STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
OLD FARM LAKE COMPANY	:	DECISION DTA No. 807058
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 Old Farm Lake Company, 1075 Central Park Avenue, Scarsdale, New York 10583 filed an exception to the determination of the Administrative Law Judge issued on October 10, 1991 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. Petitioner appeared by Winick & Rich, P.C. (Richard I. Bier, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Paul A. Lefebvre, Esq., of counsel).

Petitioner did not submit a brief on exception. The Division of Taxation filed a letter in lieu of a brief in response to petitioner's exception. Oral argument was not requested.

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

ISSUE

Whether the Division of Taxation, in computing the total consideration received with respect to petitioner's transfer of certain real property, properly determined that a promissory note, which formed a portion of such consideration, should be valued at the face amount of the note even though it was non-interest-bearing and was not secured by a mortgage upon the property in question.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge and make additional findings of fact. The Administrative Law Judge's findings of fact and the additional findings of fact are set forth below.

On January 30, 1991, the representatives for petitioner, Old Farm Lake Company ("OFLC"), and for the Division of Taxation entered into a written stipulation, the contents of which are set forth below. Paragraph "10" of the stipulation refers to the documents which were to be submitted intoevidence at the hearing. With the exception of OFLC's power of attorney, these were the only documents presented and accepted into evidence. Paragraph "11" of the stipulation reserved the rights of the parties to provide the Administrative Law Judge with legal briefs and oral arguments concerning the issue to be considered herein. The contents of paragraphs "10" and "11" are not, therefore, hereinafter set forth.

OFLC sold certain real property (a portion of a condominium development which included the recreational facilities) located in the Town of New Castle, County of Westchester, State of New York to Old Farm Lake Community Association, Inc. ("OFLCAI") in December 1987 for the sum of $500,000.00. (Apparently, the condominium units were sold in separate transactions.)

The purchase price consisted of a non-interest-bearing promissory note ("Note") with a face value of $500,000.00 and a term not to exceed 15 years.

We find an additional finding of fact to read as follows:

> A portion of the promissory note, $47,400.00 of the $500,000.00 total, was paid to OFLC, in the form of a cash payment, at the time of closing. Thus, the total amount of the purchase price deferred by the promissory note was $452,600.00.

Pursuant to its terms, the Note was to be paid in installments equal to the product of $300.00 and the number of members in OFLCAI, other than OFLC, existing on such payment date as follows:

a. the first installment was payable at the closing held in December 1987;

b. thereafter, annual installments were to be payable on each anniversary date of the Note (December 1, 1987) until the earliest of (i) the date on which the Note was paid in full, or (ii) the date on which the sixteenth installment was paid; and

c. any unpaid balance remaining after the sixteenth installment would be forgiven.

We find an additional finding of fact to read as follows:

> The first installment referred to in "a" above consisted of the $47,400.00 mentioned in the additional finding of fact above.

Payment of all obligations of OFLCAI under the Note were partially guaranteed by Old Farm Lake III Condominium pursuant to a limited guaranty dated December 2, 1987. Old Farm Lake I Condominium and Old Farm Lake II Condominium were also requested to execute guarantees but did not do so.

We make additional findings of fact to read as follows:

> The guarantee signed by Old Farm Lake III Condominium (hereinafter "OFL III") was in the nature of a written promise to pay the amount owed by OFLCAI to OFLC if OFLCAI defaulted, but only to the extent of OFL III's proportionate share of OFLCAI's liability, namely, the amount owed on 40 of the 177 condominiums involved in the transfer. As no other guarantees for the promissory note were executed, the note was only guaranteed to a maximum of 23% of the total $500,000.00 owed by OFLCAI. The guarantee signed by OFL III was not, in turn, secured by a mortgage, purchase money mortgage, lien, or other encumbrance.

The Note was unsecured, i.e., it was not secured by a mortgage upon the real property subject to the sale.

In July 1987, OFLC submitted to the New York State Department of Taxation and Finance a Form TP-580, Transferor Questionnaire, and a Form TP-581, Transferee Questionnaire. The transferor questionnaire set forth the consideration to be paid and the anticipated New York State real property transfer gains tax ("gains tax"). On the TP-580 and TP-581, OFLC valued the Note in the amount of $299,463.53.

OFLC arrived at the figure of $299,463.53 as the value of the Note by using a computation contained within Internal Revenue Code § 483 regarding imputed interest to ascertain the then present fair market value of the Note. OFLC used a discount rate of 10.45 percent, which is 120

percent of the applicable Federal long-term rate in effect in June 1987. This figure has not been verified by the Division of Taxation. The parties herein agree that, if OFLC prevails in this proceeding, this matter shall be remanded to the Division of Taxation for verification of the payments made pursuant to the terms of the Note and for verification of the computation which OFLC utilized to arrive at the amount of the refund claimed.

On October 14, 1987, the Division of Taxation issued a Tentative Assessment and Return which valued the Note at its face value of $500,000.00, resulting in an assessment of gains tax in the amount of $50,000.00.

On December 1, 1987, OFLC filed a Supplemental Return (Form TP-583) along with the Tentative Assessment and Return (see, above) prepared by the Division. OFLC paid the sum of $25,000.00 (50 percent of the tax due) upon closing of the property on December 10, 1987 with the balance to be paid on a deferred basis.

On May 9, 1988, OFLC filed a Claim for Refund of Real Property Transfer Gains Tax (Form TP-165.8). By letter to OFLC dated July 13, 1988, the Division of Taxation denied the claim for refund in its entirety. This letter stated, in pertinent part, as follows:

> "The basis of the claim is that in computing your project [sic] tax the department valued the 15 year promissory note that was given in full payment of the purchase price at its face value of $500,000. The claimant feels we should have used a discounted value of $299,436.53, which would have resulted in lower tax.
>
> Section 590.12 of the New York State Transfer Gains Tax Regulations provides that in a case where the price paid for the interest in real property is in the form of cash and a purchase money mortgage, the consideration is 'the sum of the cash and the face amount of the mortgage taken back by the transferor'."

OPINION

The Administrative Law Judge determined that the promissory note in question was properly valued by the Division of Taxation (hereinafter the "Division") at its face amount of $500,000.00, in accordance with this Tribunal's rulings in Matter of Normandy Assocs. (Tax Appeals Tribunal, March 23, 1989) and Matter of Festival Leasehold Co. (Tax Appeals Tribunal, January 20, 1989), the latter of which the Administrative Law Judge cites for the proposition that

a non-interest-bearing promissory note secured by (what appears to be) no more than a letter of credit is factored into "consideration" at its face amount. The Administrative Law Judge concluded that, just as the letter of credit was treated as equivalent to a mortgage for gains tax purposes in Festival Leasehold, the guarantee on the note at hand should cause the note to be treated as a mortgage, to be valued at face amount. Further, the Administrative Law Judge rationalized that the note at hand served the same purpose as a mortgage in that it was a loan which enabled the transfer to occur.

On exception, petitioner challenges the logic of the Division's interpretation of "consideration" as defined in the gains tax statute, claiming that the Division "stubbornly clings to the technical wording of the statute" (Tax Law § 1440[1][a]), valuing mortgages at their face amount rather than present value (petitioner's exception). Petitioner argues, in effect, that economic reality dictates that money today is worth less tomorrow and that, therefore, it is irrational to treat the amount printed on a non-interest-bearing promissory note today as if it represented the true value of the note. Petitioner asserts that the Internal Revenue Code, in gains situations, has consistently calculated tax liability using the discount or present value, rather than the face amount, of non-interest-bearing unsecured promissory notes received as partial payment for the property sold (citing 26 USC § 483). In the alternative, petitioner maintains that even if the statute has been correctly interpreted by the Division and the Administrative Law Judge, the note in question is an unsecured promissory note, not a "mortgage," and it cannot be treated as a mortgage for tax purposes.

We note that rather than launch a substantive challenge to the use (by the Administrative Law Judge and the Division) of Festival Leasehold as precedent on this last point, petitioner's representative challenged the value of the review process (noting in his correspondence to the Administrative Law Judge dated April 12, 1991, "[w]e feel we are merely going through the motions of exhausting our remedies as required under applicable law"), reminding the Administrative Law Judge that "justice delayed is justice denied" (supra), and urged this Tribunal to "expedite [our] decision . . . in order to minimize any additional delay" since the

Tribunal would, apparently, be "bound to follow the decisions cited by the Division . . . " (petitioner's exception, cover letter).

In response, the Division asks that the determination of the Administrative Law Judge be sustained in its entirety, finding that the Administrative Law Judge "correctly applied" the decisions cited above (Division's letter brief, p. 1), and apparently agreeing with the Administrative Law Judge's treatment of the note as a mortgage. The Division finds further support for its position in the legislative history of Article 31-B of the Tax Law, which the Division claims manifests a "clear . . . intent to eliminate the requirement of present valuing instruments," as language referring to present valuations was specifically struck from the bill before it was passed (Division's letter brief, p. 2, citation omitted). Finally, the Division urges, the fact that the word "mortgage" is listed along with the words "lien or other encumbrance" in the definition of "consideration" is evidence of the Legislature's intent to value mortgages at face amount because neither liens nor encumbrances are of an interest bearing nature and, therefore, could not be factored into consideration at present value.

We reverse the determination of the Administrative Law Judge.

Under the New York State gains tax, a transferor of real property within the State is taxed at the rate of 10% on the gain of such transfer, or "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 §§ 1141 and 1140[3], emphasis added). Tax Law § 1140(1)(a) defines "consideration" as: "[t]he price paid or required to be paid for real property . . . whether expressed in a deed and whether paid or required to be paid by money, property, or any other thing of value and including the amount of any mortgage, purchase money mortgage, lien or other encumbrance . . . ."

The consideration paid by OFLCAI to petitioner/transferor OFLC consisted of a non-interest-bearing promissory note for $500,000.00 -- $47,400.00 of which was paid at the time of closing. Despite the Administrative Law Judge's treatment throughout his determination of the note at the total original amount of $500,000.00, we find it necessary for gains tax purposes to

distinguish between the amount paid outright and the amount deferred. Thus, in calculating the amount of consideration received by petitioner on the transfer, $47,400.00 would be factored in at its full amount. The question we face is, how is the remainder of the note, the $452,600.00 balance, to be factored into the consideration.

The Administrative Law Judge likened the note to a mortgage and, therefore, valued the note at its face amount, or $500,000.00. While we agree with the Administrative Law Judge's reliance upon Matter of Normandy Assocs. (supra) for the proposition that Tax Law § 1440(1)(a) includes as consideration mortgages, purchase money mortgages, liens, or other encumbrances at their face amount rather than at present value, we do not agree with the Administrative Law Judge's treatment of the promissory note as if it were a "mortgage." Our decision in Normandy Assocs. that mortgages are to be included in consideration at their face amount was founded upon the specific language in section 1440(1)(a) that defines consideration to include "the amount of any mortgage, purchase money mortgage, lien or other encumbrance . . . " (emphasis added).[1] Thus, to be within the holding of Normandy Assocs., the instant instrument would have to fit within this specific statutory phrase (see also, 20 NYCRR 590.15[a]). As mentioned in our additional findings of fact, the note here was guaranteed to 23% of the original $500,000.00 by the written promise of OFL III. Yet, we do not find this "promise of payment" guarantee to be included in the type of security implicit in the terms "mortgage, purchase money mortgage, lien or other encumbrance," each of which connotes recourse to tangible assets. The guarantee at hand is no more than a written promise to pay by OFL III which is not further secured by anything tangible.

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[1]The legislative history cited by the Division confirms our interpretation that mortgages are to be included in consideration at their face amount, rather than their value. The Division points out that Article 31-A, which was enacted in 1981 and repealed in 1982, served as a model for Article 31-B (Division's letter on exception). Article 31-B included as consideration a purchase money mortgage, but specifically provided "that the value of any such mortgage shall be the value thereof if such mortgage were sold to a willing buyer from a willing seller at arm's length on the date of the giving of such purchase money mortage" (Tax Law former § 1440[3]). As enacted, Article 31-B dropped this market value provision and substituted the language "including the amount of any mortgage, purchase money mortgage, lien or other encumbrance . . . ." (Tax Law § 1440[1][a]). Although we agree with the Division that this change indicates that the Legislature intended that mortgages, particularly purchase money mortgages, be included in consideration at their face amount, rather than at their market value, we see nothing in this change to support the Division's contention that the Legislature intended all instruments to be included at their face amount.

Further, we find misplaced the Administrative Law Judge's reliance on Matter of Festival Leasehold Co. (supra) to support his decision to treat the promissory note as a mortgage. Although in Festival Leasehold the note which was ultimately factored into the consideration at face amount was non-interest-bearing and was secured by a letter of credit, the issue of the valuation of that note was not before this Tribunal in that case. Since the issue was not directly addressed by the Tribunal's decision in Festival Leasehold, that decision is not precedential on this point (see, Matter of Velez v. Division of Taxation, 152 AD2d 87, 547 NYS2d 444). Further, it is not certain from the facts in Festival Leasehold that the note was not secured by a mortgage. The facts are silent as to the existence of a mortgage.

Since the instant note is not a "mortgage, purchase money mortgage, lien or other encumbrance," it is included in the definition of consideration as "any other thing of value" (Tax Law § 1440[1][a]; 20 NYCRR 590.15). Accordingly, we conclude that the actual value of the note is the consideration and we remand this matter to the Division, according to the agreement of the parties, for verification of the payments made pursuant to the note and of the computation that OFLC utilized to determine the amount of the refund claimed.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of petitioner Old Farm Lake Company is granted to the extent that this matter is remanded to the Division of Taxation to verify petitioner's calculation of the refund claimed;

2. The determination of the Administrative Law Judge is reversed;

3. The petition of Old Farm Lake Company is granted to the extent outlined in paragraph "1" above; and

4. The Division of Taxation is directed to verify petitioner's calculation of the refund claimed according to the agreement of the parties.

DATED: Troy, New York
April 2, 1992

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

/s/Maria T. Jones
Maria T. Jones
Commissioner