STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition of **CHASE MANHATTAN BANK, N.A., AS TRUSTEE** 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.	**DETERMINATION** DTA NOS. 815239 AND 815240
In the Matter of the Petition of **FOUR PLUS CORPORATION** 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, Chase Manhattan Bank, N.A., as Trustee, 1211 Avenue of the Americas, New York, New York 10036 and Four Plus Corporation, 1114 Avenue of the Americas, New York, New York 10036-7794, filed petitions for revision of determinations or for refund of tax on gains derived from certain real property transfers under Article 31-B of the Tax Law.

A consolidated hearing was held before Brian L. Friedman, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on April 10, 1997 at 1:15 P.M., with all briefs to be submitted by September 2, 1997, which date began the six-month period for the issuance of this determination. Petitioners appeared by Winthrop, Stimson, Putnam & Roberts (Stephen Lefkowitz, Esq., of counsel). The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Michael J. Glannon, Esq., of counsel).

ISSUE

Whether the Division of Taxation properly denied petitioners' requests for refund of real property transfer gains tax upon the sale of certain real property in which each petitioner owned an undivided one-half interest.

FINDINGS OF FACT

1. In or about 1936, a certain parcel of real property located at 525 Eleventh Avenue, New York, New York ("the property") was owned 50 percent by John S. Appleby and 25 percent each by Edgar T. Appleby and Francis S. Appleby. On September 15, 1936, John S. Appleby conveyed his 50 percent interest in the property to the Four Plus Corporation ("Four Plus"), a New York corporation formed by John S. Appleby in 1935. Upon the deaths of Edgar T. Appleby and Francis S. Appleby, each of their undivided 25 percent interests came to be held by Chase Manhattan Bank, N.A. ("Chase"), as Trustee, under each of their wills.

2. In 1958, Edgar T. Appleby died and his interest in the property was then managed by his brother, Francis S. Appleby.

3. Jonathan Lang, president of Four Plus since January 1, 1990, appeared at the hearing and testified concerning his knowledge of the history of Four Plus.[1] In the early 1960s, Four Plus was operated by Waldo Hutchins, Jr., son-in-law of John S. Appleby. Mr. Hutchins had real estate holdings of his own; therefore, with his expertise in New York City real estate, he ran Four Plus. Mr. Hutchins and Fred Carasona, an attorney who performed legal work for the Applebys, negotiated a lease agreement with The Greyhound Corporation. Both Mr. Hutchins and Mr. Carasona are deceased.

Mr. Lang testified that he has searched for tax returns filed by Four Plus from the 1960s and 1970s, but has been unable to locate any returns prior to the mid-1980s when he became executive vice president.

4. On or about March 1, 1963, Francis S. Appleby, as executor of the estate of Edgar T. Appleby, Francis S. Appleby, individually, and Four Plus, as landlords, entered into a lease agreement with The Greyhound Corporation ("Greyhound"), as tenant, whereby the landlords agreed to lease the property to Greyhound for a period of 41 years and 2 months (ending

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[1]Mr. Lang stated that his knowledge of the history of Four Plus was based upon the fact that, prior to his assuming the presidency, he was executive vice president since 1986. Before that (since September 1978), he was involved with the corporation as an associate in a law firm which provided legal counsel to Four Plus.

April 30, 2002).

5. Pursuant to Article Ninth of the lease, Greyhound was to erect, within five years of the date of execution of the lease (lease modifications extended this date to December 31, 1971), a building for the storage, maintenance and repair of buses and other vehicles (hereinafter "the bus garage") at a cost of at least $3,000,000.00. The obligation to construct the bus garage was to survive a termination of the lease resulting from any default on the part of Greyhound. Article Nineteenth of the lease provided that the bus garage to be erected under the terms of the lease, all additions, alterations and improvements thereto and all fixtures and equipment installed (except certain trade fixtures and machinery and equipment used by Greyhound in connection with the operation of the garage and repair shop) would, immediately when erected and installed, be deemed to be attached to the realty and become the property of the landlord (these petitioners) to the same extent as if they had been erected and installed prior to the execution of the lease. There exists no provision in the lease which specifically states that, in return for constructing the bus garage, Greyhound was to pay a reduced or below market value rental.

6. Article Thirtieth of the lease provided that, at any time during the term of the lease,[2] after Greyhound erected the bus garage per the terms of Article Ninth and if not in default in the performance of the terms of the lease, Greyhound could demolish and remove any building on the property for the purpose of replacing it with another new building of like value (the new building had to be completed within 18 months from the date of the demolition and removal of the first building).

7. On June 30, 1993, Four Plus and Chase, each of which then held a one-half undivided

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[2]The term of the lease was 41 years and 2 months, commencing March 1, 1963 and ending April 30, 2004. The lease provided, in Article Twenty-eighth thereof, for two renewal options of ten years each which, upon Greyhound's performance of all of the terms, covenants and conditions of the lease, could be exercised upon certain notice to petitioners. The rental to be paid was to be at an amount agreed upon between the parties, but, as to the first renewal option, not less than the annual net rent reserved and agreed upon for the preceeding four-year period of the lease. For the second renewal option, the rent was to be at an amount not less than the annual net rent reserved and agreed upon for the first renewal lease.

interest in the property, transferred their interests in such property to the New York City Transit Authority at a total selling price of $39,000,000.00 (each transferor received $19,500,000.00). On the form TP-580 (transferor questionnaire) filed by each of the petitioners, one half of the $3,000,000.00 required to have been expended by Greyhound pursuant to the terms of the lease, or $1,500,000.00, was included as part of the original purchase price used to compute gains tax due. On a schedule of adjustments attached to the Tentative Assessment and Return issued by the Division of Taxation ("Division") to each transferor/petitioner, this sum of $1,500,000.00 was disallowed with the following explanation:

> "Capital improvements expended by the tenant in the amount of $1.5 million are not allowable as part of the transferor's original purchase price, since it has not been demonstrated that the rental payments were reduced accordingly."

8. As a result of the aforesaid disallowance set forth in the Tentative Assessment and Return issued to each transferor/petitioner, Four Plus paid gains tax in the amount of $1,899,532.40 and Chase paid gains tax in the amount of $1,941,250.00.

9. On January 21, 1994, the Division received claims for refund (form TP-165.8) from Chase and Four Plus which requested refunds of $150,000.00 each, representing the tax on the disallowed amounts expended by Greyhound on the construction of the bus garage.

10. Letters to petitioners' representative from the Division, dated April 21, 1994, indicated that it was the position of petitioners that the rental payments pursuant to the lease "were reduced in exchange for the tenant's agreeing to make $3,000,000.00 in capital improvements by constructing a bus garage on the premises." The letters stated that this position lacked substantiation and, accordingly, requested that the Division be provided with copies of petitioners' Federal and State tax returns to demonstrate how the $3,000,000.00 was treated for income tax purposes. A follow-up letter, dated June 6, 1994, again requested this additional information. By letter dated June 29, 1994, petitioners' representative indicated that petitioners were unable to find any records relating to the original negotiation of the lease in 1963 and that all parties who were involved in that negotiation were deceased. The letter referred the Division to the Retrospective Appraisal, submitted with the refund claims, which

was prepared by Robert Von Ancken of James Felt Appraisal and Consulting Services.

11. By letters to each petitioner dated July 13, 1994, the Division denied, in full, the claims for refund.

12. The terms of the lease provided that from March 1, 1963 through April 1, 1970, the rent was to be $100,000.00 per year; from May 1, 1970 through April 30, 1980, $158,000.00 per year; and from May 1, 1980 through April 30, 1990, the rent payable was to be agreed upon between the landlord and tenant, provided, however, that it could not exceed $167,480.00 per year. From May 1, 1990 through the expiration of the lease on April 30, 2004, the rent was to be agreed upon by the landlord and tenant, but if they could not agree, the rent would be established at a rate equal to 6 percent of the fair market value of the property as if vacant. As of May 1, 1990, the rent became $2,550,000.00 per year which Greyhound paid until the sale of the property in 1993.

13. Jonathan Lang, president of Four Plus, testified that Greyhound built a four-story bus garage, including basement and roof parking, of at least 500,000 square feet. It was built of reinforced concrete with ramps and elevators. He stated that the bus garage, which was completed in 1971, takes up the entire block.

14. Robert Von Ancken, executive director of Grubb & Ellis Appraisal and Consulting Company (formerly known as James Felt Appraisal & Consulting Services) appeared at the hearing and testified concerning a rental analysis of 525 Eleventh Avenue, New York, New York which was prepared by him in October 1993.

Mr. Von Ancken began appraising commercial property and became a member of the Real Estate Board of New York in 1960. He is a member of the American Institute of Real Estate Appraisers. He is certified as a general real estate appraiser in New York, New Jersey and Connecticut and is an assistant professor in the Graduate Program of Valuation at New York University. Attached to his rental analysis is an extensive listing of professional affiliations and overall experience (including clients and attorneys for whom he performed services).

Mr. Von Ancken stated that in preparing the analysis, he attempted to emulate what the real estate market was when the lease was executed in March 1963. He indicated that rental value is determined by multiplying the value of the land by the rate of return which, in the early 1960s, was six percent.

The property consists of an entire city block located on 40th Street, between 11th and 12th Avenues. Mr. Von Ancken stated that most city blocks in New York City are 600 feet long; this property is 800 feet long with an area of approximately 158,000 square feet. To determine the fair market value of the property as of the date of the commencement of the lease, he researched sales of land located between 10th and 12th Avenues which occurred between 1960 and 1964. The area between 10th and 12th Avenues was chosen because he wanted industrial sites similar to this property and also because parcels located further east, i.e., midtown, sold at much higher rates.

Mr. Von Ancken selected five sales which he used for purposes of comparison; he testified that he found no leases of entire city blocks which were located on the west side of New York City. All of the properties were on the west side, from 33rd Street to 46th Street. Certain adjustments were made for size and zoning classification (the property was commercially zoned to permit either office or manufacturing). He stated that the property, because of its larger size, would have had a greater demand because of its increased utility (this is referred to as "plottage value"). Mr. Von Ancken indicated that the best comparable parcel was the one on his land sales grid designated as No.5, located at 615-31 10th Avenue, between 44th and 45th Streets. This was the largest of the five parcels (approximately 45,000 square feet) and had a similar location. The average value derived from the sales of these five parcels was $20.69 per square foot.

The rate of return from leases occurring in the early 1960s was determined to be 6 to 6.5 percent per year. Applying this rate to the land value (this was calculated by multiplying the square footage of the property by the price per square foot based upon selling price), Mr. Von Ancken stated that the range for the rental of the property should have been from $189,600.00

to $236,210.00 per year (this was calculated by multiplying the land value by the rate of return).

16. The New York City Department of Finance's record of assessments for the property for the years 1946-47 through 1965-66 indicates that for 1963-64 (as of January 1963), the Department of Finance assessed the land value of the property at $165,000.00. For the following year (1964-65), the land value was assessed at $1,660,000.00. Mr. Von Ancken explained that this increase represented a recognition by the Department of Finance that, after execution of the lease to Greyhound, all of this land was now considered to be one parcel. The record of assessments also indicates that there was a claim (either by petitioners or by Greyhound, which pursuant to paragraph [i] of Article Fifth of the lease, was obligated to pay real estate taxes) that the assessment of $1,660,000.00 was too high. The record of assessments shows that on April 24, 1968, a settlement was reached whereby the agreed upon land assessment was to be $1,540,000.00 (total assessment was to be $1,670,000.00) for 1964-65. By dividing the assessed land value of $1,540,000.00 by the equalization rate of 60 percent, the market value of the land for 1964-65 was determined to be $2,567,000.00.

For the year 1971-72, the City of New York's annual record of assessed valuation of real estate indicates that the land was assessed at $2,600,000.00. Applying the equalization rate of 60 percent results in a land value of $4,333,333.00.[3] With improvements, the 1971-72 record of assessed valuation states that the assessed value was $9,000,000.00, or $6,400,000.00 attributable to the improvements on the property. Again, by applying the equalization rate of 60 percent, the actual value of the building and improvements was $10,666,667.00.

For 1966-67, the Department of Finance's land value calculation indicates a land assessment of $1,685,000.00 and an assessed value for improvements of 0. In 1967-68, improvements were assessed at $100,000.00; in 1968-69, at $1,305,000.00; and in 1969-70, at $6,505,000.00 (this figure was then reduced to $6,400,000.00 where it remained through 1974-75). Mr. Von Von Ancken stated that the Department of Finance's records indicate that in

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[3]Robert Von Ancken stated that, based upon his experience, he knew the equalization rate in New York City to be 60 percent prior to 1985; after 1985, the rate became 45 percent.

1966, there was no building on the property. Thereafter, the increases in the assessment show that the improvements were assessed on a partial basis until they were completed.

17. Prior to the lease with Greyhound, the property was leased to eight tenants for a total rent of $78,000.00 per year. The property, as rented to these tenants, consisted of 64 1/5 lots. The amounts of rent paid by these tenants were agreed to at various times, all of which were several years prior to the execution of the lease with Greyhound. Prior to the lease with Greyhound, there were stockyards and frame buildings on the property which, pursuant to the terms of the lease, were demolished and removed by Greyhound.

18. Mr. Von Ancken concluded, based upon his rental analysis and retrospective appraisal, that petitioners, as the landlords in the lease with Greyhound, offered the tenant (Greyhound) a below market rent in order to have the tenant build a sizable improvement on the property so as to enhance its value.

SUMMARY OF THE PARTIES' POSITIONS

19. The position of petitioners may be summarized as follows:

a. In exchange for a below market rent, the tenant (The Greyhound Corporation), agreed to construct a substantial improvement, i.e., the bus garage, on petitioners' property. Since petitioners gave up rental income in exchange for the garage, pursuant to 20 NYCRR 590.15, they may properly include the construction cost of the garage in their original purchase price.

b. Petitioners have satisfied their burden of proof by submission of expert testimony and documentary records to establish that Greyhound paid below market rent.

c. While petitioners did not submit documentation from Greyhound as to the amount which it expended in constructing the bus garage, they have provided ample proof of such costs. The lease required that at least $3,000,000.00 be expended; the president of Four Plus testified that the improvements were, in fact, completed; and, the New York City real

property tax records reflect that the assessed value of the improvements rose from zero prior to the construction of the bus garage to $6,505,000.00 afterward.

d. The Division's contention that petitioners have violated the parol evidence rule is without merit, since they have not attempted to change the language of the lease nor to use extrinsic facts to interpret its meaning. Petitioners seek to use extrinsic facts solely to determine the economic substance of the transaction between petitioners and Greyhound.

e. While 20 NYCRR 590.29(c) entitles a tenant to include, in its original purchase price, the cost of any capital improvements made by the tenant, Greyhound would not be able to avail itself of this regulation since, contrary to the language of the regulation, a reduction in rental payments did occur.

The Division of Taxation contends as follows:

a. Petitioners' claim for refund must be denied because the cost of constructing the bus garage was paid for by Greyhound. Both Tax Law § 1440(5)(a) and 20 NYCRR 590.16 provide that the transferor may claim capital improvement costs in original purchase price if such costs were paid by the transferor. In this case, petitioners, as transferors, did not pay for the construction of the bus garage.

b. Petitioners have failed to prove that Greyhound paid below market rent. The tenants prior to Greyhound paid total yearly rent of $78,000.00 and were not required to make capital improvements.

c. Petitioners did not prove the actual amount expended by Greyhound in building the bus garage. While the lease stated that its cost was to be at least $3,000,000.00, Greyhound could have constructed it for less and not informed petitioners.

d. The appraisal relied on by petitioners in their attempt to establish that

Greyhound paid below market rent was defective and unreliable since it reviewed sales rather than leases of buildings. Mr. Von Ancken used sales and tried to convert selling prices into rental numbers. There is no way of knowing whether other assets such as good will or tangible personal property were included in those selling prices.

e. The parol evidence rule should prohibit Mr. Von Ancken's testimony and the documents pertaining to his appraisal from changing the unambiguous language of the lease.

f. Petitioners' reliance on 20 NYCRR 590.29(c) is misplaced. It has no reference to lessors and cannot be read to include lessors as petitioners contend.

g. Petitioners will not be treated unfairly if they are not allowed to claim the purported cost of the bus garage as part of their original purchase price. Upon the sale of the property to the New York City Transit Authority in 1993, petitioners received payment for the bus garage even though they never expended any of their money to construct it.

CONCLUSIONS OF LAW

A. Tax Law § 1441, which became effective March 28, 1983,[4] imposes a 10% tax upon gains derived from the transfer of real property located within New York State.

B. 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."

C. Tax Law § 1440(5)(a)(i)(B), in effect for the period at issue, defined "original purchase price", for purposes of computing gains tax liability, to include:

"the consideration paid or required to be paid by the transferor . . . for any capital

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[4]Chapter 309 of the Laws of 1996 repealed Article 31-B of the Tax Law, pertaining to the tax on gains derived from certain real property transfers, for transfers occurring on or after June 15, 1996.

> 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 commissioner, incurred for the construction of such improvements." (Emphasis added.)

20 NYCRR 590.17 defines "capital improvement" and sets forth a list of specific costs "if paid for by a transferor, that are allowable as a cost of capital improvements made to real property for purposes of determining original purchase price." (Emphasis added.)

D. The applicable statute and regulation both clearly state that in order for the costs of a capital improvement to be includable in original purchase price for purposes of computing gains tax, the costs thereof must be borne by the transferor (in this case, by petitioners). There is no dispute that the costs for construction of the bus garage were paid by Greyhound. The provisions of the lease required that Greyhound expend at least $3,000,000.00 to construct the garage; Jonathan Lange, president of Four Plus testified that it was completed in 1971. While, as the Division correctly points out, petitioners have failed to introduce proof as to the exact amount of Greyhound's expenditures, they have attempted to show, by means of the testimony of Robert Von Ancken along with certain records of the New York City Department of Finance, that the assessed value of the bus garage (and any other related improvements) actually exceeded the $3,000,000.00 expenditure required by the lease.

It is petitioners' position that, despite the fact that they did not actually pay for the construction of the bus garage, by virtue of their having agreed to a below market rent from the date of execution of the lease through April 30, 1990 (when the rent rose from $167,480.00 to $2,550,000.00), they bore the cost of the capital improvement. Accordingly, they contend that each is entitled to include 50 percent of the $3,000,000.00, or $1,500,000.00, in original purchase price for purposes of computing the gains tax liability of each petitioner.

E. Upon review of the testimony of Robert Von Ancken, the rental analysis performed by him and the documents submitted by petitioners therewith (the New York City Department of Finance assessment records and interest rate tables), it must be found that Greyhound did, in fact, pay a below market rent for the property from the date of execution of the lease through April 30, 1990. Petitioners have satisfied their burden of proof in this regard since Mr. Von

Ancken's credentials and experience in appraising New York City real estate established his testimony as credible.

It should be noted that the Division's contention that the parol evidence rule should be applied to prohibit Mr. Von Ancken's testimony and the documents pertaining to his appraisal is without merit since, as petitioners maintain, the testimony and documents were not offered to change the language of the lease or to interpret its meaning. Such evidence was presented, as stated in petitioners' reply brief, "solely to determine the economic substance of the transaction between petitioners and Greyhound." Accordingly, the question which must be answered is whether, by accepting a below market rent in exchange for the tenant's agreeing to construct the bus garage, petitioners can be found to have "paid" for the garage.

F. It is well settled that the statutes imposing the gains tax employ an expansive definition designed to maximize revenues (see, Matter of Iveli v. Tax Appeals Tribunal of State of N.Y., 145 AD2d 691, 535 NYS2d 234, lv denied 73 NY2d 708, 540 NYS2d 1003; Matter of Bombart v. Tax Commn., 132 AD2d 745, 747, 516 NYS2d 989).

In Matter of Shechter (Tax Appeals Tribunal, October 13, 1994), the Tribunal, citing Matter of Von-Mar Realty Co. (Tax Appeals Tribunal, December 19, 1991 affd Matter of Von-Mar Realty Co. v. Tax Appeals Tribunal, 191 AD2d 753, 594 NYS2d 414, lv denied 82 NY2d 655, 602 NYS2d 803), stated that with regard to the transfer gains tax, the general rule that form takes precedence over substance in the analysis of tax cases does not apply and, therefore, the focus of the analysis must be on the economic reality of the transaction. What, of course makes the analysis in this case particularly difficult is the fact that all of the parties who were involved in the lease negotiation are deceased.

G. While it should be noted that the lease between petitioners and Greyhound was executed approximately 20 years prior to the enactment of the gains tax and, therefore, could not have contemplated possible gains tax consequences, it must be found that the terms of the lease were structured in a manner which would benefit both the landlord and the tenant, i.e., the terms contained therein evidenced a conscious business decision to have Greyhound erect a

building, tailored to its business needs and to be used by it for at least 41 years and, based upon the existence of the renewal options, for a potentially longer period. While obligated to expend at least $3,000,000.00 (based upon the assessed value per the Department of Finance records, it is possible that Greyhound spent an even greater sum), it was able to ensure that the building would be constructed according to its specifications. The fact that the lease provided that Greyhound could demolish and remove the bus garage and construct a new building of like value contemplates an even longer term use by Greyhound. In return for such a considerable expenditure of money, Greyhound was able to pay a reduced or below market rental for approximately 27 years (March 1, 1963 through April 30, 1990).

Petitioners, in turn, also received considerable benefit from the terms of this transaction. They were ensured of a tenant and, therefore, rental income for at least 41 years. A building costing at least $3,000,000.00 was constructed on the property, the value of which would be and, in fact, was realized first, by market value rent beginning in 1990 and, second, upon the sale of the property (for $39,000,000.00 in 1993). Moreover, petitioners were not burdened with the problems associated with overseeing construction. Despite the real estate expertise of Waldo Hutchins, Jr., who ran Four Plus during the time of the execution of the lease, there is no evidence that he was in any way knowledgeable in the area of building construction (and specifically with respect to a bus garage).

Lease agreements which provide that a tenant will make certain improvements or repairs or perform certain services (such as painting, mowing or snow removal) in exchange for a lesser rental payment are not rare. In such cases, it cannot be said that the landlord has paid for such improvements, repairs or services. The landlord certainly had the option of doing (or hiring someone to do) the work himself and then charging market value rent for the property.

In this case, while the focus must be on the "economic reality" rather than the form of the transaction, it must be found that the form (i.e., that Greyhound was to pay for the bus garage in exchange for certain concessions from petitioners) elucidated a business decision made by knowledgeable business people. Notwithstanding petitioners' contentions to the contrary, it

must nevertheless be found that petitioners did not pay for the capital improvement at issue herein. Had petitioners and Greyhound been able to foresee the enactment of the gains tax, it is possible that the terms of their agreement would have been structured differently. We must, however, consider the facts as they exist and apply the applicable law. Tax Law § 1440(5)(a)(i)(B) and 20 NYCRR 590.17 state that in order to be includable in original purchase price, the subject capital improvement had to be paid for by the transferor. This was not the case for the transaction at issue.

H. Petitioners have pointed to 20 NYCRR 590.29(c) for the principle that if it was held that petitioners could not include the cost of the bus garage in its original purchase price, this regulation would also act to prohibit Greyhound from including the costs of the bus garage since expending such costs resulted in a reduction of rental payments. First, it must be pointed out that this regulation pertains to original purchase price for the creation of a taxable lease. Second, the taxability of the lease is not at issue herein since it was executed 20 years prior to the enactment of the gains tax. Third, the Division of Tax Appeals has no jurisdiction to consider issues relating to Greyhound's tax liability since Greyhound has filed no petition in this matter. Reliance on 20 NYCRR 590.29(c) is, therefore, misplaced.

I. The petitions of Chase Manhattan Bank, N.A., as trustee, and of Four Plus Corporation are hereby denied.

DATED: Troy, New York
February 12, 1998

/s/ Brian L. Friedman
ADMINISTRATIVE LAW JUDGE