STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
SWAG ASSOCIATES	:	DETERMINATION DTA NO. 810470
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, Swag Associates, c/o Gordon I. Remer, Esq., 1501 Broadway, Suite 2401, New York, New York 10036, 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 Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on August 16, 1993 at 1:15 P.M., with all briefs and documents to be submitted by February 16, 1994, which commenced the six-month period for issuing this determination. The Division of Taxation filed a brief on December 7, 1993. Petitioner filed a brief on February 16, 1994 and an amended brief on February 17, 1994.[1] Petitioner appeared by Gordon I. Remer, Esq. The Division of Taxation appeared by William F. Collins, Esq. (David C. Gannon, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation erred in allowing, in the calculation of consideration, only 6 percent of a 25 percent finder's fee paid by petitioner on the sale of 12 tenant-occupied cooperative apartments.

II. Whether the Division of Taxation erred in disallowing brokerage commissions paid on the

[1]It is recognized that petitioner's amended brief was filed one day late. The short delay does not warrant rejecting petitioner's amended brief (see, Matter of Angelico, Tax Appeals Tribunal, June 16, 1993).

sale of two cooperative apartments.

FINDINGS OF FACT

Petitioner, Swag Associates ("Swag"), was the sponsor of a "non-eviction" plan to convert apartments in a building located at 245 East 87th Street, New York, New York to cooperative ownership.

Swag employed the services of a sales agent, known as Dapesa Corp., ("Dapesa") to promote the sale of cooperative apartments. Dapesa ultimately sold in excess of 90 apartments. A majority of the apartments handled by Dapesa were sold to tenants who occupied the apartments at the time of the conversion. Some apartments, which were vacant, were sold to parties who purchased for their own occupancy. Accordingly, all sales by Dapesa Corp. were made to people who were previously living in the building or moving into the building for their own use and occupancy.

Prior to the Tax Reform Act of 1986, a cottage industry developed in New York City which consisted of selling occupied apartments in groups to syndicate partnerships or individuals in order to obtain certain tax advantages. The tax advantages were important because the rent that the owner of the apartment would receive from the tenant was less than the amount of maintenance or expense that the owner would have to pay the cooperative corporation. Thus, there was no economic reason to buy the apartments other than the tax advantage. Since such sales were made for tax considerations, sales were made through investment advisors, tax advisors and accountants. After the enactment of the Tax Reform Act of 1986, the cottage industry of selling occupied apartments quickly ended because once the tax advantage was removed, there was no economic incentive to purchase a tenant-occupied apartment.

Some of the occupants of the apartment building chose to remain as tenants and not to purchase shares of the new cooperative apartment corporation. Mr. David Swersky, who, as president of Dapesa, handled the sale of vacant apartments, did not feel qualified to sell tenant-occupied apartments because he did not feel equipped to engage in this type of highly

specialized sale. Therefore, in 1985, petitioner engaged the services of Mr. Charles Hack and Mr. James B. Mintzer and their company, Parkview Associates, Inc., in order to sell certain apartments which were tenant-occupied.

At the time Messrs. Hack and Mintzer's services were retained, they were well known as large sellers of occupied apartments. When Mr. Swersky first met with Messrs. Hack and Mintzer, they boasted that they had sold in excess of 1,500 apartments. Mr. Swersky felt that this displayed extraordinary ability.

Mr. Hack advised Swag that the fee for selling tenant-occupied apartments was 25 percent of whatever the consideration was. Petitioner was unhappy with the fee, but felt that it had no choice but to accept.

In a document dated May 1, 1985, Mr. Sandler, who was the principal of Swag, on behalf of Swag, and Messrs. Hack and Mintzer agreed to certain fees. The document embodying their agreement provided, in part, as follows:

> "1. . . . Messrs. Hack and Mintzer (collectively, the 'Participants') have arranged for the sale of the Apartments to various investors, in consideration for which services Swag shall pay to the Participants a finder's fee equal to twenty-five percent (25%) of the net consideration received. The Participants agree to accept such fee in kind, i.e., they will accept twenty-five percent (25%) of the cash consideration received by Swag and a twenty-five percent (25%) interest in the purchase money notes received by Swag upon the sale of the Apartments to the investors procured by Participants.
>
> "2. To implement the foregoing, Swag confirms that upon the sale to the Investors, the Participants will have a twenty-five percent (25%) equity interest (the '25% Interest') in the proceeds from the sale thereof, and hereby assigns and conveys to the Participants the 25% Interest, effective upon the sale of each Apartment.
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> "3. Swag agrees that twenty-five percent (25%) of the cash consideration received from each purchaser at closing shall be paid to Participants and that the Purchaser Notes will be made payable to the Participants and Swag.
>
> "4. Swag will have a seventy-five percent (75%) interest in the Purchaser Notes and the collateral given to secure same (the 'Collateral') and Participants will have a twenty-five percent (25%) interest in the Purchaser Notes and the Collateral, as tenants in common."

Initially, it was contemplated that Messrs. Hack and Mintzer would sell 16 apartments. However, after six months of marketing, meetings and tax planning with attorneys, accountants

and their principals, they were able to sell only 12 apartments.

The 12 occupied apartments sold for a gross price of $1,465,230.00. In order to sell the tenant-occupied apartments, Mr. Hack had to prepare an offering memorandum including cash flow projections and tax analysis and hire additional staff in order to bring a group of investors together to buy the apartments. In contrast, in the sale of the approximately 90 apartments by Dapesa, petitioner did not have to prepare any projections. In the opinion of Mr. Swersky, Messrs. Hack and Mintzer were not selling real estate. They were engaging in tax planning and the real estate that went along with it was incidental. Similarly, in the opinion of Mr. Sandler, Messrs. Hack and Mintzer were not selling real estate. Rather, he testified as follows:

> (Division's representative) Q: "Now, regarding your dealing with Mr. Hack and Mintzer, you stated to your recollection or at least to your understanding, they were licensed brokers; yet the agreement between yourself and them specifically stated 'finders fee' as opposed to 'brokerage' or 'commission' or anything to that effect. I'm curious about that.
>
> (Mr. Sandler) A: "They used that term, and my understanding was they weren't selling real estate. If they were selling real estate, they would be getting 7 or 8 percent cash at the closing. That was not the deal. They were doing projection analyses, meetings with investors and accountants. They were doing a whole program that was a little different than what your typical real estate broker does" (tr., pp. 39-40; emphasis added).

In hindsight, Mr. Swersky felt that the 25 percent fee was reasonable because Parkview Associates, Inc. was able to obtain good prices in December 1985 despite the fact that there were discussions about changing the tax law.

In one contract, for sale of a unit, Mr. Sandler is listed as the seller. This is because at one point Swag was down to a limited number of apartments that could not be sold. Mr. Sandler and his associate divided the remaining apartments. Eventually, one apartment became vacant. Thereafter, Mr. Sandler sold the vacant apartment and three other occupied apartments as part of a package deal. The price for all four apartments was approximately $200,000.00 which was about the market price for a vacant apartment.

Mr. Hack's name was listed as a 25 percent owner of apartment 18B on a contract for sale because he claimed at one point to have sold 13 apartments. As compensation, Mr. Hack claimed a 25 percent interest in the note which was consideration for the 13th apartment.

The builder who constructed the apartment building obtained six units. This was part of the original consideration for the building.

In an undated letter, the Division of Taxation ("Division") advised petitioner that, based upon an audit, a claim for refund which Swag had previously made was denied and additional tax, penalty and interest was due. The letter stated, in pertinent part, as follows:

> "[I]t has been determined that the 25% 'finder's fee' paid to Mr. Charles Hack and Mr. James Mintzer is not considered a customary or reasonable cost to be claimed as brokerage. As per our phone conversation, we agreed to allow 6% of the consideration received on the 12 units involved. This resulted in the allowance of $87,914.00 plus $113,342.00 that was documented as actual brokerage paid on other units."

Although not expressly discussed in the foregoing letter, the Division disallowed the brokerage commissions which petitioner claimed it paid on apartments 7B and 10B. The brokerage commissions were disallowed because petitioner was unable to substantiate the brokerage commission paid on the two apartments. The latter two apartments were not sold by Messrs. Hack and Mintzer.

On the basis of the foregoing conclusions, the Division issued a Notice of Determination, dated November 8, 1991, which asserted a deficiency of tax in the amount of $4,175.50, plus interest of $352.30 and penalty of $1,169.14, for a current balance due of $5,696.94.

In the experience of Mr. Sandler, as a sponsor involved in the conversion of real estate, he has never had an agreement with a broker to accept some form of note to pay a commission at the time of the transaction. It is Mr. Sandler's experience that brokers want cash at the time of closing.

Mr. Charles Hack was not a licensed real estate broker. He was issued a Real Estate Salesperson License in 1986. Mr. Mintzer was not a licensed real estate broker or salesperson from at least November 1, 1985 through August 25, 1993.

The contract of sale pertaining to apartment 7B, which is dated July 12, 1984, contains a paragraph 14 which provides:

"14. Purchaser represents to Seller that Purchaser has not dealt with any brokers in

connection with this transaction other than

BRUCE BAUM

and Seller agrees to pay said broker a commission."

The contract of sale regarding apartment 10B contains the same paragraph as that set forth above except that the broker listed was Bellmarc Realty.

The affidavit of David Swersky and the credible testimony of the same individual at the hearing show that apartment 10B was sold to Samuel and Florence Fertig and that Bellmarc Realty was the real estate broker that brought about this sale. From the proceeds of the sale, Bellmarc Realty was paid a commission of $11,400.00. Apartment 7B was sold to Rodman Reef and Bruce Baum was the real estate broker that brought about the sale of this apartment. From the proceeds of the sale, Bruce Baum was paid a commission of $10,000.00.

At the hearing, Mr. Swersky was unable to recall when the sale of apartments 7B and 10B occurred.

SUMMARY OF THE PARTIES' POSITIONS

It is petitioner's position that the disallowed portion of the finder's fee should have been allowed as a reduction of consideration. Petitioner submits that there was nothing customary about this transaction. According to petitioner, the Division has not demonstrated that it is able to determine what is a customary brokerage fee under the circumstances involved herein of a bulk sale of occupied apartments, at steeply discounted prices with a guaranteed monthly cash loss for which the purchaser paid only five percent of the purchase price at closing. It is contended that petitioner was in business and if it could have retained someone who would have obtained the same sales price for a smaller fee, they would have been retained.

Petitioner next argues that the finder's fee was reasonable and necessary. The apartments were losing money, declining in value and that any market for their sale would soon disappear. Although petitioner was unhappy about paying a 25 percent fee, it would have paid more because it was unable to sell them any other way.

Lastly, petitioner contends that the Division erred in disallowing the brokerage

commissions paid on the sales of apartments 7B and 10B. It is petitioner's position that substantiation for finding that brokerage commissions were paid may be found in the contracts for the sale of the apartments and in the testimony of Mr. Swersky.

Initially, the Division argues that the finder's fee of 25 percent was not a customary fee and that the term "customary" relates to the amount of the fee and not the manner in which it was earned. The Division submits that the testimony of one of petitioner's own witnesses shows that the finder's fee exceeded customary brokerage fees.

The Division next submits that the disallowed portion of the finder's fee consists of advertising and marketing fees which were not allowable under the gains tax law in effect at the time of the transfer.

The Division contends that the form of the finder's fee raises the question of whether an arm's-length transaction occurred. The Division posits that the manner in which Messrs. Hack and Mintzer were paid was a surreptitious profit-sharing maneuver intended to "front-load" some of the management fees that the purchasers would ultimately be paying to Parkview Associates, Inc. The foregoing argument is based on several factors. First, the Division questions why Messrs. Hack and Mintzer would settle for a portion of the fee up front and have the balance tied up with long-term notes. Next, the Division questions why Messrs. Hack and Mintzer did not take 100 percent of the cash received at the closing and require a short-term guarantee for the remainder. Third, the Division asserts that the payment schedule favored petitioner to the detriment of Messrs. Hack and Mintzer. Thereafter, the Division questions why Messrs. Hack and Mintzer would negotiate a deal more favorable to petitioner if petitioner was in a bind.

Lastly, the Division argues that petitioner has failed to demonstrate that the Division erred in disallowing broker commissions on two other units. The Division contends that the value of Mr. Swersky's testimony is nil because it is not supported by documentation and because it relies on statements made by individuals not available for questioning. Further, Mr. Swersky could not recall the year in which the sales occurred. The Division also contends

that the contracts for the sale of the apartments are of no value because they offer no evidence beyond naming a broker.

CONCLUSIONS OF LAW

A. The first question presented is whether petitioner has established that the Division erred in allowing only 6 percent of the 25 percent finder's fee paid by petitioner on the sale of 12 tenant-occupied cooperative apartments.

B. Article 31-B of the Tax Law imposes a tax on the gains derived from the transfer of real property within the State (Tax Law § 1441). The term "gain" is defined 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" (Tax Law § 1440[3]).

C. Tax Law § 1440(1)(a) defines the term consideration, in part, 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" (emphasis added).

D. In essence, the Division maintains that the term "customary" pertains to the amount of the fee and that the testimony herein establishes that a finder's fee of 25 percent is not customary. In contrast, petitioner submits that one must look at the circumstances in order to determine what is customary and that, under these circumstances presented herein, a fee of 25 percent was reasonable.

E. An examination of the statutory section in issue shows that the term "customary brokerage fees" represents an amount which is to be subtracted from "the price paid or required to be paid for real property or any interest therein . . . ." On its face, the term "customary" sets a limit on the amount that may be deducted from the price paid or required to be paid.

F. In this case, the testimony of Mr. Sandler clearly establishes that a fee of 25 percent is not a customary fee for a broker selling real estate (Finding of Fact "9"). Further, Mr. Sandler's testimony is consistent with the testimony of Mr. Swersky, that Messrs. Hack and Mintzer were engaging in tax planning and not selling real estate. Therefore, it is concluded that the Division properly found that a portion of the finder's fee was not allowable as a customary brokerage fee.

G. The Division also properly determined that the disallowed portion of the finder's fee was not allowable under the provisions of the gains tax law at the time of the transfer. At the time the transfers of the apartments occurred, Tax Law former § 1440(5)(a) provided, in part:

> "Original purchase price shall also include the amounts paid by the transferor for any customary, reasonable and necessary legal, engineering and architectural fees incurred to sell the property . . . ."

The Commissioner's regulations interpreting this section show that only certain selling expenses may be included in original purchase price (20 NYCRR 590.17).

H. Tax Law § 1440(5)(a) was amended by chapter 57 of the Laws of 1993. The amendment was made applicable to taxable years beginning on or after January 1, 1993 and transactions occurring on or after April 15, 1993. As amended, Tax Law § 1440(5)(a) provides:

> "Original purchase price shall also include the amounts paid by the transferor for any customary, reasonable and necessary legal, engineering and architectural fees and any customary, reasonable and necessary advertising and marketing costs not included in customary brokerage fees paid by the transferor incurred to sell the property . . . ."

The testimony herein establishes that Messrs. Hack and Mintzer were engaged in order to market certain occupied apartments. Since the Legislature did not authorize the inclusion of marketing expenses in the original purchase price until after the transactions at issue herein, said expenses were properly disallowed. Petitioner's arguments that the expenses were reasonable and necessary have no bearing on this matter. A taxpayer can only deduct those expenses which are permitted by the Tax Law.

I. The Division's argument that the finder's fee agreement raises the question of whether there was an arm's-length transaction between Swag and Messrs. Hack and Mintzer has been considered and rejected on the record presented herein. Having found that Messrs. Hack and Mintzer were not performing customary brokerage services, no conclusion can be drawn from the fact that their fee arrangement did not correspond with that of other brokers.

J. Petitioner has submitted sufficient evidence to establish that brokerage commissions were paid on apartments 7B and 10B. The contracts for the sale of the apartments show that a broker brought about the transactions. Further, Mr. Swersky was able to provide credible

testimony regarding the payment of brokerage commissions. Even in the absence of supporting documentary evidence, this testimony is sufficient to establish that the brokerage commissions in issue were paid (see generally, Matter of Pay TV of Greater New York, Tax Appeals Tribunal, July 14, 1994). Although the testimony of Mr. Swersky relies partially on hearsay, said testimony may be given weight because hearsay is admissible at an administrative hearing (see, e.g., Matter of Kucherov v. Chu, 147 AD2d 877, 538 NYS2d 339). Further, the fact that Mr. Swersky could not recall the year in which the sales occurred, does not diminish the weight which may be given to his testimony.

K. The petition of Swag Associates is granted only to the extent of Conclusion of Law "J" and the Division is directed to modify the Notice of Determination, dated November 8, 1991, accordingly; except as so granted, the petition is otherwise denied and the Notice of Determination is sustained.

DATED: Troy, New York
August 11, 1994

/s/ Arthur S. Bray
ADMINISTRATIVE LAW JUDGE