STATE OF NEW YORK
DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
IVANCREST ASSOCIATES	:	DETERMINATION DTA NO. 810980
	:	
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, Ivancrest Associates, 1161 Meadowbrook Road, North Merrick, New York 11566, filed a petition for revision of a determination or for refund of tax on gains derived from certain real property transfers under Tax Law Article 31-B.

On or about July 7, 1993, petitioner by its duly appointed attorney and representative, Margolin, Winer & Evens (James L. Tenzer, Esq., of counsel), and the Division of Taxation by William F. Collins, Esq. (Andrew J. Zalewski, Esq., of counsel), signed a waiver of hearing and consented to have the matter determined upon stipulated facts, documents and briefs. On August 11, 1993, the Division of Taxation submitted its exhibits. On October 1, 1993, Petitioner submitted the agreed Stipulation of Facts with attached exhibits. The last day for filing briefs was December 3, 1993, and petitioner's reply brief was filed on that date. After due consideration of the evidence and arguments had herein, Carroll R. Jenkins, Administrative Law Judge, renders the following determination.

ISSUE

I. Whether the original purchase price for residential apartments acquired by petitioner and which were later transferred to a cooperative housing corporation as part of a conversion to cooperative use, should bebased on petitioner's original cost for the property or the cooperative housing corporation's cost for such property.

II. Whether the cooperative housing corporation's mortgage indebtedness on the property should be allocated to and included in consideration received by petitioner upon its sale of cooperative housing corporation shares.

III. Whether the Division of Taxation's different treatment of cooperative corporations and non-cooperative corporations with regard to the determination of original purchase price and the treatment of mortgages in determining consideration violates the Equal Protection clauses of the New York State and Federal constitutions.

IV. Whether petitioner is entitled to compute its gains tax liability with respect to the cooperative conversion it sponsored by utilizing the "Option B" calculation method as opposed to the method employed by the Division of Taxation on audit.

V. Whether petitioner has established that penalties asserted for failure to timely file certain returns and failure to timely remit tax due should be abated.

VI. Whether petitioner has demonstrated that the Division has improperly computed interest on the assessment.

FINDINGS OF FACT

The parties do not appear to disagree on the facts. Petitioner, Ivancrest Associates, 1161 Meadowbrook Road, North Merrick, New York 11566 (referred to herein variously as "petitioner", "sponsor" or "transferor") is the sponsor of a plan to convert to cooperative ownership, real property known as Rivercrest Apartments, 103 Gedney Street, Nyack, New York ("the property").

Petitioner acquired the property consisting of 94 apartment units for the sum of $1,715,562.00 in June 1966.

On March 12, 1980, petitioner, as sponsor, caused 103 Gedney Owners, Inc., a cooperative housing corporation ("CHC"), to be incorporated in the State of New York. In May 1980, petitioner caused the CHC to submit for approval to the Attorney General of the State of New York, a plan for the sale of the CHC's shares to persons intending to purchase the cooperative's apartment units ("Units"). The plan was approved and declared effective April 24, 1981.

On March 4, 1980, petitioner entered into an agreement to convey the property to the CHC. On September 16, 1981, pursuant to the March 4, 1980 agreement, petitioner conveyed the property to the CHC in exchange for: a) the total proceeds from the sale of shares; b) the remaining unsold shares; c) a purchase money mortgage note; and d) the CHC taking the property subject to the first mortgage. The amount paid to petitioner by the CHC upon the transfer of the property was $4,936,276.00, computed as follows:

Cash	$1,550,961.00
Value of 14,917 unsold shares	924,400.00
Rome Savings Bank Mortgage Assumed by the CHC	1,260,915.00
Mortgage note from the CHC to petitioner	1,200,000.00
TOTAL:	$4,936,276.00

The gains tax became effective March 28, 1983. After the effective date of the gains tax petitioner sold shares representing interests in eight of the cooperative's residential apartments, but did not file gains tax forms or pay applicable tax to the Division of Taxation ("Division"). The Division wrote petitioner's attorney on December 1, 1988 advising him that petitioner, as sponsor of a cooperative housing plan, the shares of which have an aggregate value exceeding $1 million, was required by Article 31-B (§ 1447) of the Tax Law to file questionnaires, infra, with the Division at least 20 days prior to the date of each transfer. The letter went on to request that petitioner comply with these filing requirements.

On or about February 7, 1989, petitioner filed the required transferor's Real Property Transfer Gains Tax Schedule of Original Purchase Price (DTF-700[9/85]). On the schedule of original purchase price, petitioner reported its price to acquire the property as $4,936,276.00 as computed in Find of Fact "4". It is noted that petitioner did not report the price it paid in 1966 ($1,715,562.00) as the cost of acquiring the property, but rather, the amount contracted for by the CHC upon petitioner's transfer of the property to the CHC.

On February 7, 1989 and February 16, 1989, petitioner filed Unit Submission Questionnaires for Cooperatives and Condominiums (DTF-702[9/85]). These questionnaires together reflect that the subject property contains 94 apartment units, which constituted 54,685 shares in the CHC. At the time of filing these questionnaires, petitioner reported 79 units

(46,321 shares) had been sold for $2,152,564.00 prior to the effective date of the gains tax statute (March 28, 1983), with 15 units (8,364 shares)[1] remaining unsold. These forms reported that no gains tax was due, since the sale of all of these units' shares were "exempt", except for one. The one exception was Apartment 5A. Although that unit was sold after March 28, 1983, petitioner reported no gains tax was due. The cover letter from petitioner's representative, included with these filed questionnaires stated, in pertinent part:

> [W]e are enclosing the properly executed and notarized . . . forms in connection with the above-captioned matter reporting the transfer of 78 "grandfathered" units and one "taxable" unit (i.e., a sale after March 28, 1983 which was not subject to a binding contract entered into prior to March 29, 1983).
>
> Please note that since the transferor believed that 78 of the units previously sold were "grandfathered". . , that the "total anticipated selling price," as computed under "safe harbor," of the 16 "taxable" units was $473,778 (i.e., the $2,632,378 amount reported on Form DTF-701(6/85). . . less the consideration includible therein attributable to the "grandfathered" units in the amount of $2,158,600), which amount is less than one million dollars, and that the "gain subject to tax" for any sales subsequent to March 28, 1983 was a loss, the Transferor, in good faith, did not previously file for such transfers and intended to file for the first transfer, if any, for which tax would become due. (Emphasis in original.)

In a March 15, 1989 letter from petitioner's representative, James L. Tenzer, to the Division, Mr. Tenzer urged that since petitioner's transfer of the property to the CHC occurred on September 16, 1981 and prior to the effective date of the gains tax, the original purchase price ("OPP") of the property must be "stepped-up" to the $4,936,276.00 contract amount set forth in petitioner's contract with the CHC. Further, petitioner urged that since the amounts represented by the Rome Savings Bank Mortgage ($1,260,914.00) and the mortgage issued by the CHC to petitioner ($1,200,000.00) were received by petitioner on September 16, 1981, prior to the March 28, 1983 effective date of the Tax Law's gains tax provisions, such mortgage amounts are "grandfathered" and cannot be included in computing total consideration for gains tax purposes.

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[1] This figure was subsequently increased to 8,936 shares. This increase was due to adding the 572 shares attributable to Unit 5-A, which petitioner reported as having no tax due (see Finding of Fact "10").

The Real Property Gains Tax Questionnaire (DTF-701[9/85]) filed by petitioner on February 7, 1989 reported actual gross consideration (up to that time) of $2,152,564.00[2], estimated additional gross consideration upon the sale of remaining shares of $216,778.00, and total anticipated (actual plus estimated) gross consideration of $2,369,342.00 once all shares have been sold. This form indicates that total anticipated consideration under the Plan was computed using the actual selling price for all units sold or then under contract and "safe harbor" estimates for the seven unsold units. Exhibit "C" attached to this questionnaire stated, in relevant part:

> The Transferor respectfully asserts that the entire amount of $2,460,914.00 in mortgage indebtedness (the "Mortgage Amount") is "exempt" and, therefore, should be excluded from "gross consideration". . . . The sale of the Property and the "receipt" by the Transferor of the Mortgage Amount . . . occurred on September 16, 1981, which was before the effective date (i.e., March 19,[sic] 1983) of the "gains"tax. . . . The Transferor respectfully asserts that the entire Mortgage Amount is "grandfathered." Accordingly, the Mortgage Amount should be excluded from "gross consideration," which is consistent with the treatment of "grandfathered" transfers of interests in real property prior to March 29, 1983.

The Division conducted an audit of petitioner's sales of cooperative units under the offering plan. The full list of actual post-March 28, 1983 sales by petitioner determined upon audit and upon which tax has been asserted in this case, are as follows:

Unit	Shares	Sale Price	Closing Date
5A	572	$ 57,000.00	July 22, 1983
6B	600	132,000.00	March 15, 1987
1E	467	105,000.00	August 4, 1986
1G	387	30,960.00	August 29,1985
4G	490	80,000.00	May 9, 1986
LJ	400	40,000.00	August 29,1985
LK	590	67,500.00	January 14,1986
5P	572	93,500.00	January 14,1986
TOTALS:	4,078	$ 605,960.00	

The Division determined that the total anticipated gross consideration to be received by petitioner for the eight cooperative units actually sold after March 28, 1983, plus the seven units

[2]This amount includes petitioner's sales occurring prior to March 28, 1983.

not yet sold at the time of audit, was $1,217,488.00.

The Division determined petitioner's original purchase price ("OPP") based on the price it paid to acquire the property in 1966 ($1,715,562.00), rather than the reported fair market value (i.e., the so called, "stepped-up basis") of the premises ($4,936,276.00) on the date it was sold by petitioner to the CHC on September 16, 1981.

The Division's audit determined that the portion of total original purchase price attributable to the 8 units sold, plus the 7 units yet to be sold, after the March 28, 1983 effective date of the gains tax was $360,678.00.

The Division's audit disallowed petitioner's brokerage fees for lack of substantiation.

As a result of the Division's audit, a Statement of Proposed Audit Changes was issued to petitioner on May 14, 1989, asserting real property gains tax in the amount of $40,201.74 plus penalty and interest. A Notice of Determination asserting this real property gains tax, plus penalties and interest, was issued to petitioner on October 5, 1989. Petitioner disagreed with the tax asserted and timely filed a request for a Conciliation Conference with the Division's Bureau of Conciliation and Mediation Services ("BCMS").

At the BCMS conference, petitioner produced additional documentation to substantiate actual and anticipated brokerage fees in the amount of $53,213.00. In addition, the conferee allowed additional amounts for capital improvements. As a result, Conciliation Order No.101444 was issued March 19, 1992 reducing the tax asserted to $36,672.63 plus penalty and interest.

The Gains Tax remaining in dispute in this proceeding is based solely upon sales occurring after the March 28, 1983 effective date of the gains tax, and is computed as follows:

Actual Consideration (8 units=4,078 shares):	$ 605,690.00	
Estimated Consideration for unsold units (7 units= 4,858 shares):	$ 611,528.00	
TOTAL ANTICIPATED GROSS CONSIDERATION:		$1,217,488.00
Less actual brokerage fees:	(26,489.00)	
Less estimated brokerage fees:	(26,724.00)	
Less capital improvements allowed:	(24,120.00)	

Less Original Purchase price
allocated to 8,936 shares: $ (336,558.00)

TOTAL ANTICIPATED GAIN
(on 15 Units equalling 8,936 shares): $ 803,717.00
Gains Tax at 10%: $ 80,359.70
Taxable shares = 8,936
Tax Per Share = 8.9928

Unit No.	Shares	Closing Date	Tax/Share	Tax Due
5A	572	July 22, 1983	8.9928	$5,143.88
6B	600	March 15, 1987	8.9928	$5,395.68
1E	467	August 4, 1986	8.9928	$4,199.64
1G	387	August 29, 1985	8.9928	$3,480.21
4G	490	May 9, 1986	8.9928	$4,406.47
LJ	400	August 29, 1985	8.9928	$3,597.12
LK	590	January 14, 1986	8.9928	$5,305.75
5P	572	January 14, 1986	8.9928	$5,143.88

4,078 Shares Gains Tax Asserted $36,672.63

Petitioner submitted a series of interrogatories to the Division. The interrogatories and the responses of the Division were submitted as part of the Stipulation in this matter and are summarized as follows:

(a) Individuals purchase real property and transfer the real property to a partnership, which thereafter transfers it to a corporation in exchange for its stock, all prior to March 28, 1983. The OPP for determining the gain on the sale of the stock so acquired by the partnership is the fair market value of the property on the date of the transfer to the corporation.

(b) The partnership in (a) above distributes the stock of the corporation to its partners before March 28, 1983. The OPP for determining the gain on the subsequent sale of the stock by the partners is the fair market value of the property on the date of the distribution. There is no distinction between shares of stock of a corporation that is qualified to sell its stock to tenant-shareholders and shares of other corporations.

(c) Property transferred by a partnership to a corporation (including a cooperative corporation), prior to March 28, 1983, is subject to the encumbrance of a bargain lease.[3] The value of the bargain lease is consideration received prior to the effective date of the gains tax law and, therefore, is not included in the consideration on the subsequent sale of the stock to the tenant-shareholders after March 28, 1983.

(d) Property, transferred by a partnership to a corporation (including a cooperative corporation), prior to March 28, 1983, is subject to the encumbrance of a mortgage. The value of the mortgage is not consideration received prior to March 28, 1983 and, therefore, is included in the consideration on the subsequent sale of the stock.

(e) Subsequent to March 28, 1983, property is transferred by a partnership to a corporation (including a cooperative corporation) which is subject to the encumbrance of both a bargain lease and a mortgage. The value of both is included on a pro-rata basis in the consideration on the subsequent sale of the stock.

SUMMARY OF THE PARTIES' POSITIONS

Petitioner argues:

a) that the computation of total anticipated gross consideration cannot include the mortgage amounts payable to petitioner by the CHC, since these amounts were "received" by petitioner prior to the effective date of the gains tax, and must be "grandfathered"; and

b) that the computation of OPP must be based on the "stepped-up" fair market value of the property at the time of transfer to the CHC in September 16, 1981, and not on the price paid by petitioner when it acquired the property in 1966; and

c) that the Division's policy governing computation of original purchase price is "illogical", "discriminatory" and "unconstitutional", since a cooperative housing corporation, like petitioner, cannot properly be treated differently than any other business corporation.

Petitioner argues that the above issues are matters of first impression not previously

[3] A "bargain lease" is a lease providing for a rent below fair market rent. Such a lease is valued at the time that it is created at the present value of the difference between the rent payable under the lease and the fair market rent over the term of the lease.

passed on by the courts or the Tax Appeals Tribunal.

Petitioner also urges that penalties should be abated, since its computation of "no tax due" was the result of a "good faith" interpretation of Article 31-B of the Tax Law by its representatives.

Finally, petitioner claims the Division incorrectly computed interest on the assessment. Here, petitioner argues that based on its computations, no gains tax was due, and therefore, no penalty or interest can properly be asserted.

The Division argues that the real property gains tax was designed to treat cooperative housing corporations differently from non-cooperative corporations; that the Division's application of the gains tax to cooperatives, and to this petitioner, was proper and without constitutional infirmity; that the Division properly determined petitioner's consideration and original purchase price; and that petitioner has failed to prove that the Division's interpretation and application of the Tax Law in this matter is unreasonable or unlawful. Finally, the Division argues that petitioner has failed to demonstrate reasonable cause for abatement of penalties.

CONCLUSIONS OF LAW

A. As a general proposition, a "sponsor" or "transferor", such as this petitioner, is one who purchases a building and, as owner, wishes to transfer the same in receipt of a gain. By effecting this transfer through a cooperative conversion method, the sponsor ultimately accomplishes his end purpose of transfer in receipt of gain via the transfer(s) of shares allocated to the various apartment units to unit purchasers. A necessary step in this overall process is the sponsor's transfer of the building and underlying realty to a cooperative housing corporation (the realty transfer). Thereafter, subscribed shares of the corporation as allocated to the apartment units are transferred to unit purchasers (in general simultaneously), with the balance of unsold shares taken back by the sponsor for future transfer to unit purchasers.

B. Tax Law § 1441, which became effective March 28, 1983, imposes a tax at the rate of 10% on gains derived from the transfer of real property within New York State. Tax Law

§ 1440(3) defines "gain" as "the difference between the consideration for the transfer of real property and the original purchase price for the property." The term "original purchase price" is defined as, generally, the consideration paid or required to be paid by the transferor to acquire the interest in real property, plus the cost of certain improvements and customary expenses as set forth in the statute (Tax Law § 1440[5][a]). The threshold level at which this tax first applies is reached when the consideration for the property transferred equals or exceeds $1,000,000.00 (Tax Law § 1443).

C. For purposes of computing the gains tax, a cooperative conversion is treated as a single transfer rather than as two separate transfers (i.e., the sponsor-to-CHC transfer is viewed as part of the overall conversion process and is not itself treated as a taxable event separate from transfers of shares to individual apartment unit purchasers). In turn, the payment of tax is not due until the transfers of shares to the purchasers of individual apartment units (Tax Law § 1442[b]; see, Matter of Mayblum v. Chu, Sup Ct, Queens County, May 11, 1984, Graci, J., affd 109 AD2d 782, 486 NYS2d 89, modified 67 NY2d 1008, 503 NYS2d 316; Matter of 1230 Park Associates, Tax Appeals Tribunal, July 27, 1989, confirmed 170 AD2d 842, 566 NYS2d 957, lv denied 78 NY2d 859, 575 NYS2d 455). In calculating the amount of tax due on each cooperative apartment unit transferred, Tax Law § 1442(b) calls for "an apportionment of the original purchase price of the real property and total consideration anticipated under such cooperative . . . plan."

D. Petitioner argues that the OPP should be based upon the fair market value of the property when petitioner transferred it to the cooperative housing corporation rather than upon the transfer to petitioner. This position of petitioner is based upon the different treatment provided by the Division to cooperative corporations as compared to non-cooperative corporations. In the non-cooperative corporation situation, it is the Division's practice to use the real property's fair market value on the date of the last transfer prior to the effective date of the gains tax, March 28, 1983, as the OPP so long as consideration was paid for the transfer. In the situation where the sponsor transferred the real property prior to March 28, 1983, the basis of the OPP is the transferor's acquisition costs.

Petitioner's argument is neither new, nor compelling. Initially it is noted that the courts and the Tax Appeals Tribunal have ruled that the gains tax statutory scheme was designed with the concept that the cooperative corporation exists as a conduit in transferring residential apartment units to third parties. In Mayblum v. Chu (supra), the Court of Appeals held that the gains tax:

> "is imposed by the statute upon the overall cooperative plan except as the Article exempts transfer of shares in the cooperative pursuant to a written subscription agreement entered into prior to March 28, 1983, the effective date of the Article."

The court further stated that:

> "In interpreting article 31-B, we are guided by what the Legislature intended. The necessary implication of section 1443(6), which exempts from its tax on real property a transfer after the effective date of the act because made pursuant to a written contract entered into before its effective date, is that the transfer of shares as part of a cooperative plan (which is the only way a cooperative corporation can transfer an interest in real property) is taxable. That construction is supported by the exception in section 1440(7) of the transfers pursuant to a cooperative or condominium plan, and by section 1442 fixing the date of a transfer under a cooperative plan. That the latter section deals with payment of the tax is not inconsistent with construing the over-all transaction as taxable; it merely demonstrates that although for purpose of computation of the tax the cooperative conversion is treated as a single transfer, it is not to be so treated with respect to date of payment, just as it would not be so treated with respect to exemption from tax (§1443[6])."

The Tax Appeals Tribunal, in Matter of Normandy Associates (March 23, 1989), discussed the gains tax statutory scheme as it relates to the cooperative conversion process as follows:

> "The essence of petitioner's argument is that the transfer of the real property by the realty transferor to the cooperative housing corporation is the taxable event for gains tax purposes . . . . In contrast to the structure petitioner would impose on the gains tax, we conclude that the tax treats the transfer of shares by the realty transferor to unit purchasers as the taxable event. However, the gain on these transfers is measured by the difference between the consideration for the shares and the realty transferor's original purchase price in the real property prior to its transfer to the cooperative housing corporation. This scheme in effect ignores the realty transferor's transfer to the cooperative housing corporation and instead treats the realty transferor as if he were directly transferring his interest in the real property to the unit purchasers. Under this scheme, the gains tax is imposed on the entire cooperative conversion plan, encompassing the real property prior to its transfer to the cooperative housing corporation and the sale of shares by the realty transferor subsequent to the property's conversion to cooperative ownership. The transfer to the cooperative corporation is then treated merely as a conduit which allows the

> transformation of the real property into shares allocated to units." (See also, Matter of 1230 Park Associates, supra; Matter of Birchwood Associates, Tax Appeals Tribunal, July 27, 1989; Matter of 61 East 86th Street Equities Group, Tax Appeals Tribunal, January 21, 1993)

The Tribunal, in both Normandy and Birchwood, went on to state that provisions of Article 31-B, specifically former sections 1440.7, 1442 and section 1443.6, "articulate a statutory scheme which treats the realty transferor in a cooperative conversion as if he is transferring his real property interest directly to the unit purchasers."

Under this statutory scheme, the transfer to the cooperative corporation is treated differently from transfers to non-cooperative corporations. However, former sections 1440.7, 1442 and section 1443.6 provide ample support for the Division's decision to treat cooperative corporations differently from non-cooperative corporations. Petitioner's constitutional claims with respect to this, and other, alleged differences in treatment will be addressed separately, infra.

E. Petitioner argues that in computing total consideration, the Division must treat mortgages in the same manner as it would bargain leases. Where the consideration attributable to a mortgage or bargain lease is created or assumed at the time the real property is sold to a corporation (with such sale occurring after March 28, 1983), the consideration is presumed to relate to all shares of stock in the corporation and a proportionate share of the mortgage and/or bargain lease relates to each share of stock. However, where the bargain lease was created in a sale to a corporation prior to March 28, 1983, the Division considers the consideration attributable to the bargain lease, unlike a mortgage, to have been entirely received prior to March 28, 1983 and "grandfathered" and not included in determining the gain on shares of stock sold after March 28, 1983. Petitioner demands to have the mortgages involved in its transaction with the CHC treated as a bargain lease, and argues that the Division's refusal to do so is irrational and discriminatory.

Again, this issue has been previously decided. The Tax Appeals Tribunal has held that a mortgage given by the cooperative housing corporation to the sponsor (petitioner), in a transaction occurring prior to the enactment of the gains tax law, is treated as consideration to the sponsor (see, Matter of Birchwood Associates,supra; Matter of 1230 Park Associates, supra; Matter of 61 East 86th Street Equities Group, supra).

Although any one of the above cases, separately or together, are dispositive of this issue, the Division has, in addition, put forth a rational basis for the different treatment it affords mortgages and bargain leases that directly addresses petitioner's argument. The Division's position is adopted and presented as follows:

A cooperative conversion which includes a bargain lease is typically accomplished in the following steps:

(1) Sponsor conveys real property to the CHC:
(the CHC = cooperative housing corporation)
Sponsor ------------[real property]---------------} the CHC

(2) In return for the conveyance of the real property to the cooperative housing corporation, the sponsor receives cash, debt (a mortgage), a bargain lease on commercial space and the unsold units (shares).
the CHC----[cash, debt, bargain lease, unsold units]----} sponsor

(3) Sales of Residential Units to Purchasers
Sponsor-----[shares and *proprietary lease]-----} purchasers
* the proprietary lease has no relation to the bargain lease.

The Gains Tax Effect of the Bargain Lease

For the bargain lease, the cooperative corporation is the lessor and the sponsor is the lessee. The difference between fair market rent and the nominal rent charged to the sponsor under the terms of the bargain lease is valued to the sponsor at the moment the lease is executed. Clearly, this value is "consideration" within the meaning of Tax Law § 1440.1(a). It is this economic gain to the sponsor which the Division focuses on for gains tax purposes. To the extent, however, that this lease transaction occurs prior to the effective date of the gains tax, the Division views this as consideration received at the time of the conveyance of the lease. Through present value calculations, the consideration arising from this lease transaction is fixed and ascertainable at the time the lease is formed. Therefore, the Division treats the consideration attributable to the bargain lease as grandfathered, just as the Division treats the consideration received from units sold before the effective date of the tax as grandfathered.

The Gains Tax Effect of the Mortgage

For the mortgage, the cooperative corporation is the mortgagor and the sponsor is the mortgagee. The mortgage is an encumbrance on all units (shares). The bargain lease encumbers only a commercial unit or units; it is not an encumbrance on any of the residential units and the unit purchasers are not parties to, and assume no obligations under, the bargain lease.

The servicing of the purchase money mortgage is directly linked to the sales of the residential units. Upon the sale by the sponsor of each unit, the purchaser assumes that portion of the purchase money mortgage which the number of shares allocated to the purchaser's unit bears to the total number of shares. The consideration received by the sponsor which is attributable to the purchase money mortgage is therefore recognized when units (shares) are sold to purchasers. Subject to occupancy requirements, each unit purchaser may claim the mortgage interest he or she pays as an itemized deduction for Federal income tax purposes (see, Internal Revenue Code § 163[h][4][B]).

Subject only to the Tax Law § 1443.6 "grandfather" exemption, the tax on the sale of cooperative units is due on the date of the transfer of each unit (Tax Law § 1442[b]); see also, Mayblum v. Chu, supra). Those units that are sold before the effective date of the gains tax are grandfathered and that consideration is excluded; those units sold after the effective date of the gains tax are taxed.

In addition to case law, this analysis provides a rational basis for the difference in treatment afforded mortgages and bargain leases created before March 28, 1983, the effective date of the gains tax.

F. Petitioner next claims that the Division's refusal to use the fair market value as of the date of transfer to the the CHC (i.e. the "stepped-up basis) as the basis for determining "original purchase price" and the Division's refusal to grandfather mortgages placed on the real property before the effective date of the gains tax in determining the sponsor's consideration are violative of the Equal Protection clauses of the New York State and Federal constitutions.

The constitutionality of the statute itself has been considered and decided. In Trump v.

Chu (65 NY2d 20, 489 NYS2d 455), the Court of Appeals held that the gains tax statute's different treatment of developers of condominiums and cooperatives from developers of subdivided improved real property was constitutional. The Court of Appeals provided the following analysis for its decision:

> "Turning to the Legislature's different tax treatment of condominium and cooperative developers on the one hand and subdivided improved realty on the other, it is apparent that the classification employed is rationally related to the legitimate State purpose of raising the revenues necessary to finance the State budget and provide needed government services because: (1) condominium and cooperative developments involve greater administrative cost to State government as a result of more extensive special laws, regulations and inquiries than apply to subdivided improved realty (see, e.g., General Business Law §§ 352-e - 352-eee [application of Martin Act to condominiums and cooperatives]; Real Property Law §§ 339-d - 339-ii [Condominium Act]); (2) condominium and cooperative developments, because they are more likely to occur in urban areas than subdivisions, make greater demands on needed public services; and (3) treating sales of condominium and cooperative units as separate tax transactions would entail greater administrative costs than in the case of subdivided realty, thereby reducing the net revenue produced by the tax. In addition, the Legislature rationally could have believed that the challenged classification would further the conceivable purposes of encouraging the development of individually owned residences while at the same time discouraging the rapid conversion of scarce rental apartments to condominiums and cooperatives." (Trump v. Chu, supra.)

G. While the Court of Appeals has held the gains tax statute constitutional, it will now be determined whether the law is unconstitutional "as applied" to petitioner. Petitioner premises this argument on the statement that, "The legislative intent is to exempt from Gains Tax all transfers of realty to a corporation in exchange for stock, not merely cooperative corporations." (Reply brief, p.5, citing Tax Law §§ 1443.4 and 1443.5 [emphasis in original]). Petitioner goes on to state that:

> "'[The] law does not permit an agency to grant one person the right to do that which it denies to another similarly situated. There may not be a rule for Monday, another for Tuesday, a rule for general application, but denied outright in a specific case."(Id., citing, Sharron Motor Lines, Inc. v. United States, 633 F2d 1115; emphasis added).

From this premise, petitioner argues that if real property were transferred to a business corporation, other than a cooperative housing corporation, prior to the effective date of the gains tax, the Division would have allowed the transferor's original purchase price to be stepped-up to the fair market value of the property on the date of the transfer into the corporation (Reply brief, p.5). On the other hand, if the same pre-gains tax law transfer were made to a cooperative corporation, the Division would compute OPP based on the price paid by the transferor when he acquired the property.

Petitioner claims that for the Division to thus treat cooperative housing corporations differently from other business corporations, denies petitioner equal protection of the law (Reply brief, p.6). This argument is without factual support (evidence) or legal foundation. At the outset it must be pointed out, contrary to petitioner's argument, that not all corporations are "similarly situated." Not even all cooperative corporations are "similarly situated".[4]

The only case cited by petitioner in support of its argument, Sharron Motor Line, Inc. v. United States (supra), dealt with the Interstate Commerce Commission's denial of a carrier's license to an applicant. The Court of Appeals held that the Commission's denial of the application was fundamentally unjust, arbitrary and capricious, in view of petitioner's proof showing that later applications were granted to similarly situated carriers.

While petitioner purports to argue that the Division cannot treat "similarly situated" corporations differently for purposes of the gains tax, it has offered no evidence of unequal treatment here (as the petitioner did in Sharron Motor Line, supra).

Specifically, this petitioner had the burden to show that the Division had applied the gain tax law to it in a manner that was different from other similarly situated cooperative housing corporations. Upon such a showing, the burden of going forward would have shifted to the Division to justify and explain its actions, if it could, by demonstrating that there was a rational basis for the alleged differences in treatment and that its actions were in furtherance of accomplishing a legitimate state purpose (cf., Trump v. Chu, supra). Inasmuch as petitioner failed to present any evidence to show that it has been treated differently from other similarly situated cooperative housing corporations petitioner failed to meet its burden.

H. Petitioner argues that the Division is applying a two-step, hybrid, method (using

[4]Petitioner's argument that a cooperative corporation is similarly situated to a business, or other type of corporation because they are all "corporations", is like saying that people, dogs and whales are similarly situated because they are all mammals.

Option A and Option B) to compute gain (and tax due) upon audit; that such method is inappropriate (and in fact not allowable); and that petitioner is entitled to calculate gain (and tax due) under Option B.

In short, petitioner disputes the Division's allocation to the taxable units sold the actual cash portion of consideration, the mortgage portion of consideration and OPP, and then computing the gain on such taxable units. Petitioner argues that all unit transfers, including non-taxed grandfathered transfers, should be counted in calculating gain per share under Option B.

It is undisputed that petitioner did not report the sale of any of the units sold after the effective date of the gains tax (March 28, 1983) until requested to do so by the Division. In this case the transfers upon which the tax asserted after audit was based, had already occurred and thus were not, at the time of audit, "anticipated". Petitioner did not report any of the eight taxable (post-March 28, 1983) transfers, file returns for the eight taxable transfers, or elect any method (i.e., then available Option A or Option B) of reporting when any of the transfers were made. There is nothing in this record to indicate that the tax was ever paid. No reason has been advanced for these failures. As a result, petitioner lost its entitlement to choose between Option A or Option B (Matter of Normandy Associates, supra).

I. In a related argument, petitioner seeks "the best of all possible worlds". While petitioner would not want to have the gain from the sale of grandfathered units made subject to tax, it nevertheless feels that the grandfathered units should be used in calculating (reducing) its gains.

In this argument, petitioner claims that since the gains tax is applied to and treats the cooperative conversion process as a single transfer of real property then all unit transfers, including grandfathered transfers, must be counted in calculating gain per share under Option B. Including grandfathered transfers (which occur early in the conversion) would nearly always result in a lower overall gain-per-share amount because such early transfers are frequently made at discounted prices and because in times of rising real estate prices early sales will be for lower prices than later sales. However, it is noted that Tax Law § 1442 refers to calculating "tax due" on cooperative apartment unit transfers, and requires an apportionment of total consideration anticipated and original purchase price "for each such . . . unit." In turn, Tax Law § 1443(6) exempts "grandfathered" units from the tax. Thus, each "such" unit under Tax Law § 1442 would clearly mean only those units subject to tax (i.e., non-grandfathered units) and would exclude from such calculation those units upon which tax would not be due (i.e., grandfathered units). Accordingly, the Division's computational method which deals specifically with actual consideration received on taxable (non-grandfathered) units is reasonable. It is in harmony with determining whether the cooperative conversion itself is taxable in its own right based on whether consideration anticipated on taxable (non-grandfathered) units alone reaches $1,000,000.00. Hence, petitioner's argument to include grandfathered units is rejected.

J. Tax Law former § 1446.2(a) provides that:

> "[a]ny transferor failing to file a return or to pay any tax within the time required by this article shall be subject to a penalty . . . . If the tax commission determines that such failure or delay was due to reasonable cause and not due to willful neglect, it shall remit, abate or waive all of such penalty and such interest penalty."

Between July 1973 and March 1987, petitioner transferred eight taxable units without filing any gains tax schedules or questionnaires and without the payment of gains tax. Not until February and April 1989, and only after being requested by the Division, did petitioner file gains tax questionnaires and schedules.

Nevertheless, petitioner claims that penalties should be abated because its determination that no tax was due was the result of a good faith interpretation of Article 31-B of the Tax Law by its representatives. Petitioner claims further, that it acted in good faith and upon a reasonable interpretation of the law in concluding that the mortgages in this case were not part of total consideration. It is uncontested that petitioner filed returns late and there is no evidence that the subject tax has been paid to date. Therefore, the question is whether the delay in filing and paying the tax may be considered reasonable.

In determining reasonable cause, all of the actions of a taxpayer are considered relevant (Matter of LT & B Realty Corp. v. New York State Tax Commn., 141 AD2d 185, 535 NYS2d

121). The review of these actions must be made in light of information available at that time (Matter of 1230 Park Assoc. v. Commr. of Taxation & Fin. of the State of New York, supra; Matter of 61 East 86th Street Equities Group, supra).

In August 1983, the Division issued Publication 588, "Questions and Answers - Gains Tax on Real Property Transfers". Question and answer number 20 addressed the application of the gains tax to cooperative conversions.

On August 22, 1983, the Division issued TSB-M-83-(2)R, "Computation and Original Purchase Price for Condominium or Cooperative Projects". This document describes the two methods of computing the gains tax due upon the sale of a unit in a cooperative scenario, and is consistent with the August 1983 Publication 588.

On May 11, 1984, Mayblum v. Chu (supra) was decided, and set forth the proposition that, in a CHC scenario, the taxable event is the transfer of shares. This decision was affirmed by the Appellate Division, Second Department on March 11, 1985 (Mayblum v. Chu, 109 AD2d 782, 486 NYS2d 89).

In November 1984, a revised Publication 588 was issued by the Division. Question and answer number 33 reiterated the proper treatment of cooperative conversions under the gains tax law.

In addition, on July 27, 1989, at about the same time as petitioner filed its gains tax questionnaires and schedules, the Tax Appeals Tribunal rendered its decision in Matter of 1230 Park Associates, (supra) rejecting two of the same arguments presented in this case, i.e., that mortgages entered prior to the effective date of the gains tax could not be considered in computing consideration and that the "purchase price" of the property was the fair market value of the property at the time of transfer to the CHC (see also, Matter of Normandy Associates, supra; Matter of 61 East 86th Street Equities Group, supra).

Given the available information and case law, it was unreasonable for petitioner to have failed to file the transferor questionnaires and schedules for the eight taxable unit transfers and to fail to pay the gains tax due on those transfers. Therefore, petitioner has failed to establish reasonable cause.

K. Finally, petitioner claims that since no gains tax was due in this case, no interest can properly be asserted on the assessment. In view of the holding that tax and penalties were properly asserted, and there being no other evidence or basis having been offered by petitioner to show that interest was improper, this claim is rejected.

L. The petition of Ivancrest Associates is denied and the Notice of Determination dated October 5, 1989, as adjusted by Conciliation Order No. 101444, is sustained.

DATED: Troy, New York
April 7, 1994

/s/ Carroll R. Jenkins
ADMINISTRATIVE LAW JUDGE