

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petitions	:	
of	:	
HAUBECK REALTY CORP. and	:	DETERMINATION
MADISON PARK LOFT CORPORATION	:	DTA NOS. 815374,
	:	815375 AND 815429
for Revision of Determinations or for Refunds	:	
of Tax on Gains Derived from Certain Real	:	
Property Transfers under Article 31-B of the	:	
Tax Law.	:	

Petitioners, Haubeck Realty Corp. and Madison Park Loft Corporation, as nominees for DiLorenzo Properties Company, 1040 Second Avenue, New York, New York 10022, filed petitions for revision of determinations or for refunds of tax on gains derived from certain real property transfers under Article 31-B of the Tax Law.

On April 30, 1997 and May 2, 1997, respectively, petitioners by their duly appointed representative Ziegler, Sagal and Winters, P.C. (Stephen S. Ziegler, Esq. and Lanny M. Sagal, Esq., of counsel), and the Division of Taxation by Steven U. Teitelbaum, Esq. (Herbert M. Friedman, Jr., Esq., of counsel), waived a hearing and agreed to submit the matter for determination based upon documents and briefs to be submitted by September 19, 1997, which date commenced the six-month period for issuance of this determination (Tax Law § 2010[3]). After due consideration of the evidence and arguments submitted, Dennis M. Galliher, Administrative Law Judge, renders the following determination.

ISSUE

Whether petitioners may include the consideration for certain long-term leases (computed as the present value of such leases at the time of their creation) as part of their original purchase price for the properties subject to the leases.

FINDINGS OF FACT¹

1. Petitioners, Haubeck Realty Corp. and Madison Park Loft Corporation, are nominees for DiLorenzo Properties Company ("DPC"), a New York partnership.

2. DPC was the owner of the following real properties ("the properties") located in New York City:

462-468 Broadway
686-688 Lexington Avenue
12-16 West 27th Street
30-34 West 26th Street
12-14 West 21st Street
1367-1369 Broadway
681-685 Lexington Avenue

3. Each of the properties was subject to a 90-year net lease created on or about September 1, 1981, which date is prior to the March 28, 1983 effective date of the real property transfer gains tax ("gains tax") imposed under Tax Law former Article 31-B.² Accordingly, no gains tax was paid (or payable) on the creation of the leases.

4. The leases provided for fixed rental payments for the first 30 years and, starting with the 31st year, provided for rent increases of three percent per annum thereafter. The tenants under these net leases were unrelated to DPC.

5. The properties were sold in 1995 to unrelated third parties, subject to the leases. In connection with the 1995 sale of the properties, petitioners filed gains tax transferor and transferee questionnaires. In these filings, petitioners stepped-up their original purchase price ("OPP") for the properties so as to reflect the net leases, which had been entered into prior to the effective date of the gains tax.

6. Included with the documentary evidence submitted in this matter are:

¹The parties stipulated to certain facts in this matter. Petitioners also submitted proposed findings of fact numbered "1" through "12" which essentially follow and restate the stipulated facts. The Division of Taxation has raised no objection to petitioners' proposed facts. Accordingly, said proposed facts, in conjunction with the stipulated facts, form the basis for the findings of fact set forth herein.

²The real property transfer gains tax imposed by Tax Law Article 31-B was repealed on July 13, 1996. The repeal applies to transfers of real property that occur on or after June 15, 1996 (L 1996, ch 309, §§ 171-180).

- a. alternative calculations of gain by the Division of Taxation ("Division") and by petitioners, and
- b. petitioners' reported calculations of the consideration for the amount of the leases (the adjusted OPP reported by petitioners).

7. In response to petitioners' filings, tentative assessments were issued by the Division denying the claimed step-up in OPP pursuant to Tax Law § 1440(5)(e) on the ground that no gains tax was paid on the creation of the leases.

8. Petitioners paid the tentative assessments and thereafter filed timely refund claims with respect to each of the transfers, as follows:

<u>PROPERTY</u>	<u>REFUND CLAIMED</u> ³
462-468 Broadway	\$227,937.00
686-688 Lexington Avenue	107,073.00
12-16 West 27th Street	113,453.00
30-34 West 26th Street	201,603.00
12-14 West 21st Street	117,943.00
1367-1369 Broadway	94,137.00
681-685 Lexington Avenue	146,333.00

9. The Division denied all of the refund claims in their entirety.
10. In each case (with the exception of 1367-1369 Broadway), petitioner filed a request for conciliation conference in response to the Division's refund denial. In each such case, a Conciliation Order was issued by the Division's Bureau of Conciliation and Mediation Services ("BCMS") sustaining the Division's denial.
11. Petitioners, in response, timely filed the petitions at issue herein.
12. The record on submission includes copies of the long-term net leases, together with an affidavit made by Marc DiLorenzo, managing partner of DPC, attesting to their authenticity.

³The petition inadvertently lists the \$107,073.00 figure set forth (presumably due to a typographical error) in the Division's denial letter regarding 681-685 Lexington Avenue. The parties have stipulated that the correct amount in issue should be \$146,333.00, and the petition shall be deemed amended to refer to this amount as the amount in dispute.

SUMMARY OF THE PARTIES' POSITIONS

13. The parties are in agreement that there is only one issue in this case, to wit, whether petitioners are entitled to include in their OPP for the properties the present value of the long-term leases at the time of their creation notwithstanding that no gains tax was paid or payable on such leases.⁴ Petitioners maintain that it is inequitable to deny such an OPP step up in the case of a long-term lease entered into before the effective date of the gains tax, when such a step up is allowed in the case of a long-term lease entered into after the effective date. Petitioners point out that if the long-term leases in this case had been created after the effective date of the gains tax they would have been subject to the tax, with the consideration for the leases being equal to the present value of the rents to be paid over the terms of the leases. In turn, such consideration would have been includable as part of the OPP for the leased properties (i.e., a step up) upon the later transfer of the properties. Petitioners go on to argue that the creation of the long-term leases in this case falls within the definition of a "transfer" under Tax Law former § 1440(7)(a). Petitioners argue that, Tax Law former § 1440(5)(e) and 20 NYCRR 590.29(b) provide for the OPP of the properties in this case to be stepped up so as to include the present value of the rental stream under the long-term leases to which such properties are subject. Petitioners argue that the cited statute and regulation do not state that a different OPP rule is to be applied, i.e., that a step up in OPP is denied where the long-term leases are created prior to the gains tax effective date.

14. The Division, in contrast, argues that the plain language of Tax Law § 1440(5)(e) clearly requires the lessor to have paid gains tax with respect to the leases, in order to claim a step up. The Division asserts that the leases in this case were created well before the effective date of the gains tax and thus were simply not subject to the tax. The Division goes on to argue that the transfers at issue, the sales of the various properties subject to the long-term leases, are not in any sense "grandfathered" transactions (i.e., transfers occurring after the gains tax

⁴The parties have raised no dispute as to the underlying dollar amounts involved in this case, and are in agreement that if petitioners are entitled to include the lease values in OPP then they are entitled to the claimed refunds plus interest, whereas if such values are not includable then the refund denials will be sustained.

effective date which are exempt because they are made pursuant to a contract entered into on or before the gains tax effective date [*see*, Tax Law former § 1443(6)]. Rather, the Division points out that the transfers occurred after the gains tax effective date pursuant to contracts entered into after such effective date. The Division argues, in sum, that since no gains tax was paid on the leases at the time of their creation, petitioners are simply not entitled to include in OPP the consideration for the leases at the time of their creation.

CONCLUSIONS OF LAW

A. Tax Law former Article 31-B provided, at the time of the property transfers in question here, for the imposition of a tax at the rate of 10 percent upon gains derived from the transfer of real property within New York State (Tax Law former § 1441). "Gain", for purposes of this tax, was defined to mean "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 former § 1440[3]). There is no dispute between the parties that the transfers of the properties in this case were transfers subject to the gains tax.

B. It is also clear that the gains tax, effective March 28, 1983, encompassed the creation of certain leaseholds within its definition of "transfer of real property" potentially subject to tax, as follows:

"'Transfer of real property' means the transfer of any interest in real property by any method, including but not limited to sale, exchange, assignment, surrender Transfer of an interest in real property shall include the creation of a leasehold or sublease only where (i) the sum of the term of the lease or sublease and any options for renewal exceeds forty-nine years, (ii) substantial capital improvements are or may be made by or for the benefit of the lessees or sublessees, and (iii) the lease or sublease is for substantially all of the premises constituting the real property." (Tax Law former § 1440[7][a].)

The parties do not dispute that the long-term leases in this case would have been subject to the gains tax if such leases had been created after the effective date of the tax. However, it is clear that the leases were entered into before the effective date, and thus could not have been (and were not) subject to the tax.

C. In the case of long-term leases which were subject to the gains tax, Tax Law former § 1440(1)(b) provided, with respect to consideration, as follows:

"In the case of (i) the granting of an option with use and occupancy of real property or (ii) the creation of a leasehold or sublease that is a transfer of real property . . . consideration shall also include the value of the rental and other payments attributable to the use and occupancy of the real property or interest therein, the value of any option to purchase or renew included in such transfer and the value of rental or other payments attributable to the exercise of any option to renew.

D. Law former § 1440(5)(e) provided, in turn, as follows:

"The consideration, described in paragraph (b) of subdivision one of this section, received by the lessor of a taxable lease, shall become such lessor's original purchase price of the interest in the real property leased; provided, that such lessor paid the tax imposed by this article on such lease or is paying such tax pursuant to the installment payment provision of section fourteen hundred forty-two of this article." (Emphasis added.)

It is this provision which allows for a step up in OPP based on the consideration received by a lessor of a taxable lease.

E. Petitioners seek to apply the terms of Tax Law former §§ 1440(7)(a) and 1440(5)(e) to the circumstances of their transfers. Petitioners maintain that if they are denied a step up in OPP, they will be taxed on a portion of the gain from their 1995 transfers of the properties attributable to transfers (the creation of the leases) which took place prior to the gains tax effective date. Petitioners assert that such a result would circumvent the gains tax enabling statute which states that "the tax . . . should not apply to any transfer made on or before the effective date [of the gains tax]" (L 1983, ch 15, § 184[n]; amended L 1983, ch 16, § 8).

F. Petitioners' position is rejected as simply not meeting the clear language of Tax Law former § 1440(5)(e), which specifies that for lease consideration to be included in OPP, such consideration must have been received by the lessor of a taxable lease. Former section 1440(5)(e) further requires such lessor to have paid the tax (or to be paying the tax in installments). Petitioners are unable to meet these clear statutory requirements because the subject leases, by virtue of having been entered into before the gains tax effective date, were not subject to the tax. Since such leases were not taxable, petitioners can neither be the lessors of taxable leases nor can they have paid (or be paying) the tax.

G. The flaw in petitioners' position is the attempt to apply the definitions and impose the consequences of former Article 31-B to transfers that occurred prior to its enactment.

Petitioners argue that since the leases in question meet the definition of "transfer of real property," they are thus "taxable leases" for purposes of Tax Law former § 1440(5)(e). This argument ignores the fact that the leases were created before the gains tax was in existence. It is true that the creation of leases such as those in question here literally falls within the definition of a transfer of an interest in property subject to tax under former Article 31-B. If such leases had been created after the effective date of the tax, they would have been transfers subject to the tax (i.e., taxable leases), and petitioners would have been "taxable lessors." Consistently, as the lessor of a taxable lease (and assuming the tax had been paid or was being paid), petitioners would have been entitled to include the consideration received for the leases in the OPP for the properties subject to the leases. This inclusion, or step up, would prevent the lease consideration which was subject to gains tax upon creation of the leases from being subjected to gains tax again upon sale of the properties. However, it does not follow that such lease consideration must therefore always be includable in OPP regardless of when the leases were created.

H. Petitioners assert that applying the definition of the term "transfer" found in Tax Law former § 1440(7)(a) to a lease entered into before the effective date of the gains tax is warranted under the so-called "grandfather" exemption from the gains tax (Tax Law former § 1443[6]). The grandfather exemption exempts from tax a transfer of real property where the contract for the transfer of that property was executed prior to the effective date of the gains tax law, even though the actual transfer occurred after the effective date of the statute imposing the tax. Petitioners' claim must fail because none of the transfers in issue here occurred as a result of a contract entered into prior to the effective date of the gains tax law.

The long-term leases in issue were created before the effective date of the gains tax, and for that reason alone, the creations of the leases were not subject to gains tax. The sales of the properties, subject to the leases, occurred in 1995, and those transfers were subject to the gains tax. Petitioners did not enter into a contract for the sale of the properties before the effective date of the gains tax and then transfer those properties pursuant to the contract after the gains

tax became effective. Accordingly, the grandfather exemption does not apply to these transactions.

In this case, the only transfers subjected to gains tax were the 1995 property transfers which occurred after the effective date of the gains tax. The fact that the properties transferred included the long-term pre-effective date leases does not change the fact that such leases themselves (as discrete transfers) were simply not taxable because they were created before the effective date of the gains tax. Petitioners, in requesting a step up in OPP, seek a benefit based on having been subject to gains tax on the consideration for their leases when in fact they were not subject to gains tax on such consideration. The statute clearly provides for a step up in OPP for lease consideration where such lease consideration has been subject to gains tax. The statute also clearly prevents such a step up where, as here, the lease consideration has not been subject to gains tax (Tax Law § 1440[5][e]).⁵

I. The petitions of Haubeck Realty Corp. and Madison Park Loft Corporation are hereby denied and the Division's denials of petitioners' refund claims are sustained.

DATED: Troy, New York
March 5, 1997

/s/ Dennis M. Galliher
ADMINISTRATIVE LAW JUDGE

⁵Finally, petitioners cite to *Matter of Ader* (Tax Appeals Tribunal, September 15, 1994) for support. That case involved the pre-gains tax effective date transfer of individually owned co-op shares to a tenancy-in-common entity ("TIC") in return for an ownership interest in such TIC proportionate to each transferor's prior individual ownership interest. Under 20 NYCRR 590.36(6) (formerly 20 NYCRR 590.35[6]), an OPP step up to fair market value of the shares was allowed for a transfer which, after the gains tax effective date, would otherwise have been a mere change in form transfer with the transferee taking a carryover OPP (Tax Law former § 1443[5]). This case, unlike *Ader*, does not involve co-op shares, and does not involve the impact of a mere change in the form of ownership interest. Here, there was no change in the form of ownership of the properties upon creation of the leaseholds. Moreover, the present matter involves a specific statute (Tax Law former § 1440[5][e]) and a regulation (20 NYCRR 590.29[b]) different from those at issue in *Ader*. Accordingly, petitioners' reliance on *Ader* is misplaced.