

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
BIRCHWOOD ASSOCIATES	:	DECISION
for Revision of a Determination or for Refund	:	
of Tax on Gains Derived from Certain Real	:	
Property Transfers under Article 31-B of the	:	
Tax Law.	:	

Petitioner, Birchwood Associates, 410 East Jericho Turnpike, Mineola, New York 11501, filed an exception to the determination of the Administrative Law Judge issued on March 3, 1988 with respect to its petition for revision of a determination or for refund of tax on gains derived from certain real property transfers under Article 31-B of the Tax Law (File No. 802267). Petitioner appeared by Lowenthal, Landau, Fischer & Ziegler, P.C., Esqs. (Stephen S. Ziegler, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Paul A. Lefebvre, Esq., of counsel).

Each party filed a brief on exception. Oral argument was heard at the request of the petitioner on October 26, 1988.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUES

- I. Whether a cooperative conversion is treated as a single transfer for gains tax purposes.
- II. Whether petitioner has established that penalties asserted by the Division of Taxation for failure to timely file certain returns and failure to timely remit tax due should be abated.

FINDINGS OF FACT

On September 23, 1987, authorized representatives for petitioner (Stephen S. Ziegler, Esq.) and for the Division of Taxation (Paul A. Lefebvre, Esq.) executed a Stipulation of Facts pertaining to the matter at issue. This stipulation, modified by the Administrative Law Judge

only insofar as to delete references to various documents included with the stipulation as exhibits (the existence and authenticity of which documents are not disputed), provides as follows:

1. Birchwood Associates ("Birchwood") is a New York general partnership with offices at 410 East Jericho Turnpike, Mineola, New York 11501.

2. Prior to January 1982, Birchwood built and thereafter operated the apartment houses known as 17-85 215th Street, Bayside, Queens ("17-85"); 18-05 215th Street, Bayside, Queens ("18-05"); and 18-15 215th Street, Bayside, Queens ("18-15") (hereinafter sometimes collectively referred to as the "Properties").

3. In January 1982, Birchwood sold each of the 17-85, 18-05 and 18-15 Properties to cooperative housing corporations (the "CHCs") named respectively, 17-85 215th Street Owners, Inc.; 18-05 215th Street Owners, Inc.; and 18-15 215th Street Owners, Inc., as more specifically set forth below.

4. Birchwood's costs for the Properties at the time of the transfers to the CHCs were as follows:

17-85	\$9,996,589
18-05	9,651,413
18-15	9,601,717

5. The terms of the transfers to the CHCs were as follows:

(a) On January 19, 1982, January 26, 1982 and January 21, 1982 (the "closing dates"), Birchwood sold the Properties to the CHCs for sales prices payable as follows:

	<u>17-85</u>	<u>18-05</u>	<u>18-15</u>
Cash, Subscribers' Notes and allowances	\$10,109,571	\$ 3,183,835	\$ 3,048,022
CHCs' acquiring property subject to mortgage payable to The Bowery Savings Bank (the "Mortgage")	4,151,124	4,151,124	4,151,124
CHCs' issuance to Birchwood of Unsold Shares valued at a price of \$55 per share	<u>2,375,395</u>	<u>8,236,910</u>	<u>8,208,035</u>

Total Sales Price	\$16,636,090	\$15,571,869	\$15,407,181
Divided by Shares	<u>197,512</u>	<u>190,693</u>	<u>190,693</u>
Cost to CHC per share	<u>\$ 84.2282</u>	<u>\$ 81.6594</u>	<u>\$ 80.7957</u>

(b) On each respective closing date, each CHC issued shares to two groups of persons, that is:

(i) as part of the consideration for the transfer of the Property to the CHC, the CHC issued shares to Birchwood, and

(ii) the CHC issued shares to persons other than Birchwood (i.e., the "Subscribers") for cash contributions to the CHC.

The shares issued by each CHC are as follows:

	<u>17-85</u>	<u>18-05</u>	<u>18-15</u>
<u>Shares issued to</u>			
Birchwood	43,189	149,762	149,237
Subscribers	<u>154,323</u>	<u>40,931</u>	<u>40,473</u>
	<u>197,512</u>	<u>190,693</u>	<u>189,710</u>

(c) The cash portion of the sales price for the Properties paid to Birchwood represented the proceeds from the issuance of the CHCs' shares to the Subscribers. By separate check and by closing adjustments, Birchwood paid to a reserve fund for the CHCs, \$500,000 in the case of 17-85 and \$30,000 in the case of each of the other Properties.

(d) In calculating the sales price received from the CHCs for the Properties for Federal and State income tax purposes, the Unsold Shares issued to Birchwood were valued at 45.8% of the offering price on an "as vacant" basis (\$120 per Share). The discount was based on the fact that the apartments relating to these Shares were occupied by persons who had the right to remain as tenants indefinitely under a noneviction plan and paying only such rent increases as authorized under the rent stabilization law.

6. Birchwood initially filed gains tax returns with regard to transfers of Unsold Shares in the Properties under Option A. Thereafter, with the Department's approval, later sales as to 18-05 and 18-15 (but not 17-85) were reported under Option B. The numbers of shares reported sold were as follows:

	<u>Option A</u>	<u>Option B</u>	<u>Total</u>
17-85	19,320	-0-	19,320
18-05	23,347	25,562	48,909
18-15	20,312	23,098	43,410

7. As of November 30, 1986, Birchwood had paid gains tax as follows:

	<u>Option A Sales</u>	<u>Option B Sales</u>	<u>Total</u>
17-85	\$120,858	-0-	\$120,858
18-05	199,879	\$ 74,816	274,695
18-15	<u>181,356</u>	<u>79,850</u>	<u>261,206</u>
	<u>\$502,093</u>	<u>\$154,666</u>	<u>\$656,759</u>

8. On January 9, 1985, Birchwood filed claims for refund of gains tax (the "Refund Claims"). The Refund Claims were made on the following two grounds (hereinafter referred to as the "Basic Issues"):

(a) the Mortgages on the CHCs' Properties should not be included in Birchwood's sales prices for the Unsold Shares, and

(b) Birchwood's cost for the Unsold Shares should be determined by reference to each CHC's cost for its respective Property, rather than by reference to Birchwood's original costs for each Property prior to transfer of each of the Properties to the respective CHC.

9. In reliance on the Basic Issues, Birchwood calculates the Refund Claims with regard to gains tax paid under Option A as follows:

	<u>17-85</u>	<u>18-05</u>	<u>18-15</u>
Sales Price	\$1,762,623	\$2,785,254	\$2,497,162
Less: Brokerage Fee	(24,088)	(38,821)	(31,617)
Less: Capital Improvements	<u>(47,050)</u>	<u>(74,655)</u>	<u>(63,990)</u>
Net Gain before purchase price	<u>\$1,691,485</u>	<u>\$2,671,778</u>	<u>\$2,401,555</u>
<u>Less: Purchase Price</u>			
Purchase Price per Share	\$ 84.2282	\$ 81.6594	\$ 81.2144
(¶ 5[a]) ¹			
x Number of Unsold Shares transferred	x <u>14,069</u>	x <u>23,347</u>	x <u>20,312</u>

¹Paragraph references ("¶") refer numerically to the Findings of Fact herein.

Purchase Price	<u>\$1,185,006</u>	<u>\$1,906,502</u>	<u>\$1,649,627</u>
Gain	\$ 506,479	\$ 765,276	\$ 751,928
x Tax Rate	<u>x 10%</u>	<u>x 10%</u>	<u>x 10%</u>
Tax Due	\$ 50,648	\$ 76,528	\$ 75,193
Less: Tax Paid (¶ 7)	<u>(120,858)</u>	<u>(199,879)</u>	<u>(181,356)</u>
Refund Claimed	<u>\$ 70,210</u>	<u>\$ 123,351</u>	<u>\$ 106,163</u>

10. By letter dated April 3, 1985, the Department denied the Refund Claims.

11. On June 10, 1985, Birchwood filed a petition with the State Tax Commission for a redetermination of the decision of the Department denying its Refund Claims (the "Petition").

12. On October 4, 1985, Birchwood filed amended returns (the "Amended Returns") under Option B in regard to 18-05 and 18-15, but not in regard to 17-85. ²

13. The Amended Returns under Option B were calculated on the basis of the Department's position in regard to the Basic Issues raised in the Refund Claims. In the Amended Returns, Birchwood calculated its estimated gain per share for 18-05 and 18-15 as follows:

(a) With Respect to 18-05:

<u>CONSIDERATION</u>	<u>PRESENT</u>	<u>ESTIMATED</u>	<u>TOTAL</u>
1. Actual Non-Grandfathered Sales	\$4,562,361		\$ 4,562,361
2. Estimated Future Sales		\$5,869,545	5,869,545
3. Mortgages Taken over by CHC	3,093,750		3,093,750
4. Less: Brokerage Fee - \$2 per share	<u>(70,802)</u>	<u>(213,438)</u>	<u>(284,240)</u>
5. CONSIDERATION	<u>\$7,585,309</u>	<u>\$5,656,107</u>	<u>\$13,241,416</u>
6. LESS: <u>COSTS</u>			
7. Purchase Price and Other Acquisition Costs	\$9,651,413		\$ 9,651,413
8. Capital Improvements	163,371	364,800	528,171
9. Expenses to Create Ownership in Cooperative Form			
10. Mortgage Amortization - Schedule	-0-	<u>86,569</u>	<u>86,569</u>
	<u>\$9,814,784</u>	<u>\$ 451,369</u>	<u>\$10,266,153</u>

²Since approximately 95% of the Shares of 17-85 had been sold, i.e., gains tax returns had been filed and gains tax paid in regard thereto, Birchwood could not utilize Option B in calculating gains tax on the sales of 17-85 Shares.

11. LESS: Percent of Costs Attributable to Grandfathered Shares (25.472%)			(\$ 2,500,022)
12. Cost Attributable to Taxable Shares			<u>\$ 7,766,131</u>
13. Gain			\$ 5,475,285
14. LESS: Gain already reported on Option A sales ³			<u>(1,998,930)</u>
15. Remaining Gain to be reported on Option B sales			\$ 3,476,355
16. Number of Taxable Shares under Option B (118,773 Shares) ⁴	Divided by	<u>118,773</u>	
17. GAIN PER SHARE		<u>\$ 29.27</u>	

(b) With Respect to 18-15:

<u>CONSIDERATION</u>	<u>PRESENT</u>	<u>ESTIMATED</u>	<u>TOTAL</u>
1. Actual Non-Grandfathered Sales	\$4,281,866		\$ 4,281,866
2. Estimated Future Sales		\$5,893,305	5,893,305
3. Mortgages Taken over by CHC	3,064,775		3,064,775
4. Less: Brokerage Fee - \$2 per share	<u>(65,822)</u>	<u>(214,302)</u>	<u>(280,124)</u>
5. CONSIDERATION	<u>\$7,280,819</u>	<u>\$5,679,003</u>	<u>\$12,959,822</u>
6. LESS: <u>COSTS</u>			
7. Purchase Price and Other Acquisition Costs	\$9,601,717		\$ 9,601,717
8. Capital Improvements	101,595	549,600	651,195
9. Expenses to Create Ownership in Cooperative Form			
10. Mortgage Amortization - Schedule	<u>-0-</u>	<u>86,552</u>	<u>86,552</u>
	<u>\$9,703,312</u>	<u>\$ 636,152</u>	<u>\$10,339,464</u>
11. LESS: Percent of Costs Attributable to Grandfathered Shares (26.17%)			(\$ 2,539,357)
12. Cost Attributable to Taxable Shares			<u>\$ 7,800,107</u>
13. Gain			\$ 5,159,715

³ Approximate tax paid per ¶ 9 (\$199,879) divided by .10.

⁴ Total Shares 190,693 [see ¶ 5(b)(ii)]
Less: Grandfathered Shares (48,573)
Less: Shares on which tax paid under Option A (23,347) [see ¶ 6]
Shares subject to Option B 118,773

14. LESS: Gain already reported on Option A sales ⁵			<u>(1,813,910)</u>
15. Remaining Gain to be reported on Option B sales			\$ 3,345,805
16. Number of Taxable Shares under Option B (119,750 Shares) ⁶	Divided by	<u>119,750</u>	
17. GAIN PER SHARE			<u>\$ 27.94</u>

14. By letter dated March 10, 1986, the Department confirmed the foregoing calculation of gains tax per share under Option B in regard to sales of Unsold Shares of 18-05 and 18-15.

15. If Birchwood's position on the Basic Issues is sustained, the Option B gain per Share on 18-05 and 18-15 should be recalculated as follows:

(a) With Respect to 18-05:

<u>CONSIDERATION</u>	<u>PRESENT</u>	<u>ESTIMATED</u>	<u>TOTAL</u>
1. Actual Non-Grandfathered Sales	\$ 4,562,361		\$ 4,562,361
2. Estimated Future Sales		\$5,869,545	5,869,545
3. Mortgages Taken over by CHC	[omitted]		
4. Less: Brokerage Fee - \$2 per share	<u>(70,802)</u>	<u>(213,438)</u>	<u>(284,240)</u>
5. CONSIDERATION	\$ <u>4,491,559</u>	<u>\$5,656,107</u>	<u>\$10,147,666</u>
6. LESS: <u>COSTS</u>			
7. Purchase Price and Other Acquisition Costs	15,571,869		15,571,869
8. Capital Improvements ⁷	[omitted]	364,800	364,800

⁵Approximate tax paid per ¶ 9 (\$181,356) divided by .10.

⁶Total Shares 189,710 [see ¶ 5(b)(ii)]
Less: Grandfathered Shares (49,648)
Less: Shares on which tax paid under
Option A (20,312) [see ¶ 6]
Shares subject to Option B 119,750

⁷Since this claim for refund is calculated on the basis of the corporation's cost for the Property, the expenditures exclude the capital improvements made by Birchwood totaling \$163,371.

9. Expenses to Create Ownership in Cooperative Form			
10. Mortgage Amortization - Schedule	<u>-0-</u>	<u>86,569</u>	<u>86,569</u>
	<u>\$15,571,869</u>	<u>\$ 451,369</u>	<u>\$16,023,238</u>
11. LESS: Percent of Costs Attributable to Grandfathered Shares (25.472%)			(\$ 4,081,439)
12. Cost Attributable to Taxable Shares			<u>\$11,941,799</u>
13. Gain (Loss)			(\$ 1,794,133)
14. LESS: Gain on Option A sales (as adjusted if Birchwood's ⁸ positions are sustained)			<u>(765,276)</u>
15. Remaining Gain to be reported on Option B sales			(\$ 2,559,409)
16. Number of Taxable Shares under Option B ⁹		Divided by	<u>118,773</u>
17. GAIN PER SHARE			<u>\$ 0</u>

(b) With Respect to 18-15:

<u>CONSIDERATION</u>	<u>PRESENT</u>	<u>ESTIMATED</u>	<u>TOTAL</u>
1. Actual Non-Grandfathered Sales	\$ 4,281,866		\$ 4,281,866
2. Estimated Future Sales		\$5,893,305	5,893,305
3. Mortgages Taken over by CHC	[omitted]		
4. Less: Brokerage Fee - \$2 per share	<u>(65,822)</u>	<u>(214,302)</u>	<u>(280,124)</u>
5. CONSIDERATION	<u>\$ 4,216,044</u>	<u>\$5,679,003</u>	<u>\$ 9,895,047</u>
6. LESS: <u>COSTS</u>			
7. Purchase Price and Other Acquisition Costs	\$15,407,181		\$15,407,181
8. Capital Improvements ¹⁰	[omitted]	549,600	549,600
9. Expenses to Create Ownership in Cooperative Form			
10. Mortgage Amortization - Schedule	<u>-0-</u>	<u>86,552</u>	<u>86,552</u>
	<u>\$15,407,181</u>	<u>\$ 636,152</u>	<u>\$16,043,333</u>

⁸See ¶ 9.

⁹See Footnote "4".

¹⁰Since this claim for refund is calculated on the basis of the corporation's cost for the Property, the expenditures exclude the capital improvements made by Birchwood totaling \$101,595.

11. LESS: Percent of Costs Attributable to Grandfathered Shares (26.17%)			<u>(\$ 4,198,540)</u>
12. Cost Attributable to Taxable Shares			<u>\$11,844,793</u>
13. Gain (Loss)			(\$ 1,949,746)
14. LESS: Gain already reported on Option A sales (as adjusted if Birchwood positions are sustained) ¹¹			<u>(751,928)</u>
15. Remaining Gain to be reported on Option B sales			(\$ 2,701,674)
16. Number of Taxable Shares under Option B ¹² total shares	Divided by		<u>119,750</u>
17. GAIN PER SHARE			<u>\$ 0</u>

16. If Birchwood prevails on the Basic Issues, the refunds claimed are as follows:

	<u>17-85</u>	<u>18-05</u>	<u>18-15</u>
<u>Option A - (See ¶ 9)</u>	<u>\$70,210</u>	<u>\$123,351</u>	<u>\$106,163</u>
<u>Option B</u>			
Shares Sold	-0-	25,562	23,098
x Gain per Share	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>
Option B Gain (See ¶ 7)	--	-0-	-0-
x Rate of Tax	<u>x 10%</u>	<u>x 10%</u>	<u>x 10%</u>
Option B Gains Tax	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>
Less: Option B Tax Paid (See ¶ 7)	<u>-0-</u>	<u>\$ 74,816</u>	<u>\$ 79,848</u>
Option B Refund Claimed	\$ -0-	\$ 74,816	\$ 79,848
Refund Claimed (Option A and Option B)	<u>\$ 70,210</u>	<u>\$198,167</u>	<u>\$186,011</u>

17. By Notices of Tax Due dated March 4 and March 5, 1986, the Department assessed against 18-05 and 18-15, penalties and interest of \$8,439 and \$11,248, respectively.

18. Birchwood has protested the assessment of the penalties and interest and the Department is presently considering an audit agent's recommendation to waive the penalties and interest.¹³ The basis for the waiver is Tax Law § 1446.2(a), which provides as follows:

¹¹See ¶ 9.

¹²See Footnote "6".

¹³This is the fact as stipulated to by the parties; however, that this matter is before us indicates that the Division of Taxation did not follow the auditor's recommendation.

"If the tax commission determines that such failure or delay was due to reasonable cause and not due to willful neglect, it shall remit, abate or waive all of such penalty and such interest penalty."

Birchwood claims that it had "reasonable cause" for failure to pay the tax on the grounds that:

(a) after the Department authorized the use of Option B for purposes of calculating gains tax for sales of shares of CHCs, several months passed before the Department clarified the method of calculation under Option B, which, in turn, delayed the preparation and filing of gains tax returns by Birchwood on the basis of Option B; and

(b) while the Department, the Division of Tax Appeals and/or the courts may disagree with Birchwood's positions in the claim for refund (which give rise to the proposed tax deficiencies on which the penalties are based), Birchwood submits that there are reasonable grounds for said positions.

19. Birchwood and the Department agree that the Basic Issues are as follows:

(a) whether the CHCs' Mortgages should be included in Birchwood's sales price for the Unsold Shares (as determined by the Department);

(b) whether Birchwood's purchase price for the Unsold Shares should be determined by making an allocation of the CHCs' cost for the Properties (as claimed by Birchwood), rather than an allocation of Birchwood's cost for the Properties prior to transfer of the Properties to the CHCs (as determined by the Department); and

(c) whether there should be a waiver of penalty interest and penalties with respect to an issue if the Division of Tax Appeals decides against Birchwood on a Basic Issue.

20. Birchwood agrees that if the Department wins on any legal issue, Birchwood concedes that the gains tax should be calculated in regard to that issue as set forth in the Amended Returns with regard to 18-15 and 18-05 and in accordance with the Department's prior Notices of Tax Due in regard to 17-85. Thus, Birchwood concedes the Department's determinations of:

(a) the cost to Birchwood for the Properties which would be the cost for the Unsold Shares under the Department's position; and

(b) the allocation of the Mortgages to each unit for inclusion in the sales price of the Unsold Shares under the Department's position.

21. The Department agrees that if Birchwood wins on the Basic Issues:

(a) the gains tax should be calculated as set forth in ¶ 9 in regard to the Option A sales and ¶ 15 in regard to the Option B sales; and

(b) Birchwood would be entitled to refunds as provided in ¶ 16. Thus, the Department concedes Birchwood's figures on the cost of the Properties to the CHCs.

22. The Division of Taxation retains the right to audit all future refunds on sales not covered by this stipulation.

23. The parties hereto agree that the Division of Tax Appeals shall render such decision as shall be proper upon the above facts and its interpretation of the legal issues set forth in ¶ 19.

OPINION

The Administrative Law Judge concluded that a cooperative conversion was an indivisible transaction for gains tax purposes with the tax to be computed as if it was a single, overall transfer. The Administrative Law Judge also held that penalties should not be abated.

The petitioner requests on exception that we reverse the Administrative Law Judge and find that:

1) the gains tax recognizes as separate taxable events the realty transfer from the realty transferor to the cooperative housing corporation and the subsequent sale by the realty transferor of the shares received on the cooperative conversion.

2) the penalties asserted against petitioner should be abated.

For the reasons stated below, we affirm the Administrative Law Judge and find against petitioner on all issues. We address each issue below.

I. Whether a cooperative conversion is treated as a single transfer for gains tax purposes.

The essence of petitioner's argument is that the transfer of the real property by the realty transferor to the cooperative housing corporation is one of two separate taxable events for gains tax purposes. The second event is the transfer of shares by the realty transferor to unit purchasers. Petitioner acknowledges that pursuant to the Court of Appeals decision in Mayblum

v. Chu (Sup Ct., Queens County, May 11, 1984, Graci, J., affd 109 AD2d 782, mod 67 NY2d 1008), it cannot avoid paying gains tax on the sale of shares to individual unit purchasers even though petitioner transferred the realty to the cooperative housing corporation prior to the effective date of the statute. However, petitioner maintains that the gains tax due on the sale of the shares must be calculated separately and distinctly from the gains tax due on the transfer of the realty from the realty transferor to the cooperative housing corporation.

Petitioner advances its theory of the application of the gains tax to cooperative conversions to achieve two calculation goals. First, petitioner seeks to include the amount of the Mortgage as consideration only on the transfer from the petitioner to the cooperative housing corporation. Second, petitioner wants the original purchase price for the sale of shares to be determined based on the cooperative corporation's acquisition of the realty, rather than by the petitioner's acquisition of the realty.

Petitioner would apply its two stage taxation theory and the calculations to the instant facts as follows. According to petitioner, since the realty transfer to the cooperative housing corporation took place prior to March 28, 1983 these transfers would presumably be exempt from tax. Further, since petitioner would treat the Mortgage as consideration for this exempt transfer, the Mortgage would not generate any gain subject to tax. With respect to the second stage of the conversion, while petitioner would treat the sale of shares as taxable, the gain on these sales would be significantly reduced by "stepping up" their original purchase price to reflect the value of the realty at the time it was acquired by the cooperative housing corporation, rather than its value at the time it was acquired by petitioner.

In Matter of Normandy Associations (Tax Appeals Tribunal, March 23, 1989) we were also presented with the theory that cooperative conversions should be viewed as a two stage transaction for gains tax purposes. In Normandy the taxpayer sought this approach so that the realty transfer to the cooperative housing corporation would be the only taxable event. Like petitioner, the taxpayer in Normandy asserted that the decision in Mayblum v. Chu (supra) did not control the resolution of its issue. We conclude that our analysis in Normandy is completely

applicable to the instant matter, including our conclusion that Mayblum decides this issue against petitioner.

In contrast to the two stage theory advanced by petitioner, we conclude, as we did in Normandy, that the tax treats the transfer of shares by the realty transferor to unit purchasers as the only taxable event. However, the gain on these transfers is measured by the difference between the consideration for the shares and the realty transferor's original purchase price in the real property prior to its transfer to the cooperative housing corporation. This scheme in effect ignores the realty transferor's transfer to the cooperative housing corporation and instead treats the realty transferor as if it were directly transferring its interest in the real property to the unit purchasers. Under this scheme the gains tax is imposed on the entire cooperative conversion plan, encompassing the real property prior to its transfer to the cooperative housing corporation and the sale of shares by the realty transferor subsequent to the property's conversion to cooperative ownership. The transfer to the cooperative corporation is then treated merely as a conduit which allows the transformation of the real property into shares allocated to units.

We find this scheme articulated in each of the special provisions in Article 31-B that deal with transfers pursuant to a cooperative plan. Further, it is significant that these provisions consistently treat transfers pursuant to a cooperative plan in exactly the same manner as transfers pursuant to a condominium plan. From this we conclude that the Legislature intended transfers pursuant to a cooperative plan to be treated exactly like transfers pursuant to a condominium plan - as transfers directly by the realty transferor to the unit purchasers.

This intent of Article 31-B is expressed in the aggregation clause of section 1440.7 of the Tax Law which specifically defines as a "transfer of real property" transfers pursuant to a cooperative or condominium plan. Further, section 1442 of the Tax Law provides that "In the case of a transfer pursuant to a cooperative or condominium plan, the date of transfer shall be deemed to be the date on which each cooperative or condominium unit is transferred." This section also bases the tax due on each transfer pursuant to a cooperative or condominium plan on "an apportionment of the original purchase price of the real property and total consideration

anticipated under such cooperative or condominium plan . . . for each such cooperative or condominium unit" (Tax Law § 1442). Finally, section 1443.6 provides that for purposes of the grandfather exemption, "A written agreement to purchase shares shall be deemed a written contract for the transfer of real property . . .". Taken as a whole, these provisions articulate a statutory scheme which treats a cooperative conversion as a single transaction, and taxes the realty transferor as if it was transferring its real property interest directly to the unit purchasers.

Petitioner's two stage theory ignores this statutory scheme and would destroy the parallel treatment obviously intended by the Legislature to be applied to transfers of cooperative and condominium plans.¹⁴

Next we deal with petitioner's argument that the decision in Mayblum, as modified by the Court of Appeals, does not preclude a holding that the gains tax applies to cooperative conversions in two distinct stages. We disagree.

The Court of Appeals modified the trial court's order to provide that the gains tax "is imposed by the statute upon the overall cooperative plan except as the Article exempts transfers of shares in the cooperative pursuant to a written subscription agreement entered into prior to March 28, 1983" (Mayblum v. Chu, supra at 1008). The trial court's order had read that the gains tax "is imposed by the statute upon the transfer of shares of stock by the Apartment Corporation which is declared to be the taxable event" for the imposition of the gains tax.

We believe that by so modifying the trial court's order the Court of Appeals was explicitly embracing the position that the gains tax is imposed on cooperative conversions as a single

¹⁴The legislative decision to treat the realty transferor in a cooperative conversion similarly to a transferor of condominium units was seemingly motivated by a desire to avoid placing the former at an economic disadvantage compared to the latter. Under the single transaction approach, the realty transferor in a cooperative conversion is not required to pay gains tax until the conversion has the potential to generate cash by the sale of individual units. Petitioner's two stage theory could economically harm a realty transferor in a cooperative conversion by requiring it to pay tax on the transfer of the real property to the cooperative conversion which may occur before significant amounts of cash have been generated by the sale of units. In contrast, the transferor of condominium units would not face this potential cash flow problem, since tax would continue to be due only as units were sold, and cash generated. Of course, petitioner itself would not suffer from such a cash flow problem since the instant transfers of real property would presumably be exempt from tax under petitioner's theory.

transaction. This view is also supported by the language of the Court of Appeal's decision where it is stated "[t]hat the latter section [1442] deals with payment of the tax is not inconsistent with construing the overall transaction as taxable; it merely demonstrates that although for purposes of computation of the tax the cooperative conversion is treated as a single transfer, it is not to be so treated with respect to the date of payment . . . " (Mayblum v. Chu, *supra*, at 1009).

If the language of the Court of Appeals' decision was not clear enough, the briefs of the parties in *Mayblum* make it clear that an issue before the Court was whether a cooperative conversion was to be taxed in a single stage or in two stages. The plaintiff-appellant argued that even if the Court of Appeals sustained the lower court's interpretation, there would be no gain on the transfer of units because the realty transferor's original purchase price in the shares would be "stepped-up" to reflect the value of the real property at the time it was transferred to the cooperative corporation (plaintiffs' brief before the Court of Appeals, p. 9). In response, the respondent-defendant (Roderick G. W. Chu as Commissioner of Taxation and Finance) disputed the accuracy of the lower court's declaration that the taxable event for gains tax was the transfer of shares from the cooperative corporation to unit purchasers (respondent's brief before the Court of Appeals, p. 19). Instead, the respondent argued it is the "entire cooperative conversion plan, not any separate transfers contemplated therein, that is taxable under Article 31-B" (respondent's brief, p. 19, emphasis in original). This background makes it absolutely clear that the Court of Appeals' decision and modification of the trial court's order precludes a holding that a cooperative conversion is a two stage process for purposes of the gains tax.

Since we conclude that a cooperative conversion is taxed as a single transfer, it follows that we reject petitioner's calculations that would allocate the Mortgage entirely to the realty transfer to the cooperative corporation and "step-up" the original purchase price of the shares.

II. Penalty Abatement.

We now address the issue whether the penalties asserted against petitioner should be abated. Tax Law section 1446.2(a) provides, inter alia, as follows:

"Any transferor failing to file a return or to pay any tax within the time required by this article shall be subject to a penalty

If the Tax Commission determines that such failure or delay was due to reasonable cause and not due to willful neglect, it shall remit, abate or waive all of such penalty and such interest penalty."

In arguing that its failure to timely file returns and remit the applicable tax was due to reasonable cause, petitioner points to the reasonableness of its substantive arguments, which were supported by consultations with counsel, as a basis for abating the penalty. Petitioner maintains that its substantive positions were reasonably taken in light of the then newly enacted statute which contained less than clear language regarding its application to cooperative conversions.

First, it is clear that reliance on the advice of counsel does not itself establish reasonable cause (Matter of L T & B Realty v. State Tax Commn., App. Div., 3d Dept, October 27, 1988, Mahoney, J.). Next, we believe that the reasonableness of petitioner's positions can only be evaluated as these positions are compared to the Division of Taxation's articulated policy.

In August 1983, the Division issued Publication 588, "Questions and Answers - Gains Tax on Real Property Transfers." At question and answer number 20, the Division describes in some detail the application of the gains tax to cooperative conversions. This explanation is directly contrary to the two stage theory advanced by petitioner. In addition, on August 22, 1983 the Division issued TSB-M-83(2)R, which describes two options for calculating the tax due on each transfer of a cooperative conversion or condominium plan. These options are consistent with Publication 588 in that a cooperative conversion is taxed as a single transaction. On May 11, 1984 the trial court's decision in Mayblum was issued upholding the Division's application of the gains tax to cooperative conversions.

In November of 1984 the Division issued a revised Publication 588, which specifically states that cooperative conversions are not taxed in two stages (Question and Answer No. 33) and explicitly states that mortgages on the real property are to be allocated among the shares sold (Question and Answer No. 36). These guidelines are obviously in direct conflict with petitioner's positions. These guidelines were adopted as regulations on September 24, 1985 (20 NYCRR

590.33, 590.36). The trial court's decision in Mayblum was affirmed by the Appellate Division, Third Department on March 14, 1985.

All of these statements contrary to petitioner's position were issued prior to petitioner's October 1985 change from Option A to Option B. We conclude that petitioner's reliance on its position in the face of this opposition does not establish reasonable cause.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Birchwood Associates is denied;
2. The determination of the Administrative Law Judge is affirmed; and
3. The petition of Birchwood Associates is denied.

DATED: Troy, New York
July 27, 1989

/s/John P. Dugan
John P. Dugan
President

/s/Francis R. Koenig
Francis R. Koenig
Commissioner

/s/Maria T. Jones
Maria T. Jones
Commissioner