

New York State Department of Taxation and Finance
Office of Tax Policy Analysis
Technical Services Division

TSB-M-07
(5) C Corporation Tax
(5) I Income Tax
June 13, 2007

**Notification of New York Listed Transaction -
Certain Charitable Contribution Deductions**

The purpose of this memorandum is to identify the transaction described below as a New York listed transaction. A taxpayer that has participated in the listed transaction must make disclosure of his, her, or its participation as described in this notification.

Background

For tax years beginning on or after January 1, 2006, any taxpayer who participates in a New York reportable transaction is required to disclose his, her, or its participation with his, her, or its tax return as prescribed by Part 2500, *New York Reportable Transactions*, of the Tax Department's Procedural Regulations (Regulations). (20 NYCRR Part 2500)

A New York reportable transaction is a transaction that has the potential to be a tax avoidance transaction under Article 9 (corporation tax), 9-A (franchise tax on business corporations), 22 (personal income tax), 32 (franchise tax on banking corporations), or 33 (franchise tax on insurance corporations) of the Tax Law. The term *transaction* includes all of the factual elements relevant to the expected tax treatment of any investment, entity, plan, or arrangement and includes any series of steps carried out as part of a plan. There are three categories of New York reportable transactions: New York listed transactions, New York confidential transactions, and New York transactions with contractual protection.

Section 2500.3(b) of the Regulations provides that a New York listed transaction is a transaction that is the same as or substantially similar to one of the types of transactions that the Commissioner of Taxation and Finance has determined to be a tax avoidance transaction and identified by notice or other form of published guidance as a New York listed transaction. For purposes of identifying a New York listed transaction, the determination that a transaction is a tax avoidance transaction must be based upon a finding that:

- The transaction is not done for a valid business purpose, that is, one or more business purposes, other than obtaining tax benefits, that alone or in combination constitute the primary motivation for the transaction;
- The transaction does not have economic substance apart from its tax benefits; or
- The tax treatment of the transaction is based upon an elevation of form over substance.

Using the criteria in Section 2500.3(b) of the Regulations, the following transaction has been determined to be a tax avoidance transaction and identified as a New York listed transaction, and a taxpayer participating in the transaction must disclose his, her, or its participation in the transaction.

New York Listed Transaction – Certain Charitable Contribution Deductions

In this type of transaction, a person (hereinafter, promoter) purchases a remainder interest in real property encumbered by a long-term lease. For purposes of this memorandum, a remainder

TSB-M-07
(5) C Corporation Tax
(5) I Income Tax
June 13, 2007

interest is a future possessory interest in real estate that matures after the passage of a certain amount of time or upon the happening of a certain event. The promoter then forms a limited liability company (LLC) or advises interested participants to form an LLC. The newly formed LLC will be treated as a partnership for federal income tax purposes and, therefore, will also be treated as a partnership for New York franchise and income tax purposes. The newly formed LLC's members (hereinafter, partners) make capital contributions to the LLC in the form of cash in exchange for their membership interests.

The promoter then sells the remainder interest in the real property to the LLC for the amount the promoter paid for the remainder interest. After holding the remainder interest for one year, the LLC contributes the remainder interest to an exempt organization (for example, an educational institution such as a university). By holding the remainder interest for more than one year, the LLC meets the requirements under the Internal Revenue Code (IRC) to compute the charitable contribution deduction based on the fair market value of the remainder interest. At the time of the donation, the LLC has the property appraised. The appraiser values the property by using an income approach that takes into consideration the amount of lease payments remaining over the period of time remaining on the long-term lease. The present value of the remaining lease payments is computed using the valuation rates under IRC section 7520. This approach results in an appraisal value of the remainder interest that is substantially higher than the amount the promoter paid for the remainder interest or the amount the promoter sold the remainder interest to the LLC.

The LLC generally does not have any business activity other than making the charitable contribution. The capital contributions to the LLC generally equal the sum of the amount paid by the LLC for the remainder interest, the charge for the appraisal by a certified property appraiser, and any filing fees that might be due.

After the charitable contribution is made, the LLC dissolves and files a final partnership return. The LLC's partnership return shows the noncash charitable contribution, the expenses related to the appraisal and other fees. The LLC issues a federal Schedule K-1 to each partner showing the partner's distributive share of the charitable contribution and expenses. Each partner then claims his, her, or its distributive share of the charitable contribution and expenses in computing his or her New York taxable income or, in the case of a corporation, its entire net income or alternative entire net income. The charitable contribution deduction distributed to each partner is typically much greater than the partner's original capital contribution to the LLC.

Variations on this transaction may also occur. The transaction could be effectuated by any pass-through entity. One variation involves the acquisition of a remainder interest associated with specific real property by a special-purpose, single-beneficiary Delaware Business Trust (DBT). The single beneficiary sells its interest in the DBT to an entity such as an LLC that is formed by or for interested participants in the shelter. Thereafter, the LLC contributes its interest in the DBT to a charitable organization.

The Commissioner has determined this transaction to be a tax avoidance transaction and intends to challenge any purported tax benefits from such a transaction, or a substantially similar transaction, on the following grounds: (1) the method of appraisal is inappropriate and results in an

TSB-M-07
(5) C Corporation Tax
(5) I Income Tax
June 13, 2007

inflated fair market value of the donated property; (2) the transaction was not done for a valid business purpose; (3) the transaction does not have economic substance other than for obtaining tax benefits; and (4) the tax treatment of the transaction is based upon an elevation of form over substance.

For purposes of Part 2500 of the Regulations, transactions that are the same as, or substantially similar to, the transaction described in this TSB-M are identified as New York listed transactions on the date this TSB-M was issued. For this purpose, any acquisition of an interest in a pass-through entity (such as an LLC, partnership, trust, or S corporation) with the expectation of receiving a charitable contribution deduction equal to three or more times the capital contribution or purchase price of the interest in the entity is deemed to be a substantially similar transaction.

A taxpayer described in Section 2500.4 who is required to file a return or report under Article 9, 9-A, 22, 32, or 33 of the Tax Law has participated in the listed transaction if (1) the taxpayer's tax return reflects the tax consequences or the tax strategy (or a tax benefit derived from such tax consequences or a tax strategy) described in this TSB-M or (2) the taxpayer knows or has reason to know that the taxpayer's tax benefits are derived directly or indirectly from the tax consequences or tax strategy described in this TSB-M.

How to report

A taxpayer who has participated in a listed transaction as described in this TSB-M for a taxable year beginning on or after January 1, 2006, must report the listed transaction using Form DTF-686, *Tax Shelter Reportable Transactions Attachment to New York State Tax Return*, and Form DTF-686-ATT, *New York Reportable Transaction Disclosure Statement and Request for a Determination*. These forms must be included with the taxpayer's tax return when filed. See Form DTF-686-I, *Instructions for Form DTF-686*, and Form DTF-686-ATT-I, *Instructions for Form DTF-686-ATT*, for more information.

If this transaction was identified as a New York listed transaction after a taxpayer has filed a tax return that reflected the transaction but before the end of the period of the statute of limitations for the Department to issue an assessment pursuant to Sections 683 and 1083 of the Tax Law, the taxpayer must disclose the New York listed transaction with the next tax return filed after the date the transaction is listed regardless of whether the taxpayer participated in the transaction in that tax year.

Extended statutes of limitation

If a taxpayer is required to disclose the New York listed transaction and fails to do so within the time and manner prescribed under Section 25 of the Tax Law and Section 2500.5 of the Regulations, then the statute of limitations to assess any tax with respect to the New York listed transaction does not expire until one year after the date the taxpayer files Form DTF-686-ATT and discloses any required information with the Tax Department.

In addition, tax may be assessed at any time within six years after the return was filed if a deficiency is attributable to an abusive tax avoidance transaction. An *abusive tax avoidance*

transaction means a plan or arrangement devised for the principal purpose of avoiding tax. Abusive tax avoidance transactions include, but are not limited to, New York listed transactions.

Penalties

The Tax Law imposes the following penalties associated with nondisclosure of participation in these transactions and for any underpayment of taxes resulting from participation in these transactions:

- Penalty for understatement of tax where the understatement is attributable to a reportable transaction (Tax Law sections 685(p-1), 1085(k-1));
- Penalty for paid preparers who, with the intent that tax be evaded, aid or assist in the preparation or presentation of fraudulent returns, reports, statements, or other documents under Article 22 of the Tax Law (Tax Law section 685(r));
- Penalty for persons who fail to disclose or provide reportable transaction information (Tax Law sections 685(x), 1085(p));
- Penalty for understatement of liability by tax return preparers under certain conditions (Tax Law sections 685(aa), 1085(s)); and
- Penalty for promoters of abusive tax shelters (Tax Law sections 685(bb), 1085(t)).

Recordkeeping

Every person required by section 25 of the Tax Law to disclose any transaction, file any duplicate report, or maintain any list, must retain all relevant correspondence, memoranda, notes, valuation studies, meeting minutes, spreadsheets, models, opinions, records required to be retained pursuant to section 6011 of the IRC, and all other records or documents related to the disclosure, filing, and list maintenance requirements of section 25 of the Tax Law for six years. The information must be made available for inspection by the Commissioner of Taxation and Finance in connection with any examination.

NOTE: A TSB-M is an informational statement of changes to the law, regulations, or Department policies. It is accurate on the date issued. Subsequent changes in the law or regulations, judicial decisions, Tax Appeals Tribunal decisions, or changes in Department policies could affect the validity of the information presented in a TSB-M.