

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

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In the Matter of the Petition	:	
of	:	
<b>R &amp; V COMPANY</b>	:	DECISION
	:	DTA NO. 812213
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.	:	

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Petitioner R & V Company, c/o Arthur Goldstein, Esq., 18 West Carver Street, Huntington, New York 11743, filed an exception to the determination of the Administrative Law Judge issued on May 22, 1997. Petitioner appeared by Howard M. Koff, Esq. The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Paul A. Lefebvre, Esq., of counsel).

Petitioner filed a brief in support and a reply brief. The Division of Taxation filed a brief in opposition. Oral argument, at petitioner's request, was heard on October 8, 1997 in Troy, New York.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision. Commissioner DeWitt took no part in the consideration of this decision.

***ISSUE***

Whether "consideration" includes the balance outstanding on a nonrecourse mortgage, plus accrued interest, upon the transfer by foreclosure of the real property, where the mortgage indebtedness exceeds the fair market value of the property.

***FINDINGS OF FACT***

We find the facts as determined by the Administrative Law Judge, except for findings of fact “1,” “11” and “12” which have been deleted.<sup>1</sup> The remaining findings of fact of the Administrative Law Judge are set forth below.

Petitioner R & V Company ("R & V") owned real property located in the Town of Huntington, Suffolk County. As of July 17, 1991, R & V owed, on a first mortgage held by the Estate of John Froehlich, \$7,000,000.00 in principal and \$1,130,116.44 in unpaid interest for the total amount of \$8,130,116.44. At the same time, Reliance Federal Savings Bank held a second mortgage on the same property for the approximate amount of \$6,500,000.00 which included accrued interest. The second mortgage was not a purchase money mortgage and was nonrecourse with no personal liability on the part of R & V.

Reliance Federal Savings Bank foreclosed on the second mortgage. The real property was transferred on foreclosure on July 16, 1991. On the transferor questionnaire, R & V listed Reliance Federal Savings Bank as the transferee and \$8,130,116.00 (the amount on the first mortgage) as the gross consideration to be paid by the transferee for the transfer. R & V stated that it did not include the amount of the second mortgage as "consideration" on the questionnaire because the second mortgage was not a purchase money mortgage and R & V had no personal liability on that mortgage. Therefore, asserted petitioner, it was not receiving any value from the discharge of the second mortgage in foreclosure.

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<sup>1</sup> We have deleted finding of fact “1” of the Administrative Law Judge’s determination as not being an actual finding of fact. We have, however, included it here as a footnote: “On November 8, 1996 and November 13, 1996, respectively, the Division of Taxation and petitioner R & V Company, signed a stipulation of facts which have been incorporated into the following findings of fact.”

Findings of fact “11” and “12” have been deleted since they are in the nature of argument. However, the substance thereof is included under “Arguments on Exception” to the extent relevant to the issues on exception.

On the transferor questionnaire, R & V also included in its original purchase price legal fees in the amount of \$1,250,000.00 as the cost of capital improvements to the real property. The parties stipulated that these legal fees were incurred to challenge the existing zoning classification of the property to allow for higher density residential development. The parties stated that these fees were never paid by petitioner and that, due to the transfer in foreclosure, petitioner never had a chance to develop the property which instead remained in the same physical condition from the time it was acquired until the time it was transferred.

Reliance Federal Savings Bank subsequently sold the real property to The Nature Conservancy on October 31, 1991 for \$12,425,000.00, substantially less than the combined amount owed by petitioner on the first and second mortgages.

The Division of Taxation ("Division") sent to petitioner a Schedule of Adjustments, dated January 21, 1992, concerning its transfer of the real property to Reliance Federal Savings Bank. In that statement, the Division informed petitioner that it was disallowing certain amounts claimed as capital improvement costs, including legal fees. The Division also stated that the amount due on the second mortgage (\$6,847,507.96) was to be included as consideration for the transfer of the property.

The Division issued to petitioner a Notice of Determination, dated September 21, 1992, for tax due in the amount of \$602,957.97, plus \$64,903.92 in interest and a \$211,035.16 penalty, for the total amount of \$878,897.05.

After a conciliation conference, the conferee issued a conciliation order, dated August 20, 1993, sustaining the statutory notice.

R & V filed a petition, dated August 26, 1993, challenging the notice of determination. Petitioner argued that the Division erred by including the full amount of the second mortgage as

"consideration" and that the Division erred in disallowing the legal fees as part of the original purchase price. Petitioner noted that the fair market value of the property was substantially less than the combined amount of the first and second mortgages; that the foreclosure resulted in a loss rather than a gain; and that the legal fees were incurred to convert the property "from raw land to approved development status" and, as a result, the value of the property was enhanced substantially.

The Division filed an answer, dated October 21, 1993, affirmatively stating that the transfer of real property resulted in gain which was subject to the real property transfer gains tax, and that petitioner has the burden of proving that the Division's determination was improper.

***THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE***

Tax Law former § 1441<sup>2</sup> imposed a tax on gains derived from the transfer of real property at the rate of 10% of the gain. Tax Law former § 1440(3) defined "gain" as the difference between the consideration for the transfer of real property and the original purchase price. The statute defined "consideration" as including:

any price paid or required to be paid, whether expressed in a deed and whether paid or required to be paid by money, property, or any other thing of value and including the amount of any mortgage, purchase money mortgage, lien or other encumbrance, whether the underlying indebtedness is assumed or taken subject to. Consideration includes the cancellation or discharge of an indebtedness or obligation [Tax Law former § 1440(1)(a), emphasis added].

Petitioner claimed that because the second mortgage was nonrecourse, it had no personal liability on the second mortgage and was free to "walk away" from the obligation. Therefore, petitioner reasoned, the amount owed on the second mortgage should not be included in

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<sup>2</sup>The real property transfer gains tax imposed by Tax Law Article 31-B was repealed on July 13, 1996. The repeal applies to transfers of real property that occur on or after June 15, 1996 (L 1996, ch 309, §§ 171-180). .

computing “consideration” on the transfer of the real property upon foreclosure of the second mortgage.

The Administrative Law Judge rejected this argument, relying on our decision in *Matter of Shed Developers* (Tax Appeals Tribunal, October 26, 1995), where we addressed this issue. In *Shed*, the Administrative Law Judge noted, the taxpayer transferred real property to the mortgagee in lieu of foreclosure. The mortgage indebtedness to the mortgagee was nonrecourse and the taxpayer argued that because the mortgage indebtedness discharged by the transfer in lieu of foreclosure exceeded the fair market value of the property at the time of its transfer, the consideration for the transfer was limited to such fair market value. The Administrative Law Judge noted that in *Shed*, we held that under Tax Law § 1440(1)(a) consideration for gains tax purposes includes the amount of mortgage indebtedness discharged as a result of the transfer regardless of whether the indebtedness is secured by a recourse or nonrecourse mortgage.

The Administrative Law Judge rejected petitioner's attempt to distinguish the facts here from those in *Shed*. The Administrative Law Judge concluded that the holding in *Shed* addressed the same relevant facts and issues as exist here. The Administrative Law Judge went on to conclude that inasmuch as R & V's debt obligation under the second mortgage was discharged when the property was transferred at foreclosure, the outstanding debt and accrued interest under the second mortgage should have been included as "consideration" for the property transferred to Reliance Federal Savings Bank for gains tax purposes.

R & V next asserted that legal fees incurred as an incident to obtaining subdivision approvals for its contemplated capital improvements should be included in original purchase price.

In *Matter of Kalikow Yaphank Dev. Corp. v. Tax Appeals Tribunal* (234 AD2d 721, 651 NYS2d 647), the Appellate Division held that legal, architectural and engineering expenses incurred to obtain subdivision approval after the purchase of the property cannot be included as part of the original purchase price in a subsequent sale of the real property. Based on the Court's decision in *Kalikow Yaphank*, the Administrative Law Judge concluded that petitioner may not include these legal fees as part of the original purchase price and, thus, she sustained the Notice of Determination.

### ***ARGUMENTS ON EXCEPTION***

Petitioner takes exception to conclusions of law "A" and "C" of the Administrative Law Judge's determination. No exception has been taken to the issue of legal fees.

Petitioner argues, as it did below, that *Shed* is distinguishable from the facts herein. Petitioner, for the first time on exception, would have us distinguish *Shed* because, according to petitioner, under Tax Law former § 1440(1)(a) "consideration" included the amount of the mortgage only if such mortgage was "assumed" or taken "subject to." In *Shed*, petitioner urges, the mortgage was taken "subject to" by the transferee. In this case, the property was transferred by foreclosure and the mortgage was simply cancelled.

Petitioner also argues that, since it was free to "walk away" from the indebtedness of the second mortgage, the foreclosure on the second mortgage did not give petitioner something of value and, therefore, it was not in receipt of any consideration with respect to the foreclosure on the second mortgage.

In its reply letter brief, relying on our decision in *Matter of Old Farm Lake Co.* (Tax Appeals Tribunal, April 2, 1992), petitioner argues that since the indebtedness was cancelled, the consideration for the transfer is the fair market value of the property.

**OPINION**

We affirm the determination of the Administrative Law Judge.

The facts in this case are nearly identical on every relevant point to those found in *Shed*. Mr. Koff, petitioner's representative here, was also the representative in *Shed*. Mr. Koff makes the same arguments here as we rejected in *Shed*, with two additions. Petitioner, apparently for the first time on exception, argues that we should distinguish our decision in *Shed* because that case involved a transfer in lieu of foreclosure and the mortgage was taken "subject to" by the transferee. Accordingly, petitioner concludes, "consideration" can only include the amount of the mortgage "if such mortgage is assumed or taken subject to" (Petitioner's Brief in Support). In this case, the property was transferred in foreclosure and the mortgage was simply cancelled.

Petitioner next argues that because the mortgage that was cancelled was nonrecourse, the consideration for the transfer cannot exceed the fair market value of the property because it was entitled to "walk away" from the mortgage (*citing Matter of Old Farm Lake Co., supra*).

We find no merit in either argument.

The statute defined "consideration" as including the:

price paid or required to be paid, whether expressed in a deed and whether paid or required to be paid by money, property, or any other thing of value and including the amount of any mortgage, purchase money mortgage, lien or other encumbrance, whether the underlying indebtedness is assumed or taken subject to.  
Consideration includes the cancellation or discharge of an indebtedness or obligation [Tax Law former § 1440(1)(a), emphasis added].

The statute is clear that consideration is the amount paid or required to be paid, however expressed, including, by way of example in the statute, a mortgage, purchase money mortgage, etc. It is also clear from the language of the statute that it makes no difference whether the debt is "assumed" or taken "subject to."

Petitioner's alternative argument is also rejected. Petitioner urges, based on the decision in *Old Farm*, that where there is a cancellation of a nonrecourse mortgage, consideration for the transfer is limited to the fair market value of the property. This argument fails on three grounds. First, Tax Law former § 1440(1)(a) made no distinction between recourse or nonrecourse debts or obligations. Second, even if it did, petitioner has not offered sufficient evidence to establish the fair market value of the property at the time of transfer. Any conclusions we might draw on the property's fair market value would be mere speculation. Third, *Old Farm* does not stand for the proposition cited by petitioner. *Old Farm* dealt with the question of whether an unsecured promise to pay, e.g., a promissory note, should be treated in the same manner as a promise to pay which is secured by a mortgage, i.e., secured by recourse to the property. For reasons not relevant here, we held that it should not. Our holding in *Old Farm*, however, has no application to the facts in this case. Unlike *Old Farm*, petitioner here owed a debt which was secured by a mortgage. Ultimately, that mortgage was enforced, petitioner transferred (lost) the property in foreclosure, and the mortgage debt was cancelled. The outstanding mortgage debt, plus accrued interest, that was cancelled upon foreclosure constituted consideration for the transfer of the property.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of R & V Company is denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petition of R & V Company is denied; and

4. The Notice of Determination, dated September 21, 1992, is sustained.

DATED: Troy, New York  
March 12, 1998

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Carroll R. Jenkins  
Commissioner

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Joseph W. Pinto, Jr.  
Commissioner