STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
470 NEWPORT ASSOCIATES	:	DECISION DTA No. 804485
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.	:	

Petitioner 470 Newport Associates, 66 Commack Road, Suite 300, Commack, New York 11725, filed an exception to the determination of the Administrative Law Judge issued on October 8, 1992. Petitioner appeared by Hutton & Solomon (Kenneth I. Moore and Stephen L. Solomon, Esqs., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Kenneth J. Schultz, Esq., of counsel).

Petitioner filed a brief in support of its exception. The Division of Taxation filed a letter in lieu of a brief in response. By letter received on January 19, 1993, petitioner informed the Secretary to the Tax Appeals Tribunal that no reply brief would be filed. This date began the six-month period for the issuance of this decision. On April 8, 1993, the six-month period was tolled in order to allow petitioner time to file a supplemental brief. By letter dated June 17, 1993, the parties were informed that no more briefs were due and the six-month time period to issue this decision resumed to run. Petitioner's request for oral argument was denied.

The Tax Appeals Tribunal renders the following decision per curiam.

ISSUES

I. Whether, for purposes of gains tax, the "original purchase price" of the stock acquired by petitioner in exchange for the real property at 470-480 Halstead Avenue prior to March 28, 1983 is (i) the fair market value of the property at the date of its transfer to the cooperative

corporation on November 10, 1982, or (ii) the purchase price of such property when acquired by petitioner on September 15, 1976, as adjusted.

II. Whether the Division of Taxation properly allocated pro rata the value of a mortgage assumed by the cooperative corporation in exchange for the property, among all tenant-shareholders upon the subsequent sale of stock.

III. Whether penalties for failure to pay gains tax should be abated.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

On January 20, 1987, following an audit of the cooperative conversion of property located at 470-480 Halstead Avenue, Harrison, New York, the Division of Taxation ("Division") issued to petitioner, 470 Newport Associates ("the sponsor"), a Notice of Determination of Tax Due under Gains Tax Law assessing total tax due in the amount of $445,581.00, penalty of $72,634.00 and interest of $40,174.00, for a total amount due of $558,389.00. The notice also reflected amounts paid of $479,417.00 leaving a balance due of $78,972.00.

Petitioner, a New York limited partnership, purchased the property located at 470-480 Halstead Avenue (the "Property") on September 15, 1976 for $5,750,000.00.

On May 10, 1981, petitioner entered into an agreement as a realty transferor to sell the Property to 470 Owners Corp., a cooperative housing corporation ("CHC"), which had been incorporated under the laws of the State of New York on April 14, 1981. A cooperative conversion plan was submitted to the Attorney General's Office for approval. The sale of the Property from petitioner to the CHC pursuant to the agreement of May 10, 1981 was closed on November 10, 1982.

In exchange for a fee interest in the property, petitioner received various consideration valued at $15,773,302.20, which was comprised of the following:

Cash	$ 2,171,100.00
Unsold shares of the CHC	6,935,162.57
Mortgages to which the Property was subject	6,667,039.63
	$15,773,302.20

The audit summary and other pertinent documentation submitted into evidence established that the plan to convert the Property to cooperative ownership involved an offering of 140,030 shares, after various amendments, of which 55,295 shares were sold prior to March 29, 1983 and therefore considered "grandfathered". Thus, the total number of shares subject to tax was 84,735. The notice of determination represents real property gains tax assessed upon the sale of 45,695 shares of the cooperative corporation sold by petitioner between March 29, 1983 and the time of the audit. The 45,695 shares upon which the additional tax is assessed represents 32.63% (45,695 divided by 140,030) of the total offering plan. The mortgage indebtedness component of consideration received by petitioner from the CHC and the original purchase price ("OPP") are allocated to the shares being taxed in accordance with such percentage. The tax assessed was computed as follows:

Estimated consideration (per audit)	$4,832,602
Mortgage indebtedness 6,700,000 x 32.63%	2,186,405
Gross consideration	7,019,007
Less: brokerage fees	481,797
	6,537,210
Less: OPP:	
Acquisition Cost	$5,750,000
Acquisition Expenses	35,617
Capital Improvements	379,418
Co-oping Expenses	153,365
Total OPP	$6,318,400
	x 32.63%
	2,061,883
Gain on shares - taxed per audit	$4,455,827
Tax due @ 10%	445,583
Penalty	72,634
Interest	40,174
Total due	558,391

Amount paid	479,417
Balance Due	$ 78,974

The total mortgage indebtedness assumed by the CHC was divided by the total number of shares per the cooperative offering plan, as amended, to arrive at the mortgage indebtedness per share. Using this calculation, the auditor allocated $47.85 of assumed mortgage debt to each share.

Petitioner's position utilizes as unallocated OPP the consideration received upon transfer of the property to the CHC. Petitioner requests a refund of $479,417.00 (the entire amount of tax it has paid), premised upon a computation of "gain" as follows:

Estimated consideration (per audit)	$ 4,832,602
Less: brokerage	481,797
	4,350,805
Less: OPP ($15,773,302 x 32.63%)	5,146,828
Gain on shares	-0-

Tax due @ 10%	-0-
Penalty	-0-
Interest	-0-
Total due	-0-
Amount paid	479,417
Overpayment	$ 479,417

One of the issues in this case involves the sale of a cooperative unit referred to as 480-6J. Introduced into evidence was a document entitled "Application for Non-Binding Apartment Reservation", dated March 26, 1983. It indicates that petitioner was in receipt of a deposit which reserved for the prospective purchaser an apartment for 30 days, after which a binding purchase agreement would be signed and a down payment made toward the purchase if the purchaser chose to complete the transaction. The application also contained the following declaration:

> "Reservation Deposit to be held in GWFAT 470 SPECIAL ACCOUNT in trust until returned or applied as set forth in Offering Plan for the cooperative. The Apartment Reservation Deposit shall be refunded in full, without interest, on demand, at any time before Purchaser executes a binding Purchase Agreement and upon return of the Offering Plan. Sponsor reserves the right to return said deposit at the expiration of the Reservation Period. In any event, the Apartment

> Reservation Deposit shall be returned no later than 30 days after the date hereof should Purchaser not execute a binding Purchase Agreement. Pursuant to the requirements of governmental authorities having jurisdiction, a Purchase Agreement for the sale and purchase of shares of a cooperative apartment may not be executed and exchanged between a Selling Agent and Prospective Purchaser until after the Prospective Purchaser has had not less than 72 hours to review the Cooperative Offering Plan." (Emphasis supplied.)

The sale of apartment 480-6J took place on May 10, 1983. The Division asserts that the sale effectively took place after March 26, 1983 and should therefore be subject to gains tax. The calculation of the tax by the Division was as follows:

Consideration	$52,800
Mortgage Indebtedness (550 shares x $47.85)	26,318
Gross Consideration	$78,118[1]
Less: Sales Commission	$ 3,168
Conversion Fee	2,466
Capital Improvement (550 shares x $45.12)	24,816
	30,450
Taxable Profit	$47,668
Tax @ 10%	$ 4,767
Interest	1,573
Total	$ 6,340

OPINION

The Administrative Law Judge determined that petitioner was not entitled to an OPP based on the transfer from the sponsor to the CHC (a "stepped up" OPP) because this result required that a cooperative conversion be treated for gains tax purposes as two separate transfers. The Administrative Law Judge noted that this two transfer analysis had already been rejected in Mayblum v. Chu (67 NY2d 1008, 503 NYS2d 316), Matter of Birchwood Assocs. (Tax Appeals Tribunal, July 27, 1989) and Matter of Normandy Assocs. (Tax Appeals Tribunal, March 23, 1989). The Administrative Law Judge rejected petitioner's argument that cooperative corporations had to be treated the same as other corporations, finding that the Legislature chose to treat the corporations differently and that under Trump v. Chu (65 NY2d 20, 489 NYS2d 455, 459, appeal dismissed 474 US 915), such differences in treatment were

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[1] This amount should be $79,118.00.

authorized so long as not "palpably arbitrary" or amounting to "invidious discrimination." Next, the Administrative Law Judge held that it was not unreasonable for the Division to treat a "bargain lease" (a lease providing for rent below fair market value) that was created prior to the effective date of the gains tax differently from a mortgage that was created prior to the effective date of the gains tax. The Administrative Law Judge noted that it was the Division's policy to make a pro rata apportionment of such a mortgage to each share in the CHC and, thus, to include in consideration the portion attributable to nongrandfathered sales. In contrast, the Administrative Law Judge pointed out, the Division excludes the entire value of the pre-gains tax bargain lease from consideration. The Administrative Law Judge concluded that this difference in treatment was reasonable because the two types of encumbrances were different, i.e., a mortgage encumbered each individual unit, but the bargain lease did not. The Administrative Law Judge also concluded that petitioner was not entitled to the grandfather exemption with respect to Unit 480-6J because petitioner failed to show that a binding contract to sell the unit had been entered into prior to the effective date of the gains tax. Finally, the Administrative Law Judge determined that petitioner had not shown that penalty should be abated. The Administrative Law Judge noted that petitioner maintained an interpretation of the gains tax contrary to the articulated position of the Division and, relying on Matter of Auerbach v. State Tax Commn. (Sup Ct, Albany County, July 7, 1987, Williams, J., affd 142 AD2d 390, 536 NYS2d 557), held that the abatement of penalty was not appropriate in such circumstances.

On exception, petitioner argues that the Division must use the fair market value of the property on the date it was sold by petitioner to the CHC to compute the OPP of the shares sold after March 28, 1983 (i.e., "step up" the OPP) because it is the Division's practice to do so in the case of transfers to entities other than CHCs that occurred prior to the effective date of the gains tax. Similarly, petitioner asserts that there is no basis in law for the Division to treat a bargain lease created prior to the effective date of the gains tax differently for purposes of calculating consideration than a mortgage placed on the property prior to such date. Petitioner contends that the Division's policies constitute discrimination violative of both the United States and

New York State Constitutions. With respect to the penalty, petitioner argues that it should be abated because the underpayment was not due to willful neglect and that no case has yet addressed the issue raised by petitioner.

In response, the Division states "[s]ince Petitioner's Exception Brief contains the same arguments which were properly rejected by the Administrative Law Judge, the Division of Taxation will rely on the ALJ determination in support of its position" (Division's letter in opposition).

We affirm the determination of the Administrative Law Judge.

First, we agree with the Administrative Law Judge that petitioner's argument with respect to a stepped up OPP for the CHC is in direct conflict with the principle that for purposes of the imposition of the gains tax a cooperative conversion is treated as if it were a single transfer (Mayblum v. Chu, supra; Matter of 1230 Park Assocs. v. Commissioner of Taxation & Fin., 170 AD2d 842, 566 NYS2d 957, lv denied 78 NY2d 859, 575 NYS2d 455; Matter of 61 East 86th St. Equities Group, Tax Appeals Tribunal, January 21, 1993; Matter of Birchwood Assocs., supra; Matter of Normandy Assocs., supra). Although only two of these cases, Birchwood Assocs. and Normandy Assocs., involved facts where the real property was, as here, transferred to the CHC prior to the enactment of the gains tax, all of these cases are applicable because whether the real property was transferred to the CHC prior to March 28, 1983 has no significance for gains tax purposes. This rule was established in Mayblum v. Chu (supra) when the Court of Appeals held that the transfer to the CHC was not the taxable event and that a pre-March 28, 1983 contract to transfer real property to a CHC did not exempt the conversion from the gains tax.

Petitioner seeks to dismiss this body of case law by arguing that the cases have not addressed the denial of equal treatment argument it advances here. In Matter of 61 East 86th St. Equities Group (supra), we addressed a similar challenge, i.e., that there was no statutory support for treating CHCs differently from non-cooperative corporations. We rejected this claim, stating:

> "[a]s we noted in 1230 Park, Article 31-B has a number of provisions that single out transfers pursuant to a cooperative or condominium

> plan for treatment different from that applied to other types of transfers. In our view, these provisions, contained in former sections 1440(7), 1442, and section 1443(6), provide ample support for the Division's decision to tax transfers pursuant to a cooperative plan like transfers pursuant to a condominium plan and, as a result, to treat cooperative corporations differently from non-cooperative corporations" (Matter of 61 East 86th St. Equities Group, supra).

This legislative decision to treat cooperative corporations differently from other entities:

> "enjoys a presumption of constitutionality which 'can be overcome only by the most explicit demonstration that [the] classification is a hostile and oppressive discrimination against particular persons and classes. The burden is on the one attacking the legislative arrangement to negative every conceivable basis which might support it' (citations omitted)" (Trump v. Chu, supra, 489 NYS2d 455, 458-459).

Petitioner has made no such showing and its burden seems even more onerous here, as the Court of Appeals in Trump has already sustained the different gains tax treatment of cooperative and condominium developments compared to subdivided improved realty.

Turning to the mortgage allocation issue, the Court in 1230 Park sustained the same method of allocation as employed here. Although the mortgage in 1230 Park was placed on the property after the effective date of the gains tax, we believe that this difference also has no significance because the creation of the mortgage is not the taxable transfer (Tax Law § 1440[7]). The mortgage is treated only as consideration and, for both mortgages created before and after the effective date of the gains tax, only the portion of the mortgage allocated to the shares sold after the effective date of the tax, pursuant to contracts entered into after such date, are included in the calculation of the tax. As the Administrative Law Judge noted in Matter of Birchwood Assocs. (supra), we sustained the application of this method of allocation where the mortgage had been placed on the property prior to the effective date of the gains tax.

With respect to petitioner's argument that the Division must treat the pre-gains tax mortgage the same as a pre-gains tax bargain lease, we do not find this argument persuasive because, contrary to petitioner's arguments, we do not find the two to be identical types of encumbrances. Obviously, a lease is significantly different from a mortgage. Among the differences, as noted by the Administrative Law Judge, is the fact that a mortgage encumbers each individual unit, while a lease does not. Petitioner has not sustained its burden to show that the differences

between a lease and a mortgage do not warrant the different treatment accorded them by the Division.

Even if petitioner had shown that a bargain lease and a mortgage must be treated the same, petitioner has not even attempted to show why the mortgage treatment should be conformed to the bargain lease, rather than vice versa. Petitioner acknowledges that a bargain lease created after March 28, 1983 and a mortgage created after such date are treated the same, i.e., the consideration attributable to each of them is presumed to be related to all the shares of stock in the CHC (Petitioner's brief on exception, p. 20). Against this background, it appears to us that the rule that is out of harmony is the rule that the consideration of a pre-gains tax bargain lease is allocated entirely to shares sold before the effective date of the tax. Thus, if petitioner had convinced us that a mortgage and a bargain lease had to be treated the same, it would seem more reasonable to us to conclude that the lease should be treated as the mortgage is, i.e., allocated to all the shares.

Finally, in order to have penalty abated, petitioner must show both that the failure to pay was due to reasonable cause and was not due to willful neglect (Tax Law § 1446[2][a]). Even if, as claimed by petitioner, its failure to pay was not due to willful neglect, petitioner has not established that the failure was due to reasonable cause (see, Matter of 1230 Park Assocs. v. Commissioner of Taxation & Fin., supra). Therefore, we agree with the Administrative Law Judge that the penalty should be sustained.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of 470 Newport Associates is denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petition of 470 Newport Associates is denied; and

4. The Division of Taxation's denial of the claim for refund of real property transfer gains tax is sustained.

DATED: Troy, New York
September 2, 1993

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

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