STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
RIVER TERRACE ASSOCIATES	:	DECISION DTA No. 807404
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 River Terrace Associates, c/o Blundon Thylan Associates, 369 Lexington Avenue, New York, New York 10017 filed an exception to the determination of the Administrative Law Judge issued on December 12, 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 Graubard, Mollen, Horowitz, Pomeranz & Shapiro, Esqs. (Allen Greenberg, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Michael J. Glannon, Esq., of counsel).

Petitioner filed a brief on exception. The Division of Taxation filed a brief in response. Oral argument, requested by petitioner, was denied.

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

ISSUES

I. Whether petitioner correctly calculated its consideration using the value of a mortgage rather than its face amount.

II. Whether reasonable cause exists to abate or waive the penalty and interest imposed by the Division of Taxation for petitioner's failure to pay the additional real property gains tax due on subsequent sales of stock in the cooperative corporation in a timely manner.

FINDINGS OF FACT

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

In April of 1982 petitioner, River Terrace Associates, a limited partnership formed under New York law, purchased a two-story building containing 103 rental apartments and one superintendent's apartment located at 150 Rinaldi Boulevard, Poughkeepsie, New York, for $1,700,000.00.

In 1983, petitioner engaged the law firm of Phillips, Nizer, Benjamin, Krim & Ballon to file necessary and appropriate papers with the New York State Department of Law for the cooperative conversion of the apartment house under the sponsorship of petitioner. Petitioner caused the Hudson Terrace Owners Corporation ("Owners Corp.") to be organized and petitioner entered into a contract to sell the apartment house to Owners Corp. under a plan of cooperative conversion to be filed with the Attorney General's office.

Petitioner made capital improvements to the property in preparation for its sale to Owners Corp.

About the time when petitioner thought it was to receive final approval of the offering plan, petitioner approached various financial institutions in an attempt to determine the cash realizable on the sale of the purchase money mortgage it knew it would have to take back from Owners Corp. in partial satisfaction of the selling price. The Connecticut Bank and Trust Company, N.A., by letter dated July 26, 1984, advised petitioner that it would not consider purchasing the 2 million dollar first mortgage from River Terrace Associates for more than $1,158,242.00.

Pursuant to an offering plan of cooperative organization (the "plan"), petitioner sold the apartment house on August 17, 1984, to Owners Corp. for an expressed purchase price of $6,302,223.50.

Pursuant to the plan, a total of 14,000 shares of the Cooperative Corporation's capital stock was allocated to and among the 103 stockholder apartments.

At the closing of title on August 17, 1984, Owners Corp. issued shares of its capital stock and proprietary leases to 19 individuals who purchased apartments in consideration of $783,880.50 cash to Owners Corp. Owners Corp. paid the $783,880.50 to petitioner in part payment of the purchase price. Owners Corp. issued the remaining shares of its capital stock allocated to the 84 unsold apartments to petitioner at the aggregate offering price listed in the plan of $3,518,343.00, in further part payment of the purchase price.

On August 17, 1984, the subject property at 150 Rinaldi Boulevard, Poughkeepsie, New York, was subject to a first and second mortgage indebtedness in the unpaid principal amount of $1,123,826.82. Owners Corp. purchased the apartment house subject to this existing indebtedness.

In payment of the $876,173.18 balance of the purchase price, Owners Corp. delivered to petitioner its third mortgage.

Petitioner purchased the first and second mortgages from the holders thereof and consolidated these two preexisting mortgages with its third mortgage into one mortgage securing the principal sum of $2,000,000.00. The consolidated mortgage was due and payable on August 17, 1994. Interest on the consolidated mortgage was payable at the rate of 8% per annum, or $13,333.33 per month. The three mortgages were consolidated pursuant to a consolidation, modification and extension agreement, dated August 17, 1984, executed by officers of Hudson Terrace Owners Corp. and River Terrace Associates.

Prior to the date of the closing of sale by petitioner to Owners Corp., petitioner, through its attorneys, filed with the Division of Taxation (hereinafter the "Division") a Gains Tax Transferor Questionnaire, Form TP-580, and Tentative Assessment and Return, Form TP-582.

On August 17, 1984, the date of closing, petitioner remitted a certified check to the New York State Department of Taxation and Finance in the sum of $19,021.30 in payment of real property gains tax on the 17 units which had closed as of August 17, 1984.

Next to the signature on the face of said check, was the handwritten notation "paid under protest." On the reverse side of said check, the following handwritten notation appeared:

> "Paid under protest
> the payer reserving all rights inuring to its benefit as a result of any
> pending and/or future matters attacking the right of the State of
> New York to collect such proceeds."

In Schedule 3 attached to the paper submitted to the Division with the $19,021.20 check referred to above, petitioner noted that it had added to its anticipated costs in connection with the cooperative conversion, an $843,000.00 reduction in the aggregate proceeds it would receive from the sale of the Owners Corp. stock by reason of the discount it would have to take on a sale of the mortgage. Petitioner computed the $843,000.00 reduction by comparing the Connecticut Bank's evaluation of approximately 1.158 million dollars against the two million dollar mortgage principal sum.

Subsequent to August 17, 1984, and from time to time thereafter, petitioner sold the shares in remaining units at prices which at times were discounted at 20% of the offering prices listed in the plan.

On November 7, 1985, petitioner caused to be prepared revised computerized schedules estimating the real property gains tax due on the sale of the cooperative shares. The anticipated consideration for the project was computed with deductions for expenditures remaining to be incurred for cooperative conversion plan costs. The consolidated mortgage was discounted at 50% to one million dollars to arrive at its anticipated selling price. The estimated gains tax payable was computed to be $15,989.00, an amount less than the $19,021.30 paid to the Division with the first filing on August 17, 1984.

On June 27, 1986, petitioner sold the consolidated mortgage to Eastern Savings Bank, a federally chartered savings bank, pursuant to a whole loan sale and purchase agreement dated June 27, 1986 for the sum of $1,410,000.00.

During the year 1986, the Division conducted an audit of petitioner with regard to the cooperative conversion in issue. During the course of the audit, various schedules were prepared, including one in which "actual" and "anticipated" consideration was broken down. The anticipated consideration was the estimated consideration on sell-out after deduction of all pre-August 17, 1984 and post-August 17, 1984 plan conversion expenses. The Division valued the consolidated mortgage at 2 million dollars in arriving at the total anticipated gain, making no allowance for the discount of $590,000.00 incurred on the actual sale of the mortgage to Eastern Savings Bank.

The Division issued a Statement of Proposed Audit to petitioner on September 5, 1986, indicating gains tax due in the sum of $251,893.10, penalty of $65,492.00 and interest of $19,554.00, for a total amount due of $336,940.00.

Petitioner remitted an aggregate of $251,894.00 in additional real property gains tax to the Division by three checks, to wit:

Date of Checks	Amount
September 22, 1986	$100,000.00
September 29, 1986	75,000.00
September 26, 1989	76,894.00
Total	$251,894.00

On September 26, 1989, petitioner submitted a claim for refund of real property transfer gains tax in the sum of $59,000.00 and also sought an abatement of penalty and interest. Said claim for refund in the sum of $59,000.00 was based upon petitioner's contention that the face amount of the consolidated mortgage was improperly used by the Division in its calculation of anticipated gain under the cooperative plan, rather than the actual market value of the loan.

At hearing, an expert witness, Alfred Schimmel, a real estate appraiser and economic consultant, testified that, in his opinion, the fair market valuation of the consolidated mortgage calling for the payment of two million dollars on August 17, 1994 and bearing an interest rate of 8% payable monthly, was $1,276,837.00. Mr. Schimmel explained that in August of 1984, the

prime interest rate was 13% and that the United States was in an inflationary period. He stated that 10-year United States Treasury bonds, which had complete safety, yielded 12.83%, municipal grade A tax-exempt bonds yielded 10.03% and corporate, A-rated bonds yielded 13.38%. In view of these competing alternatives, investment sources and the risks involved in real estate mortgages, Mr. Schimmel testified that a holder of the consolidated mortgage would want to receive a 15% return on its investment. Discounting at 15% the right to receive $13,333.33 interest per month for 120 months and 2 million dollars at the end of 120 months, gave a present fair market value of $1,276,837.00 to the consolidated mortgage on August 17, 1984. In fact, the consolidated mortgage sold at a 14.25% discount rate, or $1,410,000.00, in 1986 because interest rates were lower in 1986 and there was a shorter time to maturity.

Following disagreement with the basic tax, penalties and interest assessed pursuant to the Statement of Proposed Audit on September 5, 1986, the Division issued to River Terrace Associates a Notice of Determination of Tax Due under Gains Tax Law, dated January 29, 1988, setting forth real property gains tax due in the amount of $270,915.00, penalty of $72,413.00 and interest of $29,586.00 for a total amount due of $372,914.00. The Notice of Determination indicated that $194,021.00 had been paid leaving a balance due of $178,893.00. It appears that penalty and interest were also assessed on tax paid on date of closing (see above).

OPINION

The Administrative Law Judge determined that, based on the express language of Tax Law former § 1440(1), the correct determination of consideration under the gains tax required the use of the face amount of the mortgage, not its value. The Administrative Law Judge also determined that petitioner's interpretation of the statute, without guidance from the Division, failed to demonstrate reasonable cause.

On exception, petitioner asserts that there are two sets of provisions for the calculation of consideration. The first is the general provision set out in Tax Law former § 1440(1), where consideration is meant to include "the amount of any mortgage, purchase money mortgage, lien

or other encumbrance . . . ." Petitioner argues that the second provision, meant to address the circumstances of a cooperative conversion, is set out in Tax Law former § 1442, which provides that "total consideration anticipated" is used to determine gains tax due. Basically, petitioner states that gains tax due on a cooperative conversion is based on anticipated proceeds from the sale of shares in the co-op, and that the Division allows the initial statement of anticipated proceeds to be modified to reflect changes in the value of the units being sold. Therefore, petitioner asserts, it is proper to include a change in the value of a mortgage when making a modification to the amount of anticipated proceeds. Petitioner finds this analysis to be not inconsistent with this Tribunal's decision in Matter of Normandy Assocs. (Tax Appeals Tribunal, March 23, 1989).

Alternatively, petitioner asserts that, pursuant to Tax Law § 1440(5), the reduction of the value of the mortgage should be considered a "customary, reasonable and necessary" expense which should be added to the original purchase price.

Petitioner also excepts to the conclusion of the Administrative Law Judge that it did not have reasonable cause for its interpretation of the law. Petitioner states that it: fully complied with the filing requirements; timely paid the tax due as calculated by petitioner; fully disclosed the position it was taking on determining the gains tax due; and paid the additional tax asserted by the Division. Petitioner asserts that these factors distinguish it from other taxpayers denied the abatement of penalties and interest and justify an abatement in this instance. Further, petitioner submits that recently enacted legislation (L 1992, ch 55, § 65) supports its assertion that reasonable cause has been demonstrated, as the amendment to section 1446 of the Tax Law allows for the waiver of penalties where substantial authority is shown for the tax treatment adopted, or where the tax treatment adopted was disclosed in pre-transfer audit filings. Petitioner takes the position that either of these criteria apply to its actions in this case and that, therefore, reasonable cause has been demonstrated.

In response, the Division states that Tax Law former § 1440(1) and Matter of Normandy Assocs. (supra) support the conclusion that the face amount of the mortgage is the amount to be considered when determining consideration. Further, the Division asserts that there is nothing inconsistent with the operation of the definition of consideration in Tax Law former § 1440(1) in conjunction with Tax Law former § 1442, and that the assignment of the mortgage for cash had nothing to do with the original acquisition of the property.

As to the reasonable cause issue, the Division agrees with the Administrative Law Judge's decision not to abate penalties and interest, and states that the new legislation which petitioner relies upon is inapplicable because: section 427(g) of the new legislation states that the amendments to section 1446 of the Tax Law are inapplicable when a determination has been issued by the Division of Tax Appeals; the language of section 427(g) implies that the amendment was meant to be a settlement device for the commissioner of taxation and finance; and section 427(g) requires interest to have been paid for section 65 to apply, something that has not been done in this case.

We affirm the determination of the Administrative Law Judge for the reasons set forth below.

Tax Law § 1441 imposes a tax at the rate of 10% upon gains derived from the transfer of real property within New York State. Tax Law § 1440(3) defines gain as:

> "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(1) states that:

> "In this article:
>
> "1. 'Consideration' means the price paid or required to be paid for real property or any interest therein, less any customary brokerage fees related to the transfer if paid by the transferor. Consideration includes any price paid or required to be paid, 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, lien, or other encumbrance, whether or not the

> underlying indebtedness is assumed, purchase money mortgage, or payment for an option" (emphasis added).

This issue has been previously addressed by the Tribunal in Matter of Normandy Assocs. (supra). In Normandy, we concluded that the interpretation of Tax Law § 1440(1)(a) (Tax Law former § 1440[1]) set forth by the Division, i.e., that the face amount of the mortgage, not the value, is considered when determining consideration, was proper based upon the wording of the statute (see also, Matter of Old Farm Lake Co., Tax Appeals Tribunal, April 2, 1992). This conclusion was based upon the fact that the Legislature used the term "amount" when defining a mortgage as consideration, but used "value" when defining lease payments as consideration later in the same section of the law, thus, distinguishing the application of the two concepts as they relate to the factors making up "consideration."

Petitioner states that its position is not inconsistent with the decision in Normandy, as the taxpayer in Normandy failed to prove that it received less consideration than originally anticipated, and failed to show that it had sold its mortgage and actually received less consideration. Basically, petitioner is attempting to distinguish Normandy from the instant case on factual and evidentiary differences, implying that it has gone the distance that the petitioner in Normandy had failed to go, thereby proving that the value of the mortgage is the proper element to be used in determining consideration. However, the statutory analysis of Tax Law § 1440(1)(a) (Tax Law former § 1440[1]) is the key point in Normandy, and this analysis and conclusion are not altered by the facts and evidence set forth in the present case. The statute says "amount"; evidence concerning alleged losses or valuation will not alter the meaning and application of this term.

Petitioner also asserts that there are two interpretations of the term "consideration": one general meaning, plus a variation for cooperative conversions. We disagree. The definitional section of Article 31-B begins with the express qualification (quoted supra) that the definitions set out in Tax Law § 1440 are applicable to the entire article. Therefore, the definition of

"consideration" set out in Tax Law former § 1440(1) is controlling whenever the term appears in other sections of Article 31-B.

Tax Law former § 1442, as relevant, stated:

> "[i]n 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. For purposes of calculating the amount of tax due in each such transfer, an apportionment of the original purchase price of the real property and total consideration anticipated under such plan shall be made for each such cooperative and condominium unit" (emphasis added).

This provision is consistent with the definition of consideration set out in Tax Law former § 1440(1). Tax Law former § 1442 discusses "anticipated consideration" because the gains tax is imposed upon the overall cooperative plan but the tax is paid, pursuant to section 1442, as the individual units are transferred (Mayblum v. Chu, 67 NY2d 1008, 503 NYS2d 316). To accommodate the fact that the total consideration received pursuant to the entire cooperative plan is not actually received nor determinable until all of the units are sold, section 1442 of the Tax Law and the Division's filing procedures (see, TSB-M-86-[5]-R; Form DTF-701-I) require the transferor to estimate the tax due while sales pursuant to the cooperative plan proceed, and to make an actual calculation of tax due only when sales pursuant to the plan are completed (see, Matter of Belvedere Gardens Assocs., Tax Appeals Tribunal, June 18, 1992; Matter of Albe Realty Co., Tax Appeals Tribunal, March 26, 1992). Thus, section 1442 allows for the fact that in cooperative conversions the consideration is actually received over a period of time. This section does not, as petitioner suggests, create a special rule for cooperative conversions that allows the consideration actually received by the transferor to be decreased or increased by subsequent events. We have expressly rejected such a rule with respect to consideration in a cooperative conversion in the form of a lease (Matter of Cheltoncort Co., Tax Appeals Tribunal, December 5, 1991; see also, Matter of V & V Props., Tax Appeals Tribunal, July 16, 1992 [where we rejected the Division's attempt to reduce a transferor's original purchase price in a

condominium conversion based on events occurring after the transfer]). Therefore, the face amount of the mortgage at the time it was obtained by petitioner was properly includible as consideration.

In the alternative, petitioner asserts that, under Tax Law § 1440(5) and 20 NYCRR 590.39, the reduction of the value of the mortgage should be considered a customary, reasonable, and necessary expense which should be added to the original purchase price. Tax Law § 1440(5)(a) provides:

> "'Original purchase price' means the consideration paid or required to be paid by the transferor; [sic] (i) to acquire the interest in real property, and (ii) for any capital improvements made or required to be made to such real property, including solely those costs which are customary, reasonable, and necessary, as determined under rules and regulations prescribed by the tax commission, incurred for the construction of such improvements . . ." (emphasis added).

We disagree with petitioner's assertion. The sale of a mortgage to obtain cash equal to the present value of the debt secured by the mortgage has not been shown to fall within the guidelines in Tax Law § 1440(5), nor within the spirit of the examples in 20 NYCRR 590.39, which sets out required and customary expenses incurred when effecting a cooperative conversion (see, Matter of 1230 Park Assocs. v. Commissioner of Taxation & Fin., 170 AD2d 842, 566 NYS2d 957, lv denied 78 NY2d 859, 575 NYS2d 455 [where maintenance and management charges exceeding rental income received -- "negative carry" -- were disallowed as an element of the property's original purchase price]; Matter of V & V Props., supra [where costs related to refinancing and protecting title to the property were disallowed as an element of the property's original purchase price]; Matter of Albe Realty Co., supra [where a mortgage obtained months prior to the conversion was disallowed as an element of the property's original purchase price]).

Our basic objection to petitioner's position is its failure to demonstrate why the sale of the mortgage was necessary to the cooperative conversion plan. None of the examples in the regulations are comparable to the actions taken by petitioner, i.e., the sale of a mortgage.

Petitioner's sale of the mortgage simply represents a method of raising capital. Although the mortgages were transferred to petitioner in conjunction with a cooperative conversion plan, it does not follow that the alleged loss taken on the sale of the consolidated mortgage may be considered a customary, reasonable, and necessary cost incurred to create ownership interests in the cooperative form.

In sum, the statutory language states that it is the amount, not the value, of the mortgage which is to be considered, and petitioner has failed to demonstrate how this language allows for the use of the value, rather than the face amount, in this case.

We turn now to the issue of abatement of penalty and interest. Tax Law former § 1446(2) stated:

> "[a]ny transferor failing to file a return or pay any tax within the time required by this article shall be subject to a penalty of ten per centum of the amount of tax due plus an interest penalty of two per centum of such amount for each month of delay or fraction thereof after the expiration of the first month after such return was required to be filed or such tax became due. If the tax commission determines that such failure or delay was due to reasonable cause and not due to willful neglect, it shall remit, abate or waive all of such penalty and such interest penalty."

Petitioner asserts that its timely filing of transfer questionnaires, payment of the initial tax, cooperation during the audit, and payment of the additional tax assessed constitutes grounds for a finding of reasonable cause and, therefore, an abatement of penalties and interest. We disagree. These factors are not determinative of whether petitioner had reasonable cause to interpret the definition of consideration in the manner that it did. Rather, petitioner needed to demonstrate the basis for its decision to use the value rather than the amount of the mortgage.

When petitioner received the mortgage, it had the language of Tax Law former § 1440(1), as well as the reiteration of this language in the first Publication 588, to guide its calculation of consideration. Further, as of November of 1984, the second Publication 588 was available. This document expressly addressed the issue of mortgage valuation, stating:

"12. Purchase Money Mortgage

"Q. How is the consideration for the transfer of real property computed where the price paid for the interest is in the form of cash and a purchase money mortgage?

"A. The consideration paid for the transfer is the sum of the cash and the face amount of the mortgage" (emphasis added).

This language was incorporated, verbatim, into the Division's regulations at 20 NYCRR 590.12 in September 1985. Therefore, when petitioner filed its revised estimates of gains tax due in November 1985, its failure to make adjustments to a position which conflicted with the guidelines set out in the regulations contradicts a finding of reasonable cause (see, Matter of 1230 Park Assocs. v. Commissioner of Taxation & Fin., supra; Matter of Pelham Manor Assocs., Tax Appeals Tribunal, July 27, 1989).

Petitioner's position is further undermined by the testimony of Norman Greenberg, one of petitioner's sponsors, during cross examination of Mr. Greenberg by the Division's representative, Mr. Glannon:

"Q Mr. Greenberg, did you ever check with anyone from the Tax Department as to how to value the mortgage?

"A No, I didn't" (Tr., p. 37).

To summarize, in light of the statutory language, explanatory information promulgated by the Department of Taxation and Finance, and the availability of Tax Department personnel to answer questions, make private letter rulings, and issue advisory opinions, we find petitioner's use of its own interpretation of the law, without any contact or discussion of its position with the Department, to be unreasonable. Therefore, we determine that penalties and interest should not be waived.

We will now address petitioner's assertion that recently enacted legislation warrants a finding of reasonable cause. The legislation, in pertinent part, provides:

"§ 65. Section 1446 of the tax law is amended by adding a new subdivision 5 to read as follows:

> "5. For the period from April first, nineteen hundred ninety-two through February twenty-eight, nineteen hundred ninety-three:
>
> "(a) For the purposes of paragraph (a) of subdivision two of this section, 'reasonable cause' includes, but is not limited to, (1) the existence of substantial authority for the tax treatment of any item by the person liable for the tax or (2) the disclosure of such treatment in the pre-transfer audit procedure filing in the absence of any published authority, written instruction or guidance issued by the department of taxation and finance to the contrary. 'Substantial authority' shall include legal authority other than mere reliance on professional advice or the application of generally accepted accounting principles to the reporting of the tax imposed by this article. Notwithstanding such paragraph (a), the commissioner of taxation and finance may remit, abate, or waive a portion of the penalty and interest penalty imposed thereunder on a showing by the person liable for tax that there is reasonable cause for remittance, abatement or waiver of such portion."
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> * * *
>
> "§ 427. This act shall take effect immediately provided that:
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> * * *
>
> "(g) . . . provided, further, that this act shall not apply to any penalty or interest penalty paid (1) on or before the date on which this act shall have become a law or (2) on or after March 1, 1993 nor where a determination has been issued by the division of tax appeals before March 1, 1993 . . ." (L 1992, ch 55, §§ 65, 427, emphasis added).

Given the restriction set out in section 427, we conclude that this new legislation is unavailable to petitioner because a determination has already been issued by the Division of Tax Appeals in this case.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of River Terrace Associates is denied;

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

3. The petition of River Terrace Associates is denied; and

4. The notice of determination of tax due under the gains tax law is sustained together with penalty and interest, except for the recomputation of penalty and interest as directed in conclusion of law "F" in the Administrative Law Judge's determination.

DATED: Troy, New York
October 22, 1992

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

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

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