

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petitions :
of :
WESTPORT REALTY COMPANY : DECISION
for Revision of Determinations or for Refund of Tax on : DTA No. 807658
Gains Derived from Certain Real Property Transfers under : AND 808183
Article 31-B of the Tax Law. :

Petitioner Westport Realty Company, 97-77 Queens Boulevard, Rego Park, New York 11374, filed an exception to the determination of the Administrative Law Judge issued on March 14, 1994. Petitioner appeared by Graubard, Mollen, Horowitz, Pomeranz & Shapiro (Allen Greenberg, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Andrew J. Zalewski, Esq., of counsel).

Petitioner filed a brief in support of its exception. The Division of Taxation filed a brief in opposition and petitioner filed a reply. The reply brief was received on July 25, 1994 and began the six-month period for the issuance of this decision. Petitioner's request for oral argument was denied.

The Tax Appeals Tribunal renders the following decision per curiam.

ISSUES

I. Whether the anticipated consideration for cooperative shares allocated to unsold units in a cooperative building, which were occupied by tenants with a continuing right to occupancy under rent laws and regulations, was properly calculated by the Division of Taxation.

II. Whether petitioner has substantiated additional expenses for capital improvements, which should be included in the calculation of original purchase price.

III. Whether, if gains tax is determined due, penalties should be abated.

FINDINGS OF FACT

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

Petitioner, Westport Realty Company, was the sponsor of a cooperative offering plan for the conversion of rental apartments into cooperative housing units involving a building located at 2800 Coyle Street in the Sheepshead Bay section of Brooklyn, New York. The building contained a total of 157 apartments, including a superintendent's apartment, with 13 apartments on the lobby level and 24 apartments on each of the floors one to six. Pursuant to the original Offering Plan, a total of 98,600 shares in 2800 Coyle Street Owners Corp., the cooperative housing corporation, was allocated to and among 156 residential apartments, with no shares allocated to the superintendent's apartment. By the Fourth Amendment dated July 15, 1986 to the Offering Plan, the total number of shares allocated to the apartments was reduced to 98,575.

Petitioner was described in the Offering Plan as follows:

"The Sponsor, Westport Realty Company, is a New York partnership with a place of business at 97-77 Queens Boulevard, Rego Park, New York. The partners of Sponsor are Samuel J. Lefrak and Richard Lefrak.

"Members of the Lefrak family and trusts for the benefit of several of them have been engaged in the ownership, operation and management of residential and commercial properties in the New York metropolitan area for numerous years and have participated as principals in the cooperative conversions [of five projects in Forest Hills, three in Kew Gardens, two in Brooklyn and one each in Woodside and Elmhurst].¹ In addition, Richard S. Lefrak was the sole stockholder of Pierrepont Realty Corp., the Sponsor of the offering plan of cooperative ownership for 35 Pierrepont Street, Brooklyn, New York.

"Samuel J. Lefrak and Richard Lefrak are also partners of Lefrak Management Company, the company which has the laundry room concession and stockholders of Foremost Management Corp., the Managing Agent, and Westport Leasing Corp., the current Owner of the Property."

The Division of Taxation ("Division") issued two notices of determination, both dated March 6, 1989, asserting additional real property gains tax due, plus penalty and interest, as follows:

¹The street addresses for such projects have been omitted.

Amount Asserted As Due:

<u>Assessment ID</u>	<u>Tax Period Ended</u>	<u>(i) Tax</u>	<u>(ii) Penalty and Penalty Interest</u>	<u>(iii) Interest</u>	<u>(iv) Total</u>
L-000006162-8	April 14, 1986	\$ 34,928.00	\$56,414.00	\$11,952.10	\$103,294.10
L-000006168-2	August 8, 1986	<u>89,283.00</u>	31,249.00	21,536.65	142,068.65
	Total:	\$124,211.00			

The notice for the tax period ended April 14, 1986 showed the following calculation for tax asserted as due:

Tax per taxpayer:	\$126,256.00
Tax per Dept. of Tax & Finance:	161,184.00
Timely Payments/Credits:	0.00
Late Payments:	126,256.00
Amount Previously Assessed/Refunded:	<u>0.00</u>
Balance:	\$ 34,928.00

The notice for the tax period ended August 8, 1986 showed the following calculation for tax asserted as due:

Tax per taxpayer:	\$ 0.00
Tax per Dept. of Tax & Finance:	89,283.00
Timely Payments/Credits:	0.00
Late Payments:	0.00
Amount Previously Assessed/Refunded:	<u>0.00</u>
Balance:	\$89,283.00

A Statement of Proposed Audit Adjustment dated September 8, 1988 showed additional gains tax due of \$124,210.00, plus penalty and interest. Five schedules attached to the statement were referenced as the "explanation of adjustments". A schedule labelled "WEC & Audit Schedule", which perhaps is an abbreviation for "worksheet estimated consideration", shows the following calculation of tax per share of \$5.3980:

	<u>Actual</u>	<u>Anticipated</u>	<u>Total</u>
Cash consideration	\$2,861,178.00	\$2,765,275.00	\$5,626,453.00
Less: Grandfathered			-0-
Total Taxable Cash Consideration			\$5,626,453.00

Less: Reserve Fund	\$ 156,774.00	
Working Capital Fund	<u>35,000.00</u>	
Total Funds	\$ 191,774.00	<u>(191,774.00)</u>
Estimated Cash Consideration		\$5,434,679.00
Mortgage Indebtedness		<u>2,000,000.00</u>
Total Taxable Consideration		\$7,434,679.00
Less: Brokerage Commissions		
Insiders (\$1,533,675.00 x .025)	\$ 38,342.00	
Outsiders (\$1,327,503.00 x .04)	53,100.00	
Anticipated (\$2,765,275.00 x .04)	<u>110,611.00</u>	
	(\$202,053.00)	(202,053.00)
Less: Original Purchase Price		<u>(1,911,510.00)</u>
Anticipated Gain on Taxable Sale		\$5,321,116.00
Anticipated Tax		532,112.00
Anticipated Tax Per Share		\$5.3980

The original purchase price of \$1,911,510.00 was calculated on a so-called "cacic sheet" (calculation of acquisition, capital improvements and cooping costs), another one of the five schedules attached to the statement, as follows:

Acquisition Expenses:	
Land	\$ 64,911.00
	<u>1,358,884.00²</u>
Total original purchase price	\$1,423,795.00
Capital improvements	\$ 360,685.00
Less: Disallowed improvements ³	<u>(184,966.00)</u>
	\$ 175,719.00
Cooping expenses	\$1,496,459.00
Less: Disallowed expenses	<u>(1,184,463.00)</u>
Total cooping expense	\$ 311,996.00
Total Original Purchase Price as of 2/16/88	\$1,911,510.00

A third schedule attached to the Statement of Proposed Audit Adjustment, labelled "Schedule of Capital Improvements", provides the following details of capital improvements claimed by petitioner which were disallowed:

²The "cacic sheet" references a 1967 U.S. corporation tax for this amount. However, the amount shown on the tax return marked into evidence as the Division's Exhibit "P" does not seem to correspond. It is also unclear whether this amount represents the cost of the building, although it is likely that it does.

³The "cacic sheet" includes a line under capital improvements showing \$2,500.00 as "anticipated capital improvements to be substantiated" for each unsold apartment. However, no such amount was allowed in calculating capital improvements.

	<u>Claimed</u>	<u>Disallowed</u>	<u>Allowed</u>
Tile and floor covering	\$ 43,834.00	\$ 17,534.00	\$ 26,303.00
Kitchen appliances (stoves)	9,276.00	7,029.00	2,247.00
Venetian blinds	4,801.00	4,801.00	--
Glass	3,032.00	2,387.00	645.00
Doors and door locks	18,172.00	7,269.00	10,903.00
Renovation costs	4,552.00	4,552.00	--
Plumbing & heating	58,656.00	23,459.00	35,197.00
Lighting fixtures	4,450.00	2,388.00	2,062.00
Air conditioners	14,181.00	14,181.00	--
Fixtures - bath & kitchen	9,060.00	1,651.00	7,409.00
Decorating & painting	37,520.00	23,956.00	13,564.00
Mail boxes	1,441.00	434.00	1,007.00
Electrical	4,109.00	1,535.00	2,574.00
Signs	287.00	287.00	--
Roof & waterproofing	22,612.00	12,487.00	10,125.00
Landscaping & brick planter	3,507.00	3,507.00	--
Woodwork & sheetrock	7,717.00	1,062.00	6,655.00
Compactors	967.00	--	967.00
Sprinklers	153.00	153.00	--
Handrails & smoke alarms	1,061.00	--	1,061.00
[Unreadable item]	829.00	829.00	--
	<u>\$250,220.00</u>	<u>(\$129,501.00)</u>	<u>\$120,719.00</u>
Inception through 12/31/82	<u>110,465.00</u>	<u>(55,465.00)</u>	<u>55,000.00</u>
	<u>\$360,685.00</u>	<u>(\$184,966.00)</u>	<u>\$175,719.00</u>

A fourth schedule attached to the Statement of Proposed Audit Adjustment, labelled "Schedule of Cooping Costs", showed the Division's calculation for allowed cooping expenses of \$311,996.00, as follows:

	<u>Claimed</u>	<u>Adjustment (Disallowed) Additional</u>	<u>Allowed</u>
Legal fees	\$ 45,000.00		\$ 45,000.00
Engineering fees	4,300.00		4,300.00
Filing fees	14,185.00		14,185.00
Working capital	35,000.00	\$ (35,000.00)	--
Reserve fund	156,774.00	(156,774.00)	--
Advertising	15,000.00	(15,000.00)	--
Accounting fees	1,500.00	2,000.00	3,500.00
Fee for preparation of plan	50,000.00	(17,500.00)	32,500.00
Printing	15,000.00		15,000.00
Discount on wraparound mortgage	1,000,000.00	(1,000,000.00)	
Title closing costs:			
NYC transfer tax	110,000.00	(4,825.00)	105,175.00
Mortgage recording tax	18,000.00	(115.00)	17,885.00
NYS deed stamp	23,700.00		23,700.00

Fee insurance premium	7,500.00	5,118.00	12,618.00
Mortgage insurance premium		5,936.00	5,936.00
Recording charges	500.00	3,600.00	4,100.00
Searches, corporation		423.00	423.00
Survey		675.00	675.00
NYS transfer tax		21,036.00	21,036.00
Offering expense - legal fee additional		<u>5,963.00</u>	<u>5,963.00</u>
	<u>\$1,496,459.00</u>	<u>(\$1,184,463.00)</u>	<u>\$311,996.00</u>

The "WEC [worksheet estimated consideration] & Audit Schedule" described in Finding of Fact "4" showed a balance due of \$124,210.00 computed as follows:

Anticipated Tax Per Share	\$5.3980
Number of shares taxed per audit (46,400)	
Total tax liability per audit	\$ 250,467.00
Less: Previous payments	<u>(126,257.00)</u>
Balance Due	\$ 124,210.00

As noted above, 98,575 shares in the cooperative housing corporation were allocated to and among 156 residential apartments. As noted above, 46,400 shares were taxed per audit. Unsold shares amounted to 52,175 shares, and the Division calculated "anticipated" cash consideration for the future sale of such shares of \$2,765,275.00 by using \$53.00 per share (52,175 shares x \$53.00 = \$2,765,275.00). Such amount per share was used by the Division because under the "Offering Plan of Cooperative Conversion of Premises known as the Westport, 2800 Coyle Street, Brooklyn, New York", which indicated an approximate date of first offering of May 31, 1985, tenants in occupancy of residential apartments could purchase the shares allocated to their respective apartment at \$53.00 per share (the so-called "insider's price").

Petitioner challenged the Division's use of the "insider price" of \$53.00 per share to calculate "anticipated" cash consideration of \$2,765,275.00 for the 52,175 unsold shares. According to the testimony of Alfred Schimmel, petitioner's well-qualified expert witness, the value of the unsold shares was \$2,155,950.00. Mr. Schimmel estimated the value of the unsold shares by three calculations:

- (1) From the date of passing title to the coop corporation (April 14, 1986) and the date of the State audit (June 1987): \$ 930,000.00

(2) From June 1987 to August 1989:	\$ 550,000.00
(3) From August 1989 until estimated sellout value:	<u>\$ 675,950.00</u> \$2,155,950.00

During the period from the date of title passing to the coop corporation of April 14, 1986 to the date of the State audit of approximately June 1987, there were sales of 20 units as follows:

<u>Unit</u>	<u>Shares</u>	<u>Price</u>	<u>Share Price</u>	<u>Date of Sale</u>
722	1,150	\$ 60,950.00	\$ 53.00	4/15/86
607	610	32,330.00	53.00	4/25/86
610	890	47,170.00	53.00	4/25/86
625	535	28,355.00	53.00	4/25/86
703	910	48,230.00	53.00	5/01/86
604	970	51,410.00	53.00	5/01/86
407	580	30,740.00	53.00	5/01/86
708	550	29,150.00	53.00	5/01/86
422	1,090	57,770.00	53.00	5/21/86
223	515	27,295.00	53.00	5/21/86
109V	445	51,175.00	115.00	6/06/86
322V	1,070	130,540.00	122.00	7/29/86
515V	520	57,340.00	110.00	8/05/86
415	455	55,510.00	122.00	8/11/86
511	470	57,340.00	122.00	10/03/86
620	610	74,420.00	122.00	10/22/86
401V	505	61,610.00	122.00	11/05/86
105V	435	53,070.00	122.00	12/18/86
523	535	27,560.00	51.51	2/02/87
521	<u>525</u>	<u>82,950.00</u>	158.00	3/04/87
	13,370	\$1,064,915.00		

Mr. Schimmel valued the 20 units sold during this period at \$930,000.00, not the total sales price of \$1,064,915.00, because of petitioner's cost to renovate the vacant units in order to sell them.

His analysis, set forth in a written appraisal dated June 1, 1992 but noted to be "as of April 14, 1986 and June 1987", was as follows:

"The first ten sales were sales to insiders who had previously subscribed for the stock but were unable to close on April 14, 1986.

"The last nine of the ten sales were sales to outsiders. Five apartments, marked 'V', had been vacant and unsold at the closing. These apartments had 5,035 shares and sold for a total of \$623,955. The average price per share was \$123.92. This figure must be adjusted for the estimated cost of renovating the units at an

average cost of \$15,000 per apartment. Therefore, we deduct \$135,000 from the gross proceeds (9 x \$15,000) for an adjusted value of \$488,955. This adjusted figure brings the per share value down to \$97.11 per share.

"The first ten sales averaged \$53 per share which was the 'insiders' price. These ten sales involved 7,800 shares at the fixed insider price of \$53 per share.

"The sale of apartment 523, with 535 shares at \$27,560, is either a misprint or a special case; we have, therefore, treated it separately.

Summary

- a) The value of 7,800 shares @ \$53 = \$413,400
 - b) The value of 5,035 shares @ \$97.11/share = 488,955
 - c) The value of 535 shares @ \$51.51 share = 27,560
- \$929,915
- Say: \$930,000"

From June 1987 to August 1989 there were sales of 11 units with 5,930 shares at a total sales price of \$798,735.00. However, Mr. Schimmel again reduced such total for renovation costs, and, in addition, he "discounted for an average future time of one year at 15%" as follows:

"The total sales price for the 5,930 shares represented by the eleven sales amounted to \$798,735. We adjust this gross price for the renovation cost of \$15,000 per unit, or \$165,000. The adjusted price amounts to \$633,735. This figure is in turn discounted for an average future time of one year at 15%. Therefore:

$$\$633,735 \times .8695 = \$551,032, \text{ say } \$550,000"$$

According to the June 1992 appraisal, since late August 1989, petitioner has had no further sales of units. Mr. Schimmel valued the remaining 75 unsold apartments with 47,225 shares as follows:

"The rent for these units exceeds the maintenance by \$5,025.41 per month, or \$60,304.92 per annum. The last three sales of vacant apartments, involving 1,870 shares, sold for a total of \$245,120, or an average of \$131 per share.

"If we assume a turnover rate of 2.5 units per year until all units become vacant, it would take thirty years from 1989 to sell all the shares.

"We can now assume that the 47,225 shares would sell at an average price of \$140 per share, or \$6,625,500 over the thirty year period.

"The present value of the right to receive \$1 in fifteen years at 15% is .12289. The gross discounted value of the right to receive \$6,625,500 x .12289 = \$814,208.

"The estimated expenses of renovating the seventy-five apartments over the thirty year period at \$15,000 per apartment = \$1,125,000 x .12289 = \$138,251.

"The net value of the shares for the period August 1989 to the year 2019 is, therefore, \$675,957, say \$675,950."

Mr. Schimmel concluded in his appraisal that "[t]he total estimated retail sellout value for the unsold shares amounts to \$2,155,950.00."

Mr. Schimmel rejected the idea that the unsold units had value as occupied apartments. In his appraisal report, he pointed to the Tax Reform Act of 1986, the October 19, 1987 crash of the stock market and the economic recession of 1988 as major reasons for his conclusion that petitioner's unsold units, which were occupied by tenants with rights to continued occupancy under rent laws and regulations, had little or no value until they became vacant. Mr. Schimmel provided the following historical information concerning the value of occupied units in his appraisal report:

"In the mid-1980s shares in occupied units typically sold for 25%-30% of the full retail market value as if vacant. In 1989 the value of occupied units plunged as low as 10-25% for units in good locations, with rent higher than maintenance, and as low as 5% for units with higher maintenance charges than rent. It should be noted that such 'percentages', reported by brokers in unsold units as well as newspaper articles, only refer to transactions which have taken place. Time Equities marketed thousands of shares in occupied apartments between 1987 and 1990, dropped prices to as low as 10%, and still hadn't sold a single share in an occupied apartment as of January 1991. It should be noted that a number of brokers in unsold shares who were contacted in 1989, were out of business as of August 1991.

* * *

"After discussion with sponsors and brokers, we have discovered that during the spring of 1989 a number of sponsors began using 10% of full retail market value as if vacant, a measure of the value of shares in occupied apartments for accounting purposes. This figure applies to shares with higher rent than maintenance. Recent announcements of upcoming auctions confirm this as the general asking rate. However, actual transactions may be considerably lower. Some sponsors have tried to give away shares in occupied apartments to the tenants

to relieve themselves of debt. Even in buildings where there is a clear positive cash flow from the occupied units, obtaining financing continues to be difficult and banks are reluctant to become involved in the very depressed market of cooperative apartments. Even if financing were available, it would add to the carrying costs of the shares and a potential investor would require a high rate of return for risking equity and receiving few tax incentives."

How Petitioner Reported the Transactions for Gains Tax Purposes

By a letter dated March 17, 1986, prior to its transfer of the property to the cooperative housing corporation, petitioner's accountant submitted a Form TP-580, Transferor's Questionnaire, which disclosed an estimated gain of \$2,050,066.00 subject to tax of \$205,007.00 computed as follows under Option B:

	Actual to Date <u>4/10/86</u>	Estimated Additional Through <u>Completion</u>	Total Anticipated (actual plus estimated) <u>on Sell Out</u>
Gross Consideration	\$ -0-	\$3,944,373.00	\$3,944,373.00
Mortgage Indebtedness	-0-	<u>2,000,000.00</u>	<u>2,000,000.00</u>
Total Consideration	-0-	\$5,944,373.00	\$5,944,373.00
Less: Brokerage Fees	-0-	<u>(127,514.00)</u>	<u>(127,514.00)</u>
Consideration	-0-	\$5,816,859.00	\$5,816,859.00
Acquisition Cost	\$1,727,059.00		\$1,727,059.00
Capital Improvements	293,275.00	250,000.00	543,275.00
Cooperative Conversion Costs	<u>1,034,485.00</u>	<u>461,974.00</u>	<u>1,496,459.00</u>
Total Original Purchase Price	\$3,054,819.00	\$ 711,974.00	\$3,766,793.00
Estimated Gain Subject to NYS Gains Tax			\$2,050,066.00
Estimated NYS Gains Tax (10%) on Sell Out			\$ 205,007.00

Petitioner showed the following calculation for its acquisition cost (or original purchase price) of \$1,727,059.00 for the property:

Land	\$ 74,742.00
Building and Improvements	1,617,490.00
Miscellaneous Fixed Assets	<u>34,827.00</u>
	\$1,727,059.00

Petitioner also provided the following details concerning reported gross consideration of \$3,944,373.00:

36,385 shares allocated to 56 apartments subscribed for as of April 10, 1986	\$2,017,375.00
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8,970 shares allocated to
12 vacant apartments not
subscribed for x \$53.00 per share 475,410.00

52,785 shares allocated to
87 occupied apartments not yet
subscribed for x \$27.50 per share 1,451,588.00

Total Consideration: \$3,944,373.00

In addition, petitioner detailed its so-called "cooperative conversion costs" claimed of \$1,496,459.00 as follows:

	Actual to Date <u>4/10/86⁴</u>	Estimated Additional through <u>Completion</u>	Total Anticipated (actual plus estimated) <u>on Sell Out</u>
Legal Fees	\$ 20,000.00	\$ 25,000.00	\$ 45,000.00
Engineering Fees	4,300.00	-0-	4,300.00
Filing Fees	10,185.00	4,000.00	14,185.00
Working Capital Fund	-0-	35,000.00	35,000.00
Reserve Fund	-0-	156,774.00	156,774.00
Advertising	-0-	15,000.00	15,000.00
Accounting Fees	-0-	1,500.00	1,500.00
Fee for Preparation of Plan	-0-	50,000.00	50,000.00
Printing	-0-	15,000.00	15,000.00
Title Closing Cost ⁵	-0-	159,700.00	159,700.00
Discount on Wraparound Mortgage	<u>1,000,000.00</u>	<u>-0-</u>	<u>1,000,000.00</u>
	\$1,034,485.00	\$461,974.00	\$1,496,459.00

Petitioner also attached the following schedules:

(a) A schedule designated "D" labelled "Schedule of Capital Improvements from the Inception Through 1985", which had column headings of (i) vendor, (ii) description and (iii) amount, and disclosed a total for "equipment & capital improvements from the inception through 1985" of \$222,817.00;

⁴Petitioner's schedule did not provide column headings, but these headings, which were used on other schedules attached to the letter, were probably intended to be used.

⁵In a footnote to the schedule, petitioner broke down its "title closing cost" as follows: City transfer tax - \$110,000.00; mortgage recording tax - \$18,000.00; State deed stamps - \$23,700.00; insurance premium - \$7,500.00; recording charges, inspection and searches - \$500.00.

(b) A schedule designated "E" labelled "Schedule of Cooperative Conversion and Renovation Costs for the Years 1984 & 1985", which had column headings of (i) vendor,⁶ (ii) description and (iii) amount, and disclosed a total for "coop conversion & renovation costs" of \$70,458.00; and

(c) A schedule designated "A" which listed 56 transferees, with column headings and information concerning (i) apartment number, (ii) number of shares, (iii) percentage of taxable shares, (iv) allocated sales price including mortgage indebtedness, (v) allocated brokerage, (vi) allocated cost of unit, (vii) estimated gain and (viii) estimated tax due which totalled \$76,607.00 on an estimated gain of \$766,072.00.

The Division issued a Form TP-582, Tentative Assessment and Return, dated April 11, 1986 showing a "date of anticipated transfer" of April 14, 1986. Arthur Klein, described thereon as an "authorized agent", executed an "affidavit of transferor" on April 14, 1986 on the bottom of such form. The tentative assessment was computed as zero.

Petitioner amended its preliminary filing described above by a letter dated April 22, 1986, subsequent to the closing date, at which time only 45 units, not 51, were transferred. In addition, petitioner reported a lower original purchase price of \$1,459,217.00 (\$64,911.00 allocated to land and \$1,394,306.00 to building and improvements) instead of the earlier reported amount of \$1,727,059.00. Petitioner reported a larger amount for capital improvements of \$638,185.00 instead of the earlier reported amount of \$543,275.00. In the amended filing, petitioner reported an estimated gain of \$1,956,035.00 with estimated gains tax on sell out of \$195,603.00 calculated as follows on a summary schedule:

Actual to Date <u>4/14/86</u>	Estimated Additional Through <u>Completion</u>	Total Anticipated (actual plus estimated) <u>on Sell Out</u>
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⁶Many of the entries under this heading merely note "various vendors."

Gross Consideration	\$1,533,675.00	\$2,155,248.00 ⁷	\$3,688,923.00
Mortgage Indebtedness	<u>579,006.00</u>	<u>1,420,994.00</u>	<u>2,000,000.00</u>
Total Consideration	\$2,112,681.00	\$3,576,242.00	\$5,688,923.00
Less: Brokerage Fees	<u>52,817.00</u>	<u>86,210.00</u>	<u>139,027.00</u>
Consideration	\$2,059,864.00	\$3,490,032.00	\$5,549,896.00
Acquisition Cost	\$1,459,217.00		\$1,459,217.00
Capital Improvements	360,685.00	277,500.00	638,185.00
Cooperative Conversion Costs	<u>1,034,485.00</u>	<u>461,974.00</u>	<u>1,496,459.00</u>
Total Original Purchase Price	\$2,854,387.00	\$ 739,474.00	\$3,593,861.00
Estimated Gain Subject to NYS Gains Tax			\$1,956,035.00
Estimated NYS Gains Tax (10%) on Sell Out			\$ 195,603.00

The amended filing also showed the following recalculation of consideration:

28,545 shares allocated to 45 apartments subscribed for as of April 14, 1986	\$1,533,675.00
8,970 shares allocated to 12 vacant apartments not subscribed for x \$53.00 per share	475,410.00
61,085 shares allocated to 99 occupied apartments not yet subscribed for x \$27.50 per share	1,679,838.00
Total Consideration:	\$3,688,923.00

Substantiation of Additional Capital Improvements and Expenses

As noted above, the Division allowed only some of petitioner's claimed expenses for capital improvements. Petitioner presented the testimony of Allen Egidio, the director of operations for an entity called Foremost, which according to the witness is a subsidiary of the Lefrak organization responsible for managing Lefrak properties "after they become co-op." Mr. Egidio also testified that he is "in charge of the renovations of the apartments" and was involved in the management and renovation of the property at issue in this matter. Mr. Egidio identified representative invoices in support of his testimony that, in 1992 pricing, the cost to renovate a vacant apartment was approximately \$5,000.00. He testified that in 1987 the cost was

⁷It is noted that in both its initial filing and this amended one petitioner used a value of \$27.50 per share to value shares allocated to occupied apartments "not yet subscribed." Petitioner's accountant, Norman Greenberg, testified that he "didn't arrive at [the \$27.50 per share value]" but that it was provided to him by "management" who "are real estate oriented for 40 years." It is noted that management's reasoning was not elucidated.

approximately \$3,700.00. With reference to the Division's Exhibit "S", which was described in detail above, Mr. Egidio testified as to each of the items listed thereon. He noted that there might be other "materials" substantiating expenses, but they were not presented at the hearing.

Petitioner's accountant, Norman Greenberg, testified that he extracted information from (i) the workpapers from an independent accounting firm, (ii) petitioner's tax returns and (iii) a computer printout from the Lefrak organization to ascertain petitioner's capital improvements. However, invoices and/or cancelled checks for such expenses were not provided to substantiate capital improvement expenses in excess of those allowed by the Division.

Mr. Greenberg also defended petitioner's inclusion of \$50,000.00 as a conversion expense for services provided by Howard Boris and Arthur Cline, employees of the Lefrak organization, who appear to have been responsible for the development and implementation of the cooperative conversion at issue herein. However, no documents were provided to substantiate this amount claimed.

The parties entered into a stipulation dated June 3, 1992 which was marked into the record as the Division's Exhibit "A". Relevant portions have been incorporated herein.

In addition, a stipulation dated July 9, 1993 between the parties resolved an issue concerning the Division's disallowance of the \$1,000,000.00 discount claimed by petitioner on the wraparound mortgage. Pursuant to such stipulation, petitioner paid additional tax and interest resulting from such disallowance, and the Division abated penalties and penalty interest attributable to such additional tax.

Petitioner submitted 19 proposed findings of fact. Proposed findings of fact "1" through "6", "8", "9", "10", "13", "15", "17" and "18" are accepted and incorporated herewith.

Proposed findings of fact "7", "12" and "19" are accepted in part. The accepted parts are incorporated herewith. The rejected parts are as follows:

(i) Proposed finding of fact "7" includes an inexact statement that Mr. Morano or Mr. Hroncich (employees of the Division's Gains Tax Unit) made "no objections" to petitioner's use of the \$27.50 per share figure for the unsold shares. Petitioner cites the testimony of Norman Greenberg in support of this point. However, Mr. Greenberg never specifically testified concerning such point.

(ii) Proposed finding of fact "12" includes the inexact use of the word "detailed" in noting that petitioner "attached 26 pages of detailed description of expenditures constituting capital improvements and coop conversion costs" to its amended filing. Such pages had columns for the date, the name of the vendor, a very general description and amount. For example, the first entry shows the date of 1/31/83, Kew Equipment Corp. as the vendor, "[r]eplace tile bathroom" as the description and the amount of \$71.00. No details are provided concerning the amount or type of tile, price per unit for material, cost of labor, etc.

(iii) Proposed finding of fact "19" includes the statement that "[t]he market value on April 14, 1986 of the unsold apartments was \$2,155,950", which is more in the nature of an ultimate finding of fact or a conclusion of law.

Proposed findings of fact "11", "14" and "16" are not accepted:

(i) With reference to proposed finding of fact "11", petitioner established that it submitted schedules listing the transferees (which were included in its submissions described in detail above), but did not establish that transferee questionnaires were submitted for each person who subscribed to purchase shares.

(ii) With reference to proposed finding of fact "14", an analysis of Exhibit "V" shows total sales of 18,475 shares to 28 apartments, for which petitioner received \$1,337,063.00 in cash during the period following the closing date of April 14, 1986 through

November 23, 1987 not "17,855 shares to 27 apartments, for which it received \$1,327,503 in cash" as proposed.

(iii) With reference to proposed finding of fact "16", a more detailed description of expenses disallowed by the Division is provided above.

Opinion

As stated in the facts, the Administrative Law Judge found that "[a]ccording to the testimony of Alfred Schimmel, petitioner's well-qualified expert witness, the value of the unsold shares was \$2,155,950.00." However, the Administrative Law Judge held that:

"Mr. Schimmel's appraisal does not shoulder petitioner's burden of proving the total consideration anticipated in April 1986. Mr. Schimmel prepared his appraisal six years after the relevant period and noted that the October 19, 1987 crash of the stock market and the economic recession of 1988 reduced the value of the unsold units. . . . In short, 'anticipated consideration' for the unsold shares as of April 1986 was an amount in excess of Mr. Schimmel's estimate, which was affected by an awareness of the collapse in the market for cooperative apartment units and, in particular, occupied units" (Determination, conclusion of law "D").

Although we agree with the Administrative Law Judge's description of Mr. Schimmel's appraisal, because of the unique circumstances of this case, we disagree with the Administrative Law Judge's conclusion that petitioner failed to establish that it used an appropriate figure to anticipate consideration in 1986.

The first important factor influencing our decision is that "anticipated consideration" is not a defined term. Section 1442 of the Tax Law provides that the gains tax is to be paid on transfers pursuant to a cooperative plan as each cooperative unit is transferred. This section also provides that the tax is to be calculated for each unit transferred based on apportionment of the original purchase price of the real property and the total consideration anticipated under the cooperative plan. Article 31-B does not define "anticipated consideration." Nor has the Division published any standard defining "anticipated consideration."

Through its creation of the Option B filing method, which was utilized by petitioner, the Division established that anticipated consideration meant an estimate of consideration (see, TSB-M-83-[2]-R). Under Option B, the consideration anticipated pursuant to the cooperative plan is revised, as each 25% of the project is sold, based on the actual consideration received for the sold shares, but not until May 1, 1986 did the Division offer any guidance to the public on how to estimate the consideration on the shares that had not been sold. On May 1, 1986, after the filing in this case, the Division issued TSB-M-86-(3)-R, the "Safe Harbor Estimate for Transfers Pursuant to Condominium and Cooperative Plans." Through this memorandum, the Division advised taxpayers that if they followed specific formulas in estimating consideration for the unsold shares in a cooperative conversion, they would not be subject to penalty and interest on any underpayment. However, this memorandum did not require that the safe harbor rules be followed (Matter of Mendler, Tax Appeals Tribunal, September 23, 1993). With respect to earlier filings, the memorandum stated: "[t]he establishment of the Safe Harbor Estimates is not intended to indicate that any estimate of consideration made before the new Gains Tax filing procedure was or was not reasonable" (TSB-M-86-[3]-R). Accordingly, the Safe Harbor Rules are irrelevant to analyze the appropriateness of petitioner's anticipated consideration. Thus, the Division is asserting in this case that petitioner's estimate of anticipated consideration is too low, however, the Division has no apparent standard for evaluating petitioner's estimated consideration.

Further, the Division has offered no persuasive explanation as to why its estimate of consideration is better than petitioner's. The Division asserts that it "found a more reasonable anticipated consideration that the petitioner could expect would be, at the very least, 100% of the insider's price for purchasing unsold shares" (Division's brief, pp. 3-4). As support for this conclusion, we are referred to the "offering plan documents for the subject conversion that show that the 59,315 unsold shares for the project were valued at \$9,371,770 or \$158 per unsold share" (Division's brief, p. 4). However, the document referred to by the Division does not value the

unsold shares at \$158.00 per share, it simply sets this as the price per share and also provides that apartments may be sold at lower prices (Exhibit "Z," p. 35). We have previously recognized that the occupancy of a cooperative unit may reduce the market value of the apartment well below the offering plan price of the apartment (Matter of Mendler, supra). The Division's own assessment, based on \$53.00 per share, indicates that the Division does not believe that the shares have a value of \$158.00 per share.

The only other justification offered by the Division for its estimate is that "[i]t is also notable that 100% of the insider's price is, at a minimum, required by the Division of Taxation's safe harbor guideline" (Division's brief, p. 4). As discussed earlier, the safe harbor guidelines do not set requirements for any filing and they have absolutely no application to this filing which was begun before the guidelines were issued.

In contrast to the Division's lack of justification for its estimate, petitioner has offered testimony of a qualified expert that values the unsold shares at an amount equal to the consideration anticipated by petitioner in April 1986. Although we agree with the Administrative Law Judge that the appraisal is flawed, e.g., it values the shares based on events unknown in April 1986, we believe that the appraisal does support the anticipated consideration utilized by petitioner. In the context of the instant facts, where the Division has established no standard for anticipating consideration and has not convincingly demonstrated why its number is more reasonable than petitioner's, we believe that the appraisal is sufficient to show the appropriateness of petitioner's anticipated consideration.

We next address the adjustments made to petitioner's cost of capital improvements. As indicated in the facts, the Division disallowed \$184,966.00 out of a total \$360,685.00 claimed by petitioner with respect to improvements already made. In addition, the Division disallowed \$277,500.00 (\$2,500.00 for each of 111 apartments) claimed by petitioner as renovation costs that would be required in the future to sell the unsold apartments. The Administrative Law Judge sustained the disallowances by the Division on the bases that 1) "[i]t would be purely speculative

to allow as a capital improvement cost an expense which has not yet been incurred" and 2) "petitioner failed to present 'a coherent accounting' of its capital improvement costs so that no further costs are allowable" (Determination, conclusion of law "E").

We agree with the Administrative Law Judge's conclusion that petitioner failed to adequately document the \$184,966.00 disallowed by the Division and we sustain the Administrative Law Judge's determination on this issue for the reasons stated in the determination. However, we disagree with the Administrative Law Judge's conclusion that petitioner is not entitled to the \$255,700.00 because the costs were not yet incurred and were too speculative. Under the Option B filing method, petitioner was required to estimate his total original purchase price by combining the total of his actual capital improvement costs incurred up to the date of filing with the capital improvement costs that were "Estimated Additional through Completion" (TSB-M-83-[2]-R). Fairness requires this estimate of future original purchase price costs as an offset to the anticipated consideration the taxpayer is required to include in the calculation of gain. Thus, under the Option B filing method petitioner was entitled to estimate the cost of future capital improvements. We believe that the testimony of Mr. Egidio was adequate to establish the amount at \$2,500.00 per apartment. To the extent that this estimate is incorrect, it will be corrected based on the actual amounts expended at the 50%, 75% and 100% update points under Option B.

Next, petitioner claims that the Division improperly excluded \$35,422.00 from the building cost claimed by petitioner. Petitioner asserts that this amount represents construction period interest and construction period real property taxes that are allowable under 20 NYCRR 590.16(D). The record does not contain any evidence to support these assertions, therefore, we sustain the disallowance of this amount.

Lastly, the Administrative Law Judge sustained the imposition of penalty against petitioner. With respect to that portion of the assessment we have sustained against petitioner,

the Administrative Law Judge imposed penalty because petitioner had failed to explain why it was "unable to substantiate with documents and in a coherent fashion its claimed costs for capital improvements" (Determination, conclusion of law "F"). We sustain the Administrative Law Judge's determination on this issue for the reasons stated in the determination.

Accordingly it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Westport Realty Company is granted to the extent that petitioner's estimate of anticipated consideration based on \$27.50 per unsold share is accepted and petitioner is allowed \$277,500.00 as additional estimated capital improvement costs, but the exception is otherwise denied;

2. The determination of the Administrative Law Judge is modified to the extent indicated in paragraph "1" above, but is otherwise affirmed;

3. The petition of Westport Realty Company is granted to the extent indicated in paragraph "1" above, but is otherwise denied; and

4. The Division of Taxation is directed to modify the notices of determination dated March 6, 1989 in accordance with paragraph "1" above, but such notices are otherwise sustained.

DATED: Troy, New York
January 12, 1995

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

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