STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition of UNITED STATES LIFE INSURANCE COMPANY IN THE CITY OF NEW YORK 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.	: : : : : :	DETERMINATION ON REMAND DTA NO. 809614

Petitioner, United States Life Insurance Company in the City of New York, 125 Maiden Lane, New York, New York 10038, 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 Catherine M. Bennett, Administrative Law Judge, at the offices of the Division of Tax Appeals, Riverfront Professional Tower, 500 Federal Street, Troy, New York, on February 4, 1992 at 4:00 P.M., with all briefs to be submitted by July 3, 1992. The Division of Tax Appeals received petitioner's post-hearing brief on April 20, 1992, the Division of Taxation's letter brief on June 15, 1992, and petitioner's reply on June 29, 1992. Petitioner appeared by Dreyer and Traub (Jay I. Gordon, Esq., and Joseph Gulant, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Kenneth Schultz, Esq., of counsel).

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on March 25, 1993. Petitioner appeared by Dreyer and Traub (Jay I. Gordon, Esq., of counsel). The Division ofTaxation appeared by William F. Collins, Esq. (Kenneth Schultz, Esq., of counsel).

The Division of Taxation and petitioner filed briefs and oral argument was held on October 14, 1993. The Tax Appeals Tribunal rendered its decision on March 24, 1994, remanding the matter to the Administrative Law Judge for issuance of a supplemental determination. Addressing the supplemental issues, the Division of Taxation filed its brief on June 13, 1994. Petitioner's supplemental brief was received by the Division of Tax Appeals on July 18, 1994. Upon review of the documents submitted and the record in this matter, Catherine M. Bennett, Administrative Law Judge, renders the following determination.

SUPPLEMENTAL ISSUES

I. Whether the creation of a contract to sell real property with use and occupancy is a taxable transfer of real property for gains tax purposes.

II. Whether the transaction in 1960 was the type of transaction described in Issue I and, if so, whether it would have been taxable had it occurred after March 28, 1983.

III. If so, whether petitioner properly computed the original purchase price of the 1960 transaction.

IV. If it is determined that petitioner has overpaid real property gains tax, whether the Administrative Law Judge has the authority to grant a refund of the same.

FINDINGS OF FACT

United States Life Insurance Company in the City of New York ("petitioner") and the Division of Taxation ("Division") stipulated to numerous facts which have been fully incorporated into the findings below.

Petitioner is a domestic life insurance company having its principal place of business and home office in Manhattan. On January 6, 1960, petitioner petitioned for the approval of the New York State Superintendent of Insurance to enter into a contract for the purchase of land located at 125 Maiden Lane in New York City. Such petition was the result of petitioner's projection in January 1954 of its own growth rate and the desirability of a site capable of handling petitioner's operations vis-a-vis its growth rate. After review of numerous sites, land was purchased in 1955 by Continental Casualty Company, a corporation which then owned the majority of petitioner's stock, for the purpose of erecting on such property a new home office building for petitioner. In July 1956, Continental Casualty Company sold its majority interest in petitioner and abandoned its plans to construct petitioner's office space.

Petitioner was unable to acquire the land itself and construct a building thereon because of its status as a regulated insurance company. Its petition to the Superintendent of Insurance indicated that the economics of New York City real estate coupled with the investment limitations imposed by the New York Superintendent of Insurance under the law precluded petitioner from owning a building providing the desired floor area and requisite space for its growth. Thus, petitioner sought approval of the Superintendent of Insurance to the transactions which will be described in this matter.

Although petitioner was prohibited from directly acquiring or constructing a building due to regulatory restrictions, petitioner sought the approval of the Superintendent of Insurance of the transactions described below which were designed to effect a "proprietary interest". Petitioner presented its position in its petition to the Superintendent of Insurance, describing the proposal for which it sought approval as follows:

> "[W]hereas the occupancy lease . . . makes no provision for petitioner's acquisition of a proprietary interest in the building occupied as its home office, and whereas it is desirable that there be such a proprietary identification of petitioner with the building, and whereas it would be to petitioner's advantage to invest in the subject property in consideration of the return offered, and whereas petitioner is desirous of securing control over future allocations of space . . . . "

In 1958, a developer, 125 Maiden Lane Building Company ("MLBC"), acquired the land located at 125 Maiden Lane ("Land") from Continental Casualty Company for $1,300,000.00. MLBC sold the Land to General Electric Pension Trust ("GEPT") for $1,400,000.00 under a bargain and sale deed dated March 1, 1960 pursuant to a sale/leaseback arrangement under which GEPT immediately leased the Land back to MLBC (the "Ground Lease") for 30 years and 10 days. MLBC issued a deed to the Land to GEPT in exchange for payment of $1,400,000.00, the price paid by MLBC for the Land, plus a reasonable allowance for taxes and carrying expenses from the date of acquisition to the passing of title. MLBC reserved title in the building for itself. The Ground Lease provided that MLBC would retain no interest or other rights in the building upon termination of the lease, but instead the building would by contract and operation of law become the property of the owner of the Land. The Ground Lease between GEPT and MLBC was at an annual rate of $77,000.00, which was equivalent to interest at the rate of 5½% on the $1,400,000.00 advance to purchase the Land. At the end of 30 years and 10 days GEPT would have unencumbered legal title to the property comprised of the Land and the building. Since it was petitioner who desired to own the Land and building at the end of the Ground Lease, petitioner and GEPT simultaneously entered into a purchase agreement requiring petitioner to acquire the land 30 years later in 1990 upon termination of the Ground Lease for $1,400,000.00, the same acquisition cost established in the 1960 transaction.

In order for MLBC to construct the building on the Land, it required additional financing of $6,750,000.00. GEPT (as mortgagee) agreed (pursuant to the Consolidation, Extension, Modification and Spreading Agreement dated March 1, 1960) to loan this amount to MLBC (as mortgagor) based on the credit of petitioner since it was petitioner's funds that would ultimately repay the debt through its rental obligation. Thus, GEPT loaned $6,750,000.00 to MLBC secured by a mortgage (the "Leasehold Mortgage") on MLBC's Ground Lease and required MLBC to re-lease the entire building to petitioner (the "Building Lease"). According to petitioner, the Building Lease required an annual rental equivalent to the ground rent described above plus the Leasehold Mortgage debt service and other items, including real estate taxes. In the event of refinancing of the Leasehold Mortgage, the Building Lease incorporated a rental adjustment to maintain equality with the debt service. Petitioner claims that, as a result of the fact that MLBC pledged the Building Lease to GEPT as further security for the Leasehold Mortgage, petitioner became directly and unconditionally obligated to make payments to GEPT of all expenses of the property as well as amounts due under the Leasehold Mortgage and Ground Lease.

As petitioner described the transactions proposed in its petition for approval of the New York Superintendent of Insurance, petitioner indicated that it desired an arrangement under which it could expand into areas of a site location as its growth required. However, the agreements obligated petitioner to pay rent and occupy the entire building. In order to compromise these competing factors, petitioner entered into an arrangement with MLBC which provided MLBC an opportunity to profit. Petitioner subleased the entire building back to MLBC (the "Sublease"), who in turn leased the majority of the building to petitioner and the remainder to unrelated third parties with terms identical to that of the Building Lease requiring MLBC to pay petitioner exactly that which petitioner was obligated to pay MLBC under the Building Lease. MLBC's opportunity to profit existed if it was able to attract tenants other than petitioner who would pay rent at levels higher than that which was to be paid by MLBC under the Sublease. The components of the form of the transaction and the flow of the funds was as follows:

(a) funds received by MLBC from the rental of a portion of the building to unrelated third parties and petitioner would be paid by MLBC to petitioner pursuant to the Sublease;

(b) in form such funds would be paid from petitioner to MLBC under the Building Lease; and

(c) then flow from MLBC to GEPT and others for the expenses of maintaining the property, such as for payment of the debt service and real estate taxes. In reality, GEPT sought payment from petitioner directly, bypassing MLBC.

It is noted that petitioner's cost to occupy the building was not set at a market rate of rent. In fact, petitioner rented the space for approximately $4.00 per square foot as a result of the March 1960 transactions when it would have otherwise had to pay $4.75 per square foot.

Another simultaneous agreement entered into in March 1960 was established to pay MLBC a fee for developing the property. This agreement between petitioner and MLBC provided that upon the acquisition by petitioner of legal title to the property petitioner would enter into a new ground lease (the "Second Ground Lease") with MLBC for an initial term of 20 years at an annual rent of $140,000.00 plus 50% of the annual net income from the building. Petitioner asserts that MLBC's right to 50% of the net income for a predetermined period represented compensation to MLBC.

In 1975 MLBC defaulted under the Sublease and filed for bankruptcy. Petitioner's rights under the agreement entitled it to accelerate the purchase of land under the Purchase Agreement with GEPT. Petitioner and MLBC settled the matter by entering into a Joint Venture Agreement dated May 24, 1976 which was deemed effective October 1, 1975 and was to supersede the Building Lease and the Sublease to the extent of any inconsistencies. Although the Joint Venture Agreement provided that petitioner and MLBC would be required to make equal contributions to cover expenditures of the building, if in fact MLBC failed to make its required contribution, petitioner was required to advance amounts due and thereafter to be paid therefor (with interest) from the interest of MLBC in all future distributions that would have been payable to MLBC under such agreement. Petitioner waived further rights against MLBC for its failure to make required contributions. From October 1, 1975 to the dissolution of such agreement on September 9, 1986, only petitioner made cash contributions to the Joint Venture. Petitioner claims to have incurred a primary and direct legal obligation to satisfy all obligations of the property in lieu of its obligations under the Building Lease. Petitioner asserts that it acquired a "beneficial interest" in the property and directly assumed liability for the Leasehold Mortgage (the balance of which was $4,478,288.00) and all other debts and expenses under the terms of the Joint Venture Agreement. The termination of the Joint Venture Agreement was March 10, 1990 and upon termination MLBC was obligated to convey its interest in the property to petitioner at no cost.

In 1986 petitioner paid MLBC $3,342,400.00 in exchange for all of its rights, title and interest in the Joint Venture Agreement, the Land and the building. Petitioner obtained the ground lease position and title to the building subject to the Purchase Agreement and Leasehold Mortgage. On November 26, 1986, petitioner acquired legal title to the Land from GEPT in accordance with the Purchase Agreement for $1,300,000.00. GEPT had agreed to accelerate the closing date from the original proposed date of March 1, 1990 and discount the purchase price from $1,400,000.00 to $1,300,000.00. Petitioner subsequently sold the property to RREEF USA Fund III ("RREEF") in December 1986 for $48,333,000.00. When petitioner filed its gains tax documents with reference to the sale of 125 Maiden Lane to RREEF, petitioner calculated its total original purchase price in the amount of $9,120,628.00 for gains tax purposes as follows:

(a) $4,478,228.00 represented the outstanding balance of the Leasehold Mortgage as of October 1, 1975;

(b) $3,342,400.00 represented funds paid to MLBC in exchange for its interest in the building in 1986; and

(c) $1,300,000.00 was the amount paid by petitioner to acquire legal title to the Land from GEPT.

The basis for the parties' disagreement relates to the amount of the Leasehold Mortgage properly includable in original purchase price. The Division allowed $1,423,811.54 of the Leasehold Mortgage in petitioner's original purchase price which was equivalent to the outstanding balance of such debt as of the date petitioner acquired legal title in August 1986. The disallowed portion in the amount of $3,054,416.46 represented that portion of the mortgage balance outstanding as of October 1, 1975 which was amortized through payments by petitioner between 1975 and 1986.

MLBC carried the building as an asset on its balance sheet and depreciated the building for income tax purposes at all relevant times prior to the transfer of the building to petitioner in 1986. Petitioner took no depreciation expense deductions with respect to the building for income tax purposes until after it acquired legal title to the building in 1986.

Petitioner took no interest deductions attributable to the amortization of the mortgages encumbering the Land and building for income tax purposes until after it acquired legal title to the Land and building in December 1986.

Transferor and transferee questionnaires were properly issued by petitioner and RREEF in accordance with the sale between petitioner and RREEF dated December 5, 1986. On December 16, 1986 a Tentative Assessment and Return was computed by the Division based on the filing of such questionnaires indicating total gains tax due of $3,782,888.10. A post-audit review of the information provided with the questionnaires reporting the transfer of 125 Maiden Lane indicated the following:

> "The Joint Venture Agreement between U.S. Life and 125 Maiden Lane Bldg. Co. provides that '[e]ach joint venturer shall retain the basis that it now has in the Joint Venture property'. Based on the foregoing, the claimed mortgage assumption of $4,478,228.00 by U.S. Life, has been disallowed."

A Statement of Proposed Audit Changes dated October 30, 1989 was issued assessing additional tax of $447,822.80,[1] plus interest in the amount of $124,516.43, for a total amount assessed of $572,339.23. Subsequently, on December 26, 1989, the Division issued to petitioner a notice of determination assessing additional tax due of $305,441.65, plus interest in the amount of $92,888.72, for a total amount assessed of $398,330.37.

The Division's Request for Findings of Fact - Supplemental Determination

Pursuant to the State Administrative Procedure Act, the Division requested an additional Finding of Fact be incorporated into the determination. The information as reflected by documents in evidence is provided below.

Transferor and transferee questionnaires dated August 18, 1986 were filed in preparation of the transfer of legal title to the property in question to U.S. Life (Petitioner's Ex. "6"). Such questionnaires, which were filed in connection with petitioner's acquisition of the developer's interest in the property, reflected the following sums and allocation thereof:

Transferor	Interest Transferred	Consideration Paid by U.S. Life	OPP (of Papock, Tuttle & the Maiden Lane Partnership)
Herbert Papock	13.730% interest in fee of bldg. and leasehold	$ 458,900.00	$ 866,916.00

[1]This amount represented tax on the claimed mortgage assumption by petitioner of $4,478,228.00 which the Division disallowed. It was adjusted before the issuance of the notice to reflect the fact that the Division ultimately allowed $1,423,811.54 of the Leasehold Mortgage in original purchase price (balance in August 1986).

Wylie F.L. Tuttle	17.102% interest in fee of bldg. and leasehold	$ 571,600.00	$1,079,825.00
125 Maiden Lane Bldg., LP and 125 Maiden Lane Bldg., a partnership	69.168% interest in fee of bldg. and leasehold	$2,311,900.00	$4,367,287.00
Total:		$3,342,400.00[2]	$6,314,028.00

SUMMARY OF THE PARTIES' POSITIONS

Petitioner's primary position is that the property was transferred to petitioner for purposes of gains tax in 1960 and that from that point in time petitioner's status was that of a contract vendee in possession. More specifically, petitioner continues to assert its position that the transfer of real property includes the transfer by any method of any "interest", which includes title in fee, a leasehold interest, a beneficial interest or "any other interest with the right to use or occupancy of real property." Petitioner maintains that since the structure of the transaction in 1960 qualifies as a contract to sell with use and occupancy, a transfer took place which would be taxable for gains tax purposes had it occurred after March 28, 1983.

Regarding the computation of the original purchase price for the property, petitioner supports the finding of the Administrative Law Judge that the original purchase price shall be the sum of what petitioner paid for the land ($1,300,000.00) plus the cost to construct the building ($6,750,000.00) plus the amount paid to the builder ($3,342,000.00), totalling $11,392,000.00. Alternatively, petitioner argues that the

regulations concerning leases with options (20 NYCRR 590.27; 590.29) provide another method to determine original purchase price by calculating the present value of all payments required to be made under the contract to acquire possession, plus subsequent capital expenditures.

With respect to the issue of whether petitioner has the right to

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2 This amount corresponds to the amount provided in Finding of Fact "9".

obtain a refund of overpaid gains tax if such a conclusion is reached, petitioner maintains that the use of "may" in Tax Law § 1445, allowing a taxpayer to file an application for a refund of gains tax, implies that the provision is elective and that it is merely one way to obtain a refund of such tax. Another is under the broad grant of authority of Tax Law § 1444.1, pursuant to which the Division of Tax Appeals is given the authority to make a "determination" of the proper amount of tax due, as exercised in this matter.

Consistent with private rulings issued by the Division on this issue, the Division agrees that the execution of a contract to sell real property with use and occupancy is a "transfer of real property" which is not exempt from gains tax, and a determination of whether it is a taxable transaction depends on whether consideration for the transfer exceeds the original purchase price. The Division further concedes that if the 1960 transaction (contract of sale with GEPT and the lease arrangement with MLBC) had occurred after March 28, 1983, the transaction would constitute a taxable transfer of real property within the meaning of the gains tax law.

The Division takes the position that the consideration for the creation of a lease with a contract of sale would be equal to the present value of the net lease payments plus the consideration paid for the contract, applying the same regulatory provisions as petitioner. The Division further states that if the lease and contract were later transferred, the OPP would be the "consideration paid or required to be paid by the transferor . . . to acquire the interest[s] in real property" pursuant to Tax Law § 1440.5.

With respect to the issuance of a refund of potentially overpaid gains tax by petitioner, the Division asserts that the Administrative Law Judge did not have jurisdiction to grant such refund without a refund claim by petitioner as a predicate. The Division claims that petitioner was required to file an application for refund (which it did not do) within two years from either the date of transfer or the date of payment, whichever is later.

CONCLUSIONS OF LAW

A. Tax Law § 1441 imposes a tax on gains derived from the transfer of real property, which is defined as a "transfer . . . of any interest in real property by any method . . ." (Tax Law § 1440[7]). "Interest" in real property includes the following:

> "title in fee, a leasehold interest, a beneficial interest, an encumbrance, a transfer of development rights or any other interest with the right to use or occupancy of real property or the right to receive rents, profits or other income derived from real property. Interest shall also include an option or contract to purchase real property." (Tax Law § 1440[4].)

This matter centers around a component of original purchase price, which the Tax Law defines, in pertinent part, as "the consideration paid or required to be paid by the transferor . . . to acquire the interest in real property . . ." (Tax Law § 1440[5][a]).

B. As previously described in more detail, the transactions herein were structured such that, at the termination of the Ground Lease, petitioner would receive legal title to the property at a price equal to the cost 30 years earlier and GEPT would receive back the $1,400,000.00 it advanced to MLBC. Any appreciation in the value of the building inured to petitioner's benefit. Petitioner argues that GEPT was nothing more than a lender and the Ground Lease, taken with the Purchase Agreement, was a financing device to accomplish petitioner's purchase goals. As such, petitioner believes it is appropriately deemed a contract vendee in possession.

Petitioner was in possession of the building under the Building Lease where its obligation was equal to the total of principal and interest payments to GEPT under the loan to construct the building, MLBC's Ground Lease payments, plus other expenses of operating the business. In fact, petitioner paid amounts due under the Building Lease (between MLBC and petitioner) directly to GEPT with no payments passing through MLBC. Petitioner asserts after 30 years when the leases terminated and the Purchase Agreement with GEPT was met, petitioner would have been entirely responsible for the cost of operating the property, repaying the land acquisition cost (by fulfilling the Ground Lease obligations), and extinguishing the construction loan (by satisfying the Leasehold Mortgage), with the ultimate result of clear and free title. Petitioner suggests that in evaluating this arrangement the interaction of the various documents must be considered. Petitioner notes that if it were in default under the Building Lease, GEPT would not be obligated to perform under the Purchase Agreement. Petitioner asserts GEPT held legal title only as security for repayment of its advance and if certain amounts were not repaid pursuant to the Building Lease, GEPT would not have to release its security. In addition, it is noted that the documents provide that in the event of a complete condemnation of the property, GEPT would be entitled only to the first $1,400,000.00 of proceeds in spite of its legal title and any remainder would be applied toward repayment of the Leasehold Mortgage. Thereafter, petitioner would receive any proceeds. Had GEPT been the true owner of the property, it would have received all proceeds.

C. Given the structure of the transaction, the parties agree that the execution of a contract to sell real property with the right to use and occupy such property is a "transfer of real property" which, but for the fact that the transaction occurred in 1960 (i.e., pre-1983), would constitute a taxable transfer. This conclusion, reached by both, is supported by the regulations, and prior decisions and policies published by the Division (Tax Law § 1440[4]; see, Bonnie Heights Realty Corp., Advisory Opinion, January 24, 1990 [TSB-A-90(1)R]; Dept of Tax & Fin Priv Ltr Rul, October 17, 1986) and I am in agreement with such conclusion.

D. As established above, the granting of a lease with an option to purchase real property which includes the use or occupancy of such property is a taxable transfer for gains tax purposes. Accordingly, the transfer to petitioner in 1960 would have been subject to real property gains tax had it occurred after March 1983. Nonetheless, a transfer took place and the consideration for such transfer is equal to:

> "the value of the rental and other payments attributable to the use and occupancy of the real property or interest therein, the value of any option to purchase or renew included in such transfer and the value of rental or other payments attributable to the exercise of any option to renew" (Tax Law § 1440[1][b]).

The regulation supporting the calculation of consideration in a transfer of this type is 20 NYCRR 590.27 which provides the following guidance:

> "Question: Is the creation of a lease for a term less than 49 years which contains an option to purchase the real property subject to the gains tax?

"Answer: Yes. Section 1440(4) of the Tax Law defines an interest in real property to include an option. The consideration for such a transfer is the present value of the net rental payments under the lease plus the consideration paid for the option to purchase (Tax Law, section 1440[1][b]). Rental payments for periods that occur after an option is no longer exercisable are not included in the calculation of the present value of the rental payments. If the sum of the present value of the net rental payments and the price paid for the option is $1 million or more, the transfer is subject to the tax (Tax Law, section 1440[1]). The present value of the net rental payments should be determined as set forth in section 590.26 of this Part."(Emphasis supplied)

20 NYCRR 590.26 sets forth the valuation of leases in determining consideration. In pertinent part, it provides as follows:

"Question: What method will be used to value the lease payments to the lessor for a lease subject to the gains tax?

"Answer: The consideration paid to the lessor includes the present value of the right to receive the rental payments for the term of the lease and the present value of the rental payments attributable to any renewal term.

"A discount rate equal to 110 percent of the federal long-term rate compounded semiannually, which is determined pursuant to section 1274(d) of the United States Internal Revenue Code, is required to be used in determining the present value of such payments. Such federal long-term rate in effect 30 days prior to the date of transfer shall be used when computing such discount rate. If the taxpayer establishes: (i) that a discount rate which is greater than 110% of the federal long-term rate is appropriate in his or her particular circumstances; and (ii) that using a discount rate equal to 110 percent of the federal long-term rate results in the computation of consideration which exceeds the fair market value of the real property subject to the lease or sublease, the Department will allow the use of a discount rate that results in the computation of consideration equal to the fair market value of such real property.

"The discount rate shall be applied to net rents . . . ."

20 NYCRR 590.28 provides additional guidance for the determination of OPP for leases. Subdivision (c) specifically addresses the question, "What is the original purchase price of a lessee for his leasehold interest?" as follows:

"Answer: The original purchase price of a lessee for his leasehold interest includes costs incurred by the lessee to acquire the leasehold interest (e.g., attorneys' fees and brokers' fees), consideration paid for an option to renew the lease or purchase the underlying property, and the costs of any capital improvements made by the lessee, but only to the extent the costs for capital improvements do not result in a reduction of rental payments required to be paid by the lessee. Although rent payments generally are not includible in the lessee's original purchase price, a lessee/optionee may include that amount of payments made under the lease that are proven to the State Tax Commission to be payments for the option or the real property, rather than for occupancy of the premises prior to the exercise of the option."

E. The parties agree that 20 NYCRR 590.27 (which references 20 NYCRR 590.26) is the controlling regulation. Petitioner interpreted the regulations and applied them to the transactions herein where petitioner computed the present value of the annual (net rent) payments of $511,825.11[3] due under the Building Lease ($8,144,384) and the present value of the $1,400,000.00 due under the Purchase Agreement ($352,962) for the land over 30 years at 4.70%.[4] The combined total of $8,497,346.00 added to the $3,342,400.00 paid to MLBC in exchange for all of its rights, title and interest in the Joint Venture Agreement, the land and the building results in an original purchase price of $11,839,746.00.

The Division offered no corresponding computations in this regard.

F. The inclusion of the present value of the rental payments in OPP is dictated by regulation 590.27 determined with respect to the discount rate provisions of 590.26. Petitioner has correctly calculated this amount. The OPP of a lessee pursuant to 590.28 includes consideration paid for the purchase of the underlying property. The amount petitioner was to pay 30 years into the future for the land was $1,400,000.00. Petitioner appropriately included

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[3]The Building Lease reflects the payment at $511,825.56 per annum payable in equal monthly installments of $42,652.13.

[4]Petitioner provided the following explanation for its use of the 4.70% rate of interest:

> "Regulation section 590.26 requires that payments be present valued at 110% of the 'applicable federal long-term rate . . . determined pursuant to section 1274(d) of the United States Internal Revenue Code' for the month prior to the month in which possession is obtained. Section 1274(d)(1)(C) of the Internal Revenue Code provides, in effect, that the 'applicable federal rate' is determined based on the average market yield of marketable obligations of United States with remaining maturities of over nine years in the case of the 'long-term' rate. Attached hereto as Exhibit 2 is a copy of the financial page of The New York Times for March 1, 1960 showing Treasury Bond rates for February 29, 1960. The bottom seven bond issues all have remaining maturities of over nine years from March 1, 1960 for all of the bonds that were part of the issue. The average yield on these bonds is 4.28%. Taking 110% of this number, the interest rate determined 'pursuant to section 1274(d)' is 4.70%." (Petitioner's Brief for Supplemental Determination, p. 6.)

this amount in OPP at its present value again applying the discount provisions of 590.26. The final amount included in OPP was paid to the developer (MLBC) in 1986 to secure all final rights in the property, and is properly included as an amount paid for the interest in the underlying property. Accordingly, petitioner's calculation of OPP in the amount of $11,839,746.00 is accepted and my original determination of OPP is modified.

G. Refunds under the real property transfer gains tax are covered by Tax Law § 1445(1)(a) which provides that:

> "[a] person claiming to have erroneously paid the tax imposed by this article may file an application for refund within two years from either the date of transfer or the date of payment, whichever is later."

The Division maintains that petitioner is no longer able to claim a refund of real property gains tax if the same was miscomputed since it did not do so within two years from either the date of transfer of the property in question or the date of payment of the tax. Petitioner does not dispute that neither the transfer nor the payment of tax falls within the two-year statute of limitations since the transfer was made at the end of 1986 and the gains tax was required to be paid at that time. Petitioner argues that the application for refund under Tax Law § 1445(1)(a) is only an elective provision and one method by which petitioner is able obtain a refund. Petitioner asserts that the Division of Tax Appeals under its broad authority to determine the correct amount of tax due is fully authorized to grant a refund to petitioner if in fact a component of OPP was found to have been in error when compared to the amount used in the original computation.

H. In general, the Tax Law provides that an overpayment of tax may be recovered under various provisions so long as the action is brought within the time prescribed by statute. One of those statutes is stated above. However, even though the time for filing a claim for refund has expired, a taxpayer may have a right to plead a claim in recoupment for an alleged deficiency for the same period (58 NY Jur, Taxation, § 72).

In this case, the Division opened the question of petitioner's real property gains tax liability by questioning its computation of OPP and determined a deficiency based on the sale of the property in this matter. It appears as though petitioner should be entitled to equally raise the amount of any overpayment it believes to have been made of real property gains tax during the same period under review and, in this case, based on the same transaction, although petitioner did not file a timely refund claim. In opposition to the deficiency assessment, and in its assertion of a refund due to it, petitioner essentially brings to light its rights in recoupment. The discretion afforded the Adminstrative Law Judge to make a proper determination of tax due requires consideration of such rights.

Although the Tribunal was precluded from specifically determining the applicability of recoupment in Matter of Kadish (Tax Appeals Tribunal, November 15, 1990), it stated that:

> "The basic rule concerning recoupment is that credit for overpayment of taxes in a previous year which is barred by the statute of limitations may not be recouped against taxes due for a different year on different transactions not under audit (Matter of Mobil Oil Corporation v. State Tax Commn., 62 AD2d 668, 406 NYS2d 365). Stated alternatively, credit for overpayment may be recouped against taxes for the same period on the same transactions under audit" (National Cash Register Company v. Joseph, 299 NY 200, 86 N.E.2d 561).

The essential requisites of the doctrine of equitable recoupment can be seen from a series of three United States Supreme Court cases, beginning with the landmark decision of Bull v. United States (295 US 247, 79 L Ed 1421). In Bull, the executor of an estate paid the estate taxes in 1921 on the decedent's share of income from a partnership. Four years later, the Commissioner of Internal Revenue imposed an income tax assessment against the estate for the same year and on the same income. The taxpayer argued that the income could not be treated as both corpus and income to the estate. Although the statute of limitations barred any independent action by the executor for an estate tax refund, the Supreme Court agreed with the taxpayer that when the government brought a new proceeding to collect the income tax arising out of the same transaction involved in the earlier proceeding, a claim for the estate tax unjustly retained by the government may be made by way of recoupment and credit in an action arising out of the same transaction. The court's rationale in that matter was based on its theory that:

> "recoupment is in the nature of a defense arising out of some feature of the transaction upon which plaintiff's action is grounded. Such a defense is never barred by the statute of limitations so long as the main action itself is timely" (id., at 262).

The court also concluded that the equities of such a situation favored the use of such a doctrine since the government's "unjust retention is immoral and amounts in law to a fraud on the taxpayer's rights."

In another matter, Stone v. White (301 US 532, 57 S Ct 851, 81 L Ed 1265), both the claim and the recoupment involved a single taxable event which was receipt by an estate of income for a period. The trustees in that matter had paid an income tax on the estate income, but a State Court of Appeals held that it was taxable to the beneficiary. Assessment against the beneficiary had meanwhile become barred. Subsequently, the trustees sued for a refund, which would inure to the beneficiary. Recognizing the identity of interest between the trust and the beneficiary, the Court treated the transaction as a whole and allowed recoupment of the tax which the beneficiary should have paid against the tax the Government should not have collected from the trustees. The court concluded that the equities of the situation again favored use of equitable recoupment and determined that "[e]quitable conceptions of justice compel the conclusion that the retention of the tax money would not result in any enrichment of the government" (id., at 537).

In the third historical case regarding equitable recoupment, Rothensies v. Electric Storage Battery Company (329 US 296, 91 L Ed 296), the Court displayed a reluctance to extend the application of equitable recoupment as applied in both Bull and Stone. The taxpayer in Rothensies wanted to recover excise taxes paid from 1919 through 1922 that were time barred by the statute of limitations and apply them against its 1935 income tax deficiency imposed by the Collector of Internal Revenue. The Court distinguished Bull and Stone, stating that both the original claim and the defendant's plea for recoupment required a single taxable event and that the doctrine of recoupment has:

> "never been thought to allow one transaction to be offset against another, but only to permit a transaction which is made subject of a suit by a plaintiff to be examined in all its aspects and judgment to be rendered that does justice in view of the one transaction as a whole" (id., at 299).

In that matter, since there were two distinct taxable transactions separated by some 16 years of time, the court refused to grant a credit to the taxpayer on the income tax deficiency.

As set forth by Superior Air Products International v. Director, Division of Taxation (9

NJ Tax 463), there are essentially three elements necessary to apply equitable recoupment: (1) a single transaction; (2) an identity of interest among parties; and (3) a need to balance the equities. In this case, there is a single transaction and that same transaction, and the tax computed thereon, is the subject of controversy between the parties. Although the Division agrees with petitioner's theory of OPP as addressed in this supplemental determination, the Division has not made clear that such theories (of transfer and OPP) are the ones applicable to this set of facts and accepted by it. To the extent petitioner is held to its original computation by the position asserted by the Division, their positions with regard to the computation of OPP conflict and both cannot subsist at the same time. With respect to the other elements, there is clearly an identity of interest since the taxpayer against whom the claim is being made is also the taxpayer who would benefit from recoupment. Third, there is certainly a need to balance the equities. If the Division had not pursued a claim with respect to the computation of OPP, petitioner's calculation and any error associated thereto would remain. However, in a case where the Division questions a computation which petitioner specifically believes has been computed in error and submits information proving the same, the doctrine of recoupment should be applied. In a more recent U.S. Supreme Court case, United States v. Dalm (494 US 596, 108 L Ed2d 548), the court stated:

> "our decisions in Bull and Stone stand only for the proposition that a party litigating a tax claim in a timely proceeding may, in that proceeding, seek recoupment of a related, and inconsistent, but now time-barred tax claim relating to the same transaction" (id., at 608).

In the case of National Cash Register Company v. Joseph (299 NY 200), the City of New York reopened a sales tax liability matter for a given period and assessed a tax deficiency against the company for that period. The Court of Appeals held that the vendor was given an equitable right to plead against the City a recoupment claim for taxes of the same type which the vendor alleged it had erroneously paid to the comptroller in the same period. In that case, recoupment was defined as "a deduction from a money claim though a process whereby cross demands arising out of the same transaction are allowed to compensate one another and the balance only to be recovered" (id., at 203; emphasis supplied).

Case law entertaining recoupment principles in taxation matters must address the issue of whether the taxpayer overpaid its taxes and this places in issue, at minimum, the entire tax liability for the same tax for the same year (Dysart v. United States, 340 F2d 624, 65-1 US Tax Cas ¶ 9188; Lewis v. Reynolds, 284 US 281, 52 S Ct 145, 76 L Ed 293). The Rothensies theory of examining the transaction in all its aspects and rendering a judgment which does justice in view of the transaction as a whole would appear to command a refund of taxes due petitioner in this matter, since a supported recomputation previously calculated in error should be corrected. Having adopted a broad view of the doctrine of equitable recoupment, the New York Court of Appeals' language in National Cash Register clearly leads one to believe that recoupment principles have been extended in tax matters to provide for a "recoverable balance", referred to in the case history as "affirmative recovery". However, a closer review of the history of recoupment reveals that a party raising recoupment may not obtain affirmative relief against its opposition for any balance proven in such party's favor, because as a recoupment, such party's claim may only serve to abate, in whole or in part that demanded by the opposition (Title Guarantee & Trust Co. v. Hicks, 283 App Div 723, 127 NYS2d 340; Peuser v. Marsh, 218 NY 505). Thus, when the benefits of the recoupment doctrine are sought by a taxpayer, the function of the doctrine is to allow the taxpayer to reduce the amount of a deficiency recoverable by the Government by the amount of an otherwise barred overpayment of the taxpayer (Brigham v. U.S., 470 F2d 571, 73-1 US Tax Cas ¶ 9116; O'Brien v. U.S., 766 F2d 1038, 85-2 US Tax Cas ¶ 9492).

It appears that the operation of the doctrine of recoupment, though applicable, may not in any way benefit petitioner. Nonetheless, it is held to apply in the event it is needed to further a just determination between the parties. With the exception of the application of the recoupment theory, no additional basis is available for the granting of a refund of overpaid real property gains tax in this matter.

I. The petition of United States Life Insurance Company in the City of New York is hereby granted and the notice of determination dated December 26, 1989 is cancelled.

DATED: Troy, New York
January 18, 1995

/s/ Catherine M. Bennett
ADMINISTRATIVE LAW JUDGE