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

TSB-A-95 (9) R
Real Property Transfer
Gains Tax
August 30,1995

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. M950403A

On April 3, 1995, a Petition for Advisory Opinion was received from Prudential Insurance Company of America, 751 Broad Street, Newark, New Jersey 07102-3777.

The issue raised by Petitioner, Prudential Insurance Company of America, is whether the Employee Retirement Income Security Act (hereinafter "ERISA") will preempt the assessment of the Real Property Transfer Gains Tax (the "gains tax") against the gain realized by the Prudential Property Investment Separate Account (hereinafter "PRISA") from the sale of the Smith Haven Mall.

The Smith Haven Mall is located in Suffolk County and is owned by Petitioner on behalf of its PRISA. PRISA is a separate account of Petitioner that invests primarily in real estate. As such, its assets belong to Petitioner as a matter of State law. However, such assets must be segregated from the other assets owned by Petitioner and must be held for the benefit of the PRISA contract holders.

PRISA has 190 contract holders. Of these contract holders, 171 are private employer sponsored pension plans and 19 are government (local and state) sponsored pension plans (the "government pension plan"). The private employer plans are subject to the provisions of the ERISA.

Petitioner states that the PRISA is not an investment company registered under the Investment Company Act of 1940 and is not required to be registered because the assets it holds are not securities. Petitioner's contract does not provide a guarantee of a fixed rate of return with respect to the contract holders investment in the PRISA. Further, Petitioner has not, under the terms of the contract, provided any guarantee of an aggregate amount of benefits to be payable to contract holders and/or beneficiaries with respect to a contract holder's investment in the PRISA. The contract's investment risk remains with the contract holder. The value of a contract holder's share or units in the PRISA may vary depending upon the success of Petitioner's investments. Petitioner has not guaranteed that the value of the assets in the PRISA would not fall below a stated level.

Petitioner anticipates that a portion of the proceeds realized from the sale of Smith Haven Mall will be retained within PRISA for the benefit of the contract holders. The balance of the proceeds will be distributed to the PRISA contract holders.

Pursuant to Sections 1441 and 1443.1 of the Tax Law and Section 590.1 of the Gains Tax Regulations the gains tax is a ten percent tax on the gain derived from the transfer of any interest in real property, which includes the acquisition or transfer of a controlling interest in any entity with

an interest in real property, where the real property is located in New York State and where the consideration for the transfer is one million dollars or more.

Section 1440.4 of the Tax Law states as follows:

> 4. "Interest" when used in connection with real property includes, but is not limited to, title in fee, a leasehold interest, a beneficial interest, an encumbrance, a transfer of development rights or any other interest with the right to use or occupancy of real property or the right to receive rents, profits or other income derived from real property. Interest shall also include an option or contract to purchase real property. (emphasis added)

Section 1443 of the Tax Law provides, in part, as follows:

> Sec. 1443. Exemptions.-- A total or partial exemption shall be allowed in the following cases:
>
> * * *
>
> 3. If the transferor is one of the following:
>
> (a) The state of New York, or any of its agencies, instrumentalities, political subdivisions, or public corporations, including a public corporation created pursuant to an agreement or compact with another state or Canada.

29 U.S.C. Section 1144(a) of the Employee Retirement Income Security Act provides that the provisions of ERISA shall supersede "any and all State laws insofar as they may now or hereafter relate to any employee benefit plan."

In 21 Properties, Inc. v. Romney, 360 F Supp 1322, 1326 (1973) the Courts held that the New York State Teachers' Retirement System is a State agency. (emphasis added)

In Morgan Guaranty Trust Co. v. Tax Appeals Tribunal, 80 N.Y.2d 44 (1992), the New York Court of Appeals held that the gains tax was preempted by ERISA because the tax related to an employee benefit plan "in more than a tenuous, remote or peripheral way." Id., at 46. Morgan Guaranty involved a transfer of real property located in New York by an employee benefit plan covered by the provisions of ERISA. The trustee under the American Motors Corporation Union Retirement Income Plan, paid the gains tax due and thereafter filed a claim for refund of gains tax paid on the grounds that the imposition of the tax was preempted by ERISA. In construing the statutory provisions of 29 USC § 1144(a), the Court of Appeals said:

> Applying the broad common sense meaning of the statutory phrase 'relate[s] to,' we conclude that this gains tax has more than a tenuous, remote or peripheral connection to employee benefit plans and is therefore preempted by ERISA. We reach that

> conclusion from analysis of the structural, administrative and economic impact of the tax on the Plan, viewed against the backdrop of the terms and objectives of ERISA [citations omitted].
>
> The gains tax clearly impacts on the structure and administration of the Plan. As the dissenting Tribunal member noted, the gains tax would impose certain record keeping and reporting requirements on the Plan, mandating administrative procedures pertaining to asset disposition not required in other jurisdictions [citations omitted].
>
> Far more significant than this administrative burden, however, is the influence the gains tax will necessarily have on the Plan's investment strategy. ERISA imposes federal standards of conduct on the managers of benefit plans, and fiduciaries are required to tailor investment strategy to those guidelines [citations omitted]. Although real estate transactions such as the one in issue are sanctioned by ERISA, New York fiduciaries will have to consider the state law that, by directly taxing gains on the sale of such assets, makes them less attractive investments. By the same token, an administrator taking the cost of the New York gains tax into account may be required to retain an asset that would otherwise have been liquidated. Id., at 51.

Thus, based upon the holding in Morgan Guaranty Trust Co. v. Tax Tribunal, supra, if the Smith Haven Mall is a Plan asset, then the gains tax imposed on the transfer of the real property is preempted by the provisions of ERISA.

The ERISA statute "contains no comprehensive definition of 'plan assets.' "John Hancock Mutual Life Insurance Company v. Harris Trust and Savings Bank, 510 US, 126 L Ed 2d 524, 533 (1993). For purposes of ERISA's fiduciary responsibility provisions, certain assets are not considered to be assets of a pension plan." However, the Department of Labor Regulations does address the issue of whether the underlying assets are considered to be Plan assets where a Plan invests in a separate account of an insurance company.

"In attempting to discern and implement the will of Congress in this matter, the Department of Labor has embraced the general proposition that, where a pension plan invests in an equity interest of another entity, the underlying assets of that entity are properly viewed as plan assets and must be managed in accordance with the fiduciary responsibility provisions of ERISA, unless there are circumstances that make these provisions unnecessary or inappropriate. In the case of any plan investment in a group trust or common or collective trust of a bank which pools the investments of more than one plan, or any investment in a separate account of an insurance company, the plan assets are deemed to include the underlying assets of the entity, except where the entity is a registered investment company, regardless of any other rules." D.M. McGill and D.S. Grubbs, Fundamentals of Private Pensions, 440 (6th ed. 1989) (emphasis added)

Section 2510.3-101(h)(1)(iii) of the Department of Labor Regulations provides, in part, as follows:

> (h) Specific rules relating to plan investments. Notwithstanding any other provisions of this section -
>
> (1) Except where the entity is an investment company registered under the Investment Company Act of 1940, when a plan acquires or holds an interest in any of the following entities its assets include its investment and an undivided interest in each of the underlying assets of the entity:
>
> * * *
>
> (iii) A separate account of an insurance company, other than a separate account that is maintained solely in connection with fixed contractual obligations of the insurance company under which the amounts payable, or credited, to the plan and to any participant or beneficiary of the plan (including an annuitant) are not affected in any manner by the investment performance of the separate account.

In Avis, Inc. and Avis, Inc. Employee Stock Ownership Plan, Adv 0p Comm T&F, June 15, 1993, TSB-A-93(9)-R the Commissioner held that the transfer of a controlling interest by Avis, Inc. ESOP, of its stock in Avis, Inc. for a consideration of $100 million fell within the ambit of the gains tax, but that pursuant to 29 U.S.C. Section 1144(a) of ERISA and Morgan Guaranty Trust Co. v. Tax Appeals Tribunal as long as Avis, Inc. ESOP is subject to the provisions of ERISA, its sales of stock in Avis, Inc. would not be subject to gains tax.

In the instant case, Petitioner on behalf of its PRISA will sell its interest in Smith Haven Mall for a consideration in excess of $1 million. PRISA has 190 contract holders. Of these contract holders 171 are private employer sponsored pension plans subject to the provisions of ERISA and 19 are government pension plans. Petitioner states that the PRISA is not an investment company registered under the investment Company Act of 1940 and is not required to be registered because the assets it holds are not securities. The real property, the Smith Haven Mall, is held in a separate account (PRISA) maintained by Petitioner for the benefit of the contract holders. Assuming the exception provided in Section 2510.3-101(h)(1)(iii) of the Department of Labor Regulations cited above is not applicable, the underlying real property assets in the PRISA would be considered Plan assets for purposes of ERISA's fiduciary responsibilities.

The exception specified in Section 2510.3-101(h)(1)(iii) of the Department of Labor Regulations is not applicable since Petitioner's PRISA is not maintained solely in connection with fixed contractual obligations. Petitioner's contracts with the 190 contract holders do not provide a guarantee of a fixed rate of return with respect to the contract holders investment in the PRISA. Further, Petitioner has not, under the terms of the contract, provided any guarantee of an aggregate amount of benefits to be payable to contract holders and/or beneficiaries with respect to a contract holder's investment in the PRISA. The contract's investment risk remains with the contract holder.

The value of a contract holder's share or units in the PRISA may vary depending upon the success of Petitioner's investments. Petitioner has not guaranteed that the value of the assets in the PRISA would not fall below a stated level. Therefore, the contract between Petitioner and the contract holders represents a separate account of an insurance company whereby the underlying assets of the PRISA (the real property assets) are considered to be Plan assets, for purposes of ERISA's fiduciary responsibilities. Accordingly, since the 171 private employer sponsored pension plans are subject to the provisions of ERISA, and the real property held by Petitioner is a Plan asset of the PRISA, pursuant to Section 1144(a) of ERISA, Morgan Guaranty Trust Co. v. Tax Appeals Tribunal, supra, and Avis Inc. and Avis, Inc. Employee Stock Ownership Plan, supra, the gains tax is preempted from the apportioned amount of the gain attributable to such contract holders.

It is noted, however, that the government pension plans do not fall under the provisions of the ERISA statute. Therefore, we must examine if pursuant to Article 31-B of the Tax Law the apportioned amount of the gain attributable to such contract holders would be subject to tax.

Pursuant to Section 1443.3(a) of the Tax Law the transfer of real property by the State of New York or any of its agencies is not subject to gains tax. In accordance with 21 Properties, Inc. v. Romney, supra, a State or local governmental pension plan would be deemed to be an agency of the State of New York. However, the exemption afforded to an agency of the State of New York only applies to the disposition of real property where the agency is in title to such property or the disposition of real property beneficially owned by them.

The question of whether the government pension plans are in fact the beneficial owner of the real property being transferred is an appropriate inquiry because it is well established that for purposes of taxation the substance, and not the form, of the transaction controls. The term "beneficial owner" is not defined within Article 31-B of the Tax Law or within the gains tax regulations. In the context of federal income tax questions, the term beneficial ownership has been described as being "marked by command over property or enjoyment of its economic benefits." Yelencsis v. Commissioner, 74 T.C. 1513 (1980), citing Anderson v. Commissioner, 164 F2d 870 (7th Cir. 1947), aff'g. 5 T.C. 443 (1945).

In Anderson v. Commissioner, supra, the Court held:

> The Supreme Court has repeatedly said that taxation is an intensely practical process concerned less with legal formalities than with economic realities and that tax consequences flow from the substance rather than the form of a transaction; that command over property or enjoyment of its economic benefits marks the real owner for federal income tax purposes. (emphasis added)

Factors showing "beneficial ownership" of property may include "a right to [the property's] enjoyment as exists where the legal title is in one person and the right to such beneficial use or interest is in another, and where such right is recognized by law, and can be enforced by the courts, at the suit of such owner or someone in his behalf." Montana Catholic Missions v. Missoula County, 200 US 118, 127-128 (1906). Other factors, such as dominion and control over the property or the

right to income from the property may also indicate beneficial ownership. Macon, Dublin & Savannah Railroad Co. v. Commissioner, 40 B.T.A. 1266, (1939), acq., 1940-1 C.B. 3.

While it is true that all income, appreciation, gains or losses with respect to the assets of the PRISA are for the sole benefit or burden of the participating contract holders, Petitioner and not the contract holders holds legal title to the real property. Further, the government pension plans do not have the use of the real property. In addition, they do not have dominion or control over the property. Accordingly, the government pension plans are not the beneficial owners of the real property. Therefore, since the governmental plans do not hold legal title to the real property and are not the beneficial owners of the real property, the apportioned gain attributable to such plans from the transfer of the real property would be subject to gains tax.

DATED: August 30, 1995

/s/
PAUL B. COBURN
Deputy Director
Taxpayer Services Division

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