STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
AARON ZIEGELMAN	:	DETERMINATION DTA NO. 809760
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, Aaron Ziegelman, 152 West 57th Street, New York, New York 10019, 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 Brian L. Friedman, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on December 16, 1992 at 9:15 A.M., with all briefs to be submitted by May 17, 1993. Petitioner appeared by Ziegler, Sagal & Winters, P.C. (Lanny M. Sagal and Alan Winters, Esqs., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Andrew J. Zalewski, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation erroneously failed to treat the transfer of real property by a sponsor (petitioner) to a cooperative housing corporation as a transfer subject to gains tax which, as a result thereof, precluded petitioner from excluding the mortgage received on that transfer from consideration in subsequent sales of shares of stock (since the transfer occurred prior to the effective date of the tax) and furtherprecluded petitioner from stepping up the original purchase price to include a portion of the cooperative housing corporation's cost of the property.

II. Whether "negative carry" and "estimated negative carry" incurred by petitioner with respect to apartments occupied by tenants protected by rent control and rent stabilization laws ("protected tenants") should be included in the original purchase price of each apartment as a

cost of conversion.

III. Whether the consideration received by petitioner should be reduced by the "adjustment payments" (excess of maintenance payments and other expenses over rent paid by "protected tenants") made by petitioner or, in the alternative, whether these payments should be considered part of the sales price other than for real property and, therefore, not subject to gains tax.

FINDINGS OF FACT

On December 16, 1992, the parties entered into a "Stipulation Admitting Certain Facts" which has been incorporated into the following Findings of Fact.[1] In addition, petitioner submitted 14 proposed findings of fact. Some of them (proposed findings of fact "1", "2", "4", "5", "6", "7", "8", the first paragraph of "10", and "13") are, for the most part, restatements of provisions of the aforesaid stipulation and, accordingly, have been incorporated, but not separately set forth, into the following Findings of Fact. The balance of the proposed findings of fact have been dealt with as follows:

(a) Proposed finding of fact "3", while incorporated into the following Findings of Fact, is relevant only if it is determined that the transfer by the sponsor (petitioner) to the cooperative housing corporation is a transfer subject to gains tax and, by virtue of such determination, permits a step-up of the original purchase price to include a portion of the cooperative housing corporation's cost of the property;[2]

(b) Proposed findings of fact "9" and "11" are incorporated in the following Findings

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[1]Attached to the Stipulation Admitting Certain Facts were two exhibits (Exhibit "A" is a copy of the offering plan; Exhibit "B" is a copy of the closing statement). Several of the paragraphs of the stipulation contain references to the aforesaid exhibits which, for purposes of incorporation into the Findings of Fact, have been omitted.

[2]Reference to the transfer of the property by the sponsors to the cooperative housing corporation as the "Realty Transfer" has been omitted due to its implication that, by virtue thereof, a taxable event occurred. In addition, the value of unsold shares ($1,500,000.00) is accepted herein only for the limited purpose of valuing consideration paid by the cooperative housing corporation to the sponsor.

of Fact;

(c) The second paragraph of proposed finding of fact "10" and proposed finding of fact "12" are contentions of petitioner and, while based upon the testimony of a witness called to testify on petitioner's behalf, are rejected as conclusory in nature and not otherwise supported by evidence in the record; and

(d) Proposed finding of fact "14" is a statement of the issues and the parties' positions on each of these issues. Since the contents thereof are not facts, they will be addressed separately in paragraphs under the heading "Summary of the Parties' Positions" which immediately follows the Findings of Fact.

Aaron Ziegelman ("petitioner") and William K. Langfan were the sponsors of a cooperative conversion of the property located at 37-27 86th Street, Jackson Heights, New York (the "property"). Petitioner had a 50% tenants-in-common interest therein.

The conversion of the property was accomplished by the sponsors transferring the real property to the cooperative housing corporation ("CHC") in exchange for:

(a) the stock of the CHC not sold to unrelated parties at the time of conversion (the "unsold shares");

(b) the proceeds from the sale of stock of the CHC to unrelated parties at the time of conversion (net of certain expenses); and

(c) the assumption and/or the granting of a mortgage on the real property.

The consideration paid by the CHC to the sponsors for the transfer of each property was as follows:

Shares subscribed to prior to closing (5,335 shares)	$ 486,514.00
Shares not subscribed to prior to closing ("Unsold Shares")	1,500,000.00
First mortgage	669,197.00
Second mortgage	571,816.00
Gross Price	$3,227,527.00
Deduct:	

Capital Improvements	$322,000.00	
Working Capital Fund	45,000.00	
Brokerage	24,326.00	
Legal Fees	35,000.00	
Other	42,074.00	
		468,400.00
Net Purchase Price		~~$2,759,127.00~~

The effective date of the conversion was prior to March 28, 1983, the effective date of the gains tax. Accordingly, there were sales of cooperative apartments which were exempt from the gains tax because the sales occurred before the effective date of the tax or were made pursuant to contracts entered into before the effective date of the tax (the "grandfathered sales"). The grandfathered sales in the conversion may be summarized as follows:

Total Number of Shares	% Grand-fathered	Shares Allocable to Grandfathered Sales	Shares Allocable to Taxable Sales
42,425	16.1579%	6,855	35,570

The conversion was made pursuant to a noneviction plan. Accordingly, the sponsor was required to make sales of apartments to at least 15% of the existing tenants of the property in order to have the plan effective.

The sponsor offered discounts to the existing tenants. The sales to insiders were made at a discount in order to:

(a) achieve the level of insider sales necessary to have an effective plan; and

(b) achieve the lowest possible level of apartments occupied by "protected tenants" (as that term is defined below).

Under State and local laws, tenants of the property who did not wish to purchase their apartments (the "protected tenants") were entitled to remain as tenants as long as said tenants paid the rent increases permitted under the rent stabilization and rent control laws (which laws remained applicable to a protected tenant after the conversion) and did not breach their lease or statutory tenancy. Under these rent stabilization and rent control laws the sponsor, which becomes the owner of the apartments occupied by the protected tenants, is limited in its ability to raise the rents of protected tenants and may terminate their tenancies in only very limited

circumstances.

From the effective date of the cooperative conversion until an apartment occupied by a protected tenant is sold, the sponsor was liable to the CHC for the maintenance payable with respect to such apartment, and the sponsor was liable under the offering plan, the proprietary lease and applicable law for other expenses related to the tenancy of the protected tenant (e.g., interior repairs, appliance repairs, painting as required by rent stabilization laws). If the sponsor did not pay the maintenance on the units occupied by protected tenants, it would forfeit said units -- on which the maintenance charges are a first lien.

The sponsor was also entitled to the rent paid by the protected tenant occupying such apartment. The maintenance payments and other expenses incurred by petitioner as owner of the apartments occupied by protected tenants (i.e., insurance, repairs, management fees) exceeded the rent paid by the protected tenants. (Such excess is hereinafter referred to as the "negative carry"). It is usual for a sponsor of a cooperative conversion to pay negative carry with respect to the unsold shares received by the sponsor in the conversion.

The total negative carry incurred by petitioner was $72,392.00.

The sponsor sold to unrelated investors apartments occupied by protected tenants (the "investor sales"). The sales contract provided that the sponsor would pay any negative carry incurred by the investor from the date the investor purchased the apartment until the date the protected tenant terminated its tenancy (such payment by the sponsor is hereinafter referred to as the "adjustment payment").

During the period 1983 through 1990, the actual amount of adjustment payments made by petitioner was $12,549.00.

The Division of Taxation ("Division") computed the tax on the conversion as follows:[3]

Consideration:	
Sales Price of Shares	$2,626,465.00

[3]Per 8/8/90 Audit Schedule which differs slightly from Notice of Determination.

Mortgage	1,020,001.00[4]
Less: Brokerage Fees	(131,323.00)[5]
Less: Reserve Fund	(36,986.00)[6]
Less: Mortgage Amortization	(8,783.00)
Total Consideration	~~$3,469,374.00~~
Original Purchase Price:	
Sponsor's Purchase Price to Acquire	$1,550,000.00
CHC Purchase Price to Acquire	-0-
Acquisition Costs	26,769.00
Capital Improvements	320,500.00
Conversion Costs	84,338.00
Negative Carry	-0-
Subtotal	$1,981,607.00
x Non-Grandfathered %	x .82191
Total Original Purchase Price	~~$1,628,703.00~~
Gain Subject to Tax	$1,840,671.00
x Rate	x .10
	~~$ 184,067.00~~

On August 21, 1989, the Division issued a Notice of Determination to petitioner in the amount of $354,560.52 ($187,411.00 additional gains tax; $101,555.67 interest; $65,593.85 penalty).

The Division's Bureau of Conciliation and Mediation Services, by a Conciliation Order dated May 17, 1991 (CMS No. 100720), recomputed the tax due from $187,411.00 to $181,307.00, plus penalty and interest computed at the applicable rate.

At the hearing (see, tr., pp. 15-17), the Division's representative stated that the actual amount of tax at issue was $180,445.00,

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[4] $1,241,013.00 x .82191 non-grandfathered percentage of units sold per audit.

[5] $2,626,465.00 cash consideration x 5%.

[6] $45,000.00 x .82191 non-grandfathered percentage of units sold per unit.

which amount is the result of multiplying the number of shares taxed (34,870 shares) times the amount of tax per share ($5.1748).

At the hearing, James L. Levy of Appraisers and Planners, Inc. in New York City testified as to the value of apartments occupied by protected tenants. Based upon his analysis of comparable sales, Mr. Levy stated that, for the years 1982 through 1984, sales of occupied cooperative apartments were generally made at a discount rate of 50 to 70%. Pursuant to his testimony (see also, Exhibit "3"), these apartments (containing 37,090 shares) were sold by petitioner at 50% of market value. Mr. Levy testified that, in reality, the percentage was lower because petitioner agreed to pay the negative carry after the ownership of the apartments was transferred to the investors and, in addition, because the investors did not have to put down any cash (petitioner provided 100% financing). Based upon the 50% discount and a negative cash flow of $19,258.00 (see, Exhibit "2") which was capitalized at 10%, the value of these shares was appraised by Mr. Levy at $1,395,015.00 which, when rounded off, became $1,500,000.00.

SUMMARY OF THE PARTIES' POSITIONS

The positions of petitioner with respect to each of the issues may be summarized as follows:

(a) The transfer by petitioner (sponsor) to the CHC should be recognized as a separate taxable event. Since this transfer occurred prior to the effective date of Article 31-B of the Tax Law (March 28, 1983), the mortgage received would be excluded from consideration

on later sales of shares. In addition, the original purchase price ("OPP") would be stepped up to include a portion of the CHC's costs for the property. While the Appellate Division, Third Department has previously addressed this issue in Matter of 1230 Park Assoc. v. Commr. of Taxation & Fin. of the State of New York (170 AD2d 842, 566 NYS2d 957, lv denied 78 NY2d 859, 575 NYS2d 455), petitioner contends that the court's ruling is contrary to statute and is, therefore, incorrect;

(b) Upon petitioner's sale of unsold shares, he should be permitted, in calculating gains tax due, to include in OPP the negative carry (and estimated negative carry) through the date of sale of the shares. Petitioner contends that negative carry is deductible as

"customary, reasonable and necessary expenses incurred to create ownership interests in property in cooperative or condominium form . . ." (Tax Law § 1440.5[a]). In the alternative, petitioner maintains that negative carry could be included in OPP as a cost of acquisition of the property sold or as a capital improvement cost incurred by petitioner, i.e., changing the acquired property from a unitary rent-stabilized apartment building into shares of vacant cooperative apartments; and

(c) Petitioner's gain should be reduced to take into account his obligation to make adjustment payments. By virtue of petitioner's agreement to assume these payments, the investors paid more for the shares than they would otherwise have. It is

petitioner's contention that the adjustment payments constitute either a purchase price adjustment, a payment for an asset which is not real property (and, therefore, is not subject to the gains tax), or a discount, credit or rebate.

The Division has taken the following positions with respect to these issues:

(a) Based upon Matter of 1230 Park Assoc. (supra), the Division asserts that the Tax Appeals Tribunal and the Appellate Division, Third Department have correctly held that, for gains tax purposes, the transfer by the sponsor to the CHC is to be disregarded;

(b) Again relying on Matter of 1230 Park Assoc. (supra), the Division contends that gain subject to the gains tax may not be reduced by the negative carry incurred by the sponsor; and

(c) Adjustment payments do not reduce consideration. At the time of execution of the sales contracts, these payments were contingent upon future events and, as such, had an indeterminable value.

CONCLUSIONS OF LAW

A. As petitioner points out in his brief, the issue of whether the transfer of real property by a sponsor to a cooperative housing corporation should be treated as a transfer subject to gains tax has been addressed both by the Tax Appeals Tribunal and by the courts.

In Matter of 1230 Park Assoc. v. Commr. of Taxation & Fin. of the State of New York (supra, 566 NYS2d at 959), the Appellate Division, Third Department, stated as follows:

> "We reject petitioners' initial argument that two separate and distinct taxable transfers within the purview of Tax Law article 31-B occurred. We find that Mayblum v. Chu, 67 NY2d 1008, 503 NYS2d 316, 494 NE2d 447, in which the Court of Appeals held that the gains tax is imposed by the statute upon the overall cooperative conversion plan, is dispositive here. The corporation was merely a conduit through which ownership of individual units could be transferred by petitioners to the purchasers through the sale of shares. We fully agree with the conclusion reached by the Second Department in Mayblum that the making of a contract of sale for the transfer of the real property from a sponsor to an apartment corporation is not a taxable event separable for gains tax purposes from the overall conversion (Mayblum v. Chu, 109 AD2d 782, 486 NYS2d 89, mod 67 NY2d 1008, 503 NYS2d 316, 494 NE2d 447)."

In Matter of 61 East 86th Street Equities Corp. (Tax Appeals Tribunal, January 21, 1993), in support of its contention that the transfer of property to a CHC is a taxable event, the petitioner raised the exact same issues as petitioner has presented in his brief submitted herein.[7]

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[7]It must be noted that 61 East 86th Street Equities Group was represented by Ziegler, Sagal & Winters, P.C., the law firm which also represents petitioner Aaron Ziegelman.

These issues may be summarized as follows:

(1) That the conclusions of the Appellate Division in Matter of 1230 Park Assoc. (supra) are erroneous in that they do not take into account the modifications made by the Court of Appeals in Mayblum v. Chu (supra);

(2) The decision of the Tribunal and the Appellate Division in Matter of 1230 Park Assoc. (supra) is inconsistent with the Tribunal's decision in Matter of Cheltoncourt Co. (Tax Appeals Tribunal, December 5, 1991, confirmed 185 AD2d 49, 592 NYS2d 121);

(3) The statutory definition of "transfer" (Tax Law § 1440[7]) does not permit the Division's interpretation;

(4) Petitioner's position is consistent with the manner in which the Division would apply the statute to non-cooperative taxpayer/ corporations;

(5) The failure of the Legislature to amend the gains tax statutes to add language adopting the Division's position on CHCs is additional support for petitioner's position;

(6) The New York State real estate transfer tax was amended to conform substantially to the gains tax, yet Tax Law § 1405-B imposes the tax upon both the initial transfer to the CHC and on subsequent transfers of shares from the CHC;

(7) Amendments to the New York City real property transfer tax provide for the tax to be imposed on both the original transfer of shares by the cooperative corporation or cooperative plan sponsor and subsequent transfer of shares; and

(8) That there are substantial factual and economic differences between condominium conversions and cooperative conversions which require different treatment.

In light of the fact that the Tax Appeals Tribunal has, in detail, considered each of petitioner's contentions (Matter of 61 East 86th Street Equities Group, supra) and, based upon its decisions and decisions of both the Court of Appeals and the Appellate Division of this State which have rejected these contentions, this Administrative Law Judge must, by virtue of the principle of stare decisis, deem such decisions as precedential and, therefore, dispositive of this

issue. Accordingly, nothing has been presented herein to justify conclusions contrary to those reached by the Tribunal and the courts.

B. With respect to the second issue, i.e., inclusion of negative carry in original purchase price computation, petitioner contends that the Division's position in excluding these costs is unreasonable and irrational and that in Matter of 1230 Park Assoc. (supra), the Appellate Division applied an incorrect standard in determining that it was required to defer to the taxing authority's interpretation that negative carry was neither consideration paid to acquire the interest in real property nor money expended for capital improvement to real property.

As with the previous issue, the Tribunal, in Matter of 61 East 86th Street Equities Group (supra), considered each of the contentions raised by petitioner herein and rejected the same. Citing Matter of 1230 Park Assoc., the Tribunal stated:

> "Since the Appellate Division, Third Department reviews our decisions (Tax Law § 2016), and not vice versa, we decline to comment on petitioner's criticism of the Appellate Division's decision."

Since the Tax Appeals Tribunal reviews Administrative Law Judge determinations (Tax Law § 2006[7]), and not vice versa, this Administrative Law Judge shall not disturb the decisions of the Tribunal in Matter of 1230 Park Assoc. (affirmed by the Appellate Division) and Matter of 61 East 86th Street Equities Group.

C. The final issue to be considered herein is whether the consideration received by petitioner should be reduced by the "adjustment payments" (excess of maintenance payments and other expenses over rent paid by "protected tenants") made by petitioner because the payments constituted a purchase price adjustment or a discount, credit or rebate. In the alternative, petitioner contends that since the consideration was received for the transfer of real property subject to gains tax (the cooperative apartments) as well as for the transfer of intangible personal property (petitioner's commitment to pay the operating deficit incurred by the investors by virtue of their ownership thereof), a portion of this consideration (that portion allocable to the intangible personal property) should not be subject to gains tax.

Tax Law § 1440.1(a) defines "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, including payment for an option or contract to purchase or use real property. 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, purchase money mortgage, lien or other encumbrance, whether the underlying indebtedness is assumed or taken subject to. Consideration includes the cancellation or discharge of an indebtedness or obligation."

20 NYCRR 590.37 was promulgated to deal with situations where the amount of consideration is reduced to reflect the value of an incentive such as a discount, credit or rebate offered by the seller. This regulation provides, in part, as follows:

> "Question: How do discounts, credits or rebates affect the calculation of gains tax on transfers pursuant to a cooperative conversion?
>
> "Answer: To the extent a discount, credit or rebate provides an economic benefit that the transferee realizes immediately upon the transfer of the shares, the total amount of such realized benefit is a reduction of consideration.
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> * * *
>
> "The treatment of a discount, credit or rebate which does not provide the transferee with an economic benefit realized immediately upon the transfer depends on whether the transferee's right to receive the future credit, discount or rebate is absolute or contingent. If the transferee's right to the future credit, discount or rebate is absolute, as provided for in the offering plan or agreement to purchase the shares, the present value of the discount, credit or rebate is a reduction of consideration at the time of the transfer. It will be presumed that a discount factor of 10 percent will be appropriate for calculating the present value of a credit, discount or rebate to which the transferee has an absolute right. If the transferee's right to receive the credit, discount or rebate is contingent upon any condition, the credit, discount or rebate is a reduction of consideration only to the extent that the transferor and transferee have attributed a reasonable value to the credit, discount or rebate in the offering plan or in the agreement to purchase the shares." (Emphasis added.)

In the present matter, there is no evidence that these payments, referred to in the contract of sale (see, Exhibit "A" of Petitioner's Exhibit "1" [contract of sale contained in Eleventh Amendment to Offering Plan]), were valued, or that there had been an allocation of the purchase price at the time of execution of the contract.

While the purchaser's right to receive the economic benefit of having the seller make these payments was absolute, it could not be valued because it was for an uncertain duration. Paragraph 13(f) of the contract of sale provided as follows:

"Seller's obligation to make payments for Operating Deficit Payments and Capital Improvement Assessments for any Apartment shall cease (and Purchaser will be required to make such payments thereafter) upon the occurrence of any of the following events:

"(i) if a non-purchasing tenant in occupancy shall surrender possession of such Apartment, voluntarily or otherwise; or

"(ii) if that portion of Principal allocated to such Apartment, as evidenced by the Promissory Note and Pledge Agreement, is paid in full; or

"(iii) the expiration of fifteen (15) years from the date of the Closing."

It is clear, therefore, that petitioner's obligation to make these payments could have extended anywhere from one day to 15 years. In addition, there was no present valuation of the amount of these payments since they could not be ascertained at the time of transfer. While petitioner has presented the testimony as well as letters of valuation of James L. Levy (see, Exhibits "3" and "4"), these valuations were made not at the time of transfer, but several years thereafter (January and December 1992), when, in retrospect, the amount of payments made by petitioner could readily be determined. Accordingly, it has not been established that the adjustment payments were incentives discounted to present value and subtracted from consideration received at the time of transfer.

20 NYCRR 590.11(a) provides as follows:

"(a) Question: How is the consideration for the real property or interest therein ascertained when the transfer includes an interest in real property and other assets?

"Answer: In the case of a transfer which includes other assets which are in addition to real property or an interest therein, the consideration must be reasonably allocated between the real property and the other assets pursuant to a written agreement signed by both the transferor and transferee. If there is no reasonable apportionment of the consideration for such real property, the consideration is that portion of the total consideration which represents the fair market value of such real property."

Since petitioner has presented no evidence of a written agreement allocating the consideration between the real property and the other assets (the intangible personal property) and since no other reasonable apportionment was made at the time of transfer, the consideration is assumed to be that portion of the total consideration which represents the fair market value of the real property alone (20 NYCRR 590.11[a]).

D. The petition of Aaron Ziegelman is denied and the Notice of Determination issued on August 21, 1989, as modified (see, Finding of Fact "12"), is sustained.

DATED: Troy, New York
November 17, 1993

/s/ Brian L. Friedman
ADMINISTRATIVE LAW JUDGE