

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petition

of

FESTIVAL LEASEHOLD CO.

DECISION

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.

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on May 19, 1988 with respect to the petition of Festival Leasehold Co., c/o A. Walter Socolow, 45 East 82nd Street, New York, New York 10028 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. 804334). Petitioner appeared by A. Walter Socolow, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Paul A. Lefebvre, Esq., of counsel).

The Division filed a statement in support of its exception; the petitioner responded with a letter in opposition. Oral argument was not requested.

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

ISSUE

Whether the reduction of consideration for the assignment of a lease, due to the revaluing of the lease payments, requires a corresponding modification to the original purchase price of the transfer.

FINDINGS OF FACT

We find the facts as stated in the Administrative Law Judge's determination and such facts are incorporated herein by this reference. The relevant facts are summarized below.

Petitioner, Festival Leasehold Co., was the tenant under a certain sublease (the "subject sublease") with Fashion Management Corp., as landlord. On December 5, 1985, pursuant to an

Agreement of Purchase and Sale of Sublease (the "Agreement") and an Assignment of Lease, petitioner transferred by assignment all of its rights, duties and obligations under the subject sublease to 57th Street Realty Corp. as purchaser. Pursuant to the terms of the Agreement, dated July 11, 1985, the purchase price for the assignment, per paragraph 4.1, was set at \$900,000.00, and was to be payable as follows:

"(a) The sum of \$100,000 will be payable to [petitioner] on the Closing Date by certified or bank check or checks.

(b) The balance of \$800,000 (the "Balance") shall be payable to [petitioner], without interest, by certified or bank check or checks on the earlier of (i) the third anniversary of the Closing Date, or (ii) the date on which [57th Street Realty Corp.] or any subtenant of [57th Street Realty Corp.], ...opens for business at the Subject Premises for non-theater purposes. [57th Street Realty Corp.] will deliver to [petitioner] on the Closing Date its promissory note or notes in the amount of the Balance (the 'Note'), payable in accordance with the preceding sentence."¹

At the time of the December 5, 1985 transfer petitioner paid, under protest, tax under Article 31-B ("gains tax") in the amount of \$26,671.90. Thereafter, on April 25, 1986, petitioner filed a claim seeking a refund of this amount of tax paid under protest, plus interest. The stated basis of petitioner's claim for refund was that the \$800,000.00 face amount of the promissory note mentioned above should be discounted to its market value as of the date of the transfer. Petitioner claims such discounting would reduce the principal amount of the note to a level whereby the overall transaction would result in a loss rather than a gain.

By a letter dated November 6, 1986, the Division denied petitioner's claim for refund. In its denial letter, the Division presented its calculation of petitioner's gain, and the resultant tax liability on the subject transfer as follows:

**Amount of Assignment	\$ 900,000
Value of Remaining Rental Payments	<u>1,276,633</u>
Total Consideration	2,176,633
Original Purchase Price	<u>1,909,917</u>
Gain	266,716

¹Pursuant to paragraph 4.2 of the Agreement, this Promissory Note was to be secured by 57th Street Realty Corp.'s provision of a letter of credit in favor of petitioner.

10% Tax

26,671.60"

The letter also explained the basis for the denial as follows:

"Section 590.31 of the New York State Transfer Gains Tax Regulations states that the consideration for the assignment of a lease is 'the amount received for such assignment. However, to apply the \$1,000,000 exemption and for purposes of filing requirements, the value of the remaining rental payments required to be made pursuant to the terms of the lease must be added to the consideration for the assignment.'

*Pursuant to Section 4.1 of the purchase agreement, the total purchase price is \$900,000, without interest. Section 590.12 of the New York State Transfer Gains Tax Regulations states that where the price paid for real property is in the form of cash and a mortgage, the consideration is the 'sum of the cash and the face amount of the mortgage'." (Emphasis as in original.)

OPINION

The Administrative Law Judge determined that the assignment of the leasehold was a transfer subject to the gains tax imposed by Article 31-B of the Tax Law and that the consideration for the transfer was the cash received, the face amount of the \$800,000 note and the present value of the remaining rental payments (discounted at a rate of 10%). The Administrative Law Judge determined the total consideration for the transfer to be \$1,715,964.00, computed as follows:

Amount of assignment (cash)	\$ 100,000.00
(note)	800,000.00
Value of remaining rental payments	<u>815,964.00</u>
	\$1,715,964.00

The Administrative Law Judge then concluded that no tax was due on the transfer because, relying on the Division's letter of November 6, 1986, petitioner had an original purchase price of \$1,909,917 in the leasehold. Since petitioner's original purchase price exceeded the consideration, the Administrative Law Judge concluded petitioner had no gain on the transfer.

The Division of Taxation has taken exception to the Administrative Law Judge's conclusion that there was no gain on the transfer, asserting that the Administrative Law Judge erred in not reducing the original purchase price of \$1,909,917. The Division contends that since the Administrative Law Judge recomputed the consideration by reducing the rental payments from their full value of \$1,276,633, as originally calculated by the Division, to a present value of \$815,964, utilizing a 10% discount factor, the original purchase price should have been similarly reduced.

The petitioner responds acknowledging that the original purchase price of \$1,909,917 included the rental payments at their face value of \$1,276,633, but argues that this calculation is correct.

We modify the determination of the Administrative Law Judge.

Section 1443.1(c) of the Tax Law provides that in the case of a lease assignment the value of the remaining rental payments is to be included in consideration only for purposes of applying the \$1 million exemption (see also, 20 NYCRR 590.31). Thus, the value of the remaining rental payments is taken into account only to determine if the transfer meets the \$1 million threshold. The value is not taken into account for purposes of calculating the gain on the transfer, either in consideration or original purchase price.

In the instant case, the Division achieved the result of eliminating the value of the rental payments from the calculation of gain by treating the value of the lease payments as if it was an element of the original purchase price of the lease assignment, although technically it is not (Tax Law { 1440.5). Since the Division treated the value of the lease payments as an element of original purchase price only to offset its inclusion as part of the consideration paid to acquire the interest in real property, obviously the amount included in the original purchase price must equal the amount included in consideration. Since the Administrative Law Judge reduced the value of the rental payments included in consideration by \$460,669 (from \$1,276,633 to \$815,964), we conclude that the original purchase price of \$1,909,917 must similarly be reduced by \$460,669 to \$1,449,248. Petitioner's tax is then properly calculated as follows:

Total consideration	\$1,715,964.00
Total original purchase price	<u>1,449,248.00</u>
Gain	266,716.00
Tax	26,671.60

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the Division of Taxation is granted;
2. The determination of the Administrative Law Judge is modified by reducing the original purchase price used to determine gain to \$1,449,248.00, finding a gain of \$266,716.00, and a gains tax due of \$26,671.60; and

3. The petition of Festival Leasehold Co. is denied and the Division of Taxation's denial of the refund claim is sustained.

Dated: Albany, New York
January 20, 1989

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

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