STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
DAVID AND KATHERINE SCHOONMAKER	:	DETERMINATION DTA NO. 810480
for Revision of a Determination or for Refund of Real Estate Transfer Tax under Article 31 of the Tax Law for the Year 1989.	:	

Petitioners, David and Katherine Schoonmaker, 257 Southdown Road, Lloyd Harbor, New York 11743, filed a petition for revision of a determination or for refund of real estate transfer tax under Article 31 of the Tax Law for the year 1989.

On May 29, 1992, petitioners by Sordi and Sordi (Nicholas A. Sordi, Jr., Esq., of counsel) moved for summary determination. The motion was returnable June 30, 1992. On June 11, 1992, the Division of Taxation by William F. Collins, Esq. (Donald C. DeWitt, Esq., of counsel) cross-moved for summary determination. Upon review of the documents submitted, Marilyn Mann Faulkner, Administrative Law Judge, renders the following determination.

ISSUES

I. Whether the Supplemental Agreement, which reduced by $20,000.00 the purchase price of residential real property, substantially amended the original contract for the conveyance of the property such that the conveyance was no longer grandfathered from the tax imposed under Tax Law § 1402-a.

II. Whether regulations, which were effective after petitioners entered into the Supplemental Agreement, may be applied in determining whether taxshould be imposed on the conveyance of residential real property under Tax Law § 1402-a.

FINDINGS OF FACT

On October 7, 1988, petitioners, David and Katherine Schoonmaker, executed a binding written contract with Kathryn T. Sargent to purchase residential real property (a house) for a

total consideration of $1,100,000.00. Petitioners established the contract date of October 7, 1988 by "independent evidence" to the satisfaction of the Division of Taxation ("Division").

Under the terms of the contract, petitioners were to pay a $50,000.00 deposit on the signing of the contract, $280,000.00 on the delivery of the deed and would provide a note secured by a purchase money mortgage in the amount of $770,000.00.

According to uncontested statements made in an affidavit by David Schoonmaker, petitioners needed the net proceeds from the sale of their then-existing house for the purchase of the house pursuant to the October 7 contract. Therefore, they listed for sale the home in which they were living; however, petitioners had a difficult time finding a buyer. Mr. Schoonmaker alleged that because the "bottom fell out" of the residential real estate market on Long Island, they reduced the selling price of their home numerous times. By four written stipulations, Ms. Sargent extended, from January 12, 1989 to September 15, 1989, the closing date originally set forth in the contract of sale in order to accommodate petitioners' delay in selling their house. Petitioners finally found a purchaser for their house but at a price much lower than anticipated. In his affidavit, Mr. Schoonmaker claimed that because they did not realize the net cash originally anticipated from the sale of their house, they did not have enough cash to purchase the house from Ms. Sargent under the terms of the contract "particularly in light of the fact that the house [they] were buying was in need of extensive and major renovations." Mr. Schoonmaker described the seller's response to petitioners' quandary as follows:

> "Fortunately for us, our Seller, Kathryn T. Sargent, was a reasonable person who also recognized the downward spiral of the real estate market, and she was willing to reduce the total price of the house and to increase the purchase-money mortgage portion of the total consideration due at closing, rather than 'lose' the sale of the house to us."

On August 18, 1989, petitioners entered into a Supplemental Agreement with Kathryn Sargent reducing the sale price of the house by $20,000.00 for the total purchase price of $1,080,000.00. The Supplemental Agreement also increased the amount of the purchase money mortgage by $55,000.00 to $825,000.00 under the same 9½% interest rate and 25-year term as existed under the October 7, 1988 contract. With the exception of these changes, all provisions

of the October 7, 1988 contract remained intact.

Tax Law § 1402-a, known as the "mansion tax", was enacted by the Legislature pursuant to section 182-a of chapter 61 of the Laws of 1989. Section 1402-a(a) imposes a tax on the conveyance of residential real property when the consideration for the entire conveyance is one million dollars or more. The tax rate is 1% of the consideration attributable to the residential real property to be paid by the purchaser of the property. In accordance with section 365(f)(3) of chapter 61 of the Laws of 1989, section 1402-a was made effective July 1, 1989 and was to apply to:

> "conveyances occurring on or after such date other than conveyances which are made pursuant to binding written contracts entered into on or before February 16, 1989, provided that the date of execution of such contract is confirmed by independent evidence, such as the recording of the contract, payment of a deposit or other facts and circumstances as determined by the commissioner of taxation and finance."

On October 16, 1989, section 575.5(b) of Title 20 of the New York Code of Rules and Regulations was filed as an emergency rule and was published in the November 1, 1989 edition of the State Register. As an emergency rule, section 575.5 was effective on the date of filing and was to expire 90 days after the October 16, 1989 filing date. Section 575.5 was filed and adopted as a final rule on December 22, 1989. The final rule was published in the January 10, 1990 edition of the State Register and became effective on the date of publication. Because the rule was made final within 90 days from the adoption of the emergency rule, section 575.5 of Title 20 NYCRR has been effective since October 16, 1989.

The Division issued to David Schoonmaker a Notice of Determination, dated May 29, 1990, assessing a real estate transfer tax due in the amount of $10,800.00, plus a $2,592.00 penalty and $768.06 in interest.

A conciliation conference was held on October 22, 1991. By Conciliation Order dated January 31, 1992, the conferee sustained the Notice of Determination with respect to the $10,800.00 tax, but cancelled the penalty.

Petitioners filed a petition dated February 7, 1992 claiming that the Division erred in applying section 1402-a to their purchase because the contract for sale was executed prior to the

effective date of section 1402-a and the Supplemental Agreement constituted a "nonsubstantial" amendment to the original contract. Petitioners also alleged that the Division erred in applying 20 NYCRR 575.5 to their purchase inasmuch as the regulation was not effective, even as an emergency rule, on September 19, 1989, when they closed title on their purchase. Petitioners contended that the application of the regulation to their transaction was "the equivalent of an ex post facto law and [was] fundamentally unfair."

The Division filed an answer, dated April 3, 1992, alleging that petitioners' amendment to the original contract constituted a "substantial change" to the original contract and thus section 1402-a applied.

On May 29, 1992, petitioners filed a motion for summary determination returnable June 30, 1992. Petitioners alleged that there were no triable issues of fact and that summary determination should be granted in their favor. Petitioners argued that, as a matter of law, the Division may not retroactively apply a regulation to the facts in this case. Citing McNulty v. State Tax Commn. (70 NY2d 788, 522 NYS2d 103), petitioners claimed that the regulation deprives them of a "statutorily-created exemption".

On June 11, 1992, the Division cross-moved for summary determination in its favor noting that there were no material facts at issue. The Division argued that 20 NYCRR 575.5 merely codified the Division's policy and did not change, in any way, the scope of section 1402-a. The Division noted that a similar regulation, effective September 24, 1985, was promulgated with respect to a "grandfather" provision under Tax Law § 1443(6) involving real property transfer gains tax and that such provisions constitute exemptions which must be strictly construed against the taxpayer.

CONCLUSIONS OF LAW

A. As noted in Finding of Fact "5", Tax Law § 1402-a, known as the "mansion tax", imposes a tax on the conveyance of residential real property when the consideration for the conveyance is one million dollars or more. The tax rate is 1% of the consideration to be paid by the purchaser of the property. With respect to the effective date and applicability of the statute,

section 365(f)(3) of chapter 61 of the Laws of 1989 provides that the statute applies to:

> "conveyances occurring on or after [the effective] date [of July 1, 1989] other than conveyances which are made pursuant to binding written contracts entered into on or before February 16, 1989, provided that the date of execution of such contract is confirmed by independent evidence...."

The Commissioner of Taxation and Finance is authorized under Tax Law § 1415(a) "to make such rules and regulations...as the commissioner may deem necessary to enforce the provisions of the article." Under this authority, the Commissioner implemented 20 NYCRR 575.5 to explicate further the grandfather provision by discussing the situation in which a binding contract entered into prior to February 16, 1989 is subsequently amended after February 16, 1989. The regulation provides that if the subsequent amendment to the contract is of a "nonsubstantial nature", then the conveyance is still considered to have been made pursuant to the original contract. In determining what constitutes a nonsubstantial change, the regulation provides that such determination be made on a case-by-case basis, but that "any change in the amount of consideration for the real property will be considered a substantial change to the contract" (20 NYCRR 575.5[b]).

Petitioners contend that the Division is improperly seeking to enforce retroactively the regulation's interpretation of language contained in Tax Law § 1402-a which clearly granted a tax exemption to them. Petitioners argue that because the regulation was promulgated subsequent to the September 19, 1989 closing of the property, they could not have been aware of the Division's possible interpretation of section 1402-a; that had the regulation "existed in any published or formal way" when they contemplated entering into the Supplemental Agreement, they would not have done so; and that, in any event, they closed title pursuant to a binding written contract entered into before February 16, 1989 in accordance with the requirement of section 1402-a. Thus, conclude petitioners, as a matter of law, the Division cannot impose a tax pursuant to section 1402-a "based on an ex post facto application of an after-issued [r]egulation."

The gravamen of petitioners' argument relies primarily on the issue of fairness. The prohibition against ex post facto laws derives from the United States Constitution and refers to

criminal, not civil, laws (Adelman v. Adelman, 58 Misc 2d 803, 296 NYS2d 999, 1003-1004; Yoli v. Yoli, 55 Misc 2d 416, 285 NYS2d 470, 472; Application of Bailey, 178 Misc 1045, 37 NYS2d 275, 280; McKinney's Cons Laws of NY, Book 1, Statutes § 51); thus, the term is not applicable to the facts of this case. Although petitioners also appear to argue that the regulation is invalid as inconsistent with the statute, citing McNulty v. State Tax Commn. (supra), they primarily focus on the retroactive application of the regulation. The retroactive application of a regulation must be measured against the policy of the statute it seeks to interpret and the principle of equity (see, SEC v. Chenery Corp., 332 US 194, 203, 91 L Ed 1995 [1947]).

> "Ordinarily, if a new regulation or interpretation merely recites settled prior law or policy, then retroactive application of the regulation or interpretation is proper. If, however, the new regulation or interpretation overrules prior law or policy, the new regulation or interpretation will not, depending on various factors, be given retroactive effect. This distinction is obviously grounded upon notions of fairness to the involved parties" (Sam v. U.S., 682 F 2d 925, 932 [Ct Cl 1982], cert denied 459 US 1146, 74 L Ed2d 993 [1983]).

Thus, the question is whether the regulation "recited" or "overruled" the statute it sought to interpret. Section 365(f)(3) of chapter 61 of the Laws of 1989 ensures that section 1402-a does not apply to conveyances made pursuant to binding written contracts entered into on or before February 16, 1989. Both parties agree that petitioners entered into a binding written contract prior to February 16, 1989. However, once petitioners entered into the Supplemental Agreement, they were no longer bound by all the terms of the original contract.

While the grandfather provision, set forth when the statute was enacted, does not specifically address the effect of an amendment to a prior binding contract, it is obvious that once an amendment changes the terms of the prior contract, conveyances are no longer being made pursuant to the prior binding contract alone. Thus, even without the application of the regulation, the grandfather provision, by itself, does not "clearly" grant an exemption to petitioners and instead should have alerted petitioners that the amendment might have jeopardized the effect of the grandfather provision with respect to the prior contract.

The regulation, which interprets the applicability of section 1402-a to conveyances, does not overrule the grandfather provision but instead clarifies that if a binding contract is

subsequently amended, the conveyance will nonetheless be considered a conveyance pursuant to the prior contract if the amendment is nonsubstantial. Whether an amendment to a binding contract is substantial or nonsubstantial depends on the degree to which the parties are bound to the terms of the original contract once the amendment is in effect. Thus, the regulation does no more than recognize that although a subsequent amendment to a prior contract changes the effect of the prior contract, such amendments may be so minor that the prior contract still controls for purposes of the grandfather clause.

By petitioners' own admission, the amendments to the purchase price of the original contract were not insignificant and were not contemplated by the original contract. If the original contract had provided for some flexibility in the financing of the house (e.g. price or sale contingent on the sale of petitioners' then current home), then an argument could be made that the change in price was contemplated in the original contract and, therefore, the subsequent amendments relate back to the original contract as the controlling document. However, the fact that the amendments were not contemplated by the original contract and were necessary for the consummation of the transaction, weighs against the notion that the prior contract should control for purposes of the application of the grandfather provision (see, Matter of the Estate of Lever v. New York State Tax Commn., 144 AD2d 751, 535 NYS2d 158).[1]

The fact that 20 NYCRR 590.21, effective September 24, 1985, contains identical language in interpreting a similar grandfather provision of section 1443(6) involving real property gains tax lends further support to the proposition that 20 NYCRR 575.5 merely recited prior law or policy with respect to property conveyances (see, Matter of the Estate of Lever v. New York State Tax Commn., supra). Inasmuch as the grandfather provision exempted from tax certain property conveyances made after the effective date of the taxing statute, the provision must be strictly construed against petitioners (see, id., 535 NYS2d at 160).

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[1]With respect to their fairness argument, petitioners claim they might not have amended the contract if they had been cognizant of the regulation. This argument might have more bearing if the terms of the amended contract were less favorable to them with the addition of the tax than the terms of the prior contract without the tax.

Accordingly, petitioners have not met their burden of clearly demonstrating entitlement to the tax exemption.[2]

B. The motion for summary determination in favor of David and Katherine Schoonmaker is denied, the cross motion for summary determination in favor of the Division of Taxation is granted, and the Notice of Determination, dated May 29, 1990, as modified by the Conciliation Order, dated January 31, 1992, is sustained.

DATED: Troy, New York
September 10, 1992

/s/ Marilyn Mann Faulkner
ADMINISTRATIVE LAW JUDGE

[2]In so holding, I do not address whether the language in the regulation -- "any change in the amount of consideration for the real property will be considered a substantial change to the contract" (emphasis added) -- is consistent with the grandfather provision with respect to section 1402-a. The Supplemental Agreement is found to constitute a substantial change to the prior contract based on the facts of this case. Whether the regulation correctly provides that "any" change in the consideration should "always" constitute a substantial change under the grandfather provision, is not addressed.