitutional challenge bears the substantial burden of demonstrating 'that "in any degree and in every conceivable application," the law suffers wholesale constitutional impairment.' (Cohen v. State of New York, 94 N.Y.2d 1, 8 (1999)" Thus, we agree with Petitioners' assertions that their contention is that the statute has been unconstitutionally applied and, thus, such contention can be reviewed by this Tribunal.

Petitioners contend that Respondent seeks to impose a tax on the transfer of stock of non-domiciliary corporations by attributing corporate property to shareholders. Petitioners refer to two cases as support for their argument that the application of the RPTT to Petitioners is unconstitutional because corporate property may not be attributed to shareholders to establish nexus to tax.[22] Petitioners rely on Rhode Island Hospital Trust Co. v. Doughton, 270 U.S. 69 (1926). That case involved the imposition of an inheritance tax by North Carolina upon the estate of a nonresident on the transfer of shares of stock of the R.J. Reynolds Tobacco Company, a New Jersey corporation that did

[22]In 2003, the State Legislature on a prospective basis amended the RPTT to redefine "grantor" to include "the entity with an interest in real property or the person or persons who transfer an economic interest in real property." L. 2003, Ch. 63, Part C, section 3. Thus, the ALJ noted that, in the future, there will be a statutory basis for assessing the RPTT against an entity over which the City clearly has jurisdiction where the transferor itself has no contact with the City.

business, and had two thirds of the value of its property, in North Carolina. In invalidating the North Carolina statute, the Supreme Court held that the owner of stock in a corporation is not the owner of the corporation's property and that jurisdiction for tax purposes over the stockholder cannot be based on the situs of part of the corporation's property within the taxing state. Petitioner also relies on In re Gates' Estate, 243 N.Y. 193 (1926), which involved the taxation of the transfer of stocks and bonds owned by a nonresident decedent where the corporations whose stocks and bonds were at issue owned real property in the State. Relying on the concept that the owner of the shares of stock in a corporation is not the owner of the corporation's property as set forth in Rhode Island Hospital Trust, *supra*, the Court of Appeals struck down this provision of the tax statute.

The State Tribunal in Cafcor, *supra* distinguished the two cases stating:

> Unlike Rhode Island Hospital or Gates' Estate, New York is not seeking to impose tax on the transfer of stock. Rather, New York is imposing a tax on the consideration or gain arising from the transfer of real property in New York.

We do not believe that Rhode Island Hospital, *supra*, and Gates' Estate, *supra*, preclude us from finding the RPTT applicable to multi-tiered transactions such as the case at bar. Both cases involved taxes imposed on the transfer or ownership at death of, among other assets, securities owned by nonresidents of the state to the extent that the securities were issued by entities that owned real property, or as was the case in Gates' Estate, *supra*, any property, located in the state. Neither tax was limited to securities representing a controlling equity interest in the entity in question. Moreover, the taxes involved in those cases applies to transfers at death, not intentional negotiated transfers, as were the Transfers involved here. Finally, those cases, decided as they were in 1926,

do not reflect the evolution of economic realities evidenced by the extensive use today of corporate, unincorporated or hybrid business entities.

The Due Process Clause nexus standards are set forth in Quill v. North Dakota, 504 U.S. 298, 306, 307 (1992):

> [t]he Due Process Clause 'requires some definite link, some minimum connection, between a state and the person, property or transaction its seeks to tax', [citation omitted] and that the 'income attributed to the State for tax purposes must be rationally related to "values connected with the taxing State.'" [citation omitted].
>
> . . .
>
> if a foreign corporation purposefully avails itself of the benefits of an economic market in the forum State, it may subject itself to the State's *in personam* jurisdiction even if it has no physical presence in the State.

The City had "some minimum connection" with the transaction it sought to tax because for all practical purposes, the Contract was a contract to sell the Four Seasons, which was located in the City. The amount subject to tax was rationally related to values connected to the City as the RPTT is based on the consideration for the conveyance attributable to the real property. The increase in value from 1996, when LLC purchased the Four Seasons for $195 million, to 1999, when the shares of the Lower Tier BVI Subs were sold for $275 million, is due to the increase in value of the Four Seasons, which is located in the City and benefitted from the City's infrastructure and tourism market.

The State Tribunal also found that the Due Process Clause standards as set forth in Quill, *supra* were met in Cafcor, *supra,* as it was clear that New York had "some

minimum connection" with the transaction it sought to tax and the income attributed to New York was rationally related to values connected to New York.[23]

The Court in Quill, *supra,* distinguished the nexus requirements under the Due Process Clause from the substantial nexus requirements of the Commerce Clause. The four-part test set forth in Complete Auto Transit v. Brady, 430 U.S. 274, 279 (1977), *rehearing denied*, 430 U.S. 976 (1977) governs the validity of state taxes under the Commerce Clause and provides that a tax will be sustained against a Commerce Clause challenge if the tax:

> [1] is applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State.

We find, as did the ALJ, that Petitioners had substantial nexus with the City through the activities of their officers and agents in the City. A corporation can have substantial nexus through the activities of an agent. *See*, Tyler Pipe Industries, Inc. v. Washington State Department of Revenue, 483 U.S. 232 (1987). Petitioners, through their agents, engaged in significant marketing activities in the City. Morgan Stanley acted not only for LLC but also for all the other entities in the corporate structure up to and including Petitioners. LLC and its direct and indirect shareholders, including Petitioners, acted in concert with respect to the activities of Morgan Stanley concerning the sale of the shares of the Lower Tier BVI Subs and the Four Seasons. Petitioners engaged Polylinks to help with the sale by Petitioners of the Lower Tier BVI Subs and Polylinks was directly compensated by Petitioners for these efforts. Because Polylinks was located in Hong

[23] *See*, footnote 24, *infra*.

Kong, it hired PKF, which had a New York office and personnel to deal with certain tasks associated with marketing the Four Seasons. The Closing Statement and the Contract identify PKF as Petitioners' agent. The Contract makes it clear that all the entities in the corporate structure were collectively considered the "Seller." Petitioners' complete control of the operations and activities of all the entities below them in the corporate structure allowed them to obligate LLC to complete the activities necessary to effectuate the Transfers.

Therefore, we find, as did the ALJ, that

> Based on a combination of the activities of their officers, the activities of their agents Morgan Stanley and PKF, and the activities of LLC (their indirect subsidiary acting on behalf of Petitioners to help effectuate the Transfers), Petitioners had the minimum contacts needed for Due Process and the substantial nexus with the City required by the Commerce Clause.[24] [Determination at 46.]

595 Investors, *supra* at 447, holds that the RPTT does not violate either the Commerce Clause or Due Process Clause of the United States Constitution. In applying the tests set forth in Complete Auto Transit, *supra*, the court found that:

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[24] Having found that Petitioners' corporate officers and agents engaged in sufficient activities in the City to create substantial nexus we do not need to address the issue of what the result would be if there were no such activities in the City nor are we subscribing to any requirement for physical presence in a RPTT matter. *See* Cafcor, *supra*, where the State Tribunal found that Commerce Clause substantial nexus was met due to the location of the real property and that it was unnecessary to establish Cafcor's physical presence in the State. Nevertheless, we note that in contexts where physical presence is a requirement for substantial nexus, physical presence "need not be substantial. Rather, it must be demonstrably more than a 'slightest presence.'" Orvis Company, Inc. v. Tax Appeals Tribunal of the State of New York, 86 N.Y.2d 165, 178 (1995). In the case at bar, this standard was met as the activities of Petitioners and their agents were more than *de minimis* and were all related specifically to the transaction sought to be taxed.

> The transaction here is the syndication of New York City real estate. Without question New York City is the predominant place where each buyer of a partnership share in plaintiff 'in every practical sense invokes and enjoys the protection of the laws, and in consequence realizes the economic advantages of his ownership.' [citation omitted]
>
> Nor can it be said that the RPTT burdens interstate commerce. On the contrary, the tax is fairly related to the services provided by New York City. The RPTT amendment was intended to tax direct and indirect transfers of New York City real estate on an equal basis, the measure of such tax being the consideration paid.[25]

With respect to the issue of international commerce, the Appellate Division in Bredero, *supra*, held that they were not "persuaded by [taxpayers'] additional suggestion that the enactment of Internal Revenue Code §897 (26 USC §897), as part of the Foreign Investment in Real Property Tax Act of 1980, precludes the application of the [State Gains Tax] to the instant conveyance." The Appellate Division concluded that the act did not preempt the State's taxing authority. Similarly, we conclude that Foreign Investment in Real Property Tax Act did not preempt the City's authority to impose the RPTT.

[25]While there is no question that the City may impose taxes on partners based on the activities or property of the partnership of which they are members, *see*, *e.g.*, Varrington Corp. v. City of New York Department of Finance, 85 N.Y.2d 28 (1995), the matter at bar involves an LLC and 3 tiers of corporate entities. Nevertheless, we view the court's reasoning in 595 Investors, *supra*, as applicable to the case at bar.

Therefore, the imposition of the RPTT on the Transfers does not violate the Due Process Clause or the Commerce Clause of the United States Constitution.[26]

Thus, for the reasons stated above we, as did the ALJ, deny Petitioners' refund claims with respect to the Transfers and sustain the Notices of Disallowance dated August 1, 2000.

Dated: June 2, 2006
New York, New York

_____
GLENN NEWMAN
President and Commissioner

_____
ELLEN E. HOFFMAN
Commissioner

[26]We have considered all other arguments raised by the parties and find them unpersuasive.