STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
LEWIS B. AND BEATRICE M. KAYE	:	DECISION DTA No. 811700
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.	:	

Petitioners Lewis B. Kaye and Beatrice M. Kaye Riccobono,[1] c/o LBK International Realty Corporation, 555 Madison Avenue, New York, New York 10022, filed an exception to the determination of the Administrative Law Judge issued on July 6, 1995. Petitioners appeared by James L. Tenzer, Esq. The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Andrew J. Zalewski, Esq., of counsel).

Petitioners filed a brief in support of their exception. The Division of Taxation filed a brief in opposition. Any reply brief by petitioners was due on January 12, 1996, which date began the six-month period for the issuance of this decision. Petitioners' request for oral argument was denied.

The Tax Appeals Tribunal renders the following decision per curiam.

ISSUES

I. Whether the Division of Taxation erroneously calculated "original purchase price", used to determine petitioners' gains tax liability on their sale of shares in cooperative apartment units, by its refusal to step up petitioners' acquisition price for such shares to the cooperative housing corporation's cost for such property because the property was transferred by petitioners to the cooperative housing corporation pursuant to a written agreement which had been

[1]On certain documents, including a power of attorney dated May 26, 1995, Beatrice M. Kaye is identified as Beatrice M. Kaye Riccobono.

executed prior to the March 28, 1983 effective date of the gains tax law.

II. Whether the Division of Taxation erroneously included a purchase money wraparound mortgage note in its calculation of "consideration" received by petitioners on their subsequent sale of shares in cooperative apartment units because this mortgage note was received by petitioners from the cooperative housing corporation pursuant to a written agreement which had been executed prior to the March 28, 1983 effective date of the gains tax law.

III. Whether the Division of Taxation erred in utilizing the actual consideration received, rather than an estimate of anticipated consideration, to calculate the tax due.

IV. Whether the differing treatment of cooperative corporations and noncooperative corporations by the Division of Taxation with regard to the determination of original purchase price and the treatment of mortgages in determining consideration violates the equal protection clauses of the New York State and United States constitutions.

V. Whether the Division of Taxation incorrectly calculated interest and penalty due.

VI. Whether petitioners have established that penalties should be abated.

FINDINGS OF FACT

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

Petitioners, Lewis B. and Beatrice M. Kaye, apparently as tenants-in-common, were the sponsors-sellers of a cooperative offering plan dated May 14, 1982 for the conversion of rental apartments into cooperative housing units involving a building located in Manhattan's Greenwich Village at a street address of 96 Perry Street. Only limited portions of the offering plan were submitted for review, which reflects the limited nature of the administrative record. It is observed that the cover sheet of the offering plan (Division of Taxation's ["Division"] Exhibit "S") shows Lewis B. and Beatrice M. Kaye as the "sponsor-seller". However, page 2 of the 22nd Amendment to the offering plan, also included in Exhibit "S", references only Lewis B. Kaye as the sponsor. This variance is unexplained. The Greenwich Village building

at 96 Perry Street contained a total of 35 apartments, which were offered for sale pursuant to the offering plan. Petitioners had acquired the property in August 1975 for $240,000.00 (Division's Exhibit "0").

On November 29, 1988, a tax technician of the Division of Taxation notified petitioners' then attorney, Alan Haberman, that a review of records at the New York State Department of Law (the Attorney General's Office) disclosed that "[t]he aggregate consideration to be received for [the conversion of rental apartments into cooperative housing units at 96 Perry Street] will exceed $1 million." Mr. Haberman was advised that the Division had checked its files and found no record that petitioners had complied with filing requirements under the gains tax law, Article 31-B of the Tax Law, which mandate that the transferor and transferee of shares allocated to cooperative housing units must file questionnaires with the Tax Department at least 20 days prior to the date of each transfer (where the total consideration from transfers will be $500,000.00 or greater).

A review of the Division's tax field audit record (also known as the auditor's log), which was marked Division's Exhibit "Q", shows that over a five-month period, from June to November 1990, petitioners by their accountant were slow to cooperate with the auditor's requests for records concerning the cooperative conversion project at issue, and, in fact, never provided the auditor with much of the requested documentation. An entry for July 11, 1990 provided as follows:

> "Meeting with Mr. Ellenbogen [petitioners' accountant] was non-productive. He was not at all prepared and did not have any information requested in appointment letter. It was agreed that I would forward to him DTF-701 & 700[2] to be completed by him along with gathering all pertinent documents and data . . . ."

Subsequent entries give a flavor of the auditor's difficulty in auditing the transfers at issue:

Entry for August 10, 1990: "Called Mr. Ellenbogen to ascertain level of progress

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[2]DTF-700 is a transferor's real property transfer gains tax questionnaire form of the Department of Taxation and Finance (emphasis added to show the abbreviation "DTF"). DTF-700 is a real property transfer gains tax schedule of original purchase price for cooperatives and condominiums. Petitioners' Exhibit "9" includes a form DTF-701 dated September 30, 1994 by petitioners as well as an, apparently, accompanying form DTF-700, which was undated as well as a form DTF-702, a transferor's real property transfer gains tax unit submission questionnaire for cooperatives and condominiums also dated September 30, 1994. The record does not include any earlier forms or questionnaires completed by petitioners.

in compiling info and documents requested in 7/12/90 letter . . . . He requested I call back in several weeks . . . ."

Entry for September 17, 1990: "Called Mr. Ellenbogen for update. He requested an additional two-three weeks to gather info . . . ."

Entry for October 15, 1990: "Established appointment for 11/20/90."

Entry for November 20, 1990: "Commenced field audit at Mr. Ellenbogen's office . . . . Although I sent Mr. Ellenbogen a letter on July 12, 1990 that provided a detail[ed] list of records and documents I needed to conduct the audit as well as giving him approximately 4 months to gather the information, he only provided me with his accounting write-up workpapers, some sales contracts and subscription agreement as documentation for the audit . . . . As indicated above, cancel[led] checks, invoices and other conventional evidence was not available to evaluate propriety of cost items. A list of additional information was presented and Mr. Ellenbogen said he would try to get the records requested, but was not optimistic he could find them."

The Division issued a Statement of Proposed Audit Adjustment (form AU-200) dated January 7, 1991 against petitioners asserting tax due per audit of $86,854.00, plus penalty and interest. An undated audit summary (Division's Exhibit "R") summarized the computation of tax due of $86,854.00, in relevant part, as follows:

"[Petitioners' accountant] only provided me with his accounting write-up workpapers, some sales contracts/ subscriptions, CHC [cooperative housing corporation] closing statement and cost schedules as documentation for the audit.

"Based upon the available information, I was able to determine that 26 units were sold for cash proceeds of $1,097,750.00, in which 11 units representing $409,100.00 in sales was exempt under the grandfather provision of the law. The 9 remaining units were valued at $184,320 based on Safe Harbor Estimate Rules. Including the taxable portion of the CHC mortgage indebtedness of $887,500.00, the total estimated taxable consideration for the project represents $1,760,470.00.

"Total OPP [original purchase price] claimed by the taxpayer was $645,975, of which $198,242.00 (31%) was disallowed. The items disallowed were primarily attributable [to] equipment and repairs claimed as capital improvements and non-allowable selling expenses. In addition to the disallowances, $129,790.00 (29%) of OPP was apportioned to the grandfather units sold. As a result of the aforementioned adjustments, the net OPP allowed was $317,763.00.

"The audited tax due is $86,854.00. Since the taxpayer did not file any questionnaires or make any tax payments, penalty of $30,399 was imposed. Along with interest of $67,032.00, the total tax assessment is $184,285.00."

Included in the record are the following 10 detailed schedules prepared by the auditor, each dated January 2, 1991, which were the basis for the Division's calculation of tax due as asserted in the Statement of Proposed Audit Adjustment described above:

Schedule	Division's Exhibit Letter
(1) WEC [Worksheet Estimated Consideration] and audit schedule	Exhibit "G"
(2) Audit schedule of units sold per audit and units available for future taxable sales	Exhibit "H"
(3) Calculation of acquisition, capital improvement and cooping costs (to determine original purchase price)	Exhibit "I"
(4) Schedule of selling expenses allowed	Exhibit "J"
(5) Schedule of conversion expenses allowed	Exhibit "K"
(6) Schedule of brokerage commission allowed	Exhibit "L"
(7) Schedule of grandfathered, sold and unsold units	Exhibit "M"
(8) Schedule of capital improvements	Exhibit "N"
(9) Schedule of purchase price and other acquisition costs	Exhibit "0"
(10) Computation of composite date of March 27, 1985 for interest and penalty	Exhibit "P"

The schedule listed as number "2" (Division's Exhibit "H"), audit schedule of units sold per audit and units available for future taxable sales, shows that out of 24[3] taxable units, petitioners transferred shares on 15 units per the audit and had 9 additional units available for future taxable sales. The Division calculated a taxable percentage of 71% as follows:

	No. of Shares	Percentage	Units
Total per offering plan	12,000	100%	35
Less: Grandfathered	3,444	29%	(11)
Total taxable units	8,556	71%	24

The schedule listed as number "3" (Division's Exhibit "I"), calculation of acquisition, capital improvement and cooping costs, shows the following calculation of total original purchase price of $477,553.00 with 71%, or $317,763.00 of such amount allocated to the taxable units:

[3]Eleven units were treated as "grandfathered" units not subject to tax because contracts for their sale were executed prior to the effective date of the gains tax law.

Original cost per [1975] contract	$240,000.00		
Acquisition expense	1,065.00		
Total original "original purchase price"			$241,065.00
Capital improvements claimed by petitioners	$177,415.00		
Disallowed capital improvements	(133,300.00)		
Allowed capital improvements			$ 44,115.00
Cooping expenses & selling expenses:			
Conversion costs claimed by petitioners & allowed		$ 38,927.00	
Selling expenses claimed by petitioners	$188,388.00		
Disallowed selling expenses	(64,942.00)		
Allowed selling expenses		$123,446.00	
Total cooping expenses			$162,373.00
Total original purchase price			$447,553.00

Grandfathered percentage 29% $129,790.00
Taxable percentage 71% $317,763.00
$447,553.00

To determine the gain subject to tax, the taxable percentage of original purchase price of $317,763.00 was subtracted from consideration of $1,672,828.00, which was shown calculated on the schedule listed as number "1" (Division's Exhibit "G") as follows:

	Actual	Anticipated	Total
Cash consideration	$1,097,750.00	$184,320.00	$1,282,070.00
Less: Grandfathered	(409,100.00)		(409,100.00)
Total consideration			$ 872,970.00
Add: Mortgage Indebtedness Actual $1,250,000.00 x 71%			887,500.00
Total estimated consideration			$1,760,470.00
Less: Working fund $64,160.00 x 71%			(45,554.00)
Less: Brokerage commissions: Actual $55,575.00 less grandfathered $24,546.00			(31,029.00)
Anticipated brokerage commissions			(11,059.00)
Balance			$1,672,828.00

The schedule listed as number "7" above (Division's Exhibit "M") shows that anticipated consideration for the 9 units available for future taxable sales was calculated by the Division, utilizing so-called "safe harbor values", to be $184,320.00 as follows:

Unsold

Apartment #	Status[4]	Shares	Safe Harbor Value[5]
1B	C	170	$ 10,200.00
1C	C	160	9,600.00
7	S	440	26,400.00
9A	S	264	15,840.00
12	C	440	26,400.00
17A	S	284	17,040.00
19	S	500	30,000.00
21A	S	294	17,640.00
23	C	520	31,200.00
			$184,320.00

This schedule also shows a total of $688,650.00 for the sale of 15 taxable units at prices ranging from $18,500.00 to $102,500.00. As noted on the schedule listed as number "1" (Division's Exhibit "G"), the Division used total consideration of $872,970.00 ($688,650.00 plus $184,320.00) in its calculation of tax due.

Petitioners' accountant, Bernard Ellenbogen, responded to the issuance of the Statement of Proposed Audit Adjustment by a letter dated February 4, 1991 to the Division's auditor (Division's Exhibit "V"). Mr. Ellenbogen requested that petitioners' original purchase price for their taxable shares be recomputed by using the "fair market value" of the real property at the time of transfer of the shares to the cooperative housing corporation because the transfer to the cooperative housing corporation on April 29, 1983 was pursuant to a written contract executed on March 3, 1982, prior to the March 28, 1983 effective date of the gains tax law.
Mr. Ellenbogen also gave four additional reasons why petitioners' original purchase price for their taxable shares should be increased:

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[4]Presumably, "C" stands for a rent-controlled apartment and "S" for a rent-stabilized apartment.

[5]As noted above, the auditor noted in his summary that the "9 remaining units were valued at $184,320 based on Safe Harbor Estimate Rules." The record does not include the specific safe harbor estimate rules utilized by the auditor. On May 1, 1986, the Division had issued TSB-M-86-(3)-R, the "Safe Harbor Estimate for Transfers Pursuant to Condominium and Cooperative Plans" which provided specific formulas for estimating consideration for unsold shares in a cooperative conversion. If such formulas were utilized, a taxpayer would not be subject to penalty and interest on any underpayment. In the matter at hand, the Division calculated safe harbor values based on a $60.00 price per share, which is 50% of the $120.00 per share specified in the offering plan (Division's Exhibit "S").

(1) An increase of $76,500.00 for the following anticipated costs to complete the project:

Vacating expense and buy-downs	$45,000.00
Legal fees	4,500.00
Apartment renovations	27,000.00
	$76,500.00;

(2) An increase of $183,877.00 for the following costs disallowed by the Division:

Capital improvements		$133,300.00
Cost of buy-outs	6,928.00	
Advertising		43,649.00
		$183,877.00;

(3) An increase of $2,365.00 for mortgage recording tax;[6] and

(4) An increase of an unspecified amount representing "costs, including conversion period interest expense, in excess of temporary, ancillary and incidental rental income."

Mr. Ellenbogen also contended that the Division should exclude from "consideration" the $1,250,000.00 wraparound purchase money mortgage, which was issued by the cooperative housing corporation pursuant to a "grandfathered" contract, because the value of a "grandfathered" bargain lease would have been excluded from the calculation of consideration. Finally, Mr. Ellenbogen argued that penalties and interest should be reduced or abated because "had [petitioners] filed timely, the 'gains' tax due, if any, would have been substantially less (or none at all)."

Accountant Ellenbogen declined an offer to discuss his letter with the auditor's section manager. According to the audit summary (Division's Exhibit "R"), "[a]fter discussing the matter with the Team Leader, a written response advising him [Mr. Ellenbogen] that the proposed assessment would remain unchanged was mailed on February 21, 1991."

The Division then issued a Notice of Determination dated April 8, 1991 against petitioners asserting gains tax due of $86,854.00, plus penalty and interest.

Petitioners Formally Contest Assertion of Tax Due

[6]This amount apparently represented the special additional recording tax of ¼%.

Petitioners timely contested the issuance of the Notice of Determination dated April 8, 1991 by the filing of a Request for Conciliation Conference dated July 2, 1991, which was signed by their representative, attorney James L. Tenzer. The basis for making their request for revision of the Division's determination, as set forth in this request, was an exact restatement of accountant Ellenbogen's letter dated February 4, 1991 (Division's Exhibit "V" detailed above).

A Conciliation Order dated December 4, 1992 denied petitioners' request and sustained the Notice of Determination dated April 8, 1991.

Petitioners then timely contested this denial of their request by the filing of a petition dated March 3, 1993, which was also executed by attorney Tenzer on petitioners' behalf. In addition to raising the issues previously noted by accountant Ellenbogen in his letter dated February 4, 1991, which were repeated in the Request for Conciliation Conference dated July 2, 1991, petitioners raised the following additional concerns:

(1) The Division improperly excluded conversion period interest, conversion period real estate taxes and other conversion period costs in its calculation of original purchase price;[7]

(2) The overall project gain' allocated to each of the units, including the grandfathered units, should be computed under "Option B"; and

(3) Penalty and interest penalty "were arbitrarily assessed and should have been abated for 'reasonable clause' [sic] . . . ."

PROCEDURAL PERMUTATION

In their brief, petitioners did <u>not</u> address the following issues raised in their petition:

(1) Original purchase price should be increased by $76,500.00 for anticipated costs to complete the project;

(2) Original purchase price should be increased by $183,877.00 representing certain

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[7]Mr. Ellenbogen in his letter of February 4, 1991 had complained that "costs, including conversion period interest expense, in excess of temporary, ancillary and incidental rental income" should be added to original purchase price which is similar to the above, although the petition specified "conversion period real estate taxes." It is observed, nonetheless, that petitioners did not introduce any evidence to document any "conversion period" expenses.

costs for capital improvements, costs of buy-outs and advertising disallowed by the Division;

(3) Original purchase price should be increased to include conversion period interest, conversion period real estate taxes and other conversion period costs; and

(4) It appears[8] that petitioners continue to contend that the overall project gain was not properly computed by the Division because it based such gain "upon the actual 'consideration' received by the petitioner and the actual OPP incurred by the Petitioner, as adjusted by the Respondent" (Petitioners' brief, p. 24; emphasis added).

In addition, in their brief, petitioners raised for the first time the additional issue, that "the anticipated 'cash consideration' as determined by [the Division] for the unsold shares is incorrect" (Petitioners' brief, p. 21). In support of this newly-raised issue, petitioners attached to their brief several exhibits, which were described in petitioners' brief on page 22 as follows:

> "1. Pursuant to Section 2 of the 'Ninth Amendment' [to the offering Plan, which was attached as petitioners' Exhibit "10"] the price per share for tenants in occupancy was established at $45.00 per share. Furthermore, as discussed in Sections 7 [Petitioners Exhibit "2" attached to the brief] and 8 [not included in the record] thereof, the actual price was subject to further reductions for certain allowances.
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> "2. As discussed in the August 30, 1994 'Agreement' [Petitioners' Exhibit "7" attached to the brief, which was an agreement between petitioners and the cooperative housing corporation] and the September 30, 1994 'Affidavit' [Petitioners' Exhibit "8" attached to the brief, which was an affidavit of petitioner Lewis B. Kaye], the Petitioners and Owners [presumably the cooperative housing corporation, 96 Perry Street Corp.] have agreed that the unsold shares will be transferred to Owners and that, based upon the substantial excess of the required monthly maintenance payments allocable to such shares over the rent that will be collected from the existing tenants (who are occupying the units pursuant to leases where rents and permitted increases in rents are governed by the provisions of rent control), such Shares have no value."

In its brief, the Division responded to the issue newly raised by petitioners in their brief, concerning the computation of anticipated consideration, by noting that it would review the

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[8]In their petition, the claim was that Option "B" should have been used by the Division to compute the gain subject to tax which seems to be similar to this argument raised in the brief.

taxpayers' recent taxfiling[9] and requested "that the taxpayer provide all records that would allow a determination of the maintenance arrears and other debts being forgiven" (Division's brief, p. 13). The Division also emphasized that "the plan's Ninth Amendment requiring a $45 per share insider's price is confusing and contradicts those records that were provided to the Department" (Division's brief, p. 13). It is observed that petitioners' Exhibit "10", a copy of the Ninth Amendment to the offering plan, is dated May 24, 1983 and provides that rent-controlled tenants may purchase the shares of the cooperative housing corporation allocated to their apartments at $45.00 per share.

In their reply brief, petitioners contend that the Division:

> "incorrectly incorporates the $60 per share amount as reported in the November 15, 1982 "Fifth Amendment to Offering Plan" [which was not included in the record] . . . . [T]his amount was reduced prior to the sale of the first 'taxable' unit to the $45 per share amount" (Petitioners' reply brief, p. 8).

OPINION

On exception, petitioners repeat the arguments made to, and rejected by, the Administrative Law Judge, specifically, that: 1) the original purchase price for shares sold by petitioners should be based upon the fair market value of the real property on the date that it was transferred to the cooperative housing corporation (stepped up); 2) no portion of the wraparound mortgage note received by petitioners should be included as consideration because the note was executed pursuant to a contract entered into prior to March 28, 1983; 3) the failure to calculate gain according to these two rules violates the Federal and State constitutions; 4) the Division was required to use an estimate of consideration, rather than the actual consideration received, when calculating the tax due on the 15 taxable units that had been sold at the time of the audit; and 5) the penalty should be abated because petitioners in good faith and based upon a reasonable interpretation of Article 31-B were of the opinion that the transfers were not subject to tax.

The Administrative Law Judge decided the first four of these issues against petitioners

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[9]As noted in footnote "2," petitioners did not file any questionnaires or forms prior to their "recent" tax filing dated September 30, 1994 upon the "project total update."

based on our decision in Matter of Belhara Assocs. Ltd. Partnership (Tax Appeals Tribunal, January 26, 1995) which, as the material quoted by the Administrative Law Judge indicates, addressed these arguments at length (see also, Matter of Ivancrest Assocs., Tax Appeals Tribunal, January 19, 1995 and Matter of 44 West 62nd St. Assocs., Tax Appeals Tribunal, August 11, 1994). Our decision in Matter of 470 Newport Assocs. (Tax Appeals Tribunal, September 2, 1993) also addressed and rejected the step up, mortgage, and constitutional arguments raised by petitioners. As noted by the Administrative Law Judge, our decision in 470 Newport was confirmed by the Appellate Division in Matter of 470 Newport Assocs. v. Tax Appeals Tribunal (211 AD2d 322, 627 NYS2d 1020), in which the Court explicitly addressed, and affirmed, our rulings denying the taxpayer a step up in original purchase price and upholding the constitutionality of this treatment. Since the issuance of the Administrative Law Judge's determination, the Court of Appeals has denied 470 Newport Associates' motion for leave to appeal (87 NY2d 804, ___ NYS2d ___) and dismissed its appeal (86 NY2d 837, 634 NYS2d 445). Therefore, contrary to petitioners' contention, these issues are well settled.

We also disagree with petitioners' contention that the Administrative Law Judge failed to address their arguments with respect to the use of actual consideration in calculating the tax due on the sale of the 15 units that had been sold at the time of the audit. The last two paragraphs quoted by the Administrative Law Judge from our decision in Belhara Assocs. address and approve the same method of calculating tax as was employed in this case (see also, Matter of Ivancrest Assocs., supra; Matter of 44 West 62nd St. Assocs., supra).

The Administrative Law Judge sustained the imposition of penalty on the ground that petitioners had not established reasonable cause for their failure to report and pay gains tax. In particular, the Administrative Law Judge stated, that "the record does not support a conclusion that petitioners made a sufficient effort to ascertain their correct tax liability" (Determination, conclusion of law "G").

On exception, petitioners have not advanced any argument that was not adequately and correctly addressed by the Administrative Law Judge. Therefore, we affirm the determination

of the Administrative Law Judge for the reasons stated in the determination.

Accordingly it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Lewis B. and Beatrice M. Kaye is denied;

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

3. The petition of Lewis B. and Beatrice M. Kaye is granted to the extent indicated in conclusions of law "D," "E" and "H" of the Administrative Law Judge's determination, but is otherwise denied; and

4. The Division of Taxation is directed to modify the Notice of Determination dated April 8, 1991 in accordance with paragraph "3" above, but such Notice is otherwise affirmed.

DATED: Troy, New York
June 13, 1996

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

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

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