STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
SHED DEVELOPERS	:	DETERMINATION DTA NO. 812289
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, Shed Developers, c/o Stanley Mishkin, Esq., 5018 Express Drive South, Suite LL-4, Ronkonkoma, New York 11779, 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 20, 1994 and April 27, 1994, respectively, petitioner by its duly authorized representative, Howard M. Koff, Esq., and the Division of Taxation by William F. Collins, Esq. (Donald C. DeWitt, Esq., of counsel) consented to have the controversy determined on submission without hearing. All documentary evidence and briefs were due by October 12, 1994.[1] The Division of Taxation filed its documents on May 11, 1994. Petitioner submitted a brief on May 20, 1994. The Division of Taxation submitted a brief on July 21, 1994. Petitioner did not submit a reply brief.[2] After due consideration of the entire record, Winifred M. Maloney, Administrative Law Judge, renders the following determination.

[1]Petitioner's representative requested and received an extension of time in which to file its reply brief based upon a new argument raised by the Division of Taxation in its brief. The Division of Taxation's representative, by letter dated September 13, 1994, informed the Administrative Law Judge that he was amending the Division of Taxation's brief by excising the first two full paragraphs of page 6.

[2]By letter dated September 16, 1994, petitioner's representative informed the Administrative Law Judge that petitioner would not be filing a reply brief.

ISSUE

Whether the full amount of the mortgage indebtedness is included in "consideration", as defined in Tax Law § 1440(1)(a), even if it exceeds the fair market value of the subject property.[3]

FINDINGS OF FACT

The Division of Taxation ("Division") and petitioner, Shed Developers, agreed to a stipulation of facts which has been incorporated into the following Findings of Fact.

On December 15, 1986, Shed Associates, Inc. acquired title to 15 lots on the proposed Map of Manhasset Glen, sections No. 1 and No. 2 ("the property"), from John W. Walter and William T. Walter.

Shed Associates, Inc. gave three mortgages to The Greater New York Savings Bank ("Greater"): one in the amount of $3,885,000.00, which is dated December 15, 1986; another in the amount of $400,000.00, which is dated March 12, 1987; and the third in the amount of $915,000.00, dated December 7, 1988. These three mortgages were consolidated to form a lien of $5,200,000.00. The record does not contain copies of the three mortgages held by Greater or the mortgage notes.

Shed Associates, Inc. transferred the property without consideration to petitioner, Shed Developers ("Shed").[4] According to the affidavit of Stanley Gross, dated August 2, 1991, the partners of Shed were the shareholders of Shed Associates, Inc.[5]

On May 10, 1991, petitioner and Greater entered into an agreement in which Shed

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[3]The Division of Taxation and petitioner agreed to the stipulated issue on April 19, 1994 and April 20, 1994, respectively.

[4]The record is silent as to when this transfer took place.

[5]Mr. Gross was a partner of Shed.

agreed to convey a portion of the property, together with certain other parcels, to Greater by executing and delivering to Greater a deed in lieu of foreclosure.

According to the agreement, Messrs. Stanley Gross, Theodore H. Hindes, Stewart Dickler and Joseph Einbinder had personally guaranteed the mortgage indebtedness to Greater.

Paragraph "Fourth" of the agreement provided, in pertinent part, that:

> "Upon the occurrence of the following conditions, the obligations of Messrs. Stanley Gross, Theodore H. Hindes, Stewart Dickler and Joseph Einbinder pursuant to the Guarantees of Payment of the Mortgage loans given by them to Greater shall be deemed extinguished and of no further force and effect:
>
> "(a) That the subdivision map known as the Map of Manhasset Glen . . . is filed in the Nassau County Clerk's Office.
>
> "(b) That simultaneously with the execution and delivery of the exchange deeds and release of part of mortgage by Greater, Shed shall convey to Greater or its designees by bargain and sale deed with covenants against grantor's acts, all of its right, title and interest in and to all of the property described in paragraph 'FIRST' above. Such conveyance shall not be deemed to merge the fee to such property and the Mortgage held by Greater and shall provide that such conveyance is subject to the outstanding Mortgage held by Greater.
>
> "(c) That Chicago Title Insurance Company insure title to the mortgage premises so conveyed in the amount of $4,969,879.21 . . . .
>
> "(d) Shed shall pay all transfer and gains taxes due in connection with the transfer of said premises to Greater as well as title insurance for the Greater."

Greater was the sole stockholder of two separate corporate entities known as The Glen at Manhasset Associates, Ltd. and Plandome-Manhasset Associates, Ltd. ("the corporations"), respectively.

On June 20, 1991, pursuant to the May 10, 1991 agreement, Greater assigned to the corporations its right, title and interest to receive a deed to the mortgaged property.

On June 20, 1991, Peter M. Boger, first vice-president of the corporations, signed the Real Property Transfer Gains Tax Questionnaire - Transferee, TP-581 ("transferee questionnaire"). According to the transferee questionnaire, the corporations were the transferees which were acquiring a 100% fee interest in Section 3, Block 167, Lots 663B, 663C, 663D, 664A, 664B, 683, 684 and 685 on the Land and Tax Map of Nassau County on June 24, 1991 for $4,969,879.21 "[m]ortgage balance per agreement" from transferor Shed.

On August 2, 1991, Stanley Gross, partner of Shed, executed a Real Property Transfer Gains Tax Questionnaire - Transferor, TP-580 ("transferor questionnaire"). According to the transferor questionnaire, Shed was the transferor which was transferring a 100% fee interest in Section 3, Block 167, Lots 663B, 663C, 663D, 664A, 664B, 683, 684 and 685 on the Land and Tax Map of Nassau County on August 20, 1991 for gross consideration "at Fair Market Value" of $3,450,000.00. According to the transferor questionnaire, the original purchase price was $4,688,453.94.

The transferee and transferor questionnaires were received by the Division on August 6, 1991.

On August 27, 1991, the Division issued a Tentative Assessment and Return to petitioner asserting real property transfer gains tax due of $72,600.00 which amount petitioner paid.

On or about December 13, 1991, petitioner transferred its interest in certain real property located within Nassau County, State of New York to Greater in lieu of foreclosure.[6]

At the time of such transfer, the subject property was encumbered by a mortgage indebtedness in favor of Greater of $4,969,879.21.

The mortgage indebtedness to Greater was nonrecourse.

On January 29, 1992, petitioner filed a claim for refund of real property transfer gains tax in the amount of $72,600.00 with the Division.

Petitioner applied to the Division for a refund of the gains tax paid as a result of the transfer, based in part on the claim that because the indebtedness discharged by the transfer in lieu of foreclosure exceeded the fair market value of the property at the time of its transfer, the consideration for the transfer was limited to such fair market value.

On April 4, 1992, petitioner's claim for refund was amended to include an additional $53,108.68 in real property transfer gains tax, which it had paid.

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[6]A copy of the deed is not part of the record.

On October 28, 1992, the Division approved a refund of $4,800.00 and denied the remainder of the amended claim for refund. In a letter dated October 28, 1992, addressed to petitioner's representative, Karen

Galarneau, Tax Technician in the Division's Transaction and Transfer Tax Bureau, stated the reasons for the Division's actions.

The Division denied this claim for refund, in part, because Tax Law § 1440(1)(a) provides that consideration includes the cancellation or discharge of an indebtedness or obligation and is not limited by the fair market value of the property at the time of its transfer.

Petitioner timely requested a conciliation conference.

A Bureau of Conciliation and Mediation Services ("BCMS") conference was held on July 27, 1993. Petitioner appeared by Howard Koff, Esq. Pursuant to the BCMS conference, a Conciliation Order (CMS No. 127065) dated September 24, 1993 was issued to petitioner with the following recomputation of the refund claim:

Refund	$53,108.68 refund approved
Penalty	-0-
Interest	Computed at Applicable Rate

Petitioner timely filed a petition, on October 1, 1993, which requested a refund of $67,800.00, the amount remaining from its original refund claim. Petitioner alleged that the Commissioner: (1) erred "in treating as 'consideration' the amount of the subject indebtedness in excess of the fair market value of the real property"; and (2) erred "in denying Petitioner's claim for refund." Petitioner asserted the following facts:

1. "The subject indebtedness due The Greater New York Savings Bank ('The Greater') was non-recourse."

2. "The property was transferred to The Greater in lieu of foreclosure."

3. "The fair market value of the real estate, as of the date of transfer, was $3,450,000.00."

The Division served its answer, dated January 13, 1994, to petitioner by a transmittal letter also dated January 13, 1994.

The sole issue involved herein is whether the full amount of the mortgage indebtedness is included in "consideration", as defined in Tax Law § 1440(1)(a), even if it exceeds the fair market value of the subject property.

If it is finally determined in this proceeding by the Division of Tax Appeals, the Tax Appeals Tribunal or a court of competent jurisdiction that consideration for the transfer by petitioner is limited to no more than the fair market value of the property at the time of its transfer, then the parties agree that this matter shall be remanded to the Division of Tax Appeals for a hearing by an Administrative Law Judge to determine the fair market value of the property at the time of its transfer on December 13, 1991.

SUMMARY OF THE PARTIES' POSITIONS

Petitioner asserts that because its indebtedness to Greater was nonrecourse, there was no forgiveness of indebtedness because it had no personal liability for the debt. It further argues that the cancellation of a nonrecourse debt was not consideration because it did not receive anything of value.

Petitioner maintains that it is entitled to the claimed refund "(assuming, of course, that it is able to establish that the subject indebtedness exceeded the fair market value of the property)."

The Division contends that for transfers in lieu of foreclosure occurring prior to the effective date of the amendment to Tax Law § 1440(1), April 15, 1993, "the amount of consideration includes the amount of any indebtedness or obligation which is cancelled or discharged, irrespective of the fair market value of the property transferred." It asserts that petitioner's position is incorrect. The Division maintains that Tax Law § 1440(1)(a) does not distinguish between recourse and nonrecourse indebtedness in providing that consideration includes the cancellation of an indebtedness or obligation.

The Division requests that the petition be denied and the denial of the refund claim, as modified by the Conciliation Order, be sustained.

CONCLUSIONS OF LAW

A. Tax Law § 1440(1)(a) provides the following broad definition of "consideration":

"'Consideration' means the price paid or required to be paid for real property . . . . Consideration includes any price paid or required to be paid, whether expressed in a deed and whether paid or required to be paid by money, property, or any other thing of value and including the amount of any mortgage, purchase money mortgage, lien or other encumbrance, whether the underlying indebtedness is assumed or taken subject to. Consideration includes the cancellation or discharge of an indebtedness or obligation" (emphasis supplied).

B. Tax Law § 1440(3) provides that:

"'Gain' means 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."

C. 20 NYCRR 590.15(a) states, in pertinent part, as follows:

"Question: What amounts are included in the price paid to acquire an interest in real property?

"Answer: The price paid to acquire an interest in real property includes the amount of money, property or any other thing of value provided or given up to acquire the interest in real property including the amount of any mortgage, lien or other encumbrance on the real property which was assumed or taken subject to. For example, if a transferor buys real property for cash and becomes liable for an existing mortgage on the property, his original purchase price includes both the amount of cash and the amount of unpaid mortgage he assumed.

"If a transferor cancelled or discharged any indebtedness of his seller when he acquired the real property, the amount of the indebtedness cancelled or discharged would also be included in his original purchase price . . . ."

D. The Tax Appeals Tribunal has rendered decisions defining the parameters of Tax Law § 1440(1)(a) for gains tax purposes. The following three decisions, Matter of Normandy Assocs. (Tax Appeals Tribunal, March 23, 1989), Matter of Old Farm Lake Co. (Tax Appeals Tribunal, April 2, 1992) and Matter of Howard Enterprises (Tax Appeals Tribunal, August 4, 1994), are particularly relevant in making a determination in this matter.

In Matter of Normandy Assocs. (supra), the taxpayer argued that the Division erred in including a ten-year wraparound mortgage note in anticipated consideration at the face amount of $6,000,000.00. The taxpayer argued that the value of the note was less than its market rate interest so actual value should be used not face amount. The Tribunal rejected this argument:

"We conclude that the Division's position that the face amount of the mortgage, rather than its value, is correct under the law. Tax Law section 1440(1)(a) provides that consideration includes 'the amount of any mortgage, purchase money

> mortgage, lien or other encumbrance'. In contrast, in the same section of the law the 'consideration' for a lease is defined to include 'the value of the rental . . . .' Since the Division's interpretation is in accord with, and gives significance to, the different terms used by the Legislature in defining consideration, we agree with the Administrative Law Judge that it is a correct interpretation" (emphasis added by Tribunal).

The Tribunal elaborated upon the above analysis in its decision in Matter of Old Farm Lake Co. (supra). The taxpayer in this matter argued that the discounted or present value of a noninterest-bearing unsecured promissory note received as partial payment for real property sold should be used rather than the face amount of the note in calculating consideration. The Tribunal, in reversing the Administrative Law Judge, reiterated its analysis in Matter of Normandy Assocs. (supra):

> "While we agree with the Administrative Law Judge's reliance upon Matter of Normandy Assocs., for the proposition that Tax Law § 1440(1)(a) includes as consideration mortgages, purchase money mortgages, liens, or other encumbrances at their face amount rather than at present value, we do not agree with the Administrative Law Judge's treatment of the promissory note as if it were a 'mortgage'. Our decision in Normandy Assocs. that mortgages are to be included in consideration at their face amount was founded upon the specific language in section 1440(1)(a) that defines consideration to include 'the amount of any mortgage, purchase money mortgage, lien or other encumbrance . . .' [emphasis added by Tribunal and footnote in Tribunal's decision omitted]. Thus, to be within the holding of Normandy Assocs., the instant instrument would have to fit within this specific statutory phrase (see also, 20 NYCRR 590.15[a]). As mentioned in our additional findings of fact, the note here was guaranteed to 23% of the original $500,000.00 by the written promise of OFL III. Yet, we do not find this 'promise of payment' guarantee to be included in the type of security implicit in the terms 'mortgage, purchase money mortgage, lien or other encumbrance', each of which connotes recourse to tangible assets. The guarantee at hand is no more than a written promise to pay by OFL III which is not further secured by anything tangible."

In Matter of Howard Enterprises (supra), the Tribunal discussed the distinction between "face amount" and "amount" of an instrument for consideration purposes. The Tribunal stated:

> "When calculating amount due on a taxable transaction, one must also recognize that the value of consideration has to be determined 'at the time of the transfer' in order to fix the tax owed (Matter of Cheltoncort Co., Tax Appeals Tribunal, December 5, 1991, affd Matter of Cheltoncort Co. v. Tax Appeals Tribunal, 185 AD2d 49, 592 NYS2d 121). Thus, we recognize that at the time of the transaction, 'amount' as stated in the statute can be less than the 'face amount' if a portion of the original principal has been paid. The Division does not dispute this result. As a result, where, as here, an existing mortgage is an element of consideration, the amount of this consideration is the unpaid principal secured by the mortgage."

The Tribunal also noted that accrued interest is consideration under Tax Law § 1440(1)(a)

(Matter of Howard Enterprises, supra).

E. Petitioner contends that the Division erred in treating as "consideration", as defined in Tax Law § 1440(1)(a), the amount of the subject indebtedness in excess of the fair market value of the real property. It cites to Matter of Old Farm Lake Co. (supra) and the portion of Tax Law § 1440(1)(a) which defines consideration as "money, property or any other thing of value." It asserts that since the subject indebtedness was nonrecourse, and the debtor could have "walked", as a matter of law there can be no forgiveness or cancellation of indebtedness. Petitioner maintains that:

> "The creditor is not giving the debtor something of value when the debtor is free to 'walk' away from such indebtedness whether or not the creditor grants 'forgiveness' or 'cancels' the debts. Hence, the debtor is not in receipt of 'consideration'."

F. Petitioner's argument is without merit. Consideration for gains tax purposes includes the amount of any mortgage on the real property "which was assumed or taken subject to" (see, Conclusions of Law "A" and "D"). The Division is correct in that Tax Law § 1440(1)(a) does not distinguish between a recourse mortgage and a nonrecourse mortgage. Applying the analysis of the Tribunal stated in Conclusion of Law "D" to the instant case, the Division properly used the figure of $4,969,879.21 as the amount of the consideration which petitioner received. In lieu of foreclosure, petitioner transferred the property to the corporations, which were Greater's assignees, subject to the three mortgages which had been consolidated. At the time of the transfer, the subject property was encumbered by mortgage indebtedness to Greater in the amount of $4,969,879.21 (see, Finding of Fact "12"). This is the amount of the mortgage which was taken subject to by the corporations as transferee and as such constitutes consideration for gains tax purposes. It should be noted that the corporations reported on the transferee questionnaire which they filed the consideration which they paid to petitioner as being the "mortgage balance per agreement" in the amount of $4,969,879.21 (see, Finding of Fact "9"). Lastly, it should also be noted that, according to paragraph 4 of the agreement, at the time of the transfer of the property to the corporations, Greater released the individual partners from their personal guarantees on the mortgage (see, Finding of Fact "6"). This discharge

constituted valid consideration as well.

The full amount of the mortgage indebtedness was properly included in "consideration" as defined in Tax Law § 1440(1)(a).

G. The petition of Shed Developers is denied and the denial of petitioner's claim for refund, as modified by the Conciliation Order, is affirmed.

DATED: Troy, New York
March 23, 1995

/s/ Winifred M. Maloney
ADMINISTRATIVE LAW JUDGE