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

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| **In the Matter of the Petitions** | : | |
| **of** | : | **DETERMINATION** |
| **THE CHASE MANHATTAN CORPORATION (f/k/a CHEMICAL BANKING CORPORATION) and SHAREHOLDERS OF THE CHASE MANHATTAN CORPORATION** | : | **TAT(H) 99- 99(RP)** **TAT(H) 99-100(RP)** |

Schwartz, A.L.J.:

Petitioners, The Chase Manhattan Corporation (f/k/a Chemical Banking Corporation) and the Shareholders of The Chase Manhattan Corporation, each filed a Petition for a redetermination of a deficiency of New York City (the "City") Real Property Transfer Tax ("RPTT") under Title 11, Chapter 21 of the City Administrative Code ("Code") in connection with a merger that took place on March 31, 1996.

A hearing was held on November 19, 2002 at which time testimony was taken and certain documents, including an extensive stipulation of facts (the "Stipulation") and supporting documents, were entered into the record. The record was kept open for certain additional documents to be submitted by each party. All documents were received by January 7, 2003, at which time the record was closed. All briefs were received by August 5, 2004. Petitioners were represented by Carolyn Joy Lee, Esq., Ronald A. Morris, Esq., and Debra L. Silverman, Esq. of Roberts & Holland LLP. The Commissioner of Finance ("Respondent" or the "Commissioner") was

represented by Robert J. Firestone, Esq., and Martin Nussbaum, Esq., Assistant Corporation Counsels.

**ISSUES**

I. Whether the RPTT enabling legislation precludes the imposition of the RPTT on the statutory merger of two Delaware corporations where the merger was consummated in Delaware.

II. Whether the RPTT applies to the transfer of a controlling economic interest in a corporation whose subsidiaries own real property in the City.

III. Whether a merger can result in the transfer of a controlling economic interest in an entity that owned real property in the City where 51.49% of the transaction is exempt from the RPTT as a mere change of form of ownership under Code §11-2106(b)(8).

IV. Assuming the merger is subject to the RPTT, whether Petitioners correctly apportioned consideration between City real property and other assets in the manner required by Code §11-2102(d) and the applicable rule thereunder.

V. Assuming the merger is subject to the RPTT, whether consideration subject to the RPTT is determined by taking into account the negative value of a leasehold interest on one property that is closely associated with another property.

VI. Whether Chemical Banking Corporation, by exchanging its shares for a controlling economic interest in The Chase Manhattan Corporation pursuant to the merger, became liable for the RPTT as a grantee.

## FINDINGS OF FACT[1]

1. On March 31, 1996, The Chase Manhattan Corporation ("Old Chase") merged into Chemical Banking Corporation ("Chemical") (the "Merger"). Both Old Chase and Chemical were incorporated in Delaware. The stock of both corporations was publicly traded on the New York Stock Exchange.

2. The Merger was a statutory merger effected under the Delaware General Corporation Law by filing a Certificate of Merger with the Secretary of State of the State of Delaware.

3. A number of activities relating to the Merger took place in the City, including meetings among the principals and their advisors, board and shareholder meetings approving the Merger, negotiations of the financial and other terms of the Merger, and preparation of the applicable documentation. The transfer agent which handled the physical exchange of Old Chase shares for Chemical Shares was based in the City. A "Closing" in respect of the Merger was held in the City on March 29, 1996. At this Closing the attorneys for Chemical and Old Chase verified, by reviewing legal opinions, inspecting corporate secretaries' certifications, etc., that all the preconditions to the Merger had been satisfied. At or immediately after this Closing the certificate of merger (the "Certificate") was executed in the City by Walter V. Shipley, Chairman of the Board of Chemical, and Mr. Shipley's signature was attested to by John B. Wynne, Corporate Secretary. The Certificate was then telecopied to Chemical's counsel in Delaware, who hand delivered the Certificate to the Office of the Secretary of State in Delaware. The Certificate was filed in Delaware by the Delaware

[1] Except for Paragraphs 4, 9-21, 35, 41 and 46, all Findings of Fact are taken verbatim from the Stipulation.

Secretary of State at 10:10 a.m., on March 29, 1996. Pursuant to the terms of the Certificate and as permitted under Delaware law, the Merger became effective at 11:59 p.m. on Sunday, March 31, 1996. In the Merger, the stock of Old Chase was automatically converted by operation of law into shares of Chemical, and the Old Chase shareholders became Chemical shareholders. All of the assets and liabilities of Old Chase were transferred by operation of law to Chemical. Chemical then adopted as its new name "The Chase Manhattan Corporation" ("New Chase").

4. Old Chase's shareholders exchanged their Old Chase shares for Chemical shares through the exchange agent designated by Old Chase and Chemical in the exchange ratio prescribed in Article 2.1 of the Agreement and Plan of Merger. While the Old Chase shares were automatically converted into shares of Chemical by operation of law, the stock certificates representing Old Chase shares were surrendered to the exchange agent as soon as practical after the Merger and were exchanged for certificates representing the appropriate number of shares of Chemical. (Stip. Ex. A, Joint Proxy Statement and Prospectus, pp. 40-41; Plan of Merger, pp. 2-4.)

5. On April 30, 1996, a Form NYC RPT Real Property Transfer Tax Return (the "Return") was filed by the Shareholders of Old Chase, as "Grantors," and by Chemical, as "Grantee" (the Grantors and Grantee are collectively referred to herein as the "Petitioners"). RPTT in the amount of $3,084,412 was paid to the City Department of Finance (the "Department") on April 30, 1996.

6. Prior to the Merger, Old Chase was a bank holding company incorporated under the laws of Delaware.

7. Old Chase's corporate headquarters were, at the time of the Merger, located in the City. Old Chase, a bank holding company, did not itself hold title to real property. The interests in real property owned by subsidiaries of Old Chase at the time of the Merger (collectively the "Old Chase Real Estate") were reported in the Return, and included over forty owned properties located in the City, and over one hundred leasehold interests in City properties. In the Merger the stock held by Old Chase in its subsidiaries was transferred by operation of law to New Chase. As a bank holding company, the activities of Old Chase were generally limited to holding stock in its subsidiaries, raising capital and operating funds for its subsidiaries, and contributing, lending or depositing the funds with subsidiaries as needed by its subsidiaries (subsidiary operating fund requirements were generally determined daily), holding and temporarily investing any funds until contributed, loaned or deposited with its subsidiaries, collecting dividends, principal and interest from its subsidiaries, repaying the obligations it incurred to fund its subsidiaries, and distributing dividends to its shareholders. These activities represented substantially all, if not all, of the activities conducted by Old Chase during the year preceding the Merger.

8. With the exceptions of the interests in real property set forth in subparagraphs (a) through (c), below, the fair market values of the Old Chase Real Estate at the time of the Merger are as set forth in the Return. The exceptions are as follows:

(a) The fair market value of the property known as 3 MetroTech is $19,215,000, and the fair market value of the property known as 4 MetroTech is $55,000,000, for a combined fair market value for the two properties of $74,215,000.

(b) The fair market value of the separate fee interest in the property known as 1 Chase Manhattan Plaza ("1CMP") is $124,000,000.

(c) The fair market value of the leasehold interest in the property known as 2 Chase Manhattan Plaza ("2CMP") is negative $64,000,000.

9. At the time of the Merger, Old Chase owned the fee interest in 1CMP, including the surrounding public plaza (the "Public Plaza") and owned the leasehold interest in 2CMP. (1CMP, 2CMP and the Public Plaza, collectively, are referred to as "Chase Manhattan Plaza.")

10. The buildings at 1CMP and 2CMP were built at different times. 1CMP was completed in the early 1960s. 2CMP, which previously had been known as 20 Pine Street, was built sometime in the 1920s. The fee interest in 1CMP had been owned continuously by Old Chase from the time the building was built in the early 1960s until the time of the Merger. While Old Chase owned 2CMP when that building was built, it sold it around the time it was building 1CMP. 2CMP subsequently changed hands, was then net leased to a third party and that net lease was later assigned to Old Chase.

11. Chase Manhattan Plaza is bounded by William Street to the East, Liberty Street to the North, Nassau Street to the West and Pine Street to the South. Prior to the construction of 1CMP and the Public Plaza, Cedar Street, a public City street, ran between William and Nassau Streets. The construction of 1CMP and the Public Plaza entailed the discontinuance of Cedar Street between Nassau and William Street. 1CMP and 2CMP are now linked by the

Public Plaza, with no intervening public street nor any vehicular traffic, nor any intervening land in the possession of another.

12. The Public Plaza is reached by a series of steps from street level. The main entrances to 1CMP and 2CMP are on the Public Plaza.

13. Chase Manhattan Plaza was built to include an interlink at the concourse level (ground level directly below the Public Plaza) which allows employees 24-hour access to both 1CMP and 2CMP, with no need to travel outdoors.

14. There is a ground level entrance to 2CMP on Pine Street for emergency use and which also provides access to the complex for disabled people. There also is a ground level entrance on Pine Street where it is possible for curbside deliveries to be made if they have been prearranged.

15. There is a driveway entrance to 1CMP on Liberty Street which provides access for trucks to get to the basement-level loading docks. Following the discontinuance of Cedar Street, the basement-level loading dock area for 2CMP has been accessible only through 1CMP.

16. The Public Plaza contains several well-known works of art that draw tourists from all over the world.

17. A variety of building operations, including security, fire safety, building management and waste removal were conducted jointly for 1CMP and 2CMP.

18. 1CMP and 2CMP have separate electricity, heating systems, hot water systems, cooling and air conditioning systems, telephone systems, elevators and fire sprinkler systems, each of which can be operated independently for each building.

19. Chase Manhattan Plaza includes a variety of facilities utilized by employees working in 1CMP and 2CMP including an employee cafeteria, an auditorium, a medical office, the security office, the property management office, a garage and bank branch facilities.

20. The City authorized Old Chase to change the name of 20 Pine Street to Two Chase Manhattan Plaza based on the physical connection of 1CMP and 2CMP and because Chase Manhattan Plaza had become a widely-recognized address.

21. 1CMP and 2CMP are two separate tax lots.

22. In computing taxable consideration on the Return, the Taxpayers added together a positive value for Old Chase's interest in 1CMP and a negative value for Old Chase's interest in 2CMP.

23. The Old Chase Real Estate included no other leaseholds with negative fair market values.

24. If Petitioners are permitted to offset either the positive fee interest value of 1CMP or the positive fair market values of all interests in Old Chase Real Estate with the negative leasehold value of 2CMP, then the total value of Old Chase Real Estate would be $628,665,000. If Petitioners are not permitted to offset either the positive fee interest value of 1CMP or the

positive fair market values of all interests in Old Chase Real Estate with the negative leasehold value of 2CMP, then the total value of Old Chase Real Estate is $692,665,000.

25. At the time of the Merger certain of the properties included in the Old Chase Real Estate were encumbered by mortgages (each a "Mortgage" and collectively the "Mortgages"). The Return reflects the amount of the Mortgage encumbering each parcel of Old Chase Real Estate, which Mortgages total $217,246,267 in the aggregate.

26. At the time of the Merger, the values of the Westbury Hotel and of the Plaza Athenee were in each case less than the amount of the Mortgage encumbering such property. Specifically, the value of the Westbury Hotel was $22,000,000, and the amount of the Mortgage encumbering such property was $36,104,604; and the value of the Plaza Athenee was $25,000,000 and the amount of the Mortgage encumbering such property was $41,027,959. These two properties are to be taken into account in computing taxable consideration in the manner set forth in Tables 1 through 4 in Finding of Fact 46, *infra*.

27. The total price paid for the stock of Old Chase ("the Stock Price") was stock of New Chase having a fair market value of $14,460,367,991. The Stock Price was net of Old Chase's liabilities, which totaled $108,438,000,000.

28. At the time of the Merger, Old Chase and its subsidiaries owned substantial assets (the "Other Assets") in addition to the Old Chase Real Estate. There was no good faith apportionment made of the consideration for the Old Chase Real Estate and such Other Assets.

29. Old Chase's Other Assets included loans and deposits, and Old Chase's liabilities included deposits, federal funds, banker's acceptances, and other liabilities.

30. As a publicly-traded company, Old Chase filed Annual Reports (Form 10-K) with the Securities and Exchange Commission (the "SEC"). Through the year ended December 31, 1994, these Annual Reports reflected the operations of Old Chase and its subsidiaries. Old Chase did not file a 10-K for 1995 or 1996. Instead, for both such years, the operations of Old Chase and its subsidiaries for the full year were combined with the full-year operations of Chemical and its subsidiaries, and reported in the 10-K filed for New Chase.

31. The 1994 Annual Report was filed with the SEC on February 28, 1995. The Merger of Old Chase into Chemical was approved by the Boards of Directors of both corporations in August, 1995, and the Joint Proxy Statement and Prospectus describing each of Old Chase's and Chemical's assets, business and activities was issued on October 31, 1995. The descriptions of the assets, businesses and activities of Old Chase as set forth in the 1994 Annual Report and in the Joint Proxy Statement and Prospectus generally reflect the assets, businesses and activities of Old Chase at the time of the Merger.

32. Following the Merger the assets and liabilities of Old Chase and Chemical were combined and reported, for purposes of Generally Accepted Accounting Principles ("GAAP"), under the "pooling of interests method." In accounting for the Merger, the gross Merger consideration was not, therefore, apportioned among each of Old Chase's assets based upon their relative fair market

values, as would have been done had the "purchase method" of accounting been employed.[2]

33. The purchase method of accounting, as it applies to stock acquisitions, treats any difference between the value of the consideration given for the assets of the acquired corporation, *i.e.*, the value of the acquired corporation's stock plus the amount of its liabilities, and the value of the acquired corporation's assets recorded on its GAAP books immediately preceding the transaction as positive or negative goodwill or other intangible, which intangible is recorded as an asset upon the combination of the two entities. The goodwill or other intangible recognized upon the acquisition is not treated as an asset of the acquired company under GAAP prior to the acquisition, because GAAP does not recognize that asset until it is acquired. Under APB #16, a business combination is accounted for under the pooling of interests method only if it satisfies the specific criteria enumerated therein. Because the failure of any one of such requirements means that the transaction cannot be accounted for under the pooling of interests method, a preponderance of the mergers involving publicly traded companies have historically been accounted for under the purchase method of accounting. In June, 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 141, "Business Combinations" (FASB #141), which supersedes APB #16, eliminates the use of the pooling of interests method, and requires that all business combinations initiated after June 30, 2001 be accounted for under the purchase method. Petitioners do not concede that the purchase

[2] The "pooling of interests method" and the "purchase method" of accounting are defined in Accounting Principles Board Opinion No. 16, "Business Combinations" ("APB #16"), and are further described in the text Charles H. Griffin, Thomas H. Williams, Kermit D. Larson, *Advanced Accounting*, Ch. 10, (Rev. Ed. 1971).

method of accounting is relevant to the Merger or to the application of the RPTT to the Merger.

34. For purposes of the apportionment formula in Schedule H of the Return, Petitioners added the $14,460,367,991 stock price, and Old Chase's liabilities totaling $108,438,000,000, and reported the total, $122,898,367,991, as the "fair market value of all assets" used in the denominator of the apportionment ratio, line B3. This fair market value of all assets included various intangibles including goodwill and "core deposits" acquired by Chemical in the Merger.

35. Because Old Chase was in the banking business, it had a large number of unsecured liabilities unrelated to the real property (Stipulation, ¶22).

36. The Department issued Notices of Determination (the "Notices") dated September 14, 1998 to the Grantors and the Grantee asserting an additional amount due of $10,333,937.98 consisting of additional RPTT in the amount of $8,320,249.31 plus interest[3] in the amount of $2,013,688.67. No penalties were asserted.

37. The Merger did not result in a transfer or issuance of a controlling interest in Chemical.

38. That portion of the Notices that asserted additional consideration for the transfer attributable to RPTT, New York State Real Estate Transfer Tax ("RETT"), and the now repealed New York State Real Property Gains Tax ("Gains Tax") is incorrect and is to

[3] Computed to October 26, 1998.

be disregarded. The payments of RPTT, RETT and Gains Tax are not additional consideration in the computation of RPTT on the Merger.

39. If the Respondent's position that the Merger constituted a taxable transfer of a controlling economic interest in real property is upheld, the Merger was exempt from the RPTT under Code §11-2106(b)(8) to the extent of 51.49%.

40. The Grantors and Grantee timely filed requests for a Conciliation Conference. At that Conference certain matters were resolved, which resolutions were included in the Stipulation and incorporated into these Findings of Fact. The resolution of those matters and other matters which were addressed prior to the hearing and incorporated into the Stipulation and these Findings of Fact effectively decreased the additional tax at issue from $8,320,249,31 to $5,656,337,54.

41. The Department issued a Conciliation Decision dated October 5, 1999, to the Grantors and the Grantee.

42. The Grantors and Grantee timely filed petitions with the City Tax Appeals Tribunal, Administrative Law Judge Division, on December 27, 1999. The Grantors' and Grantee's cases were thereafter consolidated.

43. Respondent, filed an Answer in the consolidated cases on March 17, 2000.

44. Petitioners, with the consent of the undersigned, filed an Amendment to Petition in the consolidated cases on June 14, 2001.

45. Respondent filed an Amendment to Answer in the consolidated cases on July 3, 2001.

46. The parties stipulated that if the RPTT applies to the Merger there are four possible calculations of the amount of tax due (the "Deficiency"). The four alternative calculations result from the parties' disagreements on two issues: (i) whether the method of apportioning consideration set forth in the Return is correct (the "Formula Issue"); and (ii) whether the negative value of the 2CMP leasehold is offset against the positive value of 1CMP (the "Negative Leasehold Issue"). If Respondent's positions on both the Formula Issue and the Negative Leasehold Issue are sustained in full, the parties agree that the Deficiency will be computed as set forth in Table 1 below titled "Commissioner Prevails in Formula and Negative Leasehold." If Petitioners' positions on both issues are sustained in full, the parties agree that the Deficiency will be computed as set forth in Table 2, below titled "Petitioners Prevail in Formula and Negative Leasehold." If Respondent's position on the Formula Issue is sustained but Petitioners' position on the Negative Leasehold Issue is sustained, the parties agree that the Deficiency will be computed as set forth in Table 3, below, titled "Commissioner Prevails in Formula, Petitioner Prevails in Negative Leasehold." If Petitioners' position on the Formula Issue is sustained but Respondent's position on the Negative Leasehold Issue is sustained, the parties agree that the Deficiency will be computed as set forth in Table 4, below, titled "Petitioners Prevail in Formula, Commissioner Prevails in Negative Leasehold."

**TABLE 1**

**COMMISSIONER PREVAILS IN FORMULA AND NEGATIVE LEASEHOLD**

| | | |
|---|---|---|
| 1. | Fair market value of real property | $692,665,000[4] |
| 2. | Subtract mortgages | (217,246,267) |
| 3. | Net value of real property | 475,418,733 |
| 4. | Net value of assets | 14,460,367,991[5] |
| 5. | Percentage (line 3 divided by line 4) | 3.2877% |
| 6. | Stock price | 14,460,367,991 |
| 7. | Stock price attributable to real property (line 5x line 6) | 475,418,733 |
| 8. | Add back mortgages | 217,246,267 |
| 9. | Total consideration | 692,665,000 |
| 10. | Exemption percentage | 51.49% |
| 11. | Taxable consideration | 336,011,792 |
| 12. | 6,630,000 taxable at 1.425% | 94,477.50 |
| 13. | 329,381,792 taxable at 2.625% | 8,646,272.04 |
| 14. | Total tax principal | 8,740,749.54 |
| 15. | Subtract tax paid with return | (3,084,412) |
| 16. | Revised deficiency (principal) | 5,656,337.54 |

[4] The fair market value of $692,665,000 is without any reduction in respect of a negative value for the leasehold interest at 2CMP.

[5] Petitioner reported the value of Chase's total assets on its RPTT tax return, for purposes of the formula method of allocating consideration, by adding back Chase's liabilities to the stock price. It is the Commissioner's position that the deficiency computation set forth above is in accordance with 19 RCNY §23-02, Subdivision (3), Illustrations (a) & (b) of the definition of "Consideration."

**TABLE 2**

**PETITIONERS PREVAIL IN FORMULA AND NEGATIVE LEASEHOLD**

| | | | |
|---|---|---|---|
| a. | Value of real property | | $628,665,000 |
| b. | Less amount of mortgage | | 217,246,267 |
| c. | Reduced value of real property (a-b) | | 411,418,733 |
| d. | Value of other assets | | |
| | 1. Total asset value | 122,898,367,991 | |
| | 2. Subtract value of real property | 628,665,000 | |
| | 3. Value of other assets | | 122,269,702,991 |
| e. | Total reduced value of assets (c+d3) | | 122,681,121,724 |
| f. | Price paid for stock | | 14,460,367,991 |
| g. | Price paid for stock attributable to real property | | |
| | 1. Total consideration | 14,460,367,991 | |
| | 2. Reduced value of real property | 411,418,733 | |
| | 3. Reduced value of all assets(d1-b) | 122,681,121,724 | |
| | 4. Divide line 2 by line 3 | 0.33536% | |
| | 5. Multiply line 1 by line 4 | 48,493,739 | |
| | 6. Stock price apportioned to NYC real property | | 48,493,739 |
| h. | Add amount of mortgages | | 217,246,267 |
| i. | Total consideration attributable to real property (g + h) | | 265,740,006 |
| j. | Exemption percentage | | 51.49% |
| k. | Taxable consideration | | 128,910,477 |
| l. | Tax at 2.625% | | 3,383,900 |
| m. | Subtract tax paid with return | | (3,084,412) |
| n. | Revised deficiency (principal) | | $299,488 |

**TABLE 3**

**COMMISSIONER PREVAILS IN FORMULA;**

**PETITIONERS PREVAIL IN NEGATIVE LEASEHOLD**

| | | | |
|---|---|---|---|
| 1. | Fair market value of real property | | $628,665,000[6] |
| 2. | Subtract mortgages | (217,246,267) | |
| 3. | Net value of real property | | 411,418,733 |
| 4. | Net value of assets | | 14,460,367,991[7] |
| 5. | Percentage (line 3 divided by line 4) | | 2.8451% |
| 6. | Stock price | | 14,460,367,991 |
| 7. | Stock price attributable to real property (line 5 x line 6) | | 411,418,733 |
| 8. | Add back mortgages | | 217,246,267 |
| 9. | Total consideration | | 628,665,000 |
| 10. | Exemption percentage | | 51.49% |
| 11. | Taxable consideration | | 304,965,392 |
| 12. | 6,630,000 taxable at 1.425% | | 94,478 |
| 13. | 298,335,392 taxable at 2.625% | | 7,831,304 |
| 14. | Total tax principal | | 7,925,782 |
| 15. | Subtract tax paid with return | | (3,084,412) |
| 16. | Revised deficiency (principal) | | $4,841,370 |

[6] The fair market value of $628,665,000 reflects a reduction in respect of a negative value for the leasehold interest at 2CMP

[7] *See*, Footnote 5, *supra*.

**TABLE 4**

**PETITIONERS PREVAIL IN FORMULA;**

**COMMISSIONER PREVAILS IN NEGATIVE LEASEHOLD**

| | | | |
|---|---|---|---|
| a. | Value of real property | | $692,665,000 |
| b. | Less amount of mortgage | | 217,246,267 |
| c. | Reduced value of real property (a-b) | | 475,418,733 |
| d. | Value of other assets | | |
| | 1. Total asset value | 122,898,367,991 | |
| | 2. Subtract value of real property | 692,665,000 | |
| | 3. Value of other assets | | 122,205,702,991 |
| e. | Total reduced value of assets (c+d3) | | 122,681,121,724 |
| f. | Price paid for stock | | 14,460,367,991 |
| g. | Price paid for stock attributable to real property | | |
| | 1. Total consideration | 14,460,367,991 | |
| | 2. Reduced value of real property | 475,418,733 | |
| | 3. Reduced value of all assets (d1-b) | 122,681,121,724 | |
| | 4. Divide line 2 by line 3 | 0.38752% | |
| | 5. Multiply line 1 by line 4 | 56,037,390 | |
| | 6. Stock price apportioned to NYC real property | | 56,037,390 |
| h. | Add amount of mortgages | | 217,246,267 |
| i. | Total consideration attributable to real property (g+h) | | 273,283,657 |
| j. | Exemption percentage | | 51.49% |
| k. | Taxable consideration | | 132,569,902 |
| l. | Tax at 2.625%[8] | | 3,479,960 |
| m. | Subtract tax paid with return | | (3,084,412) |
| n. | Revised deficiency – (principal) | | $395,548 |

[8] The tax under this analysis properly should be computed by computing taxable consideration as shown but then applying a tax rate of 1.425% or 2.625% on a property by property basis pursuant to 19 RCNY §23-03(c). However, in preparing Table 4, Petitioners effectively waived the benefit of the dual rate structure.

## STATEMENTS OF POSITIONS

Petitioners contend that the RPTT does not apply to the Merger because the Merger was consummated in Delaware and the RPTT enabling legislation precludes the imposition of the tax on a transaction that is consummated outside the City. The Commissioner responds that the enabling legislation in effect at the time of the Merger contained no such restriction since the restriction to which Petitioners refer was made inapplicable by a change in the law in 1965.

Petitioners further assert that the RPTT does not apply to the Merger because Old Chase did not itself own any real property. All real property with respect to which the RPTT is at issue was owned by subsidiaries of Old Chase. The Commissioner claims that the RPTT does apply because under her Rules the shares of stock in a corporation whose subsidiary owns real property also constitute an economic interest in real property.

Petitioners contend that the RPTT may not be imposed because there was no transfer of a controlling economic interest in connection with the Merger since 51.49% of the Old Chase stock was exempt under the mere change of form exemption. Respondent counters that the mere change of form exemption is applied only after determining whether there has been a transfer of a controlling economic interest and merely serves to exempt from the tax that portion of the transfer that is entitled to the exemption.

The parties agree that when computing consideration for an entity transfer where the entity owns other property in addition to real property and no good faith apportionment has been made, the consideration must be computed under a formula set forth in the

Commissioner's Rules. However, Petitioners assert that under that formula the value of all assets in the denominator of the formula is reduced by mortgage liabilities only; whereas Respondent claims that the value must be reduced by all liabilities, whether secured or unsecured.

Petitioners assert that the value of all Old Chase Real Estate must be aggregated to determine the portion of the consideration subject to tax and also the applicable tax rate. Therefore the Negative Leasehold reduces the value of the real property to which the consideration must be apportioned. Respondent counters that her Rule controls and that the value of the parcels of Old Chase Real Estate is not aggregated to determine either the amount of consideration subject to tax or the applicable tax rate. Petitioners argue, in the alternative, that if the taxable consideration is determined on a parcel by parcel basis, then 1CMP and 2CMP should be treated as one parcel. Respondent contends that the Negative Leasehold value of 2CMP should not be aggregated with the value of the fee of 1CMP both because they are separate parcels and because 2CMP merely represents an unsecured liability assumed in the Merger.

Petitioners argue that Chemical is not the grantee for RPTT purposes in connection with the Merger because Chemical did not receive any Old Chase shares since they ceased to exist by operation of law at the time of the Merger. The Commissioner counters that under Petitioners' analysis there can never be a grantee for RPTT purposes in the context of a Merger and that, in any event, the Old Chase shareholders effectively transferred their shares to Chemical in exchange for Chemical shares.

## CONCLUSIONS OF LAW

**Territorial Limitation**

Code §11-2102.b imposes the RPTT on "each instrument or transaction . . . at the time of the transfer, whereby any economic interest in real property is transferred . . .." Code §11-2101.5 limits the real property subject to tax to property located in whole or in part in the City. Code §11-2101.3 defines "instrument" to include any document (other than a deed or will) "**regardless of where made, executed or delivered,** whereby any economic interest in real property is transferred." [Emphasis added.] Code §11-2101.4 defines "transaction" to include "**any act or acts, regardless of where performed** . . whereby any economic interest in real property is transferred . . .." [Emphasis added.]

Therefore, under provisions of the RPTT, if the Merger otherwise constituted the transfer of an economic interest in real property, notwithstanding the fact that the final step in the Merger, the filing of the Certificate with the Secretary of State of the State of Delaware, took place outside the City, the transfer would be subject to the RPTT. While Petitioners do not dispute that the statutory provision would result in the imposition of the RPTT to the Merger, Petitioners contend that the imposition of the RPTT to the Merger is impermissible as being outside the scope of the enabling legislation. Petitioners note that the filing of the Certificate took place in Delaware and that Tax Law §1220 provides that: "any tax imposed under the authority of this article shall apply only within the territorial limits of the city . . . imposing the tax . . .. "

The City's authority to impose the RPTT is derived from the enabling legislation set forth in Tax Law Article 29 (Tax Law §§1201 *et seq.*). Tax Law §1201(b) permits the City to impose the RPTT on both conveyances by deed and on transfers of economic interests in real property. In addition, Tax Law §1201(b)(1) specifically provides 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].

This portion of Tax Law §1201(b)(1) was originally enacted as an amendment[9] to the predecessor of Tax Law §1201(b)[10] 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 State enabling legislation contained the following provisions:

> (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 the territorial limits of any such city, notwithstanding that some acts be necessarily performed with respect to such transaction within such limits.

[9] Ch. 785, L. 1960.

[10] Ch. 370, L. 1959, amending Ch. 215, L. 1955.

*Realty Equities*, *supra*, dealt with a transfer of real property located in the City where the deed was delivered outside the City. *Realty Equities* held that subdivision (6) above precluded the imposition of the RPTT on such a transfer. Following the 1960 amendment to the enabling act,[11] which specially addressed subdivision (6) but did not affect subdivision (3), transfers of real property located in the City were held subject to the RPTT notwithstanding that the deeds were delivered outside the City. *Samkoff v. Gerosa*, 29 Misc.2d 844 (S. Ct. N.Y. Cty. 1961).

Former subdivision 3 (now Tax Law §1220) simply 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. It places no limitation with regard to where the transfer takes place. Since the enabling legislation does not require that the transfers occur in the City, the imposition of the RPTT to the Merger is not outside the scope of the enabling legislation.

**Two-tiered Structure**

The RPTT is imposed on the transfer of a controlling "economic interest in real property." Code §11-2102(b). An economic interest in real property includes the "ownership of shares of stock in a corporation which owns real property." Code §11-2101.6. Petitioners argue that since the stock that was transferred was the stock of Old Chase, a bank holding company which itself did not hold title to real property, no economic interest in real property was transferred and, by its terms, the RPTT does not apply to the Merger.

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[11] *See*, footnote 9, *supra*.

The Commissioner responds that all of the real property at issue was owned by corporate subsidiaries of Old Chase and that the Rule that was in effect at the time of the Merger[12] treats shares of a corporation as an economic interest in real property where that corporation's subsidiary owns real property. Petitioners argue that this Rule is invalid because the statute requires that the corporation whose shares are transferred must itself own the real property. The Commissioner replies that even if this Rule were invalid, the Rule previously in effect permitted the imposition of tax where the upper-tier entity was a holding company.

To determine the validity of the Rule, it is helpful to examine its historical background. When first enacted, the RPTT applied only to transfers of real property by deed.[13] Therefore, it was possible to effectively transfer real property without incurring the RPTT by holding property in corporate form and transferring the shares in that corporation. In response to the widely-publicized sale of the corporation that owned the Pan Am Building, a sale as to which no RPTT was incurred, the State Legislature amended the RPTT enabling act[14] to permit the imposition of the RPTT on transfers of economic interests. The legislative history noted: "[t]his bill closes that loophole by permitting the taxation of transfers of controlling interests in corporations, partnerships, associations, trusts and other entities which own

[12] 19 RCNY §23-2, definition of "Economic interest in real property" subdivision (3).

[13] Ch. 398, L. 1971.

[14] Ch. 915, L. 1981.

real property. As a result, transactions which effectively, albeit indirectly, convey property will now be taxed."[15]

The Commissioner initially interpreted the RPTT's "controlling economic interest provisions" literally so that, generally, shares in an upper-tier corporation which owned no City real property directly did not constitute an "economic interest in real property" even if the upper-tier corporation owned a subsidiary which owned City real property. Shares in such a corporation thus could be transferred without incurring the tax. However, where the upper-tier corporation existed principally for the purpose of holding stock in the subsidiary that owned real property and was not substantially engaged in other *bona fide* activities, the Commissioner treated the stock of the upper-tier corporation as also constituting an economic interest in real property, and imposed a tax on the transfer of those shares. *See*, New York City RPTT Information Bulletin Number 2 (December 16, 1986), later incorporated in 1989 into Rule Article (b) [now 19 RCNY §23-2, definition of "Economic interest in real property," subdivision (2)] (the "Old Rule") applicable to transfers that occurred prior to April 24, 1995. The Old Rule was upheld in *595 Investors Limited Partnership v. Biderman*, 140 Misc.2d 441 (S. Ct. N.Y. Cty. 1988), as being within the legislative purpose of the RPTT amendments taxing economic interests.[16]

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[15] Governor Carey's approval letter. 1981 McKinney's Session Laws p. 2636-37.

[16] The entity in *595 Investors, supra,* whose interests were transferred was an upper-tier entity that was a shell whose value was derived solely from the real property owned by the lower-tier entity. In a case replete with the terms "sham" and "substance over form" (terms that clearly are inapplicable to Old Chase's corporate structure or to the Merger itself), the court disregarded what it characterized as the "passive shell" entity and permitted the City to treat the transfers of the upper-tier interests as if they were transfers of interests in the entity that owned the real property.

In 1995, the Commissioner went further, amending the definition of "Economic interest in real property" in 19 RCNY §23-2, by adding new subdivision (3), (the "Amended Rule"), to provide that "[f]or 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 . . . also constitutes an economic interest in real property." The parties agree that since the Merger occurred after the effective date of the Amended Rule, if the Amended Rule is valid, the Merger fits within the Amended Rule.

The impetus for the change in the Rule was another amendment to the RPTT[17] that provided an exemption from tax for transactions that effected a "mere change of identify 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"). The Mere Change Exemption provided much needed tax relief in a variety of transactions. However, it also provided new opportunities for tax avoidance. An operating company that also owned City real property could now contribute its City real property to a wholly-owned subsidiary without incurring the RPTT and a subsequent transfer of the parent corporation's shares would not be subject to tax under the Old Rule because the parent would not have been the type of holding company contemplated by the Old Rule.[18]

Petitioners assert that the Amended Rule, which is a change in the Department's position, goes beyond the scope of the statutory provision and is invalid. The Commissioner correctly notes that she can prospectively change her policy when interpreting existing

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[17] Ch. 170, §308, L.1994.

[18] City Record 4/24/95, p. 1022

statutory language without the necessity of further action by the Legislature so long as her prospective interpretation is consistent with the governing statute.[19] *Matter of National Elevator Industry, Inc. v. New York State Tax Commission*, 49 N.Y.2d 538, 547-548 (1980). Accordingly, the question is whether the Amended Rule is consistent with the governing statute and thus properly falls within the Commissioner's power to "amend rules and regulations appropriate to the carrying out of [the RPTT] and the purposes thereof." Code §11-2112.1.

The court in *595 Investors*, *supra*, noted that the purpose of the 1981 "anti Pan Am legislation" imposing a tax on controlling economic interest transfers was "to tax transactions which effectively, but indirectly, convey real property." While the court relied on a substance-over-form analysis in reaching its decision, its reason for doing so was because "[t]ax legislation should be implemented in a manner that gives effect to the economic substance of a transaction. [Citations omitted.] The RPTT would be rendered a nullity if it could be avoided simply by holding the real property through passive corporations or partnerships." *595 Investors*, *supra*, at 445.

From the inception of the "anti Pan Am" legislation, the Legislature intended that the RPTT be imposed on transfers of entities that effected changes in ownership of real property. The Legislature did not restrict the tax to entities whose activities were limited to holding real property. Thus, the statute provided a method for apportioning consideration between real property and

[19] Indeed, the Commissioner may even retroactively change her position under certain circumstances. *Matter of Varrington Corporation v. City of New York*, 85 N.Y.2d 28 (1995).

other assets.[20] Under the Old Rule, transfers of shares in operating companies with assets in addition to real property were taxable as transfers of "economic interests in real property" to the extent of the consideration apportioned to the real property. While the Commissioner initially chose not to tax the transfer of an operating company all of whose real property was held in a subsidiary (Old Rule, illustration (ii)), it is consistent with the purpose of the "anti Pan Am" legislation to reverse that position and tax transactions that indirectly transfer ownership of City real property.[21] As the Court of Appeals recently noted in *General Electric Capital Corp. v. New York State Division of Tax Appeals, Tax Appeals Tribunal, et al.*, 2 N.Y.3d 249, 254 (2004):

> "The cornerstone of administrative law is derived from the principle that the Legislature may declare its will, and after fixing a primary standard, endow administrative agencies with the power to fill in the interstices in the legislative product by prescribing rules and regulations consistent with the enabling legislation." (*Matter of Nicholas v. Kahn, 47 N.Y.2d 24, 31, 389 N.E. 1086, 416 N.Y.S.2d 565 [1979])*. In so doing, an agency can adopt regulations that go beyond the text of that legislation, provided they are not inconsistent with the statutory language or its underlying purposes (*Goodwin v. Perales, 88 N.Y.2d 383, 395, 669 N.E.2d 234, 646 N.Y.S.2d 300 [1996])*.
>
> This regulatory authority is, of course, not unbridled. "As an arm of the executive branch of government, an administrative agency may not, in the exercise of rule-making authority, engage in broad-based public policy

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[20] Ch. 915, L. 1981 §1(b)(vi).

[21] The Amended Rule is consistent with the regulations under the now repealed Gains Tax and the RETT. The State taxing authority's power to promulgate a regulation taxing the upper-tier entity was held to be within the rule making authority granted to it under the State Gains Tax statute. *Bredero Vast Goed. N.V. v. Tax Commission of the State of New York, 138 Misc.2d 27 (Sup. Ct., Albany Cty. 1988).* However, because this regulation was not in effect at the time of the transaction in *Bredero*, the Supreme Court decision was affirmed, on other grounds. 146 A.D.2d 155 (3rd Dept. 1989).

> determinations" *(Rent Stabilization Assoc. of N.Y. City v. Higgins, 83 N.Y.2d 156, 169, 630 N.E.2d 626, 608 N.Y.S.2d 930 [1993]. Cert denied 512 U.S. 1213, 129 L. Ed. 2d 823 [1994])*, and may adopt only rules and regulations which "are in harmony with the statute's over-all purpose" *(Goodwin v. Perales, 88 N.Y.2d at 395)*. That being said, where an agency adopts a regulation that is consistent with its enabling legislation and is not "so lacking in reason for its promulgation that it is essentially arbitrary" (*Matter of Bernstein v. Toia, 43 N.Y.2d 437, 448, 373 N.E.2d 238, 402 N.Y.S.2d 342 [1977]* [citation omitted]). . . , the rule has the force and effect of law (see *Molina v. Games Mgt. Servs., 58 N.Y.2d 523, 449 N.E. 395, 462 N.Y.S.2d 615, 618 [1983])*.

Because the Amended Rule is clearly within the statutory purpose of taxing indirect transfers of real property, it is valid and may be applied to the Merger.

**Controlling Interest**

In a corporate merger, the transfer, by operation of law, of real property from the corporation that ceases to exist to the continuing or new corporation is not subject to the RPTT. However, the related transfers of shares may be taxable. 19 RCNY §23-03(e)(2). Because both Old Chase and Chemical were publicly traded companies, certain persons were shareholders of both corporations prior to the Merger. In addition, as a result of the Merger, all of the Old Chase shareholders received stock in Chemical. The parties agree that, after the Merger, Old Chase shareholders owned 51.49% of New Chase. Petitioners therefore argue that the Merger was not a transfer of a controlling economic interest: *i.e.* a transfer of at least 50% of the stock of Old Chase. Respondent counters that 100% of the stock of Old Chase was transferred, resulting the transfer of a controlling economic interest, but that 51.49% of the transfer was not taxable. At issue, therefore, is

whether the Mere Change Exemption merely reduces the applicable tax or whether it can affect the taxability of the entire transaction.

Code §11-2101.6 defines an "economic interest in real property" to include the ownership of shares of stock in a corporation which owns real property. Code §11-2101.7 provides that the terms "transfer" or "transferred" in relation to an economic interest in real property shall include one transfer or multiple related transfers constituting a "controlling interest" in the corporation. Code §11-2101.8 defines a "controlling interest" to include fifty percent or more of the total combined voting power or value of a corporation. The applicable Rule implementing the above statutory provisions, 19 RCNY §23-02, provides that related transfers, which include transfers made pursuant to a plan to transfer a controlling economic interest in real property, must be aggregated to determine if the fifty percent threshold is met. Since all of the transfers took place pursuant to the Agreement and Plan of Merger that resulted in 100% of the stock of Old Chase being converted into stock in New Chase, these transfers may be aggregated.

Code §11-2106.b provides that the RPTT "**shall not apply** to any of the following deeds, instruments or transactions" [emphasis added] including the Mere Change Exemption contained in Code §11-2106.b(8) which provides in pertinent part:

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

Pursuant to the terms of the Merger, 100% of Old Chase's outstanding stock was converted into Chemical stock. This resulted in 51.49% of the interests continuing to be owned after the Merger by the same beneficial owners as owned the Old Chase stock. Accordingly, the Mere Change Exemption was applicable to the extent of 51.49% of the Old Chase stock exchanged for Chemical stock in the Merger.

Rule §23-05(8)(ii) states that the determination of whether a controlling interest has been transferred is made prior to the application of the Mere Change Exemption. This Rule, however, was adopted in 1999, retroactive only to May 11, 1998, and was not in effect at the time of the Merger.[22]

Petitioners argue that, although 100% of the Old Chase stock was exchanged for Chemical stock in the Merger, a controlling economic interest was not transferred because the portion of the stock not covered by the Mere Change Exemption was less than 50% and the "tax shall not apply to" the 51.49% covered by the exemption. Petitioners interpret the "tax shall not apply to" language of Code §11-2106.b to mean that such transactions are simply not recognized for RPTT purposes. Petitioners are in error.

The legislative history to the Mere Change Exemption of the RPTT indicates that the exemption was modeled after the exemptions under the RETT and the (now repealed) Gains Tax.[23] Tax Law §1405(b) provides that the RETT "shall not apply to the following

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[22] Basis and Purpose of Amendments contained in Notice of Rulemaking, City Record, April 28, 1999, p. 1139.

[23] Letter from Commissioner of Taxation and Finance Wetzler to Governor Cuomo dated June 9, 1994 recommending approval of the bill at p. 46 of the 60 page letter, contained in the Bill Jacket for ch. 170, L. 1994.

conveyances"[24] including that contained in Tax Law §1405(b)(6), "[c]onveyances to effectuate a mere change of identity or form of ownership or organization **where there is no change in beneficial ownership . . .**" [Emphasis added.] Although, on its face, the RETT mere change exemption appears to apply on an all or nothing basis, the applicable State RETT regulation includes a partial exemption by providing in Reg. §575.10 "**[t]o the extent that** a conveyance effectuates a mere change of identity or form of ownership or organization and there is no change in beneficial ownership, the real estate transfer tax does not apply." [Emphasis added.] The State RETT regulation explains what is meant by "the tax shall not apply" in example (c) under that regulation where it is stated "[s]uch conveyance **is not taxable** to the extent that there is no change in beneficial ownership." [Emphasis added.] Thus, at least under the RETT regulation in effect at the time of the enactment of the RPTT Mere Change Exemption and at the time of the Merger, the "the tax does not apply" language simply meant that the tax is not imposed to the extent that the beneficial ownership of the property remained the same. It did not mean that the portion of the transaction that is exempt is completely irrelevant to the RETT.

When enacting the RPTT Mere Change Exemption, the Legislature apparently picked up the partial exemption language provided by the State RETT regulation. The Legislature must be deemed to have been aware of the RETT and former Gains Tax statute, regulations and authorities published thereunder when enacting the RPTT Mere Change Exemption. The Commissioner's interpretation here, which is consistent with the way the State interprets the RETT and the

[24] Under the RETT, the term "conveyance" includes the transfer of a controlling interest in an entity with an interest in real property. Tax Law §1401(e).

former Gains Tax, thus is supported by the statute and its legislative history. Accordingly, the Mere Change Exemption only reduces the percentage of the transfer that is taxed and does not affect the taxability of the rest of the transfer. First, the amount of the transfer must be computed. Here, there was a transfer of 100% of the shares of Old Chase which, being at least 50% of Old Chase, constituted a controlling economic interest. After applying the Mere Change Exemption, however, only 48.51% of the transfer is taxable.

**Formula Issue**

The parties agree that when computing consideration for a stock transfer where the corporation owns other property in addition to real property and no good faith apportionment of the purchase price for the stock has been made, the consideration for the real property subject to the RPTT must be computed under a formula (the "Formula") in the Rules. This Formula apportions consideration to the real property based on the ratio of the value of the real property to the "value of all assets" and then increases the apportioned amount by any mortgages on the real property.

Petitioners assert that the Commissioner's Rule requires that the "value of all assets" in the denominator of the Formula be the full value of Old Chase's property reduced only by mortgage liabilities. However, because Old Chase was in the banking business, it had a large number of unsecured liabilities unrelated to the real property. When computing the fair market value of all assets used in the denominator of the apportionment formula, Petitioners added the stock price of $14,460,367,991 to the total of Old Chase's liabilities of $108,438,000,000 to reach a total

"fair market value of all assets" of $122,898,367,991. If the Formula is applied in the manner suggested by Petitioners, the consideration for the corporate stock will effectively be spread over these unsecured liabilities and only approximately forty percent of the value of the real property would be subject to tax. Respondent addresses this problem by claiming that, in this case, the "value of all assets" in the apportionment Formula must be reduced by all liabilities, both secured and unsecured, resulting in the full value of the real property being subject to tax. Under Petitioners' analysis, the total additional tax liability would be either $299,488 or $395,548 depending on the resolution of the Negative Leasehold issue. Under the Commissioner's analysis, the total additional tax liability would be either $4,841,370 or $5,656,378, depending on the resolution of the Negative Leasehold issue.

Code §11-2102(b) provides in the case of transfers of controlling economic interests, that the tax is imposed on "Consideration." Where a corporation whose stock is being transferred owns both real property and other assets, Code §11-2102(d), as in effect at the time of the Merger, provided:

> If a transaction subject to the taxes imposed by this section includes assets in addition to real property or interest therein, and there is no apportionment made in good faith of the consideration for such real property or interest and such assets, the tax shall be on that part of the total consideration which the **value** of the real property or interest therein bears to the **value** of all such assets, including such real property or interest. [Emphasis added.]

The parties stipulated that Old Chase and its subsidiaries owned Other Assets in addition to the Old Chase Real Estate and that there was no "good faith apportionment" made of the Merger

consideration between these two groups of assets. Therefore, Code §11-2102(d) requires that the Merger consideration be apportioned between the Old Chase Real Estate and the Other Assets in order to determine how much of the Merger consideration is subject to the RPTT.

The Code defines "Consideration" as "[t]he price actually paid for the real property or economic interest therein . . . includ[ing] the amount of any mortgage, lien or other encumbrance, whether or not the underlying indebtedness is assumed." §11-2101.9. The Commissioner's Rules at the time of the Merger provided that to compute "Consideration" in the case of transfers of controlling economic interests, "a proportionate share of the amount of any mortgage on the real property must be added to the amount paid for the stock in a corporation . . .." 19 RCNY §23-02(3) definition of "Consideration in the Case of Transfers of Controlling Economic Interests." This Rule contains the following example:

> X Corporation owns real property in New York City with a fair market value of $1,000,000 but encumbered by a $900,000 mortgage. X's stock is sold for $100,000 cash. The $900,000 mortgage is to be added to the $100,000 cash and the tax computation is based on $1,000,000 of consideration.

Thus, even though the mortgage in this example is a mortgage on the real property owned by X corporation and not a lien on the stock being sold, the Commissioner's Rule broadens the Code's definition of "Consideration" and includes the amount of the mortgage on the underlying real property in Consideration for the corporate stock.

With respect to the allocation of Consideration between real property and other assets, the 19 RCNY §23-02 definition of

"Consideration in the Case of Transfers of Controlling Economic Interests, paragraph (iii)(B) provides in pertinent part:

> If no apportionment of the consideration for the real property (or interest therein) and the other assets has been made . . . then the consideration for the real property (or interest therein) shall be calculated by multiplying total consideration by the following ratio:
>
> Fair market value of the real property (or interest therein) owned by the entity being transferred
> ———————————————————————————————————
> Fair market value of all assets owned by the entity, including the real property (or interest therein)

This Rule provides three examples, of which Illustration b is the closest to the present facts:

> X Corporation owns real property in New York City with a fair market value of $500,000, but encumbered with a $300,000 mortgage, and other assets valued at $1,000,000. All of X's stock is sold for $1,200,000 cash. The consideration subject to tax is $500,000 calculated as follows:

| | |
|---|---|
| Value of real property | $ 500,000 |
| Less amount of mortgage | 300,000 |
| Reduced value of real property | 200,000 |
| Value of other assets | 1,000,000 |
| Total reduced value of assets | $1,200,000 |
| | |
| Cash paid | $1,200,000 |
| | |
| Cash paid attributable to real property 200,000 / 1,200,000 X $1,200,000 = | 200,000 |
| Add amount of mortgage | 300,000 |
| Total consideration attributable to Real property | $500,000 |

This example indicates that in determining the portion of the Merger consideration allocable to the Old Chase Real Estate, the value of the Old Chase Real Estate net of the mortgages, the value of all the Old Chase assets, the amount of the mortgages on the Old Chase Real Estate and the Merger consideration must be entered into the appropriate places in the above Formula. This was precisely what Petitioners did when completing the RPTT Return and what Petitioners now assert is the way to compute the RPTT on the Merger.[25]

The parties have stipulated that: the consideration for the Merger that is to be allocated between the Chase Real Estate and the Other Assets was the stock price of $14,460,367,991;[26] the value of the Old Chase Real Estate was $628,665,000 or $692,665,000 depending upon the treatment of the Negative Leasehold issue discussed below;[27] and the amount of the mortgages encumbering the Old Chase Real Estate was $217,246,267.[28] While the parties have stipulated that the amount of the Old Chase liabilities was $108,438,000,000,[29] they disagree as to the role this figure plays in the Formula. In computing the portion of the Merger consideration apportioned to the Old Chase Real Estate under the Formula, Petitioners used as the value for all the Old Chase assets the amount of $122,898,367,991 being the sum of the stock price of

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[25] The major difference between the treatment on the RPTT Return and on Table 2 results from differences in valuation of some of the Chase Real Estate. The corrected values have all been stipulated to and are no longer in dispute.

[26] *See*, Findings of Fact 27 and 46, *supra*.

[27] *See*, Findings of Fact 24 and 46, *supra*.

[28] *See*, Finding of Fact 25, *supra*.

[29] *See*, Finding of Fact 27, *supra*.

$14,460,367,991 and the Old Chase liabilities of $108,438,000,000,[30] which the parties have stipulated includes various intangibles including goodwill and "core deposits" acquired by Chemical in the Merger.[31] By entering these various values into the Formula, Petitioners computed the RPTT as set forth in Finding of Fact 46, Tables 2 and 4, *supra*.

The Formula as well as the definition of consideration in 19 RCNY §23-03 are very specific in providing a three-step approach to computing the portion of the consideration subject to the RPTT:

> Step 1: The value of the real property must be reduced by any mortgages on that real property.
>
> Step 2: The consideration must be multiplied by a fraction representing the value of the real property net of those mortgages divided by the value of all property net of those mortgages.
>
> Step 3: The mortgages subtracted out in Step 1 must be added to the results of Step 2 to arrive at the amount of the consideration that is attributable to the real property.

Petitioners apply the Formula, following these three steps, to determine the amount of the Consideration attributable to the Old Chase Real Property as being $265,740,006 or $273,283,657,[32] or

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[30] *See*, Finding of Fact 46, Tables 2 and 4, *supra*.

[31] *See*, Finding of Fact 34, *supra*.

[32] Depending on the treatment of the Negative Leasehold.

roughly forty percent of the $628,665,000 or $692,665,000[33] value of the Old Chase Real Property. Respondent, however, asserts that a different interpretation of the Formula would be in accordance with her Rule. Respondent's approach to Step 2 of the Formula involves computing the "net value of the assets," which is the value of all the assets reduced by all liabilities, both mortgages and liabilities not secured by real property. (*See*, Tables 1 and 3 in Finding of Fact 46, *supra*.) This approach to the Formula results in the portion of the Consideration apportioned to the Old Chase Real Property being precisely equal to the value of that property.

The problem that Respondent is attempting to address is that a bank by the nature of its business has a great many unsecured liabilities. Accordingly, if the denominator of the apportionment formula representing the value of all the entity's assets is not reduced by the amount of all these unsecured liabilities so that it then represents net asset value, the amount of the Merger consideration that will be apportioned to the real property will be significantly less than the value of the real property.

However, nowhere in the Commissioner's Rules is there any suggestion that the value of all property in the Formula should be reduced by all liabilities and not just mortgages. Nor does the Rule contain a provision allowing the exercise of discretion should the Formula lead to an unsound result in a particular case, an approach not uncommon elsewhere in Respondent's Rules. *See, e.g.* 19 RCNY §11-67. The Commissioner, instead, attempts to justify her deviation from the Formula specified in her Rule with an extensive analysis of various accounting rules for corporate mergers under

[33] Also depending on the treatment of the Negative Leasehold.

GAAP and under the Internal Revenue Code and an extensive discussion of various bank regulatory requirements. However, none of this is determinative with respect to the proper application of the RPTT and the Rules properly promulgated thereunder.

The State enabling legislation for the RPTT in effect at the time of the Merger permitted the imposition of the tax on either consideration or value.[34] The City Council, when drafting the relevant Code provision, chose to impose the tax on consideration. Code §11-2102. Other transfer taxes have provided that the tax will always be imposed on the value of the real property. For example, the RETT provides in Tax Law §1401(d)(iii):

> In the case of a controlling interest in any entity that owns real property, consideration shall mean the fair market value of the real property or interest therein apportioned based on the percentage of the ownership interest transferred or acquired in the entity.[35]

The City has acknowledged that Code §2102(d) as in effect at the time of the Merger "allows taxpayers to transfer a controlling economic interest in an entity that has assets other than real property without adequately accounting for the value of the real property." The City of New York, Office of Management and Budget, The City of New York January 2003 Financial Plan, Fiscal Years 2003-2007, p. 28. For this reason the City requested legislation amending the enabling legislation of the RPTT. *See*, approval letter of May 7, 2003 to Governor Pataki from Mayor Bloomberg which stated in pertinent part:

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[34] Tax Law §1201(b).

[35] *See, also*, Former Tax Law §1440(1)(c) of the now repealed Gains Tax.

> [T]his legislation closes a loophole within the City's real property transfer tax that changes the way in which businesses value real property at the time of transfer of controlling economic interests in real property. Closing this loophole will produce an additional $2 million in City tax revenues.

In 2003, in response to the City's request, the State Legislature amended Tax Law §1201(b)(vi) and also Code §2102(d) to provide as follows:

> In the case of a transfer of an economic interest in any entity that owns assets in addition to real property or interest therein, the consideration subject to tax shall be deemed equal to the fair market value of the real property or interest therein apportioned based on the percentage of the ownership interest in the entity transferred.[36]

This "loophole-closing" amendment was prospective only[37] and does not apply to the Merger. Rather, Code §2102(d)'s imposition of the tax on "consideration" and not on "value" is the applicable standard with regard to the Merger. The fact thus remains that Respondent properly promulgated a Rule which Petitioners followed to the letter. As noted above in *General Electric Capital Corp., supra,* 2 N.Y.3d 249, 254 (2004)[Citations omitted]: "[W]here an agency adopts a regulation that is consistent with its enabling legislation and is not 'so lacking in reason for its promulgation that it is essentially arbitrary' . . . the rule has the force and effect of law."

Accordingly, the Commissioner, like the Petitioners, is bound by her Rules. Accordingly, Petitioners' approach to the Formula as

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[36] L. 2003, ch. 63, Part C, §§1 and 2.

[37] L. 2003, ch 63, Part C, §4.

set out in Tables 2 and 4 of Finding of Fact 46, *supra*, in which the denominator of the apportionment ratio is the gross value of the assets, is the proper approach to determining the portion of the Merger consideration subject to the RPTT.

**Negative Leasehold**

At the time of the Merger, Old Chase's corporate headquarters were located at Chase Manhattan Plaza. Old Chase owned the fee interest in 1CMP and the surrounding Public Plaza and the leasehold interest in 2CMP. The fee interest in 1CMP and the surrounding Public Plaza had a fair market value of $124,000,000, while the leasehold interest in 2CMP had a fair market value of negative $64,000,000, presumably because it represented an obligation to pay rent that was greater than market rent at the time of the Merger. Petitioners contend that when computing the RPTT, the fair market value of all the Old Chase Real Estate must be aggregated to determine the value of the real property transferred and the tax rate to be imposed. This approach would permit the negative value of 2CMP to partially offset the positive value of the rest of the Old Chase Real Estate and substantially reduce the RPTT due. The Commissioner contends that under her Rule, the RPTT must be computed on a parcel by parcel basis and, therefore, the negative value of the leasehold may not reduce the value of the property subject to tax.

Petitioners contend that, alternatively, if the tax on the Old Chase Real Estate must be computed on a parcel by parcel basis, 1CMP and 2CMP must be treated as one "parcel" so that the fee interest in 1CMP must be offset by the negative value of 2CMP to determine the fair market value of the parcel that is subject to the RPTT. The Commissioner counters that 1CMP and 2CMP are

separate parcels. Under the Commissioner's analysis, since no tax is due on a property where the consideration is under $25,000,[38] the negative value of 2CMP is not taken into account when computing the RPTT.

Code §11-2102.a(9)(ii) provides that the tax rate on commercial property transferred by deed is 1.425% of the consideration where the consideration is up to $500,000 and 2.625% where the consideration exceeds $500,000. Code §11-2102.b(1)(B)(ii) provides that the tax rate for transfers of economic interests in commercial real property also is 1.425% of the consideration where the consideration is up to $500,000 and 2.625% where the consideration exceeds $500,000. The applicable Rule, 19 RCNY §23-03(c) Rates of Tax on Transfers of Economic Interests, provides in pertinent part that:

> Where the transfer of a controlling economic interest involves more than one parcel of real property, the applicable rate is determined based upon the consideration apportioned to each parcel.
>
> Example: X Corporation owns two parcels of commercial property in New York City. Building A is worth $400,000 and Building B is worth $600,000. Y, X's sole shareholder, sells his X Corporation stock, which represents his entire interest in both parcels, to Z for $1,000,000. The tax is calculated as follows: 1.425% of $400,000 (Building A) + 2.625% of $600,000 (Building B). The tax due is $21,450.

Accordingly, if this Rule is valid, the tax must be computed on a parcel by parcel basis and the tax rate is determined separately for each parcel.

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[38] *See*, 11-2102.a.

In attacking the validity of this portion of 19 RCNY §23-3(c), Petitioners first rely on *Matter of Arbor Hill Associates, DTA No. 812825, 1997 N.Y. Tax LEXIS 296, (State Tax Appeals Tribunal, June 26, 1997),* for the proposition that the transfer of multiple properties should be treated as a single conveyance for a single consideration where the transfer is made by a single, indivisible instrument for a single, indivisible price. However, *Arbor Hill, supra,* was a State RETT case dealing with a conveyance by one deed of multiple properties. It was not a case dealing with the transfer of a controlling economic interest in an entity that indirectly owned numerous properties. Most importantly, the RETT does not have a regulation similar to the portion of 19 RCNY §23-03(c) set forth above. A decision under the RETT dealing with a conveyance by deed does not control the proper interpretation of Respondent's Rule dealing with economic interest transfers or with Respondent's authority under Code §11-2112.1 to promulgate such a Rule. Accordingly, *Arbor Hill* does not control the validity of 19 RCNY §23-03(c).

Petitioners next criticize 19 RCNY §23-03(c)'s failure to aggregate consideration to determine the tax rate by claiming that it is inconsistent with 19 RCNY §23-03(h)(8), Examples 3 and 4, which, in the context of sales of shares in a cooperative housing corporation, provide that consideration for sales of shares allocable to multiple apartments in one building should be aggregated to determine the applicable tax rate. However, the approaches in 19 RCNY §23-03(c) and 19 RCNY §23-03(h)(8) can be reconciled when one realizes that cooperative shares are not themselves real property but are economic interests in real property. (Cooperative shares are shares in a corporation which owns the land and building containing all the cooperative apartments.) All that the Commissioner has done in these two

subsections of her Rule is to provide that consideration for transfers of economic interests in the same underlying parcel of real property (the land and building owned by the cooperative housing corporation) are aggregated to determine the tax rate, but that transfers of economic interests in different underlying parcels of real property (Building A and Building B in the example under 19 RCNY §23-03(c)) are not aggregated to determine the rate. The treatment of cooperative shares by aggregation of related transfers of shares in the cooperative housing corporation is consistent with the transfers of other economic interests (except that a controlling interest is not required for the cooperative share transfers to be taxable). The decision to aggregate consideration only where the consideration relates to the transfer of a single underlying parcel is not unreasonable and is within the scope of the Commissioner's rule-making authority. Accordingly, the tax rate should be imposed on a parcel by parcel basis.

Petitioners then assert that even if the tax is to be imposed on a parcel by parcel basis, 1CMP and 2CMP should be treated as one "parcel." The Rules do not specifically define a "parcel." However, the Rules make it clear that the term is not synonymous with a "tax lot."[39] In the ordinary case, where every parcel has value of at least $25,000, if the tax rate in an entity transfer is imposed on a parcel by parcel basis, it will not benefit a taxpayer to have more than one property treated as a single "parcel," as the only possible impact would be to increase the rate of the RPTT. A case such as this, with a property with negative value, is the only kind of case where a taxpayer would benefit from treating multiple properties as one "parcel."

[39] *See, e.g.*, 19 RCNY §23-04 where the illustration deals with a "parcel" of land situated partly within Westchester County and partly within Bronx County.

1CMP and 2CMP occupied separate tax lots, were built at different times and had separate physical plants for various mechanical systems. However, they were managed as an integrated whole and were seen by the public as one integrated entity. Various facilities in both buildings and the interlink under the Public Plaza were used by employees working in both buildings. In addition, truck deliveries for both buildings were all made through one of the buildings. The fee interest in 1CMP had been owned continuously by Old Chase from the time the building was built in the early 1960's until the time of the Merger. While Old Chase owned 2CMP when that building was built in the 1920's, it sold it around the time it was building 1CMP in the 1960's. 2CMP subsequently changed hands, was then leased to a third party and that lease was later assigned to Old Chase. Therefore, at various times in its history during which Old Chase owned and occupied 1CMP, 2CMP was both owned and occupied by parties unrelated to Old Chase. Accordingly, since both the fee and the leasehold in 2CMP have been transferred independently of 1CMP at various times in the past, it was not unreasonable for the Commissioner to have treated them as separate parcels in connection with the Merger.

More importantly, the negative value of the leasehold interest in 2CMP merely represents an unsecured liability that Chemical has assumed in the Merger. Petitioners have prevailed in their position that unsecured liabilities must be included in the denominator of the Formula used to compute the taxable consideration for the Merger, even though this treatment results in approximately half of the value of the Old Chase Real Estate not being subject to the RPTT. Thus, this unsecured liability (the continuing obligation to pay above-market rent under the lease for 2CMP) has already been taken into account in computing the RPTT applicable to the Merger. The negative value of 2CMP should not be

taken into account twice in computing the Merger consideration subject to the RPTT.

**Whether Chemical was the grantee under the RPTT**

Petitioners assert that Chemical did not receive any shares of Old Chase which ceased to exist by operation of law on the Merger Date. Therefore, Petitioners claim that Chemical cannot be the grantee under the RPTT.

Code §11-2104 and 19 RCNY §23-08 specify that the RPTT "shall be paid by the grantor." The Code and Rules also provide that "[t]he grantee shall also be liable for the payment of such tax in the event that the amount of tax due is not paid by the grantor. . .." *Id.*

Rule §23-03(e)(2) provides that "[a] transfer of real property in a statutory merger . . . from a constituent corporation to the continuing or new corporation is not subject to tax. However, the related transfers of shares of stock in a statutory merger . . . may be subject to tax." Illustration (i) under this Rule makes it clear that it is the transfer of the shares of the constituent corporation (Old Chase) that may be subject to tax (if that transfer represents a controlling economic interest). Accordingly, the shareholders of Old Chase are the grantors who are primarily liable for the tax.

Petitioners assert that Chemical did not receive any shares of Old Chase which ceased to exist by operation of law on the Merger Date. Under Petitioners' characterization of the transaction, there can never be a grantee in the merger of a publicly traded corporation. This is an absurd result. While the Rule is silent

as to the identity of the grantee, there can be no doubt that Chemical is the grantee under the Merger. When the shareholders of Old Chase gave up their Old Chase shares and received, in exchange, the Chemical shares, the Old Chase shareholders, in effect, transferred their shares to Chemical as grantee. Accordingly, Chemical is liable for the RPTT as grantee.

I have considered all other arguments related to the above issues and find them unpersuasive.

**ACCORDINGLY, IT IS CONCLUDED THAT:**

A. The RPTT enabling legislation does not preclude the imposition of the RPTT on the statutory merger of two Delaware corporations where the merger was consummated in Delaware.

B. The RPTT applies to the transfer of a controlling economic interest in a corporation whose subsidiaries own real property in the City.

C. The Mere Change Exemption is applied after the determination of whether there has been the transfer of a controlling economic interest. Therefore, the Merger is subject to the RPTT even though 51.49% of the transaction was exempt as a mere change of form.

D. In apportioning the amount of the consideration subject to the RPTT between City real property and other assets, the "value of all assets" in the apportionment ratio contained in the Formula in the Rules is the value of all assets reduced only by mortgage liabilities and not reduced by all liabilities.

E. In determining the portion of the consideration subject to RPTT and the applicable tax rate, consideration is determined on a parcel by parcel basis. The negative value of a leasehold interest is not taken into account because the transfer of that interest directly would not be subject to the RPTT and because, as an unsecured liability it has already been taken into account in the denominator of the apportionment ratio.

F. Chemical is liable for the RPTT as the grantee in the Merger.

G. Because Petitioners prevailed in the Formula Issue and the Commissioner prevailed in the Negative Leasehold Issue, based on the parties' Stipulation, the additional tax due is to be computed as set forth in Table 4 of Finding of Fact 46, *supra*.

The Notices of Determination dated September 14, 1998 are sustained in part with the additional tax asserted being reduced from $8,320,249.31 to $395,548, plus applicable interest thereon.

DATED: February 4, 2005
New York, New York

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MARLENE F. SCHWARTZ
Administrative Law Judge