

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
LEONARD SPODEK	:	DECISION
for Revision of a Determination or for Refund of Tax on	:	DTA No. 808960
Gains Derived from Certain Real Property Transfers	:	
under Article 31-B of the Tax Law.	:	

Petitioner Leonard Spodek, 777 East 21st Street, Brooklyn, New York 11210 and the Division of Taxation filed exceptions to the determination of the Administrative Law Judge issued on March 26, 1992 with respect to petitioner's 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 Leonard Goldstein, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Kenneth J. Schultz, Esq., of counsel).

Each party filed a brief in support of their exception and in response to the brief filed by the other party. Petitioner's request for oral argument was denied.

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

ISSUES

I. Whether the Commissioner of Taxation and Finance properly determined that the transfers by petitioner of certain parcels of real property were formulated for the purpose of avoiding the gains tax.

II. Whether, if the transfers were so formulated, the Commissioner of Taxation and Finance was authorized to reallocate the prices paid for each parcel of real property.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for findings of fact "9," "13" and "14" which have been modified. In addition, we have moved finding of fact "8" so that it follows finding of fact "10" and have moved the final sentence in finding of fact "10" to finding of fact "8" for purposes of clarity. We have also made an additional finding of fact. The Administrative Law Judge's findings of fact, the modified findings of fact and the additional finding of fact are set forth below.

Petitioner, Leonard Spodek, was the owner of five individual properties located in Brooklyn, New York.¹ A multi-unit apartment building was situated on each property. The properties were not contiguous or adjacent, although all were located in Brooklyn.

On or about December 14, 1987, transferor and transferee questionnaires were submitted to the Division of Taxation ("Division") for each of the five properties. The questionnaires indicated that each property was to be sold to a single transferee, DAO Corporation ("DAO"), on December 1, 1988. A contract of sale for each property was submitted with each set of questionnaires. The stated consideration for each property pursuant to the questionnaires and contracts was \$995,000.00.

On or about December 17, 1987, the Division issued five tentative assessments and returns, asserting no gains tax due on any of the five transactions. By letter dated February 5, 1988, the Division advised petitioner that the tentative assessments were issued in error and requested that they be returned to the Division.

Apparently, the Division contacted the parties and requested documentation regarding the assessed valuation of the properties. With a cover letter dated March 1, 1988, petitioner returned the original tentative assessments to the Division and provided copies of five documents, each entitled "Tax Commission of the City of New York Application for Correction of Tentative

¹Petitioner owned each property either individually or through his wife, Rosalind Spodek, or through one of several business entities. He was, however, the beneficial owner of each property.

Assessed Valuation for Rent Producing Properties Assessed for Less than \$750,000.00". These applications showed the actual and transitional assessments for each of the five properties owned by petitioner.

Each of the five sales contracts submitted with the questionnaires contained a provision relating the final purchase price of each building to that building's rent rolls. Paragraph 31, subparagraph (a), of the contract for sale of 985 Ocean Avenue, Brooklyn, New York, states:

"31. Rent Roll. (a) If the rent roll for the Premises as of the Closing Date is less than \$120,000, the purchase price to be paid by Purchaser hereunder shall be reduced by five times the amount by which \$120,000 exceeds the rent roll for the Premises on the Closing Date. Any reduction in the purchase price as a result of this Paragraph 31(a) shall be split equally between the cash portion of the purchase price and the amount of the Purchase Money Mortgage."

Each of the other four sales contracts contains identical language varying only with regard to the amount of the rent roll associated with each building.

As shown in the documents submitted to the Division, the purchase price, actual assessed valuation and minimum rent roll for each of the five properties were as follows:

<u>Property</u>	<u>Purchase Price</u>	<u>Assessed Value</u>	<u>Rent Roll</u>
305 Ocean Avenue Brooklyn, New York	\$995,000	\$425,000	\$250,000
180 East 18th Street Brooklyn, New York	\$995,000	\$242,000	\$160,000
985 Ocean Avenue Brooklyn, New York	\$995,000	\$410,000	\$120,000
400 East 21st Street Brooklyn, New York	\$995,000	\$525,000	\$240,000
2416 Newkirk Avenue Brooklyn, New York	\$995,000	\$430,000	\$215,000
Totals	\$4,975,000.00	\$2,032,000.00	\$985,000.00

Based on its review of the documents submitted by petitioner, the Division determined that the purchase prices cited in the sales contracts did not accurately reflect the true market value of each property. The Division then reallocated the purchase prices based upon a comparison of the rent rolls.² As a result the Division determined that the consideration for three properties exceeded \$1,000,000.00. The consideration for 305 Ocean Avenue was determined to be \$1,263,650.00; the consideration for 2416 Newkirk Avenue was determined to be \$1,084,550.00; and the consideration for 400 East 21st Street was determined to be \$1,213,900.00. The considerations for the transfers of 180 East 18th Street and 985 Ocean Avenue were determined to be less than \$1,000,000.00. On March 18, 1988, the Division issued a schedule of adjustments to petitioner reflecting the reallocated purchase prices.

We modify finding of fact "9" of the Administrative Law Judge's determination to read as follows:

As a result of continuing negotiations between petitioner and the transferee, only two of the original five properties were transferred. 305 Ocean Drive was transferred and, according to petitioner, the price paid at the time of the closing was \$845,000.00. 180 East 18th Street was transferred and, according to petitioner, the price paid at the time of the closing was \$995,000.00.³

²To calculate the fair market value of each property, the Division divided the rent roll for each property by total rental roll. The resulting percentages were applied to the total purchase price for all properties (\$4,975,000.00) to determine the consideration for each property.

³The Administrative Law Judge's finding of fact "9" read as follows:

"As a result of continuing negotiations between petitioner and the transferee, only two of the original five properties were transferred. 305 Ocean Drive was transferred, and the price paid at the time of the closing was \$845,000.00. 180 East 18th Street was transferred and the price paid at the time of the closing was \$995,000.00."

We modified this fact to reflect that it is petitioner, not the record as a whole, that indicates that these were the prices paid for the properties.

With a cover letter dated July 12, 1988, petitioner submitted a revised transferor questionnaire for 305 Ocean Avenue, reporting consideration of \$1,263,650.00 and a gains tax due on the transfer of \$58,877.00.

The Division issued a Tentative Assessment and Return for the transfer of 305 Ocean Avenue, dated August 1, 1988, asserting gains tax due of \$58,876.00. This amount was remitted to the Division at the time of the closing. No gains tax was asserted in connection with the transfer of 180 East 18th Street since the consideration for the transfer was determined by the Division to be less than \$1,000,000.00.

We make the following additional finding of fact:

The closing was held from January 25-27, 1989.

Petitioner submitted a claim for refund of the full amount of the gains tax paid on the transfer of 305 Ocean Avenue, claiming that the actual amount of the consideration for the transfer was \$845,000.00.

By letter dated June 14, 1989, the Division agreed to grant petitioner a partial refund of the tax paid. Based on the \$150,000.00 reduction in the purchase price of 305 Ocean Avenue, the Division reduced the reallocated consideration from \$1,263,650.00 to \$1,113,650.00 and agreed to a refund in the amount of \$15,000.00 plus interest.

We modify finding of fact "13" of the Administrative Law Judge's determination to read as follows:

Petitioner challenged the Division's denial of the full amount of the refund claim. Following a conference in the Bureau of Conciliation and Mediation Services, the Division recalculated the gains tax due on the transfer of 305 Ocean Avenue as follows:

Total consideration received (305 Ocean Avenue and 180 East 18th Street)	\$1,840,000.00
Combined rent rolls	410,000.00
Rent roll: 305 Ocean Avenue	250,000.00
Rent roll: 180 East 18th Street	160,000.00
Rent roll percentage allocated to 305 Ocean Avenue	60.9756
Consideration allocated to 305 Ocean Avenue (60.9756% x \$1,840,000.00)	1,121,951.00

Original purchase price: 305 Ocean Avenue	674,881.00 ⁴
Gain	447,070.00
Tax due on gain	44,707.00
Tax paid	58,876.90
Refund due	\$14,169.90 ⁵

We modify finding of fact "14" of the Administrative Law Judge's determination to read as follows:

The Division issued a Conciliation Order dated September 28, 1990, granting petitioner a refund of \$14,169.90 plus interest. As the Division claimed at the hearing that petitioner was previously granted a refund of \$15,000.00, the Division suggested at that proceeding that petitioner is not entitled to a further refund.⁶

Petitioner buys, sells and manages real property and has done so since 1970. In the past 20 years, he has bought and sold in excess of 100 parcels. At the time the subject transfers occurred, petitioner owned in excess of 28 separate properties in Brooklyn, New York, the majority of them being multi-unit apartment buildings.

Petitioner purchased 305 Ocean Avenue in December 1985 for \$455,000.00. The building is located across the street from Prospect Park in a neighborhood that petitioner described as dilapidated and ridden with drugs and crime. The building was built in 1917 and was not kept in good repair. As a result, it had numerous code violations and was the object of tenant strikes. In contrast, 180 East 18th Street was built in 1940 and upgraded through the years with new

⁴As petitioner testified, and as the finding of fact (infra) reflects, petitioner paid \$445,000.00 to purchase the 305 Ocean Avenue property. The "original purchase price" figure of \$674,881.00 listed here reflects the purchase price paid to acquire the property (\$445,000.00), plus: other acquisition costs (\$13,137.00), the cost of capital improvements made to the property (\$191,744.00), and all allowable selling expenses (\$15,000.00) (see, Exhibit "N," "Real Property Transfer Gains Tax Questionnaire").

⁵We modified finding of fact "13" by adding footnote "4" to more fully reflect the record.

⁶The Administrative Law Judge's finding of fact "14" read as follows:

"The Division issued a Conciliation Order dated September 28, 1990, granting petitioner a refund of \$14,169.90 plus interest. As petitioner was previously granted a refund of \$15,000.00, the Division asserts that petitioner is not entitled to a further refund."

We modified the second sentence of this fact to reflect the record in more detail.

windows, pipes, boiler and trash compactor. Petitioner considers the neighborhood of 180 East 18th Street to be a stable residential area.

According to petitioner, the contract prices for the five original properties reflected the state of the New York real estate market in the mid-1980's and had no relationship to the rent rolls or the assessed value of the buildings. He testified that the \$1,000,000.00 gains tax exemption entered into the sales negotiations as a factor which he used to increase the sales prices. Petitioner stated that in his estimation none of the buildings was worth the agreed upon \$995,000.00 contract price. However, he convinced the buyer that each property was worth more than \$1,000,000.00 and that he was willing to sell for less in order to avoid paying the tax on gains. He described this sales pitch as a psychological ploy. With regard to the significance the gains tax played in negotiating the sales prices of the buildings, petitioner testified:

"I arrived at a nine ninety-five number telling them that this would save me -- instead of going over a million dollars. I feel the piece is worth more than a million dollars. But you know what, I'll settle for nine ninety-five. I don't want to go into a Cuomo area. I got to pay tax. I'll take less for the building, but the building is really worth a million and a half." (Transcript at p. 85.)

As evidence that none of the buildings was worth \$995,000.00, petitioner pointed to the fact that only one of the four buildings sold for that price: 180 East 18th Street. When the New York City real estate market dropped in the late 1980's, the potential buyer repudiated the sales contracts on three of the five properties which were part of the original transaction. The price for 305 Ocean Avenue was reduced to \$845,000.00 when the potential buyer learned that it was the object of tenant strikes that reduced rent collections.

Petitioner testified that the price of each of the original five properties was separately negotiated based on different factors. He conceded that the original agreed upon price for 305 Ocean Avenue was determined by the rent rolls. As he stated:

"305 Ocean Avenue was sold on a [sic] operational basis. That even though it was a crime-ridden area and the rent-roll is high, that based on the rent-roll and even plugging in expenses if you collected the rent, there would be a bottom line of ninety thousand,

ninety-five thousand, and he capped the bottom line and that's how he came up to a number." (Transcript at p. 80.)

According to petitioner, the price for 180 East 18th Street was agreed upon based on its potential value as a cooperative apartment building and not on its existing rent rolls.

OPINION

The Administrative Law Judge determined that, based on the evidence, it was neither arbitrary nor irrational for the Division to determine that the prices agreed to by the parties for the five properties in question were for the purpose of avoiding the real property gains tax and not for an adequate business purpose. The Administrative Law Judge concluded that, despite the fact that three of the sales did not go through, and the price of the 305 Ocean Avenue property was reduced, the "avoidance of the gains tax was a factor in the negotiated agreements reached by petitioner and the transferee" (Determination, p. 10).

Moreover, the Administrative Law Judge determined that petitioner failed to sustain his burden of proving entitlement to the exemption under Tax Law § 1443(1) for transfers of less than \$1,000,000.00, having failed to produce clear and convincing evidence that the actual fair market value of each property was less than \$1,000,000.00 and that the purchase prices were not part of a plan to avoid payment of the gains tax.

On the other hand, the Administrative Law Judge rejected the Division's position that, based on the finding that the transfers were formulated primarily to avoid the gains tax, the Division had the authority, under Tax Law § 1448(1), to reallocate the consideration for the transfers in question. Instead, the Administrative Law Judge held that in such a situation, the transfer "becomes subject to the gains tax [and] [t]he gain is calculated on the basis of the actual consideration," with the taxpayer forfeiting any exemption(s) he might otherwise have asserted (Determination, p. 11). Accordingly, the Administrative Law Judge directed the Division to recalculate the gain as well as the refund due petitioner.

On exception, petitioner asserts that since the prices agreed to by the parties for the properties -- specifically for the 305 Ocean Avenue property -- demonstrate the fair market value of the properties and, therefore, served an adequate business purpose, they were not for the purpose of avoiding the gains tax. Therefore, maintains petitioner, he is entitled to the exemption from the gains tax for the transfer of 305 Ocean Avenue which he sold for \$845,000.00.

Petitioner agrees with the Administrative Law Judge that there is no statutory basis (under Tax Law § 1448[1]) for the Division's reallocation of the consideration for the transfers. Petitioner adds that neither is this authority granted the Division under section 1444, as the Division asserts in its brief. However, petitioner disagrees with the Administrative Law Judge's conclusion that where there is an avoidance of the gains tax, the exemption otherwise applicable is forfeited. Accordingly, petitioner claims he is due a refund of \$58,877.00.

The Division, in its exception, asks that the Administrative Law Judge's determination be reversed insofar as it granted petitioner a partial refund and held that the Division had no authority to reallocate the consideration for the two properties ultimately sold. However, the Division agrees with the Administrative Law Judge's determination insofar as it concludes that in negotiating the transfer prices, petitioner's motivation was to avoid the gains tax.

The Division asserts that, contrary to the Administrative Law Judge's determination, under the circumstances, the Division was authorized under Tax Law §§ 1448(1) and 1444(1) "to use the rent roll provisions in the contracts to reallocate the purchase prices and assess tax with respect to those properties determined to have sold for more than \$1 million" (Division's exception, attached rider, p. 2). Moreover, the Division maintains that it correctly calculated the gain on the sale of the 305 Ocean Avenue property as the difference between petitioner's original purchase price and the reallocated consideration (following the conference at the Bureau of Conciliation and Mediation) of \$1,121,951.00 (Division's exception, attached rider, p. 2). Further, the Division claims that it was petitioner's burden to demonstrate that the Division's

method of reallocating the purchase prices was flawed, and that petitioner failed to carry this burden. For these reasons, the Division argues that petitioner's claim for refund was properly denied by the Division.

We affirm the Administrative Law Judge's determination in part and reverse in part.

First, we agree with the Administrative Law Judge's conclusions that the Division properly determined that the prices agreed to for the five properties were for the purpose of avoiding the real property gains tax and that the Division had the authority under section 1448(1) of the Tax Law to treat the transfer at issue as taxable. We agree with these conclusions because the record indicates that the Division had a rational basis to conclude that none of the five contracts entered into by petitioner accurately stated the consideration for its respective transfer. This is evident in the fact that petitioner had structured the overall transaction to shift consideration from more valuable to less valuable properties so that no property would have a stated consideration of more than \$1 million. On this basis, the Division assessed additional tax. We also agree with the Administrative Law Judge's conclusion that petitioner did not sustain his burden at the hearing to show that each contract did accurately state the consideration for each transfer.

However, we reverse the Administrative Law Judge's determination insofar as it concerns the second issue, that of the Division's authority to reallocate the consideration received for the two properties sold.

The Administrative Law Judge held that Tax Law § 1448(1) does not authorize the Division to redetermine the consideration or reallocate the consideration for more than one property above the \$1 million exemption. But, as the Division points out in its brief on exception, analyzing the gains tax statute as a whole, the Division is granted this power under section 1444(1) of the Tax Law.

Section 1444(1), in pertinent part, provides as follows:

"[i]f a form required by this article is not filed, or if a form when filed is incorrect or insufficient, the amount of tax due shall be determined by the commissioner of taxation and finance from such

records or information as may be obtainable, including the assessed valuation of the real property or interest therein and other appropriate factors."

Since the section is modeled on the same language as Tax Law § 1138(a)(1), pertaining to sales tax, we conclude that section 1444(1), like section 1138(a)(1), grants the Division the power to redetermine or reallocate the consideration provided the redetermination or reallocation is achieved via a method "reasonably calculated to reflect the taxes due" (Matter of W.T. Grant Co. v. Joseph, 2 NY2d 196, 159 NYS2d 150, 157, cert denied 355 US 869), with the burden on the taxpayer to prove that the method is erroneous or irrational (see, Matter of Meskouris Bros. v. Chu, 139 AD2d 813, 526 NYS2d 679; Matter of Surface Line Operators Fraternal Org. v. Tully, 85 AD2d 858, 446 NYS2d 451).

Accordingly, while we agree with the Administrative Law Judge that where facts show that a taxpayer has formulated a gains tax avoidance plan, the transfer of real property is subject to tax, we do not agree with her conclusion that the gain, in such a situation, must be calculated on the basis of the consideration stated by the taxpayer in the contracts that comprise his tax avoidance plan. The consideration claimed to have been received by petitioner in this case, as noted in the findings of fact, was \$845,000.00 for the 305 Ocean Avenue property, and \$995,000.00 for the 180 East 18th Street property. However, from our conclusion that the Division properly surmised that petitioner was stating his prices in the contracts so as to avoid the gains tax (i.e., shifting a portion of the cost of the properties which would otherwise be subject to gains tax to the other properties which would not otherwise be subject to gains tax so that no property would be sold for a price which reaches the \$1 million threshold), it necessarily follows that the actual consideration for at least one of the properties was above the \$1 million threshold. Therefore, we conclude that the Division correctly determined that the returns filed by petitioner were incorrect or insufficient within the meaning of section 1441(1) of the Tax Law and was authorized to determine the tax due from such information as was obtainable.

In the case at hand, as explained in the findings of fact, to reallocate the consideration, the Division divided the rent roll for each property by the total rent roll for the two properties combined. The resulting percentages were applied to the total purchase price for the combined properties to determine the consideration for each property. In this way, it was determined by the Division that the actual consideration for 305 Ocean Avenue was \$1,121,951.00, representing a \$447,070.00 gain over the original purchase price of \$674,881.00, for a gains tax due of \$44,707.00.

In our view, there is nothing in the record which in any way suggests that this reallocation method is irrational or unreasonable. Although petitioner at hearing argued that the Division should have taken into account other factors, petitioner did not prove how these other factors would affect the respective values of the properties. Thus, we uphold the Division's calculation of the gains tax owed on the 305 Ocean Avenue property.⁷

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of petitioner Leonard Spodek is denied;
2. The exception of the Division of Taxation is granted;
3. The determination of the Administrative Law Judge is affirmed to the extent indicated in conclusions of law "A," "B" and "E," but is otherwise reversed;
4. The petition of Leonard Spodek is denied; and

⁷As the Administrative Law Judge pointed out in her determination, the Division never assessed tax on the transfer of the 180 East 18th Street property; therefore, that property does not concern us here.

5. Petitioner's claim for refund, as adjusted pursuant to the conciliation order dated September 28, 1990, is denied.

DATED: Troy, New York
November 19, 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