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

TSB-A-96 (10) R
Real Property
Transfer Gains Tax
Real Estate
Transfer Tax
September 10, 1996

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO.M960429A

On April 29, 1996, a Petition for Advisory Opinion was received from Lew R. Wasserman, Jean Stein, Gerald H. Oppenheimer and Andrew Shiva, as Trustees of Annuity Trusts I & II under the Restatement of Doris Jones Stein Family Trust dated 4/20/82, P.O. Box 30, Beverly Hills, California 90213. The Petition raises issues concerning the combination of the two trusts. The combination was previously addressed in two earlier advisory opinions (TSB-A-95(2)-R dated April 4, 1995 and TSB-A-96(1)-R dated January 26, 1996). However, Petitioners advise that the facts concerning the combination have changed.

The issues raised by Petitioners, Lew R. Wasserman, Jean Stein, Gerald H. Oppenheimer and Andrew Shiva, as Trustees of Annuity Trusts I & II under the Restatement of Doris Jones Family Trust dated 4/20/82, are:

1. Is the combination of Annuity Trust I with Annuity Trust II, pursuant to which the New York Properties were transferred to the Surviving Trust on January 2, 1996, including the funding of the Pro Forma Account and the execution of the Loan-Back Agreement, exempt from the Real Estate Transfer Tax (the transfer tax) pursuant to Tax Law Section 1405(b)(6) and Section 575.10 of 20 NYCRR as a mere change of identity or form of ownership or organization?

2. Is the combination of Annuity Trust I with Annuity Trust II, pursuant to which the New York Properties were transferred to the Surviving Trust on January 2, 1996, including the funding of the Pro Forma Account and the execution of the Loan-Back Agreement, exempt from the Real Property Transfer Gains Tax (the gains tax) pursuant to Tax Law Section 1443(5) and Section 590.7 of 20 NYCRR as a mere change of identity or form of ownership or organization?

Petitioner presents the following facts. On April 20, 1982, Doris Jones Stein (the "Trustor"), as trustor, created a revocable inter vivos trust, known as the Doris Jones Stein Family Trust (the "Family Trust"). The instrument establishing the Family Trust, as amended and restated on April 20, 1982, provided for the creation of two charitable lead trusts following the death of the Trustor. The two trusts are referred to separately as "Annuity Trust I" and "Annuity Trust II" and collectively as the "Trusts". The Trustor died on April 7, 1984, and Annuity Trust I and Annuity Trust II were thereafter established in accordance with the terms of the Family Trust instrument and under the jurisdiction of the Los Angeles County Superior Court.

Annuity Trust I and Annuity Trust II were each required to make certain annual charitable payments until their respective termination dates. At that time any remaining assets were to be distributed to trusts for the benefit of certain heirs of the Trustor or their appointees.

The remainder beneficiaries of Annuity Trust I and Annuity Trust II are trusts for the benefit of the Trustor's grandchildren (the "Grandchild Trusts") and more remote issue (the "Issue Trusts"). The Grandchild Trusts were established, and the Issue Trusts were provided for, at the date of the Trustor's death according to the terms of the Family Trust instrument. There are now ten living grandchildren of the Trustor and none of the grandchildren has died. Since none of the Trustor's grandchildren have died leaving issue, no Issue Trusts have been established.

The terms and provisions of Annuity Trust I and Annuity Trust II were substantially identical except that the Trusts provided for different annual amounts to be paid to charity and had different termination dates. Annuity Trust I was to terminate on February 10, 2003 and Annuity Trust II was to terminate on April 7, 2012. The annual payments for the Trusts were required to be made to the Jules and Doris Stein Foundation (the "Foundation"), an organization exempt from Federal income tax pursuant to Section 501(c)(3) of the Internal Revenue Code.

The beneficiaries of Annuity Trust I and the beneficiaries of Annuity Trust II were identical at the time of the combination of the Trusts.

A substantial portion of the assets of Annuity Trust I and of Annuity Trust II consisted of stocks and securities. In addition, Annuity Trust I and Annuity Trust II were co-owners of two parcels of real property located in New York City (the "New York Properties") in undivided one-third and two-thirds interests, respectively, as tenants-in-common. Both the value and the rental income of the New York Properties have declined. Moreover, due to economic conditions, the income of the Trusts from their portfolios of stock and securities was lower than was foreseen at the time of their creation. As a result of these developments, the Trusts' obligations to make annual contributions to the Foundation were substantially greater than their income.

Due to the financial difficulties facing the Trusts, the trustees agreed to combine the Trusts on the terms and subject to certain conditions as set forth in an Agreement to Combine Trusts (the "Agreement"), a Petition for Order Authorizing Combination of Trusts and Amending Trust Instrument to Effectuate Combination which was filed with the Los Angeles County Superior Court, and an Order Authorizing Combination of Trusts and Amending Trust Instrument to Effectuate Combination which was signed by the Los Angeles County Superior Court (the "Order").

The Agreement and the Order provided that, on the effective date specified in the Agreement (the "Effective Date"), Annuity Trust I was combined with Annuity Trust II. The Surviving Trust succeeded to all of the assets and assumed all the liabilities of the Trusts existing on the Effective Date. The Surviving Trust now has an obligation to make annual distributions to the Foundation equal to the sum of obligations currently required of the Trusts. Prior to February 10, 2003 (the termination date of Annuity Trust I), the Surviving Trust is required to annually distribute an amount

to the Foundation equal to the total of the amount which would have been required to be distributed by the Trusts. After that date, the Surviving Trust will be required to distribute to the Foundation only the amount required to be distributed by Annuity Trust II.

The Family Trust provides that the trustees of Annuity Trust I and Annuity Trust II are to be the persons who serve from time to time as the directors of the Foundation. The combination of the Trusts effected no change in the identity of the trustees. In addition, the trustees now have the same powers with respect to the Surviving Trust that they had with respect to the Trusts.

The Agreement and the Order provide a method for determining the amount and timing of any distribution to be made to the remainder beneficiaries of Annuity Trust I (the "Annuity Trust I Beneficiaries") from the Surviving Trust on February 10, 2003, or thereafter. That method is such that there will be established on the books of the Surviving Trust a financial record referred to in this Agreement as the "Pro Forma Account". The Pro Forma Account was set up so that the remainder interests of the Annuity Trust Beneficiaries and the Foundation's right to distributions was not affected by the combination of the Trusts.

The Pro Forma Account functions as follows: all of the assets of Annuity Trust I and Annuity Trust II were valued at their fair market value as of the Effective Date (i.e., January 2, 1996). The Family Trust, as amended and restated on April 20, 1982 (the "Restatement"), contains an in-kind distribution clause which grants the trustees the discretion to make trust distributions in cash or in-kind or a combination thereof. Since the Restatement was the governing instrument of both Annuity Trust I and Annuity Trust II, it would therefore be at the discretion of the Trustees of the Surviving Trust as to the character of the assets to be used in order to make the distribution of the Pro Forma Account in 2003 to the various Grandchild Trusts which were the remaindermen of Annuity Trust I had it remained in existence. In other words, those Trustees will have discretion whether the distribution is to be in cash, in-kind, or a combination of cash and in-kind. Presumably, those Trustees will take into account the economic conditions at the time of distribution, the projections for the future, possible tax consequences, etc. when making the determination as to the nature of the assets which are to be distributed.

In all events, the total value of the assets to be distributed in satisfaction of the Pro Forma Account in 2003 will be equal in value to the value of the assets which would have been distributed in 2003 had the combination under the Agreement to Combine not occurred and had Annuity Trust I remained in existence. For convenience, let us call the assets actually distributed the "Distributed Assets".

Following the distribution in 2003, if any, there may (and most likely will) be a need for the Surviving Trust to borrow back some or all of the Distributed Assets in order to provide sufficient cash flow to meet the remaining annuity trust obligations to the Foundation. The distributees of the

Distributed Assets (the Trustees of the Grandchild Trusts) have agreed at this time to lend back from the Distributed Assets in 2003 such amount thereof, having a type and value reasonably required by the Trustees of the Surviving Trust, as will enable the Surviving Trust to complete its obligations to the Foundation without the need to distribute undivided interests in the New York Properties. The loan-back will be accomplished pursuant to the terms of a Loan-Back Agreement which was executed by the Trustees of the Grandchild Trusts.

To the extent liquid assets are not available in 2003 to satisfy the amount of the Pro Forma Account to be distributed, the Trustees of the Surviving Trust would deed interests in the New York Properties to the Trustees of the Grandchild Trusts at that time. If the loan-back of all or any part of such interests is required by the Trustees of the Surviving Trust pursuant to the Loan-Back Agreement, the trustees of the Grandchild Trusts will execute deeds in favor of the Trustees of the Surviving Trust, which deeds will be recorded immediately following recordation of the deeds from the Trustees of the Surviving Trust to the Trustees of the Grandchild Trusts. The Trustees of the Grandchild Trusts would jointly execute a Distributee's Receipt by which (i) the Trustees of the Grandchild Trusts acknowledge the distribution and loan-back of the assets, and (ii) the Trustees of the Surviving Trust would acknowledge the loan-back and value of the property being lent to the Surviving Trust. A loan back account for the assets which have been loaned back, and for the income, gains, losses, and distributions therefrom, will be maintained. The Loan-Back Agreement prescribes a valuation method for the assets to be loaned back.

In summary, the mechanics of the loan-back will be (1) an actual distribution to the Grandchild Trusts of all assets in 2003 which are reflected in the Pro Forma Account (if positive); (2) a loan-back of assets to the extent required by the Trustees of the Surviving Trust; and (3) the Grandchild Trusts (and their respective beneficiaries to the extent of the beneficiaries' interest) will be treated as the owners of the Distributed Assets (including the assets that are loaned back) for legal and tax purposes.

Discussion

Section 1402 of Article 31 of the Tax Law, imposes the real estate transfer tax on each conveyance of real property or interest therein when the consideration for the conveyance exceeds five hundred dollars.

Section 1401(e) of the Tax Law provides, in pertinent part, that the term "conveyance" means the transfer or transfers of any interest in real property by any method. This would include a conveyance upon the combination of trusts with an interest in real property.

Section 1405 of the Tax Law provides, in part, as follows:

> Section 1405. Exemptions.-- (a) The following shall be exempt from payment of real estate transfer tax:
>
> *   *   *
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> 6. Conveyances to effectuate a mere change of identity or form of ownership or organization where there is no change in beneficial ownership, other than conveyances to a cooperative housing corporation of the real property comprising the cooperative dwelling or dwellings ....

Section 1441 of the Tax Law imposed the gains tax on the gain derived from the transfer of real property or an interest therein, where the real property or interest therein is located in New York State and where the consideration for the transfer is $1 million or more.

Chapter 309 of the Laws of 1996 repealed the gains tax for transfers of real property that occurred or occur on or after June 15, 1996.

Section 1440.7 of the Tax Law defined the term "transfer of real property", in part, to mean the transfer or transfers of any interest in real property by any method. This would include a transfer upon combination of trusts with an interest in real property.

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

> Exemptions.-- A total or partial exemption shall be allowed in the following cases:
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> *   *   *
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> 5. If a transfer of real property, however effected, consists of a mere change of identity or form of ownership or organization, where there is no change in beneficial interest.

In <u>Hilles Timpson</u>, Add Op Comm T&F, November 3, 1992, TSB-A-92(7)R, it was held that the transfer of real property to a revocable grantor trust was exempt from the transfer tax and the gains tax pursuant to the exemptions provided at Sections 1405(a)(6) and 1443.5 (the "mere change exemption") respectively.

In this case, the beneficiaries of Annuity Trust I and Annuity Trust II were identical, and following the combination remained the same along with their respective interests. In addition, immediately after the combination of the Trusts, the charitable annuitant has the same rights to distributions that it had prior to the combination. Likewise, the remainder beneficiaries of the Trusts are entitled to the same portion of corpus to which they were entitled before the combination. The

Annuity Trust I Beneficiaries will be entitled to a distribution, or they will have a vested interest in a future distribution, on the same date that Annuity Trust I would have terminated had the combination not occurred.

With respect to issue no. 1, since the beneficiaries of the Trusts remained the same and have the same beneficial interest in the Surviving Trust as they held in the Trusts prior to their combination and the charitable annuitant has the same rights to distribution that it had before the combination, there is no change in the beneficial ownership of the real property as a result of the conveyance. Accordingly, the combination of the Trusts resulted in a conveyance which is exempt from the transfer tax pursuant to the exemption provided at Section 1405(b)(6) (the "mere change exemption").

With respect to issue no. 2, the transfer of real property resulting from the combination of the Trusts was exempt from the gains tax pursuant to the exemption provided at Section 1443.5 of the Tax Law for the same reasons.

The method of funding the Pro Forma Account and the execution of the Loan-Back Agreement does not affect the availability of the exemptions.

Dated: September 10, 1996

/s/
John W. Bartlett
Deputy Director
Technical Services Bureau

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