STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition of HENRY MENDLER for Revision of a Determination or for Refund of Real Property Transfer Gains Tax under Article 31-B of the Tax Law for the Year 1985.	: : : : :	DETERMINATION DTA NO. 805824

Petitioner, Henry Mendler, 306A East 50th Street, New York, New York 10022, filed a petition for revision of a determination or for refund of real property transfer gains tax under Article 31-B of the Tax Law for the year 1985.

On December 2, 1991 and December 5, 1991, respectively, petitioner by his representative, Fred Lichtblau, Esq., and the Division of Taxation by William F. Collins, Esq. (Andrew J. Zalewski, Esq., of counsel), consented to have the controversy determined on submission without hearing, with all exhibits and briefs due by March 27, 1992. The Division of Taxation submitted the jurisdictional documents on January 7, 1992. Petitioner submitted his brief and affidavits on January 28, 1992. The Division submitted its brief on March 2, 1992 and petitioner submitted his reply brief on March 24, 1992. After due consideration of the record, Marilyn Mann Faulkner, Administrative Law Judge, renders the following determination.

ISSUES

I. Whether petitioner was entitled to an exemption from real property transfer gains tax pursuant to Tax Law § 1443(1) because the consideration received for three of the four units of the cooperative conversion plan totaled less than one million dollars.

II. Whether the anticipated consideration for cooperative shares allocated to an unsold unit in a cooperative building should take into account that the unit is encumbered by a life estate.

III. Whether the penalty imposed pursuant to Tax Law § 1446(2)(a) should be abated.

FINDINGS OF FACT

Petitioner, Henry Mendler, purchased a four-story, four-unit "brownstone" building, located at 11 West 11th Street in New York City, for which he paid $125,000.00 in 1967. Three of the four units in the building were rented and the fourth unit was occupied by petitioner and his family as a personal residence.

On March 14, 1973, petitioner and his wife, Judith Marion Mendler, entered into a separation agreement which was incorporated without merger into a Supreme Court Judgment of Divorce, entered on February 6, 1974.

One of the provisions of the separation agreement provided Judith Mendler with a life estate in the fourth unit as follows:

> "the Wife shall have the right to the exclusive occupancy of the present marital apartment at 11 West 11th Street, New York, New York, as her personal residence. The Wife is herewith conveying all of her right, title and interest in the real property known as 11 West 11th Street, New York, New York to the Husband subject to the Wife's right to occupy said apartment free of rent for the time, and under the conditions hereinafter set forth. In connection therewith, it is further understood that the Wife shall not be obliged to pay for the maintenance of the air conditioning system, the major appliances presently contained in said apartment, all utilities including electric, gas and telephone (at a cost consonant with present usage only). Any obligation deemed necessary by this paragraph in order to satisfy the Wife's enjoyment of her life estate may be made directly to her, or directly to the appropriate creditor.
>
> It is expressly agreed that the wife's rights under this paragraph shall terminate at the earliest of (a) the Wife's death, (b) her intentional vacature or abandonment of said apartment, or (c) if the Wife is not the sole and exclusive occupant of said apartment. As used herein, 'abandonment' is understood to mean the continuous absence of the Wife from the premises for a period of no less than four months. The provisions of this paragraph shall be binding upon the present and any further owner of premises 11 West 11th Street, New York, New York and the Husband expressly covenants that he will not convey said premises except subject to the provisions herein contained. Upon the termination of the wife's occupancy, the owner of said premises shall have the right to re-enter and peaceably take possession of the apartment."

Petitioner sponsored a cooperative offering plan, dated July 28, 1983, with respect to the building located at 11 West 11th Street. The offering plan contained the following schedule of anticipated purchase prices of shares allocated to the four units:

Share	Cash purchase price at $600	Approximate amount of mortgage allocable to shares

Unit	Allocations	per share	$375 per share
C	300	$180,000	$112,500
M	325	195,000	121,875
1	375	225,000	140,625
2	600	360,000	225,000
	1,600	$960,000	$600,000

The offering plan was amended three times. The first amendment, dated June 5, 1984, reduced the principal of the wraparound mortgage from $600,000.00 to $440,000.00 thereby also reducing the amounts allocable to the apartments to $275.00 per share. The second amendment, dated August 27, 1984, reduced the price of Unit M to $570.00 per share in lieu of $600.00 per share, or $185,252.00. The purchaser of Unit M became a tenant pursuant to an interim lease in August 1984. The second amendment also declared the offering plan effective on August 27, 1984. In the third amendment, dated March 29, 1985, it was noted that on January 14, 1985 the title closing took place whereby petitioner conveyed the entire 11th Street property to a cooperative corporation, 11 West 11th Street Owners Corp., pursuant to the offering plan. It was also noted in the third amendment that on the closing date the property was encumbered by a wraparound mortgage in the principal amount of $440,000.00 which wrapped around a superior mortgage in the principal amount of $49,000.00.

By May of 1985, three of the units were sold for the following purchase prices:

Unit	
1	$205,000.00
M	185,250.00
C	170,000.00
	$560,250.00

In addition, a brokerage fee of $11,115.00 was paid by the transferor corporation with respect to Unit M.

Petitioner's ex-wife, Judith Mendler, occupied Unit 2 in accordance with the provisions of the separation agreement. In an affidavit submitted by petitioner, he stated the following:

> "Since our divorce in February, 1974, I have made numerous serious efforts to 'buy out' my ex-wife's life estate and relocate her. I engaged counsel for this purpose, who contacted my former wife's attorney. All my offers were rejected, and my former wife refused to move -- at any price. She refused to even make any counterproposals, and insisted that she remain in the apartment indefinitely. She

> insists on remaining in the apartment pursuant to the Separation Agreement and Judgment of Divorce, rent free and utility free (which I pay) for the remainder of her life."

In May of 1987, the Division of Taxation ("Division") commenced an audit of the cooperative purchase.

By letter dated October 29, 1987, petitioner's accountant objected to information contained in the Division's audit report and stated the following:

> "In reviewing your audit report we have noted your anticipated value of the unsold apt. #2 at $342,000.00.[1]
>
> The market for co-opapartments [sic] has been exceptionally soft and will apparently remain that way. We feel the anticipated selling price is considerably less and thus affects your computations.
>
> We are enclosing two independent appraisals which reflect the value of the unsold apartment.
>
> We sincerely hope you will adjust your computations to reflect the true world value [sic] and not the anticipated value.
>
> We are enclosing a check in the amount of FIVE THOUSAND DOLLARS ($5,000.00) as a partial payment of any tax due."

Attached to this letter were two letters appraising Unit 2 for $240,000.00 and $230,000.00, respectively.

Using the anticipated purchase price of $240,000.00 for Unit 2, the auditor calculated real property transfer gains tax due as follows:

	Actual	Anticipated	Total
Cash consideration	$560,250	$240,000	$ 800,250
Less reserve fund			10,000
Estimated cash consideration			790,250
(Plus) mortgage indebtedness			440,000
Gross consideration			1,230,250
(Minus) brokerage commissions			(11,115)
(Minus) original purchase price			(510,365)

1. Apparently, petitioner and 11 West 11th Street Owners Corp. filed a transferee and transferor questionnaire on December 24, 1984 stating the anticipated sale of Unit 2 on January 14, 1985 by the corporation to petitioner for $342,000.00. The transferor questionnaire stated anticipated gains tax due in the amount of $11,586.00 for the sale of Unit 2.

Anticipated gain	708,770
Anticipated tax at 10%	70,877
Anticipated tax per share (based on 1,600 shares)	44.298

The auditor multiplied the anticipated $44.298 tax per share by the 1,000 shares actually sold to determine total gains tax due of $44,298.00.

The Division issued a Notice of Determination, dated January 20, 1988, stating the following amounts due:

Tax	$44,298.00
Penalty	15,504.00
Interest	13,088.00
Total	72,890.00
Paid 11-02-87	5,000.00
Balance	67,890.00
Interest (11/3/87-2/21/88)	1,197.37
Total	$69,087.37

A conciliation conference was held on August 28, 1990. The conferee issued a Conciliation Order, dated February 8, 1991, sustaining the statutory notice.

By petition dated April 16, 1991, petitioner challenged the statutory notice arguing that the assessment was based on incomplete and erroneous facts. Petitioner contended that the evaluation of Unit 2 at $240,000.00 failed to take into account the deteriorating market conditions with respect to cooperative apartments and the fact that Unit 2 was encumbered by the life estate held by Judith Mendler. Petitioner asserted that because of the life estate, Unit 2 had only nominal value and that the value of Unit 2 "was impossible and incapable of accurate assessment in the tax year, 1985, and at the present time or at the time of audit." Petitioner concluded that there was no market for Unit 2 at the time of conversion to cooperative status and that therefore no tax was due, or, if any tax was due, such tax was a "far lesser amount than determined by the commissioner."

The Division filed an answer, dated June 25, 1991, stating, inter alia, that the notice assessed gains tax for the transfer of 1,000 shares allocated to three cooperative units.

In its submissions, petitioner filed two affidavits in support of its contention that Unit 2 was overvalued at $240,000.00 by the Division's auditor. One affidavit was by David B.

Malkin, who was a Chartered Financial Consultant, a Chartered Life Underwriter and a principal in New Jersey Life & Casualty Associates, Inc., specializing in financial planning for individuals and corporations. He stated that he was fully familiar with actuarial methods and practices and that assuming Judith Mendler was 60 years of age in 1985,[2] in reasonably good health and with a leisurely lifestyle, his opinion was, based on the Standard Ordinary Mortality Table used in 1985, that Judith Mendler had a life expectancy of an additional 21.25 years, or to age 81.

A second affidavit by Brian R. Corcoran was submitted. Mr. Corcoran was a member of the Board of Directors, an Executive Vice President, and the National Director of the Appraisal Division of Cushman & Wakefield, Inc. In his affidavit, Mr. Corcoran set forth his analysis of the market value of Unit 2 in 1985 as follows:

> "Generally, apartments which are encumbered by leases to either rent controlled or rent stabilized tenants sell in the range of 20% - 25% of the market value of the same apartment if it were vacant and available for use by the purchaser. The reason for this deep discount is the negative carrying charges which exist in terms of maintenance and financing charges, which are usually in excess of the regulated rents which can be collected from rent controlled or rent stabilized tenants and the uncertainty regarding when possession of the apartments might occur.
>
> The subject apartment is encumbered by a guaranteed life tenancy which has been granted to the former owner's wife under a separation and divorce agreement. This life tenancy carries with it <u>no</u> obligation for maintenance of the apartment and <u>no</u> obligation for any carrying charges, which rests solely with the owner. In this regard, the subject apartment is considered less attractive than the typical occupied cooperative because there is no rental income being paid to offset the cooperative maintenance
>
> charges. For these reasons, it is my opinion that the likely range in market value for the subject apartment would be between 10% and 20% of the value of the apartment as if it were vacant. Assuming, therefore, a market value of $240,000.00 if unencumbered and transferable in a vacant state, the market value for the subject apartment would have been between $24,000.00 and $48,000.00 during the subject tax year, 1985."

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[2]According to petitioner's affidavit, Judith Mendler was born on December 3, 1925.

SUMMARY OF THE PARTIES' POSITIONS

In brief, petitioner argues that the entire transaction was exempt from gains tax because, pursuant to Tax Law § 1442, the tax is not payable until the date of transfer which in the case of a cooperative plan is deemed the date the cooperative unit is transferred. Petitioner therefore alleges that inasmuch as the consideration for the three units sold was below the one million dollar threshold, no gains tax was due. Petitioner concludes that the Division's practice of using the anticipated consideration of Unit 2 in reaching the statutory threshold amount was contrary to the statutory mandate. In his reply brief, petitioner argues that because Tax Law § 1442 is ambiguous, it must be construed liberally in favor of the taxpayer.

The Division of Taxation argues that it properly imposed tax on the sale of three units or 1,000 shares of the cooperative corporation. The Division notes that petitioner misreads the relevant statutes and that Tax Law § 1442 specifically requires that in calculating the tax, an apportionment of the original purchase price of the real property and total consideration anticipated under the cooperative plan is considered for each cooperative unit transferred. The Division asserts that the $240,000.00 anticipated consideration for Unit 2 was reasonable inasmuch as it relied on documentation provided by petitioner's accountant even though the offering plan indicated the significantly higher price of $360,000.00. The Division further argues that petitioner has not shown reasonable cause for waiver of the penalty.

CONCLUSIONS OF LAW

A. Tax Law § 1441 imposes a tax on gains derived from the transfer of real property at the rate of 10% of the gain. A transfer of real property is defined as the transfer of "any interest in real property by any method, including but not limited to sale..." (Tax Law § 1440[7]). The definitional section further provides that "[f]or purposes of this article, transfers pursuant to a cooperative plan shall include all transfers of stock in a cooperative corporation which owns real property".

Petitioner contends that he is entitled to the exemption under Tax Law § 1443(1), which provides that a total or partial exemption shall be allowed if the consideration paid for the transfer of property is less than one million dollars. He theorizes that for purposes of calculating the one million dollar exemption, only the actual consideration received for sold units, rather than the anticipated consideration for all units subject to the cooperative plan, should be used. In seeking entitlement to a statutory exemption, the taxpayer bears the burden of demonstrating that his or her interpretation of the law is the only reasonable interpretation (Matter of Bredero Vast Goed, N.V. v. Tax Commission of the State of New York, 146 AD2d 155, 539 NYS2d 823, 826, appeal dismissed 74 NY2d 791, 545 NYS2d 105; see, Matter of Estate of Dworetz v. State Tax Commission, 128 AD2d 946, 512 NYS2d 745, 747, lv denied 69 NY2d 612, 517 NYS2d 1028). Here, the plain reading of the statute, regulations and case law contradicts petitioner's claim that the one million dollar exemption should be calculated solely on the basis of the actual consideration received for three of the four units.

Tax Law § 1442 concerns the payment of the gains tax. It provides that payment of the tax is due on the date of transfer and that, in the case of a transfer pursuant to a cooperative plan, "the date of transfer shall be deemed to be the date on which each cooperative...unit is transferred." However, section 1442 also provides that for purposes of calculating the amount of tax due in "each...transfer pursuant to a cooperative or condominium plan, an apportionment of the original purchase price of the real property and total consideration anticipated under such cooperative or condominium plan...shall be made for each such cooperative or condominium unit..." (emphasis added).

Thus, under the plain reading of section 1442, the total consideration anticipated under a cooperative plan is to be considered in calculating the amount of tax due on each transfer of a cooperative unit. This reading of the statute is further supported by the Court of Appeals' decision in Mayblum v. Chu (67 NY2d 1008, 503 NYS2d 316), wherein the court stated that gains tax is imposed on the overall cooperative conversion itself which is to be treated as a single transfer for computing the tax, whereas the actual payment of the tax is due upon the subsequent transfer of shares to individual purchasers pursuant to the cooperative plan (see also, Matter of 1230 Park Associates v. Commr. of Taxation and Finance, 170 AD2d 842, 566

NYS2d 957, lv denied 78 NY2d 859, 575 NYS2d 455; 20 NYCRR 590.33).

B. Based on the information made available to it, the Division correctly determined the gains tax due. On August 22, 1983, the Division set forth two options, A and B, to estimate gain on cooperative and condominium plans (TSB-M-83-[2]-R). Both of these options assumed that the cooperative plan anticipated that consideration for all of the units under the plan would total one million dollars or more. Under Option A, the gain subject to tax was based on the actual consideration paid for each share sold with an apportionment of the total purchase price to each share. Under Option B, gains tax was based on the total anticipated consideration less the total anticipated original purchase price as each share sold. Under Option B, a taxpayer was permitted to pay the estimated tax rate, even though the actual consideration received may have been greater or lower when the shares actually sold. In accordance with Option B, once the number of shares sold reached the 25%, 50% and 75% of total shares, a new tax rate per share was determined based on actual consideration received plus estimated consideration for the remaining unsold shares. At the 100% sell-out point, any underpayments or overpayments based on the actual consideration received for the total number of shares sold would be adjusted accordingly.

In 1986, the Division eliminated Option A as a method of paying the tax and directed that the new method for paying the tax would be a modified Option B (TSB-M-86-[2]-R). Under the new Option B, updating was optional at the 25% plateau and guidelines were provided for determining "safe harbor estimates" of anticipated taxes such that, in the event of underpayments, there would be no imposition of penalty or interest on the underpayments (TSB-M-86-[3]-R; see, Matter of Belvedere Garden Associates, Tax Appeals Tribunal, June 18, 1992).

Clearly, petitioner did not avail himself of either Option A or B. When a transfer occurs pursuant to a cooperative plan, the transferor is required to file a questionnaire setting forth relevant information concerning the consideration paid and amount of tax due (Tax Law § 1447). Tax Law § 1444(1) provides that if the required documents are not filed or are incorrect or insufficient, the Division may determine the amount of tax due from "such records or information as may be obtainable, including the assessed valuation of the real property or interest therein and other appropriate factors." The Division calculated the amount of tax due in accordance with Option B based on the information made available to it. Under the amended cooperative plan, petitioner anticipated total consideration for all four units in the amount of $1,390,252.00 (anticipated selling price plus the $440,000.00 mortgage [see, 20 NYCRR 590.36]). In calculating gains tax, the Division's auditor reduced this amount by a reserve fund of $10,000.00 (see, 20 NYCRR 590.38), and by using the actual consideration received for the three sold units ($560,250.00) as well as petitioner's accountant's new appraisal of $240,000.00 in anticipated consideration (as opposed to $360,000.00 stated in the offering plan) for the unsold Unit 2. Thus, at the time of the audit, the Division correctly calculated the amount of gains tax due based on the information provided to it -- the actual and anticipated consideration for all four units (see, Finding of Fact "10").

C. Since the audit, petitioner provided an appraisal of Unit 2 which, for the first time, took into account the life estate held by Judith Mendler. Clearly, the market value, or anticipated consideration, of Unit 2 was affected by the life estate which pre-existed the cooperative conversion. If, in fact, petitioner had succeeded in buying out Judith Mendler's life estate in Unit 2, such costs would have been included in the original purchase price as a cost incurred to create an ownership interest in cooperative form (see, 20 NYCRR 590.39). Therefore, the anticipated consideration should take into account the limited property interest that could be conveyed with respect to Unit 2; that is, the value of Unit 2 encumbered by the life estate. Petitioner provided evidence that the value of Unit 2 encumbered by the life estate in 1985 was between $24,000.00 and $48,000.00. Notwithstanding a reduction in the anticipated consideration to the lowest value of $24,000.00 for Unit 2, the anticipated consideration for all the units under the cooperative plan still met the one million dollar threshold. Thus, gains tax was due on the sale of the cooperative shares with respect to the three sold units. However, using $48,000.00 instead of $240,000.00 as the anticipated consideration of Unit 2 would reduce the tax per share according to the Option B method used by the Division from $44.298 to $32.298 for a total of $32,298.00 gains tax due. The penalty and interest also should be reduced accordingly.

D. With respect to the imposition of a penalty, petitioner has not demonstrated that his failure to pay the tax was due to reasonable cause as required under Tax Law § 1446(2)(a). The reasonableness of a taxpayer's failure to pay the tax must be evaluated in light of the Division's articulated policy (Matter of Benacquista, Polsinelli & Serafini Management Corp., Tax Appeals Tribunal, February 22, 1991) and "the extent of the taxpayer's efforts to ascertain its tax liability" (Matter of KAL Associates, Tax Appeals Tribunal, October 17, 1991). Here, the plain reading of the statutes and Option A and B payment methods issued by the Division contradicted petitioner's alleged belief that the tax did not apply because the three units sold did not total one million dollars in consideration. Moreover, petitioner has not established that he made any efforts to determine his tax liability on the three units sold. Therefore, petitioner has not shown reasonable cause for abatement of the penalty (see, Matter of 1230 Park Associates v. Commr. of Taxation and Finance, supra [ignorance of the law does not constitute reasonable cause]; Matter of Benacquista, Polsinelli & Serafini Management Corp., supra; Matter of KAL Associates, supra).

E. The petition of Henry Mendler is granted to the extent indicated in Conclusion of Law "C" and is otherwise denied. The Notice of Determination, dated January 20, 1988, shall be modified accordingly.

DATED: Troy, New York
August 13, 1992

/s/ Marilyn Mann Faulkner
ADMINISTRATIVE LAW JUDGE