

RPTT 2008-1
2/29/08

STATEMENT OF AUDIT PROCEDURE

REAL PROPERTY TRANSFER TAX TRANSFERS INTO AND OUT OF CHARITABLE ORGANIZATIONS

A. Background

- Generally, conveyances of property located in New York City, and economic interests in property in the City, are subject to the New York City Real Property Transfer Tax (“RPTT”). There are several exemptions from the RPTT, including transfers to or from **charitable organizations**. Specifically, conveyances to and from entities that are “organized and operated exclusively for religious, charitable or educational purposes” are exempt from the transfer tax. (See, the Rules of the City of New York, Title 19, Chapter 23, section 23-05(b)(2).)
- This transfer tax exemption is very similar to the federal charitable exemption found in section 501(c)(3) of the Internal Revenue Code. Generally, when a charitable organization shows us that it is exempt from federal tax under IRC §501(c)(3), it is also exempt from the City’s transfer tax.

B. Scope

This statement alerts auditors and taxpayers to potentially abusive situations involving exempt entities, and outlines how we will treat these situations on audit.

The transactions covered by this procedure are illustrated by the following two **examples**, which are intended to be illustrative, and not all-inclusive.

1. The owner of real property in New York City transfers the property to an exempt charity. The charity then conveys the property to another party.
2. The 100% owner of a corporation that owns real property in the City transfers the property to an exempt charity. The corporation owner then transfers control of the corporation to someone else. The charity then transfers the property back to the corporation.

C. Procedure

If a charity is involved in a series of transactions where the end result is that the property, or an economic interest, is conveyed from one non-exempt party to another, we will look at the steps of the transaction to determine if the transaction should be taxable. This “**step transaction doctrine**” (where the steps of a transaction are linked to determine proper tax treatment) will be applied if:

1. the series of transactions was entered into pursuant to **binding agreements**, or
2. **evidence** exists that the series of **transactions** was entered into **pursuant to a plan**, even if there is no binding contract.

Six Months: If the series of transactions takes place within a period of six months, the transactions will be presumed to have taken place pursuant to a plan. This may be rebutted by evidence.

Six Months to One Year: If the series of transactions occurs within a period of six months to a year, the transactions will be audited to determine if the step transaction doctrine should be applied.

More than One Year: If a series of transactions takes place within a period of more than one year, all facts and circumstances will be considered to determine if the series of transactions should be audited.

D. Discussion

Courts regularly permit taxing authorities to look at the substance rather than the form of a transaction so that “mere formalisms” do not obscure the transaction’s true nature. The “step transaction doctrine” discussed above is an example of the use of the “form over substance” principle. The doctrine will be used to prevent the use of a charity as a means to avoid paying transfer tax on an otherwise taxable transfer or series of transfers.

Generally, a taxing authority may collapse the steps of a transaction to determine if it should be subject to tax when the criteria of any one of the following three tests are met:

- **End result test:** If the **two transactions** (owner to charity and then charity to new owner) were **merely a means** for the old owner to convey the property to a new owner, the “end result” test would be met. We will look at whether the parties intended to convey the property to a new owner, not whether the parties meant to avoid tax.
- **Interdependence test:** This test would be met if it were unlikely that either of the two transfers would have taken place except in contemplation of the other.
- **Binding Commitment test:** This test would be met if the two transactions took place pursuant to contracts entered into prior to the first transaction.

E. Review of Charitable Exemption

If Finance determines that the step transaction should be applied and the transactions are deemed taxable, this will also be treated as evidence that the charitable entity in question is not operating exclusively for religious, charitable or education purposes, and other City tax exemptions granted to the entity may be re-examined.

Even if we determine that the charitable exemption should not apply, the step transaction doctrine will still be applied so that a series of transactions will only be taxed once.