STATE OF NEW YORK

TAX APPEALS TRIBUNAL

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| In the Matter of the Petition | : | |
| of | : | |
| **FAZKAP ASSOCIATES** | : | DECISION<br>DTA No. 811024 |
| 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 Fazkap Associates, c/o National Consultants Associates, 447 West 51st Street, New York, New York 10019, filed an exception to the determination of the Administrative Law Judge issued on January 27, 1994. Petitioner appeared by Fair, Aufsesser & FitzGerald, P.C. (Andrew J. Fair, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Donald C. DeWitt, Esq., of counsel).

Petitioner filed a brief in support of its exception and the Division of Taxation filed a brief in opposition. Petitioner submitted a reply brief which was received on June 15, 1994, 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 petitioner is liable for the full gains tax determined due after defaulting on a 15-year installment payment plan it entered into with the Division of Taxation (including whether a change in circumstances can reduce the consideration paid after the sale).

II. Whether petitioner's failure to timely pay the real property gains tax was due to reasonable cause and not due to willful neglect.

## *FINDINGS OF FACT*

We find the facts as determined by the Administrative Law Judge except for finding of

fact "8" which has been modified. The Administrative Law Judge's findings of fact and the modified finding of fact are set forth below.

Petitioner, Fazkap Associates ("Fazkap"), was a New York partnership at all times relevant herein.

On December 31, 1986, Fazkap entered into a contract of sale with Irving Place Realty Corp. ("Irving") for the sale of premises located at 57-59 Irving Place, New York, New York for a purchase price of $4,398,780.00 which was payable as follows:

(a) Irving assumed the first mortgage loan held by the Emigrant Savings Bank, having a principal balance of $198,780.00 as of December 31, 1986;

(b) Irving executed a note and mortgage to secure the payment of the remaining $4,200,000.00. Pursuant to the note, Fazkap was to receive only interest on the purchase price for a period of 15 years.

Section "11(b)(iii)" of the contract of sale stated that Fazkap was solely responsible for payment of the real property gains tax on the conveyance of the premises and also for filing any returns or reports required in connection therewith. The contract did not mention how Fazkap would finance the payment of the tax.

On December 31, 1986, Irving executed a Transferee Questionnaire indicating that it had purchased the premises at 57-59 Irving Place on December 31, 1986 for consideration of $4,398,780.00.

Fazkap executed a Transferor Questionnaire on January 9, 1987 indicating that it had sold the same premises to Irving for the same purchase price and that the anticipated real property gains tax due on the transfer date, anticipated to be December 31, 1986, was $379,197.52.

On January 29, 1987, the Division of Taxation ("Division") issued a Tentative Assessment and Return to Fazkap indicating a tentative assessment of tax due of $389,754.59 plus penalty and interest. The difference in the base tax from that stated on the Transferor Questionnaire was an adjustment made by the Division which was explained in the Tentative

Assessment as follows:

> "We have added the amount of transfer tax which was paid by the transferee instead of the transferor.
> 105,570.72"

On March 2, 1987, Fazkap filed a Supplemental Return which set forth a corrected tax due of $389,754.59 and indicated that it was electing to defer payment of same because the actual cash received by it on or before the date of transfer, $0.00, was less than or equal to the tax due. Said return also stated that the transfer date had been December 31, 1986. The following prefatory language was set forth above the election on the form:

> "If the transferor fails to pay any installment on the date on which it is due, the Tax Department may declare the entire unpaid balance of the tax due and owing."

On June 23, 1987, the Division sent Fazkap a letter informing it that the tax due on the transfer of the premises at 57-59 Irving Place qualified for deferred payment based upon the information submitted. The letter also stated the terms of the payment plan:

> "Annual payments in the amount of $25,983.64 will be due on the 31st day of December for the next 15 years."

We modify the Administrative Law Judge's finding of fact "8" to read as follows:

> Irving made interest payments to Fazkap for the years 1987 and 1988, pursuant to the mortgage note. During the year 1989, Irving made ten monthly interest payments and during the year 1990 made one monthly interest payment for 1989. Irving failed to make any other payments.
>
> Fazkap made the first installment payment on December 16, 1987, the second on December 16, 1988 and the third on January 5, 1990. However, no further payments were received from Fazkap.
>
> Fazkap had no other income from which to pay the tax.[1]

On March 7, 1991, the Division issued to Fazkap a Statement of Proposed Audit

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[1] The Administrative Law Judge's finding of fact "8" read as follows:

> "Fazkap made the first installment payment on December 16, 1987, the second on December 16, 1988 and the third on January 5, 1990. However, no further payments were received from Fazkap.

We modified this finding to reflect more details of the record. This record was made by the submission of documents without a hearing.

Adjustment which requested payment in the sum of $347,995.97. The statement set forth the following explanation:

> "Our records indicate that on 12/31/90 an installment of the Gains Tax was due under plan number I-641. Section 1442 of the Tax Law provides that if the transferor shall fail to pay any installment on the date on which it is due, the entire balance of the tax is due and owing.
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> | | |
> |---|---|
> | "Installment payment due | 25,983.64 |
> | Penalty 12/31/90-4/7/91 | 4,157.38 |
> | Interest 12/31/90-4/7/91 | 770.64 |
> | "Unpaid balance | 285,820.03 |
> | Penalty 3/7/91-4/7/91 | 28,582.00 |
> | Interest 3/7/91-4/7/91 | 2,682.28" |

Subsequent to the issuance of the Statement of Proposed Audit Adjustment, on May 6, 1991, the Division issued to Fazkap a Notice of Determination for the 1990 installment payment that was not made by petitioner, and accelerated the balance of the gains tax plus penalty and interest pursuant to Tax Law § 1442.

On August 15, 1991, the Division issued to petitioner a Notice and Demand for Payment of Tax Due which set forth additional tax due on or before August 25, 1991 of $311,803.67 plus penalty and interest for a total amount due of $390,023.22.

During the spring of 1991, Fazkap took back the property in lieu of foreclosure and thereafter leased the property to a third party.

Upon taking the property back, Fazkap found that the City of New York had commenced an in rem tax foreclosure action against the property for the payment of real estate taxes owed by Irving. Fazkap and the City of New York entered into an installment agreement under which Fazkap has agreed to pay the taxes owed.

## ***OPINION***

The Administrative Law Judge stated that "consideration includes the amount of a mortgage, meaning its face amount and not its present value or other value (Matter of Normandy Assocs., Tax Appeals Tribunal, March 23, 1989; see also Matter of Old Farm Lake Co., Tax Appeals Tribunal, April 2, 1992)" (Determination, conclusion of law "A"). The

Administrative Law Judge, relying on Matter of Cheltoncort Co. (Tax Appeals Tribunal, December 5, 1991, affd Matter of Cheltoncort Co. v. Tax Appeals Tribunal, 185 AD2d 49, 592 NYS2d 121), determined that the amount of tax "was correctly based upon the face amount of the purchase money mortgage from Irving and other consideration at the time of the transfer" (Determination, conclusion of law "A"). The Administrative Law Judge further determined that the Division acted properly when it declared the unpaid portion of the tax due and owing (see, Tax Law § 1442[e]; 20 NYCRR 590.70[a]). In addition, the Administrative Law Judge found nothing in the statute, regulations or case law which would require the Division to withhold acceleration of the tax, due to a taxpayer's subsequent economic difficulties.

The Administrative Law Judge also found without merit petitioner's argument that the Division's demand for full payment of the tax without petitioner having received full consideration is an unconstitutional taking of property without compensation. The Administrative Law Judge stated that statutes are presumed constitutional at the administrative level (see, Matter of Wizard Corp., Tax Appeals Tribunal, January 12, 1989; Matter of Fourth Day Enters., Tax Appeals Tribunal, October 27, 1988).

Finally, the Administrative Law Judge, relying on Matter of Ross-Viking Mdse. Corp. v. Tax Appeals Tribunal (188 AD2d 698, 590 NYS2d 576) and Matter of F & W Oldsmobile v. Tax Commn. (106 AD2d 792, 484 NYS2d 188), found that petitioner's financial difficulties did not constitute reasonable cause and sustained the penalty imposed by the Division.

On exception, petitioner argues that "[t]he Division's position, that the tax is due at the time of transfer and must be paid no matter what happens subsequent to the transfer, cannot be a proper interpretation of legislative intent" (Petitioner's brief on exception, p. 6). Petitioner goes on to say that the purpose of the deferral of tax payments under Tax Law § 1442(c) is to make payment of the tax possible and "[t]he deferral has no meaning if the total tax is due even if the payments under the mortgage are not received" (Petitioner's brief on exception, p. 6). Petitioner also argues that its situation, where consideration was not received, is different from the one presented in Cheltoncort where the value of leases in determining consideration was at issue.

Petitioner also argues that in the case of installment sales where consideration is subsequently not received, the "price paid or required to be paid" should be measured by the fair market value of the consideration received and not the face value of the note (Petitioner's brief on exception, p. 9). Petitioner further argues that the gains tax should be construed like the capital gains tax where if the installments are not paid and the taxpayer takes back the property, then the tax is cancelled.

Petitioner further argues that the Division's interpretation of the statute, that is, the gains tax is collectible even though a gain was not realized, is incorrect. Petitioner contends that this would be an unconstitutional taking of property without just compensation. Petitioner next argues that the Division is incorrect in holding that petitioner's taking back of the property from Irving constituted receipt of full consideration for the purchase price. Petitioner argues that "[e]ven if the return of the property was considered a payment to the Petitioner, the value of that payment would be the value of the property at the time it was returned" (Petitioner's brief on exception, p. 11).

Petitioner also argues that it was an inappropriate exercise of the Division's discretion to accelerate the tax. Petitioner urges that its economic situation should be considered and the tax not be accelerated. Petitioner also argues that it should be allowed to resume the installment payments.

Finally, petitioner argues that penalty should not be imposed because its facts are different from those in Ross-Viking and F & W Oldsmobile. In Ross-Viking, it was argued that organizational, financial and personnel problems were grounds for reasonable cause. In F & W Oldsmobile, sales tax was not paid over which had already been collected. The facts here, asserts petitioner, are significantly different as it was not able to pay the tax because of the nonexistence of funds.

In response, the Division argues that the Administrative Law Judge correctly relied on Cheltoncort in finding that the tax was correctly calculated on the face amount of the mortgage at the time of the transfer. Further, the Division asserts that petitioner's argument, that gain

should be computed on the present value of the note, must be rejected. The Division states that this argument was considered in Matter of Normandy Assocs. (supra) where it was determined that when computing consideration the "amount" of a mortgage means the face amount of the mortgage, rather than its present value (Division's brief, pp. 7-8).

With respect to petitioner's contention that imposing a gains tax when a gain is not actually realized constitutes the unconstitutional taking of property without just compensation, the Division argues that Trump v. Chu (65 NY2d 20, 489 NYS2d 455, appeal dismissed 474 US 915) upheld the constitutionality of the gains tax. Further, the Division argues that the Tribunal's jurisdiction does not encompass challenges to the constitutionality of a tax (Matter of Wizard Corp., supra; Matter of Fourth Day Enters., supra), and at this level of administrative review, statutes are presumed to be constitutional (Division's brief, p. 8). The Division contends that tax would be due even if petitioner did not receive any consideration due to it because "the gain is based on the difference between the consideration that the petitioner was paid or had a right to be paid and the original purchase price for the property at the time of the transfer" (Division's brief, p. 9). The Division also contends that petitioner, by exercising its security interest and obtaining title to the property which was the subject of this transaction, did receive compensation in the form of that property (Division's brief, p. 9). In any event, the Division argues that petitioner would have had to remit the remaining balance of tax due in 1991 when it received the property in satisfaction of the mortgage indebtedness pursuant to section 1442.

With respect to petitioner's request to continue the installment plan, the Division argues that an installment plan may extend beyond three years only in the case of a purchase money mortgage and only for the term of that mortgage. Therefore, the Division contends that when petitioner received the property in full satisfaction of the mortgage indebtedness, the mortgage was discharged and ceased to exist. The Division states that "[w]ith no mortgage, there was no authority to continue the installment payment arrangement since it already had been in effect for more than the three year maximum limit" (Division's brief, pp. 10-11).

The Division also argues, relying on Matter of Schoonover (Tax Appeals Tribunal, August 15, 1991), that the appraisal of the property at issue, which petitioner appended to its brief, should not be allowed into evidence.

The Division also argues that petitioner's analogy of the real property gains tax to the capital gains tax on income is inappropriate. The Division, relying on Matter of SKS Associates (Tax Appeals Tribunal, September 12, 1991), asserts that "the real property transfer gains tax is different from the capital gains tax and there is no authority that requires that they be computed similarly" (Division's brief, p. 14).

Lastly, the Division argues that petitioner has not met its burden of proof to demonstrate that its failure to pay the gains tax was due to reasonable cause and not willful neglect.

In its reply brief, petitioner argues that the Division has misconstrued its argument with respect to the constitutionality of the application of the statute. Petitioner asserts that it is not arguing that the statute is unconstitutional but that the Division is applying the statute in an unconstitutional manner; therefore, whether the Tax Appeals Tribunal has jurisdiction to address the constitutionality of a statute is not relevant here.

Petitioner also continues to argue that the Administrative Law Judge's finding, that inability to pay the tax is not reasonable cause for failure to pay, must be overturned.

While we agree with the Division that we do not have the authority to rule on the facial constitutionality of a statute, we agree with petitioner that the matter here involves the jurisdiction of the Tax Appeals Tribunal to rule on whether the Division has applied the statute in a constitutional manner. As we stated in Matter of New Milford Tractor Co. (Tax Appeals Tribunal, September 1, 1994), "the hallmark of a question of the constitutionality of a statute as applied is that it depends for its resolution on specific facts, while the question of the facial constitutionality of a statute does not." However, petitioner has not directed us to any specific authority for its proposition that the statute has been unconstitutionally applied and we are not aware of any such authority for petitioner's proposition. Therefore, we are not able to rule in petitioner's favor.

We deal next with whether the appraisal should be accepted into evidence. We agree with the Division that a brief is not the proper place for the introduction of evidence into the record. As we stated in Matter of Schoonover (Tax Appeals Tribunal, August 15, 1991):

> "In order to maintain a fair and efficient hearing system, it is essential that the hearing process be both defined and final. If the parties are able to submit additional evidence after the record is closed, there is neither definition nor finality to the hearing. Further, the submission of evidence after the closing of the record denies the adversary the right to question the evidence on the record. For these reasons we must follow our policy of not allowing the submission of evidence after the closing of the record (see, Matter of Oggi Rest., Tax Appeals Tribunal, November 30, 1990; Matter of Morgan Guar. Trust Co. of N.Y., Tax Appeals Tribunal, May 10, 1990; Matter of International Ore & Fertilizer Corp., Tax Appeals Tribunal, March 1, 1990; Matter of Ronnie's Suburban Inn, Tax Appeals Tribunal, May 11, 1989; Matter of Modern Refractories, Tax Appeals Tribunal, December 15, 1988).

We deal next with the issue of whether penalty should be abated. Petitioner was allowed to defer payment of the tax because it did not receive any cash consideration from Irving at the time of the transfer. In addition, petitioner had no income other than the mortgage payments from Irving and was dependent upon the mortgage payments from Irving to make the installment payments. When petitioner failed to make the installment payment due on December 31, 1990, this failure was the direct result of petitioner's not receiving a mortgage payment from Irving. We find this failure was due to reasonable cause and not due to willful neglect.

In addition, we find that F & W Oldsmobile can be distinguished from the matter before us as the nature of the gains tax is different from that of the sales tax, that is, no tax is collected and held in trust for the government. The economic difficulties of the taxpayer in F & W Oldsmobile did not constitute reasonable cause where the taxpayer failed to timely pay over sales and use taxes which it had already collected.

Comparing Ross-Viking to the instant matter, we find that the facts can also be distinguished. In Ross-Viking, the petitioner argued, among other things, that financial and managerial difficulties excused its late filing and late payment of franchise taxes. However, in that case, there was insufficient evidence in the record showing that these problems contributed

to the delay. As stated above, petitioner's failure to make an installment payment was the immediate result of not receiving a mortgage payment from Irving.

In view of the above, we reverse the Administrative Law Judge on this issue and find that reasonable cause exists for the abatement of penalty. All of the remaining issues were completely and accurately addressed by the Administrative Law Judge. Therefore, we affirm the determination of the Administrative Law Judge with respect to these issues for the reasons stated in said determination.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Fazkap Associates is granted to the extent that penalty is cancelled;

2. The determination of the Administrative Law Judge is modified as indicated in paragraph "1" above, but except as so modified is in all other respects affirmed;

3. The petition of Fazkap Associates is granted to the extent indicated in paragraph "1" above, but except as so granted is in all other respects denied; and

4. The Notice of Determination, dated May 6, 1991, as modified in accordance with paragraph "1" above, is sustained.

DATED: Troy, New York
October 6, 1994

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

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