STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
RIVER TERRACE ASSOCIATES	:	DETERMINATION DTA NO. 807404
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, River Terrace Associates, c/o Blundon Thylan Associates, 369 Lexington Avenue, New York, New York 10017, filed a petition 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.

A hearing was held before Joseph W. Pinto, Jr., Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on December 13, 1990 at 10:45 A.M. Petitioner filed its brief on April 10, 1991 and the Division of Taxation filed its brief on May 21, 1991. Petitioner appeared by Allen Greenberg, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Michael J. Glannon, Esq., of counsel).

ISSUES

I. Whether petitioner correctly calculated its consideration using the value of a mortgage rather than the stated face amount.

II. Whether reasonable cause exists to abate or waive the penalty and interest imposed by the Division of Taxation for petitioner's failure to pay the additional real property gains tax due on subsequent sales of stock in the cooperative corporation in a timely manner.

FINDINGS OF FACT

In April of 1982 petitioner, River Terrace Associates, a limited partnership formed under New York law, purchased a two-story building containing 103 rental apartments and one superintendent's apartment located at 150 Rinaldi Boulevard, Poughkeepsie, New York, for $1,700,000.00.

In 1983, petitioner engaged the law firm of Phillips, Nizer, Benjamin, Krim & Ballon to file necessary and appropriate papers with the New York State Department of Law for the cooperative conversion of the apartment house under the sponsorship of petitioner. Petitioner caused the Hudson Terrace Owners Corporation ("Owners Corp.") to be organized and petitioner entered into a contract to sell the apartment house to Owners Corp. under a plan of cooperative conversion to be filed with the Attorney General's office.

Petitioner made capital improvements to the property in preparation for its sale to Owners Corp.

About the time when petitioner thought it was to receive final approval of the offering plan, petitioner approached various financial institutions in an attempt to determine the cash realizable on the sale of the purchase money mortgage it knew it would have to take back from Owners Corp. in partial satisfaction of the selling price. The Connecticut Bank and Trust Company, N.A., by letter dated July 26, 1984, advised petitioner that it would not consider purchasing the 2 million dollar first mortgage from River Terrace Associates for more than $1,158,242.00.

Pursuant to an offering plan of cooperative organization (the "plan"), petitioner sold the apartment house on August 17, 1984, to Owners Corp. for an expressed purchase price of $6,302,223.50.

Pursuant to the plan, a total of 14,000 shares of the Cooperative Corporation's capital stock was allocated to and among the 103 stockholder apartments.

At the closing of title on August 17, 1984, Owners Corp. issued shares of its capital stock and proprietary leases to 19 individuals who purchased apartments in consideration of

$783,880.50 cash to Owners Corp. Owners Corp. paid the $783,880.50 to petitioner in part payment of the purchase price. Owners Corp. issued the remaining shares of its capital stock allocated to the 84 unsold apartments to petitioner at the aggregate offering price listed in the plan of $3,518,343.00, in further part payment of the purchase price.

On August 17, 1984, the subject property at 150 Rinaldi Boulevard, Poughkeepsie, New York, was subject to a first and second mortgage indebtedness in the unpaid principal amount of $1,123,826.82. Owners Corp. purchased the apartment house subject to this existing indebtedness.

In payment of the $876,173.18 balance of the purchase price, Owners Corp. delivered to petitioner its third mortgage.

Petitioner purchased the first and second mortgages from the holders thereof and consolidated these two preexisting mortgages with its third mortgage into one mortgage securing the principal sum of $2,000,000.00. The consolidated mortgage was due and payable on August 17, 1994. Interest on the consolidated mortgage was payable at the rate of 8% per annum, or $13,333.33 per month. The three mortgages were consolidated pursuant to a consolidation, modification and extension agreement, dated August 17, 1984, executed by officers of Hudson Terrace Owners Corp. and River Terrace Associates.

Prior to the date of the closing of sale by petitioner to Owners Corp., petitioner, through its attorneys, filed with the Division of Taxation a Gains Tax Transferor Questionnaire, Form TP-580, and Tentative Assessment and Return, Form TP-582.

On August 17, 1984, the date of closing, petitioner remitted a certified check to the New York State Department of Taxation and Finance in the sum of $19,021.30 in payment of real property gains tax on the 17 units which had closed as of August 17, 1984.

Next to the signature on the face of said check, was the handwritten notation "paid under protest." On the reverse side of said check, the following handwritten notation appeared:

> "Paid under protest
> the payer reserving all rights inuring to its benefit as a result of any pending and/or future matters attacking the right of the State of New York to collect such proceeds."

In Schedule 3 attached to the paper submitted to the Division of Taxation with the $19,021.20 check referred to in Finding of Fact "12" above, petitioner noted that it had added to its anticipated costs in connection with the cooperative conversion, an $843,000.00 reduction in the aggregate proceeds it would receive from the sale of the Owners Corp. stock by reason of the discount it would have to take on a sale of the mortgage. Petitioner computed the $843,000.00 reduction by comparing the Connecticut Bank's evaluation of approximately 1.158 million dollars against the two million dollar mortgage principal sum.

Subsequent to August 17, 1984, and from time to time thereafter, petitioner sold the shares in remaining units at prices which at times were discounted at 20% of the offering prices listed in the plan.

On November 7, 1985, petitioner caused to be prepared revised computerized schedules estimating the real property gains tax due on the sale of the cooperative shares. The anticipated consideration for the project was computed with deductions for expenditures remaining to be incurred for cooperative conversion plan costs. The consolidated mortgage was discounted at 50% to one million dollars to arrive at its anticipated selling price. The estimated gains tax payable was computed to be $15,989.00, an amount less than the $19,021.30 paid to the Division with the first filing on August 17, 1984.

On June 27, 1986, petitioner sold the consolidated mortgage to Eastern Savings Bank, a federally chartered savings bank, pursuant to a whole loan sale and purchase agreement dated June 27, 1986 for the sum of $1,410,000.00.

During the year 1986, the Division conducted an audit of petitioner with regard to the cooperative conversion in issue. During the course of the audit, various schedules were prepared, including one in which "actual" and "anticipated" consideration was broken down. The anticipated consideration was the estimated consideration on sell-out after deduction of all pre-August 17, 1984 and post-August 17, 1984 plan conversion expenses. The Division valued the consolidated mortgage at 2 million dollars in arriving at the total anticipated gain, making no allowance for the discount of $590,000.00 incurred on the actual sale of the mortgage to

Eastern Savings Bank.

The Division issued a Statement of Proposed Audit to petitioner on September 5, 1986, indicating gains tax due in the sum of $251,893.10, penalty of $65,492.00 and interest of $19,554.00, for a total amount due of $336,940.00.

Petitioner remitted an aggregate of $251,894.00 in additional real property gains tax to the Division by three checks, to wit:

Date of Checks	Amount
September 22, 1986	$100,000.00
September 29, 1986	75,000.00
September 26, 1989	76,894.00
Total	$251,894.00

On September 26, 1989, petitioner submitted a claim for refund of real property transfer gains tax in the sum of $59,000.00 and also sought an abatement of penalty and interest. Said claim for refund in the sum of $59,000.00 was based upon petitioner's contention that the face amount of the consolidated mortgage was improperly used by the Division in its calculation of anticipated gain under the cooperative plan, rather than the actual market value of the loan.

At hearing, an expert witness, Alfred Schimmel, a real estate appraiser and economic consultant, testified that, in his opinion, the fair market valuation of the consolidated mortgage calling for the payment of two million dollars on August 17, 1994 and bearing an interest rate of 8% payable monthly, was $1,276,837.00. Mr. Schimmel explained that in August of 1984, the prime interest rate was 13% and that the United States was in an inflationary period. He stated that 10-year United States Treasury bonds, which had complete safety, yielded 12.83%, municipal grade A tax-exempt bonds yielded 10.03% and corporate, A-rated bonds yielded 13.38%. In view of these competing alternatives, investment sources and the risks involved in real estate mortgages, Mr. Schimmel testified that a holder of the consolidated mortgage would want to receive a 15% return on its investment. Discounting at 15% the right to receive $13,333.33 interest per month for 120 months and 2 million dollars at the end of 120 months, gave a present fair market value of $1,276,837.00 to the consolidated mortgage on August 17,

1984. In fact, the consolidated mortgage sold at a 14.25% discount rate, or $1,410,000.00, in 1986 because interest rates were lower in 1986 and there was a shorter time to maturity.

Following disagreement with the basic tax, penalties and interest assessed pursuant to the Statement of Proposed Audit on September 5, 1986, the Division issued to River Terrace Associates a Notice of Determination of Tax Due under Gains Tax Law, dated January 29, 1988, setting forth real property gains tax due in the amount of $270,915.00, penalty of $72,413.00 and interest of $29,586.00 for a total amount due of $372,914.00. The Notice of Determination indicated that $194,021.00 had been paid leaving a balance due of $178,893.00. It appears that penalty and interest were also assessed on tax paid on date of closing (see Finding of Fact "15").

SUMMARY OF PETITIONER'S POSITION

Petitioner contends that its gain is the net profit realized from the sales of the cooperative shares. In computing said net profit, the $590,000.00 reduction it suffered on the sale of the consolidated mortgage should be added to the original purchase price. Petitioner reasons that since the gains tax is payable upon the transfer of the shares pursuant to a plan of cooperative conversion, and not on the initial date of transfer or closing date, the events which occurred subsequent to the petitioner's/ sponsor's transfer of the apartment house to the cooperative housing corporation should be taken into consideration when calculating the anticipated gain. As petitioner argued in its brief, when 100% of the shares are sold, the sponsor should have paid the gains tax on what money and property it actually ended up with from selling the shares pursuant to the cooperative plan. Therefore, the computation of its gain from the sale of the shares over time should take into account the fact that it both sold the cooperative shares for less than the offering plan price and that only $1,410,000.00 was realized on the sale of the consolidated mortgage.

Petitioner also argues that it was the objective of the regulations that all customary reasonable and necessary costs related to the acquisition and improvement of real property are included in the original purchase price so that the tax would only be imposed on net profit.

Petitioner contends that the loss it incurred in selling the consolidated mortgage, should be considered a necessary expense incurred to create ownership interest in property in cooperative form.

Petitioner also argues that the Division acknowledged the discounts offered by the sponsor in the sale of the cooperative shares and adjusted the anticipated consideration accordingly, but refused to do so with regard to the discount applicable to the consolidated mortgage. Petitioner argues in the alternative that the $590,000.00 loss on the sale of the consolidated mortgage can be equated with points paid to a lender or a "buy-down" of the interest rate that the cooperative purchaser is obligated to pay in monthly maintenance. Since the regulation at 20 NYCRR 590.39, which lists various costs that are includible in the original purchase price, is nonexclusive, petitioner argues that the loss it suffered on the sale of the consolidated mortgage was such a cost includible under the terms of the regulation.

Petitioner further contends that Matter of Normandy Associates (Tax Appeals Tribunal, March 23, 1989) should not be controlling in this case since in Normandy the taxpayer did not introduce expert testimony on the market value of the underlying note and the taxpayer did not in fact sell the note during the course of effecting the sales of the cooperative stock. Further, in Normandy the taxpayer did not argue that the reduction in value was part of the original purchase price.

Petitioner also argues that penalty and interest should be abated because reasonable cause exists to do so. Petitioner argues that it acted reasonably in trying to comply with the required filings.

SUMMARY OF THE DIVISION OF TAXATION'S POSITION

The Division of Taxation argues that Tax Law § 1441(a) requires that the face value of the mortgage be included as consideration, citing Matter of Normandy Associates (supra) and Matter of Festival Leasehold (Tax Appeals Tribunal, January 20, 1989). The Division argues that the discounting of the mortgage was not a necessary expense to create cooperative ownership interest, only a way to raise needed cash. The Division also points out that petitioner

had received 22 monthly interest payments of $13,333.33 prior to the sale of the mortgage on June 27, 1986, and that petitioner did not offset its claimed mortgage discount by the interest payments received.

The Division also opposes the abatement of interest and penalties since petitioner clearly did not make timely payment of the gains tax due.

Finally, petitioner never requested direction from the Division of Taxation regarding reporting requirements or the proper valuation of the mortgage, a failure which led directly to petitioner's gains tax liability. Petitioner's actions were also taken subsequent to the release of Publication 588, and the Division's memorandum, TSB-M-83(2)R, concerning the issue of mortgage valuation.

CONCLUSIONS OF LAW

A. Tax Law § 1441 imposes a tax at the rate of 10% upon gains derived from the transfer of real property within the State. The term "gain" is defined in Tax Law § 1440(3) 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."

B. Tax Law § 1440(former [1]), in effect at the time of the closing herein, defined "consideration" as follows:

> "'Consideration' means the price paid or required to be paid for real property or any interest therein, less any customary brokerage fees related to the transfer if paid by the transferor. Consideration includes any price paid or required to be paid, whether expressed in a deed and whether paid or required to be paid by money, property, or any other thing of value and including the amount of any mortgage, lien, or other encumbrance, whether or not the underlying indebtedness is assumed, purchase money mortgage, or payment for an option." (Emphasis added.)[1]

On the date of the closing, August 17, 1984, there were no regulations in effect promulgated pursuant to the Tax Law regarding the real property gains tax. However, Publication 588, dated August 1983, was in effect and the second edition of Publication 588 was only three months away. The provision in the second Publication 588 at question number 12 read as follows:

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[1] The critical language cited has not been changed in the current Tax Law § 1440(1)(a).

"12. Purchase money mortgage.

Q. How is the consideration for the transfer of real property computed where the price paid for the interest is in the form of cash and a purchase money mortgage?

A. The consideration paid for the transfer is the sum of the cash and the face amount of the mortgage."

This question and answer contained in Publication 588 was later codified in the regulation at 20 NYCRR 590.12 (effective September 24, 1985).

Perhaps the lack of any regulations and the silence of Publication 588 to address itself to the valuation issue should have raised a red flag to

petitioner before assuming that the definition of consideration included the value of a mortgage rather than its face amount.

C. In fact, Tax Law § 1440 (former [1]) provided, in part, as follows:

"[I]n the case of (i) an option transferred with use and occupancy of real property (ii) creation of a leasehold or sublease that is a transfer of real property as defined in subdivision seven of this section, consideration shall also include the value of the rental and other payments attributable to the use and occupancy of the real property or interest therein and the value of any option to purchase or renew included in such transfer. (Emphasis added.)

With respect to leases, Publication 588, Question and Answer #16, valuation of leases in determining consideration, provided, in part, as follows:

"Q. What method will be used to value a lessor's interest in a lease subject to the gains tax?

A. The consideration paid to the lessor is the present value of the right to receive the rental payments for the term of the lease."[2]

This "Q and "A" number 16 from Publication 588 also provides for the computation of a discount rate to be used in determining present value.

D. In Matter of Normandy Associates (supra), the Tribunal, in dealing with that petitioner's assertion that a ten-year wraparound mortgage note should not have been included

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[2] Note that this "Q and A" number 16, Publication 588, was modified pursuant to TSB-M-83-(3)-R, December 13, 1983. However, the modifications have no effect on the issue in this matter.

in the consideration at its face amount, but should have, instead, been included in consideration at the value thereof, stated as follows:

> "We conclude that the Division's position that the face amount of the mortgage, rather than its value, is correct under the law. Tax Law § 1440(1)(a) provides that consideration includes 'the amount of any mortgage, purchase money mortgage, lien or other encumbrance' (emphasis added). In contrast, in the same section of the law the 'consideration' for a lease is defined to include
>
> 'the value of the rental...' (emphasis added). Since the Division's interpretation is in accord with, and gives significance to, the different terms used by the Legislature in defining consideration, we agree with the Administrative Law Judge that it is a correct interpretation."

The arguments raised by petitioner herein as to why Normandy should not apply are deemed without merit. The fact that there was no expert testimony with regard to the market valuation of the note, that the mortgage was not in fact sold during the course of sales of cooperative stock, that the petitioner in Normandy did not actually argue that the reduction in value is part of the original purchase price or that its net profit was in fact reduced, does not disturb the reasoning of Normandy wherein the Tribunal emphasized the language of the statute, i.e., "the amount of any mortgage, purchase money mortgage, lien or other encumbrance", and highlighted the "value" language applied to leases in the very same paragraph of Tax Law § 1440(1)(a).

Petitioner's other arguments are clever but not persuasive. It is true that the gains tax on transfers of cooperative shares is payable not when the sponsor transfers property to the owners corporation, but when the shares in the individual units are sold. (Mayblum v. Chu, 67 NY2d 1008, 503 NYS2d 316 [1986].) Petitioner points out that the computation of its gain from the sale of shares over a period of time took into account the fact that it sold the cooperative shares for less than the price stated in the offering plan and therefore the same notice should be taken of the actual amount realized on the sale of the consolidated mortgage, not its face amount. To accept such logic requires one to accept the loss suffered by petitioner on the sale of its consolidated mortgage as a "necessary expense".[3] Petitioner reasons that the loss it suffered on

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[3]It is noted that in Publication 588, August 1983, the word "necessary" was not included when describing allowable expenses.

the sale of the consolidated mortgage must be construed as a fee paid to a lender such as a point or "buy-down". However, nothing in the documentation produced, voluminous as it was, indicated that there was any such intent on the part of the parties involved to effect such a "buy-down" of the interest rate or that the loss suffered on the sale of the consolidation mortgage was equivalent to "points" paid to a lender.

The fact that a party incurs a loss as a result of economic conditions or in order to raise cash does not dictate a different interpretation of Tax Law § 1440(1) than that proferred by the Tax Appeals Tribunal in Normandy Associates. It is clear from the language of Tax Law § 1440(1) that the Legislature fully intended to distinguish, for purposes of defining "consideration", leases from mortgages, where the former would look to value and the latter to amount.

For the reasons stated, the Division of Taxation correctly determined the amount of tax due, using the face amount of the consolidated mortgage herein.

E. Tax Law § 1446(former [2]) provided, in part, as follows:

> "Any transferor failing to file a return or 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 for each month of delay or fraction thereof after the expiration of the first month after such return was required to be filed or such tax became due."

Tax Law § 1446(former [2]) was amended by the Laws of 1984 (ch 900, effective September 4, 1984), and was deemed to be in full force and effect

retroactive to March 28, 1983. The following language was also applicable to that period:

> "If the tax commission determines that such failure or delay was due to reasonable cause and not due to willful neglect, it shall remit, abate or waive all of such penalty and such interest penalty."

Clearly, petitioner herein failed to pay its tax within the time required under Article 31-B of the Tax Law. Its only defense of substance is that it truly believed that the loss suffered on the sale of the consolidated mortgage should have been included as an expense in the original purchase

price. However, it is not considered to be reasonable due to petitioner's failure to request an opinion from the Division in light of the lack of regulations with regard thereto.

It has been consistently held by the Tax Appeals Tribunal that the reasonableness of the taxpayer's position must be evaluated by a comparison to the Division's articulated policy (Matter of Benaquista, Polsinelli & Sarafini Management Corp., Tax Appeals Tribunal, February 22, 1991; Matter of Birchwood Associates, Tax Appeals Tribunal, July 27, 1989; Matter of Copley Plaza Co., Tax Appeals Tribunal, June 8, 1989; and Matter of Normandy Associates, supra).

Since the wording with regard to the "amount" of any mortgage was contained in Tax Law § 1440 at the time of the closing in this matter, any interpretation of that section by petitioner inferring a valuation of the mortgage rather than its amount must be considered an aggressive interpretation of the Tax Law taken at petitioner's own risk. Failure to contact the Division for an opinion with regard to its interpretation cannot be considered reasonable. Therefore, penalty and additional interest is sustained.

F. If, in fact, the Division in its Notice of Determination asserts a penalty and interest on the timely remittance of $19,021.30 tendered on the date of closing, August 17, 1984, it appears that no penalty or additional interest should have been asserted and the Division is directed to recalculate said penalty and interest based upon said finding.

G. The petition of River Terrace Associates is denied, and the Notice of Determination of Tax Due under Gains Tax Law dated January 29, 1988, is sustained together with additional penalty and interest, except for the recomputation of penalty and additional interest as directed in Conclusion of Law "F" above.

DATED: Troy, New York

12/12/91

ADMINISTRATIVE LAW JUDGE