STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
MONTCLAIR SPONSOR CORPORATION	:	DECISION DTA NO. 815551
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 Montclair Sponsor Corporation, c/o Millennium III Real Estate, 228 East 45th Street, 18th Floor, New York, New York 10017-3317, filed an exception to the determination of the Administrative Law Judge issued on January 28, 1999. Petitioner appeared by Margolin, Winer & Evens LLP (Wayne M. Olson, Esq., of counsel). The Division of Taxation appeared by Terrence M. Boyle, Esq. (Michael J. Glannon, Esq., of counsel).

Petitioner and the Division of Taxation relied on their briefs filed below. Oral argument was not requested.

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

ISSUES

I. Whether the Division of Taxation timely issued the Notice of Determination in this matter.

II. Whether the Division of Taxation properly disallowed, in the computation of original purchase price, certain costs which petitioner contends were acquisition costs or costs of capital improvements.

III. Whether a settlement payment made by petitioner to resolve litigation with the condominium association is properly included in the computation of original purchase price for purposes of applying the real property transfer gains tax.

IV. Whether legal fees associated with petitioner's litigation with the condominium association are properly included in the computation of original purchase price for purposes of applying the real property transfer gains tax.

V. Whether the Division of Taxation properly computed the interest due on any unpaid gains tax determined to be due.

VI. Whether the penalty imposed pursuant to Tax Law § 1446 should be abated.

FINDINGS OF FACT

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

On March 27, 1995, the Division of Taxation ("Division") issued to petitioner, Montclair Sponsor Corporation, a Notice of Determination assessing additional tax due under Article 31-B of the Tax Law ("gains tax") in the amount of $148,755.00, plus penalty and interest. The Notice of Determination was based upon a field audit pertaining to property located at Alpine Drive, Wappingers Falls, New York.

Petitioner is the sponsor of a plan to convert property located at Montclair Townhouses, Alpine Drive, Wappingers Falls, New York (the "property") to condominium ownership. The

property consists of 37 buildings containing 296 residential apartment units, a pool house, sewer plant, water shed, and maintenance garage. As sponsor, petitioner offered for sale as condominium units all 296 residential apartment units along with each unit's undivided percentage interest in the common elements at the property.

Petitioner acquired the property from Fishkill-Montclair Associates, a limited partnership, which transfer qualified as a partial "mere change of identity or form of ownership."[1] The original purchase price ("OPP") reported by petitioner and accepted by the Division was $8,771,369.00, the calculation of which follows:

Purchase Price- Land and Building	$6,700,000
Other Acquisition Costs	296,848
Real Property Capital Improvements Costs	723,859
	$7,720,707
"Taxable" Gain from Transfer	1,050,662
Total Purchase Price Paid to Acquire Real Property	$8,771,369

The shareholders of petitioner are Herbert Somekh, Raymond Bernstein, Harold Bernstein, Jay Bernstein, Gene Bernstein, Donita Williams, Gerard Cerchio, Tony Providenti, Milton Askinas, Arthur Zelniker and Andrew Garr.

The offering plan, an eviction plan, became effective July 23, 1987. The record only includes 27 pages of the offering plan, and the condominium offering plan's second amendment dated July 23, 1987.

Review of the offering plan's table of contents reveals that sections H, I, J and K discuss the rights of tenants, including "eligible senior citizens and eligible disabled person," interim

[1]The exact date of the transfer is not part of the record. The record also does not include any documents related to that transfer.

leases, as well as the obligations of unit owners occupied by nonpurchasing tenants. None of these sections are part of the record. According to the section entitled "Special Risks" (page iv of the offering plan), a nonpurchasing tenant could be evicted at the expiration of his lease and did not have any right to an extension of the term of his lease or any right to remain in possession of his apartment subsequent to the expiration of his lease.

The offering plan's table of contents also contains sections concerning unit closing costs and adjustments (section P), rights and obligations of the sponsor (section Q), management and other contractual agreements (section Z) and sponsor's profit (section Z-2). None of these sections are part of the record.

Both the cover page and page 108 of the offering plan list the selling agents as "Innovative Properties Corp." ("Innovative") and "Robert-Mark Realty Inc. and Robert-Mark Agency Inc." ("RM Agency"). According to the offering plan, the RM Agency, an institutional broker, has extensive experience in the marketing of condominium units. It described Innovative as "a licensed real estate broker in the State of New York" whose shareholders are Herbert Somekh and Andrew Garr.

The record includes a copy of the brokerage agreement between petitioner and the RM Agency. Pursuant to the RM Agency agreement, petitioner retained the RM Agency as agent to sell 246 ("selling agent units") of the 296 units. However, the RM Agency was not authorized to sell the remaining 50 units ("sponsor units"). The RM Agency was to receive commissions equal to: (a) 4% of the gross sales price of each selling agent unit sold ("commission") and (b) 1½% of the gross sales price of each sponsor unit sold ("total commission"). The brokerage agreement also stated that the RM Agency was to be the exclusive sales agent with respect to the selling

agent's units except that petitioner could also designate Innovative as an additional sales agent. However, even if Innovative brought about any sale, the RM Agency was still entitled to receive the full commission and added commission, as applicable. Petitioner was to pay any commission due and owing Innovative. The record does not include a copy of any brokerage agreement which may have existed between petitioner and Innovative.

By mid 1989, 295 units had been sold and transferred.[2]

On November 16, 1989 and December 26, 1989, the Division requested petitioner to file a complete project update for the property.

On or about May 1, 1990, petitioner filed transferor questionnaires, forms DTF-700 (9/85), DTF-701 (6/85) and DTF-703 (6/85), with attachments, including a schedule of gains tax paid by unit, for the project update.[3] According to the project update documents, 295 units were sold having 99.56306% of the common interest. In the update filing, petitioner reported total anticipated gross consideration in the amount of $18,974,832.00 (consisting of $18,888,086.00 in actual consideration and $86,746.00 in estimated additional consideration). Petitioner computed the total anticipated gross consideration "using the actual selling prices for units for which contracts of sale have been executed and 'safe harbor' estimate for the unsold unit (i.e., 100% of selling prices set forth in the Offering Plan)." Petitioner reported total anticipated brokerage fees of $1,609,368.00 (consisting of $1,602,456.00 of actual to date and $6,912.00 of estimated additional) broken down as follows: $858,148.00 to RM Agency and $751,220.00 to Innovative. It reported total anticipated OPP in the amount of $10,062,550.00, composed of: (A) Capital

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[2]The 295th unit was sold on or about June 7, 1989 .

[3]The accompanying cover letter specifically refers to the filing as a "Project Update."

improvements totaling $305,325.00 which consisted of: architectural fees of $5,161.00; construction material of $19,500.00; consideration paid to contractors to make capital improvements of $165,791.00; built-in appliances of $10,801.00; landscaping and site planning of $1,600.00; initial painting of new buildings, structures, or additions of $47,355.00; appraisal fees of $500.00 and additional capital improvements (i.e., carpentry, electrical, plumbing, tile, carpeting and windows) in the total amount of $54,617.00. (B) Conversion costs totaling $981,411.00 consisting of legal, accounting and engineering fees of $156,290.00; filing and recording fees of $5,860.00; offering plan printing expenses of $24,261.00 and developer's fee of $795,000.00. (C) Total anticipated allowable selling expenses (legal) of $4,445.00 (consisting of $4,195.00 actual to date and $250.00 estimated additional). The project update reported a total anticipated gain subject to tax in the amount of $7,302,914.00.

At some point in 1989, the Board of Managers of Montclair Townhouse Condominium commenced an action against petitioner, Innovative, the architect and 13 individuals. Sometime in 1990, Millennium III Real Estate Corporation commenced an action for breach of a management agreement against the Montclair Townhouse Association and the five members of the condominium association board of managers. The record does not include copies of the complaints filed in either of these matters.

On March 12, 1992, the parties to both actions, "to avoid the expense and continuation of litigation and without acknowledging liability of any party," entered into a "Settlement and Release Agreement" ("agreement"). Under the terms of the agreement, petitioner agreed to pay to the condominium board of managers the sum or value of $108,000.00 "in full satisfaction of all claims, payable as follows:" the sale of unit #14A, at the property, at a sale price of

$90,000.00 and upon acceptance of the deed to unit #14A, the payment of $18,000.00. According to paragraph 1 of the agreement, the agreement constituted a contract of sale for unit #14A.

Prior to the anticipated date of transfer of unit #14A, April 30, 1992, the required transferee questionnaire was filed. On this questionnaire, the transferee is listed as The Board of Managers of Montclair Townhouse Condominium, the transferor is listed as Fishkill-Montclair Associates and the consideration to be paid for unit #14A is $90,000.00. While not part of the record, it appears that petitioner also filed the required transferor questionnaire. On April 28, 1992, the Division issued to petitioner a Form TP-582 "Tentative Assessment and Return" for the unit reporting the tentative assessment of tax due in the amount of $3,198.63.

After a field audit, the Division issued a Statement of Proposed Audit Adjustment ("statement") dated February 13, 1995 against petitioner asserting real property transfer gains tax due of $148,755.00, for various transfers. This amount of gains tax asserted due was based upon the Division's calculation of a total gains tax due of $885,295.00 less prior payments of $736,540.00, for a balance due of $148,755.00, plus interest (from October 15, 1989 through March 13, 1995) in the amount of $92,683.00 and a 10% penalty in the amount of $14,875.00.

Attached to the Statement of Proposed Audit Adjustment is the auditor's computation of the gains tax due and supporting schedules of proposed adjustments. The auditor determined anticipated gain to be $8,852,947.00, by subtracting a total of $10,167,999.00 (consisting of Reserve Fund of $30,000.00; Working Fund of $10,000.00; Brokerage fees of $1,041,202.00 and OPP in the amount of $9,086,797.00) from actual consideration of $19,020,946.00.

The auditor's computation was based upon adjustments to brokerage fee, capital improvements and conversion costs. According to the statement's supporting brokerage schedule, using a commission rate of 5.5%, per the RM Agency agreement, for all sales except the last unit's transfer, "as it was transferred as a result of a lawsuit," the auditor allowed brokerage fees totaling $1,041,202.00 ([19,020,946.00 – 90,000.00] x .055 = $1,041,202.00). This schedule also contains a notation that, on audit, petitioner claimed only $1,562,008.00 in brokerage fees. Review of the capital improvements schedule reveals that, of $305,325.00 in total capital improvements claimed on audit, the auditor disallowed $143,771.00, composed of $132,970.00 in consideration to contractors and $10,801.00 for built-in appliances. The disallowed figure represented amounts claimed for "lost rents, furniture & fixtures and appliances." Of the $981,411.00 in conversion costs claimed on audit, the auditor allowed only $149,429.00. She disallowed $36,982.00 of "refinancing, accounting & litigation fees" and an unsubstantiated developer's fee in the amount of $795,000.00.

On March 11, 1995, petitioner's representative sent a letter to the auditor stating that petitioner disagreed with all of the proposed audit adjustments including the computation of interest and the imposition of a penalty and requested a conference. In the same letter, petitioner claimed that the $108,000.00 litigation settlement should be included in OPP as a "cost to create ownership interests in . . . condominium form." It also claimed additional legal fees of $9,500.00 "relating to the settlement and transfer of the last condominium unit."

Petitioner did not receive a response to its March 11, 1995 letter, nor was the requested conference ever held. As noted above, on March 27, 1995 the Division issued the Notice of Determination asserting additional gains tax due, plus interest and penalty.

In its request for conciliation conference, petitioner disagreed with the audit adjustments which resulted in the additional tax, interest and penalty asserted in the Notice of Determination. It also claimed that the $108,000.00 settlement with the condominium association and an additional $9,500.00 in legal fees relating to the settlement are includible in OPP. Petitioner also claimed that the statute of limitations had expired on either June 7, 1992, or, in the alternative, no later than May 1, 1993, long before the Notice of Determination was issued in this matter. After a conciliation conference, the conferee issued a Conciliation Order (CMS No. 148436), dated September 13, 1996, sustaining the Notice of Determination.

In its petition, petitioner asserts that the Division made the following errors, among others in its computation of gain: (1) arbitrarily computed brokerage fees; (2) improperly excluded the following amounts from OPP: "consideration paid to contractors" in the amount of $132,970.00; the entire cost of new built-in appliances in the amount of $10,801.00; legal, accounting and engineering fees in the amount of $36,982.00; and developer and supervisory fees in the amount of $795,000.00; (3) failed to include the "$108,000 of 'settlement payments' made to the condominium association in order to resolve certain claims by the association relating to improvements to the property" in OPP; (4) improperly used October 15, 1989 as the starting date for the computation of interest on any additional gains tax due; (5) assessed penalties which are not applicable in this matter. In the alternative failed to abate the penalties for "reasonable cause"; and (6) issued the Notice of Determination after the statute of limitations had expired.

The record includes invoices from two law firms. The first is an invoice dated August 30, 1989 from petitioner's New York City law firm which shows a total balance due in the amount

of $25,342.66 for professional services rendered in connection with "Millennium/Montclair Litigation." This invoice reflects balances from prior statements totaling $25,194.66. The second is an invoice dated June 1, 1992 from a New Paltz law firm for professional services rendered with respect to "Millennium III Real Estate Corp. v. Montclair Townhouse Condo." and "Board of Managers of Montclair Townhouse Condo. v. Montclair Sponsor Corp., *et al*." The legal fee of $9,500.00 was for

> [a]ll services rendered, including Court attendance, review of Offering Plan, preparation of pleadings, preparation of Demand for Bill of Particulars, conduct extensive settlement negotiations, preparation of RJI and Trial Term Note of Issue, motion practice, agreement, preparation of deed and attendance at closing of title, all correspondence and telephone communications (including telefax) with client and opposing counsel.

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THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge first decided that the Notice of Determination was not barred by the statute of limitations set forth in Tax Law former § 1444(3)(a).[4] Petitioner argued (a) that the last sale pursuant to the offering plan took place on June 7, 1989 and that it never planned on selling the lone remaining unit; (b) that the offering plan had become stale; (c) that the final project update was filed on May 1, 1990; and (d) that the transfer of the unit was pursuant to a litigation settlement on an earlier date and should not be considered a transfer for purposes of determining the three-year assessment period.

The Administrative Law Judge determined that the gains tax was imposed on the overall plan, not the sale of individual units pursuant to the plan (***see***, ***Mayblum v. Chu,*** 67 NY2d 1008,

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[4]The real property transfer gains tax imposed by Article 31-B of the Tax Law was repealed on July 13, 1996. The repeal applies to transfers of real property that occur on or after June 15, 1996 (***see,*** L 1996, ch 309, §§ 171-180).

503 NYS2d 316; ***Matter of 1230 Park Assocs. v. Commissioner of Taxation & Fin. of State of New York,*** 170 AD2d 842, 566 NYS2d 957, ***lv denied*** 78 NY2d 859, 575 NYS2d 455). The Administrative Law Judge reasoned that the plan offered all 296 units for sale since petitioner filed no amendment limiting the number of units to be sold or notice of abandonment of the plan with the Attorney General (***see***, 13 NYCRR 23.1[n][2]). The Administrative Law Judge found further support for her conclusion in the fact that the May 1, 1990 project update computed anticipated gross consideration on the actual selling prices for the 295 sold units and the "safe harbor" estimate for the unsold one.

The Administrative Law Judge rejected petitioner's argument that the litigation settlement agreement should not be considered a transfer, given the language in the agreement which stated that it constituted a contract of sale for the unit and called for the transfer of the unit to the Board of Managers along with $18,000.00. Nothing in the by-laws restricted ownership and occupancy of units (***see***, Real Property Law § 339-v[2][a],[c]). Since it was determined that the transfer of the unit was made pursuant to the plan on April 30, 1992, the Division's notice was timely issued on March 25, 1995.

The Administrative Law Judge noted the provision of Tax Law former § 1440(1)(a) which defined consideration as the amount paid or required to be paid for an interest in real property less customary brokerage fees related to the transfer if paid by the transferor. The Administrative Law Judge then painstakingly reviewed the definitions of "gain" and "original purchase price" ("OPP") in the Tax Law (Tax Law former §§ 1440[3] and 1440[5][a]) and the regulations promulgated thereunder (20 NYCRR former 590.15, former 590.16, former 590.17 and former 590.39). Specifically, the Administrative Law Judge considered which preacquisition and

acquisition costs and capital improvements may be included in the computations of OPP and found that only the brokerage fees paid pursuant to the RM Agency agreement were proper since there was no evidence in the record with regard to brokerage fees paid to Innovative.

With regard to petitioner's claimed expenses for lost rents, furniture and fixtures for the models, the Administrative Law Judge found that there was no documentary substantiation or explanation of these expenditures other than in petitioner's brief. Without further proof, the Administrative Law Judge denied the claimed expenses (***see***, ***Matter of V & V Properties***, Tax Appeals Tribunal, July 16, 1992). Likewise, the Administrative Law Judge denied the claimed expense for appliances since there was no evidence of the type of appliance or their manner of affixation to the property. While built-in appliances may be included in OPP as a capital improvement (20 NYCRR former 590.16), petitioner has provided no evidence that its expenditures fall within the definition in the regulation.

The $5,490.00 in legal expenses claimed with respect to refinancing was also rejected by the Administrative Law Judge based on the fact that the only explanation of the expense appeared in petitioner's brief, and there was no proof that the expenses were allowable (***see***, ***Matter of V & V Properties***, ***supra***). Similarly, the Administrative Law Judge denied the claimed developer and supervisory fee of $795,000.00 because there was no evidence to demonstrate what services were provided for the fee.

The Administrative Law Judge rejected petitioner's claim that its expenditure of $108,000.00 to settle litigation with the condominium association was properly included in OPP as a cost of creating ownership interests in condominium form because the Administrative Law Judge found the payments represented settlement of two lawsuits to avoid additional litigation

costs. The character of a settlement payment is best determined by looking at the litigation documents (***Raytheon Prod. Corp. v. Commissioner***, 144 F2d 110, 44-2 USTC ¶ 9424, ***cert denied*** 323 US 779, 89 L Ed 622; ***Matter of Harkness Co.***, Tax Appeals Tribunal, May 16, 1991). The only litigation document in evidence states that the settlement was entered into by the parties to avoid the expense of continued litigation and there was no mention of creating an ownership interest in property. Relative to this disposition, the legal fees attendant to the litigation with the condominium association were not includible in OPP since they were determined to be for litigation and not the sale of the property (***Matter of Benacquista, Polsinelli & Serafini Mgt. Corp. v. Commissioner of Taxation & Fin. of State of New York,*** 191 AD2d 80, 598 NYS2d 829). Although one invoice indicated the preparation of a deed for unit # 14A and attendance at a closing for that unit, there was no breakdown of the total fee, making it impossible to determine what portion should have been apportioned to the transfer of the unit. For this failure of proof, the entire fee was disallowed (***see***, 20 NYCRR 3000.15[d][5]; ***Matter of V & V Properties***, ***supra***).

The Administrative Law Judge determined that the Division correctly calculated the interest and penalty due pursuant to the Division's guidelines set forth in the Technical Services Bureau Memorandum 86(3)(R). Therein it states:

> Penalty and interest may accrue during the Sell Out Period, however, for the underpayment of Gains Tax resulting from the understatement of any other component of the Plan Consideration or the overstatement of original purchase price (TSB-M-[86][3][R]).

Since it was concluded that petitioner's underpayment of tax was the result of its overstatement of OPP and/or understatement of consideration, the penalty and interest were properly calculated.

The Administrative Law Judge, in reliance on ***Matter of Auerbach v. State Tax Commn.*** (Sup Ct, Albany County, July 7, 1987, Williams, J., ***affd*** 142 AD2d 390, 536 NYS2d 557), upheld the assessment of penalty. The Administrative Law Judge rejected the taxpayer's contention that abatement of penalty was justified herein because any failure on its part to pay the gains tax was based on well-reasoned conclusions that the transfers were properly reported. However, seeking relief based upon having adopted an interpretation of the Tax Law different than the Division is not considered reasonable cause (***Matter of Auerbach v. State Tax Commn.***, ***supra***) and the penalty was sustained.

ARGUMENTS ON EXCEPTION

On exception, petitioner raises no new arguments in support of its exception and relies on its brief and reply brief it submitted to the Administrative Law Judge. The Division of Taxation also relies on its brief previously submitted to the Administrative Law Judge and the determination issued below.

Since we have summarized the arguments made to the Administrative Law Judge above, we will not repeat them here.

OPINION

Each of the arguments raised by petitioner on exception were raised before the Administrative Law Judge as well. We find that the Administrative Law Judge completely and

adequately considered and addressed those arguments, and we affirm the determination in its entirety based upon the reasoning and conclusions set forth therein.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Montclair Sponsor Corporation is denied;

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

3. The petition of Montclair Sponsor Corporation is denied; and

4. The Notice of Determination, dated March 27, 1995, is sustained.

DATED: Troy, New York
December 9, 1999

/s/Donald C. DeWitt
Donald C. DeWitt
President

/s/Carroll R. Jenkins
Carroll R. Jenkins
Commissioner

/s/Joseph W. Pinto, Jr.
Joseph W. Pinto, Jr.
Commissioner