STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition of **NORMANDY ASSOCIATES** 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.	DECISION DTA NO. 804333

Petitioner, Normandy Associates, c/o Orsid Realty Corp., 250 West 57th Street, New York, New York 10107, filed an exception to the determination of the Administrative Law Judge issued on June 9, 1988 with respect to its 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 (File No. 804333). Petitioner appeared by Joel E. Miller, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Thomas C. Sacca, Esq., of counsel).

The petitioner filed a brief on exception; the Division of Taxation did not. Oral argument was not requested.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUES

I. Whether the transfers of shares after March 28, 1983 by the realty transferor pursuant to a cooperative conversion plan are subject to the gains tax imposed by Article 31-B of the Tax Law even though the real property was transferred to the cooperative housing corporation prior to such date.

II. Whether, in the course of its audit (and assuming the transfers in question were properly subject to tax), the Division of Taxation properly computed the anticipated total consideration with respect to petitioner's transfers of shares pursuant to the cooperative conversion plan.

III. Whether the Division's imposition of penalty based upon petitioner's failure to have timely

filed returns and paid tax due (Tax Law § 1446.2[a]) was appropriate and should be sustained.

FINDINGS OF FACT

We find the facts as stated by the Administrative Law Judge and such facts are incorporated herein by this reference, except that we change all references from "sponsor" to "realty transferor" and that we modify finding of fact "7" asindicated below. The facts found by the Administrative Law Judge that are relevant to the issue on exception and the modified fact are stated below.

On November 7, 1986, following an audit, the Division of Taxation issued to petitioner, Normandy Associates, a Notice of Determination of Tax Due under Tax Law Article 31-B ("gains tax"), indicating gains tax due in the amount of $34,416.00, plus penalty and interest. This Notice pertained to an audit concerning Normandy Owners Corporation (the "corporation"), a cooperative housing corporation to which petitioner, as realty transferor under a cooperative conversion plan, had transferred certain real property located at 140 Riverside Drive, New York, New York.

The subject premises consisted of a total of 248 individual apartment units in an apartment building acquired by petitioner by purchase on September 28, 1960. The subsequent closing between petitioner, as realty transferor, and Normandy Owners Corporation, pursuant to the plan of cooperative conversion (the "realty transfer"), occurred on September 4, 1980.

Pursuant to the plan of cooperative conversion, a total of 22,575 shares of the cooperative corporation's stock was allocated to and among the 248 apartments. As of the time of the September 4, 1980 realty transfer, the shares allocated to 159 apartments had been subscribed to by various outside purchasers and, upon closing, petitioner itself received the balance of shares allocated to the other 89 apartments. The realty transfer was for a total expressed price of $16,200,000.00, broken down into 3 elements as follows: (a) $2,100,000.00 in cash; (b) a short-term mortgage note in the amount of $8,100,000.00 (carrying an interest rate of 10-3/8%); and (c) a ten-year wraparound mortgage note in the amount of $6,000,000.00 (carrying an interest rate of 8-3/4%). The corporation also retained a reserve fund of $575,000.00.

Subsequent to the realty transfer, petitioner made ongoing transfers of apartment units[1] in the ensuing years. During October of 1985, the Division of Taxation contacted petitioner with notice that a gains tax audit of the conversion would be conducted. This audit was commenced on November 7, 1985 and took approximately one year to complete (including a four to five month hiatus caused by the auditor's illness).

As determined upon audit, of the 89 apartments acquired by petitioner at the time of the September 4, 1980 realty transfer, 49 of such apartments had been transferred by petitioner prior to the March 28, 1983 effective date of the gains tax and hence were deemed "grandfathered" and not subject to tax. An additional seven apartment units had been transferred by petitioner subsequent to the effective date of the gains tax and, as of the time of the conclusion of the audit, 33 units were still owned by petitioner. In terms of shares, of the 22,575 shares allocable to the 248 total apartments, 19,539 shares related to the 208 grandfathered apartments, and 3,036 shares related to the 40 potentially taxable apartments. Of these latter 40 apartments, 477 shares related to the 7 units transferred as of the close of the audit and subsequent to the effective date of the gains tax, thus leaving 2,559 shares pertaining to the remaining 33 units unsold as of the end of the audit.

With respect to the seven apartment units transferred subsequent to the effective date of the gains tax, no gains tax returns were filed nor was any gains tax paid thereon prior to conclusion of the audit. The Division's auditor determined that tax was due on these seven units, with the amount of tax as computed reflected in the aforementioned Notice of Determination of Tax Due. The Division also calculated and imposed penalty on five of these seven apartment unit transfers, excluding penalty from the last two of such transfers since they occurred during the pendency of the audit. To date, petitioner has paid $25,000.00 against the outstanding Notice of Determination, such payment being made "to demonstrate good faith" but without abandonment of any of the arguments advanced by petitioner in this proceeding.

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[1]Said transfers of cooperative apartment units are accomplished via the transfer (to the purchaser) of those shares of the corporation allocated to the particular apartment unit together with a proprietary lease appurtenant to the apartment.

We modify finding of fact "7" to read as follows:

> To determine the tax due on the seven units transferred, the auditor first calculated the total anticipated gain that would be realized by petitioner on the eventual sale of all 3,036 shares relating to the 40 units. The total anticipated tax on all sales was then calculated as 10% of the total anticipated gain. The total anticipated tax was then divided by the 3,036 shares to calculate an anticipated tax due per share. The tax due on the seven units transferred was calculated by multiplying the number of shares allocated to these units by the anticipated tax due per share.
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> To calculate the total anticipated gain on the sale of 3,036 shares allocated to the 40 units the auditor first calculated the total anticipated consideration to be received on the sale of the 40 units. This total anticipated consideration was calculated as follows:

"Cash actually received (477 shares)	$1,312,500
Estimated future cash (2,559 shares)	173,108
Total Cash Consideration	$2,485,608
Less: Reserve fund[2]	77,338
	$2,408,270
10-year mortgage note[2]	807,000
	$3,215,270
Less: Brokerage fees (actually paid; 477 shares)	67,596
Consideration	$3,147,674"

The "cash actually received" figure of $1,312,500.00 was calculated by the auditor based upon the amount of cash actually received by petitioner on the seven transfers at issue herein as follows:

Date	Apartment	Shares	Cash Price
5/11/83	11D	71	$ 145,000
6/1/83	2J	89	225,000
11/3/83	14P	67	130,000
3/14/84	15L	65	167,500
10/12/85	2O	62	205,000
9/27/86	12P	66	220,000
10/3/86	3P	57	220,000
		477	$1,312,500

From the total anticipated consideration the auditor subtracted the

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[2] Allocated amount of total based on 13.45% of total units being taxable.

total anticipated original purchase price attributable to the 40 units to determine the total anticipated gain.

OPINION

The Administrative Law Judge determined that (1) the fact that the realty transfer to the cooperative housing corporation took place prior to March 28, 1983 did not remove from the scope of the gains tax transfers of units that took place after such date pursuant to agreements entered into after such date; (2) the transfers of such units were taxable as transfers pursuant to a cooperative plan; (3) the Division properly calculated the tax due on the units transferred at the time of the audit when it included the actual consideration received on the transferred units as an element of the total anticipated consideration; (4) the Division properly included as an element of total anticipated consideration the ten year wraparound note at its face amount; (5) the Division properly reduced consideration by the amount of brokerage fees actually paid on the seven units transferred rather than by 6% of the actual cash received on such units; (6) the Division improperly reduced the conversion fee allowed as an addition to original purchase price and (7) the petitioner did not establish reasonable cause for its failure to file and pay gains tax on the seven units transferred.

The petitioner takes exception to all of the Administrative Law Judge's conclusions, except the conclusion that the Division improperly reduced the conversion fee allowable as a selling expense to increase original purchase price. We will state the arguments raised by petitioner in support of its position as we address each issue. In response to petitioner's exception brief challenging the Administrative Law Judge's determination, the Division relied on the Administrative Law Judge's determination.

I. Whether transfers after March 28, 1983 pursuant to this cooperative conversion plan are subject to the gains tax as transfers pursuant to a cooperative plan.

Petitioner argues that all transfers of units pursuant to this conversion plan are not subject to the gains tax because the transfer of the real property to the cooperative housing corporation took place before the effective date of the gains tax. In support of this contention petitioner points to the effective date of Article 31-B which stated that “The tax . . . shall not apply to any transfer made on

or before the effective date [March 28, 1983] of this act" (L 1983, ch 15, { 184[n]). Petitioner also suggests that the case of Mayblum v. Chu (Sup Ct, Queens County, May 11, 1984, Graci, J., affd 109 AD2d 782, mod 67 NY2d 1008) does not decide the issue presented here.

We affirm the Administrative Law Judge on this issue.

The essence of petitioner's argument is that the transfer of the real property by the realty transferor to the cooperative housing corporation is the taxable event for gains tax purposes. The petitioner argues that the realty transferor's subsequent transfers of shares allocated to units are not taxable events but merely payment events. Petitioner asserts that the many provisions of the gains tax dealing with the transfer of shares are intended only as deferred payment provisions and are not intended to indicate that the transfer of shares is a taxable event. We conclude that petitioner's analysis is inconsistent with the provision of the gains tax.

In contrast to the structure petitioner would impose on the gains tax, we conclude that the tax treats the transfer of shares by the realty transferor to unit purchasers as the taxable event. However, the gain on these transfers is measured by the difference between the consideration for the shares and the realty transferor's original purchase price in the real property prior to its transfer to the cooperative housing corporation. This scheme in effect ignores the realty transferor's transfer to the cooperative housing corporation and instead treats the realty transferor as if he were directly transferring his interest in the real property to the unit purchasers. Under this scheme the gains tax is imposed on the entire cooperative conversion plan, encompassing the real property prior to its transfer to the cooperative housing corporation and the sale of shares by the realty transferor subsequent to the property's conversion to cooperative ownership. The transfer to the cooperative corporation is then treated merely as a conduit which allows the transformation of the real property into shares allocated to units.

We find this scheme articulated in each of the special provisions in Article 31-B that deal with transfers pursuant to a cooperative plan. Further, it is significant that these provisions consistently treat transfers pursuant to a cooperative plan in exactly the same manner as transfers pursuant to a condominium plan. From this we conclude that the Legislature intended transfers

pursuant to a cooperative plan to be treated exactly like transfers pursuant to a condominium plan - as transfers directly by the realty transferor to the unit purchasers.

This intent of Article 31-B is expressed in the aggregation clause of section 1440.7 of the Tax Law which specifically defines as a "transfer of real property" transfers pursuant to a cooperative or condominium plan. If, as urged by petitioner, the transfer to the cooperative housing corporation was the taxable transfer, this definition would be unnecessary. Further, section 1442 of the Tax Law provides that "In the case of a transfer pursuant to a cooperative or condominium plan, the date of transfer shall be deemed to be the date on which each cooperative or condominium unit is transferred." This section also bases the tax due on each transfer pursuant to a cooperative or condominium plan as "an apportionment of the original purchase price of the real property and total consideration anticipated under such cooperative or condominium plan . . . for each such cooperative or condominium unit" (Tax Law § 1442). Finally, section 1443.6 provides that for purposes of the grandfather exemption "A written agreement to purchase shares shall be deemed a written contract for the transfer of real property . . .". If the transfer to the cooperative housing corporation was the taxable event, this exemption relating to the transfer of units would not make sense. Taken as a whole, these provisions articulate a statutory scheme which treats the realty transferor in a cooperative conversion as if he is transferring his real property interest directly to the unit purchasers.

We also believe that Mayblum v. Chu (supra) has already decided this issue. In Mayblum the taxpayers sought a declaratory judgment to establish that the realty transfer to the cooperative housing corporation was the taxable event to support their contention that a pre-March 28, 1983 contract to transfer the real property to a cooperative housing corporation exempted the entire conversion plan. The Court of Appeals rejected this analysis and modified the trial court's order to provide that the gains tax "is imposed by the statute upon the overall cooperative plan except as the Article exempts transfers of shares in cooperatives pursuant to a written subscription agreement entered into prior to March 28, 1983" (Mayblum v. Chu, 67 NY2d 1008 at 1008). This statement that the tax is imposed on the overall cooperative plan clearly supports our conclusion that the tax is

imposed as if petitioner directly transferred its real property to the unit purchasers. Moreover, the rationale which led the Court of Appeals to conclude that the transfer to the cooperative housing corporation was not the taxable event for purposes of applying the grandfather exemption also requires the conclusion that this is not the taxable event to determine whether the tax applies to the entire cooperative plan.

With respect to petitioner's argument that the effective date of Article 31-B indicates that the tax has no application to a cooperative conversion where the realty transfer took place prior to March 28, 1983, we note that as originally enacted Article 31-B had a specific effective date for cooperative conversions (L 1983, ch 15, § 184[n][ii]). This provision would have excluded transfers of units after the effective date of the tax, provided that the cooperative plan had been filed with the Attorney General prior to such date and if certain other conditions were satisfied. This provision was repealed before Article 31-B became effective (L 1983, ch 16, § 8) and in its place the second sentence was added to the grandfather exemption at section 1443.6 of the Tax Law (L 1983, ch 16, § 3). As noted above, this provision exempts transfers of shares pursuant to an agreement entered into on or before March 28, 1983. This legislative history indicates an intent to treat transfer of shares allocated to a cooperative unit as all other transfers of real property, i.e., a transfer of shares after March 28, 1983 is subject to tax unless pursuant to a pre-March 29, 1983 contract.

Based on the foregoing, we conclude that the transfer of shares by petitioner that took place after March 28, 1983 pursuant to contracts entered into after such date are subject to gains tax as transfers pursuant to a cooperative plan. Accordingly, we need not address petitioner's argument that the shares are not subject to tax under other possible theories.

II. Anticipated Consideration

The next issue is whether the Division of Taxation properly calculated the anticipated consideration received on the transfer of the seven units at issue for purposes of calculating the tax due on these units. This issue requires a brief explanation of the calculation of gains tax on sales pursuant to a cooperative plan.

The Tax Law, sections 1442 and 1443.1, requires a person making sales pursuant to a cooperative plan to begin paying tax on the transfer of the first unit, if the consideration to be received pursuant to the entire plan will exceed $1 million. Since the exact amounts of consideration and original purchase price to calculate the actual gain received pursuant to the plan may not be known until far in the future, the transferor of shares must necessarily estimate the total tax that will be due and allocate it to each transfer as it is made.

As explained in the description of the audit stated in the facts, the auditor made a calculation of the anticipated gain petitioner would receive on the sale of the 3,036 shares, allocated to the 40 units, it would transfer after the effective date of the gains tax. The auditor calculated the anticipated gain on these transfers by calculating the anticipated consideration and the anticipated original purchase price of these units. It is with the calculation of this anticipated consideration that petitioner has raised several exceptions.

Petitioner's first point is that in calculating the anticipated consideration to be received on the 40 units the auditor incorrectly totalled the actual consideration received on the 7 units already sold ($2,485,608.00) with the estimated consideration to be received on the remaining 33 units. Petitioner asserts that it had the right to add an estimated consideration ($1,504,369.00) with respect to the first 7 units to the estimated consideration for the remaining 33 units, to determine the total anticipated consideration. Petitioner bases its claim of right on the guidelines issued by the Division on August 22, 1983 in TSB-M-(83)-(2)-R which set forth two options, A and B, to estimate gain on cooperative and condominium plans.[3] Under Option B, petitioner could have elected, prior to the time it started making taxable transfers, to estimate the consideration to be received on all future sales. Payment of tax based on this estimate could have continued until petitioner sold 25% of its shares, at which time petitioner would have been required to adjust its estimated consideration to reflect the actual consideration received on the completed sales. Even if the estimate for the first

[3]Under Option A the actual consideration paid for each unit with an apportionment of the total original purchase price to each unit determines the gain subject to tax. Under Option B the total consideration anticipated less the total anticipated original purchase price determines the total anticipated gain which is then allocated to each unit.

25% was less than the consideration that was actually received on the transferred units, the Option B election would have protected petitioner from the imposition of penalty or interest on the underpayment. The amount of underpaid tax would be made up during the sellout of the remaining units as the anticipated consideration was adjusted based on the actual consideration at 25%, 50% and 75% sell out points. Petitioner claims that the auditor should have applied Option B to its sales as if no transfers had yet taken place, i.e., estimated consideration for all 40 units and disregarded the actual consideration received on the 7 units already transferred. Petitioner argues that the Division's method increases the tax, and thus interest and penalty on transfers in 1983 based on events unknown at that time, transfers in 1986.

While the Division's method has the effect of increasing tax, interest and penalty allocated to the 7 sold units, it was petitioner's failure to timely file and pay that allowed the audit calculation to include the consideration actually received at the time of the audit. The Division's guidelines for estimating consideration are clearly designed to protect the transferor of shares who is unable to accurately predict the consideration he will receive on future sales. A transferor, as petitioner, who makes transfers and fails to file has avoided the need to estimate consideration with respect to these sales. Accordingly, we agree with the determination of the Administrative Law Judge that there is nothing unreasonable about this element of the Division's calculation and that petitioner lost its ability to estimate consideration with respect to the first seven sales by petitioner's election not to file or pay tax on these sales.

Petitioner next argues that the Division erred in including the ten year wraparound note in anticipated consideration at its face amount of $6,000.000.00. Petitioner argues that the value of the note was less than its face because it bore a less than market rate interest. Petitioner argues that the value of the note should be included in consideration rather than its face amount.

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" (emphasis added). In contrast, in the same section of the law the "consideration" for a lease is defined to

include "the value of the rental . . ." (emphasis added). 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.

The next issue raised by petitioner on exception is that the Division improperly computed the brokerage fees allowable under section 1440.1(a) to reduce consideration. Petitioner raised two objections to this calculation. First, that the Division improperly calculated the total of brokerage fees actually paid on the seven units transferred. The Division allowed $67,596.00 as actually paid, the petitioner asserts that the correct amount is $78,750.00. Since we find absolutely nothing in the record to support petitioner's claimed amount, we cannot make any adjustment to this portion of the calculation.

Petitioner's second point is that the Division improperly failed to allow any amount of anticipated brokerage fees to offset the anticipated consideration. Although the Administrative Law Judge concluded, and the Division did not challenge this conclusion, that a 6% brokerage commission was allowable in reducing estimated future consideration, the Administrative Law Judge did not direct the Division to adjust the tax due on the instant transaction to reflect the anticipated brokerage fees. We find that the Administrative Law Judge erred in this respect.

Since the tax due on the 7 transfers at issue is based on an allocation of the gain anticipated on the entire plan (total anticipated consideration less total anticipated original purchase price), the future brokerage fees are a necessary element to calculate this tax. Accordingly, the Division is directed to recalculate the tax allowing petitioner to reduce the estimated future consideration ($1,173,108.00) by a 6% estimated brokerage commission of $70,386.00 ($1,173,108.00 x .06). This adjustment is in accord with the instructions for the Option B filing method set forth in TSB-M-82-(2)-R as well as the Division's current cooperative filing forms, DTF-701.

III. Penalties

On exception petitioner argues that penalties and interest penalties asserted under section 1446.2(a) should be abated because petitioner's position with respect to the transaction is reasonable, petitioner cooperated throughout the audit, "voluntarily" paid $25,000.00 at the

conclusion of the audit and the interest charges that will accrue in any event are very heavy.

Section 1446.2(a) imposes penalty and interest for "failing to file a return or to pay any tax within the time required by this article [31-B]". The penalties may be abated if it is determined that such failure or delay was due to reasonable cause. Of the points raised by petitioner to support his request for abatement the only one that is relevant to the failure to file and pay is the assertion that petitioner's position, that these transactions were not subject to tax, was reasonable. Petitioner's cooperation on audit, though laudable, does not explain the failure to file or pay and certainly does not show that this failure was due to reasonable cause.

With respect to why petitioner failed to file and pay tax, until audited, we note first that petitioner did not appear at the hearing, through any of its partners, to offer testimony as to why it failed to file. Having failed to present any evidence on this point, petitioner clearly could not have sustained its burden to prove reasonable cause.

Without any testimony on this point all we have before us is whether petitioner's position, on its face, is reasonable. We conclude on the facts of this case that it was not. In November 1984 the Division stated its position, in Publication 588, Question and Answers on the Gains Tax, that the fact that real property was transferred into a cooperative corporation prior to March 29, 1983 did not, itself, exempt the subsequent transfer of shares (Q&A No. 34). The Division cited the Supreme Court decision in Mayblum v. Chu (Sup Ct, Queens County, May 11, 1984, Graci, J., affd 109 AD2d 782, mod 67 NY2d 1008) as authority for its interpretation. This statement was subsequently included in the gains tax regulations adopted on August 28, 1985. Notwithstanding this clear statement of the Division's position, and the Appellate Division, Second Department's affirmance of Mayblum v. Chu (109 AD2d 782) on March 11, 1985, petitioner still had failed to commence filing on the transfers at issue by October 1985 when the audit had commenced.[4] In the face of these facts, we conclude that petitioner's position was not reasonable and that petitioner has failed to prove

[4]We also note that petitioner's behavior compares unfavorably with the taxpayer in LT & B Realty v. State Tax Commn. (141 AD2d 185) who initiated, rather than waiting until audit, gains tax filings a few months after the Supreme Court decision in Mayblum v. Chu, (supra). Even on these more sympathetic facts, the Appellate Division, Third Department, sustained the State Tax Commission's imposition of penalty for failing to file gains tax.

reasonable cause.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Normandy Associates is granted to the extent that the Division of Taxation is directed to recalculate the tax by allowing petitioner an anticipated brokerage commission of $70,386.00 but except as so granted is in all other respects denied;

2. The determination of the Administrative Law Judge is modified as indicated in paragraph "1" above but except as so modified is in all other respects affirmed; and

3. The petition of Normandy Associates is granted to the extent indicated in paragraph "1" above and in conclusions of law "G(2)" and "L" of the Administrative Law Judge's determination but except as so granted is in all other respects denied and the Notice of Determination dated November 7, 1986 as modified in accordance herewith is sustained.

Dated: Albany, New York
March 23, 1989

/s/John P. Dugan
John P. Dugan
President

/s/Francis R. Koenig
Francis R. Koenig
Commissioner