STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
SIDNEY RAPOPORT	:	DECISION DTA No. 811824
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 Sidney Rapoport, Rapoport/Metropolitan Printing, 195 Hudson Street, New York, New York 10013, filed an exception to the determination of the Administrative Law Judge issued on July 7, 1994. Petitioner appeared by Drake, Sommers, Loeb, Tarshis & Catania, P.C. (Steven L. Tarshis, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Donald C. DeWitt, Esq., of counsel).

Petitioner filed a brief in support of his exception. The Division of Taxation filed a brief in opposition, to which petitioner filed a reply. Oral argument was heard on March 16, 1995, which date began the six-month period for the issuance of this decision.

The Tax Appeals Tribunal renders the following decision per curiam. Commissioner Donald C. DeWitt took no part in the consideration of this decision.

ISSUES

I. Whether petitioner's conveyance of a leasehold interest which contained an option to purchase was a transfer of an interest in real property subject to the gains tax.

II. Whether termination of aforesaid lease, prior to the exercise of an option to purchase, affected the taxability of the lease transaction, thereby warranting a refund of gains tax and interest previously paid.

III. Whether imposing tax on the instant transaction was an unconstitutional application of the gains tax statutes.

FINDINGS OF FACT

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

On September 7, 1993, the representatives of Sidney Rapoport and the Division of Taxation entered into a written stipulation (including Exhibits "A" through "R"), the relevant portions of which have been incorporated into Findings of Fact "1" through "17".

1. On or about July 16, 1990, Sidney Rapoport ("petitioner"), as lessor, entered into a lease agreement with the Joseph Gardner Trust U/A/D December 30, 1987, as lessee, relative to real property located at 187-195 Hudson Street in New York City. The term of the lease was July 16, 1990 through May 31, 2039.[1]

2. On or about May 31, 1990, transferor and transferee questionnaires were filed with the Division of Taxation ("Division"). The transferor questionnaire set forth the following computation:

[1]The copy of the lease attached to the stipulation (Exhibit "A") was unsigned and undated. However, on the first page of the lease agreement, under the heading "TERM," the lease stated as follows:

> "2. The term of this lease (the 'Demised Term') shall commence on June ___, 1990 (the 'Term Commencement Date'), and shall terminate on May 31, 2039 (the 'Expiration Date')."

"1. Gross Consideration (Present value of lease using a 10% factor + Option + Brokerage to be paid by transferee to broker ($5,249,826 + $499,990 + $100,000) $5,849,816

2. Brokerage 100,000

3. Consideration $5,749,816

4. Original purchase price x Value of Lease payments = Adjusted of Real Property Fair Market Value of Prop. OPP

$2,000,000 x $5,749,816 = $1,839,941 Adjusted OPP
$6,250,000

Gross Consideration	$5,749,816
Less Adjusted OPP	(1,839,941)
Gain Subject to Tax	$3,909,875
Tax Due (10% of $3,909,875)	$ 390,988"

Petitioner, on or about the same date, filed a supplemental gains tax return wherein he elected to pay the tax in 15 annual installments of $26,066.00. By check dated May 31, 1990, the first installment of gains tax due was paid.

3. By letter dated October 2, 1990, the Division notified petitioner that his election to pay the gains tax due in installments had been accepted as filed.

On or about July 7, 1991, petitioner paid the second installment of tax due in the amount of $26,066.00, plus interest in the amount of $41,846.29. Therefore, as of July 7, 1991, petitioner had paid a total of $93,978.29 which consisted of tax in the amount of $52,132.00, plus interest of $41,846.29.

4. On or about November 8, 1991, petitioner and the lessee agreed to terminate the lease and executed a Lease Termination Agreement. As part of the Lease Termination Agreement, the parties thereto agreed that the option to purchase the property was likewise terminated.

5. On or about February 15, 1992, a date which was within two years of the filing of the return and the payment of the first installment of tax due, petitioner filed a claim for refund of gains tax due in the amount of $52,132.00, plus interest of $41,846.29.

6. By letter dated March 31, 1992, the Division denied petitioner's refund claim in its entirety.

7. On June 30, 1992, a Request for Conciliation Conference was filed by petitioner requesting a refund in the amount of $93,978.20, representing tax and interest paid as of that date.

8. On October 30, 1992, after written notice to all parties by the conciliation conferee, a conciliation conference was held in Rye Brook, New York before Bruce M. Rauch, Conciliation Conferee. Glen L. Heller, Esq., appeared on behalf of petitioner; no personal appearance was made by any representative of the Division.

9. On November 9, 1992, petitioner's representative received a copy of the written position of the Division.

10. On November 16, 1992, a Notice and Demand for Payment of Tax Due was issued to petitioner in the amount of $60,423.14 ($26,066.00 representing the 1992 installment due and $34,357.14 in interest).

11. By letter dated November 27, 1992 (received by petitioner's representative on December 2, 1992), the conciliation conferee notified petitioner of his intention to sustain the position of the Division.

12. On December 8, 1992, the conciliation conferee issued a consent reflecting his decision to sustain the refund denial.

13. On December 21, 1992, petitioner paid the 1992 gains tax installment payment of $26,066.00, plus interest in the amount of $34,357.14. Attached thereto was a letter which advised the Division that these payments were being made under protest.

14. By Conciliation Order (CMS No. 123978) dated January 22, 1993, the Division's denial of petitioner's claim for refund was sustained.

15. By check dated July 6, 1993, petitioner paid the sum of $49,525.25 (tax of $26,066.00 and interest of $23,459.25).

16. On April 15, 1993, petitioner filed a petition with the Division of Tax Appeals. By letter dated April 21, 1993, the Division of Tax Appeals acknowledged receipt of the petition.

17. On August 4, 1993, petitioner's representative received the answer of the Division under letter dated August 2, 1993.

18. Petitioner owned the Hudson Street property since 1981. He conducted his printing business there since 1960. Because of his desire to downsize his business and to ultimately retire from it, petitioner consulted with Peter Hauspurg of Eastern Consolidated Properties, Inc., an attorney and real estate broker who represented the Joseph Gardner Trust, and ultimately entered into a Commission Agreement with him (see, Exhibit "1"). No commission was ever paid to Peter Hauspurg since the agreement was contingent upon the Joseph Gardner Trust ultimately acquiring the property.

In 1989, petitioner met with his attorney, John Flateau, with Peter Hauspurg and with Joseph Gardner relative to the sale of the Hudson Street property. Despite the fact that petitioner initially desired to sell the property, Joseph Gardner preferred to lease it and petitioner was ultimately convinced that leasing it was a preferable alternative.

19. As part of the lease agreement, the Joseph Gardner Trust paid petitioner the sum of $499,990.00 for an option to purchase the property (see, paragraph 32 of lease agreement). Pursuant to the agreement, the lessee could not exercise the option until July 1, 1995. Petitioner had the option to accelerate this date to no earlier than January 1, 1994 upon giving proper notice to the lessee.

20. Pursuant to the terms of the lease, petitioner was to receive $490,000.00 per annum payable in equal monthly installments of $40,833.33 each (this was the annual rental from the term commencement date through May 31, 2000; from June 1, 2000 through May 31, 2039, the annual rent was to increase at five-year intervals). Petitioner testified that he received monthly rental payments from July 1990 until October or November 1991 at which time the Joseph Gardner Trust informed petitioner's attorney of its desire to terminate the lease.

21. After receipt of the $499,990.00, petitioner expended approximately $200,000.00 for back taxes, $33,000.00 to repave sidewalks and set aside $30,000.00 to cure fire code violations. Petitioner also put money in escrow for elevator insurance and for potential City code violations. The tenant demanded most of these expenditures and, as a result, petitioner netted only about $150,000.00 from the option fee received.

22. At the time of the execution of the lease, the building was fully rented. A short time thereafter, the tenant on the sixth floor filed for bankruptcy and, without rent from this tenant, the building was a losing proposition. As a result, the Joseph Gardner Trust informed petitioner's attorney of its intention to terminate the lease agreement.

23. As indicated in Finding of Fact "4", petitioner entered into a lease termination agreement on November 8, 1991 (the agreement was entered into with the co-trustees of the Joseph Gardner Trust). Pursuant to this agreement (paragraph 7 thereof), the purchase option was terminated and the option payment ($499,990.00) remained the sole property of petitioner.

24. Petitioner testified that at the time of entering into the lease, he did not understand the provisions of paragraph 31 of the lease, which provided as follows:

> "Landlord agrees to look solely to Tenant's estate and interest in this lease, and the Demised Premises, for the satisfaction of any right or remedy of Landlord for the collection of a judgment (or other judicial process) requiring the payment of money by Tenant, in the event of any liability by Tenant, and no other property or assets of Tenant shall be subject to levy, execution, attachment, or other enforcement procedure for the satisfaction of Landlord's remedies under or with respect to this lease, the relationship of Landlord and Tenant hereunder, or Tenant's use and occupancy of the Demised Premises, or any other liability of Tenant to Landlord."

OPINION

Tax Law § 1441 imposes a 10 percent tax on the gains derived from the transfer of real property located in New York State.

Former Tax Law § 1440(7) defines "transfer of real property," in part, as:

> "the transfer or transfers of any interest in real property by any method, including but not limited to sale, . . . option, . . . [and] 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."

Tax Law §1440(4) provides in part: "'[i]nterest' when used in connection with real property includes . . . an option or contract to purchase real property."

Former 20 NYCRR 590.27 provides:

> "Question: Is the creation of a lease for a term less than 49 years which contains an option to purchase the real property subject to the gains tax?
>
> "Answer: Yes. Section 1440(4) of the Tax Law defines an interest in real property to include an option. The consideration for such a transfer is the present value of the net rental payments under the lease plus the consideration paid for the option to purchase (Tax Law, section 1440[1][b]). Rental payments for periods that occur after an option is no longer exercisable are not included in the calculation of the present value of the rental payments. If the sum of the present value of the net rental payments and the price paid for the option is $1 million or more, the transfer is subject to the tax (Tax Law, section 1440[1]). The present value of the net rental payments should be determined as set forth in section 590.26 of this Part."

Former Tax Law § 1440(1)(b) provides:

> "[i]n the case of (i) the granting of an option with use and occupancy of real property or (ii) the creation of a leasehold or sublease that is a transfer of real property, as defined in subdivision seven of this section, consideration shall also include the value of the rental and other payments attributable to the use and occupancy of the real property or interest therein and the value of any option to purchase or renew included in such transfer.

Tax Law § 1443, which sets forth exemptions under Article 31-B, provides in subdivision (7) that:

> "[w]here a transfer of real property consists of the execution of a contract to sell real property without the use or occupancy of such property or the granting of an option to purchase real property without the use and occupancy of such property.

The Administrative Law Judge held that this Tribunal's decision in 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), in which we held that gains tax is determined at the time of the transaction, applies to the valuation of every taxable transaction, including petitioner's. Consequently, the Administrative Law Judge found the fact that the option could

not be exercised until approximately six years later was of no moment. The Administrative Law Judge, in denying petitioner's refund, also relied on Matter of Von Ford Assocs. (Tax Appeals Tribunal, May 26, 1994). In Von Ford, the Tribunal affirmed the determination of the Administrative Law Judge which held that a lease with an option to purchase, while not exercisable until year 18 of the lease, was nevertheless a taxable transaction. The Administrative Law Judge also pointed to the fact that the Administrative Law Judge in Von Ford rejected the taxpayer's argument that the subject transaction should be exempt from the gains tax because the option could become nonexistent due to the transferee's default in rental payments or failure to exercise the option.

The Administrative Law Judge further rejected petitioner's assertions that subsequent events can affect the taxability of a transaction. The Administrative Law Judge stated that Tax Law § 1444(3) provides for, except in limited circumstances, a three-year statute of limitations. The statute's purpose, according to the Administrative Law Judge, is to permit the Division to have sufficient time to determine whether a taxpayer's computation of tax is correct, not to consider the effect subsequent events may have on the computations. The Administrative Law Judge also rejected petitioner's argument that former 20 NYCRR 590.27 supported petitioner's argument. Former 20 NYCRR 590.27 provides that "[r]ental payments for periods that occur after an option is no longer exercisable are not included in the calculation of the present value of the rental payments." The Administrative Law Judge stated that the regulation provides for computation at the time of the creation of the lease, rather than waiting to see if the option is exercised. The Administrative Law Judge further rejected petitioner's argument that Advisory Opinion (TSB-A-87[8]-R) established that subsequent events will be considered for gains tax purposes. The Advisory Opinion addressed a 30-year extension of an existing lease which was created in the nineteen fifties and had, at the time of its modification, a remaining balance of approximately 30 years. The Administrative Law Judge noted that the extension was considered a new agreement because the term of the lease was now 67 years (the remaining 37 plus 30 additional years). However, the Administrative Law Judge stated that the result "is not

a consideration of events occurring subsequent to a taxable transfer but is, instead, a determination that, as of the effective date of these modifications, a taxable transaction had now occurred" (Determination, conclusion of law "E").

Petitioner on exception asserts that at the time the parties entered into the lease, there was not an option to purchase which would require this transaction to be subject to the gains tax because the earliest the option would be exercisable was January 1, 1994. Petitioner argues that applying the result reached by the Tribunal in Matter of Cheltoncort Co. (supra) to the instant case would be arbitrary and capricious. Petitioner further argues that petitioner did not anticipate that the lessee would default on the lease. As a result of the lease termination agreement, petitioner contends the transaction is no longer subject to the gains tax and a refund is owed.

Petitioner argues that the result of the Administrative Law Judge's interpretation of the Advisory Opinion should have been that petitioner is entitled to a refund. Petitioner notes that the Administrative Law Judge interpreted the Opinion as finding the modification to constitute a new agreement. Consequently, petitioner asserts that the Opinion considered subsequent events in finding a new transaction.

The Division on exception disputes petitioner's assertion that Cheltoncort is distinguishable because it involved the transfer of title to real property. The Division argues that while a title transfer was at the heart of the transaction in Cheltoncort, there was also a lease-back at issue to the cooperative sponsor. The Division pointed out that this Tribunal analyzed:

> "the effect of subsequent events on the value of the consideration given at the time of the transfer (and the Appellate Division's confirmation of that rationale) specifically relates to a leasehold interest and the non-effect of subsequent rental income on the value of the consideration at the time of the transfer" (Division's brief in opposition, p. 11).

We affirm the determination of the Administrative Law Judge.

We cannot agree with petitioner that the lease termination agreement removes the subject transaction from gains tax liability. We have already addressed, in Matter of Starburst Dev. Co.

(Tax Appeals Tribunal, May 5, 1994) the issue of when a transaction is determined to be a transfer within the meaning of Tax Law § 1440(7). In Starburst, we held that:

> "the moment that the taxable event occurs, i.e., the transfer of the real property, is the temporal restriction underlying the entire gains tax. Consistent with this interpretation, we have held that the consideration for the transfer is fixed at this moment and is not reduced by subsequent events (Matter of Cheltoncort Co., supra; see also, Matter of V & V Properties, Tax Appeals Tribunal, July 16, 1992 [where we held that consideration as an element of original purchase price was also fixed at the time of transfer and could not be reduced by the Division based on subsequent events]). To deviate from this theory, as petitioner suggests, and exclude transactions from the definition of transfer of real property based on subsequent events would, in our view, be contrary to the entire scheme of the tax" (Matter of Starburst Dev. Co., supra).

In the matter before us, at the time the subject transfer occurred it consisted of the granting of an option coupled with a lease. The granting of an option to purchase is a transfer of real property under Tax Law § 1440(7). If there is no grant of use and occupancy coupled with the option, then the transaction is exempt under Tax Law § 1443(7). Given that a lease constitutes use and occupancy, the granting of an option with a lease is a taxable transfer (see, former 20 NYCRR 590.27). Based on the above, petitioner incorrectly characterized this matter in arguing that the Division "cannot require taxpayers to pay gains tax on transactions that they had anticipated would occur, but in fact, never occur" (Petitioner's brief on exception, p. 8). Because the granting of an option with a lease is a transfer under the gains tax, whether the option is exercised is irrelevant to the taxability of the granting of the option.

We believe that the Administrative Law Judge correctly analyzed TSB-A-87(8)-R and we agree with him that this Advisory Opinion is consistent with the result reached here.

As a final point, we wish to note that petitioner's assertion, that he did not anticipate the lessee would cancel the lease within 16 months of inception, supports our conclusion that the termination agreement cannot affect the value of the lease. In this respect, the instant matter is distinguishable from our decision in Matter of Fort Tryon Apts. (Tax Appeals Tribunal, August 10, 1995) in which we held that the potential right of a cooperative corporation to cancel a lease with a sponsor existed at the time of the transfer, as it was explicitly provided for in the

lease agreement. Further, the terms of the agreement in Fort Tryon strongly favored the sponsor. As a result, we held that the possibility of termination was clearly a factor that would affect the value of the lease and should be taken into account in valuing the leasehold for gains tax purposes. In the matter before us, petitioner's own admission that he was unaware of the possibility of the lease being cancelled compels the result that termination of the lease agreement cannot affect the taxability of this transaction.

We next address petitioner's assertion that the instant transaction violates the Equal Protection Clause of the United States Constitution and/or Article I, § 11 of the New York State Constitution.

Citing Executive Land Corp. v. Chu (150 AD2d 7, 545 NYS2d 354, 358, appeal dismissed 75 NY2d 946, 555 NYS2d 692), the Administrative Law Judge stated that neither the Federal nor State Constitutions require that all taxpayers be treated the same. The Administrative Law Judge further noted the Federal and State Constitutions only require that similarly situated taxpayers be treated in a uniform manner. Therefore, the Administrative Law Judge rejected petitioner's constitutional argument because:

> "it is clear that the Tribunal's holding (which was affirmed by the Appellate Division in Matter of Cheltoncort Co. v. Tax Appeals Tribunal, 185 AD2d 49, 592 NYS2d 121) that the value of consideration must be determined at the time of transfer in order to finally fix the tax owed and that the value of the consideration cannot be altered by subsequent events is a statutory interpretation which applies to all transferors subject to the gains tax" (Determination, conclusion of law "G").

As a result, the Administrative Law Judge points out that, while the imposition of tax on a gain computed on the date of the transfer can result in seemingly unjust treatment, such treatment cannot be found to be unconstitutional because petitioner has not shown that he has been treated differently than any other transferor subject to the gains tax.

Petitioner asserts that he is being pooled with other lessors who enter into similar agreements, with the difference being that the other lessors are receiving the entire

consideration under the lease. As a result, argues petitioner, because of his class he is still subject to the tax.

Petitioner, citing Stewart Dry Goods Co. v. Lewis (294 US 550, reh denied 295 US 768) likens the effect the gains tax has on the subject transfer to a gross receipts tax. Petitioner asserts that requiring him to pay tax on anticipated gain is akin to taxing vendors on a gross receipts method. Petitioner, citing Merit Oil v. New York State Tax Commn. (111 Misc 2d 118, 443 NYS2d 604), argues that because taxes based on volume are unconstitutional, so too should be a tax based on anticipated consideration. Petitioner further asserts that the result reached by the Administrative Law Judge is inconsistent with Trump v. Chu, (65 NY2d 20, 489 NYS2d 455, appeal dismissed 474 US 915) where it was stated that "the tax will only be imposed on a net profit" (Trump v. Chu, supra, 489 NYS2d 455, 460).

The Division agrees with the Administrative Law Judge's treatment of petitioner's constitutional argument and urges that the Administrative Law Judge's determination be affirmed in every respect.

Petitioner emphasizes in his reply brief that the transfer gains tax as applied to the facts and circumstances is unconstitutional and that petitioner makes no assertion that the statute is invalid on its face. Petitioner further asserts that "[t]here is no rational basis in a decision that would require a Petitioner who has not transferred title and did not receive the consideration bargained for to pay a Transfer Gains Tax" (Petitioner's reply brief, p. 6).

We reject petitioner's argument and affirm the Administrative Law Judge.

Pursuant to former Tax Law § 1440(1)(b), consideration for an option coupled with the right to use and occupancy is the value of rent and other payments attributable to the use and occupancy as well as the value of the option to purchase. Consistent with our holding in Matter of Cheltoncort Co. (supra), the value of the rental payments and option is calculated at the time of the transfer. We find that requiring petitioner to pay tax is not in violation of petitioner's constitutional rights because petitioner is treated the same as similarly situated taxpayers, i.e., they are taxed on the value of the consideration at the time of the transfer. This application does

not render the gains tax a gross receipts tax, nor a tax imposed without regard to profits (see, Matter of Union Carbide Chemicals & Plastic Co. v. Tax Appeals Tribunal, ___AD2d___, 623 NYS2d 393). To do as petitioner requests, which would be to impose tax based on what was actually received, would be treating petitioner differently than similarly situated taxpayers by considering the effect time has had on the subject transaction, while all other taxpayers are required to pay based on the value of the consideration at the time of transfer (see, Matter of Union Carbide Chemicals & Plastic Co. v. Tax Appeals Tribunal, supra). Consequently, petitioner's equal protection argument is rejected.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Sidney Rapoport is denied;
2. The determination of the Administrative Law Judge is affirmed; and
3. The petition of Sidney Rapoport is denied; and
4. Petitioner's claim for refund is denied.

DATED: Troy, New York
August 31, 1995

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

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