STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
JANE MANSIONS	:	DECISION DTA No. 810171
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.	:	

The Division of Taxation and petitioner Jane Mansions, c/o Leslie Susser, 6 East 43rd Street, 19th Floor, New York, New York 10017, each filed an exception to the determination of the Administrative Law Judge issued on February 24, 1994. Petitioner appeared by Leslie Susser, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Michael J. Glannon, Esq., of counsel).

Petitioner did not file a brief in support of its exception. The Division of Taxation filed a brief in support of its exception and in opposition to petitioner's exception. Petitioner filed a brief in opposition to the Division of Taxation's exception and in reply to the Division of Taxation's brief. The Division of Taxation declined to submit a reply brief. The reply brief was due by July 12, 1994, which date began the six-month period for the issuance of this decision. Neither party requested oral argument.

The Tax Appeals Tribunal renders the following decision per curiam.

ISSUES

I. Whether the Administrative Law Judge erred in finding that the creation of a lease was not additional consideration for the transfer of real property to a cooperative housing corporation.

II. Whether, pursuant to Tax Law § 1440(7), the Administrative Law Judge correctly aggregated consideration petitioner received for the creation of a leasehold in real property with consideration petitioner received for the transfer of the real property to a cooperative housing corporation.

FINDINGS OF FACT

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

Petitioner, Jane Mansions, a limited partnership, was the owner of a six-story apartment building located at 2 Jane Street, New York, New York.

On November 15, 1985, petitioner, as sponsor, filed with the New York State Department of Law a plan to convert the subject property to cooperative apartments ("the Plan").

Under the terms of the Plan as filed on November 15, 1985, upon transfer of title to the property from the sponsor to the cooperative housing corporation known as Two Jane Street Owners Corp. ("the CHC") the sponsor was to take back a 49-year master lease on certain ground floor commercial space and cellar storage space.

Petitioner subsequently entered into a master lease with an entity known as Duffield Corp., dated June 1, 1986, on the ground floor commercial space and cellar storage space of 2 Jane Street. This was essentially the same space which, under the plan as filed on November 15, 1985, was to be leased back by the CHC to petitioner.

The master lease between petitioner and Duffield Corp. was for 20 years with the lessee having two options to renew, one for 15 years and the other for 14 years, for a total lease term, if the options were exercised, of 49 years.

The master lease set the rent for the first year at $21,000.00. This was intended to be and, in fact, was a below-market rental. At the time the lease was entered into, the commercial space in the building was occupied by two stores. One store was operated as a veterinary office and was under a lease with annual rent of approximately $21,000.00. The other store was vacant at the time the lease was entered into, but had previously been operated as a gourmet food store and generated approximately $30,000.00 in annual rent.

As consideration for entering into the master lease, Duffield Corp. paid petitioner $50,000.00 in cash and gave petitioner a leasehold mortgage, also dated June 1, 1986, for $350,000.00.

For years following the first year, the master lease set annual rental as the sum of one-fifth of the lessor's expenses for real estate taxes and interest on the lessor's mortgage indebtedness plus one-ninth of the lessor's expenses applicable to its operation of the property. Also contained in the lease was a provision whereby, in the event the property was conveyed to a cooperative housing corporation which thereby became the lessor under the lease, the annual rent would be capped at 19.5% of the cooperative housing corporation's gross income. According to petitioner, this provision was included in the lease to ensure compliance with the so-called "80/20 rule" for cooperative corporations under section 216 of the Internal Revenue Code.

Pursuant to the $350,000.00 leasehold mortgage given by Duffield Corp. to petitioner, repayment of principal and interest under the mortgage was to be contingent upon Duffield's successful subleasing of the leased premises. The mortgage allowed for the waiver of interest payments for the first five years and deferral of interest payments for the remaining term of the mortgage where rents received by Duffield Corp. in respect of the leased premises were exceeded by the sum of rents payable by Duffield in respect of the same premises plus certain costs. The mortgage required principal repayment after the fifth year, but also provided for the deferral of repayment of principal for a total period of 30 years under the same circumstances.

The mortgage also provided that the parties thereto agreed that the mortgage provided rights to the mortgagor only against the mortgagee and only as provided in the mortgage. The mortgagor had no rights against the lessor of the premises if such lessor was not the mortgagee.

The mortgagee also had no rights against the mortgagor under the mortgage except as provided in the mortgage, i.e., the mortgagor incurred no personal liability under the mortgage.

The mortgagor, Duffield Corp., was created for the purpose of acquiring the master lease to the premises. It had no other assets. Its sole shareholder was Leonard Epstein, who was a less-than-ten percent limited partner of petitioner.

The Plan as filed on November 15, 1985 set forth terms of rental with respect to the proposed lease between the cooperative housing corporation, as lessor, and petitioner, as lessee, which were substantially similar to the terms of rental contained in the lease between petitioner and Duffield Corp. entered into on June 1, 1986.

The terms of the Plan were modified and supplemented by several amendments thereto. A summary of the provisions of the master lease between petitioner and Duffield Corp. and the related mortgage was set forth in the "Second Amendment" to the Plan, dated June 17, 1986.

The Plan, as amended, became effective July 11, 1986. Pursuant to the Plan, title to the subject property was conveyed in fee simple by petitioner to the cooperative housing corporation on August 13, 1986. Such title was conveyed subject to the lease dated June 1, 1986 between petitioner and Duffield Corp. Pursuant to the terms of such lease, upon the transfer of title to the cooperative housing corporation the CHC became the landlord under the lease.

Subsequent to the transfer to the CHC, Duffield Corp. paid rent under the lease to the CHC.

The transactions herein were ultimately structured in the manner described above in an effort to avoid the application of the Federal Condominium and Cooperative Abuse Relief Act of 1980 (15 USC § 3601 et seq)[1] which provided for the termination, without penalty, of contracts between sponsors and CHC's under certain circumstances. Petitioner was advised that this act might apply to a master lease of stores retained by a sponsor. This advice led to discussions between Mr. Leslie Susser, general partner of petitioner, and Leonard Epstein, which led, in turn, to Mr. Epstein's formation of Duffield Corp. and to the transaction as described herein. Also, in an effort to avoid the Federal Condominium Abuse Act, the lease between petitioner and Duffield Corp. provided that the leased premises were to serve the public generally and could not be used as property to serve the cooperative unit owners.

In connection with the transfer to the CHC, petitioner, as transferor, made timely filings as required under the Real Property Transfer Gains Tax Law. Upon review of a 50% project update

[1]It is noted that the original Plan, as filed on November 15, 1985, stated that the Federal Condominium Abuse Act did not apply to the contemplated lease between petitioner, as lessee, and the CHC, as lessor.

filing by petitioner, dated March 1, 1989, the Division of Taxation ("Division") made certain adjustments, set forth in a Schedule of Adjustments dated January 9, 1990, which had the net effect of increasing petitioner's anticipated gain from $770,708.00, as reported on the project update filing, to $1,241,547.00. Of this $470,839.00 net increase in anticipated gain, $400,000.00 resulted from an increase in petitioner's actual consideration from the transfer, which was, in turn, attributable to the $50,000.00 in cash and $350,000.00 leasehold mortgage given by Duffield Corp. to petitioner upon execution of the master lease on June 1, 1986.

The Schedule of Adjustments explained the $400,000.00 increase in actual consideration as follows:

> "IN ASSIGNING THE SPONSOR'S LEASEHOLD INTEREST IN 2 JANE STREET TO THE COOPERATIVE HOUSING CORPORATION, THE RETENTION BY THE SPONSOR OF THE RIGHT TO RECEIVE PAYMENTS UNDER THE LEASEHOLD MORTGAGE OF 6/1/86 (REPRESENTING THE DIFFERENCE BETWEEN FAIR MARKET VALUE RENTS AND THE RENTAL PAYMENTS TO BE MADE UNDER THE TERMS OF THE LEASE) RESULTS IN AN ECONOMIC GAIN TO THE TRANSFEROR."

Although, as noted, it appears that adjustments totalling $470,839.00 were made by the Division, only the $400,000.00 adjustment attributable to the Duffield leasehold transaction is at issue herein.

Taking into account the various adjustments, the Schedule of Adjustments calculated a tax due per share amount of $16.5540. Based upon this per-share figure, the Division subsequently issued to petitioner a Statement of Proposed Audit Changes dated May 21, 1990 wherein the Division proposed a gains tax assessment of $31,633.30, plus interest. The statement provided that the proposed assessment was based upon the Schedule of Adjustments dated January 9, 1990.

On July 7, 1990, the Division issued to petitioner a Notice of Determination which assessed a total amount due of $38,346.72, which included tax due of $31,633.30, plus interest accrued to that point.

Following a conciliation conference, the Bureau of Conciliation and Mediation Services issued a Conciliation Order dated September 13, 1991 which sustained the assessment and also noted that payments totalling $8,166.62 had been applied to the tax liability. After crediting such payments, the tax assessment herein is now $23,466.68, plus interest.

Petitioner received a net total of $1,476.00 in interest payments under the mortgage during the first three years of the mortgage.

Petitioner received no payments of principal under the mortgage.

Petitioner entered into the record calculations prepared by its accountant which indicate that the net present value of the mortgage as of the date of the leasehold transfer was $99,875.00.

OPINION

In his determination, the Administrative Law Judge sustained the Division's July 2, 1990 Notice of Determination. In arriving at his decision, the Administrative Law Judge rejected the Division's theory that the consideration given by Duffield Corp. constituted consideration received by petitioner for its transfer of the fee interest to the CHC. The Administrative Law Judge found the Division's reliance on Matter of Cheltoncort Co. (Tax Appeals Tribunal, December 5, 1991, affd Matter of Cheltoncort Co. v. Tax Appeals Tribunal, 185 AD2d 49, 592 NYS2d 121) misplaced due to his belief in the existence of factual differences between petitioner's case and Cheltoncort. In petitioner's case, petitioner created a leasehold interest in the property prior to the transfer of the fee interest to the CHC. In Cheltoncort, the petitioners transferred the entire fee simple interest to a CHC then took back a leasehold interest. The Administrative Law Judge found it pertinent that petitioner created the leasehold interest and transferred it to a third party before transferring the fee to the CHC.

However, the Administrative Law Judge embraced the Division's argument that the consideration petitioner received for its creation of the leasehold interest should be aggregated with the consideration it received for the fee interest due to the operation of Tax Law § 1440(7). Specifically, he stated:

> "In the instant matter, petitioner clearly contemplated the disposal of the entire subject parcel. Furthermore, had the transaction been

> structured as initially intended under the conversion plan as originally filed on November 15, 1985, the transfer of the leasehold back to petitioner would have constituted consideration subject to gains tax under the precedent of Matter of Cheltoncort Co. (supra). Accordingly, it is proper to aggregate the consideration received in respect of the leasehold transfer with the consideration received under the conversion plan" (Determination, conclusion of law "G").

The Administrative Law Judge next turned to the issue of how to value this consideration. He stated that "the face amount of a mortgage, rather than its value, is considered when determining consideration for gains tax purposes" (Determination, conclusion of law "H"). Accordingly, the Administrative Law Judge valued the leasehold mortgage petitioner held at its face amount and added to this amount the initial $50,000.00 payment petitioner received.

On exception, petitioner contends that the Administrative Law Judge improperly concluded the consideration petitioner received for its creation of the leasehold interest should be aggregated with the consideration it received from the co-op conversion. Petitioner bases this argument on the premise that one cannot aggregate consideration received from two transactions if only one of the transactions constitutes a transfer of an interest in real property as defined by the Tax Law. Specifically, petitioner asserts:

> "There can not be any aggregating of the consideration involved in the sale of, say, the fee-owners' boat or jewelry along with the sale of the fee-owners' real property. For the aggregation rules to apply there must be more than one transfer of real property. Here there was only one transfer of an interest in real property, that is, the transfer of the fee" (Statement appended to petitioner's exception, p. 2).

Petitioner argues that pursuant to Tax Law § 1440(7), which defines a transfer of an interest in real property, its creation of a leasehold interest in the property did not constitute a transfer of an interest in real property.

Alternatively, petitioner maintains that because a "good business purpose" existed for structuring the transaction in the way petitioner did, there existed no "agreement or plan to effectuate by partial or successive transfers a transfer which would otherwise be included in the coverage of the gains tax" (Statement appended to petitioner's exception, p. 3). Furthermore,

petitioner asserts that because no plan or agreement existed to circumvent the gains tax, the aggregation provision of Tax Law § 1440(7) does not apply to these transactions.

Finally, on exception, petitioner contends the Administrative Law Judge correctly found that Matter of Cheltoncort Co. v. Tax Appeals Tribunal (185 AD2d 49, 592 NYS2d 121) does not apply to the particular facts of petitioner's situation. Petitioner points out that the Administrative Law Judge stated "the Division of Taxation's 'reliance upon Cheltoncort is misplaced for that case is factually distinguishable from the instant matter'" (Petitioner's brief, p. 7).

Accordingly, petitioner requests that the Tax Appeals Tribunal reverse the Administrative Law Judge's determination of February 24, 1994 which sustained the Division's Notice of Determination.

In its exception, the Division

> "agrees with Judge Alston that the leasehold consideration should be combined with the consideration received from the transfer of the fee interest to determine total consideration. However, the Division . . . believes that the Judge incorrectly rejected the Division's argument that pursuant to the principals [sic] enunciated by the Appellate Division in Matter of Cheltoncort Company v. Tax Appeals Tribunal, 185 AD2d 49, the consideration received by the sponsor Jane Mansions from the lease was part of the total economic gain received in transferring its interest in the concerned premises" (Division's brief, pp. 2-3).

On exception, the Division contends Cheltoncort applies to petitioner's circumstances as well because the "Jane Mansions transaction had the same economic substance as that of Cheltoncort and the rationale of Cheltoncort should be applied making the entire consideration received by Jane Mansions from the master lease and fee interest subject to gains tax" (Division's brief, p. 6). Furthermore, the Division states that "[c]ombining consideration on the overall cooperative conversion by including the lease consideration with the fee consideration would be consistent with the expansive view of gains tax endorsed by the Court of Appeals in Matter of Bredero Vast Goed, N.V. v. Tax Commn. (146 AD2d 155, appeal dismissed 74 NY2d 791)" (Division's brief, p. 7).

The Division also argues that since the co-op shareholders "would be affected the same whether the master lease was implemented according to the original offering plan or pursuant to the amended offering plan," consideration received from the master lease should be included as part of total consideration (Division's brief, p. 7). The Division contends that because the economic gain petitioner realized from the lease reduced the co-op shares' value, pursuant to Cheltoncort, the consideration petitioner received from the lease's creation is subject to gains tax. Notably, the Division asserts that "[t]he correct and proper approach is to combine the total consideration from the master lease and the fee interest in determining gains tax on the overall cooperative plan" (Division's brief, p. 8).

On exception, the Division objects to petitioner's attempt to enter into the record an affidavit attached to its exception. In support of this objection, the Division directs us to Matter of Greenwald (Tax Appeals Tribunal, November 24, 1993) where we stated "this Tribunal has made it perfectly clear that, on exception, additional evidence may not be added to the record made at hearing."

We first address the exception of the Division contending that the Administrative Law Judge erred in finding that the consideration received from Duffield Corp. did not constitute consideration received by petitioner for its transfer of the fee interest to the CHC. We agree with this conclusion of the Administrative Law Judge and his conclusion that Matter of Cheltoncort Co. v. Tax Appeals Tribunal (supra) is not dispositive of this issue.

The Division's argument that Cheltoncort is controlling overlooks the fundamental distinction between the facts here and in Cheltoncort. In Cheltoncort, the transaction at issue involved a single transfer of real property for gains tax purposes: the transfer of the fee interest from the sponsor to the CHC. The favorable lease from the CHC to the sponsor was additional consideration given by the CHC for the fee interest. Thus, the transaction at issue in Cheltoncort involved one transfer, with a single transferor and a single transferee. In contrast, the instant case consists of a single transferor involved in two transactions with two transferees: the fee transfer to the CHC and the creation of the lease with Duffield Corp. To be within Cheltoncort, we

would have to find that the favorable lease given by petitioner to Duffield Corp. was actually additional consideration given by the CHC to petitioner for the fee interest. We simply see no basis for making such a conclusion and, therefore, decline to do so.

Although the Administrative Law Judge refused to find that the favorable lease constituted consideration for the transfer of the fee to CHC, he did find that the consideration for the two transactions should be aggregated for purposes of the $1 million exemption of section 1443(6) of the Tax Law. We conclude that he erred in this aspect of his determination.

Tax Law § 1441 imposes a tax on "gains derived from the transfer of real property within the state" (emphasis added). Tax Law § 1440(7) defines what constitutes a "transfer of real property." Specifically, section 1440(7) states:

> "'Transfer of real property' means the transfer or transfers of any interest in real property by any method, including but not limited to sale, exchange, [or] assignment . . . . Transfer of an interest in real property shall include the creation of a leasehold or sublease only where (i) the sum of the term of the lease or sublease and any options for renewal exceeds forty-nine years, (ii) substantial capital improvements are or may be made by or for the benefit of the lessee or sublessee, and (iii) the lease or sublease is for substantially all of the premises constituting the real property" (emphasis added).

Tax Law § 1440(7) also includes the "aggregation clause" which provides that:

> "Transfer of real property shall also include partial or successive transfers, unless the transferor or transferors furnish a sworn statement that such transfers are not pursuant to an agreement or plan to effectuate by partial or successive transfers a transfer which would otherwise be included in the coverage of this article."

As petitioner notes, the creation of a lease is only a transfer of an interest in real property where all of the three statutory conditions are satisfied. The lease involved here was for a term, including renewals, of 49 years. Because the term, including renewals, did not exceed 49 years the creation of this lease was not a transfer of real property for gains tax purposes. We also agree with petitioner that the "partial or successive transfers" referred to in the aggregation clause are transfers of real property and, therefore, the aggregation clause only aggregates consideration from a transaction if it is a transfer of real property for gains tax purposes. To hold otherwise would expand the gains tax beyond the imposition authorized by section 1441 on the gains

derived from the transfer of real property. Accordingly, we conclude that the consideration from the 49 year lease cannot be aggregated with the consideration from the transfer of the fee to apply the $1 million exemption.

Of course, we did not consider the affidavit submitted by petitioner on exception, after the closing of the record (see, Matter of Schoonover, Tax Appeals Tribunal, August 15, 1991).

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the Division of Taxation is denied;

2. The exception of Jane Mansions is granted;

3. The petition of Jane Mansions is granted;

4. The determination of the Administrative Law Judge is reversed; and

5. The Notice of Determination, dated July 2, 1990, is cancelled.

DATED: Troy, New York
December 29, 1994

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

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