

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
AARON ZIEGELMAN	:	DETERMINATION
	:	DTA NO. 812030
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, Aaron Ziegelman, 152 West 57th Street, New York, New York 10019, 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 April 25, 1994 and May 5, 1994, respectively, petitioner, represented by Ziegler, Sagal & Winters, P.C. (Alan Winters, Esq., of counsel), and the Division of Taxation, represented by William F. Collins, Esq. (Donald C. DeWitt, Esq., of counsel), signed an agreement consenting to have the controversy determined on submission without a hearing, with all briefs and documents due by October 31, 1994. The Division of Taxation filed documentary evidence on June 6, 1994. Petitioner filed his brief on July 25, 1994. The Division of Taxation filed its brief on August 16, 1994. Petitioner filed his reply brief on October 20, 1994. After review of all evidence submitted, Marilyn Mann Faulkner, Administrative Law Judge renders the following determination.

ISSUES

I. Whether the transferor is no longer entitled to pay real property transfer gains tax in installments pursuant to Tax Law § 1442(c) once the transferee defaults on a purchase money mortgage and returns the property to the transferor in lieu of foreclosure.

II. Whether there is reasonable cause to abate the imposition of a penalty for failure to pay the transfer gains tax.

FINDINGS OF FACT

Petitioner, Aaron Ziegelman, and the Division of Taxation ("Division") signed a Stipulation Admitting Certain Facts, dated April 13, 1994. These stipulated facts are incorporated into Findings of Fact "2" through "10", and "13".

On or about May 31, 1985, petitioner sold 17 condominium apartments located at 504-510 110th Street, New York, New York (the "apartments") to an unrelated partnership (the "purchaser").

As consideration for such sale, the purchaser issued to petitioner notes secured by 17 purchase money mortgages in the combined face amount of \$1,178,540.00 (the "notes"). Each note required that no payment of principal was required until the sale of the apartment to which the note related. Interest payments were required to be made monthly. The notes imposed personal liability on the purchaser for payment of interest for the first five years and, thereafter, said notes were without recourse against the purchaser for payment of either interest or principal.

The Division issued a Tentative Assessment with respect to the transfers assessing real property transfer gains tax of \$63,475.13. The parties agree that petitioner is liable for this gains tax. The sole issue presented in this case is when such tax is due to be paid.

Petitioner timely elected under Tax Law § 1442(c) to pay the gains tax on the sale of the apartments in 15 annual installments of \$4,231.67 each with payments commencing on May 31, 1986. The Division approved this election.

Tax Law § 1442(c) provides:

"(c) Installment payments

"Notwithstanding the foregoing, if the tax due exceeds fifty percent of the cash portion of the consideration received by the transferor on or before the date of transfer and also exceeds ten thousand dollars, the transferor shall in accordance with subdivision (f) of this section not later than the fifteenth day after the date of transfer elect (i) to pay the entire tax, or (ii) where the cash portion of the consideration exceeds the tax due, to pay fifty percent of such cash portion, or (iii) where the cash portion of the consideration is equal to or less than the tax due, to pay the lesser of fifty percent of the tax due or such cash portion, and (iv) in the case of payments pursuant to clauses (ii) and (iii) hereof, to pay the balance over three years or, in the case of a purchase money mortgage given by the transferee to the transferor, the lesser of the term of the purchase money mortgage or fifteen years, in equal annual installments payable on the anniversary date of the transfer,

provided however that no such annual installment shall be in an amount less than the total tax due on the transfer multiplied by a fraction, the numerator of which is the payments received by the transferor during the annual period and the denominator of which is the total payments due to the transferor for the transfer, and further provided that such payments shall be limited to the total tax due plus interest as provided in subdivision three of section fourteen hundred forty-six of this article. Notwithstanding the foregoing provisions of this section with respect to payment of the tax due in installments on an anniversary date of the transfer, if prior to such date the transferor receives ninety percent or more of the balance of the cash portion of the consideration required to be paid to such transferor for the real property transferred, the balance of the total tax due shall be payable on the receipt of such consideration." (Emphasis added.)

The Division's regulations require a taxpayer who elects to pay the gains tax in installments to file a Tentative Assessment and Return (Form TP-582) along with a Supplemental Return (Form TP-583). Petitioner filed both forms. The Supplemental Return contained the following printed language:

"If the transferor fails to pay any installment on the date on which it is due, the Tax Department may declare the entire unpaid balance of the tax due and owing."

Petitioner timely paid the installments due in 1986, 1987, 1988, 1989, 1990 and 1991. After these payments, petitioner paid no further installments.

The purchaser defaulted on the notes and, on or about January 17, 1990, the apartments were transferred back to petitioner by deed in lieu of foreclosure. Petitioner had no recourse against the purchaser for further payments under the notes. Petitioner did not report to the Division the transfer of the property back to him in lieu of foreclosure.

In a Notice of Determination, dated October 17, 1991 (Notice No. L-002937251-4), the Division asserted that all gains tax due with respect to the transfers, which remained unpaid on January 17, 1990 (i.e., the date the apartments were transferred back to petitioner) in the amount of \$38,085.11, became due and payable on that date. In addition, the Division assessed interest (\$8,709.69) and penalties (\$15,572.57) for the failure of petitioner to pay unpaid gains tax on January 17, 1990.

The Division's position was that the return of the apartments by the purchaser to petitioner was in satisfaction of the balance of the cash consideration payable to petitioner under the notes, so that for purposes of the last sentence of Tax Law § 1442(c), petitioner should be

considered to have received "ninety percent or more of the balance of the cash portion of the consideration required to be paid." The Division contended that for purposes of the last sentence of Tax Law § 1442(c), the "balance of the cash portion of the consideration required to be paid" is the amount which was actually received by petitioner in satisfaction of the notes, even if this amount was less than the amount of cash the transferee promised to pay at the time of the original sale pursuant to the notes. Further, the Division reasoned that section 1442(c) allows payment of the gains tax in installments over three years, except in the case of a purchase money mortgage when payments may be made for the lesser of the term of the mortgage or 15 years, and that when a purchase money mortgage is satisfied, there is no longer any basis to continue the installment payment of tax beyond the normal three-year period, and instead, the balance of deferred tax is due on satisfaction of the mortgage.

A conciliation conference was held. The conferee issued a Conciliation Order, dated April 2, 1993, sustaining the statutory notice.

Petitioner filed a petition, dated June 17, 1993, and the Division filed an answer, dated November 8, 1993.

Petitioner's position is that, notwithstanding the transfer of the apartments back to him, he may continue to pay installment payments on the gains tax due from the initial sale. Petitioner reasons that after the purchaser defaulted on the notes, petitioner ceased to receive further cash payments under the notes, so that he should not be considered, for purposes of Tax Law § 1442(c), to have received "ninety percent or more of the balance of the cash portion of the consideration required to be paid"; that is, for purposes of the last sentence of the Tax Law § 1442(c), the "cash portion of the consideration required to be paid" is the amount of cash the transferee promised to pay at the time of the original sale pursuant to the notes, even if subsequent events result in the transferee actually paying less cash than was required under the notes. Petitioner asserts that the fact that the notes were satisfied in the foreclosure does not change this result.

CONCLUSIONS OF LAW

A. Under Tax Law Article 31-B, section 1441 imposes a 10% tax on gains derived by a transferor from the transfer of real property. Tax Law § 1442(c) permits the transferor to elect installment payments to pay the tax in the situation where the transferor is given a purchase money mortgage by the transferee. The statute permits annual installment payments over the lesser of the term of the purchase money mortgage or 15 years. In the event the transferee accelerates payments to the transferor or the transferor receives 90% or more of the balance of the cash portion of the consideration, the annual installment payments are similarly affected. Tax Law § 1442(c) provides that in the case of accelerated payments to the transferor, the installment payment due on the gains tax is increased proportionally (annual installment shall equal the total tax due multiplied by the fraction the numerator of which is the amount of payment received by the transferor during the annual period and the denominator of which is the total payments due to the transferor for the transfer). The parties refer to this provision as the proportionality rule. In the case where the transferor receives 90% or more of the balance of the cash portion of the consideration for the transferred property, the balance of the total tax on the gain is due upon the receipt of such consideration.

The issue is whether the 90% rule applies to petitioner based on the transferee's transfer of the apartments back to petitioner in lieu of foreclosure. Petitioner does not contest his liability for the full amount of the tax.¹ He argues, however, that he is entitled to continue the installment payments, notwithstanding the return of the apartments to him, as if the apartments were not returned to him. Thus, contends petitioner, he is not liable for the interest and penalty asserted by the Division because until the date of the Notice of Determination he was current on

¹In calculating the total amount of gains tax due, the consideration includes the face value of any purchase money mortgage (Tax Law § 1440.1[a]; 20 NYCRR 590.12; Matter of Normandy Assoc., Tax Appeals Tribunal, March 23, 1989). Subsequent defaults on mortgages do not alter the amount of gains tax due inasmuch as the value of the consideration is finally fixed at the time of the initial transfer (see, Matter of Cheltoncort Co. v. Tax Appeals Tribunal, 185 AD2d 49, 592 NYS2d 121).

his annual installment payments. Petitioner notes that at the time of default, the value of the apartments was less than the face value of the purchase money mortgage. He claims that he will never recognize the full amount of the consideration that was used to calculate the amount of gains tax due and that the Division's application of the 90% rule would undermine the legislative purpose of Tax Law § 1442(c) to relieve taxpayers by deferring payment of the tax until the transferor receives the cash payments for the sale.

The Division asserts that petitioner's receipt of the apartments was in full satisfaction of the balance of the cash portion of the consideration with no further payments due on the purchase money mortgage, therefore, 90% or more of the balance of the cash portion of the consideration has been received. Alternatively, the Division argues that petitioner's 1990 annual installment payment should be computed based on the notion that the transferee accelerated all payments in 1990 by relinquishing the apartments to petitioner. Thus, under the proportionality rule, petitioner was required to remit in 1990 the full balance of the tax remaining.

With respect to petitioner's hardship argument, the Division notes that Tax Law § 1440(1) provides that in the case where a mortgagee receives the property which secured the mortgage in lieu of foreclosure, the consideration received by the mortgagee is the amount of the lien remaining on the property, except that where that amount exceeds the fair market value of the real property, such consideration shall be equal to the fair market value of the property. The Division argues that this provision does not apply to petitioner because: (1) this provision was added to the statute in 1993 and therefore only applies to transfers after the effective date of the amendment in April 15, 1993; and (2) petitioner has provided no evidence of the fair market value of the property when it was transferred back to petitioner in 1990. The Division further argued that petitioner had not shown that his failure to timely pay the total gains tax due in 1990 was due to reasonable cause and not due to willful neglect.

In his reply brief, petitioner argues that in the stipulation the Division asserted only the 90% rule and installment period argument as the basis for acceleration and that it was in

reliance on this stipulated agreement that petitioner did not introduce evidence as to the fair market value of the apartments. Therefore, contends petitioner, he should be given an opportunity to present evidence with respect to the fair market value. Notwithstanding this request, petitioner argues that he carried his burden to show that the value of the apartments was less than the amount of the debt encumbering them. Specifically, petitioner notes that this point is evidenced by the fact that the apartments were returned to him by deed in lieu of foreclosure inasmuch as it would make no sense for the debtor to return the apartments if he could have sold the apartments for more than the mortgage debt. In addition, petitioner argues that the 1993 amendment to section 1441 is "legislative confirmation . . . that a deed in lieu of foreclosure is made where the fair market value of the property transferred is less than the debt encumbering that property."

In Matter of Fazkap Associates (Tax Appeals Tribunal, October 6, 1994), the Tribunal upheld the Division's acceleration of payments on gains tax due when a taxpayer/transferor failed to make an installment payment of gains tax on a property transfer. Similar to the present case, the transferee defaulted on the mortgage held by the transferor and the transferor thereafter took back the property in lieu of foreclosure. The Tribunal upheld the reasoning of the Administrative Law Judge ("ALJ") who stated that the Division was entitled to demand full payment of the unpaid balance based on the terms set forth on the Supplemental Return. The ALJ relied on the following language contained on that tax form:

"If the transferor fails to pay any installment on the date on which it is due, the Tax Department may declare the entire unpaid balance of the tax due and owing."

Unlike the situation in Fazkap, the Division in this case did not rely on the acceleration provision of the Supplemental Return inasmuch as it appears that petitioner had not defaulted on an installment payment at the time the Notice of Determination was issued. Petitioner made a payment in 1991 and the notice indicated that the total unpaid balance of \$38,085.11 of gains tax was due from the time petitioner took back the property in January of 1990. The Division reasoned that the statutory 90% rule applied inasmuch as petitioner would receive no further payments from the transferee after the property was returned to petitioner. Although the 90%

rule or other provisions of Tax Law § 1442(c) were not specifically addressed in Fazkap, the Tribunal decision stands for the proposition that a taxpayer is liable for the full amount of the transfer gains tax owed based on the face value of a purchase money mortgage given by a transferee even though the property was returned to the transferor in satisfaction of the unpaid portion of the mortgage.

According to Tax Law § 1442(c), gains tax may be deferred in the case of a purchase money mortgage "for the lesser of the term of the purchase money mortgage or 15 years." Inasmuch as the transferor here no longer holds a purchase money mortgage, there is no further "term" left on the mortgage and, thus, no basis for deferring the gains tax. The 90% rule provides further justification for the Division's actions based on the value of the property returned and the reasonable assumption that the fair market value of the property is the price at which a willing seller and a willing buyer will trade (see, Matter of Beekman Country Club, Tax Appeals Tribunal, April 16, 1992, confirmed 199 AD2d 640, 604 NYS2d 989; Matter of Bridgehampton Investors Corp., Tax Appeals Tribunal, August 11, 1988). Contrary to petitioner's claims, he has not provided evidence that the real property returned was not worth 90% of the principal remaining on the purchase money mortgage after January of 1990.

B. With respect to petitioner's request that he be allowed to submit further evidence on the fair market value issue, petitioner raised in his brief that the value of the returned property was less than the face value of the purchase money mortgage. Therefore, he had an opportunity to submit documents at the time he submitted his brief to substantiate any claims in support of his case. The parties were informed by letter, dated May 11, 1994, that the record would be closed as of July 26, 1994, the date petitioner was to file his brief and documents, and that no further evidence would be received after that date. Therefore, to the extent petitioner is requesting in his reply brief to reopen the record to submit further evidence, that request is denied (see, Matter of Schoonover, Tax Appeals Tribunal, August 15, 1991).

C. Petitioner claims that there was reasonable cause for nonpayment of the gains tax when the property was transferred back to him based on his reasonable belief that he was

entitled to continue the installment payments. He argues that there is no case, regulation or other Division notice that sets forth a position contrary to petitioner's interpretation of the statute.

Tax Law § 1446.2(a) permits abatement or waiver of a penalty if it can be determined that a taxpayer's failure to timely file and pay the gains tax was due to reasonable cause and not due to willful neglect. The reasonableness of a taxpayer's failure to pay the tax must be evaluated in light of the Division's articulated policy (see, Matter of Benaquista, Polsinelli & Serafini Mgt. Corp. v. Commr. of Taxation & Finance of the State of N.Y., 191 AD2d 80, 598 NYS2d 829, 832) and "the extent of the taxpayer's efforts to ascertain its tax liability" (Matter of KAL Associates, Tax Appeals Tribunal, October 17, 1991). Here, there is no evidence that petitioner made an effort to contact the Division to ascertain the effect of the return of the property on his installment payment agreement with the Division. Inasmuch as the installment payment was based on the existence of the purchase money mortgage, petitioner should have made inquiries concerning the tax impact of the default and return of the property.

In Matter of Fazkap Associates, (*supra*), the Tribunal abated the penalty based on its finding that the transferor had no income other than the mortgage payments from the transferee and was dependent on the mortgage payments to make the installment payments. Therefore, concluded the Tribunal, the transferor's failure to make the installment payments was the direct result of not receiving mortgage payments from the transferee. In the present case, petitioner continued to make an installment payment after the transferee's default and has not shown that he had no other income (e.g., no rental income from the return of the apartments) other than the mortgage payments to meet his tax obligation. Thus, petitioner has not met his burden, as the petitioner did in Fazkap Associates, to justify abatement of the penalty.

D. The petition of Aaron Ziegelman is denied and the Notice of Determination, dated October 17, 1991, is sustained.

DATED: Troy, New York
April 6, 1995

/s/ Marilyn Mann Faulkner
ADMINISTRATIVE LAW JUDGE