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Sounds Like a Plan? Taxpayer Wins NYC Real Property Transfer Tax Aggregation Case

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New York City real property transfer tax applies both to transfers of real property located in New York City and to transfers of a controlling interest in an entity that owns real property in New York City. There is a presumption that multiple transfers of entity interests that are made within a three-year period are related, in which case they would be aggregated for purposes of determining whether there has been a transfer of a controlling interest. Taxpayers can rebut this presumption by proving that the transfers are unrelated, although the NYC Department of Finance has often challenged taxpayers attempting to do so. New York City taxpayers will welcome a recent decision by a New York City Administrative Law Judge, which held that a taxpayer had successfully met its burden of proving that transfers made within a three-year period to a single transferee were unrelated.

Background

The NYC Administrative Code imposes a real property transfer tax (“RPTT”) that is generally at a rate of 2.625% of the consideration with respect to transfers of real property located in New York City for more than \$500,000.

The New York City RPTT applies to the transfer of a “controlling interest” in entities that own real property located in New York City. The term “controlling interest” means, with respect to a partnership or limited liability company, 50% or more of the capital, profits, or beneficial ownership of the entity.

The Real Property Transfer Tax Rules and Regulations provide that related transfers are aggregated in determining whether a controlling economic interest has been transferred. Related transfers include transfers “made pursuant to a plan to either transfer or acquire a controlling economic interest in real property.” Transfers made within a three-year period are “presumed to be related and are aggregated, unless the grantor(s) or grantee(s) can rebut this presumption by proving that the transfers are unrelated.”

*In the Matter of the Petition of Jonis Realty/E. 29th Street, LLC*¹

Facts

A New York City Administrative Law Judge (“ALJ”) recently considered whether multiple transfers of LLC interests should be aggregated for purposes of determining whether there was a transfer of a controlling interest. The matter involved real property in New York City that was owned by a limited liability company (“Property Owner LLC”). Prior to August, 2005, Jonis Realty/E 29th Street, LLC (“Jonis LLC”) owned a 96% interest in Property Owner LLC. Two brothers, Steven Halegua and Nathan Halegua, each owned a 46.5% interest in Jonis LLC.

In August, 2005, an unrelated party (the “Transferee”) contributed cash to Property Owner LLC in exchange for a 30% interest in Property Owner LLC. Then, “some months later,” the Transferee acquired an additional 18% interest in Property Owner LLC (also apparently in exchange for a cash contribution by the Transferee to Property Owner LLC). Property Owner LLC used cash from the Transferee to acquire additional real estate.

After the Transferee had acquired its 48% interest in Property Owner LLC, Steven (per his testimony) became uncomfortable with his investment in Jonis LLC, because he could not get answers to his questions about the status of the development, and because he was not receiving any income from the property. In addition, he was worried that his interest in Jonis LLC would be diluted (possibly down to zero) if there were additional capital calls that he would not be able to meet.

In response to these concerns, Steven initially offered to sell his interest in Jonis LLC to the architect on the development project. Steven then offered to sell his interest to Nathan or the Transferee during a telephone conversation, and the Transferee accepted

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the offer. Nathan, who did not have sufficient funds to purchase Steven's interest, repeatedly asked Steven not to sell. Steven felt that he was "forced to sell" and, on March 14, 2006, he transferred his entire beneficial interest in the property to the Transferee. This transfer increased the Transferee's interest in Property Owner LLC from 48% to 70.32%.

Jonis LLC filed a Form NYC-RPT and paid \$651,285.16 to the NYC Department of Finance (the "Department") on October 25, 2006 (which included \$139,565.38 of interest and penalties that apparently were paid because the return was filed late). Then, on September 15, 2007, Jonis LLC filed an Application to Claim a Refund for the entire amount that it had paid, together with an explanation of how the third transfer to the Transferee was unrelated to the first two.

The NYC Department issued a Notice of Disallowance which stated that the "three transfers of economic interest in Real property within a three year period must be aggregated. The aggregation of the conveyance resulted in a controlling economic interest in the Real Property, which is subject to the Real Property Transfer Tax." After a conference with the Conciliation Bureau, Jonis LLC filed a petition with the ALJ.

ALJ Decision

In The Matter of the Petition of Jonis Realty/E. 29th Street, LLC, the ALJ initially rejected an argument made by the Department that the petition should be denied on technical grounds related to the improper grant of a power of attorney.

The ALJ then noted that, since the transfers at issue took place within a three-year period, they are presumed to be related and Jonis LLC had the burden to rebut that presumption. In deciding in favor of Jonis LLC, the ALJ cited an Example in the Regulations where,

within a three-year period, (i) a 1/3 shareholder of a corporation sells her interest in order to have funds to satisfy a judgment and (ii) another 1/3 shareholder transfers his interest to his spouse pursuant to a separation agreement. The Example concludes that the transfers "will not be aggregated because the transfers are not related." The ALJ also cited a Finance Letter Ruling issued by the Department which concluded that transfers made by the same person were not related where (i) a father transferred an aggregate 0.8% interest to his daughters and then (ii) within three years his unexpected death triggered the sale of his remaining 49.9% interest for cash.

The ALJ stated that the evidence is "uncontradicted" that the third transfer was made for reasons unrelated to the initial transfers, as the first two transfers were made "to gain the funding and expertise of the Transferee" and the third transfer "was prompted by Steven's desire to exit the investment." The ALJ also noted that the transfer of Steven's interest was "unplanned" and "unexpected" at the time of the earlier two transfers. Thus, the ALJ concluded that the transfer of Steven's interest may not be aggregated together with the first two transfers for purposes of determining whether there has been a transfer of a controlling interest. Accordingly, since the other two transfers to the Transferee involved the transfer of only a 48% beneficial interest in the property, the transfers were not subject to New York City RPTT and the Claim for Refund was allowed.

Analysis

Significantly, the ALJ did not distinguish either the above-described Example or Finance Letter Ruling (which each included more than one transferee) from the case at hand, despite the fact that each of the transfers in *Jonis* was

made to the same transferee. This determination makes sense since the taxpayer was able to demonstrate that, at the time of the first two transfers, there was no plan for the Transferee to acquire any additional interests (or for any other transfers to be made). Therefore, there was no "plan to either transfer or acquire a controlling economic interest in real property."

The taxpayer in *Jonis* certainly did not help itself by initially paying RPTT and then trying to recover money from the City as a refund of RPTT that it had previously paid. The Department has been aggressive in challenging taxpayers attempting to obtain a refund of RPTT payments in many circumstances. (The fact that the Department argued that the case before the ALJ should be dismissed because of a technicality regarding a power of attorney may be indicative of the Department's approach toward RPTT refund claims.)

In any case, it is not unusual for the Department to challenge taxpayers that claim to rebut the presumption that transfers made within a three-year period are related and should be aggregated together. It is noteworthy that there is no indication from the ALJ's decision that the Department even made arguments in support of the transfers all being related to each other. Rather, the Department seems to have argued that the transfers should automatically be aggregated based on the presumption that they are related since they were made within a three-year period. The ALJ's decision in *Jonis* should serve as a reminder that the presumption that transfers made within a three-year period are related can indeed be rebutted—even when all of the transfers are made to the same transferee.

¹ Determination TAT(H)09-9R(RP).

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