

**New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau**

TSB-A-90(4)R
Real Property
Transfer Gains Tax
May 11, 1990

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. M900214B

On February 14, 1990, a Petition for Advisory Opinion was received from Long Shadow, Inc., 26 Henkes Lane, Latham, New York 12110.

The issues raised by Petitioner, Long Shadow, Inc., are whether the transfer of title to real property situated in New York State constitutes a taxable transfer under section 1440.7 of the Real Property Transfer Gains Tax Law (hereinafter the "gains tax"), if the change is pursuant to an income tax free corporate reorganization under section 368(a)(1)(D) and Section 355 of the Internal Revenue Code in the split-off or split-up fact pattern. In addition, whether the transfer of title is exempt under section 1443.5 of the Tax Law as a mere change in form of ownership or organization without a change in beneficial ownership. Also, whether the distribution of shares of the subsidiaries in the "split-up" pursuant to a liquidation of the Petitioner constitutes a change of controlling interest of an entity with an interest in real property.

Long Shadow, Inc., a New York Corporation since its inception in June, 1983, has been actively engaged in real estate development, improvement, and subdivision for retail sale of one large tract of land. The Petitioner acquired that tract of land by a tax-free transfer pursuant to Section 351 of the Internal Revenue Code from its four shareholders in June, 1983. Those shareholders had acquired the parcel by devise from the Estate of John Henkes, Sr.

The four shareholders (two husband and wife groups, hereinafter A and B) have decided to pursue different philosophies in operating the corporation and developing the remaining portion of this tract. Accordingly, a plan for a divisive "D" reorganization has been proposed pursuant to Section 368(a)(1)(D) of the Internal Revenue Code, followed by an income tax-free "split-up" or "split-off" pursuant to Section 355 of the Internal Revenue Code.

The "split-up" plan envisions an equal division of the real property (each shareholder group currently holds 50 percent of the Petitioner), followed by a transfer of the land to two newly created subsidiaries. At this point, the Petitioner will own all the stock of the subsidiaries. Then the shares of the subsidiaries would be distributed (all of the shares of one subsidiary to Group A and all of the shares of the other subsidiary to Group B), followed by the liquidation of the Petitioner.

The "split-off" plan envisions the creation of one subsidiary, followed by a transfer of one-half of the real estate to the newly created subsidiary. At this point, the Petitioner will own all the stock of the subsidiary. The shares of the newly created subsidiary would then be distributed to one

of the two shareholder groups in exchange for their shares in the Petitioner.

The gains tax is a 10% tax on the gain derived from a transfer of real property, which includes the transfer or acquisition of a controlling interest of an entity with an interest in real property, where the consideration for the transfer is one million dollars or more and the real property is located in New York State.

The term "controlling interest" is defined at Section 1440.2 of the Tax Law to mean, in the case of a corporation, either 50% or more of the total combined voting power of all classes of stock of the corporation or 50% or more of the capital, profits or beneficial interest in such voting stock of the corporation.

Also, Section 590.44 of the Gains Tax Regulations provides that in the case of a corporation which has an interest in real property, the acquisition of a controlling interest in the corporation occurs when a person or group of persons acting in concert acquires a total of 50% or more of the voting stock in such corporation.

Section 590.47 of the Gains Tax Regulations provides as follows:

(a) Question: Is the price paid for the ownership interest in an entity the consideration for a controlling interest used to calculate gain?

Answer: Generally, no. Section 1440(1) of the Tax Law states that:

". . . there shall be an apportionment of the fair market value of the interest in real property to the controlling interest to ascertain the consideration for the controlling interest."

Example: A corporation's only asset is a \$4 million fair market value piece of property. If 100 percent of the stock is purchased, the consideration is \$4 million (\$4,000,000 x 100 percent). If a 50-percent interest were acquired, only \$2 million consideration is used to calculate gain.

(b) Question: How is the fair market value determined?

Answer: Generally, by appraisal. It is the amount a willing buyer would pay a willing seller for the real property. It is not net fair market value, which deducts mortgages on the property from fair market value.

Thus, in the example in subdivision (a) of this section, if the property is encumbered by a \$3 million mortgage, and \$1 million is paid for 100 percent of the stock, the amount of consideration for the acquisition is \$4 million, not \$1 million.

Further, Section 590.45 of the Gains Tax Regulations provides:

(a) Question: Is the property owned by an entity aggregated in determining if the \$1 million exemption applies when an acquisition of a controlling interest occurs?

Answer: Only if it is contiguous or adjacent. The same rules apply to the property owned by an entity as if the real property were transferred directly by the entity.

Moreover, Section 1443.5 of the Tax Law provides a partial or total exemption for a transfer of an interest in real property to the extent that it consists of a mere change of identity or form of ownership or organization, where there is no change in beneficial interest.

Accordingly, in the case of the "split-up" plan, the equal division and transfer of the real property to two newly created subsidiaries, the stock of which is wholly owned by the Petitioner, would be deemed a mere change of identity since there is no change in beneficial interest. Therefore, such transfer would not be subject to the gains tax.

When all the shares of stock of one subsidiary are distributed to Group A and all the shares of stock of the other subsidiary are distributed to Group B, such distributions would constitute transfers of a controlling interest in each subsidiary to the extent of the 100% interest owned by the Petitioner. The consideration for the transfer would be the apportioned fair market value of each property to the controlling interest acquired in each subsidiary. Since the properties are contiguous, the consideration for each property must be aggregated. The gain subject to tax would be the difference between the consideration and the original purchase price of the property being transferred. Nevertheless, a partial mere change of identity exemption will be afforded to the extent of Group A's and Group B's indirect ownership interest in the subsidiaries prior to the distributions. The subsequent liquidation of the Petitioner would not subject the transaction to the gains tax since the Petitioner no longer has an ownership interest in real property.

As for the "split-off" plan, the equal division and transfer of one of the parcels of the real property to a newly created subsidiary, the stock of which is wholly owned by the Petitioner, would be deemed to be a mere change of identity since there is no change in beneficial interest. Therefore, the transfer would not be subject to gains tax.

The distribution of all the shares of stock of the newly created subsidiary to one of the shareholder groups would constitute the transfer and acquisition of a controlling interest to the extent of the 100% interest transferred and acquired. The acquiring shareholder group would receive a partial mere change of identity exemption to the extent of the 50% interest it held in the Petitioner

prior to the distribution. Also, by virtue of the shareholder group surrendering its interest in the Petitioner, the remaining shareholder group will be deemed to acquire a controlling interest to the extent of 50% interest in the Petitioner.

DATED: May 11, 1990

s/PAUL B. COBURN
Deputy Director
Taxpayer Services Division

NOTE: The opinions expressed in Advisory Opinions
are limited to the facts set forth therein.