STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
CHANDRU JAGWANI	:	DETERMINATION DTA NO. 813400
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.	:	
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Petitioner, Chandru Jagwani, 35 Aldgate Drive East, North Hills, Manhassett, New York 11030, 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 August 16, 1995, petitioner by his attorney, Babcock MacLean, Esq., and on August 21, 1995, the Division of Taxation ("Division") by Steven U. Teitelbaum, Esq. (Herbert M. Friedman, Jr., Esq., of counsel) waived a hearing and agreed to submit this case for determination, with all documents and briefs to be filed by February 12, 1996, which date commenced the six-month period for the issuance of this determination. The Division's documents were submitted on October 17, 1995. Petitioner's documents and brief were received on November 20, 1996. The Division's answering brief and petitioner's reply brief were received on January 8, 1996 and February 13, 1996, respectively.[1]

After due consideration of the entire record, Frank Barrie, Administrative Law Judge, renders the following determination.

ISSUES

I. Whether the Division of Taxation, in calculating consideration for the transfer of a certain interest in real property, properly included the face value of a purchase money mortgage despite the fact that the mortgage subsequently became valueless.

[1]Petitioner's reply brief was timely filed because it was mailed before the due date.

II. Whether the imposition of gains tax on petitioner, when he has not realized any economic gain, violates his constitutional rights to equal protection.

FINDINGS OF FACT

1. On May 19, 1986, petitioner, Chandru Jagwani, as purchaser, contracted with Port Jeff Development Corp., as seller, for the purchase of real property located at Old Town Road, Route 347, in Port Jefferson Station, Suffolk County. Petitioner agreed to purchase this subdividable and apparently unimproved Long Island property at a purchase price of $6,375,000.00. There is nothing in the record that discloses the names of the principals behind Port Jeff Development Corp. or to what extent this transaction was, in fact, at arm's length. Petitioner's contract with this entity was not made a part of the record.

2. More than a year later, rather than closing on the property, petitioner assigned his contract rights to an individual identified as Lawrence Hahn. According to a statement attached to the transferor's questionnaire dated October 20, 1987 filed by petitioner, which was marked into the record as the Division's Exhibit "I", petitioner "[o]n August 31, 1987 . . . executed a contract with Lawrence Hahn for the assignment of the contract for a total price of $8,075,000.00." This contract of assignment also was not submitted for review. The statement attached to the questionnaire further disclosed that Mr. Hahn "assigned his contract for no consideration to Port Jeff Developers." Mr. Hahn's assignment of his contract with petitioner to Port Jeff Developers, in consideration of the sum of $1.00, is attached to the transferee questionnaire dated October 8, 1987 of Port Jeff Developers, which was marked into the record as the Division's Exhibit "J". This transferee questionnaire discloses that Lawrence Hahn was a partner of Port Jeff Developers. Both the petitioner's transferor and Port Jeff Developers' transferee questionnaires report a date of anticipated transfer of December 15, 1987. However, the transfer apparently did not take place until February 1989. There is nothing in the record to explain this 14-month delay.

3. A real property transfer gains tax supplemental return dated February 14, 1989 filed by petitioner, which was marked into the record as the Division's Exhibit "K", reveals that Port

Jeff Developers was a "co-partnership". Petitioner in an amendment to his agreement with Lawrence Hahn, which is an attachment to this supplemental return, noted his consent to the assignment of his agreement with Mr. Hahn "to a partnership, one of whose partners shall be a corporation of which Lawrence Hahn and/or Robert Feldman and/or members of their immediate families, or their spouses, own all of the issued and outstanding stock."

4. On his transferor questionnaire dated October 20, 1987, petitioner reported anticipated real property transfer gains tax due of $118,720.00 on a gain subject to tax of $1,187,204.00, which was computed as follows:

Gross consideration to be paid for transfer by Port Jeff Developers, as transferee	$8,075,000.00
Less: Brokerage fees to be paid by transferor	484,500.00
Consideration	$7,590,500.00
Purchase price paid to acquire property	$6,375,000.00
Other acquisition costs	10,000.00
Cost of capital improvements	3,296.00
Attorneys fees	15,000.00
Original purchase price	$6,403,296.00
Gain subject to tax (Consideration less original purchase price)	$1,187,204.00

5. Petitioner filed the real property transfer gains tax supplemental return dated February 14, 1989 in order to elect to pay the gains tax reported due of $118,720.40 in installments on the basis that no part of the consideration to be received by petitioner, on or before the date of transfer of the real property, was cash consideration. As a result, petitioner chose to defer payment of the gains tax reported due of $118,720.40. By a letter dated April 10, 1989, which was marked into the record as petitioner's Exhibit "8", petitioner's election to pay the gains tax due in installments was accepted by the Division.

6. Petitioner paid a first installment of $39,573.46 of the total gains tax reported due of $118,720.40 in February 1990, which was one year after the closing. Two years after the closing, in February 1991, petitioner paid a second installment of $39,573.46.

7. Subsequently, the Division issued a Statement of Proposed Audit Changes dated May 4, 1992 against petitioner, which was marked into the record as petitioner's Exhibit "2", asserting gains tax due of $39,573.46 plus penalty and interest for the following reason:

> "Our records indicate that on 02/14/92 an installment of the gains tax was due under plan number I-878. Section 1442 of the Tax Law provides that 'if the transferor shall fail to pay any installment on the date on which it is due . . . the entire balance of the tax is due and owing'."

8. Petitioner responded quickly to the Division's Statement of Proposed Audit Adjustment by noting his disagreement with the assertion of tax due in his own statement dated May 13, 1992, which was attached to a payment document he filed with the Division, and which was marked into the record as petitioner's Exhibit "3". In this statement, petitioner requested a refund of the first two installment payments:[2]

> "The transaction relating to the above assessment closed on February 14, 1989 and concerned the assignment of a contract of sale by [petitioner] to Port Jeff Developers (which in turn assigned the contract to an entity known as House Beautiful at Port Jefferson).
>
> The Tentative Assessment and Return originally provided for a Transfer Gains Tax of $118,720.40. On the date of the closing a supplemental return . . . was completed and filed indicating that no payment was due on the closing date by reason of the amendment of the contract of sale providing for the major portion of the purchase price to be paid by way of a purchase money mortgage[3] in lieu of cash. On April 10, 1989, this was accepted by the Department, with a stipulation for payment of tax in installments over a period of not more than three years.

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[2]The Division withdrew its contention, which was affirmatively asserted in its answer, that petitioner failed to file a timely refund claim.

[3]A copy of this purchase money mortgage was not made a part of the record. Neither was a copy of the note, which was secured by the mortgage, made a part of the record. It is observed that in its answer, the Division affirmatively stated that "at the time of transfer of this property, a note secured by a purchase money mortgage in the face amount of $1,500,000.00 was given by the transferee to the petitioner and formed part of the consideration received by the petitioner." Attached to the real property transfer gains tax supplemental return is a copy of an amendment dated November 30, 1988 to the agreement between petitioner as assignor and Port Jeff Developers as assignee which described how the "balance on closing of title" would be paid as follows:

> "[B]y execution and delivery of a purchase money third mortgage payable three (3) years from the closing of title with interest at the rate of ten (10%) percent per annum payable quarterly. Said mortgage and note shall be drawn on the standard form of New York Board of Title Underwriters."

The first installment of the tax was paid one year after the closing, in February 1990, and the second two years after the closing, in February 1991. The payment requested at this time is for the third and final installment, together with intrest [sic] and penalties.

Payment of this installment is strenuously objected to, since no money has been received on account of the principal
balance of the mortgage at all. In fact, it is questionable as to weather [sic] any money will ever be received. By its terms, the mortgage principal was due and payable on February 14, 1992. It has not been paid. Moreover, it is subordinate to a first mortgage held by Port Jeff Development Corp. in the amount of $3,360,000 which is in default and on which foreclosure proceedings have been instituted and are presently pending . . . .

In the circumstances I do not believe that I am responsible for the payment of any tax, which is a 'gains tax' since the circumstances are that I have made no gain on the assignment of the contract. In addition, the first two installment payments which I made should be refunded to me. . ." (emphasis in original).

9. In response to petitioner's statement of disagreement, the Division by a letter dated June 19, 1992, which was marked into the record as petitioner's Exhibit "4", sent petitioner a form TP-165.8 for completion so he could formalize his refund claim. Petitioner completed the form to which he attached his statement of disagreement cited in Finding of Fact "8", and eventually, by a letter dated May 4, 1993, which was marked into the record as the Division's Exhibit "G", the Division denied petitioner's refund claim because:

"No error was made at the time the tax was paid because the consideration paid or required to be paid was $8,075,000.

The tax was properly calculated at that time.

Since the tax is due on the date of transfer, there was no erroneous payment made at the time the tax was paid. Therefore, the refund must be denied in its entirety" (emphasis in original).

10. In an affidavit of petitioner dated November 15, 1995, which was marked into the record as petitioner's Exhibit "7", petitioner explained that the transaction at issue soured:

"2. Due to the decline of the real estate market, the Property could not be developed successfully by Buyer [Port Jeff Developers].[4] The Property was to consist of 170 residential units. However, only 10 units were partially completed by Buyer, and none were sold by Buyer. At the present time, the estimated fair

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[4] It is unknown why petitioner referred to Port Jeff Developers as the entity which could not successfully develop the property at issue since as noted in Finding of Fact "8", the ultimate assignee of the contract to purchase the Port Jefferson Station property was House Beautiful at Port Jefferson.

market value of the Property is approximately 20% of its value at the time of the transfer by me to Buyer.

3. The second[5] mortgage held by me was by its terms due and payable on February 14, 1992. It has not been paid. Moreover, it is subordinate to a first mortgage held by Port Jeff Development Corp. in the amount of $3,360,000, which is in default and on which foreclosure proceedings were instituted. As the holder of the junior mortgage, I was named as a defendant in this action. . . . Subsequently, the Property has been foreclosed by the first mortgagee. The fair market value of the Property is less than the amount of the first mortgage. Therefore, there has not been and there will not be any payment made to me on account of my second mortgage. I have not realized and will not realize a gain on the transaction" (emphasis in original).

SUMMARY OF THE PARTIES' POSITIONS

11. Petitioner argues that denying his refund claim "is contrary to the Tax Law and to basic principles of fairness and common sense" (Petitioner's brief, p. 1). According to petitioner, "the gains tax is imposed only on actual economic gain" (Petitioner's brief, p. 8). He supports this statement by citing to "litigation in the bankruptcy context" where the gains tax has been viewed not as a stamp tax but rather as an income tax, or a tax imposed on economic gain. He also cites to the amendment of the gains tax law in 1993 which deemed "consideration" to be limited to the fair market value of the property transferred to a lender in foreclosure proceedings or a transfer in lieu of foreclosure. Further, petitioner maintains that to "tax a real estate transaction even where gain is not derived, is defective under the equal protection clause" (emphasis in original) (Petitioner's brief, p. 9).

12. The Division counters that in computing consideration the face amount of a mortgage at the time of transfer is properly used, citing the Tax Appeals Tribunal decision in Matter of Normandy Associates (March 23, 1989). Subsequent events "which may effect the transferor's actual receipt of [a gain]" are irrelevant (Division's brief, p. 5). The Division also points out that the Tax Appeals Tribunal rejected an equal protection argument, similar to the one made by petitioner, in Matter of Rapoport (August 31, 1995).

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[5] As noted in Finding of Fact "8", petitioner held "a purchase money third mortgage" on the property. This discrepancy was not explained in the record.

13. In his reply brief, petitioner maintains that in the cases cited by the Division in its brief, the Tax Appeals Tribunal did not address the situation where "a seller of real property has been taxed on a gain which he did not receive because the purchase money mortgage he held was worthless" (Petitioner's reply brief, p. 1).

CONCLUSIONS OF LAW

A. Tax Law § 1440, which became effective March 28, 1983, imposes a 10% tax upon gains derived from the transfer of real property located within New York State.

B. Tax Law § 1440(former [7]) defined "transfer of real property" to encompass an array of transactions as follows:

> "'Transfer of real property' means the transfer or transfers of any interest in real property by any method, including, but not limited to sale, exchange, assignment, surrender, mortgage foreclosure, transfer in lieu of foreclosure, option, trust indenture, taking by eminent domain, conveyance upon liquidation or by a receiver or acquisition of a controlling interest in any entity with an interest in real property".[6]

There is no question that petitioner's assignment of his contract to purchase the Long Island real property at issue was a "transfer of real property" subject to real property transfer gains tax.

C. Tax Law § 1440(3) defines "gain" 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."

Tax Law § 1440(5)(a)(i) defines "original purchase price" to mean"

> "the consideration paid or required to be paid by the transferor (A) to acquire the interest in real property, and (B) for any capital improvements made or required to be made to such real property . . . ."

"Consideration", in turn, is defined by Tax Law § 1440(1)(a) to mean:

> "the price paid or required to be paid, for real property or any interest therein. . . . 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

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[6] The definition of "transfer of real property" noted above was applicable to the transaction at issue which took place prior to a 1994 amendment which deleted the words "or transfers" from the definition.

> money mortgage, lien or encumbrance, whether the underlying indebtedness is assumed or taken subject to."

D. Petitioner is wrong that gains tax may be imposed only in the case of an actual gain. Rather, gains tax has been imposed in situations of speculative profit and in situations where real estate transactions have soured. In Matter of Brockman (Tax Appeals Tribunal, April 4, 1996), arguments similar to those which petitioner has made in this matter were all rejected.

The facts in Brockman mirror the ones in the matter at hand. Various members of the Brockman family together owned an interest[7] in a parcel of unimproved land on Long Island. In the fall of 1990, the Brockmans, and two other parties, executed a contract for the sale and purchase of their land for a purchase price of $9,500,000.00 with a purchaser who would later default. The major portion of the sales price was financed by a purchase money note and mortgage from the buyer in the amount of $8,500,000.00. The buyer never made any payments on this note and mortgage, and a foreclosure proceeding was instituted. Like petitioner, the Brockmans contended that because they suffered a loss, the imposition of gains tax was not rational and violated their equal protection rights. The Tribunal, in affirming the administrative law judge, denied the Brockmans' claims for refund of gains tax and held them liable for gains tax totalling $193,121.00 on the real estate transaction that had eventually soured.

In its decision in Brockman, the Tribunal emphasized that subsequent events do not alter the value that the consideration had at the time of the transfer citing its earlier decision in Matter of Starburst Dev. Co. (Tax Appeals Tribunal, May 5, 1994) where the Tribunal stated:

> "the moment that the taxable event occurs, i.e., the transfer of the real property, is the temporal restriction underlying the entire gains tax. Consistent with this interpretation, we have held that the consideration for the transfer is fixed at this moment and is not reduced by subsequent events. . . . To deviate from this theory, as petitioner suggests, and exclude transactions from the definition of transfer of real property based on subsequent events would, in our view, be contrary to the entire scheme of the tax."

The Tribunal in Brockman further noted that the Appellate Division had recently sustained its conclusion that the amount of gains tax due is finally determined by the amount of

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[7]The Brockmans owned a 25% interest in certain unimproved Long Island Property. Two other parties owned the remaining interest in the property.

consideration paid or required to be paid on the date of the transfer (see, Matter of Wanat v. Tax Appeals Tribunal, __ AD2d __ , 638 NYS2d 251, lv denied __ NY2d __ , __ NYS2d __ [May 7, 1996], confirming Matter of Wanat, Tax Appeals Tribunal, September 15, 1994; Matter of South Suffolk Recreation Ventures v. Tax Appeals Tribunal, __ AD2d __, 638 NYS2d 515, lv denied __ NY2d __, __ NYS2d ___ [May 7, 1996], confirming Matter of South Suffolk Recreation Ventures, Tax Appeals Tribunal, November 3, 1994). In Wanat, which is particularly on point, the Tribunal had decided that the amount of the consideration calculated at the time of the transfer is not affected by the transferee's later default on a note and mortgage.

E. Petitioner's contention that the amendment of the gains tax law in 1993, which deemed "consideration" to be limited to the fair market value of the property transferred to a lender in foreclosure proceedings, means that gains tax may be imposed only on an actual gain is rejected. Laws of 1993 (ch 57, § 60) added a paragraph (d) to the definition of "consideration" at Tax Law § 1440(1) so as to limit "consideration" with respect to a foreclosure transfer (or a deed-in-lieu) to the fair market value of the real property that is transferred. This amendment applies to transactions occurring on or after April 15, 1993, pursuant to Laws of 1993 (ch 57, § 418[8]). Moreover, as noted in Finding of Fact "10", the property at issue was foreclosed, not by petitioner, but by Port Jeff Development Corp.

F. The Legislature has manifested no intent to ignore a transaction for purposes of gains tax due to subsequent events. Rather, as noted in Conclusion of Law "B", the Legislature's definition of "transfer of real property" is extremely broad, and such definition evidences no intent on the part of the Legislature to ignore a transaction as a sale because the sale later turned sour, and the seller failed to profit as planned (cf., Matter of Shechter, Tax Appeals Tribunal, October 13, 1994 [wherein the Tribunal noted that the Legislature evidenced its intent to "look through" an entity to determine the beneficial owners of property by the way it defined "interest in property"]).

G. It is further noted that petitioner is correct that the real property transfer gains tax is not viewed as a stamp tax, but rather as a tax on income in the context of bankruptcy litigation

(see, In re Fifth Avenue Associates, L.P., 963 F2d 503, cert denied 506 US 947, 121 L Ed 2d 302). Further, such tax is entitled to a priority status under 11 USC § 507(a)(8)(A) as "a tax on or measured by income or gross receipts" (see, In Re Williams, 173 Bankr 459, affd 188 Bankr 331). However, the conclusion that gains tax due is calculated at the time of transfer and may not be reduced by subsequent events does not mean that it is not "a tax on or measured by income or gross receipts" (see, Matter of Brockman, supra).

H. Finally, petitioner's argument that his right to equal protection of the law is violated, by holding him liable for gains tax on a transaction that later soured, is also rejected. The Tribunal addressed this issue in Matter of Brockman (supra) as follows:

> "Neither the Federal nor the State constitution require that all taxpayers be treated identically; they only require that those similarly situated be treated uniformly (see, Matter of Foss v. City of Rochester, 65 NY2d 247, 491 NYS2d 128; Matter of Executive Land Corp. v. Chu, 150 AD2d 7, 545 NYS2d 354). Requiring petitioners to pay the gains tax does not violate their constitutional rights because petitioners are being treated the same as all other similarly situated taxpayers -- they are required to calculate the tax based upon the value of the consideration at the time of the transfer (see, Matter of Rapoport, Tax Appeals Tribunal, August 31, 1995)."

I. The petition of Chandru Jagwani is denied and the Division of Taxation's denial of petitioner's refund claim is sustained.

DATED: Troy, New York
July 18, 1996

/s/ Frank W. Barrie
ADMINISTRATIVE LAW JUDGE