STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
FORT TRYON APARTMENTS	:	DECISION DTA No. 810198
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 Fort Tryon Apartments, 4611 12th Avenue, Brooklyn, New York 11219, and the Division of Taxation each filed an exception to the determination of the Administrative Law Judge issued on July 14, 1994. Petitioner appeared by N. C. Caller, P.C. (Carl Caller, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Michael J. Glannon, Esq., of counsel).

Each of the parties filed a brief in support of its exception, in opposition to the other party's exception and in reply to the other party's brief in opposition. The Division's reply brief was received on February 16, 1995, which date began the six-month period for the issuance of this decision. Oral argument was not requested.

The Tax Appeals Tribunal renders the following decision per curiam.

ISSUE

Whether the Division properly determined the value of a lease from a cooperative housing corporation to a sponsor.

FINDINGS OF FACT

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

Petitioner, Fort Tryon Apartments ("Fort Tryon"), was a New York general partnership having its office in Brooklyn, New York. It was the sponsor of a plan to convert an apartment

building located at 245-303 Bennett Avenue a/k/a 4489-4521 Broadway, New York, New York to cooperative ownership.

The Cooperative Offering Plan stated that it was a non-eviction plan and that a non-purchasing tenant would not be evicted by reason of the conversion to cooperative ownership. The Introduction of the Cooperative Offering Plan explained that "[a]t Closing, the Apartment Corporation willacquire fee title to the land, the building and other improvements thereon." It also explained that the purchaser of a cooperative apartment buys shares of the apartment corporation which owns the building in which the apartment is located. The owner of shares is entitled to a proprietary lease and has the right to vote annually for the board of directors who are responsible for the affairs of the apartment corporation and supervision of the operation of the building. A lessee is directed to pay a proportionate share of the apartment corporation's cash requirements for the operation and maintenance of the building and creation of a reserve for contingencies. There were a total of 114,032 shares being offered which were allocated to 350 apartments in the building.

The Cooperative Offering Plan contained a section entitled "The Commercial Lease" which provided, in part, for the rental of the garage space in the apartment building as follows:

> "On or prior to the Closing Date, the Apartment Corporation, as Landlord, will enter into a lease (the 'Commercial Lease') with the Sponsor, or an entity designated by the Sponsor, as tenant (the 'Tenant'), for the garage space. The Commercial Lease will provide for an initial annual rent of $30,000 payable in equal monthly installments of $2,500 and will permit the garage area to be used for any lawful purpose.
>
> "The term of the Commercial Lease will commence on the Closing Date and will expire on the day prior to the forty-seventh anniversary of the Closing Date."

The Cooperative Offering Plan explained that the subtenants occupying the garage area would pay rent for the garage area directly to the tenant. Further, the annual rental which the tenant pays the landlord, which was initially set at $30,000.00 per year, was to increase every fifth year "in the same proportion as the maintenance payable by shareholders to the Apartment Corporation increases over the immediately prior period." The Cooperative Offering Plan then

explained that, in all events, the annual rental which was to be paid by the tenant would not exceed 70% of the rental income which was paid by the subtenants to the tenant. According to the Cooperative Offering Plan, the current rental income from the garage was approximately $90,000.00 per year.

The last paragraph of The Commercial Lease section of the Cooperative Offering Plan stated the following:

> "Section 608 of the federal Condominium and Cooperative Abuse Relief of 1980 (15 U.S.C. §3607) provides that certain contracts between a cooperative and a sponsor or an affiliate of a sponsor may be terminated without penalty by the vote of the owners of not less than two-thirds of all of the units in the cooperative other than units owned by the sponsor or by an affiliate of the sponsor. Such vote must occur only during the two-year period beginning on the date on which (i) the sponsor (or its successor) ceases to be in 'special developer control' of the cooperative or (ii) the sponsor (or its successor) owns 25 percent or less of the units in the project, whichever occurs first. The Department of Law has advised the Sponsor that the provisions of the Act, particularly Section 608 (15 U.S.C. §3607), MAY POSSIBLY APPLY TO THE COMMERCIAL LEASE discussed above. Sponsor disagrees strongly with this position, and in no way concedes the applicability of Section 608 to this lease, or to the management agreement discussed further in this Plan, by providing this disclosure. Sponsor further points out that the price for shares offered to initial tenant-purchasers and other offerees are premised on the continuing existence of the commercial lease and management agreement contemplated between the Apartment Corporation and the Sponsor. Without such lease or agreement, the prices for shares would be higher than set forth in this Plan."

Petitioner filed a Transferor Questionnaire which stated that 114,032 shares were being offered. The shares were allocated as follows: 20,856 shares were subscribed for at a price of $3,106,100.00; 82,981 shares were allocated to occupied unsold apartments and were valued at $100.00 per share; and 10,195 shares were allocated to vacant apartments and were valued at $200.00 per share. In addition, the cooperative corporation would have an indebtedness of approximately $5,455,000.00. The foregoing amounts were reduced by the amount to be contributed to the reserve fund of $342,096.00 and the amount to be contributed to the working capital fund of $15,000.00, resulting in an anticipated gross consideration of $18,541,104.00. Petitioner did not treat the commercial lease as part of the consideration for the transfer.

The closing took place on December 8, 1986. The Closing Statement describes the transaction, in part, as follows:

> "In connection with the conversion to cooperative ownership of the premises located at 243-303 Bennett Avenue a/k/a 4489-4521 Broadway, New York, New York (the 'Premises'), Transferor conveyed fee title to the Premises to Transferee by bargain and sale deed with covenant against grantor's acts dated December 8, 1986."

Fort Tryon Apartments Corp., as landlord, and petitioner, as tenant, executed a document entitled "Commercial Lease" dated December 8, 1986 which leased the garage space in the building 245-303 Bennett Avenue a/k/a 4489-4521 Broadway, New York, New York. The lease term was set as "one day less than forty-seven (47) years, commencing on the date hereof and ending on December 1, 2033, unless sooner terminated as hereinafter provided." The lease does not contain a provision for its termination by the tenant-shareholder in less than 47 years.

On the basis of a field audit, the Division of Taxation ("Division") issued a Notice of Determination, dated May 14, 1990, to petitioner, Fort Tryon Apartments. The notice assessed real property gains tax due of $74,988.43, plus interest of $22,451.14 and penalty of $26,245.95, for a current balance due of $123,685.52. After the Notice of Determination was issued, the matter proceeded to a conciliation conference. In a Conciliation Order dated August 30, 1991, the amount of tax asserted due was reduced to $52,468.00, plus penalty and interest. To the extent at issue herein, the asserted deficiency of tax is based on the Division's position that the economic gain attributable to the lease of the garage space of a building is additional consideration for the transfer of real property subject to the real property transfer gains tax. In order to determine the amount of the consideration, the Division estimated, on the basis of the rent roll for the garage area, that the income from the garage was $100,000.00 per year. Since petitioner pays $30,000.00 per year to the cooperative corporation for maintenance charges, the consideration for the garage area was based on the net income of $70,000.00 for the first year of the lease. The Division's calculation of the present value of the lease then proceeded as if the income from the lease increased at a rate of 10% per year for each of the remaining years of the lease.[1] The Division's calculation resulted in the determination that the present value of the lease was $2,990,909.09.

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[1]A notation at the top of the page in the Division's exhibit showing payments and present value of the lease states that there were yearly increases of 5%. After the hearing, it was explained that this was a misstatement.

At the hearing, petitioner raised a number of arguments. Initially, petitioner asserted that when it transferred the building to the cooperative corporation, it retained the right to collect the rent from the parking garage. According to petitioner, reservation of the interest did not constitute additional consideration since it is merely the reservation of an item which was not transferred to the cooperative corporation.

Petitioner also raised a number of arguments with respect to the way the lease was valued. Initially, petitioner pointed out that the Division's schedule of present value was erroneous on its face since it called for increases of 5% each year and the auditor calculated an increase of 10% each year. Secondly, petitioner submitted that the projection of 5% increases over 47 years was unrealistic since this lease is governed by rent stabilization which increases only in accordance with the rent guidelines. Petitioner also contended that the assumption that it collected rents of $100,000.00 per year was erroneous. According to petitioner, there was a substantial amount of uncollected rent because there were some people who did not pay and then left the apartment. Lastly, petitioner maintained that the Division's computation is erroneous because the auditor did not factor in the contingency that the lease could be cancelled.

Petitioner submitted a series of documents in support of its position. One document was a schedule of garage rents collected from December 1986 through May 1993. This document shows the amount collected less the sales tax which was included in the total amount collected.

Petitioner offered a schedule which had columns for year of the lease (numbered 1 through 47), collections, lease payment, net (collections minus lease payment) and present value. The amounts listed under collections correspond to the actual amounts of rent collected, less sales tax, during the first six years of the lease. Thereafter, petitioner estimated an increase in collection of 3% in each year of the lease. Petitioner used 3% for increases because the garage is occupied by tenants who are subject to rent control laws and the increases over the past few years have not exceeded 3%. Lease payments started out at $30,000.00 and increased

in steps at the rate of 8% once every five years.[2] The rate of 8% was used because it corresponded with the actual increase in lease payments which occurred at the end of the first five years. The lease payments were computed in five-year increments because the lease provided that every five years the cooperative corporation may increase the rent.

After the hearing, petitioner submitted three documents in support of its position. One document was an affidavit which stated, in part, that on February 1, 1993 a majority of the shareholders of the Fort Tryon Apartments Corp. voted to terminate the garage lease held by the sponsor.

Petitioner also offered an appraisal of the Commercial Lease, dated September 24, 1993, from a licensed New York State real estate broker who is engaged in buying, selling and managing income properties in New York City. The appraisal noted that the lease called for annual rentals of $30,000.00 in equal monthly installments of $2,500.00. It was the appraiser's understanding that the lessor would increase the rent every fifth year in the same proportion as the maintenance payable by shareholders to the apartment corporation increased over the immediately prior period. The appraiser also noted that the lessor is entitled to the rents from the users of the garage spaces.

The appraiser pointed out that petitioner's representative, Mr. Caller, provided him with a projection of future collections from the users of the garage spaces and the rental payments to be made by the lessee to the lessor. Mr. Caller also provided the appraiser with the present value of the collections. Finally, the appraiser stated that he was informed that the lease is subject to cancellation by the lessor when the tenant-shareholders take control of the board of directors, and that this will occur five years after the inception of the lease.

On the basis of the foregoing, the appraiser presented the following analysis:

> "CONCLUSION
>
> "Based upon the projections presented, and considering the cancellation contingency, I have determined the value of the [l]ease to be $327,375.73.
>
> "This analysis is based on the following:

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[2]At the hearing, petitioner stated that the lease payments increased by 7.4% every five years (Tr., p. 37). It is assumed that this was an inadvertent misstatement.

> "The value of the [l]ease for the first 5 years is: $198,778.95. The projected value for the remaining period has been projected based on estimates of the collections and lease payments over the remaining term. This projected sum is approximately $491,063.60. Based on my analysis of the lease terms, I concluded that the Lessor had every reason to cancel the lease since the Lessor would derive a much greater income by cancelling the [l]ease than by continuing the lease. Accordingly, I discounted the remaining projected value by 2/3rds. In consideration of the cancellation contingency, the projected value has been discounted to be 2/3rds of this amount, which is approximately $327,375.73."

The last document offered by petitioner was a memorandum of law which stated that the rent stabilization law applies to garage spaces.

OPINION

The Administrative Law Judge rejected petitioner's first argument that the garage space was not sold, but was retained by petitioner as sponsor. The Administrative Law Judge held that the value of the lease did constitute additional consideration to petitioner in the cooperative conversion because "petitioner transferred its entire interest in the building to the cooperative housing corporation and then took back a lease in the garage space under apparently favorable terms" (Determination, conclusion of law "B"). No exception was taken to this conclusion.

Next, the Administrative Law Judge addressed three issues involved in the valuation of this lease. First, the Administrative Law Judge rejected petitioner's contention that the Division's valuation of the lease was erroneous because it failed to take into account the fact that the lease could be cancelled by the cooperative corporation after five years. The basis for the Administrative Law Judge's conclusion was the statement in the offering plan that petitioner strongly disagreed with the position of the Department of Law that the owners of the apartments might have the right to cancel the lease under certain circumstances. Based on this statement, the Administrative Law Judge concluded that the parties did not contemplate the lease terminating before 47 years and the Division properly declined to consider this factor in its computation.

On exception, petitioner argues that the "[c]ancellation right of the master lease agreement by the Apartment Corporation must be factored in when appraising the value of the master lease agreement since the cancellation can substantially affect the value of the future

projected income from the subleasing of parking spaces" (Petitioner's brief on exception, p. 3).

In response, the Division states that the Administrative Law Judge correctly determined this issue.

We reverse the Administrative Law Judge on this issue.

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) establishes that the value of the consideration must be determined at the time of the transfer in order to finally fix the tax owed. In this case, the potential right of the Apartment Corporation to cancel the lease which existed at the time of the transfer was clearly a factor that would affect the value of the lease and, therefore, should have been taken into account by the Division in valuing the leasehold.

The Administrative Law Judge's conclusion that the parties did not contemplate terminating the lease is flawed because this conclusion was based solely on the position of petitioner as stated in the offering plan and did not reflect the position of the other party to the transaction, the Apartment Corporation. Given that the lease was favorable to petitioner, it is obvious that petitioner would take the stance that the lease could not be terminated. It is equally obvious that the Apartment Corporation, which was burdened with this below market lease, would take the position that the lease could be terminated. Therefore, the Administrative Law Judge had no support for his conclusion that the parties had a united intention with respect to the future of the lease.

Next, we must determine what affect the cancellation factor should be given in calculating the value of the lease. The Division offered nothing to contradict the opinion of petitioner's appraiser that the cancellation provision would reduce the projected value of the rent after the fifth year of the lease by two-thirds. Therefore, we conclude that the projected value of the lease after the five years must be discounted by two-thirds.

The next factor considered by the Administrative Law Judge in valuing the lease was whether the actual rents collected during the first six years of the lease should be considered in

order to apply a default factor to the rent rolls utilized by the Division. The Administrative Law Judge held that the defaults in paying rents were events that occurred after the transfer and, thus, under Cheltoncort were not relevant to determine the value of the lease.

On exception petitioner argues that "[i]n determining the future income, appraisers will take into consideration the income of a similar master lease agreement in a similar area with similar factors; they further estimate the probable annual expenses in operating the leased property, and determine a 'discount to the gross income estimate to allow for vacancy and collection loss' (emphasis added)" (Petitioner's brief on exception, p. 2).

The Division responds that the Administrative Law Judge correctly decided this issue.

We affirm the determination of the Administrative Law Judge on this point.

It may be that it would be appropriate in certain circumstances to discount the projected rent stream from a lease based on the likelihood that there would be defaults in paying the rent; however, petitioner has not demonstrated that such a factor should have been applied here, nor what the appropriate factor would have been. Petitioner's burden was to show the value of the consideration at the time of the transfer. The information submitted by petitioner indicates what the actual rental payments were during the first six years of the lease, but does not show that this is the rate of rental payment that was anticipated at the time of the transfer. Therefore, we conclude that petitioner is not entitled to adjust the value of the lease downwards based on a rent default factor.

The next element of the lease valuation considered by the Administrative Law Judge was the amount by which the lease payments for the parking spaces should be projected to increase each year over the term of the master lease. As stated in the facts, the Division's schedule of the future parking space rents states that yearly increases of 5% would be applied, but in fact the schedule calculates yearly increases of 10%. The Administrative Law Judge noted that the Division presented no explanation as to why the 10% rate was warranted. On the other hand, the Division did not dispute petitioner's assertion that the parking spaces were subject to rent control. The Administrative Law Judge stated that the rent control "factor only establishes an

outer limit on the rate at which revenues could increase. It does not establish what the appropriate rate of compounding revenues should be" (Determination, conclusion of law "I"). Ultimately, the Administrative Law Judge concluded that "[a]lthough the premise offered by petitioner for the appropriate rates of compounding may be questioned, it is the only rationale in the record. The rates of compounding of revenues and expenses proposed by petitioner is accepted" (Determination, conclusion of law "J").

On exception, the Division disagrees with the Administrative Law Judge's conclusion that the parking spaces were subject to rent control. In addition, if the spaces were subject to rent control, the Division disagrees with the use of the 3% increase factor arguing that petitioner did not demonstrate a basis for this rate.

The Administrative Law Judge obviously weighed the evidence submitted by petitioner against the lack of evidence submitted by the Division to support a 10% or a 5% annual increase and concluded that petitioner sustained its burden to prove that the Division should have utilized a 3% annual increase factor. We agree with the Administrative Law Judge's weighing of the evidence (see, Matter of Shop Rite Wines & Liquors, Tax Appeals Tribunal, February 22, 1991) and affirm the determination on this point.

In particular, we point out that the Division did not offer any explanation of the 10% factor. The Division did not present an auditor to explain the 10%, the audit papers said 5% but then applied 10% and did not explain a basis for either figure. On the other hand, the taxpayer did not just generally allege that 10% was unreasonable, it said a specific reason why, i.e., 10% failed to take into account rent control. The Division did not dispute petitioner's assertion that some spaces were subject to rent control.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Fort Tryon Apartments is granted to the extent that the Division is directed to recalculate the value of the lease by discounting by two-thirds the projected value of the rents after the fifth year of the lease to reflect the cancellation right of the Apartment Corporation, but such exception is in all other respects denied;

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

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

4. The Division of Taxation is directed to recompute the Notice of Determination dated May 14, 1990 in accordance with paragraph "1" above and conclusions of law "J" and "K" of the Administrative Law Judge's determination, but such Notice, as modified by the Conciliation Order, is otherwise sustained.

DATED: Troy, New York
August 10, 1995

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

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

COMMISSIONER DeWITT concurring in part and dissenting in part:

I concur with the decision by the majority of the Tribunal in this matter except for its affirmance of the determination of the Administrative Law Judge on the issue of the amount by which the lease payments for the parking spaces should be projected to increase each year over the term of the master lease.

In its calculation of the present value of the leasehold interest as of the date of transfer, the Division used an annual rate of increase of 10%. Petitioner argued that an annual rate of increase of 3% was appropriate given the applicability of rent control regulations to some of the parking spaces at issue. The Administrative Law Judge properly concluded that the rent control factor "only establishes an outer limit on the rate at which revenues could increase. It does not establish what the appropriate rate of compounding revenues should be" (Determination, conclusion of law "I"). However, the Administrative Law Judge accepted the factor of 3% offered by petitioner because "it is the only rationale in the record" (Determination, conclusion

of law "J"). Relying on the weight of the evidence submitted by petitioner against the lack of evidence submitted by the Division, the Administrative Law Judge concluded that petitioner had sustained its burden of proof that a 3% annual increase in rents was appropriate. I disagree.

In Matter of Atlantic & Hudson Ltd. Partnership (Tax Appeals Tribunal, January 30, 1992), this Tribunal stated that:

> "[a]lthough a determination of tax must have a rational basis in order to be sustained upon review . . . the presumption of correctness raised by the issuance of the assessment, in itself, provides the rational basis, so long as no evidence is introduced challenging the assessment
> . . . . [W]here, as here, petitioner has failed to make any inquiry into the audit method or calculation, the presumption of correctness raised by the issuance of the assessment provides the rational basis for the assessment. To hold otherwise would be in irreconcilable conflict with the principles that the Division does not have the burden to demonstrate the propriety of its assessment [citations omitted]" (Matter of Atlantic & Hudson Ltd. Partnership, supra).

Additionally, this Tribunal has held that:

> "[p]etitioners cannot meet their obligation to prove by clear and convincing evidence that the result of the method was unreasonable, inaccurate or that the amount of the tax assessed is erroneous merely by arguing a different method for estimating tax liability, even if the proposed alternative method has merit" (Matter of Petak's of New York, Tax Appeals Tribunal, September 9, 1993, affd ___ AD2d ___ [July 20, 1995]).

Petitioner has provided no evidence other than the testimony of its representative to overcome the presumption of correctness surrounding the Division's use of an annual increase in rental income of 10% or to support the application of a 3% factor to the overall annual rental income.

This case is distinguished from Matter of Shop Rite Wines & Liquors (supra). There, the Tribunal noted that:

> "[i]n other cases where we found the record did not contain sufficient evidence to determine the source of an audit factor, we concluded that the appropriate remedy was to remand the matter for further testimony to describe the basis of the audit [citations omitted]" (Matter of Shop Rite Wines & Liquors, supra).

This Tribunal concluded that:

> "based on the auditor's testimony, that there exists no rational basis for the use of a 2% figure for theft and breakage. On the other hand, petitioners did introduce evidence at the hearing to substantiate their claim that 2%

> was too low a percentage. In addition to testimony, petitioners submitted an article from the Beverage Media, an industry magazine, which . . . stated that the average nationwide loss in package liquor stores to theft alone was 7% of inventory. . . . Weighing the evidence submitted by petitioners, versus the lack of any evidence by the Division to support the 2% allowance, we conclude that petitioners sustained their burden of proof" (Matter of Shop Rite Wines & Liquors, supra).

Here, petitioner's estimate of value was prepared by petitioner's representative (Transcript, p.. 31-32, 40). By his own statement, he is not a qualified appraiser (Transcript, p. 40). Although the representative was allowed time subsequent to the hearing to submit documentation to support his use of a 3% factor, no supporting documentation was submitted. It appears from the offering plan that not all of the leased garage spaces were subject to rent control. Yet, there is no evidence in the record as to how many such spaces were subject to rent control on December 8, 1986, the date as of which consideration for the transfer must have been calculated. Thus, even if 3% were an accurate figure for annual rental increases for those garage spaces subject to rent control in this project, there is no basis for concluding that this figure is applicable to the rentals as a whole.

In short, I conclude that petitioner has not met its burden to prove by clear and convincing evidence that the Division's use of an annual rental increase factor of 10% was erroneous and that a figure of only 3% should have been used instead. Therefore, I would reverse the determination of the Administrative Law Judge on this point.

DATED: Troy, New York
August 10, 1995

/s/Donald C. DeWitt
Donald C. DeWitt
Commissioner