STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
PHILIP MORRIS COMPANIES, INC.	:	DECISION DTA No. 810276
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 and petitioner Philip Morris Companies, Inc., 120 Park Avenue, New York, New York 10017, each filed an exception to the determination of the Administrative Law Judge issued on June 17, 1994. Petitioner appeared by Hunton & Williams (James W. Shea and David A. Agosto, Esqs., of counsel). 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 support of its exception and in opposition to petitioner's exception. Petitioner filed a brief in opposition to the Division of Taxation's exception and in reply to the Division of Taxation's brief in opposition to petitioner's exception. The Division of Taxation filed a reply to petitioner's brief in opposition to its exception. Oral argument was heard on May 11, 1995, which date began the six-month period for the issuance of this decision.

The Tax Appeals Tribunal renders the following decision per curiam. Commissioner Francis R. Koenig took no part in the consideration of this decision.

ISSUES

I. Whether an appraisal commissioned by petitioner accurately reflected the fair market value of certain real property for purposes of the real property transfer gains tax.

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

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for finding of fact "7" which has been modified. The Administrative LawJudge's findings of fact and the modified finding of fact are set forth below.

Petitioner, Philip Morris Companies, Inc. ("Philip Morris"), is a corporation organized and existing under the laws of the Commonwealth of Virginia. Prior to its merger into Kraft, Inc. in 1988, General Foods Corporation ("General Foods") was a corporation organized and existing under the laws of the State of Delaware. Its corporate headquarters were located at 800 Westchester Avenue, Rye Brook, New York.

On November 2, 1985, petitioner completed the acquisition by purchase of all of the issued and outstanding shares of common stock of General Foods. Petitioner paid $120.00 per share for approximately 47 million shares and options of General Foods stock, for a total purchase price of over $5.6 billion. Petitioner offered testimony that during the four months prior to the announcement of its bid for the shares of General Foods, over 31 million shares of General Foods stock was traded, and the average price per share traded during that period was nearly $80.00. In connection with the sale of its stock to petitioner, General Foods paid $14,061,766.00 in fees to Goldman, Sachs & Co. ("Goldman") and Shearson Lehman Brothers, Inc. ("Shearson") ($7,030,883.00 each) "[f]or services rendered pursuant to our letter agreement dated September 26, 1985" and "[f]or financial advisory services rendered to General Foods Corporation pursuant to our fee agreement of September 26, 1985", respectively, as indicated on invoices issued by Goldman and Shearson to General Foods. The letter and fee agreements of September 26, 1985 were not introduced into the record of this matter. Petitioner's Director of State and Local Taxes testified that the services paid for were advising General Foods during the merger and providing advice to General Foods as to whether the offer being made by petitioner was in the best interests of the General Food shareholders. In addition, he stated that the invoice amounts represented the fees for all services rendered in the merger. At the time of the purchase of its stock by petitioner, General Foods owned real property holdings throughout the United States, of which 12, including General Foods' corporate headquarters, were located in the State of New York.

In 1983, General Foods built its corporate headquarters on a parcel of land comprising approximately 55 acres located at 800 Westchester Avenue, Rye Brook, New York (the "property") at a cost of approximately $97 million. The headquarters is a nine-story structure containing a floor area of 1,063,000 square feet, of which 500,000 square feet make up the parking garage located on the lobby level and first and second floors. The building is considered a one-of-a-kind, signature type corporate headquarters. The building houses a dome-topped atrium which provides a panoramic view of the landscaped grounds and the pond (7 acres) situated on the Rye Brook property from several levels of the building.

Upon entering the building, one circles a fountain and passes the main lobby. The main lobby features mirrored walls and ceiling which reflect the lighting. Windows in the glass ceiling of the lobby provide a glittering view of the atrium above. Other features include an employee cafeteria seating 1,200, a service dining room, conference dining rooms, offices above the parking garage and in the atrium dome (for top executives), various shops, a fully-equipped fitness center, a soundproof studio for television productions, computer center and a state-of-the-art auditorium. The professional appraiser (Mr. Andrew Gyetvan, Jr.), who developed the valuation of the corporate headquarters for petitioner with regard to the real property transfer gains tax, testified that the headquarters building is a one-of-a-kind corporate headquarters built for a specific user to create a particular image.

Prior to the building being completed, the Town of Rye placed a market value on the Rye Brook property for real property tax purposes of $44 million as of February 1983. The following year, the Town of Rye commissioned two appraisers to evaluate the property for real property tax purposes as of February 1984. The two appraisers developed a value of $62,750,000.00.

The Town of Rye's increase in market value translated into an increase in the assessed value of the Rye Brook property of approximately $2 million. General Foods then commissioned an appraisal of the Rye Brook property to support an appeal for a reduction in assessed value. The appraisal commissioned by General Foods concluded that the market value for the Rye Brook property as of February 1985 was $65,000,000.00. The Town of Rye and General Foods reached a compromise value of $63 million based on a combination of their appraisals, resulting in a reduction of tax assessed.

On October 24, 1985, prior to the completion of the acquisition of General Foods, the Tax Manager of General Foods informed the Department of Taxation and Finance's Tax Compliance Division of the substance of the transaction and explained that the filing of gains tax returns would be delayed due to the complexities of the transaction. The letter requested an extension of time until December 31, 1985 to file the gains tax returns. By letter dated October 29, 1985, petitioner's Director of State and Local Taxes independently advised the Department of the transaction.

Having not received a reply, on November 6, 1985 General Foods sent a second request for extension to file a gains tax return. The Division of Taxation ("Division") responded on November 29, 1985 with its position regarding the filing of gains tax returns in the case of the acquisition of a controlling interest, namely that, in determining whether reasonable cause existed for failure to pay the gains tax, the Division will take into account the fact that it may not be possible to determine the consideration until sometime after the acquisition. In letters dated December 26, 1985, March 12, 1986, September 3, 1986 and December 12, 1986, General Foods requested extensions of time to file gains tax returns due to the continuing difficulty in accumulating the necessary information regarding the "original purchase price" and "consideration" received relating to the real estate held in New York State. The last letter requested an extension to March 31, 1987. The Division responded in a letter dated December 22, 1986 to General Foods that any future request for an extension of time to file the gains tax returns was unwarranted. The letter further stated that if the required forms were not filed by January 31, 1987, penalty and interest would be imposed from that date.

On February 9, 1987, General Foods informed the Division that appraisers were currently determining the market value of all the assets located throughout the United States and would not complete the determination of New York assets until August 1987. The letter also indicated that General Foods was aware that the Division did not grant extensions of time to file transfer tax returns. Subsequently, telephone calls from the Division to General Foods were made on February 2, 1988, August 22, 1988, August 23, 1988, August 24, 1988, September 2, 1988, September 6, 1988, September 9, 1988, September 19, 1988, September 21, 1988, October 26, 1988 and October 28, 1988.

The Division sent a letter, dated January 11, 1989, requesting that General Foods provide the following documents relating to the New York property:

a. Transferor Questionnaire, TP-580

b. Transferee Questionnaire, TP-581

c. Contract of Sale - Transferor's Original Acquisition

d. Closing Statement - Transferor's Original Acquisition

e. Contract of Sale - Proposed

f. Copy of the executed broker agreement for proposed transaction

In response, General Foods advised on January 23, 1989 that it was accumulating the necessary data and forwarded a list of the real estate holdings in New York State, including the Rye Brook property. The Division replied on April 25, 1989, that before a final determination could be made, the following information should be submitted:

> "- A copy of the agreement (with all statements) setting forth the terms of the transfer (e.g., contract of sale of real property, contract for sale of stock of a corporation or economic interest in a partnership or other entity).
>
> "- The fair market value of the real property in New York State, on the date of transfer. Also, include the basis used to determine the fair market value."

In addition, the Division telephoned General Foods on January 17, 1989 and June 12, 1989.

On July 11, 1989, the Division sent a letter to General Foods accompanied by copies of letters sent and listing the telephone calls made by the Division to General Foods relating to the transaction at issue. The letter stated that although General Foods had indicated that the appraisals would be completed by August 1987, questionnaires from the transferor (General Foods) or transferee (petitioner) had not been received. The letter requested that the questionnaires be provided, that the consideration be substantiated by appraisals and that documentation for the original purchase price be provided.

Petitioner responded on August 22, 1989 by filing executed transferor and transferee gains tax questionnaires relating to its acquisition of General Foods on October 28, 1985. Petitioner enclosed a check in the amount of $2,630,066.00 in payment of the tax of $1,862,284.00 and interest of $767,782.00. Petitioner and General Foods calculated and set forth the taxable gain as follows:

Gross Consideration	$ 75,451,681.00
Original Purchase Price	(56,828,835.00)
Gain subject to tax	$ 18,622,846.00

In connection with the purchase by petitioner of all of the issued and outstanding stock of General Foods, an election was made pursuant to Section 338 of the Internal Revenue Code ("IRC") to treat the stock purchase as an acquisition of all of the assets of General Foods by petitioner. Accordingly, the assets were treated as having been sold by General Foods to petitioner at fair market value as of the acquisition date. In order to determine the fair market value of the assets transferred under the IRC § 338 election, the assets of General Foods, including the Rye Brook property, were valued as of the acquisition date (November 2, 1985) in accordance with Accounting Principles Board Opinion Number 16 ("APB No. 16").

Petitioner and General Foods retained Kenneth Leventhal & Company ("Leventhal") to perform the appraisals required with respect to the election made under IRC § 338. The purpose of the Leventhal valuations was "to estimate the fair market value of certain real property assets owned by General Foods . . . as of November 2, 1985 for purposes of basis allocation pursuant to the Section 338 election." The report defines "market value" as "the most probable price in terms of money which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller, each acting prudently, knowledgeably and assuming the price is not affected by undue stimulus". The report provides that certain conditions are implicit in the above definition, including the following:

> "a. Buyer and seller are typically motivated
>
> "b. Both parties are well informed or well advised, and each acting in what they consider their own best interest."

One of the contingent and limiting conditions contained in the Leventhal Report states that:

> "This report is to be used only by Philip Morris or General Foods for the purpose of estimating the value of the subject property for federal income tax basis allocation and accounting and financial reporting application of Accounting Principles Board Opinion #16, should not be used for any other purpose."

Leventhal employed only the cost approach in developing its valuation of $113,335,700.00 for the Rye Brook property. The estimation is as follows:

	Land	Sec. 1245	Sec. 1250	Total
Land	$11,962,500.00	$ -	$ -	$ 11,962,500.00
Land Improvements	-	-	1,514,400.00	1,514,400.00
Building	-	-	95,384,700.00	95,384,700.00
Building Improvements	-	4,474,100.00	-	4,474,100.00
	$11,962,500.00	$4,474,100.00	$96,899,100.00	$113,335,700.00

This appraised value of $113,355,700.00 was used by petitioner on its Federal returns to represent the value of the Rye Brook property. The appraiser who did the evaluation of the Rye Brook property for purposes of the gains tax filings, Mr. Gyetvan, testified that while the use of one valuation approach may be sufficient to satisfy the requirements of IRC § 338 and APB No. 16, a determination of market value for other purposes, including the gains tax, should be far more encompassing with development of all three approaches: cost, sales and income.

The copy of the Leventhal Report introduced into the record of this matter contained 5 of the 18 pages of the report, and also lacked three schedules, maps and site plans that are part of the original document. It was these 5 pages that upon which the appraiser based his evaluation.

Petitioner and General Foods hired Valuation Research Corporation ("Valuation") to conduct an appraisal of the Rye Brook property as of November 2, 1985 for purposes of the gains tax filings. In a letter dated August 14, 1989 to petitioner, Valuation stated that:

> "The purpose of the appraisal was to determine the fair market value of the fee simple interest of the subject property as of November 2, 1985, in compliance with Article 31-B of the New York Tax Law, which imposes a tax on the gain realized from the transfer of real property . . . ."

The report further added that the definition of market value for the purposes of the gains tax conforms closely to the generally accepted definition of market value. The appraisal opinion of Valuation was based upon the definition of market value contained in the gains tax regulations.

Mr. Gyetvan, who developed the valuation of the Rye Brook property for Valuation, testified that he determined a value for the property using the cost approach, the income approach and the sales comparison approach. For all three approaches, the land was valued at $200,000.00 per acre for a total value of the 55-acre parcel of $11,000,000.00.

We modify the third paragraph of finding of fact "7" to read as follows:

> The cost approach involved the following steps as employed by the appraiser:
>
> 1. Estimating the cost to reproduce (or replace) the basic improvements, new.
>
> 2. Estimating the dollar amount of accrued depreciation due to:
>
> a. physical deterioration
> b. functional obsolescence
> c. external obsolescence
>
> 3. Deducting the total amount of accrued depreciation from cost new to derive the present depreciated cost of the basic improvements.
>
> 4. Adding the land value estimate to the depreciated cost of the improvements to arrive at a value indication by the Cost Approach.
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> The appraiser used the Marshall Valuation Service as a guide to develop a unit rate for the building improvements which included the office space, the garage and site improvements. The original cost of the building ($97,000,000.00) was considered but not used. One reason the original cost was rejected was because the appraiser was informed by representatives of Philip Morris that the original appraisal included numerous cost overruns and, therefore, the cost figure would not necessarily reflect the property's value. The section of the office tables and cost-per-square-foot tables from the Marshall Valuation

> Service were not introduced into the record of this matter nor could the appraiser remember which tables were used. The cost summary was as follows:

Corporate Headquarters (1,063,000.00 SF @ $76.75) =	$ 81,600,000.00
Site Improvements	5,400,000.00
Developer's Profit and Overhead (15%)	13,050,000.00
Total Reproduction Cost New	$100,050,000.00

> From this estimate is deducted the three types of depreciation that cause a loss in value: physical depreciation, functional obsolescence and external obsolescence. As the building was only two years old, the appraisers considered it new, without physical depreciation.[1]

The second type of depreciation, functional obsolescence, which was defined as "an impairment of design resulting from a loss in functional utility, capacity, layout or efficiency" tends to have a negative impact on the value of a building. The report stated that such examples include the maintenance expense associated with the building's aluminum clad exterior surfaces, insufficient restroom facilities located in the general office area and the generally overbuilt elaborate nature of the building. The report provided for an allowance of 10% for functional obsolescence.

The third type of depreciation and the second applied to the building at issue is external obsolescence, which involves external factors which negatively impact the value of the building. An example of external obsolescence as it related to this building was the size and unique nature of the building which would limit the number of potential users and, hence, make the marketing of the building difficult. Another external obsolescence factor, according to the appraiser, was the association of the building with General Foods. The appraiser testified that the building was built for a specific user to create an image, and, therefore, someone that goes in is going to have to rework the image. A 15% allowance was made for external obsolescence. The total accrued depreciation (25%) was subtracted from the reproduction cost (new) to arrive at total value of improvements which when added to land value resulted in total value of $86,000,000.00.

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1 We modified finding of fact "7" by inserting the fourth sentence in the third paragraph in order to reflect additional details in the record.

The income approach is defined in the Valuation report as:

> "a mathematical measure of what an investor would pay to acquire a property which can reasonably be expected to produce a certain level of net operating income over its remaining economic life; the higher the earnings, the higher the value."

Under the income approach, the appraiser examined comparable properties in the marketplace and developed a rent that the property would command. Due to the unique features and construction of the building, the appraiser's analysis was based on a single-user tenant situation.

The appraiser examined comparable leased properties in the Westchester County and Fairfield County areas with respect to rent level, location and amenities offered in determining a rental value of the building. He then determined a potential gross annual rent in the amount of $10,234,000.00, after making adjustments based on differences between the comparable rentals and the building. This gross annual rent was adjusted to account for vacancy rates, collection loss and management fees, repairs and other expenses, resulting in a net operating income of $7,919,828.00 with respect to the building. The net operating income was then converted into a property value by use of an overall capitalization rate of 9.75% resulting in a value of $81,000,000.00 for the Rye Brook property under the income approach.

The Valuation Report describes the sales comparison approach as follows:

> "The Sales Comparison Approach is based upon an analysis of actual sales of other similar properties which are compared with the subject. Comparable sales represent the actions of typical buyers and sellers in the marketplace and their actions in the market will determine a price for the subject. When there is an adequate number of sales of truly similar properties with sufficient information for comparison, a range of values for the subject property can be developed."

The appraiser testified that for this approach he went into the market and identified sales of property that he felt were comparable to this property. Due to the nature of the property, he endeavored to identify properties in the immediate locale that were most similar. In addition, the appraiser went outside the immediate area to identify sales of corporate, quality headquarters throughout the country, and using a combination of both, through an adjustment process, came to an adjustment unit rate. Adjustments to the selling prices were necessary due to the variations in the comparable sales. Although the adjustments are listed in the report's summary, none of the adjustment percentages were placed in evidence. In this case, for the 563,000 square feet, the appraiser came to a value of land of $150.00 per square foot. The value of the Rye Brook property under the sales comparison approach was $84,500,000.00.[2]

The report concludes that the fair market value of the Rye Brook property for gains tax purposes as of November 2, 1985 was $81,000,000.00.

Mr. Lloyd Looram, C.P.A. and state and local tax consultant, after reviewing data (referred to as "share movement" and "share transactions" occurring prior to the acquisition), supplied by the Director of State and Local Taxes for Philip Morris, testified that during the four months prior to the announcement of petitioner's bid for the shares of General Foods over 31 million shares of General Foods stock was traded, and the average price per share traded during that period was nearly $80.00. Mr. Looram developed a document entitled "Adjusted Price and Volume Report" which was introduced into the record of this matter. The report lists the daily volume, daily high, daily low and daily close of the stock of General Foods for the days beginning May 31, 1985 and ending September 30, 1985. Also introduced was a listing of the institutional holders of General Foods stock and the amount owned on June 14, August 2, September 30 and October 25, 1985.

On November 24, 1989, the Division issued to petitioner a notice of determination asserting real property gains tax due in the amount of $2,451,756.69, including interest. The notice was based upon the Leventhal Report valuation of the Rye Brook property.

On February 20, 1990, petitioner timely filed a Request for Conciliation Conference. A conciliation conference was held on January 22, 1991 and the Conciliation Order, dated September 13, 1991, sustained the Division's notice of determination.

Petitioner filed a petition with the Division of Tax Appeals on December 11, 1991, and subsequently filed an amended petition on April 13,

[2]The largest comparable property was 44 acres, with the next being 10 acres. The age of the comparable properties ranged from 5-10 years. Two of the comparable properties are only listed in "good" condition, while the subject property was in "excellent" condition.

1992. On April 27, 1992, the Division filed its Answer which assessed, for the first time, penalty on the transfer at issue.

OPINION

The Administrative Law Judge found that the Valuation Research report and the testimony of Mr. Gyetvan were sufficient to meet petitioner's burden of proof by showing clearly and convincingly that the fair market value of the Rye Brook property as of November 2, 1985 was $81 million. The Administrative Law Judge rejected the Leventhal report in favor of the Valuation Research report in part because of the former's failure to account for functional and external obsolescence. The Administrative Law Judge further found that the Leventhal report did not follow the Uniform Standards of Professional Appraisal Practice. The Administrative Law Judge found it was not critical to petitioner's case that the cost-per-square foot table relied on in creating the Valuation Research report was not in evidence given petitioner's expert's testimony and the fact the report included a discussion of the methods, information and supporting documentation used to arrive at the appraisal of the property. The Administrative Law Judge concluded that petitioner was not bound by the value of the property placed on its tax returns because the regulations specifically provide that the fair market value of property such as that at issue is generally determined by appraisal.

We affirm the determination of the Administrative Law Judge on the issue of valuation.

Tax Law § 1441 provides that "[a] tax is hereby imposed on gains derived from the transfer of real property within the state. The tax shall be at the rate of ten percent of the gain."

Gain is defined as "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" (Tax Law § 1440[3]).

Tax Law § 1440(7) defines a "transfer of real property" to mean:

> "the transfer of any interest in real property by any method, including but not limited to sale . . . or acquisition of a controlling interest in any entity with an interest in real property."

The term "consideration" is defined as "the price paid or required to be paid for real property or any interest therein . . ." (Tax Law § 1440[1][a]). Section 1440(1)(c) further provides, in part, that:

> "[i]n the case of a transfer of a controlling interest in an entity with an interest in real property, 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."

Section 1440(2) provides as follows:

> "'Controlling Interest' means (i) in the case of a corporation, either fifty percent or more of the total combined voting power of all classes of stock of such corporation, or fifty percent or more of the capital, profits or beneficial interest in such voting stock of such corporation . . ."

20 NYCRR former 590.47 provides in part:

> "Consideration
>
> "(a) Question: Is the price paid for the ownership interest in an entity the consideration for a controlling interest used to calculate gain?
>
> "Answer: Generally, no. Section 1440(1) of the Tax Law states that '. . . there shall be an apportionment of the fair market value of the interest in real property to the controlling interest to ascertain the consideration for the controlling interest.'
>
> > "Example: A corporation's only asset is a $4 million fair market value piece of property. If 100% of the stock is purchased, the consideration is $4 million ($4,000,000.00 x 100%). If a 50% interest were acquired, only $2 million consideration is used to calculate gain.
>
> "(b) Question: How is fair market value determined?
>
> "Answer: Generally by appraisal. It is the amount a willing buyer would pay a willing seller for the real property . . . ."

The Division's position on exception is that the valuation of assets under Internal Revenue Code § 338 is premised on fair market value and, as a result, petitioner must be bound by the figure reported on its Federal income tax returns.[3] In support of its position, the Division

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[3]The figure the Division seeks to rely on was determined pursuant to an election to treat a stock purchase as an asset acquisition as allowed under Internal Revenue Code § 338. A significant aspect of a sale for which a 338 election was made was that the "Target" corporation's assets acquired an adjusted grossed-up basis. The adjusted grossed-up basis is the sum of (i) the grossed-up basis of recently purchased stock, (ii) the basis of non-recently

asserts that the instant matter is controlled by the decisions in Matter of Vogt v. Tully (53 NY2d 580, 444 NYS2d 441) and Matter of Heffron v. Chu (144 AD2d 729, 535 NYS2d 141). In Vogt, the Court of Appeals determined that a statement on a partnership's New York State tax returns could not operate as a binding admission on an individual limited partner personally (Matter of Vogt v. Tully, supra, 444 NYS2d 441, 445). In so holding, the Court of Appeals noted, however, that "an admission as to tax consequences . . . if made by a taxpayer or on his behalf might be binding on him and might therefore properly be made the predicate for imposition of tax liability" (Matter of Vogt v. Tully, supra, 444 NYS2d 441, 445). Relying on the decision in Vogt, the Court in Heffron held that a statement on a partnership's State income tax returns, "[a]lthough . . . not a binding admission on petitioner's part . . . it was probative hearsay evidence of facts relevant to the ultimate issue in dispute, admissible in a hearing before a State administrative body [citations omitted]" (Matter of Heffron v. Chu, supra, 535 NYS2d 141, 142).

First, in previous gains tax matters we have recognized the potentially binding effect a taxpayer's statements may have on their tax liability. In Matter of Shareholders of Beekman Country Club (Tax Appeals Tribunal, April 16, 1992, affd Matter of Beekman Country Club v. Wetzler, 199 AD2d 640, 604 NYS2d 989), we held that where the subject transfer is an acquisition of a controlling interest, if a transferor and transferee attribute a value to real property for gains tax purposes, we will bind the parties to such figure, absent a showing that the figure was unreasonable (see also, Matter of Bridgehampton Investors Corp., Tax Appeals Tribunal, August 11, 1988 [appraisal was rejected and taxpayer's contract price was deemed fair market value where contract specifically provided that the purchase price was for the "Premises" only, and no amount was attributed to personal property]). In this matter, however, petitioner determined a value for a purpose wholly unrelated to reporting for gains tax purposes

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purchased stock, (iii) the liabilities of the Target corporation, and (iv) other relevant items allocated among target's assets pursuant to their fair market value (I.R.C. § 338[a][1] & [b][1], [2]). Pursuant to section 338 and the accompanying regulations, petitioner commissioned a mass appraisal of all of General Food's assets in accordance with Accounting Principles Board Opinion Number 16 (Determination, finding of fact "6"). Included therein was the property at issue here.

and we are unwilling to conclude, as the Division would have us, that accounting treatment under the Internal Revenue Code is conclusive for New York State transfer gains tax purposes (see, Matter of SKS Associates, Tax Appeals Tribunal, September 12, 1991). Therefore, we do not find controlling the fact that petitioner stated a different value for the subject property on its Federal income tax returns than was reported for gains tax purposes (see, Matter of Brooklyn Union Gas Co., Tax Appeals Tribunal, May 10, 1990 [taxpayer treated paid-in capital on parent corporation's financial statements at traditional book value and for Article 9 tax reported at fair market value of stock received]; see also, McDonald's Rests. of Illinois v. Commissioner, 688 F2d 520, 82-2 USTC ¶ 9581 [where taxpayer treated transaction as "pooling of interest" on financial statements while treated as purchase on tax return and the Court found such variations common and accepted.]) Further, as correctly pointed out by the Administrative Law Judge, binding the taxpayer to a value attributed to the property pursuant to another statutory framework ignores the Division's own regulations, which specifically provide that a taxpayer for transfer gains tax purposes may determine fair market value pursuant to an appraisal (20 NYCRR former 590.47(b).

We next address the contention by the Division that our decisions in Matter of Bernstein (Tax Appeals Tribunal, December 24, 1992, affd Matter of Bernstein v. Commissioner of Taxation & Fin., 200 AD2d 810, 606 NYS2d 445) and Matter of Fokos Lounge (Tax Appeals Tribunal, March 7, 1991) require a reversal of the Administrative Law Judge's determination. The Division asserts that the Valuation Research report is baseless because the record does not contain the tables from which the cost-per-square-foot figures were derived. The Division further argues that the testimony of petitioner's expert, Mr. Gyetvan, must be rejected because he was unable to recall the specific cost table employed. We disagree.

In Matter of Fokos Lounge (supra), we held that the record did not contain sufficiently specific evidence to determine if the subject audit had a rational basis. The decision rested on the principle that background information must be in the record in order for a taxpayer to meet his burden of proving the Division's audit methodology unreasonable. Such a concern is not at issue in this case as the burden remains with the taxpayer. Petitioner's election to not include cost tables should be considered in determining the weight to be accorded the report but does not require that the report be rejected. We point out that in accepting petitioner's proposed value for the subject property, the Administrative Law Judge did not find the absence of the cost tables critical given the credible testimony of Mr. Gyetvan and the weight of documentary evidence supporting Mr. Gyetvan's conclusions. The Administrative Law Judge stated that "[t]he Valuation Report provides a discussion of the methods, information and supporting documentation (except the Marshall Valuation Service's cost-per-square-foot tables) used to arrive at the appraisal of the property" (Determination, conclusion of law "C"). While not bound by the Administrative Law Judge's determination of credibility, we defer to the Administrative Law Judge's findings that the testimony of petitioner's expert supported the findings in the Valuation Research report (Matter of Niagara Frontier Servs., Tax Appeals Tribunal, August 9, 1990).

In Matter of Bernstein (supra), we rejected an expert's opinion as to how payments received by the petitioner were to be classified because the expert failed to consider the correct analysis. Bernstein is only relevant to the matter before us for the proposition that we are not bound to accept the opinion and appraisal of petitioner's expert (see, Matter of Bridgehampton Investors Corp, supra; see also, Estate of Sharp v. Commissioner, T.C. Memo 1994-636, 68 TCM 1521; Mooneyham v. Commissioner, T.C. Memo 1991-178, 61 TCM 2445). Given that "fair market value" is a question of fact, we are free to arrive at our own determination of value (W.T. Grant Co. v. Srogi, 52 NY2d 496, 438 NYS2d 761; see also, Matter of Bridgehampton Investors Corp., supra).

We next address the Division's claim that the Administrative Law Judge's analysis is flawed because he incorrectly restates the cost value cited in the Valuation Research report. The Administrative Law Judge, in the discussion section of the determination, stated the figure relied on in the Valuation Research report as $100,050,000.00 while the correct number was $110,050,000.00. The error occurred while the Administrative Law Judge was addressing the

Division's claim that the Valuation Research report must be rejected for failing to introduce the cost-per-square-foot tables and because the report should have used as its basis the original cost of the building instead of the tables. The Administrative Law Judge was making a comparison between the cost figure arrived at by petitioner's appraiser and a figure the Division calculated which used the original cost. The Administrative Law Judge states that the figure the Division relied on as the reproduction cost "is almost the same amount," while the Division points out that the amount separating the two is approximately ten million dollars not the one million it appears to be in the determination.

Petitioner notes that the Administrative Law Judge in finding of fact "10" correctly states the reproduction cost of the property. As a result, petitioner asserts that the Administrative Law Judge's error appears to be typographical.

We reject the Division's argument. Petitioner's expert testified that in conducting the appraisal for New York State gains tax purposes, the original cost of the subject building was considered but rejected for several reasons. One reason the original cost was rejected stemmed from conversations with representatives of Phillip Morris during which it was learned that the original cost included numerous cost overruns. Petitioner's expert testified that such figures are not necessarily reflective of the value of the property. Therefore, the Marshall Valuation Service tables were used in lieu of the original cost of the building in order to reach the subject property's fair market value. Given Mr. Gyetvan's testimony that the original cost would not have provided an accurate indication of value in this matter and that the cost-per-square-foot method was the proper selection, we find the Administrative Law Judge's error, whether it was typographical or conceptual, does not affect the disposition of this matter.

We next turn to the substance of the reports.

The Division asserts that the Valuation Research report failed to use the actual cost in determining the replacement cost. The Division further claims that the Valuation Research report's 10% depreciation figure is completely unsupported by petitioner's witness' testimony. The Division also asserts that the 15% obsolescence figure is based on the faulty premise that a new owner would have to rework the building's image. Given the fact that there will be no new owner, the Division argues that this adjustment is unnecessary. The Division rejects the sales approach because none of the comparable sales appear to be "timely, proximate and similar." The Division also contends that the numerous adjustments required to the comparable sales establishes said sales are not in fact comparable. The Division presents similar criticism with respect to the income approach, noting that too many adjustments were required.

We find the Administrative Law Judge correctly rejected the Leventhal report while concluding that the appraisal contained in the Valuation Research report is an accurate reflection of the subject property's fair market value.

We reject the Leventhal report in part because of its use of the "replacement method" as the sole basis of its method of valuation (Division's Exhibit "C," Leventhal Report, p. 4). The replacement cost method, "is the cost of construction at current prices of a building having utility equivalent to the building being appraised but built with modern materials and according to current standards, design and layout" (The Appraisal of Real Estate, p. 447). This Tribunal in the past has rejected the use of the "replacement cost method" as an accurate indicator of real property's fair market value (Matter of Shareholder's of Beekman Country Club, supra; Matter of Bridgehampton Investors Corp., supra). We see no reason to diverge from our previous position.

We also agree with the Administrative Law Judge's decision to reject the Leventhal report because it failed to consider depreciation in determining fair market value. We disagree with the Division's criticism of the Valuation Research report for electing to consider "external obsolescence." The Division rejected the consideration that a new owner would desire to create a new image for the property since there would be no new owner because General Foods continued to exist as a separate entity (Division's post hearing reply brief, pp. 14-15). This argument ignores the fact that to determine fair market value we must consider "the amount which one desiring but not compelled to purchase will pay under ordinary conditions to a seller who desires but is not compelled to sell" (W.T. Grant Co. v. Srogi, supra, 438 NYS2d 761, 767, citing Heiman v. Bishop, 272 NY 83). We find the prospect that a buyer of a signature corporate headquarters will consider such factors as the necessity to rework the image of the building entirely plausible. The Valuation Research report correctly accounted for external obsolescence in determining fair market value as such considerations will affect the value of even newly constructed improvements (The Appraisal of Real Estate, p. 443).

We further find no merit to the Division's assertion that a building with an estimated 50-year economic life cannot have experienced 10% depreciation. The Valuation Research report states that the property was considered "new" in accounting for physical depreciation and the 10% figure specifically related to "functional obsolescence," i.e., that the property was overbuilt in certain areas, the floor plan was inefficient with respect to the rest areas and the fact the structure is sided with aluminum (Petitioner's exhibit "2," pp. 28-29). Even well built, sound improvements with considerable remaining economic life may evidence significant functional obsolescence, including excessive and super-adequate construction (The Appraisal of Real Estate, p. 448).

We also reject the Division's argument that the income and sales methods of valuation are inapplicable for determining fair market value of the subject building. The Division asserts that because the building at issue is a "signature building," comparable sales are not available. The Division criticizes the Valuation Research report because the properties represented as comparable in the report required numerous adjustments, e.g., the buildings were smaller and located in other states. While we agree with the Division that the subject building lends itself more readily to the cost method for valuation, we do not find the sales and income methods to be without merit. While the Valuation Research report acknowledges numerous adjustments in comparable sales (Petitioner's Exhibit "2," p. 42), it is recognized that for certain properties numerous adjustments and comparisons must be made to comparable properties (The Appraisal of Real Estate, p. 14). Further, the Valuation Research report fully describes the adjustments made (Petitioner's Exhibit "2," pp. 50-54). With respect to the location of the comparable properties, it is accepted that in valuing office buildings one may properly consider regional, national and even international markets (The Appraisal of Real Estate, p. 313).

The Division presents the same arguments with respect to the income approach. While we note that numerous adjustments were required for the income approach, as with the sales approach, the Valuation Research report fully set forth the adjustments, explaining their necessity (Petitioner's Exhibit "2," pp. 31-40).[4] As a result, we conclude that the sales and income approaches support petitioner's claim that the fair market value of the property is $81 million.

We next address whether petitioner has established that penalties should be abated.

The Administrative Law Judge concluded that penalty, penalty interest and interest would not be abated. The Administrative Law Judge held that petitioner failed to explain why it was necessary to continuously accumulate information, why there was a necessity for extensions and why there was a two-year delay in completing the appraisal and in filing the returns.

Petitioner asserts on exception that, as transferee, it is not liable for penalty, penalty interest or interest. In support of its position, petitioner cites our decision in <u>Matter of Goldome Capital Invs.</u> (Tax Appeals Tribunal, May 16, 1991, <u>affd sub nom.</u> <u>Matter of Federal Deposit Ins. Corp. v. Commissioner of Taxation & Fin.</u>, 189 AD2d 39, 594 NYS2d 447, <u>affd</u> 83 NY2d 44, 607 NYS2d 620) in which we held that a transferee could not be held liable for penalty or penalty interest pursuant to Tax Law § 1446(2). In <u>Goldome</u>, we relied on a letter from the Division submitted to the Tribunal in which the Division conceded that a transferee was not liable under section 1446(2) to form the basis of our decision.

As a preliminary argument, the Division on exception claims that petitioner's argument cannot be heard by this Tribunal because it involves issues of fact. The Division further asserts that petitioner should be treated as the transferor because General Foods assumed filing responsibilities for gains tax purposes on behalf of its shareholders and ultimately representatives of General Foods informed the Division that all further negotiations should take

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[4]Significantly, the income valuation figure fell within close proximity to the sales comparison and cost methods, which generally reflects the credibility of an appraisal (The Appraisal of Real Estate, p. 330).

place with Phillip Morris employees. The Division goes on to point out that it was the Phillip Morris employees who filed returns on behalf of both petitioner and General Foods. Consequently, the Division argues that petitioner should be estopped from claiming protection as a transferee.

In the alternative, the Division asserts that petitioner as transferee is liable for penalty, penalty interest and interest. With respect to the imposition of interest, the Division argues that our decision in Matter of Goldome Capital Invs. (supra) did not address the assessment of interest pursuant to former section 1446(1). The Division argues that our decision was premised on an erroneous concession by a Division employee that transferees were not liable for penalty and penalty interest. Further, the Division points out that our decision in Goldome did not specifically address the amendment to section 1446 by Chapter 61 of the Laws of 1989. The amendment was referenced in the Governor's Bill Jacket to the amendment under "Gains Tax-Administration Changes," which stated in part that:

> "Current Law only refers to a transferor in the provisions regarding collection/payment of interest and penalties. Since a transferee may be held liable for the tax, this proposal clarifies that a transferee is also liable for interest and penalties. Similarly, this provision will permit a refund to be paid to the person who paid the tax, unlike current law were refunds can only be paid to the transferor" (L 1989, ch. 61, p. H11, Governor's Bill Jacket).

The Division concludes by arguing that the legislative changes were clarifying and not substantive and, as a result, petitioner as transferee is liable for penalty, penalty interest and interest.

We reverse the determination of the Administrative Law Judge on this issue.

We first note that it is settled that new legal issues may be raised on exception (Matter of Howard Enters., Tax Appeals Tribunal, August 4, 1994). Petitioner's assertion on exception that, as transferee, petitioner is not liable for penalty, penalty interest or interest is a legal issue. We find baseless the Division's assertion that factual matters are attendant to petitioner's argument. As a result, the issue of petitioner's liability as transferee is properly before us.

Tax Law former § 1446(1) and (2) provided in part:

> "If the tax commission determines that there has been an overpayment of tax, interest shall be paid by the comptroller to the transferor, on any refund paid pursuant to the provisions of section fourteen hundred forty-five of this article. If it determines that there has been an underpayment of tax, the transferor shall pay interest to the commission on the amount of any tax not paid" (Tax Law § 1446[1]).
>
> "Any transferor failing to file a return or to pay any tax within the time required by this article shall be subject to a penalty of ten per centum of the amount of tax due plus an interest penalty of two per centum of such amount . . ." (Tax Law § 1446[2]).

In Matter of Campac Assocs. (Tax Appeals Tribunal, January 12, 1995), we for the first time explicitly addressed the nature of changes made by Chapter 61 of the Laws of 1989 to Tax Law § 1446. In Campac, we stated that:

> "[w]e simply cannot read the specific word 'transferor' in section 1446(1), prior to its 1989 amendment, to include 'transferee.' As the Court stated in Matter of Velez v. Division of Taxation of Dept. of Taxation & Fin. (152 AD2d 87, 547 NYS2d 444), when rejecting our interpretation that the word 'tax' included penalty and interest:
>
> > 'Inasmuch as section [1446] itself "describes the particular situations in which it is to apply, 'an irrefutable inference must be drawn that what is omitted or not included was intended to be omitted or excluded'" (Patrolmen's Benevolent Assn. v. City of New York, 41 NY2d 205, 391 NYS2d 544, 546, quoting McKinney's Cons. Laws of NY Book 1, Statutes § 240)' (Matter of Velez v. Division of Taxation of Dept. of Taxation & Fin., supra, 547 NYS2d 444, 446; cf., Matter of Hall v. Tax Appeals Tribunal, 176 AD2d 1006, 574 NYS2d 862 [where the Court found the statutory imposition of liability for penalty and interest on "any person" to include a responsible officer of a corporation]).
>
> "Accordingly, we conclude that the Legislature's use of the word 'transferor' was intended to exclude a transferee from liability for interest.
>
> "It is obvious from the preceding conclusion that we do not find the Division's evidence of legislative intent sufficient to overcome the plain meaning of the words of the statute. In our view, the fact that the memorandum in support of Chapter 61 of the Laws of 1989 describes the substitution of the word 'taxpayer' for the word 'transferor' as a clarification is inadequate, given the unambiguity and specificity of the word 'transferor,' to establish that the Legislature always intended 'transferor' to include 'transferee'" (Matter of Campac Assocs., supra).

In this matter, petitioner as transferee acquired 100% of the stock of General Foods. Despite the fact the Division properly looked to representatives of Phillip Morris on tax compliance matters, we are constrained to conclude that the Division was not entitled to look to petitioner for penalty, penalty interest or interest. By the clear wording of Tax Law §§ 1442 and 1446 during the period at issue, the gains tax provided for transferee liability for payment of tax only. The Division has not directed our attention to any basis for concluding otherwise in this matter. Further, despite petitioner's acquisition of 100% of General Foods' outstanding stock, the transferors were the shareholders of General Foods' stock. Therefore, we find irrelevant General Foods' handling of tax matters and the subsequent assumption by petitioner of such responsibilities. As a result, penalty, penalty interest and interest assessed against petitioner must be abated.

Turning to the final two matters addressed below, the Administrative Law Judge also rejected petitioner's claim for brokerage commissions. The Administrative Law Judge determined that without the fee agreements General Foods entered into with Goldman, Sachs & Co. and Shearson Lehman Brothers, it cannot be determined what services were performed, and whether any of the services constituted customary brokerage fees. The testimony given by one of petitioner's witnesses indicated that the services performed were for financial consulting and advising, which the Administrative Law Judge noted is not deductible from consideration.

The Administrative Law Judge further determined that petitioner was not entitled to a step-up in original purchase price. As found by the Administrative Law Judge, petitioner's witness and documentary evidence did not account for the sale and resale of stock and it did not prove that none of the 31 million shares were traded more than once.

Petitioner has not excepted to the parts of the Administrative Law Judge's determination denying its claim for brokerage fees and a step-up in original purchase price. As as a result, neither issue is before us.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

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

2. The exception of Phillip Morris Companies, Inc., is granted;

3. The determination of the Administrative Law Judge is modified to the extent that penalty, penalty interest and interest are abated, but is otherwise sustained;

4. The petition of Phillip Morris Companies, Inc. is granted to the extent indicated in conclusion of law "C" of the Administrative Law Judge's determination and in paragraph "2" above, but such petition is otherwise denied; and

5. The Division of Taxation is directed to modify the Notice of Determination dated November 24, 1989 in accordance with paragraph "4" above, but such Notice is otherwise sustained. The Division is also directed to cancel the penalty, penalty interest and interest assessed in its answer.

DATED: Troy, New York
November 2, 1995

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

/s/Donald C. DeWitt
Donald C. DeWitt
Commissioner