STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
LEWIS B. AND BEATRICE M. KAYE	:	DETERMINATION DTA NO. 811700
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.	:	

Petitioners, Lewis B. Kaye, 110 East 59th Street, New York, New York 10022-1304 and Beatrice M. Kaye Riccobono,[1] Fall Clove Road, P.O. Box 115, Delancey, New York 13752, 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.

On March 29, 1994 and April 5, 1994, respectively, petitioners by their representative, James L. Tenzer, Esq., and the Division of Taxation by William F. Collins, Esq. (Andrew J. Zalewski, Esq., of counsel) executed a waiver of hearing and agreed to submit this case for determination. All documents and briefs to be submitted were due by February 1, 1995. The Division of Taxation submitted documents on May 12, 1994. Petitioners submitted their initial brief and documents on September 30, 1994. The Division of Taxation's brief was received on November 8, 1994. Petitioners' reply brief, with certain additional documents, was received on February 6,

1995, which date began the six-month period for the issuance of this determination. After due consideration of the record, Frank W. Barrie, Administrative Law Judge, renders the following

[1]On certain documents, including a power of attorney dated May 26, 1995, Beatrice M. Kaye is identified as Beatrice M. Kaye Riccobono.

determination.

ISSUES

I. Whether the Division of Taxation erroneously calculated "original purchase price", used to determine petitioners' gains tax liability on their sale of shares in cooperative apartment units, by its refusal to step up petitioners' acquisition price for such shares to the cooperative housing corporation's cost for such property because the property was transferred by petitioners to the cooperative housing corporation pursuant to a written agreement which had been executed prior to the March 28, 1983 effective date of the gains tax law.

II. Whether the Division of Taxation erroneously included a purchase money wraparound mortgage note in its calculation of "consideration" received by petitioners on their subsequent sale of shares in cooperative apartment units because this mortgage note was received by petitioners from the cooperative housing corporation pursuant to a written agreement which had been executed prior to the March 28, 1983 effective date of the gains tax law.

III. Whether the Division of Taxation properly disallowed the special additional recording tax of ¼% from inclusion in petitioners' original purchase price.

IV. Whether the anticipated consideration for shares allocated to unsold units in a cooperative building, which were occupied by tenants with a continuing right to occupancy under rent laws and regulations, was properly calculated by the Division of Taxation.

V. Whether the differing treatment of cooperative corporations and noncooperative corporations by the Division of Taxation 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 United States constitutions.

VI. Whether the Division of Taxation incorrectly calculated interest and penalty due.

VII. Whether petitioners have established that penalties should be abated.

FINDINGS OF FACT

Petitioners, Lewis B. and Beatrice M. Kaye, apparently as tenants-in-common, were the sponsors-sellers of a cooperative offering plan dated May 14, 1982 for the conversion of rental

apartments into cooperative housing units involving a building located in Manhattan's Greenwich Village at a street address of 96 Perry Street. Only limited portions of the offering plan were submitted for review, which reflects the limited nature of the administrative record. It is observed that the cover sheet of the offering plan (Division of Taxation's ["Division"] Exhibit "S") shows Lewis B. and Beatrice M. Kaye as the "sponsor-seller". However, page 2 of the 22nd Amendment to the offering plan, also included in Exhibit "S", references only Lewis B. Kaye as the sponsor. This variance is unexplained. The Greenwich Village building at 96 Perry Street contained a total of 35 apartments, which were offered for sale pursuant to the offering plan. Petitioners had acquired the property in August 1975 for $240,000.00 (Division's Exhibit "0").

On November 29, 1988, a tax technician of the Division of Taxation notified petitioners' then attorney, Alan Haberman, that a review of records at the New York State Department of Law (the Attorney General's Office) disclosed that "[t]he aggregate consideration to be received for [the conversion of rental apartments into cooperative housing units at 96 Perry Street] will exceed $1 million." Mr. Haberman was advised that the Division had checked its files and found no record that petitioners had complied with filing requirements under the gains tax law, Article 31-B of the Tax Law, which mandate that the transferor and transferee of shares allocated to cooperative housing units must file questionnaires with the Tax Department at least 20 days prior to the date of each transfer (where the total consideration from transfers will be $500,000.00 or greater).

A review of the Division's tax field audit record (also known as the auditor's log), which was marked Division's Exhibit "Q", shows that over a five-month period, from June to November 1990, petitioners by their accountant were slow to cooperate with the auditor's requests for records concerning the cooperative conversion project at issue, and, in fact, never provided the auditor with much of the requested documentation. An entry for July 11, 1990 provided as follows:

> "Meeting with Mr. Ellenbogen [petitioners' accountant] was non-productive. He was not at all prepared and did not have any information requested in

> appointment letter. It was agreed that I would forward to him DTF-701 & 700[2] to be completed by him
>
> along with gathering all pertinent documents and data . . . ."

Subsequent entries give a flavor of the auditor's difficulty in auditing the transfers at issue:

> Entry for August 10, 1990: "Called Mr. Ellenbogen to ascertain level of progress in compiling info and documents requested in 7/12/90 letter . . . . He requested I call back in several weeks . . . ."
>
> Entry for September 17, 1990: "Called Mr. Ellenbogen for update. He requested an additional two-three weeks to gather info . . . ."
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> Entry for October 15, 1990: "Established appointment for 11/20/90."
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> Entry for November 20, 1990: "Commenced field audit at Mr. Ellenbogen's office . . . . Although I sent Mr. Ellenbogen a letter on July 12, 1990 that provided a detail[ed] list of records and documents I needed to conduct the audit as well as giving him approximately 4 months to gather the information, he only provided me with his accounting write-up workpapers, some sales contracts and subscription agreement as documentation for the audit . . . . As indicated above, cancel[led] checks, invoices and other conventional evidence was not available to evaluate propriety of cost items. A list of additional information was presented and Mr. Ellenbogen said he would try to get the records requested, but was not optimistic he could find them."

The Division issued a Statement of Proposed Audit Adjustment (form AU-200) dated January 7, 1991 against petitioners asserting tax due per audit of $86,854.00, plus penalty and interest. An undated audit summary (Division's Exhibit "R") summarized the computation of tax due of $86,854.00, in relevant part, as follows:

> "[Petitioners' accountant] only provided me with his accounting write-up workpapers, some sales contracts/ subscriptions, CHC [cooperative housing corporation] closing statement and cost schedules as documentation for the audit.
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> "Based upon the available information, I was able to determine that 26 units were sold for cash proceeds of $1,097,750.00, in which 11 units representing $409,100.00 in sales was exempt under the grandfather provision of the law. The 9

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[2] DTF-701 is a transferor's real property transfer gains tax questionnaire form of the Department of Taxation and Finance (emphasis added to show the abbreviation "DTF"). DTF-700 is a real property transfer gains tax schedule of original purchase price for cooperatives and condominiums. Petitioner's Exhibit "9" includes a form DTF-701 dated September 30, 1994 by petitioners as well as an, apparently, accompanying form DTF-700, which was undated as well as a form DTF-702, a transferor's real property transfer gains tax unit submission questionnaire for cooperatives and condominiums also dated September 30, 1994. The record does not include any earlier forms or questionnaires completed by petitioners.

remaining units were valued at $184,320 based on Safe Harbor Estimate Rules. Including the taxable portion of the CHC mortgage indebtedness of $887,500.00, the total estimated taxable consideration for the project represents $1,760,470.00.

"Total OPP [original purchase price] claimed by the taxpayer was $645,975, of which $198,242.00 (31%) was disallowed. The items disallowed were primarily attributable [to] equipment and repairs claimed as capital improvements and non-allowable selling expenses. In addition to the disallowances, $129,790.00 (29%) of OPP was apportioned to the grandfather units sold. As a result of the aforementioned adjustments, the net OPP allowed was $317,763.00.

"The audited tax due is $86,854.00. Since the taxpayer did not file any questionnaires or make any tax payments, penalty of $30,399 was imposed. Along with interest of $67,032.00, the total tax assessment is $184,285.00."

Included in the record are the following 10 detailed schedules prepared by the auditor, each dated January 2, 1991, which were the basis for the Division's calculation of tax due as asserted in the Statement of Proposed Audit Adjustment described in Finding of Fact "4":

Schedule	Division's Exhibit Letter
(1) WEC [Worksheet Estimated Consideration] and audit schedule	Exhibit "G"
(2) Audit schedule of units sold per audit and units available for future taxable sales	Exhibit "H"
(3) Calculation of acquisition, capital improvement and cooping costs (to determine original purchase price)	Exhibit "I"
(4) Schedule of selling expenses allowed	Exhibit "J"
(5) Schedule of conversion expenses allowed	Exhibit "K"
(6) Schedule of brokerage commission allowed	Exhibit "L"
(7) Schedule of grandfathered, sold and unsold units	Exhibit "M"
(8) Schedule of capital improvements	Exhibit "N"
(9) Schedule of purchase price and other acquisition costs	Exhibit "0"
(10) Computation of composite date of March 27, 1985 for interest and penalty	Exhibit "P"

The schedule listed as number "2" (Division's Exhibit "H"), audit schedule of units sold

per audit and units available for future taxable sales, shows that out of 24[3] taxable units, petitioners transferred shares on 15 units per the audit and had 9 additional units available for future taxable sales. The Division calculated a taxable percentage of 71% as follows:

	No. of Shares	Percentage	Units
Total per offering plan	12,000	100%	35
Less: Grandfathered	3,444	29%	(11)
Total taxable units	8,556	71%	24

The schedule listed as number "3" (Division's Exhibit "I"), calculation of acquisition, capital improvement and cooping costs, shows the following calculation of total original purchase price of $477,553.00 with 71%, or $317,763.00 of such amount allocated to the taxable units:

Original cost per [1975] contract	$240,000.00		
Acquisition expense	1,065.00		
Total original "original purchase price"			$241,065.00
Capital improvements claimed by petitioners	$177,415.00		
Disallowed capital improvements	(133,300.00)		
Allowed capital improvements			$ 44,115.00
Cooping expenses & selling expenses:			
Conversion costs claimed by petitioners & allowed		$ 38,927.00	
Selling expenses claimed by petitioners	$188,388.00		
Disallowed selling expenses	(64,942.00)		

[3]Eleven units were treated as "grandfathered" units not subject to tax because contracts for their sale were executed prior to the effective date of the gains tax law.

Allowed selling expenses		$123,446.00	
Total cooping expenses			$162,373.00
Total original purchase price			$447,553.00
Grandfathered percentage	29% $129,790.00		
Taxable percentage	71% $317,763.00		
	$447,553.00		

To determine the gain subject to tax, the taxable percentage of original purchase price of $317,763.00 was subtracted from consideration of $1,672,828.00, which was shown calculated on the schedule listed as number "1" (Division's Exhibit "G") as follows:

	Actual	Anticipated	Total
Cash consideration	$1,097,750.00	$184,320.00	$1,282,070.00
Less: Grandfathered	(409,100.00)		(409,100.00)
Total consideration			$ 872,970.00
Add: Mortgage Indebtedness			
Actual $1,250,000.00 x 71%			887,500.00
Total estimated consideration			$1,760,470.00
Less: Working fund $64,160.00 x 71%			(45,554.00)
Less: Brokerage commissions:			
Actual $55,575.00 less grandfathered $24,546.00			(31,029.00)
Anticipated brokerage commissions			(11,059.00)
Balance			$1,672,828.00

The schedule listed as number "7" above (Division's Exhibit "M") shows that anticipated consideration for the 9 units available for future taxable sales was calculated by the Division, utilizing so-called "safe harbor values", to be $184,320.00 as follows:

Apartment #	Status[4]	Unsold Shares	Safe Harbor Value[5]

[4]Presumably, "C" stands for a rent-controlled apartment and "S" for a rent-stabilized apartment.

[5]As noted in Finding of Fact "4", the auditor noted in his summary that the "9 remaining units were valued at $184,320 based on Safe Harbor Estimate Rules." The record does not include the specific safe harbor estimate rules utilized by the auditor. On May 1, 1986, the Division had issued TSB-M-86-(3)-R, the "Safe Harbor Estimate for Transfers Pursuant to Condominium and Cooperative Plans" which provided specific formulas for estimating consideration for unsold shares in a cooperative conversion. If such formulas were utilized, a taxpayer would not be subject to penalty and interest on any underpayment. In the matter at hand, the Division calculated safe harbor values based on a $60.00 price per share, which is 50% of the $120.00 per share specified in the offering plan (Division's Exhibit "S").

1B	C	170	$ 10,200.00
1C	C	160	9,600.00
7	S	440	26,400.00
9A	S	264	15,840.00
12	C	440	26,400.00
17A	S	284	17,040.00
19	S	500	30,000.00
21A	S	294	17,640.00
23	C	520	31,200.00
			$184,320.00

This schedule also shows a total of $688,650.00 for the sale of 15 taxable units at prices ranging from $18,500.00 to $102,500.00. As noted on the schedule listed as number "1" (Division's Exhibit "G"), the Division used total consideration of $872,970.00 ($688,650.00 plus $184,320.00) in its calculation of tax due.

Petitioners' accountant, Bernard Ellenbogen, responded to the issuance of the Statement of Proposed Audit Adjustment by a letter dated February 4, 1991 to the Division's auditor (Division's Exhibit "V"). Mr. Ellenbogen requested that petitioners' original purchase price for their taxable shares be recomputed by using the "fair market value" of the real

property at the time of transfer of the shares to the cooperative housing corporation because the transfer to the cooperative housing corporation on April 29, 1983 was pursuant to a written contract executed on March 3, 1982, prior to the March 28, 1983 effective date of the gains tax law. Mr. Ellenbogen also gave four additional reasons why petitioners' original purchase price for their taxable shares should be increased:

(1) An increase of $76,500.00 for the following anticipated costs to complete the project:

Vacating expense and buy-downs	$45,000.00
Legal fees	4,500.00
Apartment renovations	27,000.00
	$76,500.00;

(2) An increase of $183,877.00 for the following costs disallowed by the Division:

Capital improvements		$133,300.00
Cost of buy-outs	6,928.00	
Advertising		43,649.00
		$183,877.00;

(3) An increase of $2,365.00 for mortgage recording tax;[6] and

(4) An increase of an unspecified amount representing "costs, including conversion period interest expense, in excess of temporary, ancillary and incidental rental income."

Mr. Ellenbogen also contended that the Division should exclude from "consideration" the $1,250,000.00 wraparound purchase money mortgage, which was issued by the cooperative housing corporation pursuant to a "grandfathered" contract, because the value of a "grandfathered" bargain lease would have been excluded from the calculation of consideration. Finally, Mr. Ellenbogen argued that penalties and interest should be reduced

or abated because "had [petitioners] filed timely, the 'gains' tax due, if any, would have been substantially less (or none at all)."

Accountant Ellenbogen declined an offer to discuss his letter with the auditor's section manager. According to the audit summary (Division's Exhibit "R"), "[a]fter discussing the matter with the Team Leader, a written response advising him [Mr. Ellenbogen] that the proposed assessment would remain unchanged was mailed on February 21, 1991."

The Division then issued a Notice of Determination dated April 8, 1991 against petitioners asserting gains tax due of $86,854.00, plus penalty and interest.

Petitioners Formally Contest Assertion of Tax Due

Petitioners timely contested the issuance of the Notice of Determination dated April 8, 1991 by the filing of a Request for Conciliation Conference dated July 2, 1991, which was signed by their representative, attorney James L. Tenzer. The basis for making their request for revision of the Division's determination, as set forth in this request, was an exact restatement of accountant Ellenbogen's letter dated February 4, 1991 (Division's Exhibit "V" detailed in Finding of Fact "6").

A Conciliation Order dated December 4, 1992 denied petitioners' request and sustained

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[6] This amount apparently represented the special additional recording tax of ¼%.

the Notice of Determination dated April 8, 1991.

Petitioners then timely contested this denial of their request by the filing of a petition dated March 3, 1993, which was also executed by attorney Tenzer on petitioners' behalf. In addition to raising the issues previously noted by accountant Ellenbogen in his letter dated February 4, 1991, which were repeated in the Request for Conciliation Conference dated July 2, 1991, petitioners raised the following additional concerns:

(1) The Division improperly excluded conversion period interest, conversion period real estate taxes and other conversion period costs in its calculation of original purchase price;[7]

(2) The overall project gain' allocated to each of the units, including the grandfathered units, should be computed under "Option B"; and

(3) Penalty and interest penalty "were arbitrarily assessed and should have been abated for 'reasonable clause' [sic] . . . ."

Procedural Permutation

In their brief, petitioners did not address the following issues raised in their petition:

(1) Original purchase price should be increased by $76,500.00 for anticipated costs to complete the project;

(2) Original purchase price should be increased by $183,877.00 representing certain costs for capital improvements, costs of buy-outs and advertising disallowed by the Division;

(3) Original purchase price should be increased to include conversion period interest, conversion period real estate taxes and other conversion period costs; and

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[7]Mr. Ellenbogen in his letter of February 4, 1991 had complained that "costs, including conversion period interest expense, in excess of temporary, ancillary and incidental rental income" should be added to original purchase price which is similar to the above, although the petition specified "conversion period real estate taxes". It is observed, nonetheless, that petitioners did not introduce any evidence to document any "conversion period" expenses.

(4) It appears[8] that petitioners continue to contend that the overall project gain was not properly computed by the Division because it based such gain "upon the actual 'consideration' received by the petitioner and the actual OPP incurred by the Petitioner, as adjusted by the Respondent" (Petitioners' brief, p. 24; emphasis added).

In addition, in their brief, petitioners raised for the first time the additional issue, that "the anticipated 'cash consideration' as determined by [the Division] for the unsold shares is incorrect" (Petitioners' brief, p. 21). In support of this newly-raised issue, petitioners attached to their brief several exhibits, which were described in petitioners' brief on page 22 as follows:

> "1. Pursuant to Section 2 of the 'Ninth Amendment' [to the offering Plan, which was attached as petitioners' Exhibit "10"] the price per share for tenants in occupancy was established at $45.00 per share. Furthermore, as discussed in Sections 7 [Petitioners Exhibit "2" attached to the brief] and 8 [not included in the record] thereof, the actual price was subject to further reductions for certain allowances.
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> "2. As discussed in the August 30, 1994 'Agreement' [Petitioners' Exhibit "7" attached to the brief, which was an agreement between petitioners and the cooperative housing corporation] and the September 30, 1994 'Affidavit' [Petitioners' Exhibit "8" attached to the brief, which was an affidavit of petitioner Lewis B. Kaye], the Petitioners and Owners [presumably the cooperative housing corporation, 96 Perry Street Corp.] have agreed that the unsold shares will be transferred to Owners and that, based upon the substantial excess of the required monthly maintenance payments allocable to such shares over the rent that will be collected from the existing tenants (who are occupying the units pursuant to leases where rents and permitted increases in rents are governed by the provisions of rent control), such Shares have no value."

In its brief, the Division responded to the issue newly raised by petitioners in their brief, concerning the computation of anticipated consideration, by noting that it would review the taxpayers' recent tax filing[9] and requested "that the taxpayer provide all records that would allow a determination of the maintenance arrears and other debts being forgiven" (Division's

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[8]In their petition, the claim was that Option "B" should have been used by the Division to compute the gain subject to tax which seems to be similar to this argument raised in the brief as discussed in Conclusion of Law "C".

[9]As noted in footnote "2", petitioners did not file any questionnaires or forms prior to their "recent" tax filing dated September 30, 1994 upon the "project total update".

brief, p. 13). The Division also emphasized that "the plan's Ninth Amendment requiring a $45 per share insider's price is confusing and contradicts those records that were provided to the Department" (Division's brief, p. 13). It is observed that petitioners' Exhibit "10", a copy of the Ninth Amendment to the offering plan, is dated May 24, 1983 and provides that rent-controlled tenants may purchase the shares of the cooperative housing corporation allocated to their apartments at $45.00 per share.

In their reply brief, petitioners contend that the Division:

> "incorrectly incorporates the $60 per share amount as reported in the November 15, 1982 "Fifth Amendment to Offering Plan" [which was not included in the record] . . . . [T]his amount was reduced prior to the sale of the first 'taxable' unit to the $45 per share amount" (Petitioners' reply brief, p. 8).

SUMMARY OF THE PARTIES' POSITIONS

In their brief, petitioners argue the following points (which have been numbered to correspond with the numbering of the issues at the beginning of this determination):

(1) The "original purchase price" for shares sold by petitioners should be based upon the fair market value of the property on the date the Greenwich Village building was sold by petitioners to the cooperative housing corporation pursuant to a written agreement which had been executed prior to March 28, 1983, the effective date of the gains tax law. In other words, petitioners contend they are entitled to a step-up in basis from their acquisition cost of $240,000.00 in August 1975 (as noted in Finding of Fact "1") to the fair market value of the property on April 29, 1983 when the fee title to the property was conveyed to the cooperative housing corporation. Consequently, petitioners seem to be arguing that their basis should be stepped-up to the purchase price for the property paid to them (as sponsor) by the cooperative housing corporation. Petitioners contend that the Division's practice in the situation where individuals buy property for $100.00, immediately transfer it to a partnership, which in turn "sells" the property to a newly-formed corporation in exchange for shares of stock at a time when the fair market value of the property is $10,000,000.00 is to treat the "original purchase price" on the subsequent sale of the shares of stock by the partnership as $10,000,000.00, not

$100.00. Petitioners contend that the Division "admitted" this practice in other matters pending in the Division of Tax Appeals. According to petitioners, the situation at hand is similar and it is of no matter that the transfer to the cooperative housing corporation was after the effective date of the gains tax law because it was pursuant to a binding contract executed prior to such effective date;

(2) The wraparound mortgage note received by petitioners pursuant to the March 3, 1982 contract of sale should be treated as "grandfathered consideration". Petitioners analogize to the Division's treatment of consideration attributable to "bargain leases". According to petitioners:

> "[I]f the 'bargain lease' was created in a sale to the corporation prior to March 29, 1983 [the effective date of gains tax law] the Respondent acknowledges . . . [its] 'practice' to consider the 'consideration' attributable to the 'bargain lease' to have been entirely received prior to March 29, 1983 and, accordingly, exempt ('grandfathered') and not to be included in determining the gain on shares of stock sold after March 29, 1983" (Petitioners' brief, pp. 16-17);

(3) The original purchase price includes the entire amount of the mortgage recording tax incurred by petitioners. There is no statutory basis to disallow the special additional mortgage recording tax imposed by Tax Law § 253[1-a];

(4) The Division incorrectly used a price per share for tenants in occupancy of $60.00 because, pursuant to section 2 of the Ninth Amendment of the offering plan, the price per share for tenants in occupancy was established at $45.00 per share. In addition, as noted in exhibits attached to petitioners' brief:

> "the Petitioners and Owners [cooperative housing corporation] have agreed that the unsold shares will be transferred to Owners and that, based upon the substantial excess of the required monthly maintenance payments allocable to such shares over the rent that will be collected from the existing tenants . . . such Shares have no value" (Petitioners' brief, p. 22).

Consequently, petitioners request that the Division "redetermine the 'anticipated cash consideration' properly recognizing that the unsold shares have no value and will be transferred to owners for no consideration" (Petitioners' brief, p. 22);

(5) Petitioners contend that their rights under the equal protection clauses of the New York State and United States Constitutions have been violated because the Division has refused

to apply "the 'step-up' and 'grandfather' rules in non-taxable transfers involving a corporation that qualified to sell its stock to tenant-shareholders, while applying those rules in all other non-taxable transfers" (Petitioners' brief, pp. 18-19);

(6) In computing interest as well as penalty and interest penalty, petitioners maintain that the Division incorrectly computed gain subject to tax "based upon the actual 'consideration' received by the Petitioner[s] and the actual OPP incurred by the Petitioner[s], as adjusted . . ." (Petitioners' brief, p. 24). Petitioners contend that the "estimated 'consideration' and estimated OPP as of the April, 1983 closing and conversion must be used to determine any Gains Tax, and any 'interest' thereon" (Petitioners' brief, p. 24);

(7) Penalty and interest penalty should be abated because petitioners' interpretation of the gains tax law and regulations was reasonable and they acted in "good faith".

The Division counters that the gains tax law was designed to treat cooperative housing corporations differently. Relying on the decisions of the Tax Appeals Tribunal in Matter of Normandy Associates (March 23, 1989) and Matter of Birchwood Associates (July 27, 1989), the Division contends that the transfer to the cooperative housing corporation is ignored for purposes of calculating original purchase price. It dismisses petitioners' constitutional objections as meritless because "the Courts and the Tax Appeals Tribunal have already ruled that the Division of Taxation is properly administering the Gains Tax as it applies to cooperatives."

The Division maintains that it "properly determined [petitioners'] consideration and original purchase price." In particular, it argues that its treatment of mortgages and bargain leases is "entirely rational":

> "[T]he Division treats the consideration attributable to the bargain lease as grandfathered, just like the Division treats the consideration received from units sold before the effective date of the tax as grandfathered" (Division's brief, p. 11).

The Division has agreed to "give the taxpayer's recent and initial tax filing additional review" but defends its use of a $60.00 per share value for unsold units because such valuation was made "without the benefit of any gains tax filing by the taxpayer" (Division's brief, p. 13).

The Division rejects petitioners' use of the $45.00 per share insider's price because it "is confusing and contradicts those records[10] that were provided the Department" (Division's brief, p. 13).

In their reply brief, petitioners explained why a per-share value of $45.00 and not $60.00 should be utilized:

> "Respondent [the Division] incorrectly incorporates the $60 per share amount as reported in the November 15, 1982 'Fifth Amendment to Offering Plan' . . . . [T]his amount was reduced prior to the sale of the first 'taxable' unit to the $45 per share amount" (Petitioners' reply brief, p. 8).

CONCLUSIONS OF LAW

A. As noted in Finding of Fact "12", petitioners did not address in their brief several issues raised in their petition concerning the Division's computation of original purchase price which did not allow various expenses as well as anticipated costs to complete the project. It is observed that the general rule is that a party's failure to address an issue in its brief means that the issue has been abandoned (see, Bello v. Tax Appeals Tribunal, ___ AD2d ___, 623 NYS2d 363). This general rule is properly applied in this matter with regard to the issues raised by petitioners in their petition concerning the Division's disallowance of certain expenses and anticipated costs from the calculation of original purchase price, especially in light of the fact that petitioners failed to introduce any evidence to document such expenses and anticipated costs (see, V & V Properties, Tax Appeals Tribunal, July 16, 1992).

B. Tax Law § 1441, which became effective March 28, 1983, imposes a 10% tax upon gains derived from the transfer of real property located within New York State. The "gain" which is taxed is the difference between the "original purchase price" for the property and the "consideration" received for the property (Tax Law § 1440[3]).

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[10]The Division attached to its brief an undated document it labeled "Exhibit 'A'", which apparently was provided by petitioners during the audit and which indicates that the insider's price was $60.00 per share.

C. The Tax Appeals Tribunal in Matter of Belhara Associates Limited Partnership[11] (January 26, 1995) rejected many of the same arguments which petitioners have made in this matter. This decision of the Tribunal's resolved the issues numbered "I", "II", "V" and "VI" at the beginning of this determination against the taxpayer as follows:

> "To begin with, it is well settled that a cooperative conversion is treated as a single transaction for purposes of applying the gains tax (Mayblum v. Chu, 109 AD2d 782, 486 NYS2d 89, mod 67 NY2d 1008, 503 NYS2d 316; Matter of 1230 Park Assocs. v. Commissioner of Taxation & Fin., 170 AD2d 842, 566 NYS2d 957, lv denied 78 NY2d 859, 575 NYS2d 455). Allowing petitioner to step-up its original purchase price of the property to its fair market value at the time of transfer would have the effect of treating the cooperative conversion as two transactions, i.e., the transfer to the cooperative housing corporation and the transfers of shares to individual unit purchasers, instead of one (Matter of 470 Newport Assocs., Tax Appeals Tribunal, September 2, 1993).[12] Furthermore, it is of no significance that the
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> property was transferred to the cooperative housing corporation pursuant to a contract entered into prior to March 28, 1983 (the effective date of the gains tax), for it is the transfer of shares to unit purchasers which is the taxable event, and not the transfer to the cooperative housing corporation (Mayblum v. Chu, supra, 503 NYS2d 316, 317).
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> "We have already considered and rejected the argument that the Division is required to tax transfers to cooperative housing corporations in the same manner as transfers to other types of entities. In Matter of 61 East 86th St. Equities Group (Tax Appeals Tribunal, January 21, 1993), we stated:
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> > '[a]s we noted in 1230 Park, Article 31-B has a number of provisions that single out transfers pursuant to a cooperative or condominium plan for treatment different from that applied to other types of transfers. In our view, these provisions, contained in former sections 1440(7), 1442, and section 1443(6), provide ample support for the Division's decision to tax transfers pursuant to a cooperative plan like transfers pursuant to a condominium plan and, as a result, to treat cooperative corporations differently from non-cooperative corporations' (Matter of 61 East 86th St. Equities Group, supra; see also, Matter of 470 Newport Assocs., supra).

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[11]It is observed that petitioners' representative appeared on behalf of the taxpayer in Belhara Associates Limited Partnership as well.

[12]The Tribunal's decision in Matter of 470 Newport Assocs. was recently confirmed by the Appellate Division on May 25, 1995 (Matter of 470 Newport Assocs. v. Tax Appeals Tribunal, ___ AD2d ___, ___ NYS2d ___ [1995 WL 318813]).

"Next, petitioner argues that the Division must treat mortgages created pursuant to a binding written agreement executed prior to March 28, 1983 the same way it treats bargain leases created prior to such date when determining consideration on the subsequent sale of the stock. Petitioner contends that since it received the mortgage pursuant to a binding agreement executed prior to March 28, 1983, the consideration attributable to such mortgage should be grandfathered. We disagree.

"A mortgage, whether created prior or subsequent to the effective date of the gains tax, is treated by the Division as consideration only on that portion of the mortgage allocated to shares sold after the effective date of the gains tax, pursuant to contracts entered into after such date. This treatment of a mortgage as consideration was sustained by the Court in Matter of 1230 Park Assocs. v. Commissioner of Taxation & Fin. (supra).

"We find no merit to petitioner's contention that the Division must treat pre-gains tax mortgages the same as pre-gains

tax bargain leases. The Division's decision to treat no portion of a pre-gains tax bargain lease as taxable consideration is not inconsistent with the Division's treatment of mortgages because they are two very different types of encumbrances (Matter of 470 Newport Assocs., supra), and the Division's treatment reflects these differences. Among the differences is the fact that a mortgage encumbers each individual unit while a bargain lease does not.

"Furthermore, even if petitioner were to persuade us that bargain leases and mortgages were to be treated the same, i.e., allocated to all units, petitioner has not attempted to explain why the pre-gains tax mortgage should be treated like the pre-gains tax bargain lease, instead of vice versa.

"Petitioner next argues that the Division's refusal to step-up original purchase price to fair market value on the date of transfer to the cooperative housing corporation and its different treatment of mortgages as compared to bargain leases violates the Equal Protection Clause of both the United States and New York State Constitutions. We disagree.

"With respect to petitioner's constitutional challenges regarding cooperative corporations as compared to other entities, as we noted earlier, Article 31-B of the Tax Law was designed to treat cooperative housing corporations differently than other entities (Matter of 61 East 86th St. Equities Group, supra). The different tax treatment accorded cooperative housing corporations:

> 'enjoys a presumption of constitutionality which "can only be overcome by the most explicit demonstration that [the] classification is a hostile and oppressive discrimination against particular persons and classes. The burden is on the one attacking the legislative arrangement to negative every conceivable basis which might support it" [citations omitted]' (Trump v. Chu, supra, 489 NYS2d 455, 458-459).

"Petitioner has not carried its burden in light of the Court of Appeals' decision upholding the different gains tax treatment of cooperative and condominium developments compared to subdivided realty in Trump v. Chu (supra).

"Turning next to petitioner's equal protection argument concerning the

Division's different treatment of mortgages and bargain leases, we find no merit to petitioner's assertion that the distinction drawn by the Division between mortgages and bargain leases violates the Equal Protection Clause of either the New York State or United States Constitution (see, Matter of National Elevator Indus. v. New York State Tax Commn., 49 NY2d 538, 427 NYS2d 586).

* * *

"Finally, we address whether the Division properly calculated gain and tax due on audit. On audit, the Division calculated gain and tax due using the actual consideration received on the units subject to tax plus the pro-rata portion of the mortgage allocated to such units minus the pro-rata portion of the original purchase price allocated to the taxable units. Petitioner argues that since the gains tax treats the cooperative conversion as a single transaction, the overall project gain should be allocated on a per-share basis for determining gain subject to tax under Option B. In essence, petitioner asserts that all unit transfers, including grandfathered transfers, be counted in calculating gain per share and the gain per share be multiplied by the number of shares subject to tax. We disagree.

"Prior to August 1986, there were two methods of calculating gains tax liability upon transfers of cooperative apartment units, Option A and Option B (see, TSB-M-83-[2]-R). Under Option A, gain was computed based on the actual consideration received less the pro-rata portion of original purchase price allocated to each unit. Under Option B, a taxpayer can elect, prior to the time it starts making taxable sales, to estimate the consideration to be received on all future sales. Although petitioner properly elected to compute its gains tax liability under Option B, it has not provided us with any support for the proposition that under Option B, gain per share is computed based on the total project gain (net of grandfathered and non-grandfathered shares) and then allocated to the non-grandfathered shares to compute tax due. We find that the Division's computational method which includes only the consideration received on taxable units is reasonable. Such method is in harmony with determining whether the cooperative conversion is taxable based on whether consideration anticipated on taxable units along reaches the $1,000,000.00 threshold."

D. Turning to the remaining issues, it is observed that the Tax Appeals Tribunal in Matter of East 61st Street Co. (May 25, 1995) recently decided that the special additional recording tax of ¼% was properly included in the computation of original purchase price. Consequently, the Division is directed to increase petitioners' original purchase price in the amount of $2,365.00, which apparently represented the special additional recording tax of ¼%.

E. With reference to issue "IV", which concerns the Division's calculation of anticipated consideration, the decision of the Tax Appeals Tribunal in Matter of Westport Realty (January 12, 1995) is helpful. The Tribunal decided in Westport Realty that the taxpayer's estimate of anticipated consideration should prevail because the Division failed to provide an adequate justification for its estimate of anticipated consideration:

"The first important factor influencing our decision is that 'anticipated consideration' is not a defined term. Section 1442 of the Tax Law provides that the gains tax is to be paid on transfers pursuant to a cooperative plan as each cooperative unit is transferred. This section also provides that the tax is to be calculated for each unit transferred based on apportionment of the original purchase price of the real property and the total consideration anticipated under the cooperative plan. Article 31-B does not define 'anticipated consideration.' Nor has the Division published any standard defining 'anticipated consideration.'

"Through its creation of the Option B filing method, which was utilized by petitioner, the Division established that anticipated consideration meant an estimate of consideration (see, TSB-M-83-[2]-R). Under Option B, the consideration anticipated pursuant to the cooperative plan is revised, as each 25% of the project is sold, based on the actual consideration received for the sold shares, but not until May 1, 1986 did the Division offer any guidance to the public on how to estimate the consideration on the shares that had not been sold. On May 1, 1986, after the filing in this case, the Division issued TSB-M-86-(3)-R, the 'Safe Harbor Estimate for Transfers Pursuant to Condominium and Cooperative Plans.' Through this memorandum, the Division advised taxpayers that if they followed specific formulas in estimating consideration for the unsold shares in a cooperative conversion, they would not be subject to penalty and interest on any underpayment. However, this memorandum did not require that the safe harbor rules be followed (Matter of Mendler, Tax Appeals Tribunal, September 23, 1993). With respect to earlier filings, the memorandum stated: '[t]he establishment of the Safe Harbor Estimates is not intended to indicate that any estimate of consideration made before the new Gains Tax filing procedure was or was not reasonable' (TSB-M-86-[3]-R). Accordingly, the Safe Harbor Rules are irrelevant to analyze the appropriateness of petitioner's anticipated consideration. Thus, the Division is asserting in this case that petitioner's estimate of anticipated consideration is too low, however, the Division has no apparent standard for evaluating petitioner's estimated consideration."

As in Matter of Westport Realty, the safe harbor rules issued on May 1, 1986 are not applicable to the matter at hand which concerns a transaction that occurred approximately three years earlier. Nonetheless, petitioners apparently agree with the Division that the insider's price per share should be utilized to calculate "anticipated consideration", with the parties disagreeing over the amount that should be used as the insider's price. It is concluded that petitioners have established, pursuant to the exhibit filed with their initial brief, that the insider's price per share was reduced prior to the sale of the first taxable unit to $45.00 per share. Consequently, the Division is directed to recompute anticipated consideration and recalculate the total consideration used to determine gains tax due.

F. It is observed that the Division has agreed to review the recent filings by petitioners, as noted in Finding of Fact "12". These filings are not at issue in this matter.

G. Pursuant to Tax Law § 1446(2)(a):

> "Any person failing to file a tentative assessment and return or to pay any tax within the time required by [Article 31-B] shall be subject to a penalty of ten per centum of the amount of tax due plus an interest penalty of two per centum of such amount for each month of delay or fraction thereof . . . ."

The interest penalty may not exceed 25% in the aggregate. In addition, said section goes on to provide that if the Commissioner of Taxation and Finance:

> "determines that such failure or delay was due to reasonable cause and not due to willful neglect, [the commissioner] shall remit, abate or waive all of such penalty and such interest penalty."

Petitioners have the burden of proving that the failure to file and pay was due to reasonable cause and that it was not due to willful neglect. Petitioners have not shouldered this burden. In particular, the record does not support a conclusion that petitioners made a sufficient effort to ascertain their correct tax liability (see, Matter of Brounstein, Tax Appeals Tribunal, January 30, 1992; Matter of KAL Associates, Tax Appeals Tribunal, October 17, 1991). In fact, as noted in Finding of Fact "2", it was more than four years after petitioners should have filed under the gains tax law that the Division's tax technician discovered their failure while reviewing records at the Attorney General's office. It is also observed that petitioners offered no evidence to show the specific steps that they or their professional advisors took to ascertain the proper gains tax liability. Mere reliance on professionals is an inadequate basis to abate penalty (see, Matter of Shechter, Tax Appeals Tribunal, October 13, 1994). Moreover, as noted in Finding of Fact "3", petitioners by their accountant were slow to cooperate with the auditor's request for records, and, in fact, never provided the auditor with much of the requested documentation.

H. The petition of Lewis B. and Beatrice M. Kaye is granted to the extent indicated in Conclusions of Law "D" and "E" and the Notice of Determination dated April 8, 1991 is to be modified to so conform, but, in all other respects, the petition is denied.

DATED: Troy, New York
July 6, 1995

/s/ Frank W. Barrie
ADMINISTRATIVE LAW JUDGE