STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
STARBURST DEVELOPMENT CO., INC.	:	DECISION DTA No. 810853
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 Starburst Development Co., Inc., c/o John Carusone, President, Carusone & Muller, 260 Bay Road, P.O. Box 143, Glens Falls, New York 1280l, filed an exception to the determination of the Administrative Law Judge issued on July 30, 1993.[1] Petitioner appeared by Lavelle & Finn (John H. Lavelle, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Kenneth J. Schultz, Esq., of counsel).

Petitioner filed a brief in support of its exception and the Division of Taxation filed a letter in response. If filed, a reply brief was due by November 29, 1993, which date began the six-month period for the issuance of this decision. Petitioner's request for oral argument was denied.

The Tax Appeals Tribunal renders the following decision per curiam.

ISSUES

I. Whether the Division of Taxation erred by not considering petitioner's sales as the sale of subdivided parcels improved with residences within the meaning of Tax Law § 1440.7.

[1]The Administrative Law Judge also held a hearing on the petition of Northern Homes, Inc. The Administrative Law Judge stated in a footnote to the opening sentence of his determination that he would not render a determination with respect to the petition of Northern Homes, Inc. because he had been informed by the parties that Northern Homes had filed a petition in bankruptcy. The Administrative Law Judge offered no further explanation for this result. Neither party has excepted to this aspect of the determination.

II. Whether petitioner is entitled to the exemption from real property gains tax pursuant to Tax Law § 1443.7.

III. Whether petitioner's sales of certain lots should be aggregated with the sales of a related corporation.

IV. Whether penalties and interest penalty should be abated.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for findings of fact "25," "27" and "30" which have been modified. The Administrative Law Judge's findings of fact and the modified findings of fact are set forth below.

Since 1945, Northern Homes, Inc. ("Northern Homes") has been in the business of manufacturing prefabricated houses. Generally, Northern Homes manufactures in accordance with a set of plans that it offers. In recent years, it also exported prefabricated homes.

It is Northern Homes' practice to manufacture parts of a home, including panels, interior walls, roof parts and floors. The prefabricated parts assist builders in the construction of the house.

In general, Northern Homes sells its homes through either a network of builders and dealers or through advertising campaigns. Depending on the state of the economy, from 10% to 50% of petitioner's customers are "do-it-yourselfers". Petitioner's competition comes from one of three sources. First, competition arises from other companies, such as itself, which sell packaged homes. A second source of competition is from manufacturers which sell components of a home but not packages as petitioner does. The third and largest source of competition is from the traditional homebuilder.

Bedford Close was a housing development which was started by Northern Homes in order to have model homes to display to its customers. Northern Homes planned on getting customers to buy models at a reduced price and then use the houses as models for its catalogue. Northern Homes also planned to show the houses during and after construction.

Generally, potential customers went to Northern Homes' office. Thereafter, Northern Homes' sales staff took potential customers to the existing homes. The sales staff and the customers would then review the catalogue.

When Northern Homes began building in Bedford Close, it did not have any intention of competing with builders that were selling lots from their own subdivisions. However, this is what happened. Later, Northern Homes decided to let the builder construct the house and Northern Homes would just make the contract deal.

Northern Homes never advertised that the lots were for sale and would have advertised differently if it had wished to sell just land.

Northern Homes could prevent the use of the lots for other than a Northern Homes house by withholding architectural approval for a structure. Northern Homes also filed covenants in order to induce a consumer to have Northern Homes build a house at Bedford Close.

Many covenants were put in deeds in order to create the setting whereby Northern Homes could take attractive photographs of its houses. Northern Homes helped its customers landscape their homes for the same reason. The package of restrictions placed on the subdivision was far more restrictive than on the typical subdivision.

When a customer first went to the office of Northern Homes, the parties reviewed the covenants and the architectural restrictions.

On one occasion, Northern Homes sold a lot to a person who subsequently tried to buy a house from a competitor. Northern Homes sued that individual and went through a lengthy process to try, without success, to prevent him from building a house. In the 20 or 30 years that Northern Homes owned Bedford Close, this was the only person who did not build a Northern Homes house. After this one incident, Northern Homes had its customers sign a contract of sale to make it clear that purchasers of lots were expected to build a Northern Homes residence.

It was Northern Homes' intention in working with its attorneys to restrict the lots to such a degree that the only use for a lot was a Northern Homes single-family house.

Northern Homes has maintained a continuing relationship with the residents of Bedford Close. For instance, the street signs in Bedford Close were designed and installed by Northern Homes. When a street sign falls down, Northern Homes performs the repair. It also maintains the flowers around the entrance of Bedford Close. Northern Homes leaves brochures for people who drive through Bedford Close and has put on a fireworks display on the Fourth of July for the residents of the housing development.

Northern Homes engaged in a number of activities which were not typical of the traditional home builder. For example, Northern Homes designed the subdivision without sidewalks or curbs because it was felt that this design showcased the houses better. Northern Homes also designed streets that were curved and set aside land as a green area because it was thought it would improve photographs of the houses.

There were occasions when people attempted to conduct business from their homes or engage in other activities which did not conform to the covenants. When this occurred, Northern Homes took steps to bring a stop to these activities.

Northern Homes has been represented by real estate attorneys and large experienced certified public accounting firms which were familiar with the gains tax throughout the development of Bedford Close. The accounting firm prepared Northern Homes' taxes and audited Northern Homes' books for the bank. Northern Homes' attorneys were experienced in real estate matters and had been with Northern Homes for a long period of time. Northern Homes' attorneys and accountants never discussed the gains tax with Northern Homes until they found out that the Division of Taxation ("Division") expected Northern Homes to pay taxes.

Northern Homes operated under the premise that it was exempt from real property gains tax. If it knew that its transactions were subject to tax, it would have structured the transactions differently in an attempt to avoid tax.

Generally, a regular builder builds a house on land that he owns or has the right to purchase and then sells the entire package to the consumer.

Northern Homes did not sell homes in the same way as a regular builder. When Bedford Close first began, Northern Homes either built the house on Northern Homes' land and then deeded the item to the consumer at the time of closing or Northern Homes deeded the land to the customer immediately and then build the house on the customer's land. The time came when banks started asking for much larger downpayments from the purchasers of homes. However, the banks permitted the customer's ownership of the land to serve as part of the equity. In order to accomplish this, the banks wanted Northern Homes to deed the land to the customer who was going to receive the mortgage. The customer then gave the first lien to the bank.

There were also occasions when Northern Homes sold the lot to builders. This arose when the builder needed construction financing to complete a home. As in the prior case, Northern Homes deeded the land to the builder and, in lieu of a payment, took back a second mortgage. Northern Homes would then look to receive its money at the final closing.

In either of the foregoing cases, Northern Homes was paid for putting a home on a lot which the owner occupied. However, there were times when Northern Homes was paid in full for the lot first.

There were separate contracts for the sale of the lot and the house. The contract for the sale of the lot might precede the sale of the home.

Everyone connected with the transaction, including the consumer, the builder and Northern Homes, was under the impression that Northern Homes was selling a single-family home to the ultimate consumer. Further, when the builders took title, they were merely an accommodation

party to help the transaction all the way through to the buyer. The consumer looked to Northern Homes rather than the builder for material warranties.

In or about 1981, high interest rates caused dislocation in the housing industry. The difference in the market interest rates and the maximum interest rates which banks were permitted to charge prompted banks to decline to offer new mortgages. The number of new housing starts dropped so precipitously, Northern Homes was forced to liquidate its manufacturing operations in Chambersburgh, Pennsylvania and enter into voluntary bankruptcy. Under these circumstances, Northern Homes was unable to raise capital and continue with the development.

We modify the Administrative Law Judge's finding of fact "25" to read as follows:

> In order to attract the capital needed to continue with the development, a group of individuals who were either associated with Northern Homes or related to someone who was associated with Northern Homes agreed to invest capital in a corporation known as Starburst Development Co., Inc. ("Starburst") in order to develop land which was owned by Northern Homes. Approximately 80% of Starburst was owned by individuals who also owned an interest in Northern Homes. The banks also agreed to invest capital provided Northern Homes contributed the land as collateral. In exchange, Northern Homes would receive 50% of the selling price of the lot.[2]

The foregoing financing deal was structured two years prior to the enactment of the gains tax.

We modify the Administrative Law Judge's finding of fact "27" to read as follows:

> The homes developed by Starburst were marketed as Northern Homes and the development was done in the same fashion as Northern Homes. Further, the mechanics of the sale of the lots, such as the consumer or builder purchasing the lot prior to the sale of the home or the restrictive covenants, remained the same. The consumers did not know of the existence of Starburst, as it played no active function in the development of the

[2]We modified the Administrative Law Judge's finding of fact "25" by adding the second sentence to reflect more details of the record.

> subdivision. The only purpose of Starburst was to facilitate the flow of loans to consumers.[3]

Starburst did not have its own employees. Each of the lots which Starburst sold were lots which were transferred to Starburst by Northern Homes.

No one on the staff of Northern Homes had any expertise regarding gains tax. The question of whether Starburst's transactions were subject to gains tax was never raised in conversation with Starburst's attorneys or in conversations with Starburst's certified public accounting firms which were experienced in real estate and tax. Prior to its audit, Starburst was never informed that its activities were subject to gains tax. It is Starburst's practice to rely on outside professionals on matters such as gains tax.

We modify the Administrative Law Judge's finding of fact "30" to read as follows:

> After a field audit, the Division determined that real property gains tax was due from Starburst in those instances where the lot was sold without being developed. The Division issued a Notice of Determination to Starburst, dated September 23, 1991, which assessed tax of $18,264.00, plus interest of $17,165.89 and penalty of $6,392.40, for a balance due of $41,822.29. The asserted deficiency of tax was premised, in part, on the finding that Northern Homes' transactions were subject to tax in those instances when the lot was sold before being developed and that the sales of Northern Homes should be aggregated with the sales of Starburst. The transfers of Northern Homes and Starburst that were aggregated by the Division all occurred after the effective date of the gains tax.[4]

In accordance with New York State Administrative Procedure Act § 307(1), petitioner's proposed findings of fact "8" and "11" have been accepted and included in the record. The remaining proposed findings of fact are conclusory and not fully supported by the record.

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[3]We modified the Administrative Law Judge's finding of fact "27" by adding the last two sentences to reflect more details of the record.

[4]We modified the Administrative Law Judge's finding of fact "30" by adding the last sentence to more fully state the basis for the notice of determination.

OPINION

Tax Law § 1441 imposes a tax at the rate of 10% upon gains derived from the transfer of real property within New York State. Tax Law § 1443(1) provides that a partial or total exemption shall be allowed if the consideration is less than $1,000,000.00.

The term "transfer of real property" is defined in Tax Law § 1440(7) which provides, in part, as follows:

> "'Transfer of real property' means the transfer or transfers of any interest in real property by any method, including but not limited to sale . . . ."

The third sentence of Tax Law § 1440(7), the "aggregation clause," provides:

> "Transfer of real property shall also include partial or successive transfers, unless the transferor or transferors furnish a sworn statement that such transfers are not pursuant to an agreement or plan to effectuate by partial or successive transfers a transfer which would otherwise be included in the coverage of this article . . . provided that the subdividing of real property and the sale of such subdivided parcels improved with residences to transferees for use as their residences, other than transfers pursuant to a cooperative or condominium plan, shall not be deemed a single transfer of real property."

The aggregation clause affects the application of the $1,000,000.00 exemption because the proceeds from the transfers that are treated as a single transfer are aggregated to determine the applicability of the exemption.

The first issue before us concerns the meaning of the statutory language that excepts parcels improved with residences from the aggregation clause. The Administrative Law Judge concluded that this provision required that the real property be improved with a residence prior to its transfer. As the transfers in issue took place prior to any improvement, the Administrative Law Judge concluded that they were not excepted from the aggregation clause.

On exception, petitioner argues that the exception from aggregation was intended to exempt homebuilders from the gains tax and that because the transactions here are "identical in result to the more commonplace example of a traditional homebuilder, as a 'matter of economic

justice' should not the taxpayer's transaction be taxed (or exempted) the same as the others?" (Petitioner's brief on exception, p. 5). Petitioner contends that the Administrative Law Judge erred in holding that the statute required a contemporaneously existing and completed home on the homesite. Petitioner asserts that "[t]he statute itself, of course, imposes no temporal requirement, only requiring that 'parcels improved with residences' be the subject of the transfer" (Petitioner's brief on exception, p. 5).

We disagree with petitioner that the statute does not impose a temporal restriction. The gains tax is imposed "on gains derived from the transfer of real property within the state" (Tax Law § 1441, emphasis added). We conclude that the moment that the taxable event occurs, i.e., the transfer of the real property, is the temporal restriction underlying the entire gains tax. Consistent with this interpretation, we have held that the consideration for the transfer is fixed at this moment and is not reduced by subsequent events (Matter of Cheltoncort Co., Tax Appeals Tribunal, December 5, 1991, affd Matter of Cheltoncort v. Tax Appeals Tribunal, 185 AD2d 49, 592 NYS2d 121; see also, Matter of V & V Properties, Tax Appeals Tribunal, July 16, 1992 [where we held that consideration as an element of original purchase price was also fixed at the time of transfer and could not be reduced by the Division based on subsequent events]). To deviate from this theory, as petitioner suggests, and exclude transactions from the definition of transfer of real property based on subsequent events would, in our view, be contrary to the entire scheme of the tax.

Further, we find no support for petitioner's theory in the words of the provision at issue. As the Court in Executive Land Corp. stated, "the Legislature has very specifically set forth (see, Tax Law section 1440(7) the one exception to the aggregation requirement for subdivided property" (Executive Land Corp. v. Chu, 150 AD2d 7, 545 NYS2d 354, 358, appeal dismissed 75 NY2d 946, 555 NYS2d 692). If in drafting this very specific exception to aggregation, the Legislature intended to include parcels to be improved with residences, as well as parcels improved with residences, we believe the statutory language would indicate this intention.

Petitioner argues that its interpretation is particularly compelling given the reasons for the structure of the transactions (the nature of the product and the economic circumstances). We do not see that the reasons for the form of the transfer provide us with any basis to alter the fundamental structure of the tax or to ignore the specific words of the statute.

Therefore, we agree with the Administrative Law Judge that the instant transactions are not within the exception from aggregation because the parcels were not improved with residences at the time of their transfer.

Petitioner next renews its argument that the transfers were within the exemption provided by section 1443(7) for transfers which consist of the creation of a contract or the granting of an option without use and occupancy. The Administrative Law Judge rejected petitioner's contention because the "Division did not attempt to tax the execution of a contract or an option to purchase real property" (Determination, conclusion of law "G").

The essence of petitioner's argument on this point is that after the transfer by it or Northern Homes the use of the lot was limited to the construction of a single family home purchased from Northern Homes and that this limited use places the substance of the transfer within the exemption.

We disagree. Although the purchaser's use of the lot may have been limited, a limited use is not the same as no use. Further, the purchasers received title to the property, not merely a contract right or an option to purchase.

The next question is whether the Division properly aggregated the consideration received by petitioner from sales of lots in the subdivision with the consideration received by Northern Homes from the sale of lots in the subdivision.

With respect to this question, the Administrative Law Judge determined, relying on Matter of Benacquista, Polsinelli & Serafini Mgt. Corp. v. Commr. of Taxation & Fin. (191 AD2d 80, 598 NYS2d 829), that, in general, lots sold pursuant to a subdivision plan are subject to aggregation. In this case, the Administrative Law Judge concluded that "the economic realities

of the transactions herein warrant aggregation of the sales of Northern Homes and Starburst" (Determination, conclusion of law "L")

On exception, petitioner argues that the critical element of aggregation clause is the:

> "one which requires that the plan of partial or successive transfers avoids 'a transfer which would otherwise be included in' the gains tax. Any plan of partial or successive transfers must be shown to avoid the gains tax on a single transfer. If the plan does not avoid the gains tax, it does not matter how many other transfers it involves, the requirement for aggregation is not met" (Petitioner's brief on exception, pp. 10-11).

Petitioner's interpretation of the aggregation clause was rejected by the Court in Cove Hollow Farm when it stated "the Legislature clearly did not intend that aggregation under Tax Law section 1440(7) is to be triggered only if the transferor engages in partial or successive transfers for purposes of tax avoidance, since respondent is otherwise statutorily authorized to ignore such devices" (Matter of Cove Hollow Farm v. State of New York Tax Commn., 146 AD2d 49, 539 NYS2d 127, 129). The correct application of the aggregation clause has been succinctly stated as follows: where "property is subdivided pursuant to an overall subdivision plan that envisions the sale of the entire property in the form of many smaller parcels, such sales are subject to aggregation for the purposes of the real property transfer gains tax" (Matter of Benacquista, Polsinelli & Serafini Mgt. Corp v. Commissioner of Taxation, supra, 598 NYS2d 829, 831).

Applying this rule to the facts of this case, it appears undisputed that petitioner and Northern Homes each had a plan to dispose of their entire interest in the subdivision. The question is whether the plan of each transferor was separate and independent from the other or whether the transferors had a single plan to dispose of the lots in the subdivision. To resolve this issue in its favor, petitioner was required to prove that it was separate and independent from Northern Homes (Matter of Lee v. Tax Appeals Tribunal, ___ AD2d ___ [Mar. 31, 1994]; Matter of Brooks v. Tax Appeals Tribunal, ___ AD2d ___ [Mar. 10, 1994].

We conclude that petitioner has not met this burden. Instead, the record indicates that petitioner, which was 80% owned by individuals that also held an interest in Northern Homes, only existed and functioned so that Northern Homes could continue the development of the subdivision. Petitioner's existence facilitated the flow of loans to consumers, but petitioner performed no active function in the transaction. From the consumer's perspective, the transfer and building were accomplished in exactly the same manner if petitioner or if Northern Homes sold the lot. Further, the record before us indicates that all of the lots petitioner sold were acquired from Northern Homes[5] and that in exchange for the lots Northern Homes received, not just a right to profits on the sale, but instead the right to 50% of the selling price of the lots. In our view, these facts indicate that the Division properly aggregated the transfers by petitioner with those by Northern Homes.

The last issue raised by petitioner is that the Administrative Law Judge erred in not abating the penalty imposed because petitioner reasonably relied on the advice of competent advisors and these are inherently complex issues.

The Administrative Law Judge stated that reliance upon legal advice warranted penalty abatement only when it is shown that the advice is reasonable under the circumstances. The Administrative Law Judge determined that petitioner had not set forth any reason why its counsel or accountants advised it not to pay gains tax. Because the Division had clearly and consistently explained in publications that sales pursuant to a subdivision plan are aggregated, the Administrative Law Judge could not find petitioner's failure to pay was due to reasonable cause.

We believe that the Administrative Law Judge correctly and adequately addressed the penalty issue and affirm his conclusion on this issue for the reasons stated in the determination.

Accordingly it is ORDERED, ADJUDGED and DECREED that:

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[5]Petitioner asserts in its exception that in fact it acquired some land from other unrelated sellers but there is no evidence of these transactions in the record.

1. The exception of Starburst Development Co., Inc. is denied;

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

3. The petition of Starburst Development Co., Inc. is denied; and

4. The Notice of Determination dated September 23, 1991 is sustained.

DATED: Troy, New York
May 5, 1994

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

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