STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
CHELTONCORT CO.	:	DECISION DTA No. 804790
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 Cheltoncort Co., 2051 Flatbush Avenue, Brooklyn, New York 11234 filed an exception to the determination of the Administrative Law Judge issued on December 28, 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 Joseph Gaier, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Paul A. Lefebvre, Esq., of counsel).

Petitioner filed a brief in support of its exception. The Division of Taxation filed a brief in opposition. Petitioner filed a responding memorandum. Oral argument, requested by petitioner, was heard on June 27, 1991.

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

ISSUE

Whether the economic gain attributed to a lease, from a cooperative housing corporation to a sponsor, of the commercial space occupying the ground floor of a building is consideration for the transfer of certain real property subject to the real property transfer gains tax (hereinafter "gains tax").

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for finding of fact "5" which has been modified. The Administrative Law Judge's findings of fact and the modified finding of fact are set forth below.

Petitioner, Cheltoncort Co., was the owner of certain real property located at 360 West 21st Street, New York, New York. On the property was situated a building which was five stories high and had a full cellar. Within the building, at the time of its conversion, were 51 residential apartments and seven stores located on the ground floor.

Cheltoncort Co. acquired the property on June 29, 1984 and subsequently converted the building to cooperative form. An offering plan, dated November 21, 1985, was accepted for filing by the Department of Law on December 20, 1985. The offering plan was declared effective on March 18, 1987, and on June 18, 1987, title to the property was transferred from Cheltoncort Co. to Cheltoncort Owners Corp. The consideration for the transfer of the property included cash, a purchase money mortgage and unsold shares. At the heart of the dispute herein, is a possible fourth item of consideration, a master lease on the commercial space occupying the ground floor of the building. The Division of Taxation contends that the lease had value and therefore represented an "economic gain" to petitioner, while petitioner argues that the commercial space was merely reserved by the sponsor and was never actually transferred to the cooperative corporation, hence, yielding no "economic gain" to the sponsor.

The Offering Plan states, on page 1, item "2", under the title "Special Risks", as follows:

> "2. The building contains seven (7) stores. On the Closing Date, the Stores will be leased to the Sponsor or an assignee of the Sponsor for a period of twenty-five (25) years with an option to renew for twenty-four (24) years for a total period of forty-nine (49) years. The rent for such stores will be $55,000.00 per year for the first two (2) years and thereafter increased or decreased as certain operating costs of the Apartment Corporation increase or decrease (see 'Management Agreement, Contracts and Leases'). The Sponsor intends to sublease the stores and make a profit on the rental. The Apartment Corporation will not receive the benefit of any increased rental value for the stores because increases in rent payments are based upon increases in certain operating costs of the Apartment Corporation. The lease does not give the Apartment Corporation control over the future use of the leased space. However, the lease provides that the stores must be used for a lawful

purpose and prohibits the maintenance of any nuisance. Sponsor shall have the right to assign the lease without the consent of the Apartment Corporation and shall also have the right to mortgage its leasehold estate without consent. Lessee shall have no personal liability for any of the terms, covenants and conditions of the lease and in the event of lessee's default, the Apartment Corporation's remedy shall be limited to lessee's leasehold estate."

The offering plan set forth each of the seven stores as they were currently leased including the address of each store, the lessee, type of business, length of lease, and current rent. As set forth in Finding of Fact "3", above, the annual rent under the master lease for the first two years was to be $55,000.00 a year. Thereafter, commencing with the third year of the lease, the lessee was to pay rent to be set annually on the first day of the month next succeeding the anniversary of the closing, equal to 17½% of the increase in certain "operating expenses" of the Apartment Corporation. For purposes of the lease, the term "operating expenses" was meant to include:

"[a] labor, but shall not include additional expenses attributable to increases in services or personnel;

[b] mortgage interest, but not in excess of the amount of interest payable at the prevailing rate, at the time the wraparound mortgage is refinanced, provided that the principal sum of said new mortgage is not in excess of the unpaid principal balance of the wraparound mortgage;

[c] real estate taxes over that paid for the fiscal tax year in which the closing occurs;

[d] fuel;

[e] water and sewer charges; (unless the stores install separate meters for water) and

[f] fire insurance premiums." (See Offering Plan, page 64.)

We modify finding of fact "5" to read as follows:

In determining the purchase price for the offering, the 51 apartments were allocated 13,245 shares, while no shares were allocated to the commercial space. Consideration received under the offering, was the cash

> received through the sale of the shares in the cooperative corporation for the 51 apartments plus the mortgage of $1,800,000.00. No cash consideration was attributed to and none was received for the commercial space.[1]

At the closing of title, simultaneously with the execution of the deed from the sponsor to the cooperative corporation, the cooperative corporation executed and delivered to the sponsor a lease for the commercial space. It is noted that the cooperative owners corporation needed to have title to the entire real property including the commercial space before it could execute a lease of part of the premises as landlord/lessor.

At the same time the lease was executed, the parties executed a New York City transfer tax return for the leased premises, which was required for the recording of the lease, in which the sponsor and the cooperative, both under oath, acknowledged that no consideration was paid for the leasehold. At the time, for the purpose of determining New York State transfer tax (.4% of the gross sales price) on the transfer of title from the sponsor to the cooperative corporation, a tax was paid based upon the cash consideration received for the apartments of $3,086,671.00 plus the mortgage of $1,800,000.00 for a total consideration of $4,886,671.00. The same consideration was the basis for the filing of the payment of the New York City transfer tax (2% of the gross consideration). Both taxing authorities accepted the consideration as stated and the payment of the tax based thereon. The same consideration, $4,886,671.00, was submitted to the Division of Taxation for gains tax purposes as well.

However, in determining the gains tax due, the Division of Taxation assumed that the lease for the commercial space was additional consideration received by the sponsor, even though there was no identifying consideration set forth in the offering plan and in spite of the fact that the commercial space was never offered for sale as part of the conversion.[2]

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[1] We modified this fact to accurately reflect that the mortgage was in the amount of $1,800,000.00 and not $1,800,000,000.00 (see, Exhibit 1).

[2] Neither the lease nor any of the attendant documents were ever submitted into evidence herein.

The Division of Taxation essentially took the difference between the rent required to be paid to the cooperative corporation under the lease and the rent received from the sub-tenants of the seven stores as they were in existence at the time the gains tax assessment was submitted for review, projected those rents for the full term of 49 years and reduced that sum to its present value. The Division of Taxation determined the "economic gain" to be $387,300.38 and increased the gains tax due thereon by 10% of that figure, or $38,730.00. Petitioner has paid $25,812.83 of this amount and filed a claim for refund in that amount dated September 3, 1987. By letter dated January 28, 1988, the Division denied the claim for refund in full.

OPINION

In his determination below, the Administrative Law Judge concluded that the Division of Taxation (hereinafter the "Division") properly assessed gains tax on the "economic gain" received by petitioner in the form of the lease by the cooperative housing corporation to petitioner on the commercial space located on the ground floor of the building. In determining that there was economic gain, the Administrative Law Judge found that the realty was transferred to the cooperative housing corporation and a portion of the premises was leased back to the sponsor under concededly advantageous terms. Therefore, the Administrative Law Judge concluded that something of value was received by the sponsor and that that value constituted part of the consideration paid by the cooperative housing corporation for the transfer of the building.

On exception, petitioner argues that the commercial space in issue was never included in the offering and, thus, there was no consideration for the transfer of the commercial space to the cooperative housing corporation. Petitioner contends that the offering plan disclosed that the 51 apartments were for sale, while the seven stores constituting the commercial space were not for sale, and were reserved by the sponsor. Therefore, petitioner argues that since the sponsor (petitioner) at no time parted with the commercial space in the building, there should be no imposition of tax. Petitioner argues that "the master lease for the commercial space, executed at the same time as the delivery of the deed to the cooperative corporation, was a mere

change of beneficial interest by the sponsor" (petitioner's brief, p. 15). Accordingly, petitioner contends that the interest itself, namely, the right to the rents and profits of the commercial space, is identical before and after the transfer. Therefore, petitioner argues that the change in beneficial interest is exempt from tax pursuant to Tax Law § 1443(5).

Secondly, petitioner argues that "it is beyond cavil that Article 31-B [of the Tax Law] is intended to apply equally to conversions of property to cooperatives as well as to condominiums" (petitioner's brief, p. 9). Therefore, petitioner contends that, since the Division conceded that this transaction would not be taxed if it were structured as a condominium conversion, petitioner's transaction should not be subject to tax.

Furthermore, petitioner argues that there is a potential for double taxation. Petitioner argues that it would be required to pay tax twice in the situation where tax is first imposed on the "economic gain" and then a second time if the master lease was offered for sale at some future time.

Lastly, petitioner contends that the valuation method used to determine the value of the master lease was irrational.

In response, the Division argues that it is clear from the offering plan that the sponsor was receiving a lease of the commercial space of the building for less than its fair market value with the expectation of making a profit. Therefore, the Division contends that this arrangement results in an economic gain to petitioner that is consideration for the transfer of the building to the cooperative housing corporation and, thus, was properly taxed.

Secondly, the Division argues that the lease in question was not reserved by the sponsor, but that the entire building was transferred from the sponsor to the cooperative housing corporation. The Division points to the fact that petitioner is paying rent on the commercial space to the cooperative housing corporation in support of its argument that petitioner does not own title to the property in question. The Division argues that since petitioner is required to pay rent to the cooperative housing corporation, it necessarily follows that it is the cooperative housing corporation which is the owner of such property, not petitioner.

Moreover, the Division disagrees with petitioner's argument that had this transaction been a condominium conversion instead of a cooperative conversion, the lease of the commercial space would not be subject to tax. The Division argues that under both formats of conversion, the transaction in issue would be subject to tax. The Division also notes that the rules which apply to condominium transfers are irrelevant to the treatment of cooperative conversions.

In a responding memorandum, petitioner argues that the Division is incorrect in its argument that a conversion under the cooperative format is different from the condominium format in the present situation, and such difference justifies the imposition of the tax on the "economic gain." Petitioner argues that this reasoning employed by the Division is in direct conflict with the clear holding of the Tax Appeals Tribunal. Further, petitioner notes that the Division conceded in its brief that if the master lease was reserved by the sponsor, then it would not be taxable. Petitioner contends that since the master lease in question was reserved by the sponsor, it is not taxable. Lastly, petitioner reasserts its position that the transfer in issue was a mere change in beneficial interest and, thus, is exempt from tax.

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

Preliminarily, petitioner argues that the seven stores constituting the commercial space in the building were not offered in the offering plan and, therefore, were not sold, but rather, were retained by the sponsor. We disagree.

It is clear from the record that the sponsor transferred his entire interest in the building to the cooperative housing corporation and then petitioner took a lease back in the commercial space located on the bottom floor. Although these two transactions occurred simultaneously, they were still two separate and distinct transactions (see, Loren Crossroads Assocs., Tax Appeals Tribunal, August 1, 1991), and the lease was not reserved by petitioner.

Petitioner's contention that the transaction constituted a mere change in beneficial interest is also without merit. Tax Law § 1443(5) provides an exemption from the gains tax if a transfer of real property consists of a mere change of identity or form of ownership, where there is no change in beneficial interest. This section of the Tax Law is not applicable in the present situation. The Division did not impose gains tax upon the transfer of the leasehold interest as a transfer of real property from the cooperative housing corporation to petitioner, but rather, the Division treated the value of the leasehold interest as additional consideration received by the sponsor for its transfer of the building to the cooperative housing corporation. Therefore, petitioner's reliance upon Tax Law § 1443(5) is misplaced.

Next, petitioner argues that condominiums and cooperatives are to be treated equally and that since a similar transfer under the condominium format would not be taxable, the lease back in issue should not be taxable. We have consistently held 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 (see, Matter of 1230 Park Assocs., Tax Appeals Tribunal, July 27, 1989, affd 170 AD2d 842, 566 NYS2d 957; Matter of Birchwood Assocs., Tax Appeals Tribunal, July 27, 1989; Matter of Normandy Assocs., Tax Appeals Tribunal, March 23, 1989). We do not dispute this issue. However, we disagree with petitioner that a similar transfer under the condominium format would not be taxable. Under the same circumstances, when a sponsor of a condominium conversion sells a unit, the unit is subject to tax. If, on the other hand, the sponsor decided to retain a unit, such unit would not be subject to tax until it was actually transferred. In the situation presented herein, petitioner did not retain the commercial space. Petitioner transferred the entire building to the cooperative housing corporation. Therefore, the transfer of the building is subject to tax as part of the overall cooperative conversion plan (see, Matter of Mayblum v. Chu, 67 NY2d 1008, 503 NYS2d 316; Matter of 1230 Park Assocs. v. Commissioner of Taxation & Fin., 170 AD2d 842, 566 NYS2d 957). The transfer by petitioner

of the entire building is clearly distinguishable from the situation to which petitioner has analogized, i.e., where a sponsor in a condominium conversion retains a unit.

Further, petitioner argues that there exists a possibility of double taxation if the Division imposes a tax on the economic gain. We disagree. As stated above, the Division has not imposed tax on the transfer of the lease in question as a transfer of real property. The Division has included the value of the leasehold interest received by the sponsor as consideration for the transfer of the building. Therefore, if the sponsor later transfers his leasehold interest, the transfer of the lease will then be subject to tax, if such transfer qualifies as a transfer of property within the meaning of Tax Law § 1440(7) and the consideration received for such transfer is $1 million or more.

Lastly, petitioner argues in its exception that the computation of additional consideration which was based on the differential between the rent received and the rents paid under the master lease is irrational because it fails to take into consideration the change in circumstances that occurred after petitioner entered into the lease. Petitioner contends that at the time of the hearing below, two out of the seven stores were vacant and, presently, four out of the seven stores are vacant.

Tax Law § 1440(1) defines "consideration," in pertinent part, as:

> "the price paid or required to be paid for real property or any interest therein, less any customary brokerage fees related to the transfer if paid by the transferor, including payment for an option or contract to purchase or use real property. Consideration includes any price paid or required to be paid, whether expressed in a deed and whether paid or required to be paid by money, property, or any other thing of value and including the amount of any mortgage, purchase money mortgage, lien or other encumbrance, whether the underlying indebtedness is assumed or taken subject to" (emphasis added).

As stated by petitioner in both its brief at the hearing below and its brief on exception, petitioner expected to realize an operating profit through the subleasing of the commercial space over the term of the net lease (see, petitioner's brief at hearing below, p. 2; petitioner's brief on exception, p. 2). Clearly, the lease had value to petitioner. However, petitioner contends that

since some of the seven stores are presently vacant, the valuation calculated by the Division was erroneous. We disagree.

In determining the value of the lease in question, the Division essentially took the difference between the rent required to be paid to the cooperative housing corporation under the lease and the rent to be received from the sub-tenants of the seven stores as they were in existence at the time that the gains tax assessment was submitted for review, projected those rents for the full term of 49 years and reduced that sum to its present value. We conclude that the Division properly valued the lease based on the facts as they existed at the time that petitioner transferred its building to the cooperative housing corporation. The gains tax is imposed on the transfer of real property (Tax Law § 1441). In calculating the amount of tax due upon a taxable transaction, the value of the consideration has to be determined at the time of the transfer in order to finally fix the tax owed. Subsequent events do not alter the value that the consideration had at the time of the transfer. Thus, the fact that petitioner now claims that there are vacancies is irrelevant to the valuation of the consideration at the time of the transfer. Therefore, we conclude that the Division properly valued the amount of the lease.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

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

4. The Division of Taxation's denial of the claim for refund of real property transfer gains tax is sustained.

DATED: Troy, New York
December 5, 1991

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

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

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