STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
61 EAST 86TH STREET EQUITIES GROUP[1]	:	DECISION DTA No. 803837
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.	:	
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Petitioner 61 East 86th Street Equities Group, c/o Ziegler, Sagal & Winters, P.C., 250 Park Avenue, New York, New York 10177 filed an exception to the determination of the Administrative Law Judge issued on March 1, 1990 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. Petitioner appeared by Ziegler, Sagal & Winters, P.C. (Stephen S. Ziegler, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Paul Lefebvre, Esq., of counsel).

On exception, both parties submitted briefs and petitioner also submitted a reply brief. Oral argument, at petitioner's request, was heard on July 23, 1992.

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

ISSUES

I. Whether the original purchase price for certain shares of a cooperative housing corporation ("CHC") acquired by petitioner should be based on an allocation of petitioner's

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[1] This matter serves as the "test case" on the issues addressed herein pursuant to a "test case agreement" executed by the parties. A list of other matters potentially affected by the outcome of this test case is included herein as Appendix "A."

original cost for the property (prior to petitioner's transfer thereof to the CHC) as opposed to an allocation based on the CHC's cost for such property.

II. Whether the CHC's mortgage indebtedness on the property should be allocated to and included in consideration received by petitioner upon its sale of CHC shares.

III. Whether petitioner should be allowed to reduce the amount of gain subject to tax by allowance of certain estimated costs, calculated as the excess of maintenance and management costs over gross rents (denominated "negative carry") and the excess of interest expense over net operating income (denominated "interest carrying cost").

IV. Whether petitioner has established that penalties asserted for failure to timely file certain returns and failure to timely remit tax due should be abated.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

On September 18, 1987, authorized representatives for petitioner (Stephen S. Ziegler, Esq.) and for the Division of Taxation (hereinafter the "Division") (Paul A. Lefebvre, Esq.) executed a Stipulation of Facts pertaining to the matter at issue. This Stipulation, modified herein 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:

STIPULATED FACTS

On July 12, 1982, Francis Greenburger ("FG"), as nominee for 61 East 86th Street Equities Corp. (the "Transferor"), entered into a contract (the "Purchase Contract"), with an unrelated party ("Seller"), to purchase for a price of $2,218,000 the property located at 61-69 East 86th Street, New York, New York (the "Property").

The Transferor was formed under a Limited Partnership Agreement by and among FG, Morton L. Olshan ("MLO") and Philip Rudd ("PR").

FG and MLO are the general partners and PR is a limited partner of the Transferor, and their percentages of the profits and losses of the Transferor are as follows:

General Partners	Profit and Loss Percentage
FG	40%
MLO	50%
Limited Partner	
PR	10%
TOTAL	100%

MLO has no family relationship to FG and is not an employee of or contractor for Greenburger or any affiliates of Greenburger.

Apart from their participation as co-partners of the Transferor and except as set forth in the next sentence, there have been no business relationships between MLO (and his affiliates) and FG (and his affiliates). In the period from June 1982 to February 1986, FG and/or affiliates purchased five properties from MLO at fixed prices totaling $10,040,000.

Olshan is an experienced and successful real estate entrepreneur, e.g.

(a) He owns directly through affiliates over 5,000 housing units in the New York City metropolitan area.

(b) His company has built over 10 million square feet of regional shopping malls.

(c) He is currently building at a cost believed to be over $100 million and is marketing condominium units in a luxury apartment house named the Savoy on 61st Street and Third Avenue.

(d) He is one of the founding members of CHIP, one of the most active real estate industry organizations in New York City and actively participates in the organization.

On October 21, 1982, the Transferor purchased the Property pursuant to the Purchase Contract.

On December 8, 1983, there was filed with the New York Attorney General an Offering Plan (the "Plan") to convert the Property to cooperative ownership. The Plan was a non-eviction plan. After subsequent amendments, the Plan was declared effective March 4, 1985.

On October 19, 1982, the Transferor entered into a Contract of Exchange (the "Exchange Contract") to transfer the Property to the Corporation in exchange for:

(a) the Corporation issuing to the Transferor all the Shares of the Corporation which had either not been subscribed for prior to the Closing Date or as to which the cash payment for subscriptions had not been received on the Closing Date or within a few weeks thereafter (the "Unsold Shares"),

(b) the Corporation agreeing to issue to the Transferor a purchase money mortgage of $2,000,000, and

(c) the Corporation paying to the Transferor an amount equal to the net proceeds realized from the sales of the Shares issued by the Corporation to persons other than the Transferor (the "Subscribers") after deducting therefrom:

(i) the expenses incurred on behalf of or by the Corporation in connection with the promulgation and consummation of the Plan and the acquisition of the Property pursuant thereto, and

(ii) the working capital and reserve funds to be retained by the Corporation at the closing.

In April 1985, the Exchange Contract was amended to provide that, instead of issuing a purchase money mortgage to the Transferor, the Corporation would acquire the Property subject to a mortgage payable to Independence Savings Bank of $1,300,000 (the "Independence Mortgage") and a mortgage payable to Chemical Bank of $300,000 (the "Chemical Mortgage") and that the Corporation would immediately retire the Chemical Mortgage.

On May 1, 1985 (the "Closing Date"), the Transferor transferred the Property to the Corporation for total consideration as follows:

Cash	$1,490,541
Corporation acquiring the Property subject to the Independence Mortgage	1,300,000
Corporation retiring Chemical Mortgage	300,000
Corporation's issuance to the Transferor of the 4,481 Unsold Shares of the Corporation's stock, valued at an estimated fair market value of $424.80 per Share[2]	1,903,529
Total Consideration	$4,994,070

As of the Closing Date, the Corporation issued 10,688 Shares of its common stock as follows:

(a) pursuant to Subscription Agreements entered into before the Closing Date, at, or shortly after the Closing Date, the Corporation issued 6,207 Shares (the "Sold Shares") to subscribers other than the Transferor (the "Subscribers") for gross proceeds of $2,685,675, and

(b) as part of the consideration for the Transferor's transfer of the Property to the Corporation, the Corporation issued its remaining 4,481 Shares to the Transferor (the "Unsold Shares").

The cash payment made by the Corporation to the Transferor as part of the consideration for the transfer of the Property represented the following:

Gross proceeds of issuance of Shares to Subscribers pursuant to Subscription Agreements in effect on Closing Date	$2,685,675
Less: Proceeds used to retire Chemical Mortgage	(300,000)
Less: Working Capital and	

[2] This represents 40% of the outsider price for the Shares sold, which was deemed to represent the fair market value of the Unsold Shares on an occupied basis.

Reserve Funds	(300,000)[3]
Less: Costs to Corporation of acquiring Property and issuing shares	(595,134)
Cash Payment	$1,490,541

The costs to the Corporation that were subtracted in imputing the cash payment were:

Tenant Buy-out payments	$ 70,000
Title & recording	120,683
Conversion fee total (15%)	402,851
Miscellaneous	1,600
	$595,134

The 6,207 Sold Shares issued to the Subscribers were all subscribed to after March 28, 1983.

Subsequent to filing the Plan, during the period from September 4, 1984 through the Closing Date (the "Pre-Closing Period")[4], the Transferor incurred an interest cost in carrying the Property (the "Interest Carrying Cost") as follows:

Interest Expense	$148,706
Less: Net Operating Income before depreciation[5]	(22,529)
	$126,177

At the time it filed its Amended Gains Tax Return, the Transferor estimated that it was incurring a net operating loss (the "Negative Carry") in holding the Unsold Shares at a monthly rate per share computed as follows:

Expenditures	
Maintenance charges to Corporation	$13,265

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[3] Of this amount $75,000 was paid by the Sponsor to the Cooperative Housing Corporation ("CHC") after the closing.

[4] September 4, 1984 was the date of an amendment to the Gains Tax statute permitting a deduction for the costs of converting a property to cooperative ownership.

[5] In computing net operating income, non-cash charges such as depreciation were not subtracted.

Management fee (3% of gross rents)	283
Repairs, insurance and other expenses (an estimated $55 per apartment per month)	800
Total Expenditures	$14,428
Less: Gross rental income	(9,435)
Negative Carry per month	$ 4,993
Divided by Number of Unsold Shares	Divided by 4481
Negative Carry per Share per Month	$ 1.11

Based on said current Negative Carry per Share per month and the assumptions in regard to the holding period of the Unsold Shares used in calculating the estimated gain per Share under Option B (which assumptions are described above), Transferor projected in its Amended Return that it would incur a total Negative Carry of $405,887 in carrying the Unsold Shares in the period from the Closing Date through the disposition of all the Unsold Shares (the "Post-Closing Period").

The assumptions as to the holding period of the Unsold Shares were that 30% of the Shares would be sold as apartments become vacant after an average holding period of 48 months and 70% of the Shares would be sold for occupied apartments after an average holding period of 96 months. These assumptions were accepted by the Department upon audit in regard to the calculation of the estimated sales price on future sales of Shares and in regard to the calculation of the deduction for post-Closing mortgage amortization.

By an agreement dated December 24, 1982 (the "Sales Agent and Services Agreement"), the Transferor retained Time Equities, Inc. ("TEI") to furnish sales agent and administrative services in regard to the conversion of the Property to cooperative ownership.

Under the Sales Agent and Services Agreement, TEI was required to provide and pay for all other direct expenses associated with all services in regard to the sales of the Shares of the Corporation and the preparation, processing and implementation of the Plan.

The fee for all services provided by TEI was a conversion fee (the "Conversion Fee") as follows:

(a) A nonrefundable retainer of $75,000 was paid on December 24, 1982, to be credited against fees earned under paragraph (b) below.

(b) TEI was to be paid a fee equal to 15% of the actual selling price of all Shares.

On sales made by the Corporation, the Transferor would cause the Corporation to pay the Conversion Fee. On sales of Unsold Shares issued to the Transferor, the Transferor would pay the Conversion Fee.

On April 1, 1985, the Transferor filed a Gains Tax return (the "Original Return") under Option B for 5,196 of the Shares which were sold by the Corporation to Subscribers as of the Closing Date. In regard to this return, the Department issued a Notice of Tentative Assessment and Return, dated May 3, 1985. Under protest, the Transferor paid the Gains Tax liability of $126,525 reported on the Gains Tax return.

On August 15, 1985, the Transferor filed an amended Gains Tax return (the "Amended Return"):

(a) covering the sales of an additional 1,011 Shares for the total of 6,207 Shares sold as of the Closing Date, and

(b) adopting certain positions required by the Department under audit of Gains Tax returns of other properties in which TEI participated in the conversion to cooperative ownership.

Under protest, the Transferor paid an additional $55,801 of Gains Tax with the Amended Return for a total tax payment of $182,326.

In preparing the Amended Return under Option B, the Transferor followed certain positions set forth by the Department in meetings with the Transferor in regard to this and other properties, that is, the Transferor:

(a) followed Revised Publication 588 by:

(i) calculating the purchase price for the Sold Shares with reference to the Transferor's original cost for the Property, rather than with respect to the Corporation's cost for the Property; and

(ii) including in the allocable portion of the sales price for the Sold Shares the allocable portion of the Mortgage on the Property held by the Corporation, instead of excluding said Mortgage from the sales price of the Sold Shares;

(b) followed the position taken by the Department on audit of other properties in which TEI participated in the conversion to cooperative ownership, by not including in the costs of converting the Property to cooperative ownership, the Interest Carrying Cost sustained by the Transferor in carrying the Property in the Pre-Closing Period;

(c) followed the position taken by the Department on audit of other properties in which TEI participated in the conversion to cooperative ownership, by not including in the costs of converting the Property to cooperative ownership, the estimated Negative Carry to be incurred by the Transferor in carrying the Unsold Shares in the Post-Closing Period; and

(d) followed the position taken by the Department upon audit of other properties in which TEI participated in the conversion to cooperative ownership, by deducting from the sales price of the Sold Shares only a 10% Conversion Fee paid to TEI, instead of deducting the full 15% Conversion Fee actually paid to TEI.

Pursuant to the Amended Return (as modified by Agreement upon audit), the Transferor calculated its estimated gain per Share as follows:

Consideration	Present	Estimated	Total
1. Actual Non-Grandfathered Sales	$2,685,675		$2,685,675
2. Estimated Future Sales		$2,854,845	2,854,845
3. Mortgage taken over by Corporation on			

Closing Date	1,300,000		1,300,000
4. Less: 10% Brokerage Fee	(268,568)	(285,485)	(554,052)[6]
TOTAL CONSIDERATION	$3,717,108	$2,569,360	$6,286,468
Less: Costs			
5. Purchase Price	$2,218,000		$2,218,000
6. Other Acquisition Costs	199,436	120,683	320,119
7. Capital Improvements	35,609	142,765	178,374
8. Expenses to Convert to Cooperative Ownership[7]	370,000		370,000
9. Mortgage Amortization	_____	60,447	60,447
10. TOTAL COSTS	$2,823,045	$ 323,895	$3,146,940
11. Less: Costs Attributable to Grandfathered Shares			-0-
12. Costs Attributable to Taxable Shares			$3,146,940
13. Gain (Difference between Total Consideration and Total Costs Attributable to Taxable Shares)			$3,139,528
14. Total Number of Shares (Sold and Unsold)		Divided by	10,688
15. Gain Per Share (Gain Divided by Total Number of Shares)			$ 293.74

Based on the foregoing calculation of gain per Share, the calculation of Gains Tax in the Amended Return for the 6,207 Sold Shares was as follows:

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[6] This calculation is not precise due to rounding differences.

[7] Working capital and reserve fund of $300,000 plus tenant buyout fees of $70,000.

Gain per Share	$ 293.74
x Shares sold	x 6,207
Total Gain	$1,823,244
x 10% Gains Tax	x 10%
Gains Tax Liability	$ 182,324

Subsequent to the filing of the Amended Return and this claim for refund with the Department the Transferor sold an additional 1,226 Shares and paid Gains Tax totaling $36,013 in regard thereto.

Hence, the Transferor has paid total Gains Tax of $218,339 ($126,525 with the original return, $55,801 with the Amended Return and $36,013 after the Amended Return) with respect to a total of 7,433 Shares.

In its Petition[8], the Transferor calculated its estimated gain per share as follows:

Consideration	Present	Estimated	Total
1. Actual Non-Grandfathered Sales	$2,685,675		$2,685,675
2. Estimated Future Sales		$2,854,845	2,854,845
3. [Mortgage taken over by Corporation omitted]			
4. Less: 15% Brokerage Fee	(402,851)	(428,227)	(831,078)
TOTAL CONSIDERATION	$2,282,824	$2,426,618	$4,709,442
Less: Costs			
5. Purchase Price	$4,994,070		$4,994,070
6. Other Acquisition Costs to Transferor[9]	70,044	120,683	190,727

[8]The following schedule reflects adjustments of figures set forth in the petition. The adjustments were determined by TEI in internal audits and represent the Transferor's most current cost figures.

[9]

Since this claim for refund is calculated on the basis of the Corporation's cost for the Property, these expenditures exclude the acquisition costs of the Transferor totaling $123,392. (See Amended Return Schedule E).

7. Capital Improvements[10]	[omitted]	147,653	147,653
8. Expenses to Convert to Cooperative Ownership			
(a) Accepted by Department	370,000		370,000
(b) Interest Carrying Cost	126,177		126,177
(c) Negative Carry		405,887	405,887
9. [Amortization of Mortgage on line 3 omitted]			
10. Total Costs	$5,560,291	$ 674,223	$6,234,514
11. Less: Costs Attributable to Grandfathered Shares			-0-
12. Cost Attributable to Taxable Shares			$6,234,514
13. Gain (Difference between Total Consideration and Total Costs Attributable to Taxable Shares)			(1,525,072)
14. Total Number of Shares (Sold and Unsold)		Divided by	10,688
15. Gain (loss) Per Share (Gain Divided by Total Number of Shares)			$ (142.69)

On this basis, the Transferor has applied for a refund of the full Gains Tax paid of $218,339, together with the interest that has accrued thereon.

By letter dated May 22, 1986, the Department denied the claim for refund.

The Transferor and the Department agree that the issues are as follows:

Issue I is as follows:

(a) should the Corporation's mortgage be included in the sales price for the Sold Shares (as determined by the Department); and

[10]Since this claim for refund is calculated on the basis of the Corporation's cost for the Property, these expenditures exclude the $35,609 of capital improvements made by the Transferor prior to the Closing Date. (See Amended Return Schedule F).

(b) should the Transferor's purchase price for the Sold Shares be determined by making an allocation of the Corporation's cost for the Property (as claimed by the Transferor), rather than as an allocation of the Transferor's cost for the Property prior to transfer of the Property to the Corporation (as determined by the Department).

Issue II.

Should the Transferor be permitted to include, in its costs for converting the Property to cooperative ownership under Section 1440-5 the Interest Carrying Cost incurred by the Transferor after September 4, 1984 in carrying the Property in the Pre-Closing Period, i.e., the excess of the interest expense in this period over the net operating income produced by the Property.

Issue III.

Should the Transferor be permitted to include in its costs for converting the Property to cooperative ownership under Section 1440-5 the estimated Negative Carry incurred and to be incurred by the Transferor after September 4, 1984 in carrying the Unsold Shares in the Post-Closing Period, i.e., the excess of the maintenance charges to the Corporation and management fees over the rents derived from tenants occupying those apartments.

Issue IV.

Should the Transferor be entitled to a deduction for the full Conversion Fee of 15% of the sales price paid to TEI (as claimed by the Transferor) rather than a 10% Conversion Fee (as determined by the Department).

The parties agree that issues I, II and III will proceed to decision based upon the briefs. A hearing will be held only on Issue IV. Following said hearing, Issue IV will be submitted for decision based upon this stipulation, the briefs and the hearing.[11]

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[11]Subsequent to execution of the parties' stipulation, a modification to the manner of proceeding was agreed to between the parties and approved by the Division of Tax Appeals. More specifically, Issue IV as described in Stipulated Fact below (the 15% versus 10% conversion fee issue) has been severed from consideration in this determination. Said severance is for the purpose of allowing the parties to pursue settlement negotiations on such issue without impeding or delaying progress to determination on the remaining issues presented herein. Should

Subject to audit, the Department concedes the Transferor's figures on amounts of:

(a) the cost of the Property to the Corporation (applicable if the Transferor wins Issue I);

(b) the Interest Carrying Cost (applicable if the Transferor wins Issue II), and

(c) the estimated Negative Carry (subject to adjustments based on the updated Gains Tax returns prepared in accordance under Option B) applicable if the Transferor wins Issue III.

The Transferor concedes the figures in the Amended Return on the cost of the Property to the Transferor (applicable if the Transferor loses Issue I).

Additional Facts

In addition to the above-stipulated facts, the following facts are found:

On May 23, 1988, a hearing was held on the issue of penalty abatement, at which time petitioner presented the testimony of TEI's general counsel, one Philip Brody, who described TEI's staffing and operation, particularly with reference to gains tax compliance.

In regard to a cooperative conversion, TEI, as the managing general partner, provides a full range of services for a sponsor including, but not limited to, preparing the co-op plan, negotiating thereon with the Attorney General and with tenants, providing sales agent services (including completing sales) and also providing legal, accounting and engineering services described, in total, as an overall coordination function. The general legal structure of TEI conversions is as follows:

(a) TEI is the service entity which renders conversion services to various partnerships which sponsor conversions.

(b) The partnership holds the property and/or the contract to acquire a property and transfers it to a CHC.

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resolution of the conversion fee issue not be achieved, a separate hearing will be held and determination rendered thereon. Finally, the parties have presented for determination in this proceeding the issue of whether penalties imposed against petitioner should be abated, with evidence and argument thereon presented at hearing on May 23, 1988 and by briefs filed thereafter. Accordingly, Stipulated Facts below are hereby deemed modified to reflect the manner of proceeding described by this footnote.

(c) TEI renders sales agent and other services to the CHC up to and including the co-op closing date and thereafter to the sponsor.

(d) TEI is responsible for filing Gains Tax returns.

During the 1983-1985 period, there were 34 conversions made by the TEI Sponsors, including the conversion sponsored by petitioner herein. In those properties, a total of approximately 1,100 cooperative apartment units were sold during such three-year period.

Prior to 1985, TEI had assigned the following staff to carry out its Gains Tax reporting duties:

(a) one full-time junior accountant;

(b) about 40% of the time of its general counsel (Mr. Brody);

(c) as a later replacement for the full-time junior accountant, a full-time employee who was an accountant and an attorney; and

(d) a substantial amount of time of outside tax counsel.

Prior to the spring of 1985, the TEI Sponsors encountered difficulty in filing returns on a timely basis related to:

(a) the burdensome nature of Option A for cooperative filings, and

(b) the apparent risks involved for any taxpayer utilizing Option B prior to the issuance of "safe-harbor" guidelines by the Division under Option B.

Option A and Option B filing methods for cooperatives and condominiums were described by the Division of Taxation via TSB-M-83(2)-R (August 22, 1983).[12]

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[12]In further explanation, prior to approximately August of 1986, the Division had allowed two acceptable methods of calculating gains tax liability upon transfers of cooperative apartment units. These two methods, known as Option A and Option B, may summarily be described as follows:

> Option A: Gain is computed based upon the actual consideration received on each unit transfer less the amount of total original purchase price apportioned to each such unit (including actual brokerage fees, advertising expenses, vacancy preparation costs and other selling expenses incurred). An update of the figures was required on four specific occasions (being respectively when 25%, 50%, 75% and 100% of the units had been transferred), or more frequently if requested by the Division.

Prior to an April 1985 audit meeting with the Division (see, above, infra), TEI made gains tax filings under Option A (that is, preparing a separate return with a different (actual) sales price and different (actual) vacancy preparation costs and selling expenses for every unit sold). While TEI filed returns for hundreds of sales in this period, many were admittedly filed late, and TEI was struggling to catch up in filings for other sales. As of the start of 1985, TEI was concededly behind in the submission of gains tax returns.

TEI attributes its lateness in filing returns to a number of factors including:

(a) the volume of cooperative conversions it was handling;

(b) the difficulty, in light of such volume of conversions, to utilize Option A which required actual calculations of amounts, as opposed to estimates (anticipated amounts) for each unit sold;

(c) a hesitance to utilize Option B (and apply estimates) based on the concern that penalties would be imposed if estimates made proved to be incorrect;

(d) the lack of written guidelines from the Division as to how to deal with certain issues ("computational uncertainties") in the preparation of gains tax returns. Such computational uncertainties included:

(i) computation of basis to a sponsor who had acquired the real property from an affiliate prior to March 28, 1983 ("affiliate purchase issue");

Option B: Gain is computed based upon the total anticipated (i.e. actual plus estimated future) consideration as apportioned to each unit less the total (i.e. actual plus estimated future) original purchase price apportioned to each unit. This method essentially allowed an apportionment of anticipated gain to each unit. Updates were required at the same sellout plateaus (or more frequently upon Division request) as for Option A.

Commencing in or about August of 1986, the Division eliminated Option A as an acceptable method of calculation. In addition, new filing procedures were established whereunder standards were set for estimating anticipated consideration under a cooperative conversion plan. These standards for estimation, when applied, would result in a so-called "safe harbor" estimate of anticipated consideration and treatment as though the transferor's estimate of consideration exactly equalled the actual consideration ultimately received. In ultimate effect, compliance with the "safe harbor" method would avoid imposition of penalty and interest on any underpayment of gains tax on unit transfers (to the extent such underpayment represented the excess of actual consideration over the safe harbor estimate of consideration). This August 1986 change resulted, in essence, in the only acceptable method of computation being a modified Option B computation including guidelines for computing the safe harbor amounts. Updating was optional at the 25% plateau, and was required at the 50%, 75% and 100% plateaus (see generally TSB-M-83-[2]-R, TSB-M-86-[2]-R and TSB-M-86-[3]-R).

(ii) deductibility of interest costs and other financing fees;

(iii) treatment of vacancy preparation costs;

(iv) treatment of contingent consideration (e.g. final sale price dependent upon certain future events/amounts).

TEI's general counsel testified that TEI attempted to contact the Division for guidance, but in most instances was unable to do so, allegedly due to the fact that at that time the Division's Gains Tax Unit only had one open telephone line for public inquiries, which was "constantly busy". Mr. Brody further testified that when TEI did reach Department officials, the issues were sufficiently complex that no clear answers were obtained.

TEI noted that, prior to the audit, TEI received no inquiries or challenges from the Division regarding its manner of reporting on many returns (i.e., specifically challenging petitioner's position on the substantive issues as raised herein).

TEI's general counsel prepared (with assistance from TEI's outside tax counsel) an "in-house" memorandum setting forth, in detail, the application of the Gains Tax to many of the issues involved in TEI's conversions, with successive revisions to this memorandum made as further knowledge was obtained. Each new staff person hired by TEI was individually instructed as to the application of the statute, based on this "in-house" memorandum.

TEI was aware that its filings were behind as of early 1985 and, in an effort to close the gap, retained an outside accounting firm, Brucia & Zwilling, on special assignment. Working with TEI's staff, the outside accounting firm completed, and submitted for audit at the April 1985 meeting with the Division's representatives (see, above, infra), Option A returns for all sales in all buildings, as to which returns had not then been filed.

In early 1985, the Division called to advise TEI that it planned to start an audit. In or about April 1985, a delegation of Division personnel visited TEI (the "audit commencement meeting"). At this meeting, the Division advised TEI that henceforth, the Division planned to mandate the use of filing Option B, because the Division could not administratively cope with

the separate returns with different figures for each sale as required under Option A. Division officials advised TEI that they realized there were possibilities for substantial tax deferral in Option B which were not present in Option A (e.g., by means of the projection of low future sales prices for unsold shares). The Division advised that this change from Option A to Option B was for the Division's administrative convenience.

At the April 1985 meeting, TEI's representatives strenuously objected to being required to use Option B in the absence of some assurance that penalties would not be imposed if TEI's estimates of sales prices, etc., were reasonable when made but proved to be different from the actual results. TEI urged the Department to adopt safe harbor guidelines regarding the projection of future sales.

At the meeting, the Division and TEI agreed to guidelines for estimating sales prices by TEI Sponsors that would be accepted by the Department as reasonable (pending the issuance of safe harbor guidelines for the entire industry), with the understanding that if TEI used these guidelines, penalties would not be imposed if the estimates proved to be incorrect. The guidelines agreed to at the meeting were that TEI would assume that 30% of the unsold shares would be sold at the outsider price, and 70% would be sold at a price representing 40% of the outsider price. This would result in a weighted average assigned sales price for the unsold shares of 58% of the outsider price -- which was 8% higher than the safe harbor guideline of 50% of the outsider price (or insider price, whichever is less) later adopted by the Department.

In summary, TEI received the following critical assistance from the April 1985 meeting with Division officials:

(a) authorization to use Option B, with guidelines which protected against penalties if certain estimated sales prices were used, and

(b) a statement of the Division's position on the Affiliate Purchase and Contingent Price issues.

TEI pledged an all out effort to prepare amended Option B Gains Tax filings for all of its conversions in a short period of time and it did so. In addition to its Gains Tax personnel mentioned above, TEI committed to this effort the services of the outside accounting firm as well as two full-time employees from its accounting department. As a result of this effort, by July 1985 (i.e., within less than two months), TEI had redone under Option B and submitted to the Division's agents for audit Gains Tax returns on all of its outstanding conversions.

TEI developed its own forms specifically for reporting under Option B since, as of that time, the Division had published no such specific Option B forms. As contrasted with the one page Transferor Form (TP 580) which the Division had theretofore issued for all transfers of real property, which had no separate calculation forms or instructions for cooperative conversions, TEI's Option B form was over ten pages long. The DTF forms issued by the Division for cooperative conversions over a year later (in June 1986), are similar to the forms developed by TEI on its own.

The Division then audited these returns. As requested by the Division representative supervising the audit, all returns were redone to reflect changes required by the Division's agents and then the returns were accepted as corrected and payment made. This took place over the period from June 1985 through October 1985.

As testified to by TEI's general counsel, through the completion of the audit in October 1985 TEI's work hours and expenditures relative to gains tax included the following:

a. TEI's legal staff spent over 4,698 man hours in these efforts for which the TEI Sponsors were billed $462,339.

b. TEI replaced the staff accountant initially working on Gains Tax returns (under the supervision of its general counsel), with a C.P.A. who was also an attorney, and who had previously worked at a large accounting firm. In addition, TEI employed an auditor with full-time Gains Tax responsibility and as his assistant, an accountant with computer experience, who computerized TEI's Gains Tax reporting.

c. As set forth above, TEI retained the accounting firm of Brucia & Zwilling on special assignment. This firm submitted bills totaling $42,718 during 1985 representing over 717 man hours.

d. In the period from January 1984 to July 31, 1986, TEI's tax counsel submitted bills on Gains Tax compliance for more than $67,327 representing approximately 392 man hours.

Petitioner maintains that penalties imposed for late filing and payment should be abated, upon any one or all of three basic premises, as follows:

(a) petitioner prevails on the basis/mortgage issues leaving no tax due; and/or

(b) petitioner's legal position on the substantive issues, although different from the Division's, was taken after consultation with outside counsel and was supportable and logical (and thus reasonable) under the terms of the statute; and/or

(c) petitioner's failures to timely file and pay resulted despite reasonable efforts to comply, as based upon the argument and facts outlined above. More specifically, petitioner points to the computational uncertainties, as well as the large volume of cooperative conversions handled by TEI, coupled with the difficulty of using Option A and the described hesitation in using Option B (before safe harbor rules) for fear of incurring penalties for incorrect estimates.

OPINION

The Administrative Law Judge determined that the issues concerning determination of the original purchase price of the property, treatment of mortgage indebtedness incurred by the CHC, and treatment of the negative carry had already been addressed by the Tribunal in Matter of 1230 Park Assocs. & Crystal Mgt. (Tax Appeals Tribunal, July 27, 1989)[13] and that petitioner had not presented any basis which distinguished the present case from 1230 Park.

[13]The determination of the Administrative Law Judge was issued on March 1, 1990. On February 21, 1991, the Appellate Division, Third department confirmed the Tax Appeals Tribunal's decision in 1230 Park (Matter of 1230 Park Assocs. v. Commissioner of Taxation & Fin. of the State of New York, 170 AD2d 842, 566 NYS2d 957, lv denied 78 NY2d 859, 575 NYS2d 455).

As to the interest carry issue, the Administrative Law Judge concluded that petitioner was not entitled to an increase in its original purchase price by the amount of the interest carrying cost for the following reasons. First, petitioner's argument that the interest expense which exceeds net operating income prior to conversion is analogous to acquisition interest expense incurred during a construction of capital improvement period is belied by the fact that petitioner admits that interest expense on acquisition indebtedness is not allowed even if incurred during a construction period. Further, petitioner fails to show why such acquisition interest expense should be allowed in the scenario where property to be co-oped is acquired. Second, even if conversion period interest was allowed, no breakdown has been provided between acquisition interest expense and conversion cost interest expense. Finally, the analogy of construction period interest expense to conversion interest expense seems tenuous, given that the former creates new property which is then placed in service and the latter simply changes the form of ownership of property already in service.

As to the abatement of penalties, the Administrative Law Judge held that petitioner had failed to demonstrate reasonable cause. The Administrative Law Judge found that: petitioner's actions were in conflict with information and relevant case law available at the time; petitioner's failure to timely file returns was attributable to the lack of proper staffing; petitioner's reluctance to use filing Option B (prior to safe-harbor provisions) is not directly applicable, given that the application of penalties under Option B would be based on a separate determination of the reasonableness of the estimates made under Option B, and is, therefore, insufficient to demonstrate reasonable cause; and, finally, the hiring of additional staff to get the filings current must be viewed in light of the impending audit.

On exception, petitioner raises several issues. First, petitioner asserts that the transfer of property to a CHC is a taxable event, and that the mortgage indebtedness of the CHC should not have been included in the sale price of shares sold by petitioner, as the mortgage should have been included in the consideration for the transfer from petitioner to the CHC. In support of this position, petitioner: (1) relies on Mayblum v. Chu (67 NY2d 1008, 503 NYS2d 316),

asserting that the conclusions of the Appellate Division in 1230 Park are erroneous in that they do not take into account the modifications made by the Court of Appeals to the judgment in Mayblum; (2) claims that the decision of the Appellate Division in 1230 Park is inconsistent with the Tribunal's decisions in Matter of Perry Thompson Third Co. (Tax Appeals Tribunal, December 5, 1991) and Matter of Cheltoncort Co. (Tax Appeals Tribunal, December 5, 1991);[14] (3) states that the regulation treating the transfer to a CHC as a nullity is inconsistent with and contradicted by the statutory definition of transfer set out at former Tax Law § 1440(7); (4) contends that its position, i.e., that transfer to a CHC is a taxable event, is consistent with the Division's treatment of non-cooperative corporations, and that there is no statutory support for treating CHCs differently; (5) submits that the failure of the Legislature to amend the gains tax by adding statutory language adopting the Division's position on CHCs is further support for petitioner's position; (6) states that the New York State Real Estate Transfer Tax (the "transfer tax") was amended to substantially conform to the structure of the gains tax and that, given this conformity, the transfer tax is relevant and supports petitioner's position because the transfer tax is imposed twice in the cooperative conversion scenario -- first to the transfer to the CHC, and then on the transfer of shares from the CHC (Tax Law § 1405-B[a]); (7) argues that its position is supported by recent amendments to the transfer tax set forth in the Administrative Code of the City of New York, which cause the City's transfer tax to be imposed on both the initial transfer of shares by the CHC and the subsequent transfer of shares; and (8) submits that there are substantial factual and economic differences between condominium conversions and cooperative conversions which dictate different treatment.

Second, petitioner asserts that the negative carry, i.e., the excess of maintenance and management costs over gross rents incurred after the transfer to the CHC, should be included in the original purchase price. Petitioner puts forth the following reasons in support of its position: (1) negative carry qualifies as a "customary, reasonable and necessary" expense under

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[14]The Tribunal's decisions in Matter of Perry Thompson Third Co. and Matter of Cheltoncort Co. have recently been confirmed by the Appellate Division, Third Department in Matter of Cheltoncort Co. v. Tax Appeals Tribunal (____ AD2d ____, ____ NYS2d ____ [Dec. 31, 1992]).

Tax Law § 1440(5)(a) given the realities of a cooperative conversion scenario and the effect rent control and rent stabilization laws have on the process; (2) the memorandum accompanying the 1984 amendments to Tax Law § 1440(5) states that allowing related costs to offset the gain would provide that the gains tax is applied more accurately to the economic gain generated by a transfer, thereby justifying the relevance of negative carry; (3) negative carry also may be properly considered an acquisition cost because it constitutes a cost for receiving an "interest in the real property" (Tax Law § 1440[5][a][i]; see, Tax Law § 1440[1][a] [" . . . or any interest therein"]), i.e., while not directly a contribution to the initial purchase of the property, the negative carry represents a cost of waiting to have control over a unit that was not vacant and protected by rent control/stabilization laws at the time the property was originally acquired; (4) the negative carry may be qualified as a capital improvement because there is no language in the text which limits the term "capital improvement" to physical improvements, as opposed to improvement of intangible rights; and (5) in 1230 Park, the Appellate Division's deference to the interpretation of the Tax Appeals Tribunal on the negative carry issue, without offering its own rationale, is contrary to and incorrect in light of Matter of SIN, Inc. v. Department of Fin. of the City of New York (71 NY2d 616, 528 NYS2d 524).

Third, petitioner asserts that the interest carry, i.e., the excess of interest expense over net operating income produced by the property incurred prior to the transfer to the CHC, should be included in the original purchase price. Petitioner concedes that, as a general rule, interest on a purchase money mortgage is not deductible pursuant to 20 NYCRR 590.15(c). Nonetheless, petitioner contends that it should be allowed to include interest income in the original purchase price for the following reasons: (1) where (a) property is purchased solely to be converted into a CHC, (b) the conversion is done in a timely fashion, (c) the debt is incurred to finance acquisition and conversion cost expenditures, and (d) the interest on the debt exceeds the net operating income generated by the property prior to transfer to the CHC, these circumstances warrant allowing the interest to be included in the original purchase price because (i) it is a reasonable and necessary expense of converting to a CHC, and/or (ii) it is part of acquisition

costs and/or improvement costs; (2) inclusion of the interest carry in the acquisition and improvement costs is parallel and analogous to the regulatory principles which treat interest and taxes incurred during the construction period as part of the improvement cost (20 NYCRR 590.16[d]) since the improvement created in either scenario is property -- physical improvements in the construction scenario, and intangible improvements, i.e., cooperative shares, in the CHC scenario; and (3) there are several special relationships between interest carry and the success of a cooperative plan which support the inclusion of the carry in the original purchase price: (a) to maximize the number of apartments that may be sold upon transfer of the property to the CHC, apartments are left vacant by the sponsor (a practice called "warehousing"), thereby generating interest carry, but also serving to increase the likelihood that many if not all apartments will be available for sale by the CHC (the ultimate goal of the co-op plan), (b) the maximization of vacant apartments prior to the transfer to the CHC constitutes an improvement being made to the property in that proceeds from the sales of shares will be maximized by having these units available.

Finally, petitioner asserts that penalties assessed against it should be abated. Petitioner bases its position upon the following: (1) the Administrative Law Judge's findings of fact are not accurate based upon evidence in the record and the testimony of Mr. Phillip Brody, general counsel of Times Equities, Inc. (the firm which coordinated the conversion on behalf of petitioner); (2) underpayment of tax is not subject to penalties when it is based upon a reasonable legal position based upon the advice of counsel for which responsible legal arguments have been made and which has been fully disclosed in documents filed with the Division; (3) the Division's position is contrary to section 1444 of the Tax Law, which allows a taxpayer to protest the tax without paying it; (4) notwithstanding petitioner's concession that late filings were made, the penalties imposed on these late filings should be waived under former Tax Law § 1446(2)(a) based upon facts contained in the stipulation executed by the parties; and (5) the Administrative Law Judge's statement that Option B estimates were an available

alternative despite the lack of safe harbor provisions "is exceedingly unfair" (Petitioner's reply brief on exception, pp. 117-118).

In response, the Division offers the following arguments. On the issue of whether a cooperative conversion consists of one or two transfers, the Division relies on the appellate court's conclusions in 1230 Park, as well as the decisions in Matter of Normandy Assocs. (Tax Appeals Tribunal, March 23, 1989) and Matter of Palmer Equities (State Tax Commn., December 13, 1985). Further, the Division asserts that petitioner's argument -- that Mayblum does not preclude the finding of two transfers -- has been rejected by the Tribunal in Matter of Birchwood Assocs. (Tax Appeals Tribunal, July 27, 1989) and Matter of 1230 Park Assocs. & Crystal Mgt. (supra).

On the issue of interest carry, the Division states that the concepts espoused by petitioner represent an income tax approach to the property and, therefore, that they are irrelevant to the structure of the gains tax. Further, the Division notes that the authority to determine what costs are includible in the original purchase price rests solely with the commissioner, citing Matter of 1230 Park Assocs. v. Commissioner of Taxation & Fin. of the State of New York (supra) and Matter of Mattone v. State of New York Dept. of Taxation & Fin. (144 AD2d 150, 534 NYS2d 478). Finally, the Division contends that, since negative carry is not a cost incurred to create a property interest, it is not deductible. The Division states that the buying-out and relocation of non-purchasing tenants is a distinguishable, allowable expense because they enhance the sponsor's interest in the real estate. However, the payment of maintenance costs are properly not allowed because they represent not costs related to creation of a property interest but, rather, investment losses related to the holding of property and are, therefore, not allowable.

The Division also maintains that interest carrying costs are not allowed as a cost related to the formation of a cooperative and are, therefore, not to be included in the original purchase price, relying on Publication 588, answer 14(c), November 1984, later promulgated at 20 NYCRR 590.15(c).

Regarding the reasonable cause issue, the Division relies on the determination of the Administrative Law Judge and the appellate court's opinion in 1230 Park.

We affirm the determination of the Administrative Law Judge for the reasons set forth below.

The Taxable Event

The Appellate Division, Third Department's decision in Matter of 1230 Park Assocs. v. Commissioner of Taxation and Fin. of the State of New York (supra) squarely addresses the issue of whether two separate and distinct taxable events occur in the cooperative conversion scenario. In 1230 Park, the Court expressly rejected the petitioner's argument that a cooperative conversion involves two distinct taxable transfers for gains tax purposes. The Court premised its position on the Court of Appeals' statements in Mayblum v. Chu (67 NY2d 1008, 503 NYS2d 316), where the Court stated that the gains tax is imposed on the overall cooperative conversion plan.

Other than its objections to the conclusions in 1230 Park, petitioner has not explained why 1230 Park should not be treated as precedent. Accordingly, we reject petitioner's contention that a cooperative conversion involves two taxable transfers in light of the 1230 Park decision (see also, Matter of Normandy Assocs., supra).

Petitioner argues that the Tribunal's and subsequent appellate court's decisions in 1230 Park are inconsistent with the Tribunal's decisions in Matter of Perry Thompson Third Co. (supra) and Matter of Cheltoncort Co. (supra). The issue in Perry Thompson and Cheltoncort was:

> "[w]hether the economic gain attributed to a lease, from a cooperative housing corporation to a sponsor, of the commercial space of a building is consideration for the transfer of certain real property . . . ."

We fail to see the inconsistency alleged by petitioner. In Perry Thompson and Cheltoncort, the Division determined that total consideration received by the sponsor of the CHC was the sum of: (1) cash, (2) a purchase money mortgage, (3) the unsold shares, and (4) the value of the commercial leases given to the sponsor by the CHC as a condition of the offering plan.

The rent payable under the commercial leases was not set at a competitive, arms-length level; rather, the leases were designed so that the rent would reach only that level necessary to cover the CHC's maintenance costs for the leased premises. In other words, the leases were expressly designed so that the holder of the lease, i.e., the sponsor, would enjoy all the economic gain generated through the subleasing of the commercial units. The Division reasoned that the failure to conduct an arms-length calculation of competitive rental values, as well as the expressly stated intent of the sponsor to receive all profits from subleasing, indicated that the granting of the leases represented another form of consideration received by the sponsor which was properly includible in the calculation of gains tax due on the cooperative conversion.

Petitioner states that the Tribunal's conclusion in these cases was that:

> "the sponsor's transfer of the property to the cooperative corporation was to be treated as a transfer for Gains Tax purposes, and that accordingly, the commercial lease should be treated as consideration given back to the sponsor" (Petitioner's reply brief on exception, p. 37, emphasis in original).

Petitioner is correct in its statement that the leases were treated as consideration received by the sponsor, but there is nothing in either Perry Thompson or Cheltoncort that suggests that the transfer from the sponsor to the CHC was treated as a separate taxable transfer. Instead, Perry Thompson and Cheltoncort held that the lease was one component of the consideration received by sponsor in the overall cooperative conversion plan, which is completely consistent with the holding of 1230 Park, i.e., "that the gains tax is imposed . . . on the overall cooperative conversion" (Matter of 1230 Park Assocs. v. Commissioner of Taxation & Fin. of the State of New York, supra, 566 NYS2d 957, 959). Accordingly, we reject petitioner's assertion of inconsistency between these cases and 1230 Park.

Petitioner contends that 20 NYCRR 590.33 treats the transfer to the CHC as a nullity, and is inconsistent with and contradicted by former Tax Law § 1440(7), which defines transfer. We disagree. The regulation does not treat the transfer to the CHC as a nullity; rather, it states that the transfer to the CHC is not the event which requires payment of the tax. The regulation

reflects the theory of the gains tax as applied to cooperative conversions. We described this scheme in Matter of Normandy Assocs. (supra) as follows:

> "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."

Petitioner takes the position that there is no statutory support for treating CHCs different from non-cooperative corporations. We disagree. As we noted in 1230 Park, Article 31-B has a number of provisions that single out transfers pursuant to a cooperative or condominium plan for treatment different from that applied to other types of transfers. In our view, these provisions, contained in former sections 1440(7), 1442, and section 1443(6), provide ample support for the Division's decision to tax transfers pursuant to a cooperative plan like transfers pursuant to a condominium plan and, as a result, to treat cooperative corporations differently from non-cooperative corporations.

Petitioner states that in 1984 the Division proposed an amendment to the gains tax concerning the treatment of CHCs, but that the Legislature did not act on the proposal.[15] Petitioner takes the position that the Division's proposal of the amendment is further proof that

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[15]In its discussion of this point, petitioner attributes the following language to the Tribunal's decision in 1230 Park:

> "'Finally, petitioners make much of the fact that the Legislature did not adopt amendments to Article 31-B specifically setting forth the computational method utilized by the Audit Division, maintaining that this failure to specify such method as accepted is tantamount to rejection. By contrast, however, it would appear that the Legislature saw no need to further specify or clarify that in fact what it originally intended was being carried out in the Audit Division's method of computation in applying Article 31-B to the cooperative conversion process'" (Petitioner's reply brief on exception, pp. 28-29).

Petitioner seizes upon the clarification language in the above-quoted opinion as support for both its position on the proposed amendment, and on the penalties issue (infra).

Contrary to petitioner's statement of the source, the above passage does not appear in the Tribunal's decision in 1230 Park. Rather, this quote may be found in an Administrative Law Judge's determination, Matter of Birchwood Assocs. (March 3, 1988). It is well settled that Administrative Law Judge determinations have no precedential value and are, therefore, inapplicable authority for matters before the Tribunal (Tax Law § 2010[5]; see, Matter of Casement, Tax Appeals Tribunal, April 2, 1992, Matter of Kornblum, Tax Appeals Tribunal, January 16, 1992).

the law does not support the interpretation embraced by the Division. We reject this conclusion in light of the Court of Appeals' analysis in Mayblum v. Chu (supra). In that case, the Court had no difficulty in accepting the Division's application of the gains tax law to CHCs, notwithstanding the Legislature's failure to codify the Division's proposed amendments.

Petitioner alleges that the New York State Real Estate Transfer Tax (the "transfer tax") supports its position because, according to petitioner, the transfer tax was amended to "conform substantially . . . to the structure of the Gains Tax . . . " (Petitioner's brief on exception, p. 29). We disagree with petitioner's contention that the structure of the transfer tax may be relied on to interpret the structure of the gains tax. First, the two taxes are set out in different parts of the Tax Law -- Article 31 contains the real estate transfer tax and Article 31-B contains the gains tax. Thus, we find it inappropriate to imply any correlation between the two Articles absent an express statement by the Legislature that the two are related. Furthermore, the Legislature has taken steps to distinguish the application of the gains tax to CHCs. This language is set out at former Tax Law §§ 1440(7), 1442 and current section 1443(6) and was the focus of the Court of Appeals' analysis in Mayblum v. Chu (supra) and was discussed, as noted earlier, in our decision in 1230 Park. These provisions have no counterpart in the transfer tax.

Petitioner also relies on amendments to the New York City Transfer Tax set out in the Administrative Code of the City of New York § 11-2102(b). We see no basis to petitioner's contention that these amendments are relevant to the construction of the gains tax.

Finally, petitioner asserts that there are substantial factual and economic differences between condominium and cooperative conversions which require different treatment. We disagree. In 1230 Park, we noted that, regarding CHCs, the scheme set forth in the gains tax:

> "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" (Matter of 1230 Park Assocs. & Crystal Mgt., supra).

Further, we went on to point out that:

> "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" (Matter of 1230 Park Assocs. & Crystal Mgt., supra).

Our decision in 1230 Park was confirmed by the Appellate Division in Matter of 1230 Park Assocs. v. Commissioner of Taxation & Fin. of the State of New York (supra). Petitioner asserts that the Appellate Division's decision in 1230 Park is in error because it does not consider the modifications made by the Court of Appeals in Mayblum. We disagree with the contention that the Appellate Division did not consider the Court of Appeals' modification. As set out in petitioner's reply brief on exception (page 16), the judgment given by Special Term in Mayblum provided that the event subject to gains tax was the transfer from the CHC to the subscriber. The Court of Appeals modified this statement so that, as modified, it stated that the gains tax "'is imposed upon the overall cooperative plan . . . '" (Mayblum v. Chu, supra, 503 NYS2d 316, 316).

The meaning of the Court of Appeals' modification was discussed, in detail, by this Tribunal in Matter of 1230 Park Assocs. & Crystal Mgt. (supra). Therefore, we conclude that the Appellate Division, in the course of its review and subsequent confirmation of our decision in 1230 Park, considered our analysis of the concept underlying the Court of Appeals' modification in Mayblum.

The Negative Carry

The Appellate Division, Third Department's decision in Matter of 1230 Park Assocs. v. Commissioner of Taxation & Fin. of the State of New York (supra) also addresses the issue of whether the excess of maintenance and management costs over gross rents incurred after the transfer to the CHC may be included in the original purchase price. In 1230 Park, the Court agreed with the Tribunal's analysis (see, Matter of 1230 Park Assocs. & Crystal Mgt., supra), and deferred to the Tribunal's resolution of the issue.

Petitioner argues that negative carry is a "customary, reasonable and necessary" expense under Tax Law § 1440(5)(a). In 1230 Park, the Tribunal addressed this issue, stating that "[t]he crucial issue is whether Negative Carry can be characterized as an expense incurred to create

ownership in the cooperative form" (Matter of 1230 Park Assocs. & Crystal Mgt., supra, emphasis in original). The Tribunal concluded that negative carry represents a cost of carrying the ownership in the cooperative form, not creating it and that, therefore, it is not includible in the original purchase price.

As part of its position on this point, petitioner alleges that the Tribunal's position on negative carry directly contradicts and is inconsistent with the Tribunal's resolution of where a taxable transfer occurs in a co-op conversion, i.e., the transfer to the CHC is treated as a nullity, yet negative carry is not allowed as a cost because it arose after the creation of the CHC's ownership interest in the property. We reject this argument because it fails to overcome the language of Tax Law § 1440(5)(a), which limits costs includible in original purchase price to, inter alia, those "incurred to create ownership interests in property in cooperative form" (emphasis added). Further, petitioner has once again relied on a mischaracterization of the treatment of the transfer to the CHC as a "nullity." As noted earlier, this transfer is not a nullity for gains tax purposes, it is just not treated as the taxable event.

Petitioner asserts that a memorandum accompanying 1984 amendments to Tax Law § 1440(5), which stated that allowance of related costs to offset original purchase price would provide a more accurate determination of economic gain, supports the inclusion of negative carry in original purchase price. Tax Law § 1440(5)(a) provides that "customary, reasonable and necessary" costs are those "determined under rules and regulations prescribed by the tax commission . . . " (emphasis added). Thus, it is within the explicative power of the Commissioner of Taxation and Finance to determine those costs properly includible in original purchase price (see, Matter of Mattone v. State of New York Dept. of Taxation & Fin., supra). Negative carry has not been classified as includible (see, 20 NYCRR 590.39); therefore, petitioner may not treat it as an element of original purchase price.

Petitioner contends that negative carry may also be treated as an acquisition cost because it constitutes a cost for receiving an "interest in real property" under Tax Law § 1440(5)(a)(i). Petitioner's basis for this position is that the interest in property sold by the CHC to the

subscriber is greater than the interest acquired by petitioner when it initially acquired the property. We see no basis for petitioner's claim that it has acquired an additional interest in real property through the payment of negative carry. Instead, as was held in 1230 Park, the negative carry is "a cost of carrying to preserve the status quo" (Matter of 1230 Park Assocs. v. Commissioner of Taxation & Fin. of the State of New York, supra, 566 NYS2d 957, 959). Therefore, it would be improper to treat the negative carry as an acquisition cost.

Petitioner states that negative carry may be treated as a capital improvement because no language in the text of Tax Law § 1440(5)(a) limits the scope of the term to physical improvements, i.e., improvement of intangible rights should also qualify as capital improvements. We disagree. Tax Law § 1440(5)(a) provides that original purchase price includes the consideration paid by the transferor:

> "for any capital improvements made or required to be made to such real property, including solely those costs which are customary, reasonable, and necessary, as determined under rules and regulations prescribed by the tax commission, incurred for the construction of such improvements" (Tax Law § 1440[5][a][ii], emphasis added).

We conclude that the language contained in the statute regarding "construction of such improvements" supports the premise that capital improvements are limited to physical improvements (Tax Law § 1440[5][a][ii]). In our opinion, to read the language so as to include petitioner's assertion, i.e., that intangible rights are capital improvements, would go beyond the plain and ordinary meaning of the term "construction" (McKinney's Cons Laws of NY, Book 1, Statutes § 76).

Finally, petitioner states that the Appellate Division's deference to the Tribunal, without comment, in 1230 Park is improper in light of Matter of SIN, Inc. v. Department of Fin. of the City of New York (supra). Since the Appellate Division, Third Department reviews our decisions (Tax Law § 2016), and not vice versa, we decline to comment on petitioner's criticism of the Appellate Division's decision.

The Interest Carry

Petitioner asserts that the interest carry, i.e., the excess of interest expense over net operating income produced by the property incurred prior to the transfer to the CHC, should be included in the original purchase price. Petitioner acknowledges that 20 NYCRR 590.15 bars interest paid on a purchase money mortgage from being deducted, but nonetheless contends that it should be allowed to include interest expense in the original purchase price. Petitioner asserts that when: property is purchased to be converted into a CHC, said conversion is done in a timely manner, the debt is incurred to fund acquisition and conversion, and the interest on the debt exceeds gross operating income prior to the transfer to the CHC, interest should be included in the original purchase price. We disagree.

Petitioner asserts that the foregoing circumstances should be considered "a reasonable and necessary expense of converting the property" (Petitioner's reply brief on exception, p. 62). Apparently, petitioner is arguing that the interest expense is a "reasonable" and "necessary" expense incurred to create an ownership interest in cooperative form. We reject the validity of petitioner's argument because the debt obligation, and its attendant interest expense, was incurred to acquire the real property, not to allow its conversion to cooperative ownership. Interest charges on funds used to acquire real property are not allowable as part of the transferor's original purchase price (Matter of Mattone v. State of New York Dept. of Taxation & Fin., supra).

Petitioner claims that another basis for allowing the interest carry as an acquisition cost is that interest carry is analogous to interest incurred during a construction period (20 NYCRR 590.16[d]), since both are directly related to improvement of the property -- construction in a physical manner, and interest carry in an intangible manner, i.e., cooperative shares. We reject this argument for a number of reasons. First, the expense in question is still acquisition interest no matter how petitioner seeks to characterize it. Second, this argument was already rejected in Matter of Mattone v. State of New York Dept. of Taxation & Fin. (supra). Finally, we disagree

based upon our discussion of capital improvements in relation to negative carry, i.e., that the improvement must be tangible.

Petitioner states that a special relationship exists between interest carry and a successful cooperative plan which supports inclusion of the interest carry in the original purchase price. Specifically, the warehousing of vacant apartments generates negative carry, but also serves to maximize the number of apartments available for sale by the CHC, and that this maximization constitutes an improvement.

We do not agree that these circumstances warrant inclusion of interest carry in the original purchase price. Basically, petitioner's position on this point, as well as both interest carry and negative carry, in general, is that any steps taken by petitioner to maximize the return on its investment constitute improvements and that, therefore, costs related to these improvements should be credited against the original purchase price. Tax Law § 1440(5) grants the commissioner the explicative power to determine which costs are permitted deduction and which are not (Matter of Mattone v. State of New York Dept. of Taxation & Fin., supra). Petitioner's disagreement with where the line is drawn is insufficient to overcome the limits that have been established. Accordingly, the discussion of the realities of cooperative conversions, and the assertion of a different set of allowances and limits, cannot, by itself, overcome the discretionary authority vested in the commissioner.

Reasonable Cause

Former Tax Law § 1446(2)(a) provides that:

> "[a]ny 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."

Petitioner admits that it late-filed returns (Hearing Tr., pp. 75, 77, 81, 96; Oral Arg. Tr., pp. 14, 16, 18, 30). Therefore, the question is whether the delay in filing may be considered reasonable.

Preliminarily, we note that reliance on counsel, by itself, does not constitute reasonable cause (Matter of LT & B Realty Corp. v. New York State Tax Commn., 141 AD2d 185, 535

NYS2d 121). Rather, we consider all of the actions of a taxpayer to be relevant in a reasonable cause determination, including the reasonableness of his reliance on his counsel (Matter of LT & B Realty Corp. v. New York State Tax Commn., supra). Further, the review of these actions must be made in light of information available at that time (Matter of LT & B Realty Corp. v. New York State Tax Commn., supra; Matter of 1230 Park Assocs. v. Commissioner of Taxation & Fin. of the State of New York, supra). Upon reviewing all of the facts and circumstances surrounding the present case, we conclude that petitioner has not demonstrated reasonable cause.

Petitioner's basic contention is that late-filing penalties should be abated because petitioner made its best efforts to meet filing deadlines in the face of a voluminous amount of filings that needed to be prepared and uncertainties regarding the proper calculation of tax due. However, this contention is undermined by the fact that petitioner was able to have all the returns prepared for the Division's auditors. Petitioner concedes that additional staffing would have facilitated the timely filing of returns, but also asserts that unresolved issues hindered it (Hearing Tr., p. 80).

We conclude that the failure to secure sufficient personnel to address the timely filing of returns is not reasonable. The fact that petitioner was able to catch up on its preparation of returns after hiring additional personnel proves this point.

As to the uncertainties that, according to petitioner, existed at that time, we find that the ultimate completion of all returns as of the date of the initial audit meeting undermines any arguments to the contrary. It is inconsistent to state that a lack of information prevented the preparation of returns, and to then state that all returns were eventually prepared, without providing a discussion of how the alleged inconsistencies were resolved. In any event, petitioner has not established that whatever uncertainties existed precluded filing and paying tax.

Further, petitioner's statements that it was unable to contact the Department via a telephone to resolve the uncertainties does not explain why petitioner did not offer any evidence that it ever made an attempt to contact the Department via written requests for clarification, e.g., opinions of counsel, declaratory rulings or advisory opinions (see, 20 NYCRR 2375, 2376).

Petitioner asserts that differences between the facts as set forth by the Administrative Law Judge and the facts as revealed by the record warrant a finding of reasonable cause. We conclude that the Administrative Law Judge's findings of fact properly set forth the facts of the case. Therefore, we see no reason to disturb them.

Petitioner states that the underpayment of tax, when based upon a reasonable legal position, is not subject to penalty. We begin by reiterating that reliance on counsel, by itself, does not show reasonable cause; that the actions of the taxpayer are relevant; and that the actions must be considered in light of the information available at the time (Matter of LT & B Realty Corp. v. New York State Tax Commn., supra).

Next, we shall set out what information was available, and when it became available. In August 1983, the Division issued Publication 588 "Questions and Answers - Gains Tax on Real Property Transfers." Question and answer number 20 addressed the application of the gains tax to cooperative conversions, setting forth an interpretation which is in direct opposition to the position espoused by petitioner.

On August 22, 1983, the Division issued TSB-M-83-(2)-R, "COMPUTATION AND ORIGINAL PURCHASE PRICE FOR CONDOMINIUM OR COOPERATIVE PROJECTS." This document describes the two methods of computing the gains tax due upon the sale of a unit in a cooperative scenario, and is consistent with the August 1983 Publication 588.

On May 11, 1984, Mayblum v. Chu (Sup Ct, Queens County, Graci, J.) was decided, and set forth the proposition that, in a CHC scenario, the taxable event is the transfer of shares. This decision was affirmed by the Appellate Division, Second Department on March 11, 1985 (Mayblum v. Chu, 109 AD2d 782, 486 NYS2d 89).

Finally, in November of 1984 a revised Publication 588 was issued by the Department. Question and answer number 33 reiterated the proper treatment of cooperative conversions under the gains tax.

Given the available information, we find it unreasonable for petitioner, in early 1985, to have still adhered to its position that two taxable transfers occur in a cooperative conversion scenario. Therefore, we find that petitioner has failed to establish reasonable cause.

Petitioner also alleges that the Division's imposition of penalty is contradicted by Tax Law § 1444 which, according to petitioner, allows a taxpayer to protest a tax without paying it. Petitioner takes the position that it is inconsistent to allow a taxpayer to protest a gains tax assessment without having paid it (Tax Law § 1444), but to impose penalties (under former Tax Law § 1446[2][a]) on the protesting taxpayer (Petitioner's reply brief on exception, p. 110). We fail to see the inconsistency. Penalties and interest are imposed under former Tax Law § 1446(2)(a) any time a taxpayer has failed to meet the filing and tax remittance time frame requirements of Article 31-B and has not established reasonable cause for his failure. Nonpayment does not inevitably lead to the imposition of penalties, but only where, as here, the taxpayer fails to establish reasonable cause.

The basic flaw with petitioner's argument is that it fails to distinguish between a challenge to an assessment of gains tax due, and compliance with the gains tax filing requirements. The right to challenge an assessment of tax without prior payment, provided by section 1444 of the Tax Law, certainly does not provide a taxpayer with an absolute right not to timely file and pay gains tax.

Petitioner characterizes the Administrative Law Judge's statement that the Option B (pre-safe harbor) method of filing was an available option as "exceedingly unfair" (Petitioner's reply brief on exception, pp. 117-118). We agree with the Administrative Law Judge that Option B was an available filing method and that inaccurate approximations under Option B could be defended through a reasonable cause analysis. For petitioner to assume that inaccuracy under Option B, though based on solid, logical, and reasonable premises that were in accord with the

Division's articulated policies, would result in adverse consequences is both premature and speculative. The essence of petitioner's argument is that it chose to file and pay late under Option A because it feared that timely estimated payments under Option B might be too low and would incur penalty. We fail to see how petitioner's choice of certain noncompliance over possible noncompliance could be described as reasonable cause.

In sum, based upon the facts of this case as set forth in the stipulation, the determination, and the record, we find that petitioner has not demonstrated reasonable cause for the late filing of gains tax returns (see, Matter of Melohn v. New York State Tax Commn., 144 AD2d 192, 535 NYS2d 123; Matter of Brounstein, Tax Appeals Tribunal, January 30, 1992; Matter of Kal Assocs., Tax Appeals Tribunal, October 17, 1991; Matter of Aire Bon Assocs., Tax Appeals Tribunal, April 18, 1991; Matter of Pelham Manor Assocs., Tax Appeals Tribunal, July 27, 1989; Matter of Baumstein, Tax Appeals Tribunal, April 20, 1989).

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of 61 East 86th Street Equities Group is denied;

2. The determination of the Administrative Law Judge is affirmed; and

3. The petition of 61 East 86th Street Equities Group is denied.

DATED: Troy, New York
January 21, 1993

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

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

APPENDIX A

Name of Sponsor	Address	Gains Tax #
4-10 West 101 St. EG	4-10 West 101st St.	G-03299
Windsor Associates	5 Tudor City Place	G-20205
Time Equities Associates	8-10 Bethune St.	C-743
Cooperative Eq. Grp. IV	25 Bethune St.	C-3062
Cooperative Eq. Grp. III	25 Chittenden	C-847
25 Tudor Associates	25 Tudor City Place	G-20296
Lincoln Park Eq. Group	29 West 64th St.	C-1015
Cooperative Eq. Grp. II	31 Gram Pk. S.	C-3153
Time Equities Associates	34-36 Bethune St.	C-1062
35 W. 90th St. Eq. Group	35 West 90th St.	C-3082
Cooperative Eq. Grp. III	40 Remsen St.	G-203
Time Equities Associates	41 Perry St.	G-3922
Cooperative Eq. Grp. III	42 Remsen St.	G-202
Cooperative EG III	44 Remsen St.	
Time Equities Associates	45 Perry St.	C-987
Prospect Associates	45 Tudor City Place	G-20406
49 West 72nd St. Eq. Group	49 West 72nd St.	G-5395
Time Equities Associates	51 Jane St.	C-742
61 E. 86th St. Eq. Group	61 East 86th St.	G-3415
Cooperative Eq. Grp. II	66 Montague St.	C-973
Time Equities Associates	66 West 84th St.	C-3318
Burns Equities Group	88 Burns St.	G-3991
70 Park Terrace East EG	70 Park Terrace East	
TMS Equities Group	80-82 Charles St.	G-5068
Charles St. Equities Group	84-88 Charles St.	G-341
100 Bennett Avenue EG	100 Bennett Avenue	G-20078
Bedford St. Equities Group	104 Bedford St.	G-3220
Cooperative Eq. Grp. IV	126 East 12th St.	G-5135
127 W. 82nd St. EG	127 W. 82nd St. (Condo)	G-20367
Cooperative Eq. Grp. II	136 West 13th St.	C-1095
143-50 Hoover EG	143-50 Hoover AVenue	G-20551-0061
Cooperative Eq. Grp. I	160 West 77th St.	C-1329
Remsen St. Equities Group	161 Remsen St.	To be filed
Time Equities Associates	176 West 87th St.	C-231
Cooperative Eq. Grp. IV	194 Riverside Dr.	C-3614
Cooperative Eq. Grp. IV	201 West 16th St.	C-3457
202-214 W. 85th EG	202-14 W. 85th St.	G-20366
220 E. 87th St. Eq. Group	220 East 87th St.	C-3278
221 W. 82nd St. EG	221-223 West 82nd St.	C-40302-B-Coop/ C-40302-A-
Condo		
West Waverly Eq. Group	227 West 11th St.	G-3584
250 Cabrini TEI Eq. Group	250 Cabrini Blvd.	G-3332
Cooperative Eq. Grp. IV	251 Seman Ave.	C-3170
Cooperative Eq. Grp. IV	255 West End Ave.	C-1303
270 Seaman Avenue EG	270 Seaman Avenue	G-03397
Bedford St. Equities Group	309 West 93rd St.	G-3557
Time Equities Associates	309-344 West 11th St. 713-715 Washington St.	G-3709
Cooperative Eq. Grp. IV	310 West 99th St.	C-1326

Time Equities Associates	320 West 90th St.	C-1034
Woodstock Associates	320 E. 42nd St.	G-20369
Cloister Associates	321 E. 43rd St.	G-20486
Time Equities Associates	323 West 11th St.	C-933
Essex Associates	325 E. 41st St.	G-20396
325 W. 45 Equities Group	325 W. 45th St.	G-30239
Bedford St. Equities Group	325 West 83rd St.	G-3471
Manor Associates	333 East 43rd St.	G-5552
Park Equities Group	333 Central Park West	G-5187
Time Equities Associates	343 West 12th St.	C-947
Time Equities Associates	344 West 12th St.	C-3051
Time Equities Associates	345 W. 4th/306 W. 13th St.	C-744
Time Equities Associates	350/4 West 12th St.	C-275
359 Ft. Washington EG	359 Fort Washington Ave.	G-30043
Cooperative Eq. Grp. V	360 Cabrini Blvd.	G-5005
415 Central Park West EG	415 Central Park West	G-03759
447 Ft. Washington EG	447 Ft. Washington Ave.	G-03544
Time Equities Associates	741 West End Ave.	C-3259
1045 Park Ave. Eq. Group	1045 Park Ave.	G-914
Cooperative Eq. Grp. IV	1855 East 12th St.	G-3801
2400 East 3rd St. EG	2400 E. 3rd St.	G-03526
3626 Kings Hwy. EG	3626 Kings Hwy.	G-20457
Susan Equities Group	4410 Cayuga Ave.	G-3523
Time Equities Associates	6035 Broadway	C-957
Clinton Hill Eq. Group	Clinton Hill	C-1104
Time Equities Associates	Washington & W. 11th St.	G-3709
371 Fort Washington Ave. Equities Group	371 Ft. Washington Ave.	G-30045
2875 Sedgewick Ave. Assoc.	2875 Sedgewick Ave.	G-30679