



On or around January 23, 2023, the parties submitted a stipulation of facts (Original Stipulation), which stipulated to certain facts and whereby the parties agreed to the admission of certain exhibits into evidence. On or around March 23, 2023, the parties submitted a supplemental stipulation of facts (together, with the Original Stipulation, Stipulation of Facts).

On April 27, 2023, a hearing was held before former Administrative Law Judge Sandra Rodriguez-Diaz at One Center Street, New York, New York, at which testimony was taken and additional exhibits were admitted into evidence.

The parties filed briefs after the hearing, the last of which was filed on December 12, 2023.

On May 28, 2024, this case was reassigned from former Administrative Law Judge Sandra Rodriguez-Diaz to the undersigned.

Petitioners were represented by Joseph Lipari and Elliot Pisem, each of Roberts & Holland LLP. Respondent was represented by Stephanie Fitos, Senior Counsel, of the City Law Department.

## **ISSUE**

Whether Respondent appropriately applied the step transaction doctrine to the Deed Transfer and to a subsequent issuance of a minority membership interest from Grantee to a third party (Interest Transfer).

## **FINDINGS OF FACT**

The below facts numbered 1 through 3, 5 through 20 and 22 were stipulated to by the parties and have been accepted by the undersigned. The below facts numbered 4, 21 and 23 were found by the undersigned based on review of the testimony at the hearing and documents that were entered into evidence.

1. Grofam, L.P. (Grofam) and Grobman Sibling, LLC f/k/a/ Grobman Sibling Partnership (GS) are, and have been continuously, since no later than as of July 15, 1997, the sole members in Grantor, with each holding a 50 percent interest in Grantor.
2. For a period of at least 19 years ending on May 2, 2017, Grantor owned the Property.
3. Grofam and GS are, and have been continuously, since no later than April 24, 2017, the sole members in GG Forest Hills, LLC (GG), with each holding a 50 percent interest in GG.
4. Grantee was formed on or around April 12, 2017, which was the date of Grantee's original operating agreement.
5. On May 2, 2017, by deed, Grantor effectuated the Deed Transfer by transferring the Property to Grantee.

6. Immediately prior to the Deed Transfer, GG was the sole member of Grantee, holding 100 percent of the interests in Grantee, with the effect that, as of a date no later than April 24, 2017, each of Grofam and GS indirectly held 50 percent of the interests in Grantee.
7. Immediately after the Deed Transfer, each of Grofam and GS held, directly or indirectly, a 50 percent interest in each of Grantor and Grantee.
8. On or about May 3, 2017, Grantor and Grantee recorded the deed with respect to the Property.
9. On or about May 3, 2017, Grantor and Grantee filed Form NYC-RPT, reporting that no New York City real property transfer tax was due, and that the transfer was entirely exempt from real property transfer tax as a mere change in identity or form.
10. At the time of the Deed Transfer, the parties anticipated that SPG Forest Hills LLC (SPG) would be admitted as a member of Grantee.
11. On or about June 28, 2017, and as of that date, the Interest Transfer was effectuated whereby SPG was admitted as a member of Grantee.
12. Immediately after the Interest Transfer, SPG held an interest in Grantee. The remaining interests continued to be held by Grofam and GS in equal shares (indirectly through GG).
13. As of September 26, 2018, SPG transferred to SPG Forest Hills Opportunity Fund LLC (SPG II) an interest in Grantee.
14. Immediately after the transfer by SPG to SPG II, SPG held an

interest in Grantee and SPG II held an interest in Grantee. The remaining interests continued to be held by Grofam and GS in equal shares (indirectly through GG).

15. SPG and SPG II, as members of Grantee, were required to provide certain guarantees (Guarantees) as provided in Article 14 of the Amended and Restated Operating Agreement of Grantee (Operating Agreement) and the First Amendment to the Operating Agreement.
16. The members of Grantee are in the process of performing their obligations under the Operating Agreement including, without limitation, the Guarantees, and are not in breach thereof.
17. The Schedule K-1s accompanying Grantee's 2017, 2018 and 2019 Forms 1065 (U.S. Returns of Partnership Income) accurately reflect the contributions reported on such Forms 1065 to the capital of Grantee made by, and the distributions by Grantee made to, the members in Grantee during the respective periods covered thereby.
18. Pursuant to the Operating Agreement, GG's capital contribution to Grantee was valued by the members of Grantor and Grantee at \$29,000,000.
19. At the time of SPG's admission as a member of Grantee, SPG made a cash capital contribution to Grantee of \$1.
20. As of the end of 2017, 2018, 2019, 2020 and 2021, respectively, SPG and SPG II had made a combined total of \$388,636, \$1,725,463, \$2,857,032, \$3,857,032 and \$5,000,000 of capital contributions to Grantee (and GG had made no further capital contributions).
21. Per Section 5.3 of the Operating Agreement, SPG received a 40

percent "Percentage Interest" in Grantee. Per Section 7.1 of the Operating Agreement, each member of Grantee's respective distribution rights are partly attributable to their respective Percentage Interest in Grantee. Therefore, SPG received distribution rights that were attributable, in part, to its Percentage Interest of 40 percent.

22. No distributions, in any ratio, have ever been made by Grantee.
23. The Notices each assert a RPTT liability in connection with the Deed Transfer. The Explanation of Adjustment(s) attached to the Notices each stated that the "exemption asserted for a mere change i[s] being adjusted to the extent that the beneficial interest of the real property or economic interest therein has not remained the same."

#### **STATEMENT OF POSITIONS**

Petitioners assert that the Deed Transfer is wholly exempt from RPTT as a "mere change in form" and it is improper to reduce the exemption, as applied to the Deed Transfer, on account of the subsequent Interest Transfer.

Respondent, relying on *GKK 2 Herald LLC*<sup>1</sup>, asserts that the transactions should be collapsed under the step transaction doctrine, resulting in a single integrated transaction to which the exemption is inapplicable to the extent of change in beneficial

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<sup>1</sup> TAT (E) 13-25 (RP), [NYC Tax Appeals Tribunal, Appeals Division, 2016], Aff'd 62 NYS 3d 20 [1<sup>st</sup> dept 2017].

ownership. Respondent's basis for asserting such recharacterization is that the substance of the collapsed transactions is the transfer of an ownership interest in the Property from Grantor to SPG.

Respondent further argues that the relevant transfer in beneficial ownership to SPG was 40 percent of the value of the outstanding membership interest in Grantee. Respondent's basis for this assertion is that, under the Operating Agreement and immediately following the Interest Transfer, SPG was entitled to a "Percentage Interest" of 40 percent.

Petitioners, in turn, argue that the step transaction doctrine is inapplicable to the present case. Petitioners' basis for this argument is that the approximate eight-week period between the Deed Transfer and Interest Transfer, as well as the force and effect of Grantee's initial operating agreement during such period, demonstrates that the Deed Transfer had substance and independent significance apart from the Interest Transfer. Petitioners also argue that the present case is distinguishable from *GKK 2 Herald LLC* because, unlike *GKK 2 Herald LLC*, in which the step transaction was found to be properly applied, the deed transferor in the present case did not "cash out" their interest in the entity that acquired the real property.

Petitioners further argue that, under the Operating Agreement, the rights attributable to the "Partnership Interest" were limited. Therefore, in Petitioners' view, the percentage of beneficial ownership of Grantee transferred pursuant to the Interest Transfer should not be determined based on the "Percentage

Interest" under the Operating Agreement. Instead, Petitioners assert that, based on the respective capital accounts of the members of Grantee, the relevant transfer in beneficial ownership of Grantee was no more than 14.706 percent.

#### **CONCLUSIONS OF LAW**

Administrative Code § 11-2102.a imposes the RPTT on "each deed . . . by a grantor to a grantee" where the consideration exceeds \$25,000.

Administrative Code § 11-2102.b(1) also imposes the RPTT on "each instrument or transaction . . . whereby any economic interest in real property is transferred by a grantor to a grantee" where the consideration exceeds \$25,000. An "[e]conomic interest in real property" includes an interest "in a partnership, association or other unincorporated entity which owns real property" (Administrative Code § 11-2101.6). "Transfer" is defined in connection with an economic interest in real property as including "the transfer or transfers . . . of . . . interest or interests in a partnership, association or other unincorporated entity, . . . whether made by one or several persons, or in one or several related transactions, which . . . interest or interests constitute a controlling interest in such . . . partnership, association, trust or other entity (Administrative Code § 11-2101.7). "Controlling interest" includes 50 percent "or more of the capital, profits or beneficial interest in a partnership, association, trust or other entity" (Administrative Code § 11-2101.8).



Thus, as stated in the *GKK 2 Herald LLC* at 7, "the RPTT applies to a deed of *any* interest in real property in the City but it applies to a transfer of an economic interest in an entity that owns real property in the City *only* if the economic interest represents a controlling (i.e., 50 [percent] or more) interest in the entity" (emphasis in original).

Administrative Code § 11-2106 lists a number of persons and transactions that are "exempt from the payment of the" RPTT, including at paragraph b(8):

"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 remains the same. . . ."

The exemption provided by Administrative Code § 11-2106.b(8) is commonly referred to as the "mere change exemption" (*GKK 2 Herald LLC* at 7).

In the instant case, the transactions, if viewed separately, are each non-taxable. While the parties disagree on the exact percentage of the beneficial interest transferred pursuant to the Interest Transfer, there is no dispute that the beneficial interest transferred was less than 50 percent and is therefore non-taxable as a transfer of a non-controlling economic interest. The Deed Transfer was a transfer between entities that shared common direct or indirect ownership by Grofam and GS, and the proportion of beneficial ownership between Grofam and GS of each of Grantor and Grantee was equal. Therefore, if viewed in a vacuum, the Deed

Transfer qualified for the mere change exemption.

However, it is appropriate to consider whether the step transaction doctrine should apply to the transactions (See *GKK 2 Herald LLC*, where the Tribunal applied the step transaction doctrine to a deed transfer which was followed by a transfer of a non-controlling economic interest). "The step transaction doctrine is a widely recognized judicially-created concept applied in tax cases whereby a court, after reviewing the facts and circumstances surrounding a series of related actions or events, can determine that they should be treated as components of a single, integrated transaction and taxed accordingly" (*Id.* at 10).

This Tribunal, and courts generally, have applied two alternative tests when considering whether to apply the doctrine. "The first test is referred to as the end result test: If it is evident that the various steps were undertaken to achieve a specific ultimate result, they will be taxed as a single transaction. The second test is called the interdependence test: Separate steps will be consolidated where it is clear that no single step would have been undertaken except as part of the whole transaction" (*Id.* at 11).

In this case, the end result test is satisfied because it is evident that both the Deed Transfer and the Interest Transfer were undertaken to achieve the specific ultimate result of expanding the joint venture ownership of property from between two parties, Grofam and GS, to include a third party, SPG.

Prior to the transactions, for a period of at least 19 years,

Grofam and GS beneficially owned the Property as a two-party joint venture through their respective ownership interests in Grantor. Within a matter of weeks after Grantee was formed, the Deed Transfer was effectuated whereby Grantee received the Property. Then, mere weeks later, the Interest Transfer was effectuated whereby SPG was admitted as a member of Grantee and the beneficial ownership of the Property was converted from a two-party joint venture to a three-party joint venture. Pursuant to the Stipulation of Facts, at the time of the Deed Transfer, the parties anticipated that SPG would be admitted as a member of Grantee. The record is void of any additional or alternative reason for the formation of Grantee and the Deed Transfer other than to facilitate the Interest Transfer, and ultimately, the expansion of the joint venture to include SPG. The facts and circumstances in this case therefore justify the inference that the expansion of the joint venture was the intended ultimate result of both the Deed Transfer and the Interest Transfer.

Petitioners argue that the Deed Transfer had substance and independent significance apart from the Interest Transfer. However, the presence of substance and independent significance is not enough to defeat the application of the step transaction doctrine (see *True v United States*, 190 F3d 1165, 1177 [10th Cir 1999], stating “[a]lthough the absence of economic effects or business purposes may be fatal to a taxpayer’s step transaction . . . suit, the presence of those factors is not dispositive”).

Accordingly, it is concluded that it was appropriate for Respondent to apply the step transaction doctrine to the Deed Transfer and to the Interest Transfer. As the end result test is

satisfied, there is no need to consider the potential application of the interdependence test.

However, a separate consideration from whether the step transaction should apply (i.e., satisfaction of either the interdependence test or the end result test) is how to apply the doctrine (i.e., in what manner to recharacterize the series of transactions) (*See Matter of Waterman Inv. Co.*, 1997 WL 519543 [NY St Div of Tax Appeals DTA 813224], stating “[h]aving determined that the [step] doctrine applies in [a] matter, [the court] must then look to the components of what remains after its application).”

Respondent asserts that the transactions should be collapsed, resulting in RPTT owed to the extent of change in beneficial ownership. Respondent's basis for asserting such recharacterization is that the substance of the transactions is the transfer of an ownership interest in the Property to SPG. Essentially, Respondent argues that the transactions should be recharacterized as if the transfer of the deed was made directly to SPG. However, no such direct deed transfer to SPG occurred either in substance or form. The step transaction doctrine “cannot generate events which never took place just so an additional tax liability might be asserted” (*Grove v. Commissioner*, 490 F2d 241, 247-248 [2<sup>d</sup> Cir 1973], quoting *Sheppard v. United States*, 176 Ct Cl 244, 257 [1966]; *See also Greene v US*, 13 f3d 577, 583-584 [2<sup>d</sup> Cir 1994]).

While this Tribunal has previously relied on substance over form principles to find that a direct deed transfer, rather than

the form of an initial deed transfer followed by a subsequent interest transfer, had occurred (See *GKK 2 Herald*), such a conclusion is not appropriate in the present case.

In *GKK 2 Herald*, the taxpayer and a third party owned, respectively, 45 percent and 55 percent tenant-in-common interests in a property. The parties contributed their respective tenant-in-common interests to a newly formed limited liability company in exchange for membership interests in the company that mirrored the ratio of their tenant-in-common interests. The Tribunal noted that the substance of the contribution agreement "was more typical of a sale than of the formation of a joint venture of any kind" (*GKK 2 Herald* at 12). On the same day, the taxpayer transferred the entirety of its membership interest to the third party in exchange for cash and relief from liability. As a result of the application of the step transaction doctrine, the Tribunal found that the substance of the collapsed transactions was the sale of the 45 percent tenant-in-common interest to the third party. Implicit in such conclusion is that the collapsed transaction was in substance a deed transfer, rather than a transfer of an economic interest. The Tribunal ultimately held that the transfer did not qualify for the mere change exemption and was therefore taxable.

In the present case, neither Grantor nor the owners of Grantor received any cash or relief from liability as part of the transactions. It is therefore not appropriate to conclude that the substance of the transactions was a sale of the underlying deed. Nor is it appropriate to conclude that the underlying deed, rather than an economic interest in the Property, was otherwise transferred as part of the collapsed transactions. Unlike *GKK 2*

