STATE OF NEW YORK

TAX APPEALS TRIBUNAL

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| In the Matter of the Petition | : | |
| of | : | |
| **SHAREHOLDERS OF BEEKMAN COUNTRY CLUB, INC.** | : | DECISION DTA No. 807242 |
| 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. | : | |

Petitioners Shareholders of Beekman Country Club, Inc., c/o McCabe and Mack, 63 Washington Avenue, P.O. Box 509, Poughkeepsie, New York 12602-0509 filed an exception to the determination of the Administrative Law Judge issued on June 20, 1991 with respect to their 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. Petitioners appeared by Charles I. Schachter, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Arnold M. Glass, Esq., of counsel).

Petitioners did not file a brief on exception. The Division of Taxation filed a letter in opposition to the exception. Oral argument, at petitioner's request, was heard on September 25, 1991.

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

***ISSUE***

Whether an allocation agreement entered into by petitioners and the transferee of shares in a corporation provided a reasonable apportionment of the consideration for the interest in real property.

## *FINDINGS OF FACT*

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

Pursuant to section 307(1) of the State Administrative Procedure Act and section 3000.10(d)(5) of the Tax Appeals Tribunal Rules of Practice and Procedure, petitioners, Shareholders of Beekman Country Club, Inc., submitted 17 proposed findings of fact. Proposed findings of fact 1, 2, 3, 4, 5, 6, 7, 10, 11, 13 and 15 were accepted and substantially incorporated into this decision. Proposed findings of fact 8, 9, 12, 16 and 17 have been expanded upon to more completely reflect the record.

The transaction at issue in this proceeding involves the transfer of a controlling interest in Beekman Country Club, Inc. (the "Corporation"). Petitioners were the holders of 100% of the outstanding shares of stock in the Corporation, as of the date of the transfer.

The Corporation operates a public golf course, restaurant and pro shop in the Town of East Fishkill, Dutchess County, New York. The Corporation's assets at the time of the transfer consisted of: 565 acres of land on which the golf course, restaurant and pro shop run by the Corporation were located, and machinery, equipment and other items of personal property, including golf carts and a sanitary sewer, water and irrigation system.

From the time the Option Agreement (referred to below) was entered into and at all relevant times thereafter, the Corporation continued to operate its business as a public golf course, restaurant and pro shop, including golf cart rentals. The Corporation's operating business generated annual revenues of at least $400,000.00 during 1985 and net profits in that year of approximately $140,000.00. In the year of the sale, 1987, the business generated annual revenues of approximately $900,000.00 and annual profits of approximately $400,000.00. At present, the transferee continues to operate the business of the Corporation in the same manner as the Corporation did prior to the sale described below, and the Corporation continues to generate substantial revenue and profits.

On November 1, 1985, petitioners entered into an Option Agreement with Empire State Land Company, Inc. (the "Transferee"). Pursuant to the Option Agreement, petitioners granted the Transferee the option to purchase 100% of the 4,217 shares of common stock in the Corporation then outstanding. The term of the option was 24 months, expiring on October 31, 1987.

Under the Option Agreement, the Transferee could exercise its option to purchase petitioners' shares in the Corporation by payment of the following amounts:

(1) $339.10 per share in cash;

(2) $1,185.67 per share in the form of a promissory note, payable in monthly installments over five years with 12% interest;

(3) $200,000.00 in satisfaction of management fees and bonuses due the management of the Corporation; and

(4) $370,000.00 for the payment in full of the mortgage then outstanding against the real property owned by the Corporation.

The exercise price was then subject to certain adjustments, to be calculated as of the date of purchase of the shares, to allow for prepaid taxes, insurances and fuel, accrued but unpaid expenses and cash in hand (but not in excess of $5,000.00), tangible personal property purchased by the Corporation between the date of the Option Agreement and the closing date and other debts and liabilities of the Corporation.

The Option Agreement did not provide any method for allocating the purchase price to be paid by the Transferee for the shares of stock in the Corporation to the various assets held by the Corporation.

On or about November 12, 1986, the Corporation and the Transferee jointly signed a document entitled "Agreement", which is referred to from here on as the "Allocation Agreement". It provides, in relevant part:

> "AGREEMENT, dated as of November 12, 1986, between BEEKMAN COUNTRY CLUB, INC., a New York Corporation, with an address in care of

McCabe & Mack, Esqs., 63 Washington Street, P.O. Box 509, Poughkeepsie, New York, 12602 (the 'Transferor') and EMPIRE STATE LAND COMPANY, INC. with an address at 45 Knollwood Road, Elmsford, New York, 10523, (the 'Transferee'); for the purpose of the New York State Real Property Transfer Gains Tax;

The parties hereto agree as follows:

1. In an option agreement between the parties dated November 1, 1985 the parties provided that the Transferee will pay the Transferor the sum of $6,429,955.09 and also will satisfy the existing first mortgage on the premises in the amount of $370,000.

2. As this transfer includes other assets in addition to real property and the improvements thereon, the consideration must be reasonably allocated between the real property and the other assets.

3. After examination of the schedule of the tangible personal property of the Beekman Country Club, Inc. including but not limited to 94 golf carts, a number of tractors and other maintenance equipment and restaurant equipment, the tangible personal property is worth approximately $409,000. The reasonable value of the real property of Beekman Country Club, Inc., with the improvements thereon, as of November 1, 1985 is $6,390,955.09.

4. Nothing herein contained shall modify any term of the option agreement as to consideration to be paid or assumed."

The sole purpose of the Allocation Agreement was to provide an allocation of the consideration to be paid by the Transferee for the shares of the Corporation's stock to the real property for purposes of the New York State real property transfer gains tax. Philip Schatz, then treasurer, signed the Allocation Agreement on behalf of the Corporation. At that time, he did not understand the tax ramifications of allocating the consideration as it was done.

On November 17, 1986, transferee and transferor questionnaires were submitted on behalf of petitioners and the Transferee to the Division of Taxation ("Division") as required by Article 31-B of the Tax Law. The questionnaires stated that the gross consideration, allocated to real property and improvements, to be paid for transfer by the Transferee was $6,390,955.09. This is the same amount allocated to real property and improvements in accordance with the Allocation Agreement which was submitted with the questionnaires.

On December 4, 1986, petitioners obtained a Tentative Assessment and Return indicating that the tax to be imposed with respect to the transaction was $490,192.05.

On September 30, 1987, Harold R. Fountain of H. R. Fountain and Co., Inc. ("Fountain"), One Fountain Square, Clinton Corners, New York, prepared an appraisal (the "Appraisal") for the Corporation of the entire 565 acres owned by the Corporation. In the Appraisal, Mr. Fountain stated that, in his opinion, as of November 1, 1985, the fair market value of the property was $3,400,000.00. The fair market value of the property was determined by Fountain by adding together the value of the unimproved land, $3,100,000.00, considering its highest and best use as single residential development and the depreciated replacement value of the improvements located on the land, $296,000.00. The fair market value of land (excluding the improvements) determined by Mr. Fountain was based on the land in its unimproved state, without any required approvals for subdivision.

At hearing, Mr. Fountain was asked whether his appraisal of the real property would have been more or less had he been asked to value the property based upon its use as a golf course. He testified as follows:

> "In my opinion less. The golf course was not processing enough net income at that time to justify the values that we found for residential lands. I believe the number was something in the neighborhood of $109,000.00 net income. If you cap that into value, you are talking about a million and a half. We found that the marketplace for residences indicated $3.4 million, or more than double that. So the highest and best use was not operating as a golf course. That was not processing enough income to justify the land's value."

On October 9, 1987, petitioners submitted to the Division of Taxation revised transferor and transferee questionnaires. The transferee's questionnaire indicated that the consideration to be paid to the transferor was $6,799,955.09. The questionnaire did not allocate the consideration to real property and other assets. The transferor's questionnaire indicated that the consideration to be paid for transfer by the Transferee, allocated to real property owned by the Corporation, was to be $3,400,000.00. Included as part of the Revised Submission were: (1) a copy of the Option Agreement; (2) the Appraisal; (3) the corporation's tax returns (Federal Income Tax Form 1120 and New York State Form CT-3) for the fiscal year ending March 31, 1986, showing that the corporation's gross income for the year reported for tax purposes was $455,038.52 and its taxable income for the year (before allowance of a net operating loss

carryover) was $158,273.17; and (4) financial statements of the corporation prepared by its independent accountants on a compiled basis for the fiscal year ending March 31, 1986, showing that the corporation's gross revenue for the year for accounting purposes was $662,640.96 and its net income was $158,273.17. In the Revised Submission, petitioners contended that the consideration apportioned to the real property by the original Tentative Assessment and Return and by the Allocation Agreement was inaccurate and unreasonable in that it did not reflect the true fair market value of the real property and did not properly account for the value of the corporation's operating business as a going concern.

On October 22, 1987, petitioners submitted additional documentation to the Division in support of their request for a revised Tentative Assessment and Return. This included: (1) a copy of the financial statements of the corporation prepared by its accountant for the five-month period ending August 31, 1987, indicating that the corporation's total income for such five-month period was $575,566.00 and that its net income for such period was $281,516.00; (2) an affidavit of Calvin R. Smith, president of Cal Smith Appraisers, Inc., Pleasant Valley, New York, dated October 20, 1987, containing an itemized appraisal of all of the personal property owned by the Corporation and stating that in Mr. Smith's opinion, the personal property owned by the Corporation as of October 20, 1987 had a value of $316,148.00; and (3) an affidavit of Lee L. Archer regarding the fair and reasonable value of the water system, sewer plant and irrigation system owned by the corporation, as of November 1, 1985, and stating that the aggregate value of the water system, sewer plant and irrigation system, as of November 1, 1985, was $114,000.00.

The Division did not issue a revised Tentative Assessment and Return.

On October 27, 1987, the Transferee exercised its option to purchase all of the outstanding shares in the Corporation. The total purchase price paid for the shares was $7,245,170.09 and consisted of the following:

(1) $339.10 per share of stock, in cash;

(2) $1,185.67 per share of stock, in cash (this portion of the purchase price was paid in cash notwithstanding the provisions of the Option Agreement which called for the transferee to give a promissory note in this amount);

(3) $370,000.00 to satisfy in full the outstanding balance of the mortgage on the real property owned by the Corporation;

(4) $200,000.00 for payment of accrued management fees owed by the Corporation to its managing employees;

(5) $5,000.00 for the cash then on deposit in the Corporation's bank account;

(6) $250,253.20 as an adjustment for equipment, inventory and other assets that were purchased by the Corporation between the date of the Option Agreement and the closing date; and

(7) A credit in the amount of $10,038.20, representing the amount of a sales tax liability then owed by the Corporation.

On the closing date, petitioners paid $490,192.50 in real property transfer gains tax, that being the amount shown on the Tentative Assessment and Return. At the time of the closing, petitioners were of the opinion that the allocation of the consideration to real property and improvements, as shown on the original transferor and transferee questionnaires, was unreasonable.

On January 1, 1988, petitioners filed a claim for refund in the amount of $299,095.47, that being the difference in the tax paid and tax that would be payable if the consideration allocated to the real property owned by the corporation was $3,400,000.00.[1]

By letter dated March 29, 1988, the Division denied petitioners' refund claim. As that letter succinctly states the Division's position on this matter, the relevant paragraphs are set forth below.

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[1]Each of the petitioners signed a signature page which was attached to the refund claim. Petitioners and the Division agreed that the Division would retain the signature pages in its own files to be used in identifying the individual shareholders if refunds are granted in this matter. The individual names of the shareholders who filed a refund claim were not made a part of the record.

"The basis of the claim is that claimant contends an overpayment of Gains Tax was made due to an erroneous allocation of the Corporation's assets on the original filing. A value of $3,400,000 should have been allocated to the real property based upon an appraisal by H. R. Fountain and Co., Inc., rather than a value of $6,390,955.09 as assessed. The amount paid by the purchaser in excess of the appraised value of the real estate is attributable to good will and/or going concern value.

* * *

The Transferor and Transferee questionnaires submitted specifically allocated the $6,390,955.09 to the real property and improvements. Not only were the questionnaires consistent with the $6,390,955.09 purchase price, but an agreement signed by both parties (Exhibit B to the Transferor questionnaire) was submitted which reiterated the $6,390,955.09 purchase price.

In the instant case, there is no need to estimate value by the appraisal process. The parties to the transaction have established fair market value through the process of negotiation. By the terms of their own agreement, both buyer and seller have mutually agreed that 'the reasonable value of the real property of Beekman Country Club, Inc., with the improvements thereon, as of November 1, 1985 is $6,390,955.09.' Therefore, it is our opinion that the documentation submitted establishes the value of the property to be $6,390,955.09 for Gains Tax purposes."

## ***OPINION***

The Administrative Law Judge determined below that petitioners failed to prove that the apportionment of the consideration for the corporation's interest in real property as provided for in the Allocation Agreement was unreasonable. The Administrative Law Judge stated that the Division accepted the apportionment of the consideration for the interest in real property, as submitted by the petitioner to the Division in the transferor and transferee questionnaires and the Allocation Agreement, as reasonable, and in order for petitioners to escape that agreement they had to prove that the original apportionment was unreasonable. The Administrative Law Judge rejected petitioners' argument that in the case of a sale of a controlling interest, 20 NYCRR 590.47 provides that the proper method for determining the fair market value of an interest in real property is by appraisal. The Administrative Law Judge reasoned that the regulation merely states that in such a case, the fair market value of the real property is generally determined by appraisal; it does not suggest that any appraisal is preferable to any other method of apportionment. Finally, the Administrative Law Judge rejected the appraisal

because the method used in the appraisal failed to establish the fair market value of the real property as required by statute.

On exception, petitioners argue that several factors combined prove the Allocation Agreement is unreasonable and, because the Administrative Law Judge only looked at these factors singly, she failed to consider the combined effect for purposes of determining whether the Allocation Agreement was reasonable. Petitioners argue that one factor is that the transfer involved a transfer of a controlling interest in stock rather than a sale of assets and, thus, the transfer did not lend itself to an allocation of the purchase price among the various assets. Another factor is that the option agreement embodied a bargain that was struck between the parties and because the allocation agreement was not negotiated, and did not alter that bargain in any way, there was no real business purpose for the allocation agreement other than to set forth an allocation for the real property gains tax. At oral argument, petitioners' representative argued that because the Allocation Agreement was entered into solely for tax purposes, it should be subject to a greater level of scrutiny in order to determine whether the allocation reasonably reflects the transaction, given that the option agreement, not the allocation agreement, bound the parties and, also, because the petitioners did not understand the tax ramifications of the allocation.

Finally, petitioners argue that the Allocation Agreement was not supported by additional consideration and it provides no substantiation for its allocation of $6,390,955.09 as the fair market value of the real property. Petitioners argue that under 20 NYCRR 590.47 the proper method for determining fair market value of an interest in real property is by appraisal and the appraisal submitted by petitioners to the Division prior to the closing date of the sale of stock establishes the fair market value of the real property at $3,400,000.00, thus rendering the apportionment in the Allocation Agreement unreasonable. Petitioners point out that the Allocation Agreement fails to apportion any value to the corporation as an ongoing business and at oral argument petitioners' representative argued that a large part of the difference between the apportionment contained in the appraisal ($3,400,000.00) and the consideration paid for the

club (over $7,200,000.00) represents the value of the corporation as an ongoing business concern.

In response, the Division argues that it properly relied on the apportionment made in the Allocation Agreement. At oral argument, the Division argued that petitioners could not unilaterally vary the original apportionment by submitting a second transferor questionnaire that decreased the fair market value of the real property especially when the second transferee questionnaire did not lower the apportionment. The Division asserts that appraisal is not the preferred method of apportionment under 20 NYCRR 590.47, rather, the test is what a willing buyer would pay a willing seller for the real property. According to the Division, the transferee's refusal to change the apportionment proves that the amount in the Allocation Agreement was what a willing buyer would pay a willing seller. Finally, the Division argues that since the entire transaction was an arms length transaction, the Allocation Agreement did not require substantiation, and that petitioners' "unilateral attempt" to change the apportionment should not relieve them from the Allocation Agreement because petitioners failed to prove the original apportionment was unreasonable.

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

Tax Law § 1441 imposes a tax on gains derived from the transfer of real property within New York State. Tax Law § 1440(7) states, in pertinent part, that the "acquisition of a controlling interest in any entity with an interest in real property" constitutes the transfer of real property, thus the sale of stock by petitioners to the Transferee constituted a transfer for gains tax purposes. Tax Law § 1440(3) defines "gain" to mean "the difference between the consideration for the transfer of real property and the original purchase price of such property, where the consideration exceeds the original purchase price."

What is at issue here is the total amount of consideration paid for the acquisition of the controlling interest in the entity and the corresponding amount that can be allocated to the real property that the entity owned, for purposes of computing the gains tax liability. Tax Law § 1440(1)(a) defines "consideration," in pertinent part, as "the price paid or required to be paid for

real property or any interest therein." "In the case of a transfer of a controlling interest in an entity with an interest in real property," Tax Law § 1440(1)(c) states, in pertinent part, that "there shall be an apportionment of the fair market value of the interest in real property to the controlling interest for the purpose of ascertaining the consideration for the transfer of such controlling interest."

The transfer here involved the purchase of 100% of the stock of the Corporation and so 100% of the fair market value of the interest in real property must be apportioned to the controlling interest. The remaining question is how to determine the fair market value of the Corporation's interest in real property.

We have stated that the fair market value of real property is "the price at which a willing seller and a willing buyer will trade" (Matter of Bridgehampton Investors Corp., Tax Appeals Tribunal, August 11, 1988, quoting Black's Law Dictionary 717 [4th ed 1957]). According to the Allocation Agreement, petitioners and the Transferee agreed that for real property gains tax purposes, the "reasonable" value of the real property was $6,390,955.09. The Allocation Agreement states that its purpose is for the New York State Real Property Transfer Gains Tax (see, Exhibit "A[b]"). It also states that because the transfer involves assets in addition to the real property, the consideration needs to be allocated between the real property and other assets, and it allocates $409,000.00 to tangible personal property and $6,390,955.09 to the real property and improvements. Therefore, absent any evidence that the apportionment in the Allocation Agreement was unreasonable, Tax Law § 1440(1)(c) was satisfied because there was "an apportionment of the fair market value of the interest in real property to the controlling interest for the purpose of ascertaining the consideration for the transfer of such controlling interest."

Petitioners argue that this apportionment was unreasonable because it does not take into account the value of the business, and they assert that the appraisal, not the Allocation Agreement, represents the fair market value of the real property. In order for us to consider the appraisal, petitioners must prove that the method of apportionment embodied in the Allocation

Agreement was unreasonable because, as discussed above, that method of apportionment indicated what the Transferee was willing to pay for the real property and it also satisfied the apportionment requirement of Tax Law § 1440.1(c).

Petitioners did not introduce direct proof that the value of the business was a large part of the difference between the consideration actually paid (over $7,200,000.00) and the fair market value of the property according to the appraisal ($3,400,000.00). Although petitioners did submit documentary evidence which enabled the Administrative Law Judge to find that the Corporation generated substantial revenue and profits before, during and after the sale, these documents are insufficient to establish that the value of the business was roughly $3,800,000.00. Furthermore, the method of appraisal used by petitioners' appraiser was similar to the method rejected by this Tribunal in Matter of Bridgehampton Investors Corp. (supra). In Bridgehampton, this Tribunal rejected an appraisal where the cost of replacing the depreciated improvements was added to the potential sales price of the land as subdivided lots, less development costs and profits. This Tribunal rejected such a method of determining the fair market value of the real property because it was not the price a willing buyer would pay a willing seller. Petitioners' appraiser used the same replacement cost method but petitioners have not proven why their situation, the sale of a controlling interest with an interest in real property, merits treatment different from the transfer of assets situation in Bridgehampton such that the replacement cost method is a valid method of determining the fair market value of the real property at issue here. Accordingly, petitioners have failed to prove that the apportionment in the Allocation Agreement was unreasonable and that the appraisal established the true fair market value of the real property.

The original transferor and transferee questionnaires also allocate $6,390,955.09 of the consideration to be paid by the Transferee to the real property and improvements (see, Exhibit "A[d]"). Tax Law § 1447(1) requires both the transferor and the transferee to file these questionnaires and such questionnaires are used by the Division for the purpose of determining the tentative assessment of the Real Property Transfer Gains Tax due. Eighteen days before the

Transferee exercised its option to purchase all of the shares of the Corporation, petitioners attempted to change their original questionnaire by submitting a revised questionnaire which allocated only $3,400,000.00 to the real property, but the Transferee's revised questionnaire stated that the consideration to be paid to the transferor for the real property was $6,799,955.09 (see, Exhibit "C[c]"). The Transferee's revised questionnaire indicates that it was willing to pay even more for the real property than what the Allocation Agreement apportioned, but absent any proof that either the Transferee's higher apportionment or petitioners' lower apportionment reflected the true fair market value of the real property, there is no reason to declare the apportionment contained in the Allocation Agreement unreasonable.

Petitioners had the burden of proving that the appraisal reflected the fair market value of the real property as required by statute and that the Allocation Agreement was unreasonable because it did not reflect the fair market value of the real property and because it failed to apportion part of the consideration to the value of the Corporation as a business. Petitioners argue that several factors combined prove that the Allocation Agreement was unreasonable. As discussed above, none of these factors prove that the Allocation Agreement was unreasonable, and we fail to see how any combination of these factors would yield a result different from the determination rendered by the Administrative Law Judge.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the Shareholders of Beekman Country Club, Inc. is denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petition of the Shareholders of Beekman Country Club, Inc. is denied; and

4. The claim for refund of real property transfer gains tax is denied.

DATED: Troy, New York
April 16, 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