

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petitions	:	
of	:	
HAUBECK REALTY CORP. & MADISON PARK LOFT CORPORATION	:	DECISION
	:	DTA NOS. 815374, 815375 and 815429
for Revision of Determinations or for Refunds of Tax on Gains Derived from Certain Real Property Transfers under Article 31-B of the Tax Law.	:	

Petitioners Haubeck Realty Corp. and Madison Park Loft Corporation, c/o DiLorenzo Properties, Attn. Steve Schwartz, 720 Fifth Avenue, 14th Floor, New York, New York 10019, filed an exception to the determination of the Administrative Law Judge issued on March 5, 1998. Petitioners appeared by Ziegler, Sagal & Winters, P.C. (Lanny M. Sagal, Esq., of counsel). The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Herbert M. Friedman, Jr., Esq., of counsel).

Petitioners filed a brief in support of their exception and a reply brief. The Division of Taxation filed a brief in opposition. Oral argument, at petitioners' request, was heard on October 15, 1998 in New York, New York.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUE

Whether petitioners may include the value which certain long-term leases had at the time of their creation as part of the original purchase price for the properties subject to such leases.

FINDINGS OF FACT

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

Petitioners, Haubeck Realty Corp. and Madison Park Loft Corporation, are nominees for DiLorenzo Properties Company ("DPC"), a New York partnership.

DPC was the owner of the following real properties ("the properties") located in New York City:

462-468 Broadway
686-688 Lexington Avenue
12-16 West 27th Street
30-34 West 26th Street
12-14 West 21st Street
1367-1369 Broadway
681-685 Lexington Avenue

Each of the properties was subject to a 90-year net lease created on or about September 1, 1981, which date is prior to the March 28, 1983 effective date of the real property transfer gains tax ("gains tax") imposed under Tax Law former Article 31-B.¹ Accordingly, no gains tax was paid (or payable) on the creation of the leases.

The leases provided for fixed rental payments for the first 30 years and, starting with the 31st year, provided for rent increases of three percent per annum thereafter. The tenants under these net leases were unrelated to DPC.

The properties were sold in 1995 to unrelated third parties, subject to the leases. In connection with the 1995 sale of the properties, petitioners filed gains tax transferor and

¹The 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).

transferee questionnaires. In these filings, petitioners stepped-up their original purchase price ("OPP") for the properties so as to reflect the net leases, which had been entered into prior to the effective date of the gains tax.

Included with the documentary evidence submitted in this matter are:

- a. alternative calculations of gain by the Division of Taxation ("Division") and by petitioners, and
- b. petitioners' reported calculations of the consideration for the amount of the leases (the adjusted OPP reported by petitioners).

In response to petitioners' filings, tentative assessments were issued by the Division denying the claimed step-up in OPP pursuant to Tax Law § 1440(5)(e) on the ground that no gains tax was paid on the creation of the leases.

Petitioners paid the tentative assessments and thereafter filed timely refund claims with respect to each of the transfers, as follows:

<u>PROPERTY</u>	<u>REFUND CLAIMED²</u>
462-468 Broadway	\$227,937.00
686-688 Lexington Avenue	107,073.00
12-16 West 27 th Street	113,453.00
30-34 West 26 th Street	201,603.00
12-14 West 21 st Street	117,943.00
1367-1369 Broadway	94,137.00
681-685 Lexington Avenue	146,333.00

The Division denied all of the refund claims in their entirety.

²The petition inadvertently lists the \$107,073.00 figure set forth (presumably due to a typographical error) in the Division's denial letter regarding 681-685 Lexington Avenue. The parties have stipulated that the correct amount in issue should be \$146,333.00, and the petition shall be deemed amended to refer to this amount as the amount in dispute.

In each case (with the exception of 1367-1369 Broadway), petitioner filed a request for conciliation conference in response to the Division's refund denial. In each such case, a Conciliation Order was issued by the Division's Bureau of Conciliation and Mediation Services ("BCMS") sustaining the Division's denial.

Petitioners, in response, timely filed the petitions at issue herein.

The record on submission includes copies of the long-term net leases, together with an affidavit made by Marc DiLorenzo, managing partner of DPC, attesting to their authenticity.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

After reviewing the applicable provisions of former Article 31-B of the Tax Law and regulations of the Commissioner pertaining to the real property transfer gains tax, the Administrative Law Judge noted the agreement of the parties that the 1995 transfers of property were subject to the real property transfer gains tax and that the long-term leases at issue herein would have been subject to the gains tax if such leases had been created after the March 28, 1983 effective date of that tax.

The Administrative Law Judge rejected petitioners' arguments that, based on the provisions of Tax Law former §§ 1440(5)(e) and 1440(7)(a), petitioners were entitled to step up their OPP for the property by the present value of the long-term leases at the time of their creation in 1981. The Administrative Law Judge did not agree with petitioners' argument that, absent such a step-up, petitioners were being improperly taxed on gain attributable to the creation of the leases, an event which took place prior to the gains tax effective date. The Administrative Law Judge concluded that based on the clear language of Tax Law former § 1440(5)(e), in order

for the value of the leases to be included in OPP as consideration, such consideration must have been received by the lessor of a taxable lease and the lessor must have paid the tax (or be paying the tax in installments) due as the result of the creation of such leasehold interests. Since the leases were not subject to the tax because they were entered into before the date on which the gains tax became effective, petitioners are neither the lessors of taxable leases nor did they pay gains tax on the creation of such leases.

The Administrative Law Judge rejected petitioners' argument that since the leases in question meet the definition of "transfer of real property," they are "taxable leases" for purposes of Tax Law former § 1440(5)(e). The Administrative Law Judge noted that former § 1440(5)(e) allowed the inclusion of consideration received for taxable leases in OPP to prevent the lease consideration from being again subjected to gains tax upon sale of the properties. However, the Administrative Law Judge stated that it does not follow that lease consideration is to be included in OPP without regard to when the leases were created.

The Administrative Law Judge also rejected petitioners' argument that because the leases were entered into before the effective date of the gains tax, they are "transfers" as defined in Tax Law former § 1440(7)(a) under the "grandfather" exemption from the gains tax (Tax Law former § 1443[6]). The Administrative Law Judge found that a transfer of real property is exempted from tax where the contract for the transfer of that property was executed prior to the effective date of the gains tax law, even though the actual transfer occurred after the effective date of the statute imposing the tax. The Administrative Law Judge concluded that petitioners' argument failed because the transfers in issue here occurred in 1995 and none occurred as a result of a contract entered into prior to the effective date of the gains tax law. The fact that the properties

transferred in 1995 were subject to the long-term leases did not change the fact that the leases themselves were not taxable.

In a footnote, the Administrative Law Judge noted that petitioners' reliance on *Matter of Ader* (Tax Appeals Tribunal, September 15, 1994) was misplaced. *Ader* involved the transfer of co-op shares and a mere change in the form of ownership interest while here there were no co-op shares transferred nor was there a change in the form of ownership of the properties upon creation of the leaseholds. Moreover, the Administrative Law Judge concluded that the present matter involves a specific statute (Tax Law former § 1440[5][e]) and a regulation (20 NYCRR 590.29[b]) different from those at issue in *Ader*.

ARGUMENTS ON EXCEPTION

On exception, petitioners argue as they did before the Administrative Law Judge that if the long-term leases in this case had been created after the effective date of the gains tax they would have been "transfers" subject to the tax. The consideration for the created leases would be equal to the present value of the rents to be paid under the leases. When property subject to a long-term lease is sold, Tax Law former § 1440(5)(e) and 20 NYCRR 590.29(b) require that the lessor's OPP be stepped up by the present value of the rental stream under the lease.

Petitioners argue that transfers of interests in real property which occurred prior to the effective date of the enactment of the gains tax, such as the creation of the long-term leases in this case, were also "transfers" pursuant to Tax Law former § 1440(7)(a). Petitioners maintain that it is inequitable to deny an OPP step-up in the case of a long-term lease entered into before the effective date of the gains tax while allowing such a step-up in the case of a long-term lease entered into after the effective date. Petitioners argue that Tax Law former § 1440(5)(e) does not

prescribe different treatment for pre- and post-March 28, 1983 transfers. Rather, that section merely requires that the lessor have paid the tax imposed by Article 31-B on the lease in order to obtain a step-up. If that Article does not impose any tax, then this condition has no application.

Petitioners also argue for the first time on exception that the Administrative Law Judge's interpretation of the statute is unconstitutional under the Due Process Clause of the United States Constitution as a retroactive tax. Petitioner argues that the gains tax requires that the present value of the rentals under the leases should be deemed to have been realized as gain at the time that the leases were entered into. Thus, by presently taxing the value of such leases, the Division is impermissibly applying the gains tax retroactively to the gain realized on the creation of the leases.

The Division, in opposition, argues that the determination of the Administrative Law Judge is correct. Pursuant to Tax Law former § 1440(5)(e), the lessor must have paid gains tax with respect to the leases in order to step up its OPP. The Division asserts that because the leases here were created prior to the effective date of the gains tax, they were simply not subject to the tax. The Division argues that petitioners seek an exemption from taxation which does not exist under the law. Since no gains tax was paid on the leases at the time of their creation, the Division asserts that petitioners are not entitled to step up their OPP by the value of the leases at the time of their creation.

OPINION

With the exception of the constitutional argument raised by petitioners in their exception, we find that the Administrative Law Judge has fully and correctly addressed each of the issues raised by petitioners and we affirm his determination for the reasons set forth therein.

On exception, petitioners argue for the first time that the Administrative Law Judge's interpretation of Article 31-B of the Tax Law violates petitioners' rights to due process by imposing a retroactive tax on gain realized on transfers which took place prior to the effective date of the gains tax. However, we have held that new legal issues may be raised on exception (*Matter of Chuckrow*, Tax Appeals Tribunal, July 1, 1993). While the Division of Tax Appeals does not have the authority to determine the constitutionality of a legislative enactment (*see, Matter of Unger*, Tax Appeals Tribunal, March 24, 1994; *Matter of Fourth Day Enters.*, Tax Appeals Tribunal, October 27, 1988), we have jurisdiction to determine whether a statute is unconstitutional as applied to petitioner (*Matter of David Hazan, Inc.*, Tax Appeals Tribunal, April 21, 1988, *confirmed Matter of David Hazan, Inc. v. Tax Appeals Tribunal*, 152 AD2d 765, 543 NYS2d 545, *affd* 75 NY2d 989, 557 NYS2d 306). The taxpayer bears the burden of proving that a statute, as applied, is unconstitutional (*Matter of Brussel*, Tax Appeals Tribunal, June 25, 1992).

In this regard, we find petitioners' constitutional argument to be without merit. The Administrative Law Judge made clear in his determination that no tax has been or is now being imposed on petitioners for the creation of the leasehold interests prior to March 28, 1983. Rather, the only transfers subjected to gains tax were the 1995 property transfers. We agree with this conclusion. The fact that the properties transferred were subject to existing long-term leases does not change the fact that the leases themselves were not taxed. Thus, there is no issue of retroactive taxation presented in this case.

Petitioners state that the premise of their due process argument is "the assumption that the present value of the rentals under the leases should be deemed realized as gain at the time that the

leases were entered into” (Petitioners’ brief in support, p. 22). Petitioners then argue that by including the value of the leasehold interests in the calculation of taxable gain on the 1995 transfer of the underlying properties, the Division has unconstitutionally applied the gains tax on a retroactive basis to the gains realized on the creation of these leases. Petitioners, in effect, present the issue as one of timing: they argue that they have accrued a gain on the creation of the leaseholds and now, on the sale of the underlying property, they are exempt from taxation on the actual receipt of that portion of their gain which is attributable to the leaseholds. There is no basis for this position. As the Administrative Law Judge noted,

[t]his inclusion, or step up, would prevent the lease consideration which was subject to gains tax upon creation of the leases from being subjected to gains tax again upon sale of the properties. However, it does not follow that such lease consideration must therefore always be includable in OPP regardless of when the leases were created (Determination, conclusion of law “G”).

In short, the purpose of the step-up in OPP is to avoid inequity by recognizing a prior gain already subjected to tax. Here, since no gain has been previously taxed, there is no inequity to avoid.

Petitioners have likewise not shown that they are being treated differently than similarly situated taxpayers. Petitioners argue that had they sold easements to third parties prior to March 28, 1983 and received installment notes in payment, the subsequent sale of the property subject to these easements would not have included the value of the notes as part of the consideration subject to gains tax. Petitioners argue that the same result should pertain in the instant case. However, it is evident from petitioners’ example that a subsequent sale of the property subject to an easement is different from the sale of the properties at issue herein, which

carried the continuing right to receive rents, profits or other income derived from real property. Thus, petitioners have failed to meet their burden of proof to demonstrate that they are being treated differently than similarly situated taxpayers.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Haubeck Realty Corp. and Madison Park Loft Corporation is denied;
2. The determination of the Administrative Law Judge is sustained;
3. The petitions of Haubeck Realty Corp. and Madison Park Loft Corporation are denied;

and

4. The Division of Taxation's denial of the refund claims is sustained.

DATED: Troy, New York
April 8, 1999

/s/Donald C. DeWitt

Donald C. DeWitt
President

/s/Carroll R. Jenkins

Carroll R. Jenkins
Commissioner

/s/Joseph W. Pinto, Jr.

Joseph W. Pinto, Jr.
Commissioner