**NEW YORK CITY TAX APPEALS TRIBUNAL**
**ADMINISTRATIVE LAW JUDGE DIVISION**

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| **In the Matter of the Petition**<br><br>**of**<br><br>**NATIONAL BULK CARRIERS, INC. and AFFILIATES** | **DETERMINATION**<br><br>**TAT(H) 04-33(GC)** |

Gombinski, C.A.L.J.:

Petitioners, National Bulk Carriers, Inc. and those of its affiliates that were included in its combined group for New York City ("City") General Corporation Tax ("GCT") purposes (the "Subsidiaries"), filed a Petition for Hearing, dated September 21, 2004 (the "Petition"), for redetermination of a deficiency of GCT pursuant to Chapter 6 of Title 11 of the City Administrative Code (the "Code") for the 1997, 1998 and 1999 calendar years (the "Tax Years").

Pursuant to the Tax Appeals Tribunal ("Tribunal") Rules of Practice and Procedure, 20 RCNY §1-09(f), the parties agreed to have this matter determined without a hearing. The parties filed a joint Stipulation of Facts, with exhibits, dated September 13, 2005, as well as briefs and reply briefs. Oral argument was held on February 15, 2006. Robert A.N. Cudd, Esq., and Lori Guttenberg, Esq., of LeBoeuf, Lamb, Green & MacRae, L.L.P., represented the Petitioners, and Robert Firestone, Esq., Senior Counsel, and George Lynch, Esq., Assistant Corporation Counsel, of the City Law Department, represented Respondent, the City Commissioner of Finance ("Commissioner").

## ISSUE

In computing the tax on capital under the GCT, are the assets to be included in Petitioners' capital their intangible partnership interests or their ratable share of those partnerships' property.

## FINDINGS OF FACT

1. During the Tax Years, Petitioner, National Bulk Carriers, Inc., a New Jersey corporation, filed GCT combined reports which included the following of its subsidiaries (the Subsidiaries), all of which were incorporated in New York: (a) Hawaiian Realty, Inc.; (b) 605 Third Avenue Realty, Inc. (for 1997 only); (c) Hawaiian 605 Special Corp.; (d) HRI 605 Mezzanine Special Corp.; (e) 1345 Sixth Avenue Company, Inc.; (f) Hawaiian 1345 Special Leasehold Corp.; (g) Hawaiian 1345 Special Fee Corp.; and (h) Hawaiian 1345 Funding Corp.

2. Certain of the Subsidiaries owned, in the aggregate, a 50% membership interest in 605 Third Avenue LLC, which owned real property located at 605 Third Avenue in the City.

3. Certain of the Subsidiaries also owned, in the aggregate, a 0.5% general partnership interest and a 49% limited partnership interest in the 1345 Fee Limited Partnership and the 1345 Leasehold Limited Partnership. The 1345 Fee Limited Partnership owns the land located at 1345 Sixth Avenue in the City and the 1345 Leasehold Limited Partnership owns the leasehold interest in the building located on that land.

4. The other interests in 605 Third Avenue LLC, the 1345 Fee Limited Partnership and the 1345 Leasehold Limited Partnership

(collectively, the "Partnerships") are owned by entities that are related to each other (the "Fisher Group") but are not related to Petitioners.[1]

5. Petitioners and the Fisher Group each have management rights in the Partnerships.

6. On their combined GCT returns (Form NYC-3A) for the Tax Years (the "Returns"), pursuant to Code §11-602(8), Petitioners included their distributive shares of the Partnerships' incomes as shown on federal Schedules K-1s in their entire net income (federal taxable income from all sources as specifically adjusted or "ENI").

7. Petitioners did not compute their GCT liability on the Returns based on the ENI method under Code §11-604(1) (the "ENI Method"), but instead, as it yielded a greater amount of tax, computed their GCT liability based on the amount of their capital under Code §11-604(2) (the "Capital Method").

8. In calculating the property factor of their combined business allocation percentage ("BAP") pursuant to Code §11-604(3)(a), Petitioners included their ratable share of the Partnerships' property (valued at the Partnerships' adjusted basis used for Federal income tax purposes).[2]

9. In determining their assets to be valued under the Capital Method, Petitioners did not include their ratable share of the

[1] Although the Partnerships include a limited liability company, the parties agree that ownership interests in partnerships and limited liability companies should be treated identically under the GCT.

[2] Petitioners did not elect to use fair market value in computing the property factor of their combined BAP.

Partnerships' assets (as they did in computing their BAP). Instead, Petitioners included their interests in the Partnerships. Because the interests in the Partnerships were intangible personal property, Petitioners valued those partnership interests at the value shown on Petitioners' books and records kept substantially in accordance with generally accepted accounting principles ("GAAP").

10. Respondent issued to Petitioners a Notice of Determination dated June 25, 2004 (the "Notice of Determination") asserting a total GCT deficiency for the Tax Years of $536,907.49 (the "Deficiency"), including principal of $343,832.46, interest of $158,691.79 computed through July 15, 2004, and a 10% substantial understatement of tax liability penalty of $34,383.24.

11. The parties stipulated that "the Notice of Determination should be sustained" if Petitioners are required to include their ratable share of the Partnerships' property as capital to be valued under the Capital Method, but that the Notice of Determination should "be cancelled" if Petitioners are required to include their interests in the Partnerships as capital to be valued under the Capital Method. Stipulation of Facts Number 14.

**POSITIONS OF THE PARTIES**

Petitioners assert that since the Code requires personal property (other than marketable securities) to be valued at its GAAP or book value, the interests in the Partnerships (being intangible personal property) must be valued using GAAP. The Commissioner counters that Petitioners should not be treated as owning the interests in the Partnerships (under the entity approach to partnership taxation), but should be treated as owning a ratable share of those Partnerships' assets (under the aggregate approach to partnership taxation).[3] Therefore, she asserts, Petitioners must be deemed to own a ratable share of the Partnerships' real property which must be valued at fair market value under the Code.

Petitioners respond that the aggregate approach to partnership taxation applies only to the tax on income under the GCT, since only the ENI Method specifically incorporates federal income tax pass-through provisions. The Commissioner counters that the Capital Method is not a separate tax based on asset value, but is an alternative method of ascertaining liability under a single franchise tax regime (the GCT) that includes both the ENI and Capital Methods. The Commissioner further asserts that the term "business capital" must be the same under both the ENI and Capital Methods as, otherwise, Petitioners would be deemed to own different assets under each of these methods. Finally, Petitioners reference a non-precedential 1998 determination by a New York State ("State") Administrative Law Judge which reaches the result they advocate and note that the Commissioner has not issued any ruling or pronouncement to the contrary.

## CONCLUSIONS OF LAW

The GCT imposes a tax on every corporation doing business in the City equal to the sum of: (a) the greatest amount of tax determined under four alternative methodss; plus (b) a tax on subsidiary capital.[4] Code §11-604.1.E. The two alternative methods relevant to this determination are the method which taxes

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[3] The aggregate approach to partnership taxation is also referred to as the "conduit" approach, a term used by Petitioners in their briefs.

[4] The tax on subsidiary capital is .00075% of each dollar of subsidiary capital allocable to the City. Code §11-604.1.E. Generally, subsidiary capital is investments in the stock of subsidiaries and certain indebtedness from subsidiaries. Code §11-602.3.

8.85% of ENI (the ENI Method) and the method which taxes .15% "for each dollar of total business and investment capital" allocable to the City, subject to a cap of $350,000 per year (the Capital Method). Code §11-604.1.E and F.[5]

During the Tax Years, Petitioner used the Capital Method to compute its GCT liability as that method yielded the greatest amount of tax. The amount of capital subject to tax under the Capital Method is computed by: (1) determining the assets that are to be valued; (2) valuing such assets (at fair market value for real property and marketable securities and at GAAP value for all other assets); (3) allocating such value to the City (using the taxpayer's BAP[6] if the assets constitute business capital[7] and investment allocation percentage ("IAP")[8] if the assets constitute investment capital); and (4) multiplying the allocated capital by the applicable tax rate.

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[5] The other two alternative bases are 8.85% of 30% of ENI plus compensation paid to officers and greater than 5% shareholders(subject to certain adjustments) and a minimum tax of $300. Code §11-604.1.E(a)(3) and (4).

[6] A taxpayer's BAP is that percentage which the average value of the taxpayer's real and tangible personal property in the City (whether owned or rented) bears to all of its owned and rented real and tangible personal property. Code §11-604.3(a)(1). In computing its BAP, unless the taxpayer elects to use fair market value (which election was not made here), the "value of the taxpayer's real and tangible personal property" is such property's adjusted basis for federal income tax purposes. *Id.* Property rented by the taxpayer is taken into account at a multiple of eight times the gross rent paid. *Id.*

[7] Generally, business capital is all of a taxpayer's capital other than its investment and subsidiary capital. Code §11-602.6. Generally, investment capital is investments in stocks, bonds and other securities, corporate and governmental, that are not held for sale to customers in the regular course of business or are included in subsidiary capital. Code §11-602.4.

[8] Investment capital is allocated to the City by multiplying the amount of investment capital invested in each stock, bond or other security by the IAP of the issuer or obligor thereof. Code §11-604.5. Generally, the IAP is determined by comparing the amount of capital of the issuer in the City to the amount of its capital everywhere. Code §11-604.3(b).

The issue in this case is whether the assets to be valued under Code §11-604.1.E(a)(2) are Petitioners' interests in the Partnerships or their ratable share of the Partnerships' assets. The difference is significant because real estate and marketable securities are valued differently than other property under Code §11-604.2 which states that:

> For purposes of this subdivision, real property and marketable securities shall be valued at fair market value and the value of personal property other than marketable securities shall be the value thereof shown on the books and records of the taxpayer in accordance with generally accepted accounting principles.

The Commissioner asserts that the aggregate approach to partnership taxation should apply to treat Petitioners as owning a ratable share of the Partnerships' real estate assets. As the Partnerships own substantial real estate assets, such assets would then be valued at their fair market value resulting in a greater tax liability than Petitioners reported.

Petitioners counter that the Code provides that only those assets which they actually own can be valued under the Capital Method; *i.e.*, that the entity approach must be used. They assert that the Code mandates the use of the entity approach with regard to the Capital Method by virtue of the provision in Code §11-604.2 that only real estate and marketable securities are valued at their fair market value. While Petitioners are correct that Code §11-604.2 would require that their interests in the Partnerships be valued at their GAAP value if those interests were the property being valued, a directive how to value various types of property does not address, and has no relevance to, the issue of what property is being valued thereunder. Thus the issue is not, as Petitioners assert, whether a partnership interest can be treated as being other than "personal property" under New York State law. Instead, the issue is whether the aggregate approach to partnership taxation can be applied to ignore Petitioner's interests in the Partnerships and treat Petitioners as owning a ratable portion of the property owned by the Partnerships for purposes of computing GCT liability under the Capital Method.

Petitioners further assert that the requirement in Code §11-604.2 that capital other than real estate and marketable securities be valued at its GAAP value on the books and records of "the taxpayer" mandates the use of the entity (rather than the aggregate, look-through) approach. However, if the aggregate approach is applied, a partner would be deemed to own a ratable share of its partnership's assets, which would include the partnerships' books and records. Since the books and records of the partnership would proportionately be the books and records of the taxpayer/partner under the aggregate approach, the requirement that the GAAP value be determined in accordance with the taxpayer's books and records does not bar the use of the aggregate approach.

Accordingly, contrary to Petitioners' assertion, the Code does not specifically address the issue of whether the aggregate or entity approach should be used to determine what property is to be valued under the Capital Method. Where, as is here, the statute is silent as to which approach to partnership taxation should be used, that determination should be made by reference to related and analogous situations. *See,* McKee, Nelson, Whitmire, *Federal Income Taxation of Partners and Partnerships* (Warren, Gorham & Lamont 2004), ¶1.02[3] (footnote omitted):

> A wide variety of situations that are not squarely covered by the statute is susceptible to resolution in dramatically different ways, depending on whether effect is given to the entity or aggregate concept. The absence of a unifying entity or aggregate theme in the statute means that these situations must be resolved on an ad hoc basis by reference to the way in which the statute applies the entity and aggregate concepts to related or analogous situations – a process that is difficult, tedious, and uncertain.

Several analogous situations exist under the GCT in which, despite the Code's silence, the aggregate approach is applied to require a taxpayer to take into account its ratable share of its partnership's assets in computing its GCT liability.[9] As Petitioners acknowledge, the Code specifically directs that the aggregate approach be used to compute the amount of a taxpayer's ENI.[10] As Petitioners further acknowledge, this statutory directive

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[9] The parties also cite to the New York State ("State") Partnership Law for analogy. This is not surprising since, as noted by Bittker and Lokken, *Federal Taxation of Income, Estate and Gifts*, 3d Ed., Vol. 4, ¶86.1.2 (Warren, Gorham & Lamont 2003): "Partnerships are also hybrids for state law, business, financial, and other nontax purposes, and there is no escape from periodic encounters with the aggregate/entity conflict." Petitioners assert that under N.Y. Partnership Law §107, a limited partner's interest in the partnership is personal property. The Commissioner asserts that partners possess "rights in specific partnership property" under Partnership Law §50 and that these rights in specific partnership property consist of a co-ownership by tenancy in partnership of the property owned by the partnership under Partnership Law §51. Since New York Partnership Law supports both the aggregate and entity approaches and more directly applicable analogies exist under the GCT itself, there is no need to rely by analogy on state partnership law.

[10] Code §11-602.8(I) defines ENI as being the "total net income from all sources, which shall be presumably the same as the entire taxable income . . . which the taxpayer is required to report to the United States treasury department . . . ." Subchapter F of the IRC adopts the aggregate approach to pass-through partnership income from partnerships to their partners, thereby taxing such income only at the partner level. Generally, under the IRC:

> The aggregate concept predominates in connection with the taxation of partnership income to the partners and the general nonrecognition provisions for contributions to and distributions from partnerships. . . . The entity approach, on the other hand, predominates in the treatment of transfers of partnership interests as transfers of

effectively mandates that the aggregate approach also be used to determine the character of Petitioners' ENI (*i.e.*, whether it is from business, investment or subsidiary capital) and the manner in which it is to be allocated to the City (through the determination of the BAP and IAP used to allocate business and investment capital). Otherwise, as Petitioners admit, significant inequities would arise. Such inequities would occur because income statutorily passed-through under the aggregate approach would always constitute business income under the entity approach (even if it arose from investment capital owned by the partnership) and such income would have to be allocated without regard to the source of the property and the activities that gave rise to such income.[11]

Petitioners nevertheless argue that the aggregate approach does not apply under the Capital Method because that method does not have a specific pass-through (aggregate) income component as does the ENI Method. However, the reason the Capital Method does not have a pass-through income component is that it is not an

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> interests in a separate entity rather than in the assets of the partnership. . . .

McKee, *supra* at ¶1.02[3] (footnote omitted). *See*, *also*, *United States v. Basye*, 410 US 441, 448, fn 8 (1973)(citations omitted); Bittker & Lokken, *Federal Taxation of Income, Estates and Gifts*, 3d Ed., Vol. 4, ¶86.1.1. Petitioners rely on the principle that the disposition of a partnership interest is generally taxed using the entity approach to argue that the entity approach should apply under the Capital Method. However, it is not the disposition of a partnership interest that is being taxed here. Instead, it is the operation of the Petitioners' business that is being subjected to a franchise tax.

[11] As Petitioners acknowledge, under the entity approach, corporate taxpayers would be deemed to own interests in partnerships (rather than in their partnerships' assets). Since partnership interests do not meet the definition of investment or subsidiary capital, they would always constitute business capital. *See,* Code §11-602.6. Thus, all income passed-through from a partnership would be deemed to be income from business capital and would be allocated using the taxpayer's BAP. Since intangible assets which constitute business capital are specifically excluded from the computation of a taxpayer's BAP under Code §11-604.3(a)(1), partnership interests would not be taken into account in computing the BAP and IAP used to allocate income to the City under the ENI Method, including the income passed-through from such partnerships.

income based computation. But the Capital Method does have a pass-through (aggregate) component: the BAP.[12] For, as Petitioners concede, there is only one definition of BAP in the Code and that definition must be used for both allocating income under the ENI Method and allocating business capital under the Capital Method.[13]

As the aggregate approach is used to determine which assets are taken into account for purposes of allocating a taxpayer's business capital, logic dictates that the same approach should be used to determine which assets are included in business capital (*i.e.*, are being allocated). *See, In re Seaman*, 78 NY2d 451 (1991) (in the absence of a clearly expressed intention to the contrary, related subjects are *in pari materia* and should be construed as a whole). Were the aggregate (pass-through) approach not consistently applied under the Capital Method, inequities would arise similar to those which would have arisen had the aggregate approach not been consistently applied under the ENI Method. That occurs because under the entity approach, all interests in a partnership would be business capital valued in accordance with GAAP. *See, fn 11, supra.* However, the value attributable to such partnership interests would have to be allocated by a BAP that is computed using the aggregate (pass-through) approach (*i.e.*, by including a ratable share of the partnership's business capital in its BAP and a ratable share of the partnership's investment capital

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[12] Thus Petitioners err when they assert that the aggregate approach has no application to the Capital Method. They also err when they assert that the ENI Method (being based on income) is effectively a different type of tax than the Capital Method (being based on capital) and that the two methods therefore are not complementary. The ENI and Capital Methods are alternative parts of a single franchise tax regime (the GCT) and being inexorably linked as alternative computations for the same tax, they must be interpreted as a whole. *See, Rangolan v. County of Nassau*, 96 NY2d 42 (2001).

[13] The only computation of BAP provided in the GCT is in Code §11-604.3(a)(1), which computes BAP for purposes of allocating a taxpayers ENI to the City under the ENI Method.

in the computation of its IAP.) Thus, the allocation of the value of that partnership interest (being made solely by the taxpayer's BAP) would fail to take into account the partnership's holding of investment capital.[14]

Consistent application of the aggregate approach is not only mandated under principles of partnership taxation, but also by the general rules of statutory construction. *See*, McKinney's Statutes §236:

> In the absence of anything in the statute indicating an intention to the contrary, where the same word or phrase is used in different parts of a statute, it will be presumed to be used in the same sense throughout, and the same meaning will be attached to similar expressions in the same or a related statute.[15]

It also is noted that using the aggregate approach to determine the property to be valued under the Capital Method accomplishes the legislative intent that real property and marketable securities be valued at their fair market value under the Capital Method.[16] Were the entity approach adopted as

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[14] As a result, instead of allocating that portion of a taxpayer's capital that is attributable to investment capital owned by a partnership by using an IAP which, being computed on the aggregate approach, takes into account that partnership's investment capital, the allocation would be made by a BAP which, although computed on the aggregate approach, only takes into account that partnership's business assets.

[15] Where divergent results were desired, specific provision for such results were made. By illustration, although property rented by the taxpayer is not valued in the computation of the taxpayer's capital under the Capital Method, Code §11-604.3(a)(1) specifically includes rental property in the BAP used to allocate such capital. Conversely, although intangible personal property owned by the taxpayer is valued under the Capital Method, Code §11-604.3(a)(1) excludes such property from being included in computing the BAP by only including real and personal property in that computation.

[16] The Legislature clearly believed that real estate is a unique type of asset as it is the only asset that must be valued at its fair market value even though such value is not readily ascertainable. Possible predicates for such treatment are that taxpayers owning City real estate derive a clear and

Petitioners assert, corporate partners with significant interests in substantially appreciated City real estate and appreciated marketable securities (such as Petitioners) could pay significantly less GCT under the Capital Method merely because those City assets were held through partnerships which would be valued at their GAAP value. Similarly, taxpayers with significant interests in City real estate and marketable securities which have substantially declined in value could pay significantly more GCT under the Capital Method merely because such assets were held through partnerships which would be valued at their GAAP value. Petitioners assert that this potentially inequitable result is merely the consequence of a taxpayer’s right to structure its affairs. This result, however, would not arise as a result of a taxpayer owning property through a partnership, but as a result of the improper adoption of the entity approach for this, and only this, one limited purpose under the GCT; *i.e.,* to preclude a corporate partner from valuing its ratable share of its partnership’s real property and marketable securities at fair market value.

Finally, Petitioners argue that their position is supported by current administrative practice. Over seven years ago, in the *Matter of Arcade Broadway*, DTA Nos. 816027-816032 (State Division of Tax Appeals, December 31, 1998), an Administrative Law Judge of the State Tax Appeals Tribunal held under an essentially identical State statutory provision (Tax Law §210(2)) that a taxpayer’s partnership interest has to be valued at its GAAP value since there is no provision in the statute for the aggregate approach to

significant benefit from City services; that the GAAP value of real property can be significantly less than its fair market value not only because of market appreciation, but because of allowable depreciation deductions under GAAP; and that real estate must, in any event, be valued on an annual basis for Real Property Tax purposes.

be used to determine capital (as there is to determine income) and because a tax measured on capital is fundamentally different in character than a tax measured on income. In the seven years since the determination in *Arcade Broadway* was issued, no public pronouncement has been made by the City that it disagreed with the result of that case. Moreover, Petitioners assert that the State Department of Taxation and Finance still follows *Arcade Broadway*.[17]

The Commissioner counters that Finance Letter Ruling 114 (October 16, 1984) indicates that "for City general corporation tax purposes, the corporate partner . . . should include in investment capital its proportional share of stocks, bonds and other securities of the partnership, less its share of partnership current liabilities attributable to such capital." As FLR 114 does not limit its scope to the Capital Method, it does provide some conceptual support for the Commissioner's position. However, as it does not directly address the Capital Method, FLR 114 would not necessarily advise the public of the Commissioner's disagreement with the subsequently reached result in *Arcade Broadway*.

However unfortunate the Department of Finance's failure to have publicly stated its disagreement with the result reached in *Arcade Broadway* may have been, this fact alone cannot mandate a different result without effectively making precedential a non-

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[17] While the Commissioner counters that the State Department of Taxation and Finance's Audit Division agrees with her position, neither party has introduced evidence or submitted any support regarding the State's current position with respect to this matter. It is noted, however, that the March 2, 2006 *New York State Bar Association Tax Section Report on Proposed Amendments to Article 9-A Regulations Relating to the Taxation of Corporate Partners,* pp. 5-6. indicates that the State Department of Taxation and Finance has issued draft amendments to their regulations which, <u>for taxable years beginning with 2006</u>, adopt the aggregate approach as the required method for computing a corporate partner's liability under the State equivalent of the Capital Method, unless the taxpayer is unable to obtain the partnership information necessary for reporting under the aggregate approach.

precedential Administrative Law Judge Determination. No authority has been cited which suggests that a non-precedential determination of an Administrative Law Judge, whether State or City, can become precedential due to the failure of the Department of Finance, over a protracted period, to disagree with its holding. Nor would the State Department of Taxation and Finance's failure to appeal *Arcade Broadway* and/or for many years state its disagreement with its result be dispositive of this issue. For neither the City nor this forum would have been bound to follow the State's audit position in this matter even if that position had been established. *See, Matter of Park Avenue Bank, N.A.*, TAT(H) 99-93(BT) (Tribunal, ALJ Division, January 7, 2002), fn 21; *aff'd*, TAT(E) 99-93(BT) (Tribunal, August 6, 2003).[18]

**ACCORDINGLY, IT IS CONCLUDED THAT** for purposes of computing its capital under the Capital Method, the aggregate approach to partnership taxation should be applied to treat Petitioners as owning a ratable share of the Partnerships' real property. Therefore, the Petition is denied and the Notice of Determination, dated June 25, 2004, is sustained in full.

Dated: May 3, 2006
New York, New York

STEVEN J. GOMBINSKI
Chief Administrative Law Judge

[18] All other arguments raised by the Petitioners have been considered and were found to be unpersuasive.