STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition of **300 EAST 74TH OWNERS CORP.** for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Years 1987 and 1988.	AMENDED DECISION DTA No. 811923

Petitioner 300 East 74th Owners Corp., c/o A. Mayas, American Landmark Management, 555 Madison Avenue, New York, New York 10022, filed an exception to the determination of the Administrative Law Judge issued on July 20, 1995. Petitioner appeared by Lerner, Lapidus & Franquinha, P.C. (Steven R. Lapidus, Esq., of counsel). The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Vera R. Johnson, Esq., of counsel).

Petitioner filed a brief on exception. The Division of Taxation filed a brief in opposition. Petitioner's reply brief was received on January 17, 1996 and began the six-month period for the issuance of this decision. Petitioner's request for oral argument was denied.

Commissioner DeWitt delivered the decision of the Tax Appeals Tribunal. Commissioner Koenig concurs. This amended decision supercedes and replaces the decision of this Tribunal issued on July 11, 1996 in this proceeding. That July 11, 1996 decision is hereby cancelled and of no further effect.

ISSUE

Whether petitioner, a cooperative housing corporation, can properly rely on a Technical Services Bureau Memorandum promulgated by the Division of Taxation to compute average fair market value of its cooperative housing property for franchise tax purposes.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for findings of fact "9" and "18" which have been modified. The Administrative Law Judge's findings of fact and the modified findings of fact are set forth below.

Petitioner, 300 East 74th Owners Corp., is a New York cooperative housing corporation and owns a cooperative apartment building at 300 East 74th Street ("the building" or "the subject premises") in New York City. This cooperative was created pursuant to an offering plan providing for98,637 shares allocated to 233 apartment units. The offering plan set forth the following price to be paid to the sponsor:

Total Cash:	$ 98,637.00
Additional Cash--Maximum Initial Price:	19,628,763.00
Mortgage Indebtedness	6,298,067.00
Total Purchase Price:	$26,025,467.00
Less: Working Capital Retained by Apartment corporation	50,000.00
Net Purchase Price of Property to Apartment Corporation:	$25,975,467.00

Petitioner claims that it computed the fair market value ("FMV") of its building on its 1986 New York corporation franchise tax report in accordance with a Technical Services Memorandum issued by the Division of Taxation ("Division") (TSB-M-85[18]C) ("the TSB Memorandum").

The TSB Memorandum provides, in pertinent part:

"Valuation of Cooperative Housing

> "Section 210.1(a)(2) of Article 9-A of the Tax Law provides for a tax on total business and investment capital of a taxpayer or the portion thereof allocated to New York. For a cooperative apartment house as defined in section 216 of the Internal Revenue Code, the statute provides for a tax on capital at a rate of four-tenths of a mill (.0004).
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> "The statute requires the use of fair market value in the valuation of assets for the tax on capital. Fair market value is defined in Section 3-4.5 of the regulations as the price at which a willing seller, not compelled to sell, will sell and a willing purchaser, not compelled to buy, will buy. An appropriate indicator of the average fair market

value of cooperative housing is the assessed value for real property tax purposes adjusted for the equalization rate.

"Where only the assessed value of the cooperative is known, average fair market value may be computed by dividing the assessed value for real property tax purposes by the equalization rate . . . [emphasis added].

"The cooperative is allowed to depreciate its costs. Thus, the values shown on the federal balance sheet are such costs less accumulated depreciation. Since this will be a constantly declining value, book value as shown on the federal balance sheet will not be allowed as an alternative determination of average fair market value [emphasis in original].

"Once a method of determining average fair market value is adopted by the taxpayer on any report and is accepted by the Tax Commission, the method may not be changed on any subsequent report without the prior consent of the Tax Commission."

Petitioner's computation of average FMV on its 1986 corporation franchise tax report was as follows (Division's Exhibit "L"):

	12/31/85	12/31/86
Total Assets from Federal Return:	$22,740,207.00	$22,217,591.00
Less: Book value of property:	($22,296,011.00)	($21,697,614.00)
Balance:	$ 444,196.00	$ 519,977.00
Plus: Actual Assessed Value 1985/86--$8,115,000 equalized at 68.29%	$11,883,145.00	
1986/87--$8,635.000 equalized at 56.83%		$15,194,440.00
Market Value:	$12,327,341.00	$15,714,417.00
Computed Average Fair Market Value: $14,020,879.00		

Petitioner opines that the computation of average fair market value on its 1987 and 1988 reports was arrived at in the same manner as is set forth above for 1986 (Division's Exhibits "H", "I" and "L"). Petitioner's New York allocation percentage for the subject years is 100 percent.

Petitioner's CT-3 filed for 1987 shows the following computation of its capital base and tax due:

Average Total Assets from Federal Return:	$22,040,287.00
Less: Real Property and securities included in previous line:	($21,398,415.00)
Balance:	$ 641,872.00
Plus: Real Property at FMV:	$16,873,215.00
Adjusted Total Assets:	$17,515,087.00
Less: Total Liabilities:	$ 6,157,665.00
Total Capital Base:	$11,357,422.00
Tax @ .0004	$ 4,543.00

Petitioner's CT-3 filed for 1988 shows the following computation of its capital base and tax due:

Average Total Assets from Federal Return:	$22,097,529.00
Less: Real Property and securities included in previous line:	($20,800,018.00)
Balance:	$ 1,297,511.00
Plus: Real Property at FMV:	$17,122,000.00
Adjusted Total Assets:	$18,419,511.00
Less: Total Liabilities:	$ 6,771,232.00
Total Capital:	$11,648,279.00
Tax @ .0004	$ 4,659.00

Petitioner's CT-3's for 1987 and 1988 did not show how it arrived at a FMV of $16,873,215.00 and $17,122,000.00, respectively, for its real property. There is no explanation for the difference in stated value on the CT-3's and petitioner's Federal corporation income tax returns (Form 1120).

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

> Sometime in 1991, the Division conducted a desk audit of petitioner's corporation franchise tax reports for 1987 and 1988.[1] Although the Division's witness testified that a letter was written to petitioner asking for additional information showing the value of the subject property, including a copy of the insurance policy on the property, no copy of the letter was introduced into evidence. Further, no copy of a response to such letter was placed in

[1]At the time of the audit the statute of limitations had run for 1986, so no assessments were issued for that year (tr., pp. 188-189).

evidence, although it appears that the auditor was provided with an insurance schedule summarizing the insurance coverages. A copy of the policy was not provided. The insurance schedule reflected that the subject real property was insured for $23,760,000.00. No other evidence of fair market value was provided by petitioner. The Division issued a Statement of Audit Adjustment dated May 29, 1991 recomputing petitioner's taxable capital base and tax due for 1987 as follows:

Total Assets from Federal Return:	$22,040,287.00
Less: Real Property included in previous line:	$21,398,415.00
Balance:	$ 641,872.00
Plus: land and building at insured value:	$27,820,730.00
Adjusted Total Assets:	$28,462,602.00
Less: Total Liabilities:	$ 6,157,665.00
Total Capital Base:	$22,304,937.00
Tax @ .004	$ 8,992.00
Tax per report	4,543.00
Deficiency	4,379.00[2]

The Division also issued a Statement o Audit Adjustment dated May 29, 1991 computing petitioner's tax for 1988 as follows:

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[2]Finding of fact "9" of the Administrative Law Judge's determination read as follows:

> "Sometime in 1991, the Division conducted an audit of petitioner's corporation franchise tax reports for 1987 and 1988. * A letter was written to petitioner asking for additional information showing the value of the subject property, including a copy of the insurance policy on the property. In response, the auditor was provided with an insurance schedule summarizing the coverages. A copy of the policy was not provided. The insurance schedule reflected that the subject real property was insured for $23,760,000.00. No other evidence of fair market value was provided by petitioner. The Division issued a Statement of Audit Adjustment dated May 29, 1991 recomputing petitioner's taxable capital base and tax due for 1987 as follows.
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> "* At the time of the audit the statute of limitations had run for 1986, so no assessments were issued for that year (tr., pp. 188-189)."

The chart of the Statement of Audit Adjusted dated May 29, 1991 has not been modified. We modified this finding in order to more accurately reflect the record.

Total Assets from Federal Return:	$22,097,529.00
Less: Real Property included in previous line:	$20,800,018.00
Balance:	$ 1,297,511.00
Plus: land and building at insured value:	$27,820,730.00
Adjusted Total Assets:	$29,118,241.00
Less: Total Liabilities:	$ 6,771,232.00
Total Capital:	$22,347,009.00
Tax @ .004	8,939.00
Tax per report	4,659.00
Deficiency	4,280.00

Both statements of audit adjustment stated as follows:

> "In determining tax on the capital base, one of the four methods of computing tax as stated in New York State Tax Law, §210(1), it is required to include real property and marketable securities at fair market value.
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> "Fair market value is defined in New York State Tax Regulations, §3-4.5 as the price at which a willing seller, not compelled to sell, will sell, and a willing purchaser, not compelled to buy, will buy.
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> "Real property [sic] was adjusted to the insured value, since this amount more closely reflects fair market value."

The Metropolitan Transportation Business Tax Surcharge ("MTA Surcharge") during the relevant period was 17 percent of a taxpayer's New York franchise tax. The issuance of franchise tax deficiencies to petitioner resulted in issuance of a corresponding MTA Surcharge for the same years. A Statement of Audit Adjustment was issued to petitioner computing the 1987 MTA Surcharge as follows:

N.Y.S. Franchise Tax:	$8,922.00
MTA Surcharge @ 17%:	1,517.00
MTA Surcharge Reported:	772.00
Deficiency:	$ 745.00

A Statement of Audit Adjustment was also issued to petitioner computing the 1988 MTA Surcharge as follows:

N.Y.S. Franchise Tax:	$8,939.00
MTA Surcharge @ 17%:	1,520.00
MTA Surcharge Reported:	792.00
Deficiency:	$ 728.00

The Division issued a Notice of Deficiency dated May 29, 1991 asserting additional corporation franchise tax due for the year 1987 in the amount of $4,379.00, plus interest. On the same date a Notice of Deficiency was issued to petitioner asserting additional MTA Surcharge for 1987 in the amount of $745.00, plus interest.

On May 29, 1991, the Division issued a Notice of Deficiency to petitioner asserting additional corporation franchise tax for 1988 in the amount of $4,280.00, plus interest. On the same date, the Division issued to petitioner a Notice of Deficiency asserting additional MTA Surcharge for 1988 in the amount of $728.00, plus interest.

Petitioner filed a request for conciliation conference with the Division's Bureau of Conciliation and Mediation Services ("BCMS") challenging the above notices.

On February 26, 1993, a Conciliation Order (CMS No. 117496) was issued to petitioner sustaining the notices. Petitioner thereupon filed a petition dated May 24, 1993 with the Division of Tax Appeals and the instant proceeding ensued.

Kathy Goodsell, Tax Technician II in the Division's corporation tax section, testified for the Division. She had reviewed the Division's audit records and was thoroughly familiar with their contents. Ms. Goodsell stated that the audit was conducted by Jim Bishop who is no longer with the Division. Ms. Goodsell represented the Division at the BCMS conference.

We modify finding of fact "18" of the Administrative Law Judge's determination to read as follows:

> Ms. Goodsell stated that at the beginning of the audit a letter was sent to petitioner seeking additional information concerning the fair market value of the subject property. (However, as previously noted, no copy of this letter or any response thereto were introduced into evidence.) This letter included a request for a copy of the insurance policy on the building. Petitioner responded by providing a schedule summarizing the various coverage limits (Division's Exhibit "G"). This document, along with the amount set forth by petitioner on its Federal return, was used by the auditor

to recompute petitioner's corporation tax liability for 1987 and 1988.[3]

The auditor adjusted petitioner's computed "total capital" for 1987 and 1988 to include the building at the insured value plus the value of the land as reported on its Federal corporation income tax return (see, above).

Upon audit no documentation was offered to the Division to substantiate petitioner's reported fair market value. The only evidence available to the Division to show the fair market value of petitioner's property was the schedule showing insurance limits on the property and the valuation placed on the property in petitioner's Federal returns. Ms. Goodsell testified that a copy of a page from petitioner's offering plan in the Division's audit file was also relied upon as an indication of the subject property's fair market value (Division's Exhibit "K"). That page shows a purchase price of $26,025,467.00.

Petitioner urges that the purchase price shown on its offering plan cannot be used as an indicator of FMV because it represents the price paid to the sponsor by the cooperative corporation, i.e., it is not an arm's-length transaction.

Ms. Goodsell was challenged on cross examination regarding the purchase price of $26,025,467.00 shown on petitioner's offering plan, and which she regarded as another indicator of the subject building's fair market value. Ms. Goodsell admitted that she did not know whether the full purchase price was ever actually received, but petitioner put in no evidence that it was not received. Ms. Goodsell acknowledged that she had no knowledge of whether later amendments

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[3]Finding of fact "18" of the Administrative Law Judge's determination read as follows:

"Ms. Goodsell stated that at the beginning of the audit a letter was sent to petitioner seeking additional information concerning the fair market value of the subject property. This letter included a request for a copy of the insurance policy on the building. Petitioner responded by providing a schedule summarizing the various coverage limits (Division's Exhibit "G"). This document, along with the amount set forth by petitioner on its Federal return, was used by the auditor to recompute petitioner's corporation tax liability for 1987 and 1988."

We modified this finding of fact to more accurately reflect the record.

to the offering plan reduced the purchase price, but petitioner offered no evidence to show that there were such amendments.

Ms. Goodsell also admitted she had not subpoenaed or otherwise obtained copies of petitioner's complete offering plan and all of its amendments from the New York Attorney General's office or the Secretary of State.

The Division did not audit petitioner's 1986 franchise tax report; therefore, the Division did not have an occasion to either accept or reject petitioner's CT-3 filed for 1986.

Dividing 98,637 shares in the offering plan into the total purchase price set forth on the offering plan ($26,025,467.00) results in $263.85 per share.

Stephen Godfrey, Tax Technician III in the Division's Condominium and Co-op section of the Gains Tax Unit, also testified for the Division. Mr. Godfrey is a supervisor in the Gains Tax Unit and has worked there since March 1983. Mr. Godfrey noted that, in addition to the 233 residential units in the subject building, there were also 7 stores and a parking garage. The 8th amendment to the offering plan (Division's Exhibit "P") shows the following 1982 projected rental income in the cooperative corporation's budget for these stores and garage as follows:[4]

Store # 1:	$ 17,238.25
Stores # 2 & 3:	20,025.00
Store # 4:	12,739.00
Store # 5:	16,987.50
Stores # 6, 7 & 8:	40,439.26
Store # 9:	24,175.08
Store #10:	10,503.28
Parking Garage:	107,409.43
TOTAL:	$249,516.80

Mr. Godfrey stated that if there had been sales of individual residential apartments by their owners, they may not have been reported to his office. There are two cases, he said, in which the gains tax filing requirements pertain to cooperative units. One is where the holder of the unsold shares of the co-op unit is the co-op sponsor, and the other situation is where a person purchases

[4]Petitioner objected to Mr. Godfrey's testimony concerning these commercial rentals. That objection was sustained. Accordingly, these figures were derived directly from the offering plan, amendment #8.

more than one unit for possible resale, i.e., investment. In these circumstances, the sale of units for a consideration of over $1,000,000.00 must be reported to the gains tax unit. However, if an individual residence were to be sold, the owner would not be required to file a gains tax form (tr., pp. 237, 254).

Mr. Godfrey provided a copy of petitioner's offering plan which included 11 amendments (Division's Exhibit "P"). Petitioner objected to the fact that the Division did not subpoena or otherwise obtain a copy of the

complete offering plan and all of its amendments from the Secretary of State.[5]

Petitioner also objected to the offering plan on the basis that it only showed facts as they existed in 1982. Petitioner was advised that if it wanted to show that the facts as shown in Exhibit "P" had changed subsequent to 1982, it was its burden to do so (tr., p. 263).

Isidor Hefter, CPA, testified for petitioner. Mr. Hefter's firm served as certified public accountants for petitioner both before and after conversion of the building to cooperative ownership.

Mr. Hefter testified that the building was converted to cooperative ownership in 1982 and, as part of the offering plan filed with the Attorney General, certified financial statements of assets and expenses ("certified statements") were filed with the State of New York. Mr. Hefter reviewed these certified statements for the period from 1979 through 1988.

Mr. Hefter stated that for the year 1986 his firm prepared petitioner's corporation franchise tax report in accordance with the TSB Memorandum. Mr. Hefter stated that he did not receive an objection to the CT-3 from the Division.

As noted, supra, the offering plan includes copies of the certified statements by certified public accountants. These statements show rent income ("revenue") and expenses of the building

[5]Petitioner did not offer any additional amendments to the offering plan into evidence, and it is unclear whether any further amendments exist.

for 1977, 1978, 1979, 1980, 1981 and 1982 (the latter being the year of conversion to a cooperative) for purposes of the public offering (Petitioner's Exhibits "5" through "8").

Petitioner's financial statement for 1982 reflects a land value of $4,060,730.00 and a value for the building of $19,454,590.00 (Petitioner's Exhibit "8"). The certified statements for 1987 and 1988 state the total value of the land and building, less depreciation (i.e., book value) is $21,099,216.00 and $20,500,820.00, respectively (Petitioner's Exhibits "13" and "14").

Petitioner also offered copies of certified statements of its revenues and expenses for the years 1983, 1984, 1985, 1986, 1987 and 1988 (Petitioner's Exhibits "9" through "14").

The books and records that were used to develop the certified financial statements were not made available at hearing (tr., p. 62).

Mr. Hefter reviewed the revenue and expense figures for the operation of the corporation in each of the certified statements and put them in a report at the request of petitioner's counsel.

Mr. Hefter used the actual revenue and expense figures in the certified statements for years 1978 through 1981 (the year prior to conversion).

Petitioner's counsel asked Mr. Hefter to extrapolate from the 1982 rent revenue in the certified statements what the rent revenues would be from 1983 through 1988 if the building remained as a rent-stabilized building and the landlord obtained the rent increases authorized by the rent stabilization law.

Mr. Hefter obtained the actual rent roll for April 1982 and multiplied by 12 to arrive at total rents for 1982 as if the property had stayed rent stabilized. He applied the annual rent stabilization increase percentages to the 1982 base year rentals to arrive at what the rentals would have been on the building through 1988 had it stayed under rent stabilization. Mr. Hefter says his figures attempt to show what the rental revenue in excess of expenses, i.e., cash flow or net operating income, would be for this building had it remained rent stabilized. In coming up with these expense figures, he did not include depreciation, the purchase and servicing of air conditioners, painting of apartments, floor scraping, advertising and leasing commissions,

replacement of equipment, officers, office and advisory salaries and office expenses, interest on loans and any extraordinary legal fees.

Expenses for 1982, the year of conversion, were calculated by Mr. Hefter in the same manner as income, i.e., he took the building's actual expenses for the first seven months of 1982 and then annualized them. For 1982, he computed expenses of $1,731,044.00.

For 1978 through 1981 and 1983 through 1988, Mr. Hefter merely copied expense figures from the certified statements.

Mr. Hefter's calculations show that, in 1987, if the subject building were still a rent-stabilized apartment building, it would have had rental revenue ("hypothetical revenue") in excess of expenses of $131,834.00. For 1988, if it were still a rent-stabilized building, it would have had expenses exceeding hypothetical revenue by $2,618.00. Factoring depreciation into these figures would have resulted in a hypothetical negative cash flow. All of Mr. Hefter's testimony was premised on the assumption that the subject building had remained a rent-stabilized apartment building.

Hefter testified that he prepared petitioner's 1987 and 1988 corporation franchise tax reports based on the aforementioned TSB Memorandum. He said he used the assessed value for the property to arrive at fair market value because he did know of any other value (other than assessed value). He said he did not know the insured value of the property at the time the reports were prepared "nor did we request it" (tr., p. 66).

When asked on cross examination how he arrived at "revenue" of $2,678,020.00 for 1987, Mr. Hefter reiterated that he used the rentals from 1982 and multiplied those amounts by the permitted annual rent stabilization increases through 1987. From these hypothetical revenues Mr. Hefter deducted the actual expenses[6] of the cooperative for each year (tr., p. 68).

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[6]Except for depreciation.

Regarding Mr. Hefter's comment that in 1988 petitioner had a negative cash flow, he was asked how that fact converted to a determination of FMV. He stated that if there is a negative cash flow, the business cannot fund its operations so that would impact adversely on the building's FMV as a rental property.[7] Mr. Hefter exhibited no reticence about deducting actual co-op expenses from hypothetical rental income in concluding that there would have been a negative cash flow for 1988.

Petitioner next called Jan A. Barenholtz. Mr. Barenholtz is a licensed real estate appraiser, consultant and broker in New York City. Mr. Barenholtz testified as to various general methods used in appraising property. Petitioner asked Mr. Barenholtz how he would appraise "rental real property located in Manhattan" (tr., pp. 79, 82).

In appraising rental property, Mr. Barenholtz would use the "income approach". He would analyze the operation of the property, analyze rental income levels and expense levels to determine income in excess of expenses, which he called net income. From this he can compute anticipated net income, i.e., "cash flow" (tr., p. 83). He would then capitalize net income by applying a multiplier of between 8 and 12 percent to net income to arrive at an estimate of fair market value (tr., pp. 90-91).

Like Mr. Hefter, Mr. Barenholtz was asked by petitioner to premise his testimony on the assumption that the subject property remained a rental property subject to rent stabilization through 1988 (tr., p. 90).

Mr. Barenholtz testified that the purchase price charged by a sponsor of a cooperative to the cooperative housing corporation would not be given "a lot of consideration" as being representative of the fair market value of property", since it is not an arm's-length transaction (tr., pp. 80-81). He also stated that the replacement cost for a building would not be an indication of

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[7]Except by 1988, there was no "business" to operate, the building long since having been converted to cooperative ownership.

FMV. Mr. Barenholtz stated that he would not "take the maximum liability of an insurance policy for the replacement of the building" as its fair market value (tr., p. 95).

Mr. Barenholtz had no opinion as to the fair market value of the subject property. Petitioner did not ask him to appraise it for purposes of this proceeding (tr., p. 112). Mr. Barenholtz was asked by petitioner to review revenue and expense figures in Mr. Hefter's report. Mr. Barenholtz said that looking at revenue in excess of expenses ("net income" or "cash flow") from 1978 to 1988 showed a volatile pattern. The trend in cash flow since 1985, he said, showed a declining trend. In fact, he said, 1988 had a negative cash flow.

He said that if he took average net income for four years, that would be "something over $100,000.00" and that could be capitalized (tr., pp. 89-90). The capitalization rate for the subject years, based on his recollection, was from 8 to 12 percent. "So if you took an average cash flow of $125,000.00 multiplied that by 10, that would suggest that the market value of the property with that kind of income stream was $1,250,000.00" (tr., p. 91). It is noted that Mr. Barenholtz did not testify that the subject building has a fair market value of $1,250,000.00. His testimony is that a hypothetical apartment building subject to rent stabilization that had the revenue and expenses set forth in Exhibit "15" would have a market value of $1,250,000.00. Petitioner did not ask Mr. Barenholtz to appraise or to give his opinion as to the fair market value of the subject property as a cooperative (tr., pp. 121-127).

As noted earlier, the building was converted to a cooperative in 1982. Mr. Hefter testified that his figures reflect actual expense numbers for the building from 1977 to 1982 (when it was a rental property) and from 1983 through 1988 (when it was a cooperative apartment building). The income numbers are actual rental income up until the conversion, and then the income numbers are projections as if the building was still rent stabilized. The Administrative Law Judge asked petitioner's counsel:

"So we're pretending . . . that the building is still rent stabilized?"

Mr. Lapidus: "Precisely."

Administrative Law Judge: "How does it [pretending] tell us what the fair market value of this building is as a cooperative . . .?"

Mr. Lapidus: "Our point is we --it doesn't tell us and we don't care because that's what the law is" (tr., p. 126).

No evidence was offered by petitioner to show the fair market value of the subject building as a cooperative.

No evidence was submitted by petitioner to show that its building was insured at 100 percent of its value, i.e., that the amount of insurance on the building represented the cost to reconstruct the building.

OPINION

During 1987 and 1988, sections 209(1) and 210(1) of Article 9-A of the Tax Law imposed an annual franchise tax on the business and investment capital of corporations allocated to New York. Capital is comprised of the corporate taxpayer's investments and assets for the taxable period. The capital base is determined by taking the average value of the gross assets included in business capital and investment capital, less any liabilities that are directly or indirectly attributable to the business or investment capital (Tax Law § 210[2]). Real property and marketable securities are valued at fair market value, which is defined as the price at which a willing seller will sell and a willing buyer will buy, neither being under any compulsion (20 NYCRR former 3-4.5[a]).

Tax Law § 210(1)(b) provides that the franchise tax on a cooperative housing corporation, defined by section 216(b) of the Internal Revenue Code, shall be computed at a rate of four-tenths of a mill for each dollar of petitioner's capital base. Pursuant to Tax Law § 209-B petitioner was also subject to the metropolitan transportation business tax surcharge at a rate of 17% of the tax imposed under Tax Law § 209 for each of the years in issue.

TSB-M-85(18)C provides that where only the assessed value of a cooperative property is known, the average fair market value of that property may be computed by dividing its assessed value for real property tax purposes by the equalization rate. Book value as shown on the

Federal balance sheet, which considers cost and accumulated depreciation, is not allowed as an alternative means of determining average fair market value.

TSB-M-85(18)C was revoked by TSB-M-85(18.1)C (December 2, 1993). In revoking the valuation method set forth therein, the Division acknowledged that all real property is unique and that no one rule can be used to determine fair market value. Rather, the value of real property should be determined in accordance with the particular requirements and circumstances of the situation and the evidence in each situation should be examined to determine if a proper value has been assigned.

In its exception, petitioner argues that it timely filed its corporate franchise tax returns for the years at issue and, in doing so, it properly calculated the fair market value of its corporate property in accordance with the provisions of the TSB Memorandum. Since the TSB Memorandum constitutes a declaration of Departmental policy, "the Department's redetermination based upon a different and legally impermissible method of calculating fair market value was without justification" (Petitioner's brief, p. 32). "Clearly" argues petitioner, "the TSB-M bars the Department from utilizing any other method of calculating FMV and the ALJ failed to recognize this and hold the Department memorandum binding upon the parties" (Petitioner's brief, p. 34). Petitioner also argues that the use of the insured value of the property as the basis of the Division's valuation is arbitrary and capricious. Petitioner argues that the value of an alleged comparable property, the sale price stated on the cover of the cooperative offering plan or the sales of individual units have no probative value as corroboration for the Division's estimate of the fair market value of petitioner's property.

Petitioner argues that the Real Property Tax Law (RPTL) § 581 requires that the Division must value a cooperative property at an amount which does not exceed the value such property would have if it were not a cooperative. The Division has already incorporated § 581 in its TSB Memorandum as an accepted method of valuing cooperative property for corporate franchise tax purposes. Relying on this assessment limitation, petitioner argues that its expert witness

properly valued the property during the years at issue at $1.25 million and a refund is appropriate.

In opposition, the Division argues that the Administrative Law Judge correctly determined that the Division's assessment had a "rational" basis and that petitioner did not meet its burden of proof to show that the assessment was erroneous. The cost/adjusted basis reported by petitioner on its Federal corporate tax returns for the years at issue supports the average fair market value utilized by the Division rather than the $1.25 million value urged by petitioner. The Division argues that petitioner's reliance on the TSB Memorandum is misplaced. Petitioner is able to use assessed value divided by the equalization rate as the basis for its computation of average fair market value, according to the TSB Memorandum, "where only assessed value is known." Petitioner has not established its right to rely on the TSB Memorandum in this case.

The Division points out that if it were bound by the valuation method of the TSB Memorandum, the Division would be precluded from auditing petitioner's corporate franchise tax returns. The Division argues that even though it did not audit petitioner's 1986 return (the first year on which petitioner used assessed value divided by the equalization rate as a method of calculating average fair market value) that does not indicate that the Division accepted petitioner's valuation nor is the Division estopped from conducting an audit of subsequent returns. Further, the Division is not restricted by the terms of RPTL § 581. Finally, even if the income approach to valuation was the method most appropriate for valuing petitioner's property, there was no appraisal of the property offered by petitioner in evidence.

In his determination, the Administrative Law Judge concluded that:

> "[t]he TSB memorandum relied on by petitioner provides that '[w]here only the assessed value of the cooperative is known' average fair market value for purposes of the franchise tax may be computed by dividing the assessed value for real property tax purposes by the equalization rate. Clearly, based on the FMV reported on petitioner's Federal returns, information, other than the property's 'assessed value,' was known to petitioner which could have been used to determine FMV of the subject property. That being the case, this TSB memorandum could not properly be used

> by petitioner to calculate the fair market value of the subject property.
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> "If the Division had audited petitioner's 1986 CT-3 and accepted it, [TSB-M-85(18)C] would require the taxpayer to continue using the same method unless the Division gave its prior consent to a change in method. This language does not, as petitioner urges, prohibit the Division from requiring a change in method of valuation. The prohibition here is on the taxpayer, not the Division . . . [and] would not have prevented the Division from auditing petitioner's 1987 and 1988 returns and asserting additional tax thereon" (Determination, conclusion of law "F").

The Administrative Law Judge found petitioner's argument that valuation of its real property for corporate franchise tax purposes is subject to the limitations imposed by RPTL § 581 to be "without merit." Although petitioner called an appraiser as a witness, it never asked him to appraise the property as a residential cooperative building nor did petitioner offer any credible evidence to show the fair market value of its real property as a cooperative apartment building (Determination, conclusion of law "G"). The Administrative Law Judge stated:

> "[p]etitioner has offered no evidence to show the value of this building as a cooperative, but instead attacks the Division's use of such indicators of FMV as: (i) the fair market value stated by petitioner on its Federal income tax returns; (ii) the amount for which the building is insured; and (iii) the purchase price shown on the offering plan.
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> "The figures used by the Division to determine the average fair market value of petitioner's cooperative were provided by petitioner. The Division used the only information available to it . . . .
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> "While the Division's method of determining FMV may not have been precise, it was rational. The Division's figures are presumed correct. To overcome that presumption, petitioner was required to come forward at hearing with clear and convincing evidence to show why the Division's valuation of its cooperative was erroneous. In two days of hearings in this matter, petitioner did not produce any evidence to show the value of this property as a cooperative or to show that the Division's determination of fair market value as a cooperative was erroneous, unreasonable or improper. As such, petitioner has failed to meet its initial burden of going forward (Matter of Atlantic and Hudson Limited

> Partnership, Tax Appeals Tribunal, January 30, 1992). It has also failed to meet its ultimate burden of proof by clear and convincing evidence" (Determination, conclusion of law "H").

We reverse the determination of the Administrative Law Judge.

We deal first with the issue of burden of proof. The Administrative Law Judge correctly concluded that the Division's assessment is presumed correct, the Division does not have the burden to demonstrate the propriety of its assessment and petitioner has a heavy burden to prove the assessment erroneous. However, we disagree with his conclusion that petitioner did not meet the burden of proof imposed upon it.

Clearly, petitioner had the right to rely upon the TSB-M-85(18)C in calculating the fair market value of the property in filling out its State tax returns. While not legally binding, the TSB-M memoranda are policy statements issued by the Division which are informational in nature, designed to disseminate the Division's current interpretation of the Tax Law in response to similar requests from a broad class of taxpayers. "On the whole, TSB-Ms are designed to aid in keeping the taxpayer as informed as possible about the application of the law" (Developing and Communicating Interpretations of the Tax Laws: A report to the Governor and the Legislature reviewing the Department of Taxation and Finance Policies and Practices, March 1989, p. 20; Matter of Garden Way, Tax Appeals Tribunal, February 24, 1994).

The TSB-M in this case sets forth the Division's interpretation that the FMV of a cooperative housing property could be properly calculated by the assessed value formula. The Division's effort was, no doubt, prompted by the fact that cooperative housing property does not generate a net income for franchise tax purposes, and that cooperative housing "buildings" are apparently not susceptible to standard appraisal techniques as indicated by the testimony of petitioner's witness, Mr. Barenholtz. As a result, determining fair market value by appraisal would be difficult and no doubt costly in relation to the tax liability. Moreover, if, as the Administrative Law Judge concluded and the Division asserts, FMV was available from Federal tax returns, there would be no need for the TSB-M. The formula in the TSB-M has, as its

virtues, the fact that it is simple (it uses assessed value of the property prepared annually by the local assessor and the equalization rate prepared periodically by the State, both known factors); it is inexpensive relative to the tax rate[8] since the labor has been done; and it is objective since the underlying valuation and sampling is done by independent third parties.[9]

Clearly, there is no apparent reason why petitioner, in the first instance, was not entitled to rely upon the TSB-M.

Is is also equally clear that the Division reserved to itself the right, upon audit, to question the validity of the FMV in a given situation. The crux of the matter in this case is whether the results of the audit support the Division's assertion that it was proper for the Division to adjust the real property "to the insured value, since this amount more closely reflects fair market value" (Determination, finding of fact "10").

We reject this assertion.

First, there is nothing in the record to support the Division's assertion that insured value is a better indication of FMV than the formula the Division itself held out to petitioner in the TSB-M.

Second, we reject the Administrative Law Judge's conclusion that petitioner could not rely on the TSB-M because "[c]learly, based on the FMV reported on petitioner's Federal returns, information, other than the property's 'assessed value,' was known to petitioner which could have been used to determine FMV of the subject property" (Determination, conclusion of law "F," emphasis added).

We agree with petitioner that the Federal returns do not contain fair market value (Petitioner's brief, p. 27). We also find the Division's explanation of the statement by the Administrative Law Judge less than persuasive. Specifically, the Division asserts that:

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[8]The rate is four tenths (4/10ths) of one mill or .0004%, which is $400.00 per $1,000,000.00 of fair market value.

The formula is that used to calculate tax and debt limits under State Constitution, Article VIII, §§ 4 and 10.

> "The ALJ correctly determined that there is no evidence of how the figures on the federal income tax returns were computed. A taxpayer on the federal income tax return reports the cost/adjusted basis of the land and buildings it owns. From that amount the taxpayer subtracts accumulated depreciation. The cost/adjusted basis is not book value. Book value is cost/adjusted basis minus accumulated depreciation. Because book value is usually lower than fair market value and is a constantly declining value, the Division prohibits the use of book value. TSB-M-85(18)C. Cost/adjusted basis, however, may be reflective of fair market value as it is the price at which a willing seller will sell and a willing buyer will buy if the point in time at which the purchase occurred is not too remote. Therefore, cost prior to accumulated depreciation is of greater significance than book value or assessed value in the absence of more persuasive valuation evidence. South Alabama Land Co. v. Commissioner, 104 F2d 27; Seaside Improvement Co. v. Commissioner, 105 F2d 990; Walter Rolland v. Commissioner, 12 TCM 124; Henry Cleland Estate Co., 29 BTA 436; and Strong, Hewat & Co., 3 BTA 1035. Therefore, the cost/adjusted basis reported by the petitioner on its 1120s is not the purchase price on the offering plan and is evidence that the value of the land and building is in excess of the value ascribed to the land and building at the hearing ($1.25 million) and the value reported on the CT-3s for the period at issue" (Division's brief, pp. 6-7).

This explanation is a far cry from the certainty of the statement by the Administrative Law Judge that petitioner's Federal returns contained FMV. In addition, the Division's argument places petitioner in the dilemma of choosing between the assessed value formula in the TSB-M and the cost/adjusted basis (with the uncertain variable of the time line). This is clearly inconsistent with the purpose of the TSB-M to provide a simple, inexpensive and objective formula to determine the FMV of cooperative housing. (We also note that the Division itself did not use the cost/adjusted basis as the FMV of the property.)

Finally, we reiterate that if the Federal return contained a fair market value as the Division asserts and the Administrative Law Judge concluded, there is no apparent reason for the TSB-M. The fact of the matter is that, in our view, the statement by the Administrative Law Judge is in error and the rationale offered by the Division to explain the statement by the Administrative Law Judge is without merit.

We also reject the finding by the Administrative Law Judge that "[w]hile the Division's method of determining FMV may not have been precise, it was rational" (Determination, conclusion of law "H," emphasis added). The strong implication of this statement is that the standard of review accorded the Division of Tax Appeals by the State Legislature is to merely determine if the action of the Division is rational, i.e., not arbitrary or capricious. In short, that we operate under an "Article 78" standard of review. We do not. As we stated in Matter of OK Petroleum Products Corp. (Tax Appeals Tribunal, November 1, 1990), the proper standard of review to be applied by the Administrative Law Judge is a de novo review.

> "The Division of Tax Appeals is an independent division within the Department of Taxation and Finance. It is administered by the three member Tax Appeals Tribunal. The powers, functions, duties and obligations of the Division are separate from and independent of the authority of the Commissioner of Taxation and Finance (Tax Law § 2002). The purpose of the Division is to provide "the public with a just system of resolving controversies with [the] department of taxation and finance and to ensure that the elements of due process are present with regard to such resolution of controversies" (Tax Law § 2000).
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> "The Division of Tax Appeals' enabling legislation with respect to the review authority of the Tribunal and the authority of the Administrative Law Judges to conduct hearings, contains no statutory limitations such as those contained in Article 78 of the Civil Practice Law and Rules which is applicable to judicial review of administrative decisions (CPLR 7803[3] and [4] [which limit judicial review of administrative decisions to questions of whether the administrative action was arbitrary and capricious]). This is consistent with the function, nature and purpose of the Division of Tax Appeals as an independent administrative body which performs an adjudicative function.
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> "Moreover, to impose an Article 78 standard on the Division of Tax Appeals would disregard the clear intent of the Legislature as expressed in § 2016 of the Tax Law, that the decision of the Tribunal be the final administrative decision to be reviewed by the courts under the Article 78 standard. Further, the application of such a standard of review by the Division of Tax Appeals would result in three redundant adjudicative determinations, i.e., the determination of the Administrative Law Judge, the decision of the Tribunal and the decision of the Appellate Division, all determining whether the action of the Division of Taxation was based on substantial evidence or was arbitrary or capricious" (Matter of OK Petroleum Products Corp., supra; see also, Matter of Felmont Oil Corp., Tax Appeals Tribunal, May 9, 1996 [applying

> the same rational to the standard of review applicable to the Tribunal]).

We deal next with the issue of whether petitioner proved that it used the assessed value formula for the years 1987 and 1988. Clearly, petitioner did compute FMV on its 1986 CT-3 State return. That calculation which began with total assets from its Federal returns, deducted the book value of the real property and added the difference to the equalized assessed value, i.e, the TSB-M formula value. Petitioner's 1987 and 1988 State returns do not indicate the equalization rate or the assessed value of the property for each year, just the result petitioner asserts it achieved through the application of the formula. We do not find this omission fatal. Petitioner's calculation of the FMV as shown on its returns of $16,873,215.00 for 1987 and $17,122,000.00 for 1988 appear to be consistent with the $14,020,879.00 FMV computed for 1986, a year where both the assessed valuation and equalization rate are known.[10] Furthermore, the Division has not controverted or in any way challenged petitioner's calculation of FMV as reported on its returns. Certainly, on audit, the Division could have pursued this issue. It did not. It merely offered its substitute for the calculation. We find no reason, therefore, to not accept petitioner's calculation of FMV as reflected on its 1987 and 1988 returns. As a result of this conclusion, we deny petitioner's request for refund based on the alleged but unsupported fair market value of $1,250,000.00.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of 300 East 74th Owners Corp. is granted to the extent that the tax liability for the years 1987 and 1988 shall be calculated in accordance with the formula in the TSB-M-85(18)C;

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

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[10]We take official notice of the New York State equalization rate of 49.24% for the year 1987 and 43.40% for the year 1988 for the Borough of Manhattan.

3. The petition of 300 East 74th Owners Corp. is granted to the extent that the tax liability for the years 1987 and 1988 shall be calculated in accordance with the formula in the TSB-M-85(18)C.

DATED: Troy, New York
July 25, 1996

/s/Donald C. DeWitt
Donald C. DeWitt
President

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