NEW YORK CITY TAX APPEALS TRIBUNAL
ADMINISTRATIVE LAW JUDGE DIVISION

In the Matter of the Petition	:	
	:	DETERMINATION
of	:	
	:	TAT (H) 16-14 (GC)
MARS HOLDINGS, INC (f/k/a MARS ASSOCIATES, INC.)	:	

Chu-Fong, A.L.J.:

Petitioner Mars Holdings, Inc. (Petitioner) filed a petition for a hearing (Petition) with the New York City (City) Tax Appeals Tribunal (Tribunal).

The Petition contests a notice of determination that asserts a City general corporation tax (GCT) deficiency in the principal amount of $888,976.10, plus statutory interest and a substantial understatement penalty, for the tax years ended December 31, 2011 and December 31, 2012 (Tax Years). The City Commissioner of Finance (Respondent) filed an Answer dated August 25, 2016.

Petitioner appeared by Hutton and Solomon, LLP (Stephen L. Solomon, Esq., and Roger S. Blane, of counsel). Respondent appeared by the City Corporation Counsel (Andrew G. Lipkin, of counsel).

On October 2, 2017, pursuant to the Tribunal Rules of Practice and Procedure (Tribunal Rules or 20 RCNY) § 1-09, the parties jointly stipulated to hear the controversy on submission without a hearing. The parties also filed a stipulation of facts, with sixteen attached exhibits.

Petitioner submitted a brief in support of the Petition, dated May 24, 2018. Respondent submitted a memorandum of law in opposition, dated August 24, 2018. Petitioner submitted a reply brief, dated November 14, 2018. Respondent submitted a sur-reply brief, dated December 12, 2018. Petitioner submitted a letter brief on February 28, 2019. Respondent submitted a responsive letter brief on April 25, 2019. Petitioner submitted another letter brief on June 25, 2019. Respondent submitted a subsequent responsive letter brief on June 27, 2019. Petitioner submitted another letter brief on August 8, 2019.

Oral argument was heard by the undersigned on October 22, 2019. On April 14, 2020, the undersigned the six-month period for the issuance of this determination (Tribunal Rules § 1-12 [e] [1]).

ISSUES

I. Whether, for GCT purposes, the federal conformity provisions of the City Administrative Code (Admin. Code) require the exclusion of the gain from the sale of an interest in a limited partnership that did business in the City.

II. Whether petitioner has established grounds for the abatement of the substantial understatement penalty.

FINDINGS OF FACT

On October 2, 2017, Petitioner and Respondent jointly stipulated to the facts relevant to this controversy (Stipulation). The Stipulation has sixteen attached exhibits, which support the stipulated facts. These facts and exhibits have been accepted. As modified, the relevant facts appear below.

1. On April 8, 1953, Mars Associates, Inc. (Mars Associates), the predecessor corporation to Petitioner, incorporated in the State of New York.

2. In 1954, Mars Associates joined with the Normel Construction Corporation to form a joint venture (Mars/Normel) to act as a construction contractor doing business primarily in the New York Metropolitan area.

3. Since the mid 1990's, Mars Associates has owned a 50% interest in Mars/Normel.

4. Mars/Normel ceased construction operations in the early 1990's.

5. In the early 1970's, Mars/Normel acquired investment interests in three limited partnerships: Fifth & 106th Street Associates LP (106th Street Associates); Cooper Gramercy Associations LP (Cooper); and, Alliance Housing II. Associates LP (Alliance).

6. 106th Street Associates, Cooper, and Alliance engaged solely in the holding, leasing, and managing of their respective real estate properties located in the City.

7. Mars/Normel also owned 1,000 shares of a stock in a publicly traded company, CH energy Group, Inc.

8. Beginning in 1974 and continuing into the tax year ending December 31, 2012, Mars/Normel owned a Class A limited partnership interest in 106th Street Associates, which owned real property in the City.

9. On June 13, 197, 106th Street Associates was formed as a partnership. Effective January 2, 1974, the partnership

agreement was amended to change 106th Street Associates into a limited partnership.

10. None of the general partners of 106th Street Associates were related to either Mars/Normel or Petitioner.

11. During the Tax Years and up until the time of the sale of its interest in 106th Street Associates. As a limited partner, Mars/Normel held a 14.167% interest in all profits, losses, and capital of 106th Street Associates.

12. Prior to and during the Tax Years and up until the time of Mars/Normel's sale of its interest in 106th Street Associates, Petitioner reported and paid GCT on its share of the income, gain, profits, and losses of 106th Street Associates, Cooper, and Alliance.

13. For the tax year ending December 31, 2012, 106th Street Associates' only significant source of income was from the holding, leasing, or managing of real property consisting of rental apartments within the City.[1]

14. During the Tax Years, Mars/Normel held a limited partnership interest in Cooper. Cooper was formed in 1973 to own and operate a rental housing project in the City.

15. Mars/Normel owned a 25% limited partnership interest in Cooper and its share of the partnership's net rental real estate income for the tax year ending December 31, 2012, was $278,058.

16. During the Tax Years, Mars/Normel also owned a 0.01% limited partnership interest in Alliance. For the tax year

[1] 106th Street Associates had minimal interest and investment income.

ending December 31, 2012, the Mars/Normel share of Alliance's net rental real estate income was $37.

17. On or about December 5, 2011, Petitioner was incorporated under the laws of the State of New Jersey, its commercial domicile, as an S corporation (Internal Revenue Code [26 USC or IRC] §§ 1361-79).

18. On or about December 20, 2011, Mars Associates was merged into Petitioner in an "F Type" reorganization, in which Petitioner was the surviving business entity and successor to Mars Associates (26 USC § 368 [a] [1] [F]).

19. As the successor to Mars Associates, Petitioner then held the 50% ownership interest in Mars/Normel.

20. On or about March 8, 2012, Mars/Normel sold its interest in 106th Street Associates to an unrelated third party. It reported its gains from the sale on its Federal, New York State, and City tax returns.

21. For the tax year ended December 31, 2012, Petitioner received its proportionate share of the gain on the sale of the limited partnership interest in 106th Street Associates sold by Mars/Normel that same tax year. Petitioner's share of the gain was $15,454,021 (Capital Gain). Petitioner reported the Capital Gain on its Federal corporation income tax return.

22. Petitioner also reported the Capital Gain on its City GCT return (Form NYC-3L, line 17[b]), but excluded it from its entire net income (ENI) as a deduction from Federal taxable income, with a notation stating, "SEE RIDER."

23. The attached Rider stated that the basis of the deduction was "Gain on the sale of partnership interest – not used in trade or business in NY."

24. Respondent conducted an examination of Petitioner's GCT returns for the Tax Years.

25. On or about May 11, 2016, the Commissioner timely issued a Notice of Determination to Petitioner asserting a GCT deficiency for the tax year ended December 31, 2012.

26. The Explanation of Adjusts section of the Notice stated, "Adjustment is made to include gain from the sale of partnership interest in 2012. All available net operating loss is applied to the additional income in 2012. Administrative Code Section 11-602(8)."

27. The referenced gain was the Capital Gain, which Petitioner received from Mars/Normel's sale of its interest in 106th Street Associates.

28. During the Tax Years, Mars/Normel's sole contacts with the City were its investment interests in 106th Street Associates, Cooper, and Alliance.

29. During the Tax Years, neither Mars/Normel nor Petitioner directly or indirectly engaged in operating or managing of any portion of business activities of 106th Street Associates, Cooper, or Alliance.

30. During the Tax Years, neither Mars/Normel nor Petitioner engaged in a unitary business with any of 106th Street Associates, Cooper, or Alliance.

31. During the Tax Years, neither Mars/Normel nor Petitioner had any part in operating or managing CH Energy Group, Inc.

32. During the Tax Years, Mars/Normel did not independently conduct a trade or business in the City or

elsewhere, and had no property, payroll, or receipts in the City.

33. During the Tax Years, Mars Associates and Petitioner, as its successor, maintained its only office in the State of New Jersey. It had no place of business in the City.

34. In the Stipulation, the parties agreed that if Petitioner properly calculated its GCT by excluding the Capital Gain from its ENI, then the Notice should be cancelled for the tax year ending December 31, 2012. The parties also agreed that if the Capital Gain should be included in determining Petitioner's ENI for the tax year ending December 31, 2012, then the amount of additional tax due will be the amount set forth in the Notice, namely $888,976.10, plus interest and penalties.

POSITIONS OF THE PARTIES

Respondent states that the deficiency results from a proper exercise of his authority. He notes that GCT is imposed upon the privilege of doing business in the City. By virtue of its ownership in 106th Street Associates, which owned, leased, and managed property within the City, he argues that Petitioner did business within the City. Respondent argues that, because Petitioner was doing business in the City, the Capital Gain is properly included in its ENI for GCT purposes.

Petitioner argues that Respondent's adjustment runs afoul of the federal conformity doctrine. It submits that as federal income is the starting point for ENI (Admin. Code § 11-602.1), federal conformity requires treating the Capital Gain as it would be under IRC § 741.[2] Petitioner cites to *Grecian Magnesite*

[2] This section provides: "In the case of a sale or exchange of an interest in a partnership, gain or loss shall be recognized to the transferor partner.

Min., Indus. & Shipping Co., SA v Commr. of Internal Revenue Serv. (926 F3d 819 [DC Cir 2019], affirming 149 T.C. 63 [2017]) for the proposition that prior to the "Tax Cuts and Jobs Act of 2017" (26 USC § 864 [c] [8]), the entity approach could apply to the disposition of a partnership interest. Under this approach, it notes, the partner is treated as though it owns a partnership interest, an intangible asset, as opposed to a proportionate share of the partnership's assets. Applied herein, Petitioner argues that the gain from the sale of the partnership interest, an intangible not used in a trade or business, should be sourced to partner's domicile, and excluded from its ENI.

Petitioner explicitly does not raise any as-applied constitutional challenges under either the Federal or New York State constitutions.[3] It argues that it is constitutionally permissible to tax this transaction using the aggregate method, as New York State does with other taxes. However, Petitioner argues that in order to do so for GCT purposes, federal conformity requires that a legislative act be taken in order to use the aggregate approach.

Respondent counters by stating that nothing in either City or State law bars the use of the aggregate approach towards the disposition of a partnership interest. He argues that the federal conformity doctrine does not apply because IRC § 741 addresses federal treatment of the disposition of a partnership interest, whereas the GCT imposes a tax on the privilege of doing business in the City. Respondent also notes that *Grecian*

Such gain or loss shall be considered as gain or loss from the sale or exchange of a capital asset…" (26 USC § 741).

[3] In this fashion, Petitioner distinguishes its argument from those addressed in *Matter of Goldman Sachs Petershill Fund Offshore Holdings (Delaware Corp)* (TAT (H) 16-9 (GC), December 12, 2018, 2018 WL 7101437).

Magnesite Mining narrowly addresses federal treatment of a disposed partnership interest for the purposes of the federal U.S. office rule.[4] He submits that New York State did not enact a change for State Corporation Franchise tax purposes and utilizes the aggregate approach.

Regarding the substantial understatement penalty, the parties agree that the penalty should be abated.

CONCLUSIONS OF LAW

The GCT imposes a tax on every corporation doing business, owning or leasing property or engaging in various other activities in the City (Admin. Code § 11-603.1). The GCT is computed as the sum of (1) the greatest amount of tax calculated under four alternative methods; plus (2) an amount of tax calculated on subsidiary capital (Admin. Code § 11-604.1.E).

For the Tax Years, Petitioner computed the GCT using the ENI method (19 RCNY § 11-26).[5] Respondent exercised his discretion and adjusted Petitioner's return for tax year ending December 31, 2012, to include the Capital Gain (Admin. Code Section 11-604.8).[6]

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[4] "The U.S. office rule provides: 'if a nonresident maintains an office or other fixed place of business in the United States, income from any sale of personal property (including inventory property) attributable to such office or other fixed place of business shall be sourced in the United States.' I.R.C. § 865(e)(2)(A)" (*Grecian Magnesite Min.*, 926 F3d 823-24).

[5] For GCT purposes, ENI means "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" (Admin. Code § 11-605.8 [i]).

[6] Admin. Code § 11-604.8 provides: "If it shall appear to the commissioner of finance that any business . . . allocation percentage . . . does not properly reflect the activity, business, income or capital of a taxpayer within the city, the commissioner of finance shall be authorized in his or her discretion, in the case of a business allocation percentage, to adjust it by (a) excluding one or more of the factors therein, (b) including one or more other factors . . . (c) excluding one or more assets in computing such allocation percentage, provided the income therefrom is also excluded in

The Rules of the City provide that:

> "a corporation shall be deemed to be doing business in the City if it owns a limited partnership interest in a partnership that is doing business, employing capital, owning or leasing property, or maintaining an office in the City" (19 RCNY § 11-06 [a]).[7]

Interpreting "doing business" to include ownership in a limited partnership that does business in the City has been upheld on multiple occasions. The New York courts have upheld this principle on several occasions (*Allied-Signal, Inc. v Commr. of Fin.*, 167 AD2d 327 [1st Dept 1990], *aff'd* 79 NY2d 73 [1991]; *Varrington Corp. v City of New York Dept. of Fin.*, 201 AD2d 282, 284 [1st Dept 1994], *aff'd* 85 NY2d 28 [1995]).[8] This Tribunal also acknowledged this standard in *Matter of National Bulk Carriers, Inc.*, (TAT [E] 04-33 [GC], November 30, 2007, 2007 WL 4359038). These decisions bind this Tribunal and are determinative in this matter (City Charter § 170 [d]).

106th Street Associates conducted business within the City because it leased, held, and managed real property in it. Petitioner, through Mars/Normel, owned a 14.167% share of 106th Street Associates. Through its ownership in 106th Street Associates, Petitioner was doing business in the City (19 RCNY 11-06 [a]). Therefore, the Capital Gain, which flowed from Mars/Normel's sale of its interest in 106th Street Associates, was properly included in Petitioner's ENI for the tax year ending December 31, 2012.

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determining entire net income, or (d) any other similar or different method calculated to effect a fair and proper allocation of the income . . . reasonably attributable to the City."

[7] This provision is subject to certain limitations, not relevant herein (*see* 19 RCNY § 11-06 [b]).

[8] In *Varrington*, the courts sustained retroactive application of 19 RCNY 11-06 (a), i.e., imposing the GCT upon a taxpayer whose only City contact was a passive limited partnership interest that did business in the City.

Petitioner's argument based upon federal conformity does not compel a different result. Petitioner correctly notes that the Admin. Code provides that relevant terms and the IRC "shall have the same meaning ... when used in a comparable context" (Admin. Code § 11-601). However, as recently noted by the New York State Tax Appeals Tribunal, federal conformity doctrine has its limits:

> "The Court of Appeals has stated that arguments in favor of applying the doctrine are particularly strong and persuasive where 'the State act and regulations were modeled upon the Federal law and regulations and both statutes and regulations closely resemble each other.' However, where state tax law diverges from federal law, there is no requirement that a court strain to read the federal and state provisions as identical" (internal citations omitted) (*Matter of BTG Pactual NY Corporation*, DTA No. 827577, NYS Tax Appeals Trib., March 24, 2020, 2020 WL 1657790).

Initially, the referenced federal and GCT statutes lack a close resemblance. IRC § 741 addresses treatment of the disposition of partnership interests for federal taxation purposes. The closest analog, Admin. Code § 11-605.8, provides that computing the GCT on an ENI basis begins with the income reported to the U.S. Treasury. However that is the end of the resemblance. Petitioner has not established any statutory authority or legislative history that would specifically bind the GCT calculations to federal treatment of the sale of a partnership interest. As a result, these differences militate against the importing federal treatment of the sale of partnership interests into the GCT's ENI basis.

Further, in *National Bulk Carriers*, this Tribunal settled which approach should apply to the ENI calculation:

> "[T]he aggregate approach has been and continues to be applied for a variety of purposes under the GCT including the computation of ENI, the character of items of income as coming from subsidiary or investment capital, and the calculation of the BAP. The same is true under the comparable State Corporate Franchise Tax. Both the State and City use the aggregate approach for purposes of determining whether a corporation is doing business in the jurisdiction.
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> The City's use of the aggregate approach for nexus purposes has been upheld by the Court of Appeals. Varrington Corp. v. City of New York Dept. of Finance, 85 N.Y.2d 28 (1995). The State regulations contain comparable provisions regarding nexus for corporate partners" (*Matter of National Bulk Carriers, Inc.*, 2007 WL 4359038, at *5)

The foregoing dispels any support for applying an entity approach to computing ENI under the GCT. Therefore, federal conformity does not require the exclusion of the Capital Gain from Petitioner's ENI for the tax year ending December 31, 2012, and issue "I" is resolved in Respondent's favor.

On issue "II," the parties agree that the substantial understatement penalty should be abated. Accordingly, it is resolved in favor of Petitioner.

The petition of Mars Holdings, Inc. f/k/a Mars Associates, Inc., is granted to the extent above but is otherwise denied. The Notice of Determination, dated May 11, 2016, is modified to the same extent but is otherwise sustained.

DATED:

June 26, 2020

/s/
Alexander F. Chu-Fong
Administrative Law Judge