STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
UNION CARBIDE CHEMICALS & PLASTICS COMPANY, INC. (FORMERLY, UNION CARBIDE CORPORATION)	:	DETERMINATION
	:	DTA NO. 806619
for Revision of a Determination or for Refund of Real Property Transfer Gains Tax under Article 31-B of the Tax Law for the Years 1985 through 1988.	:	
	:	

Petitioner, Union Carbide Chemicals & Plastics Company, Inc. (formerly, Union Carbide Corporation), 39 Old Ridgebury Road, Danbury, Connecticut 06817, 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 years 1985 through 1988.

On February 19, 1991 and on February 25, 1991, respectively, petitioner by Phillips, Lytle, Hitchcock, Blaine & Huber, Esqs. (Martha L. Salzman, Esq., of counsel), and the Division of Taxation by William F. Collins, Esq. (Paul A. Lefebvre, Esq., of counsel) agreed to have the controversy determined on submission without hearing. Petitioner filed its brief on April 11, 1991, the Division filed a letter in lieu of a brief on June 5, 1991 and petitioner filed its reply brief on July 15, 1991. After due consideration of the record, Brian L. Friedman, Administrative Law Judge, renders the following determination.

ISSUE

Whether the Division of Taxation properly denied petitioner's claim for refund of real property transfer gains tax.

FINDINGS OF FACT

The parties entered into a written stipulation of facts, the contents of which have hereinafter been incorporated in Findings of Fact "1" through "33".

Petitioner, Union Carbide Chemicals & Plastics Company, Inc., formerly known as Union Carbide Corporation, is a New York corporation with an office at 39 Old Ridgebury Road, Danbury, Connecticut 06817-0001. Petitioner's taxpayer identification number is 13-1421730.

On December 31, 1985, petitioner entered into an agreement with Keren Limited Partnership ("Keren"), a Delaware limited partnership. Pursuant to the agreement, petitioner agreed to sell and Keren agreed to purchase certain property, which included, among other items, land, buildings and improvements, owned by petitioner and located in New York State. The stated purchase price of the real property was $170,000,000.00.

The purchase price of the real property was paid by Keren's delivery to petitioner of two promissory notes and two purchase money mortgages (to secure payment of the notes). The first promissory note dated December 31, 1985 ("First Note") was for the principal indebtedness of $102,000,000.00, of which $100,000,000.00 was to evidence $100,000,000.00 of the stated purchase price and $2,000,000.00 was to evidence a loan by petitioner to Keren which was to be used to pay Keren's mortgage recording tax on the two purchase money mortgages.

The First Note bore interest at the annual rate of 11¼ percent. In the event of a default, the interest rate would increase to 14¼ percent. The principal indebtedness and interest on the First Note was due and payable on December 31, 1986. The First Note was secured by a first mortgage on the real property dated December 31, 1985.

The second promissory note ("Second Note"), also dated December 31, 1985, was for the principal indebtedness of $70,000,000.00. The maturity date of the Second Note was originally December 31, 1988. Keren could, however, under the circumstances, extend the maturity date of the Second Note to the first to occur of (i) the day which is ten days after approval of a site development plan or (ii) December 31, 1990.

There is no provision in the Second Note for the payment of interest before the third anniversary of the date of the Second Note (i.e., December 31, 1988). The Second Note provides that, after the third anniversary of the date of the Second Note, if applicable, it will bear

interest at the rate of ½ percent plus the then-prevailing interest rate under the First Note, but in no event less than ten percent. In the event of a default under the Second Note, interest would accrue at the default rate equal to the sum of three percent plus the rate of interest announced publicly by Manufacturer's Hanover Trust Company as its prime rate of interest, as changed from time to time. The Second Note is secured by a second mortgage on the real property dated December 31, 1985.

Assuming that the First Note bore an adequate rate of interest and that a discount rate of 9.25 percent, compounded semiannually, on the Second Note is appropriate, the aggregate present value of the First Note and the Second Note on December 31, 1985 was $153,368,528.00, exclusive of the $2,000,000.00 loan by petitioner to Keren.

Pursuant to Article 5 of the agreement, petitioner and Keren entered into a lease of a portion of the real property dated December 31, 1985.

Prior to the closing, petitioner received a New York State Real Property Transfer Gains Tax Tentative Assessment and Return from the Division of Taxation with respect to the sale of the real property to Keren. Per the Tentative Assessment, the Division increased the gain subject to tax (as computed by the transferor) by $15,816,782.00 from $92,367,947.00 to $108,184,473.00. Pursuant to a Supplemental Return (Form TP 583), petitioner elected to pay the tax due ($10,818,473.00) in installments. The first installment of $6,363,808.00 was paid in December 1986. The second installment of $3,606,157.00 was paid in December 1987. The third installment of $832,301.10 was paid in December 1988.

The difference between the tax shown on the Supplemental Return ($10,818,473.00) and the total tax paid ($10,802,266.10) is $16,206.90. Petitioner reduced the tax by this amount because petitioner incurred additional legal expenses of $162,069.00 in connection with selling the property. Such additional legal expenses were not deducted in the original calculation of the gain subject to tax.

In February 1988, petitioner filed a Claim for Refund of Real Property Transfer Gains Tax (Form TP 165.8) requesting a refund of $1,472,570.00. By letter dated April 20, 1988, the

Division denied petitioner's refund claim.

In February 1989, the Division issued to petitioner two "Revised" Statements of Proposed Audit Adjustment (the "Statements") showing that petitioner owed $76,033.00 in sales tax (plus interest and penalties) for the period ended December 31, 1985. The Statements were issued as a result of Keren treating as personal property and depreciating for Federal and New York State income tax purposes certain of the property purchased from petitioner which had been treated as real property for purposes of the real property transfer gains tax. Keren allocated $38,532,000.00 of the stated purchase price to personal property.

While it was disputing any sales tax liability with respect to the sale to Keren, petitioner filed a protective claim for Refund of Real Property Transfer Gains Tax (Form TP 165.8) requesting an additional refund of $1,957,821.00, the amount of the gains tax paid with respect to the property the Division sought to treat as personal property for sales tax purposes. This second refund claim is in addition to, and not in replacement of, the refund claim which petitioner filed in February 1988 and which is the subject of this action.

As a result of the second refund claim, petitioner received a refund of real property transfer gains tax of $65,908.45. This refund was based on an allocation of $1,270,481.59 of the purchase price of the property to personal property, a related reduction in the amount of gain subject to the tax and the allowance of additional selling expenses.

On December 29, 1990, petitioner filed a Claim for Refund of Real Property Transfer Gains Tax (Form TP 165.8) requesting a refund of $1,650,718.00. $1,472,570.00 of the $1,650,718.00 had been previously requested in the first refund claim. By letter dated January 15, 1991, the Division denied petitioner's third refund claim.

Petitioner purchased the subject property, as well as additional adjacent real property, in 1953 from Empire Raceway for an aggregate purchase price of $275,000.00.

Assuming a discount rate of 9.25 percent, the present value of the right to receive $70,000,000.00 at the end of three years is $53,368,528.00. The formula for determining the present value of a single payment due at a future date is:

$$\frac{FP}{(1 + i/k)^n}$$

where:

FP = the amount of the future payment,
i = the discount rate, expressed as an annual rate,
k = the number of interest compounding periods each year, and
n = the number of compounding periods in the note's term.

As defined in section 1274(d)(1)(C)(i) of the Internal Revenue Code of 1986, as amended, the applicable "federal short-term rate" is the rate determined by the Internal Revenue Service based on the average market yield (during any one-month period selected by the Internal Revenue Service that ends in the calendar month in which the determination is made) on outstanding marketable obligations of the United States with remaining periods to maturity of three years or less.

The applicable Federal rate is used for New York and Federal income tax purposes to determine the amount of imputed interest where there is inadequate stated interest on certain debt instruments issued for property and on certain below-market rate loans.

As required by section 1274(e)(1) of the Internal Revenue Code of 1986, as amended, with respect to short-term debt instruments which are given in consideration for the sale or exchange of property which is leased by the transferor after such sale or exchange, the proper discount rate for New York and Federal income tax purposes is 110 percent of the applicable Federal short-term rate, compounded semiannually.

110 percent of the December 1985 applicable Federal short-term rate, compounded semiannually, is 9.25 percent.

The present value of an obligation to pay $70,000,000.00 in three years, computed at a discount rate of 9.25 percent, 110 percent of the December 1985 applicable Federal short-term rate, compounded semiannually, is $53,368,528.00 ($70,000,000.00/$[1 + .0925/2]^6$).

The right to receive $70,000,000.00 at the end of three years has a present value of $53,368,528.00, assuming a discount rate of 9.25 percent.

The prime rate of interest ("Prime Rate") published in The Wall Street Journal is a base rate on corporate loans at large U.S. money center commercial banks. Such rate is a guide to general levels but does not always represent actual transactions.

The Prime Rate, as published in the December 31, 1985 issue of The Wall Street Journal, was 9½ percent.

A bank's Prime Rate is a rate of interest publicly announced by the bank from time to time as its Prime Rate and is a base rate for calculating interest on certain loans to its most creditworthy customers. A bank generally charges its less creditworthy customers interest at rates significantly higher than its Prime Rate.

Manufacturers Hanover Trust Company's Prime Rate on December 31, 1985 was 9½ percent.

The present value of an obligation to pay $70,000,000.00 in three years, computed at a discount rate of 9½ percent, the Prime Rate as published in the December 31, 1985 issue of The Wall Street Journal and Manufacturers Hanover Trust Company's Prime Rate on December 31, 1985, compounded monthly, is $52,700,107.00 ($70,000,000.00/$[1 + .095/12]^{36}$).

The right to receive $70,000,000.00 at the end of three years has a present value of $52,700,107.00, assuming a discount rate of 9½ percent.

On February 15, 1990, a bill was introduced in the New York State Senate (S.6998) and Assembly (A.9398). The bill was not passed in the 213th session (the 1990 regular session) of the New York State Legislature.[1]

For New York State and Federal income tax purposes, petitioner was required to report the discounted value of the Second Note, together with the face amount of the First Note, as the amount received in exchange for the property.

For New York State and Federal income tax purposes, petitioner was required to include

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[1]The relevance of this bill is apparently that it was a proposed amendment to Tax Law § 1440(1)(a) which would have amended the definition of "consideration" in the case of a purchase money mortgage where the stated interest rate exceeds the applicable Federal rate plus two percentage points.

in its taxable income, as interest income under the original issue discount rules, ratably over the term of the Second Note the amount in excess of the discounted value of the Second Note over the face amount of the Second Note.

For New York State and Federal income tax purposes, petitioner included in its taxable income, as interest income under the original issue discount rules, ratably over the term of the Second Note the amount in excess of the discounted value of the Second Note over the face amount of the Second Note.

The First Note and the Second Note were, and the Second Note remains, solely secured by the property and the cash flow generated by the property.

The total amount of the refund of real property transfer gains tax at issue is $1,650,718.00 and relates solely to the issue of whether the

discount of $16,631,472.00 on the Second Note should have been included in the gain subject to the real property transfer gains tax.

In the first real property tax bills which took into account the sale of the property to Keren, the townships of Greenburgh and Mount Pleasant, where the property is located, taxed the property on an aggregate assessed valuation of $16,868,550.00 ($10,769,000.00 for Greenburgh and $6,099,550.00 for Mount Pleasant). Given the townships' equalization ratios (i.e., the ratio of assessed valuation to estimated fair market valuation) of 15.91 percent for Greenburgh and 7.2 percent for Mount Pleasant, the townships taxed the property based on an aggregate valuation of $152,402,961.53.

The written Stipulation of Facts included 70 numbered paragraphs. In some instances, a number of paragraphs have been combined to form a Finding of Fact. The following numbered paragraphs were not included as Findings of Fact for the reasons set forth herein:

(a) Paragraphs "10", "18", "43" and "67" are allegations which are not supported by the record. In each case, the Division of Taxation, while having no reason to believe that such allegations are untrue, stated that it lacks information or knowledge to indicate the truth

thereof. Accordingly, such paragraphs cannot be found to be facts;

(b) Paragraphs "30" through "34" and "40" and "41" relate to petitions, Conciliation Orders and pleadings which, while not irrelevant, are not in dispute and need not, therefore, be set forth herein;

(c) Paragraphs "46" through "48" contain examples of applying the formula set forth in paragraph "45" (see, Finding of Fact "15") and need not be included herein as facts.

SUMMARY OF THE PARTIES' POSITIONS

Petitioner contends as follows:

(a) Only the present value of the Second Note should be included in the consideration which petitioner received from the sale and the imputed interest to be earned on the Second Note should be excluded from such consideration;

(b) For purposes of the gains tax, the Second Note should be treated in a manner consistent with New York State franchise tax and Federal income tax wherein petitioner was required to report the discounted value of the Second Note, together with the face amount of the First Note, as the amount received in exchange for the property. In addition, petitioner was required to and did include in its taxable income, as interest income under the original issue discount rules, the amount in excess of the discounted value of the Second Note, ratably over its term;

(c) There is no legislative authority to support the Division's interpretation of the term "amount of any mortgage" as such term appears in Tax Law § 1440(1)(a);

(d) The stated purpose of the gains tax is to tax the economic gain realized by the seller of real property. It is both inappropriate and a gross distortion to include imputed interest to be earned over the succeeding three years in computing petitioner's economic gain as of the date of closing. Using the formula set forth in Finding of Fact "15", the present value of the Second Note, as of the date of closing on December 31, 1985, was $53,368,528.00 and to tax petitioner on more than such amount is to substantially overstate its economic gain. The balance ($16,631,472.00) should have been excluded

from imposition of the gains tax;

(e) Treating the entire indebtedness of the Second Note, rather than its discounted value, as consideration received by petitioner for purposes of the gains tax, is not only contrary to the purpose and intent of such tax, but will also make the gains tax subject to manipulation by taxpayers. Examples are set forth in petitioner's memorandum of law which show how reducing the face amount of a note and increasing the rate of interest thereon results in less gains tax liability;

(f) The cases cited by the Division of Taxation as controlling (Matter of Normandy Associates, Tax Appeals Tribunal, March 23, 1989; Matter of Festival Leasehold Co., Tax Appeals Tribunal, January 20, 1989) are not precedential authority for the meaning of the term "amount of any mortgage" because the meaning of such term was effectively dicta in the latter case and was only a peripheral matter in the former. Moreover, petitioner maintains that the Court of Appeals, in a constitutional challenge to the gains tax, stated that such tax was constitutional because it taxes only net gains (Trump v. Chu, 65 NY2d 20, 489 NYS2d 455, appeal dismissed 474 US 915, 88 L Ed 2d 250). To impose the tax on the entire face amount of the mortgage, rather than its present value, would render the gains tax unconstitutional since it would result in imposition of an amount which is greater than the transferor's net profit, if any, from the sale; and

(g) The Division contends that there was legislative intent not to use the present value of mortgages for gains tax purposes because a bill (S.3426-A; A.4226) which would have so provided was not enacted. Petitioner maintains that, while the gains tax, as enacted, did not contain such provisions, there were many other differences in the eventual law from the bill which did not become a law. Petitioner contends that, given the numerous differences between the gains tax provisions, as enacted, and the proposed provisions of the bill, it is reasonable to assume that the definition of the term "amount of any mortgage" as found in Tax Law § 1440(1)(a) was not really considered by the Legislature.

The position of the Division of Taxation may be summarized as follows:

(a) The Tax Appeals Tribunal has already dealt with this issue (see, Matter of Normandy Associates, supra; Matter of Festival Leasehold Co., supra);

(b) Article 31-B was patterned after Article 31-A (Gains Tax on Real Property Transfers) which was enacted in 1981 and repealed in 1982. Tax Law former § 1420(3), in the definition of consideration for purposes of such Article 31-A, required that the value of a purchase money mortgage "be the value thereof if such mortgage were sold to a willing buyer from a willing seller at arm's length on the date of the giving of such purchase money mortgage." While this definition was included in the original version of the bill which was to impose the Article 31-B gains tax (S.3426-A; A.4226), this language was removed from the law as enacted. The reference to mortgages and purchase money mortgages in Tax Law § 1440(1)(a) couples such terms with liens and other encumbrances which are not usually of an interest-bearing nature, thereby further evidencing the legislative intent to impose the gains tax on "the amount of" such mortgage. The word "amount" must, therefore, refer to face amount and not to a calculation of present value;

(c) Amendments to the gains tax provisions by chapter 900 of the Laws of 1984 did not add any language relative to present value of mortgages. Had the Legislature so intended and had "economic gain" been of primary concern, such language could have been added. To date, it has not been added.

CONCLUSIONS OF LAW

A. Pursuant to Article 31-B of the Tax Law, the gains tax is imposed upon a transfer of real property within the State at the rate of 10 percent on the gain derived from such transfer (Tax Law § 1441).

"Gain" is defined as:

> "the difference between the consideration for the transfer of real property and the original purchase price of such property, where the consideration exceeds the original purchase price" (Tax Law § 1440[3]).

Tax Law § 1440(1)(a) defines "consideration", in pertinent part, as follows:

> "Consideration includes 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." (Emphasis added.)

B. The issue to be decided herein is whether or not the Division of Taxation properly denied petitioner's claim for refund of gains tax paid by including, as consideration received from Keren on the sale of the subject real property, the $16,631,472.00 of imputed interest to be earned on the Second Note over the three-year period as well as the present value of the Second Note or, stated another way, whether the face amount of the Second Note ($70,000,000.00) was properly included as consideration received.

The Division of Taxation cites to Matter of Normandy Associates (supra) and Matter of Festival Leasehold Co. (supra) for the proposition that mortgages and purchase money mortgages are to be valued, for purposes of determining consideration, at their face amount rather than at present value. Petitioner contends that the issue raised herein, i.e., the method of valuing a mortgage in determining consideration for purposes of the imposition of the gains tax, was merely peripheral to the central issues raised in Matter of Normandy Associates (supra). With respect to Matter of Festival Leasehold Co. (supra), petitioner contends this issue was not before the Tribunal nor was it briefed by counsel for the parties.

In a subsequent decision, Matter of Old Farm Lake Company (Tax Appeals Tribunal, April 2, 1992), the Tribunal apparently agreed with this petitioner's contentions as to Festival Leasehold since it stated:

> "Although in Festival Leasehold the note which was ultimately factored into the consideration at face amount was non-interest-bearing and was secured by a letter of credit, the issue of the valuation of that note was not before this Tribunal in that case. Since the issue was not directly addressed by the Tribunal's decision in Festival Leasehold, that decision is not precedential on this point (see, Matter of Velez v. Division of Taxation, 152 AD2d 87, 547 NYS2d 444)."

However, in Matter of Old Farm Lake Company (supra), the Tribunal stated that Normandy Associates did stand for the proposition that Tax Law § 1440(1)(a) includes as consideration mortgages, purchase money mortgages, liens or other encumbrances at their face amount rather than at present value. The Tribunal went on to say (in footnote "1"):

> "The legislative history cited by the Division confirms our interpretation that

> mortgages are to be included in consideration at their face amount, rather than their value. The Division points out that Article 31-A, which was enacted in 1981 and repealed in 1982, served as a model for Article 31-B (Division's letter on exception). Article 31-B included as consideration a purchase money mortgage, but specifically provided 'that the value of any such mortgage shall be the value thereof if such mortgage were sold to a willing buyer from a willing seller at arm's length on the date of the giving of such purchase money mortgage' (Tax Law former § 1440[3]). As enacted, Article 31-B dropped this market value provision and substituted the language 'including the amount of any mortgage, purchase money mortgage, lien or other encumbrance....' (Tax Law § 1440[1][a])."

It should be noted that the above references to legislative history were the same as those set forth by the Division in the present matter. Furthermore, it was stipulated by the parties that the Second Note was secured by a purchase money mortgage (see, Finding of Fact "3"). Therefore, based upon the Tribunal decisions in Matter of Old Farm Lake Company (supra) and Matter of Normandy Associates (supra), the Second Note must, for purposes of determining consideration, be valued at the face amount or $70,000,000.00.

C. Petitioner, citing Trump v Chu (supra), contends that to interpret Tax Law § 1440(1)(a) in a manner which includes, as consideration, mortgages at their face amount rather than at present value would render the gains tax provisions of the Tax Law unconstitutional. In Trump v. Chu (supra), plaintiffs sought a declaratory judgment that the gains tax violated the equal protection clauses of both the United States Constitution and the New York State Constitution. In upholding the constitutionality of the statute, the court held that, although liability for the tax is determined by the amount of gross consideration, the actual calculation of tax due depends entirely upon the gain realized from the real property transfer. This is an important distinction since the court, citing Stewart Dry Goods Co. v. Lewis (294 US 550, 79 L Ed 1054) and Merit Oil v. State Tax Commn. (111 Misc 2d 118, 443 NYS2d 604), held that gross receipts taxes that treat similarly situated taxpayers differently based on sales volume violate equal protection because they are imposed without regard to profits. The court stated that:

> "[s]o long as it taxes only net gains, it rationally could believe that 'generally speaking' profits increase as the amount of gross consideration received increases" (citations omitted).

The Court of Appeals did not, however, define the terms "gain" or "net gains" in its

decision. Petitioner contends that to value mortgages at their face amount rather than at their present value renders the gains tax unconstitutional since the tax is imposed on an amount greater than the transferor's net gain or profit from the sale of real property.

In Conclusion of Law "B", relevant Tax Appeals Tribunal decisions were cited. Administrative law judges are bound by such precedent. In addition, the administrative law judges are bound by the decision of the Court of Appeals in Trump v. Chu (supra), which held that the gains tax provisions of the Tax Law were constitutional. Whether the Tax Appeals Tribunal's holding that mortgages are to be valued at face amount was made after due consideration of Trump v. Chu cannot be ascertained from such decisions since there is no indication therein that those petitioners raised similar issues. Petitioner's proper remedy may be to raise such issues before the Tribunal by filing an exception to this determination. Based upon the foregoing, however, petitioner's claim for refund must be denied.

D. The petition of Union Carbide Chemicals & Plastics Company, Inc. (formerly, Union Carbide Corporation) for a refund of real property transfer gains tax is hereby denied.

DATED: Troy, New York
July 16, 1992

/s/ Brian L. Friedman
ADMINISTRATIVE LAW JUDGE