STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
JANE MANSIONS	:	DETERMINATION DTA NO. 810171
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, Jane Mansions, c/o Leslie Susser, 6 East 43rd Street, 19th Floor, 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 Timothy J. Alston, Administrative Law Judge, at the offices of the Division of Tax Appeals, Riverfront Professional Tower, 500 Federal Street, Troy, New York, on September 3, 1993 at 1:15 P.M. Neither party submitted a brief. Petitioner appeared by Leslie Susser, Esq., General Partner. The Division of Taxation appeared by William F. Collins, Esq. (Michael J. Glannon, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation properly included consideration received by petitioner in respect of its transfer of a 49-year leasehold interest to a third party as part of the consideration received by petitioner, the sponsor in a cooperative conversion, in respect of its subsequent transfer of its fee interest to the cooperative housing corporation.

II. If so, whether the Division of Taxation properly determined that the face value of a $350,000.00 leasehold mortgage given as part of theconsideration for the transfer of the leasehold interest was properly used to calculate consideration rather than any discounted amount.

FINDINGS OF FACT

Petitioner, Jane Mansions, a limited partnership, was the owner of a six-story apartment

building located at 2 Jane Street, New York, New York.

On November 15, 1985, petitioner, as sponsor, filed with the New York State Department of Law a plan to convert the subject property to cooperative apartments ("the Plan").

Under the terms of the Plan as filed on November 15, 1985, upon transfer of title to the property from the sponsor to the cooperative housing corporation known as Two Jane Street Owners Corp. ("the CHC") the sponsor was to take back a 49-year master lease on certain ground floor commercial space and cellar storage space.

Petitioner subsequently entered into a master lease with an entity known as Duffield Corp., dated June 1, 1986, on the ground floor commercial space and cellar storage space of 2 Jane Street. This was essentially the same space which, under the plan as filed on November 15, 1985, was to be leased back by the CHC to petitioner.

The master lease between petitioner and Duffield Corp. was for 20 years with the lessee having two options to renew, one for 15 years and the other for 14 years, for a total lease term, if the options were exercised, of 49 years.

The master lease set the rent for the first year at $21,000.00. This was intended to be and, in fact, was a below-market rental. At the time the lease was entered into, the commercial space in the building was occupied by two stores. One store was operated as a veterinary office and was under a lease with annual rent of approximately $21,000.00. The other store was vacant at the time the lease was entered into, but had previously been operated as a gourmet food store and generated approximately $30,000.00 in annual rent.

As consideration for entering into the master lease, Duffield Corp. paid petitioner $50,000.00 in cash and gave petitioner a leasehold mortgage, also dated June 1, 1986, for $350,000.00.

For years following the first year, the master lease set annual rental as the sum of one-fifth of the lessor's expenses for real estate taxes and interest on the lessor's mortgage indebtedness plus one-ninth of the lessor's expenses applicable to its operation of the property.

Also contained in the lease was a provision whereby, in the event the property was conveyed to a cooperative housing corporation which thereby became the lessor under the lease, the annual rent would be capped at 19.5% of the cooperative housing corporation's gross income. According to petitioner, this provision was included in the lease to ensure compliance with the so-called "80/20 rule" for cooperative corporations under section 216 of the Internal Revenue Code.

Pursuant to the $350,000.00 leasehold mortgage given by Duffield Corp. to petitioner, repayment of principal and interest under the mortgage was to be contingent upon Duffield's successful subleasing of the leased premises. The mortgage allowed for the waiver of interest payments for the first five years and deferral of interest payments for the remaining term of the mortgage where rents received by Duffield Corp. in respect of the leased premises were exceeded by the sum of rents payable by Duffield in respect of the same premises plus certain costs. The mortgage required principal repayment after the fifth year, but also provided for the deferral of repayment of principal for a total period of 30 years under the same circumstances.

The mortgage also provided that the parties thereto agreed that the mortgage provided rights to the mortgagor only against the mortgagee and only as provided in the mortgage. The mortgagor had no rights against the lessor of the premises if such lessor was not the mortgagee.

The mortgagee also had no rights against the mortgagor under the mortgage except as provided in the mortgage, i.e., the mortgagor incurred no personal liability under the mortgage.

The mortgagor, Duffield Corp., was created for the purpose of acquiring the master lease to the premises. It had no other assets. Its sole shareholder was Leonard Epstein, who was a less-than-ten percent limited partner of petitioner.

The Plan as filed on November 15, 1985 set forth terms of rental with respect to the proposed lease between the cooperative housing corporation, as lessor, and petitioner, as lessee, which were substantially similar to the terms of rental contained in the lease between petitioner and Duffield Corp. entered into on June 1, 1986.

The terms of the Plan were modified and supplemented by several amendments thereto.

A summary of the provisions of the master lease between petitioner and Duffield Corp. and the related mortgage was set forth in the "Second Amendment" to the Plan, dated June 17, 1986.

The Plan, as amended, became effective July 11, 1986. Pursuant to the Plan, title to the subject property was conveyed in fee simple by petitioner to the cooperative housing corporation on August 13, 1986. Such title was conveyed subject to the lease dated June 1, 1986 between petitioner and Duffield Corp. Pursuant to the terms of such lease, upon the transfer of title to the cooperative housing corporation the CHC became the landlord under the lease.

Subsequent to the transfer to the CHC, Duffield Corp. paid rent under the lease to the CHC.

The transactions herein were ultimately structured in the manner described above in an effort to avoid the application of the Federal Condominium and Cooperative Abuse Relief Act of 1980 (15 USC § 3601 et seq)[1] which provided for the termination, without penalty, of contracts between sponsors and CHC's under certain circumstances. Petitioner was advised that this act might apply to a master lease of stores retained by a sponsor. This advice led to discussions between Mr. Leslie Susser, general partner of petitioner, and Leonard Epstein, which led, in turn, to Mr. Epstein's formation of Duffield Corp. and to the transaction as described herein. Also, in an effort to avoid the Federal Condominium Abuse Act, the lease between petitioner and Duffield Corp. provided that the leased premises were to serve the public generally and could not be used as property to serve the cooperative unit owners.

In connection with the transfer to the CHC, petitioner, as transferor, made timely filings as required under the Real Property Transfer Gains Tax Law. Upon review of a 50% project update filing by petitioner, dated March 1, 1989, the Division of Taxation ("Division") made certain adjustments, set forth in a Schedule of Adjustments dated January 9, 1990, which had

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[1]It is noted that the original Plan, as filed on November 15, 1985, stated that the Federal Condominium Abuse Act did not apply to the contemplated lease between petitioner, as lessee, and the CHC, as lessor.

the net effect of increasing petitioner's anticipated gain from

$770,708.00, as reported on the project update filing, to $1,241,547.00. Of this $470,839.00 net increase in anticipated gain, $400,000.00 resulted from an increase in petitioner's actual consideration from the transfer, which was, in turn, attributable to the $50,000.00 in cash and $350,000.00 leasehold mortgage given by Duffield Corp. to petitioner upon execution of the master lease on June 1, 1986.

The Schedule of Adjustments explained the $400,000.00 increase in actual consideration as follows:

> "IN ASSIGNING THE SPONSOR'S LEASEHOLD INTEREST IN 2 JANE STREET TO THE COOPERATIVE HOUSING CORPORATION, THE RETENTION BY THE SPONSOR OF THE RIGHT TO RECEIVE PAYMENTS UNDER THE LEASEHOLD MORTGAGE OF 6/1/86 (REPRESENTING THE DIFFERENCE BETWEEN FAIR MARKET VALUE RENTS AND THE RENTAL PAYMENTS TO BE MADE UNDER THE TERMS OF THE LEASE) RESULTS IN AN ECONOMIC GAIN TO THE TRANSFEROR."

Although, as noted, it appears that adjustments totalling $470,839.00 were made by the Division, only the $400,000.00 adjustment attributable to the Duffield leasehold transaction is at issue herein.

Taking into account the various adjustments, the Schedule of Adjustments calculated a tax due per share amount of $16.5540. Based upon this per-share figure, the Division subsequently issued to petitioner a Statement of Proposed Audit Changes dated May 21, 1990 wherein the Division proposed a gains tax assessment of $31,633.30, plus interest. The statement provided that the proposed assessment was based upon the Schedule of Adjustments dated January 9, 1990.

On July 7, 1990, the Division issued to petitioner a Notice of Determination which assessed a total amount due of $38,346.72, which included tax due of $31,633.30, plus interest accrued to that point.

Following a conciliation conference, the Bureau of Conciliation and Mediation Services issued a Conciliation Order dated September 13, 1991 which sustained the assessment and also

noted that payments totalling $8,166.62 had been applied to the tax liability. After crediting such payments, the tax assessment herein is now $23,466.68, plus interest.

Petitioner received a net total of $1,476.00 in interest payments under the mortgage during the first three years of the mortgage.

Petitioner received no payments of principal under the mortgage.

Petitioner entered into the record calculations prepared by its accountant which indicate that the net present value of the mortgage as of the date of the leasehold transfer was $99,875.00.

CONCLUSIONS OF LAW

A. Tax Law § 1441 imposes a tax on gains derived from the transfer of real property within New York State. With respect to cooperative conversions, it is well established that:

> "[T]he gains tax is imposed by the statute upon the overall cooperative conversion plan . . . . The corporation [is] merely a conduit through which ownership of individual units could be transferred by [the sponsor] to the purchasers through the sale of shares . . . . [T]he 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." (1230 Park Avenue Assoc. v. Commr., 170 AD2d 842, 566 NYS2d 957, 959, lv denied 78 NY2d 859, 575 NYS2d 455, citing Mayblum v. Chu, 109 AD2d 782, 486 NYS2d 89, mod NY2d 1008, 503 NYS2d 316.)

B. Tax Law § 1440(1)(a) defines "consideration" for purposes of Article 31-B, in part, as "the price paid or required to be paid for real property or any interest therein."

C. The instant matter involves two transactions. In the first, petitioner transferred a leasehold interest in the subject property to Duffield Corp. As consideration for such transfer, Duffield gave $50,000.00 in cash and a $350,000.00 leasehold mortgage. In the second transaction, petitioner transferred its fee interest in the property to the CHC, subject to the leasehold. As consideration for this transfer, petitioner received cash from shares which had been sold at the time of closing and also took back the remaining unsold shares. The Division contends that the consideration paid to petitioner by Duffield Corp. constituted consideration received by petitioner in respect of its transfer of the fee interest in the subject property to the CHC and, ultimately, to the individual unit purchasers.

The Division's theory of liability must be rejected, for the record herein shows that the consideration received by petitioner in respect of the leasehold transfer was separate and distinct from that received by petitioner in respect of the fee transfer. The consideration given by Duffield Corp. for the lease thus did not constitute consideration given by the CHC for the fee. The mere fact that petitioner derived "economic gain" from the Duffield transaction does not validate the Division's faulty premise.

D. In support of its position, the Division relies upon Matter of Cheltoncort Co. (Tax Appeals Tribunal, December 5, 1991, confirmed sub nom Matter of Cheltoncort Co. v. Tax Appeals Tribunal, 185 AD2d 49, 592 NYS2d 121). In that case, a cooperative conversion sponsor, which had a fee simple interest in the subject property, transferred such interest to the CHC and took back a 49-year lease on certain commercial space on the subject property. Rental under the lease was below market. The lease thus had economic value. The Appellate Division confirmed a Tax Appeals Tribunal decision which found that the Division properly determined that the economic value of the lease constituted consideration given by the CHC to the sponsor in respect of the transfer of title to the subject property.

The Division's reliance upon Cheltoncort is misplaced for that case is factually distinguishable from the instant matter. In Cheltoncort, the sponsor transferred the entire fee simple to the CHC; no leasehold interest was reserved. Consequently, the simultaneous transfer back of the economically valuable leasehold was properly determined to constitute consideration for the transfer of the fee interest. As the Tribunal stated in its decision:

> "In the situation presented herein, petitioner did not retain the commercial space. Petitioner transferred the entire building to the cooperative housing corporation. Therefore, the transfer of the building is subject to tax as part of the overall cooperative conversion plan (see, Matter of Mayblum v. Chu, 67 NY2d 1008, 503 NYS2d 316; Matter of 1230 Park Assocs. v. Commissioner of Taxation & Fin., 170 AD2d 842, 566 NYS2d 957). The transfer by petitioner of the entire building is clearly distinguishable from the situation to which petitioner has analogized, i.e., where a sponsor in a condominium conversion retains a unit." (Matter of Cheltoncort Co., supra.)

In the instant matter, in direct contrast to the situation presented in Cheltoncort, the entire fee simple was not transferred to the CHC. Rather, the leasehold interest was transferred to a

third party before the fee transfer to the CHC. The leasehold was thus excluded, in form, from the conversion and no part of the consideration given by the CHC to petitioner was related to the leasehold interest. Accordingly, the holding of Cheltoncort is inapplicable to the instant matter.

E. Alternate to its assertion of liability herein pursuant to the holding of Cheltoncort, the Division contends that the consideration received by petitioner in the leasehold transfer, that is, the $50,000.00 plus the $350,000.00 leasehold mortgage, may be aggregated with the consideration received by petitioner from the CHC in the fee transfer pursuant to the aggregation provision of Tax Law § 1440(7) which states in part:

> "Transfer of real property shall also include partial or successive transfers, unless the transferor or transferors furnish a sworn statement that such transfers are not pursuant to an agreement or plan to effectuate by partial or successive transfers a transfer which would otherwise be included in the coverage of this article . . . ."

> F. "[A]ggregation applies when the seller has adopted an agreement or plan for the disposal of an entire parcel of property, which would have been subject to the real property transfer gains tax, but for the structuring of the disposal of the property into partial or successive transfers. The two types of transactions are equivalent in end result." (Matter of Cove Hollow Farms v. State of New York Tax Commn., 146 AD2d 49, 539 NYS2d 127, 129 [emphasis in original].)

G. In the instant matter, petitioner clearly contemplated the disposal of the entire subject parcel. Furthermore, had the transaction been structured as initially intended under the conversion plan as originally filed on November 15, 1985, the transfer of the leasehold back to petitioner would have constituted consideration subject to gains tax under the precedent of Matter of Cheltoncort Co. (supra). Accordingly, it is proper to aggregate the consideration received in respect of the leasehold transfer with the consideration received under the conversion plan.

H. Regarding the valuation of the consideration received in respect of the leasehold, petitioner contends that the economic value of the lease should properly constitute the consideration received for the lease. This contention is rejected. "Consideration" is defined for purposes of Article 31-B as including "the amount of any mortgage" (Tax Law § 1440[1]). This provision has consistently been interpreted as meaning that the face amount of a mortgage,

rather than its value, is considered when determining consideration for gains tax purposes (see, Matter of Union Carbide Chemicals & Plastics Co., Tax Appeals Tribunal, September 2, 1993; Matter of River Terrace Associates, Tax Appeals Tribunal, October 22, 1992; Matter of Normandy Associates, Tax Appeals Tribunal, March 23, 1989).

As explained by the Tribunal:

> "This conclusion was based upon the fact that the Legislature used the term 'amount' when defining a mortgage as consideration, but used 'value' when defining lease payments as consideration later in the same section of the law, thus, distinguishing the application of the two concepts as they relate to the factors making up 'consideration' . . . . The statute says 'amount'; evidence concerning alleged losses or valuation will not alter the meaning and application of this term." (Matter of River Terrace Associates, supra).

Accordingly, notwithstanding petitioner's contentions regarding the actual value of the leasehold mortgage, the statutory language compels the use of the face value of the mortgage in determining consideration for gains tax purposes.

I. The petition of Jane Mansions is denied and the Notice of Determination, dated July 2, 1990, is sustained.

DATED: Troy, New York
February 24, 1994

/s/ Timothy J. Alston
ADMINISTRATIVE LAW JUDGE