STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
FBE BROADWAY ASSOCIATES	:	DETERMINATION DTA NO. 811986
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, FBE Broadway Associates, c/o FBE Limited, 111 Broadway, 20th Floor, New York, New York 10006, 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 May 9, 1994 and May 13, 1994, respectively, petitioner by its duly appointed representative, Roberts and Holland, Esqs. (Carolyn Joy Lee, Esq., and Ronald A. Morris, Esq., of counsel), and the Division of Taxation by William F. Collins, Esq. (Andrew J. Zalewski, Esq., of counsel) waived a hearing and agreed to submit the matter for determination based upon documents and briefs to be submitted by September 9, 1994. The Division of Taxation submitted its documents on June 23, 1994. Petitioner submitted a brief and accompanying documents on July 25, 1994. The Division of Taxation submitted a responding brief with one accompanying document on August 24, 1994. Petitioner submitted its reply brief on September 12, 1994. After due consideration of the evidence and arguments, Dennis M. Galliher, Administrative Law Judge, renders the following determination.

ISSUE

Whether, in computing taxable gain under Article 31-B of the Tax Law, the cost of brokerage fees and commissions incurred by a landlord in leasingspace at its premises may be included in original purchase price upon the landlord's sale of the premises subject to such leases.

FINDINGS OF FACT[1]

Petitioner, FBE Broadway Associates, is a New York limited partnership.

On October 19, 1987, petitioner acquired an office building located at 270 Madison Avenue ("the property") for a purchase price of $33,000,000.00.

At the time of the 1987 purchase, a number of floors at the property were vacant or about to become vacant.

Petitioner acquired the property with the intention of enhancing the property's value by leasing the vacant space, in the expectation of later realizing a greater value upon sale of the leased-up property.

During 1988, 1989 and the early part of 1990, petitioner entered into 13 new leases (the "new leases"), affecting 7 full floors and portions of 4 additional floors at the property, under which petitioner was entitled to receive rents. The terms of such leases ranged from 25 months to 130 months.

Petitioner incurred leasing brokerage fees and commissions aggregating $1,242,980.15 in order to obtain the tenant/lessees and accompanying right to receive rents under the new leases.

It is customary for owners of rental office buildings in Manhattan to incur such leasing brokerage costs.

The property was sold in 1990 in a transaction that included the sale of petitioner's rights to receive rents under the new leases. The selling price for the property was $51,450,000.00.

At the time of the 1990 sale, the value of the property inclusive of the landlord's right to receive rents under the new leases was substantially greater than the value of the property exclusive of those rights.

The additional consideration derived by petitioner on the 1990 sale that was attributable

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[1]With its brief, petitioner submitted proposed findings of fact numbered "1" through "20". Said proposed findings of fact have been accepted and are incorporated herein.

to the value of the right to receive rents under the new leases was greatly in excess of the costs incurred by petitioner in obtaining such rights under the new leases.

On the 1990 sale of the property, petitioner filed a Transferor Questionnaire (Form TP-580) reporting thereon a taxable gain of $9,991,183.00 and a gains tax due of $999,118.30.

In response, the Division of Taxation ("Division") issued its Tentative Assessment and Return on February 28, 1990, showing a taxable gain of $11,862,813.66, and a gains tax due of $1,186,281.37.

Among the adjustments made by the Division was the disallowance of original purchase price claimed for "tenant leasing costs" in the amount of $1,261,654.00.

On or shortly after February 28, 1992, petitioner paid the gains tax of $1,186,281.37 as shown per the Tentative Assessment and Return.

On February 28, 1992, petitioner filed a refund claim in the amount of $293,427.41.

Petitioner's refund claim was allowed in part and denied in part by letter dated August 12, 1992. This letter stated, in relevant part, that:

> "The money paid for the leasing commissions rendered in connection with the leasing of the commercial space is considered operating expenses incurred in the normal course of business."

Petitioner timely filed a Request for Conciliation Conference with the Division's Bureau of Conciliation and Mediation Services ("BCMS") concerning that portion of the refund claim that had not been allowed.

On March 19, 1993, a Conciliation Order was issued denying petitioner's request for refund.

Petitioner timely filed a petition seeking a refund of gains tax paid as a result of the disallowance of the original purchase price claimed for leasing fees and commissions, as well as additional refunds on other grounds.

Following various concessions, the amount of gains tax now at issue is $124,980.15,

plus interest,[2] representing gains tax paid as a result of the Division's determination that the original purchase price used to compute the amount of taxable gain on the 1990 sale does not include the costs incurred by petitioner to acquire the right to receive rents under the new leases.

CONCLUSIONS OF LAW

A. Tax Law § 1441 imposes a tax (commonly known as the "gains tax") at the rate of 10% upon the gain derived from the transfer of real property within New York State where the consideration received for such transfer is $1,000,000.00 or more (Tax Law §§ 1441, 1443[1]). Tax Law § 1440(3) defines "gain" for purposes of Article 31-B as the:

> "difference between the consideration for the transfer of real property and the original purchase price of such property, where the consideration exceeds the original purchase price."

B. The definition of original purchase price is contained in Tax Law § 1440(former [5][a]). This provision states:

> "'Original purchase price' means the consideration paid or required to be paid by the transferor; (i) to acquire the interest in real property; and (ii) for any capital improvements made or required to be made to such real property, including solely those costs which are customary, reasonable, and necessary, as determined under rules and regulations prescribed by the tax commission, incurred for the construction of such improvements. Original purchase price shall also include the amounts paid by the transferor for any customary, reasonable and necessary legal, engineering and architectural fees incurred to sell the property and those customary, reasonable and necessary expenses incurred to create ownership interests in property in cooperative or condominium form, as such fees and expenses are determined under rules and regulations prescribed by the tax commission."

As a threshold matter, in order for petitioner to include the fees and commissions in question in original purchase price, petitioner would have to have paid the same in connection with its acquisition of an interest in real property. In this regard, there is no claim that such amounts were paid to acquire the property itself. Rather, the costs in question were incurred after the property was acquired, in order to obtain tenants and the accompanying right to receive rental income therefrom.

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[2]The parties' briefs clarify that there is no dispute as to the dollar amount of tax in question, and that the only issue is whether the leasing fees and commissions may be included in original purchase price.

C. Tax Law § 1440(4) defines an "interest in real property" to include (though not be limited to):

> "title in fee, a leasehold interest, a beneficial interest, an encumbrance, a transfer of development rights or any other interest with the right to use or occupancy of real property or the right to receive rents, profits or other income derived from real property. Interest shall also include an option or a contract to purchase real property" (emphasis added).

In addition, the term "real property" is defined to mean:

> "every estate or right, legal or equitable, present or future, vested or contingent, in lands, tenements or hereditaments, including buildings, structures and other improvements thereon and leaseholds, which are located in whole or in part within [New York State]" (Tax Law § 1440[6]; 20 NYCRR 590.2).

D. Petitioner's position is based on the statutory inclusion of "the right to receive rents, profits or other income derived from real property" as an "interest in real property" under Article 31-B. Petitioner argues that the expense it paid as brokerage commissions in acquiring the new leases with their attendant right to receive rents constitutes an expense incurred to acquire an interest in real property. Therefore, petitioner maintains such expense should be included in original purchase price reducing the amount of consideration (and ultimately gain) received upon petitioner's transfer of the property including such right to receive rents. Petitioner points out that its sale of the premises in 1990 included the land, the building and all rights attendant therewith, including the right to receive rents. Petitioner maintains that the value of the premises was increased directly as the result of its leasing of space during the period between its acquisition and sale of the premises, and therefore claims entitlement to reduce its sale proceeds by the amount of expense incurred to obtain such increase in value.

E. Article 31-B provides expansive definitions of "interest in real property" and "transfer of real property". It has been recognized that such broad definitions were designed to encompass a wide array of interests and transfers thereby maximizing revenues generated by the gains tax (see, Matter of Bredero Vast Goed, N.V. v. Tax Commn., 146 AD2d 155, 539 NYS2d 823, appeal dismissed 74 NY2d 791, 545 NYS2d 105). Thus, the gains tax encompasses not only fee interest transfers, probably the most common or usual real estate transfer, but also covers other, less-than-fee interest transfers (e.g., assignment of a contract to purchase real

property [Tax Law § 1440(7); Auerbach v. State Tax Commn., 142 AD2d 390, 536 NYS2d 557], transfer of development rights [Tax Law § 1440(4); 20 NYCRR 590.63], leasehold interests [Tax Law §§ 1440(4), 1440(7)(a)], acquisition of a controlling interest in an entity with an interest in real property [Tax Law § 1440(7)(a); see, Matter of Bredero Vast Goed, N.V. v. Tax Commn., supra]). In fact, the Division raises no dispute that a transfer of the right to receive rents, profits or other income derived from real property represents the transfer of an interest in real property potentially subject to gains tax, assuming the requisite gains tax thresholds are met (see, e.g., Tax Law § 1443).

F. In order for petitioner to prevail, the sale of the subject premises made as a fee transfer (including the property and all rights and interests therein) must be broken down into its component segments. While the right to receive rents is an interest in real property, and while such interest was included among the rights transferred in this case, it remains that the transfer herein was not simply the transfer of such an interest. Rather, the subject transfer was a fee transfer, and there is no compelling reason why such transfer should be broken down into its isolated parts. The fact that the gains tax was broadly drafted such that certain component parts of the whole interest in real property may be subjected to gains tax upon their individual transfer does not provide reason to break down a fee transfer into such component parts. Rather, such method of drafting simply indicates that such individual interests, when transferred on their own, will not escape inclusion in gains tax (thereby avoiding any incentive to transfer such interests piecemeal as a means of escaping the gains tax).[3]

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[3]In this case, adopting petitioner's position would allow costs associated with the creation of "interests" not subject to gains tax to be included in original purchase price by virtue of the transfer of the fee interest including such otherwise nontaxable interests. That is, it appears clear that none of the leases in this case were subject to gains tax in their own right when created (see, Finding of Fact "5"; Tax Law § 1440[7][a]). Petitioner's position, however, would segregate out and identify both the lessor's right to receive income (as an "interest in real property") and the broker's commission expense incurred in connection therewith, and would include such latter amount in original purchase price to reduce gain on the transfer of the fee notwithstanding that the underlying "interests" to which the cost relates would not be subject to gains tax as so segregated. In comparison, if any of the leases had been taxable, the related broker's fees and commissions would apparently be allowed in reduction of consideration received (Tax Law

G. In addition to the foregoing, it is observed that there is no distinction or specification as to the percentage of value, consideration or gain out of the selling price for the property attributable to the rental occupancy increase versus other value factors. In fact, it would seem that in agreeing upon a selling price for the fee interest, petitioner would be sure to factor in the relative value increase in the leased-up building as well as its costs incurred in operating the premises, including obtaining the leases. As noted, it is undisputed that the subject leasing commissions were not paid to acquire the property, but rather were paid to acquire the tenant/lessees and the attendant right to receive rents under the leases. Petitioner's argument that such expenses, though incurred to acquire rental receipt rights after acquisition of the property, should nonetheless be included as original purchase price upon sale of the property fails to explain why such expenses do not represent ongoing expenses of operating the

premises (expected expenses of owning and operating notwithstanding the overall intent or hope for some increased value concomitant with leasing the available space). In short, it would appear that petitioner not only increased the overall value of the property to potential buyers, but furthermore received ongoing rental income as dual consequences of its leasing activities. That the more fully-rented premises made the property more attractive to buyers (i.e., increased its market value) does not, absent more specific legislative authorization, provide reason to segregate out the components of that value or convert ongoing ownership/operating activities into acquisition costs includible in original purchase price upon sale of the fee interest in the premises.

H. Finally, petitioner points to a recent amendment to Tax Law § 1440(5) which specifically provides for the inclusion in original purchase price of certain costs, fees and expenses, including broker's fees and commissions, incurred in connection with the creation of a leasehold or sublease with respect to which real property is subject at the time of its transfer

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§ 1440[1][a]), but would not be includible again in original purchase price upon transfer of the premises including such leases (see, Tax Law § 1440[5][a][vii]).

(Tax Law § 1440[5][a][vii], as amended by L 1994, ch 170, § 90, eff June 9, 1994). This provision allows such costs, but provides two limitations thereon, to wit, (a) an amortization formula limiting the amount of such costs which may be allowed based on the unexpired term of the lease or sublease, and (b) a limitation such that the costs are allowed only to the extent they are "not otherwise included in original purchase price pursuant to the other provisions of this subdivision."[4] Petitioner

maintains this latter ("not otherwise included . . .") phrase should dispel the notion that the expenses in question were not included in original purchase price prior to the amendment. On this score, petitioner argues that the amendment (a) indicates (at least by inference) that such costs could be included in full under prior law, and (b) also imposed the described amortization limitation on such otherwise fully allowable costs. In short, petitioner's argument seems to be

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[4]As amended, Tax Law § 1440(5)(a)(vii) reads as follows:

> "Original purchase price shall also include amounts paid or required to be paid by the transferor for costs, fees and expenses (including brokerage fees and commissions, professional fees and payments to or on behalf of a tenant as an inducement to enter into a lease or sublease) incurred in connection with the creation of a leasehold or sublease with respect to which the real property is subject at the time of transfer, which costs, fees and expenses are customary, reasonable and necessary as determined under rules and regulations prescribed by the commissioner and which are not otherwise included in original purchase price pursuant to the other provisions of this subdivision. Provided however, such costs, fees and expenses incurred in connection with the creation of a lease or sublease may be included in original purchase price only to the extent of the unexpired term of the lease or sublease determined as of the date of transfer. The amount of such costs, fees and expenses to be included in original purchase price shall be determined by multiplying the total amount of such costs, fees and expenses by a fraction, the numerator of which is the number of months remaining on the term of the lease or sublease as of the date of transfer, determined without regard to any unexercised options to renew such lease or sublease, and the denominator of which is the sum of (A) the number of months of the expired portion of the term of such lease or sublease at the time of transfer and (B) the number of months remaining on the term of such lease or sublease at the time of transfer, determined without regard to any unexercised options to renew such lease or sublease."

that the 1994 amendment's purpose was simply to place a limit on the dollar amount of leasing commissions which could be included in original purchase price.

Contrary to petitioner's argument, the Legislature's prior definition of original purchase price offered no specific basis for including leasing

commissions therein, but rather left to the Commissioner of Taxation and Finance (formerly the State Tax Commission) the discretion to determine by rule and regulation those costs properly includible in original purchase price. In turn, given no evidence that such leasing commissions were includible in original purchase price, either by statute, rule or regulation (see, 20 NYCRR 590.15), prior to the 1994 amendment described herein, it would appear that the Legislature determined to specifically expand the concept of original purchase price by passing an allowance measure with an attendant limitation, to wit, specifically including leasing commissions as part of original purchase price, but limiting the dollar amount thereof based on the noted amortization formula. Finally, petitioner's reference to the amendment's phrase limiting expenses to the extent they are not otherwise included in original purchase price pursuant to other provisions of the noted subdivision must be read in connection with the full amendment. That is, the amendment covers not only broker's fees and commissions, which are specifically listed in a parenthetical (see, footnote "4", supra), but also any other customary, reasonable and necessary costs, fees and expenses incurred in creating leaseholds or subleases. In turn, since a broader group of expenses than just broker's fees and commissions is covered by the amendment, it stands to reason that there is a greater chance that some of such other expenses could be "otherwise included in original purchase price under other provisions" of Tax Law § 1440(5). Thus, the phrase to which petitioner points as meaning broker's fees and commissions were previously allowable (in full), appears to be simply a generalized means of assuring that no expense out of a large array of possibly includible expenses may be double counted.

I. In sum, prior to amendment in 1994, Article 31-B did not allow broker's fees and

commissions such as those at issue herein to be included in original purchase price upon sale and transfer of property.

J. The petition of FBE Broadway Associates is hereby denied and the Division's denial of petitioner's claim for refund is sustained.

DATED: Troy, New York
March 2, 1995

/s/ Dennis M. Galliher
ADMINISTRATIVE LAW JUDGE