STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
SWAG ASSOCIATES	:	DECISION DTA No. 810470
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 Swag Associates, c/o Gordon I. Remer, Esq., 1501 Broadway, Suite 2401, New York, New York 10036, filed an exception to the determination of the Administrative Law Judge issued on August 11, 1994. Petitioner appeared by Gordon I. Remer, Esq. The Division of Taxation appeared by William F. Collins, Esq. (David C. Gannon, Esq., of counsel).

Petitioner filed a brief on exception. The Division of Taxation filed a letter in lieu of a brief in opposition. Any reply brief from petitioner was due on March 13, 1995, which date began the six-month period for the issuance of this decision. Oral argument was not requested.

Commissioner Koenig delivered the decision of the Tax Appeals Tribunal. Commissioners Dugan and DeWitt concur.

ISSUES

I. Whether the Division of Taxation erred in allowing, in the calculation of consideration, only 6 percent of a 25 percent finder's fee paid by petitioner on the sale of 12 tenant-occupied cooperative apartments.

II. Whether the Division of Taxation erred in disallowing brokerage commissions paid on the sale of two cooperative apartments.

FINDINGS OF FACT

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

Petitioner, Swag Associates ("Swag"), was the sponsor of a "non-eviction" plan to convert apartments in a building located at 245 East 87th Street, New York, New York to cooperative ownership.

Swag employed the services of a sales agent, known as Dapesa Corp., ("Dapesa") to promote the sale of cooperative apartments. Dapesa ultimately sold in excess of 90 apartments. A majority of the apartments handled byDapesa were sold to tenants who occupied the apartments at the time of the conversion. Some apartments, which were vacant, were sold to parties who purchased for their own occupancy. Accordingly, all sales by Dapesa Corp. were made to people who were previously living in the building or moving into the building for their own use and occupancy.

Prior to the Tax Reform Act of 1986, a cottage industry developed in New York City which consisted of selling occupied apartments in groups to syndicate partnerships or individuals in order to obtain certain tax advantages. The tax advantages were important because the rent that the owner of the apartment would receive from the tenant was less than the amount of maintenance or expense that the owner would have to pay the cooperative corporation. Thus, there was no economic reason to buy the apartments other than the tax advantage. Since such sales were made for tax considerations, sales were made through investment advisors, tax advisors and accountants. After the enactment of the Tax Reform Act of 1986, the cottage industry of selling occupied apartments quickly ended because once the tax advantage was removed, there was no economic incentive to purchase a tenant-occupied apartment.

Some of the occupants of the apartment building chose to remain as tenants and not to purchase shares of the new cooperative apartment corporation. Mr. David Swersky, who, as president of Dapesa, handled the sale of vacant apartments, did not feel qualified to sell tenant-occupied apartments because he did not feel equipped to engage in this type of highly specialized sale. Therefore, in 1985, petitioner engaged the services of Mr. Charles Hack and Mr. James B.

Mintzer and their company, Parkview Associates, Inc., in order to sell certain apartments which were tenant-occupied.

At the time Messrs. Hack and Mintzer's services were retained, they were well known as large sellers of occupied apartments. When Mr. Swersky first met with Messrs. Hack and Mintzer, they boasted that they had sold in excess of 1,500 apartments. Mr. Swersky felt that this displayed extraordinary ability.

Mr. Hack advised Swag that the fee for selling tenant-occupied apartments was 25 percent of whatever the consideration was. Petitioner was unhappy with the fee, but felt that it had no choice but to accept.

In a document dated May 1, 1985, Mr. Sandler, who was the principal of Swag, on behalf of Swag, and Messrs. Hack and Mintzer agreed to certain fees. The document embodying their agreement provided, in part, as follows:

> "1. . . . Messrs. Hack and Mintzer (collectively, the 'Participants') have arranged for the sale of the Apartments to various investors, in consideration for which services Swag shall pay to the Participants a finder's fee equal to twenty-five percent (25%) of the net consideration received. The Participants agree to accept such fee in kind, i.e., they will accept twenty-five percent (25%) of the cash consideration received by Swag and a twenty-five percent (25%) interest in the purchase money notes received by Swag upon the sale of the Apartments to the investors procured by Participants.
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> "2. To implement the foregoing, Swag confirms that upon the sale to the Investors, the Participants will have a twenty-five percent (25%) equity interest (the '25% Interest') in the proceeds from the sale thereof, and hereby assigns and conveys to the Participants the 25% Interest, effective upon the sale of each Apartment.
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> "3. Swag agrees that twenty-five percent (25%) of the cash consideration received from each purchaser at closing shall be paid to Participants and that the Purchaser Notes will be made payable to the Participants and Swag.
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> "4. Swag will have a seventy-five percent (75%) interest in the Purchaser Notes and the collateral given to secure same (the 'Collateral') and Participants will have a twenty-five percent (25%) interest in the Purchaser Notes and the Collateral, as tenants in common."

Initially, it was contemplated that Messrs. Hack and Mintzer would sell 16 apartments. However, after six months of marketing, meetings and tax planning with attorneys, accountants and their principals, they were able to sell only 12 apartments.

The 12 occupied apartments sold for a gross price of $1,465,230.00. In order to sell the tenant-occupied apartments, Mr. Hack had to prepare an offering memorandum including cash flow projections and tax analysis and hire additional staff in order to bring a group of investors together to buy the apartments. In contrast, in the sale of the approximately 90 apartments by Dapesa, petitioner did not have to prepare any projections. In the opinion of Mr. Swersky, Messrs. Hack and Mintzer were not selling real estate. They were engaging in tax planning and the real estate that went along with it was incidental. Similarly, in the opinion of Mr. Sandler, Messrs. Hack and Mintzer were not selling real estate. Rather, he testified as follows:

> (Division's representative) Q: "Now, regarding your dealing with Mr. Hack and Mintzer, you stated to your recollection or at least to your understanding, they were licensed brokers; yet the agreement between yourself and them specifically stated 'finders fee' as opposed to 'brokerage' or 'commission' or anything to that effect. I'm curious about that.
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> (Mr. Sandler) A: "They used that term, and my understanding was they weren't selling real estate. If they were selling real estate, they would be getting 7 or 8 percent cash at the closing. That was not the deal. They were doing projection analyses, meetings with investors and accountants. They were doing a whole program that was a little different than what your typical real estate broker does" (tr., pp. 39-40; emphasis added).

In hindsight, Mr. Swersky felt that the 25 percent fee was reasonable because Parkview Associates, Inc. was able to obtain good prices in December 1985 despite the fact that there were discussions about changing the tax law.

In one contract, for sale of a unit, Mr. Sandler is listed as the seller. This is because at one point Swag was down to a limited number of apartments that could not be sold. Mr. Sandler and his associate divided the remaining apartments. Eventually, one apartment became vacant. Thereafter, Mr. Sandler sold the vacant apartment and three other occupied apartments as part of

a package deal. The price for all four apartments was approximately $200,000.00 which was about the market price for a vacant apartment.

Mr. Hack's name was listed as a 25 percent owner of apartment 18B on a contract for sale because he claimed at one point to have sold 13 apartments. As compensation, Mr. Hack claimed a 25 percent interest in the note which was consideration for the 13th apartment.

The builder who constructed the apartment building obtained six units. This was part of the original consideration for the building.

In an undated letter, the Division of Taxation ("Division") advised petitioner that, based upon an audit, a claim for refund which Swag had previously made was denied and additional tax, penalty and interest was due. The letter stated, in pertinent part, as follows:

> "[I]t has been determined that the 25% 'finder's fee' paid to Mr. Charles Hack and Mr. James Mintzer is not considered a customary or reasonable cost to be claimed as brokerage. As per our phone conversation, we agreed to allow 6% of the consideration received on the 12 units involved. This resulted in the allowance of $87,914.00 plus $113,342.00 that was documented as actual brokerage paid on other units."

Although not expressly discussed in the foregoing letter, the Division disallowed the brokerage commissions which petitioner claimed it paid on apartments 7B and 10B. The brokerage commissions were disallowed because petitioner was unable to substantiate the brokerage commission paid on the two apartments. The latter two apartments were not sold by Messrs. Hack and Mintzer.

On the basis of the foregoing conclusions, the Division issued a Notice of Determination, dated November 8, 1991, which asserted a deficiency of tax in the amount of $4,175.50, plus interest of $352.30 and penalty of $1,169.14, for a current balance due of $5,696.94.

In the experience of Mr. Sandler, as a sponsor involved in the conversion of real estate, he has never had an agreement with a broker to accept some form of note to pay a commission at the time of the transaction. It is Mr. Sandler's experience that brokers want cash at the time of closing.

Mr. Charles Hack was not a licensed real estate broker. He was issued a Real Estate Salesperson License in 1986. Mr. Mintzer was not a licensed real estate broker or salesperson from at least November 1, 1985 through August 25, 1993.

The contract of sale pertaining to apartment 7B, which is dated July 12, 1984, contains a paragraph 14 which provides:

> "14. Purchaser represents to Seller that Purchaser has not dealt with any brokers in connection with this transaction other than
>
> BRUCE BAUM
>
> and Seller agrees to pay said broker a commission."

The contract of sale regarding apartment 10B contains the same paragraph as that set forth above except that the broker listed was Bellmarc Realty.

The affidavit of David Swersky and the credible testimony of the same individual at the hearing show that apartment 10B was sold to Samuel and Florence Fertig and that Bellmarc Realty was the real estate broker that brought about this sale. From the proceeds of the sale, Bellmarc Realty was paid a commission of $11,400.00. Apartment 7B was sold to Rodman Reef and Bruce Baum was the real estate broker that brought about the sale of this apartment. From the proceeds of the sale, Bruce Baum was paid a commission of $10,000.00.

At the hearing, Mr. Swersky was unable to recall when the sale of apartments 7B and 10B occurred.

OPINION

In the determination below, the Administrative Law Judge, after reviewing Article 31-B of the Tax Law and Tax Law § 1440(1)(a) relative to the definition of the term consideration, held that:

> "[a]n examination of the statutory section in issue shows that the term 'customary brokerage fees' represents an amount which is to be subtracted from 'the price paid or required to be paid for real property or any interest therein . . . .' On its face, the term 'customary' sets a limit on the amount that may be deducted from

> the price paid or required to be paid" (Determination, conclusion of law "E").

The Administrative Law Judge also held that, based on the testimony of Mr. Sandler and Mr. Swersky, a fee of 25 percent is not customary for selling real estate. The Administrative Law Judge concluded that Messrs. Hack and Mintzer provided marketing services and, therefore, that "the disallowed portion of the finder's fee was not allowable under the provisions of the gains tax law at the time of the transfer" (Determination, conclusion of law "G").

The Administrative Law Judge also: 1) rejected petitioner's arguments relating to the expenses being reasonable and necessary as having no bearing since a taxpayer can only deduct those expenses which are permitted by the Tax Law; 2) rejected the Division's argument that there was not an arm's-length transaction between Swag and Messrs. Hack and Mintzer; and 3) held that sufficient evidence was submitted by petitioner to establish that brokerage commissions were paid on apartments 7B and 10B.

On exception, petitioner argues that section 1440(1)(a) of the Tax Law sets no limit on the amount of finder's fee that may be deducted from consideration. Instead, petitioner asserts that the statute provides that if a fee is customary, it is deducted from the purchase price to determine consideration and, in the matter at hand, petitioner paid a finder's fee that was customary, as established by testimony, for the type of interest in real property being transferred, namely, occupied apartments.

Petitioner also argues that: 1) in analogous situations, such as determining attorney fees and customary foreclosure expenses, the courts do not set arbitrary limits as was done by the Division in using a 6 percent cap; and 2) the finder's fee was an allowable deduction under the provisions of the gains tax law at the time of transfer.

The Division, in reply, with relation to the fee paid, argues: 1) the question is not whether the fee was customary but whether the fee was a customary brokerage fee; 2) the 6 percent allowance and disallowance of the remainder was not arbitrary, but was instead based on

conversations between the Division and petitioner's representative and, further, the testimony of petitioner's own witnesses supports said disallowance; and 3) its brief below and the analysis of the Administrative Law Judge correctly address the issue that the finder's fees were not an allowable expense under former Article 31-B of the Tax Law at the time of the transfers in question.

We affirm the determination of the Administrative Law Judge.

Petitioner has not raised any issues on exception that were not raised before the Administrative Law Judge. The Administrative Law Judge correctly analyzed and weighed all the evidence presented in this case and correctly decided the issues. We uphold the determination of the Administrative Law Judge for the reasons stated therein.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Swag Associates is denied;

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

3. The petition of Swag Associates is granted to the extent indicated in Conclusion of Law "K" of the Administrative Law Judge's determination, but is otherwise denied; and

4. The Division of Taxation is directed to modify the Notice of Determination dated November 8, 1991 in accordance with paragraph "3" above, but such Notice is otherwise sustained.

DATED: Troy, New York
July 20, 1995

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

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

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