STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
ATLANTIC & HUDSON LIMITED PARTNERSHIP	:	DECISION DTA No. 806710
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.	:	

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on December 20, 1990 with respect to the petition of Atlantic & Hudson Limited Partnership, 77-39 170th Street, Flushing, New York 11366 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 Irwin K. Liu, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Paul A. Lefebvre, Esq., of counsel).

Each party filed a brief on exception. Oral argument, at the Division's request, was heard on September 5, 1991.

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

ISSUES

I. Whether the Administrative Law Judge erred in concluding that the Division of Taxation had the burden to establish that the value ascribed to a lease by the Division of Taxation had a rational basis.

II. Whether a sponsor transferring title to a cooperative corporation and receiving as part of its consideration for said transfer a lease for commercial premises can be taxed on the gain which includes the value of said lease.

FINDINGS OF FACT

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

On January 5, 1988, the Division of Taxation (hereinafter the "Division") issued to Atlantic & Hudson Limited Partnership ("petitioner") a Notice of Determination of Tax Due Under Gains Tax Law, number 595, which set forth tax due in the sum of $15,925.00, penalty of $5,574.00 andinterest of $5,025.00, for a total amount due of $26,524.00. The notice indicated that $300.00 had been paid on June 30, 1987 and that a balance remained due of $26,224.00. The notice contained the following statement:

> "Recently a field audit was conducted by our New York District Office. As a result of that audit, it was determined that Real Property Transfer Gains Tax plus penalty and interest was due. Since the additional Gains Tax plus penalty and interest has not been paid this Notice of Determination has been issued for the following unpaid amounts."

The Division did not submit an auditor's report with regard to the audit of Atlantic and Hudson Ltd. and provided no work papers to explain the computation of additional consideration on tax. The only explanation of the additional tax on the value or "economic gain" ascribed to the lease was an unsworn statement by the Division's representative which said:

> "In creating the master lease, the sponsor sets a rental price for the space. The rental price for the space is less than the fair market value for which that space can be rented.
>
> "The difference between the rent being paid to the cooperative corporation and the fair market value has been picked up by the Audit Division, the Audit Division calls the term they use for that economic gain, but it's an estimate based on the current fair market value of the leasable space, given a present time value over the term of the lease, which in this case was 40 years, and they come up with a dollar amount which is added to the consideration the sponsor is receiving for the transfer of the remainder of the building which will be sold as cooperative units to arrive at a gross consideration from which the tax is determined." (Transcript pages 11-12.)

The Division's representative stated on page 13 of the transcript that "the gain determined under the notice which relates to the lease resulted in a tax of $9,510...."

Atlantic & Hudson Limited Partnership was the sponsor of a cooperative conversion of a building located at 14 Jay Street, New York, New York. As sponsor of the project, the partnership caused title to 14 Jay Street to be transferred to a cooperative corporation known as 14 Jay Street Owners Corporation.

Petitioner acquired the land and eight-story loft building located at 14 Jay Street, New York, New York on May 29, 1981. All seven available units of the cooperative plan were transferred by the sponsor between October 1, 1984 and January 1, 1985.[1] The offering plan with regard to the premises at 14 Jay Street explained the situation with regard to the commercial space in the building as follows:

> "The ground floor and a portion of the cellar contained commercial space (hereinafter 'Store'). The Store is presently vacant. In order to enable the Apartment Corporation to qualify as a cooperative housing corporation under Section 216 of the Internal Revenue Code so that tenant-stockholders may be eligible for tax reductions for their proportionate shares of mortgage interest and real estate taxes paid by the Apartment Corporation, it is necessary to limit the amount of income which the Apartment Corporation receives from the Store. (See the section of the Plan entitled 'Counsel's Tax Opinion' for further discussion of Section 216 of the Internal Revenue Code and tenant-stockholder tax deductions.)
>
> "To achieve this goal, the Apartment Corporation and the General Partner of Sponsor will enter into a lease for the Store (hereinafter the 'Master Lease'). (See section of the Plan entitled 'Store Lease' for more details.)"

The offering plan also provided that under the master lease, the sponsor as tenant was to pay the apartment corporation as landlord a rent equal to 18% of the apartment corporation's annual gross income. The sponsor/tenant was to be entitled to receive and retain all rent from any subtenants of the store which was expected to be more than the rent payable to the apartment corporation. The offering plan clearly set forth that the master lease was intended to provide the sponsor with additional profit and was not entered into through arms-length negotiations, but rather was prepared by sponsor's counsel.

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[1] A total of 1,000 shares of capital stock of the apartment corporation were allocated in blocks to the seven residential floors of the building. There is one apartment per floor. The stock was initially offered for sale at $1,155.00 per share.

Although there was originally an issue with regard to the payment of gains tax on the transfer of each of the cooperative units, that issue has been settled and the only issue remaining is with regard to any tax which may be due on the value of the lease which was concededly part of the consideration given by the apartment corporation to the sponsor.

OPINION

The Administrative Law Judge cancelled that portion of the assessment that related to the lease because the Division had failed to provide an adequate explanation of the method utilized to value the lease. The Administrative Law Judge concluded that without such an explanation, the assessment did not have a rational basis.

On exception, the Division asserts that petitioner never contested the computation of the tax assessed; therefore, the lease valuation was not put in issue, and the Division was not put on notice that it was required to submit any evidence on this point. The Division contends that the only issue before the Administrative Law Judge was whether or not the gain derived from the lease was taxable to the sponsor and that this issue must be resolved against petitioner. In the alternative, the Division argues that if there was any confusion over the issue presented to the Administrative Law Judge, this confusion arose from petitioner's failure to plead any ground in its petition other than abatement of the penalty and in petitioner's acquiescence to the issue as framed by the Division at the hearing. In these circumstances, the Division asserts that the matter should be remanded for a further hearing so that the parties may introduce evidence relevant to the clarified issue.

In response, petitioner argues that leases for terms of less than 49 years are specifically excluded from the definition of "transfer of real property" at section 1440(7) of the Tax Law "because these leases are subject to fluctuation over too short a time to assign a specific value" (petitioner's brief, p. 6). Petitioner states that the issue of whether the lease valuation was reached in an arbitrary and capricious manner was an issue raised at the hearing and that the Administrative Law Judge's determination should be affirmed because "[o]n its face any valuation technique used by Respondent would categorically be arbitrary and capricious

because they are esentially [sic] creating there [sic] own data to base the tax on: an unknown" (petitioner's brief, p. 5).

We reverse the determination of the Administrative Law Judge.

We agree with the Division that petitioner never contested the specific computation utilized by the Division to value the leasehold. Petitioner's representative elected to present only oral argument at the hearing held on this matter before the Administrative Law Judge. Thus, petitioner did not offer any evidence or testimony at the hearing and did not request an opportunity to cross examine an employee of the Division with respect to the method of valuing the lease. Further, in his oral statement at the hearing, petitioner's representative stated:

> "[w]e don't have an argument with the fact it is a part of the cooperative conversion that we may have received something of value. Our argument is really a matter of a question of law under 1440 section 7 of Article 31-B, that the lease is not taxable because it is not a transfer of real property under the Gains Tax Law, transfers of real property are taxable under that law but leases are excluded if they meet three criteria" (Tr., p. 16).

Petitioner's brief submitted at hearing similarly argues that the instant lease, for a term of less than 49 years, was excluded from taxation under section 1440(7) of the Tax Law. Petitioner's brief on exception, quoted above, also makes it clear that petitioner is not contesting the specific calculation made to value the instant lease, but is instead asserting that as a matter of law the Division cannot include such a lease as an element of consideration. Thus, we conclude that petitioner never challenged the specific method employed by the Division to calculate the value of this leasehold.

Even if petitioner had challenged the specific method of valuing the leasehold, we conclude that the Administrative Law Judge erred in holding that the Division had an affirmative burden to establish the rational basis for its assessment.

Although a determination of tax must have a rational basis in order to be sustained upon review (see, Matter of Grecian Sq. v. New York State Tax Commn., 119 AD2d 948, 501 NYS2d 219), the presumption of correctness raised by the issuance of the assessment, in itself, provides the rational basis, so long as no evidence is introduced challenging the assessment

(see, Matter of Tavolacci v. State Tax Commn., 77 AD2d 759, 431 NYS2d 174; Matter of Leogrande, Tax Appeals Tribunal, July 18, 1991). Evidence that both rebuts the presumption of correctness and indicates the irrationality of the audit may appear: on the face of the audit as described by the Division through testimony or documentation (see, Matter of Snyder v. State Tax Commn., 114 AD2d 567, 494 NYS2d 183; Matter of Fortunato, Tax Appeals Tribunal, February 22, 1990); from factors underlying the audit which are developed by the petitioner at hearing (see, Matter of Ristorante Puglia, Ltd. v. Chu, 102 AD2d 348, 478 NYS2d 91; Matter of Fokos Lounge, Tax Appeals Tribunal, March 7, 1991 [where the petitioner proved that its utility meter readings bore no relationship to its level of business activity]); or in the inability of the Division to identify the bases of the audit methodology in response to questions posed at the hearing (see, Matter of Basileo, Tax Appeals Tribunal, May 9, 1991; Matter of Fokos Lounge, Tax Appeals Tribunal, March 7, 1991; Matter of Shop Rite Wines & Liqs., Tax Appeals Tribunal, February 22, 1991; Matter of Fashana, Tax Appeals Tribunal, September 21, 1989). However, where, as here, petitioner has failed to make any inquiry into the audit method or calculation, the presumption of correctness raised by the issuance of the assessment provides the rational basis for the assessment. To hold otherwise would be in irreconcilable conflict with the principles that the Division does not have the burden to demonstrate the propriety of its assessment (see, Matter of A & J Gifts Shop v. Chu, 145 AD2d 877, 536 NYS2d 209, lv denied 74 NY2d 603, 542 NYS2d 518; Matter of Blodnick v. New York State Tax Commn., 124 AD2d 437, 507 NYS2d 536, appeal dismissed 69 NY2d 822, 513 NYS2d 1027; Matter of Scarpulla v. State Tax Commn., 120 AD2d 842, 502 NYS2d 113) and that the petitioner has a heavy burden to prove the assessment erroneous (see, Matter of Executive Land Corp. v. Chu, 150 AD2d 7, 545 NYS2d 354, appeal dismissed 75 NY2d 946, 555 NYS2d 692).

In Matter of Fortunato (supra), citing Anastasato v. Commissioner (794 F2d 884, 86-2 USTC 9529), Llorente v. Commissioner (649 F2d 152, 81-1 USTC 9446) and Weimerskirch v. Commissioner (596 F2d 358, 79-1 USTC 9359), we noted that under Federal case law an exception existed to the rule that an assessment was automatically entitled to a presumption of

correctness and that this exception required the government in certain limited circumstances to establish a rational basis for the assessment before the presumption was raised. Although we noted the existence of this exception under the Federal case law in Fortunato, we stated that we did not have to decide whether such an exception existed under New York law. This question was not presented because Fortunato was not a case where there was no description of the audit. Instead, the audit methodology was completely described in Fortunato and we concluded that this description indicated that the audit was irrational. Thus, our decision in Fortunato does not stand for the principle that the Division has an initial burden to demonstrate the rationality of its assessment and that if there is no description of the audit performed, the petitioner must prevail.

In the instant case, the Administrative Law Judge held that the Federal exception discussed, but not applied, in Fortunato applied here; however, the Administrative Law Judge stated no rationale for this conclusion. Since this case bears no similarity to the Federal cases where the courts have held that the government has the burden to demonstrate the rationality of the assessment, i.e., the case does not involve the assertion of unreported income from illegal sources, we see no basis for the Administrative Law Judge's conclusion.

Turning to the issue that was before the Administrative Law Judge, we agree with the Division that the leasehold interest petitioner received as part of the cooperative conversion was additional consideration and properly included in calculating petitioner's gain subject to tax.

It is undisputed that petitioner transferred title to the property at 14 Jay Street to the cooperative corporation known as the 14 Jay Street Owners Corporation. In exchange for title to the premises, petitioner received, among other things, the lease to the commercial space on the property. It is also undisputed that this lease had value, i.e., that petitioner would receive more in rents from subtenants than petitioner would owe under the terms of its lease. Consideration, for purposes of the gains tax, is defined at section 1440(1)(a) to include "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 . . . ." The valuable leasehold interest is clearly a thing of value and, thus, within this definition of consideration (see, Matter of Perry

Thompson Third Co., Tax Appeals Tribunal, December 5, 1991; Matter of Cheltoncort Co., Tax Appeals Tribunal, December 5, 1991).

Petitioner's argument that leases for less than 49 years are excluded from the definition of "transfer of real property" at section 1440(7) of the Tax Law misses the mark. The leasehold interest is not being taxed here as a transfer of real property. Instead, the leasehold interest is being treated as an element of consideration received by petitioner for the transfer of the fee interest in 14 Jay Street. Whether the leasehold interest constitutes an interest in real property is totally irrelevant to its status as an element of the consideration. Thus, the definition of transfer of real property has no bearing on the issue raised here.

Since petitioner has not established any error in the method used by the Division to calculate the value of the leasehold interest, we must sustain this valuation and the assessment that results from it.

Accordingly it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the Division of Taxation is granted;

2. The determination of the Administrative Law Judge is reversed;

3. The petition of Atlantic & Hudson Limited Partnership is denied; and

4. The notice of determination dated January 5, 1988 is sustained.

DATED: Troy, New York
January 30, 1992

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

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

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