STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
ATLANTIC & HUDSON LIMITED PARTNERSHIP	:	DETERMINATION
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.	:	

Petitioner, Atlantic & Hudson Limited Partnership, 77-39 170th Street, Flushing, New York 11366, filed a petition 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 (File No. 806710).

A hearing was held before Joseph W. Pinto, Jr., Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on February 8, 1990 at 2:45 P.M., with all briefs submitted by June 15, 1990. Petitioner appeared by Irwin K. Liu, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Paul A. Lefebvre, Esq., of counsel).

ISSUES

I. Whether a sponsor transferring title to a cooperative corporation and receiving as part of its consideration for said transfer a lease for commercial premises can be taxed on the gain which includes the value of said lease.

II. Whether the value ascribed to the lease by the Division of Taxation had a rational basis.

FINDINGS OF FACT

On January 5, 1988, the Division of Taxation issued to Atlantic & Hudson Limited Partnership ("petitioner") a Notice of Determination of Tax Due Under Gains Tax Law, number 595, which set forth tax due in the sum of $15,925.00, penalty of $5,574.00 and interest of $5,025.00, for a total amount due of $26,524.00. The notice indicated that $300.00 had been

paid on June 30, 1987 and that a balance remained due of $26,224.00. The notice contained the following statement:

> "Recently a field audit was conducted by our New York District Office. As a result of that audit, it was determined that Real Property Transfer Gains Tax plus penalty and interest was due. Since the additional Gains Tax plus penalty and interest has not been paid this Notice of Determination has been issued for the following unpaid amounts."

The Division did not submit an auditor's report with regard to the audit of Atlantic and Hudson Ltd. and provided no work papers to explain the computation of additional consideration on tax. The only explanation of the additional tax on the value or "economic gain" ascribed to the lease was an unsworn statement by the Division's representative which said:

> "In creating the master lease, the sponsor sets a rental price for the space. The rental price for the space is less than the fair market value for which that space can be rented.
>
> The difference between the rent being paid to the cooperative corporation and the fair market value has been picked up by the Audit Division, the Audit Division calls the term they use for that economic gain, but it's an estimate based on the current fair market value of the leasable space, given a present time value over the term of the lease, which in this case was 40 years, and they come up with a dollar amount which is added to the consideration the sponsor is receiving for the transfer of the remainder of the building which will be sold as cooperative units to arrive at a gross consideration from which the tax is determined." (Transcript pages 11-12.)

The Division's representative stated on page 13 of the transcript that "the gain determined under the notice which relates to the lease resulted in a tax of $9,510...."

Atlantic & Hudson Limited Partnership was the sponsor of a cooperative conversion of a building located at 14 Jay Street, New York, New York. As sponsor of the project, the partnership caused title to 14 Jay Street to be transferred to a cooperative corporation known as 14 Jay Street Owners Corporation.

Petitioner acquired the land and eight-story loft building located at 14 Jay Street, New York, New York on May 29, 1981. All seven available units of the cooperative plan were

transferred by the sponsor between October 1, 1984 and January 1, 1985.[1] The offering plan with regard to the premises at 14 Jay Street explained the situation with regard to the commercial space in the building as follows:

> "The ground floor and a portion of the cellar contained commercial space (hereinafter 'Store'). The Store is presently vacant. In order to enable the Apartment Corporation to qualify as a cooperative housing corporation under Section 216 of the Internal Revenue Code so that tenant-stockholders may be eligible for tax reductions for their proportionate shares of mortgage interest and real estate taxes paid by the Apartment Corporation, it is necessary to limit the amount of income which the Apartment Corporation receives from the Store. (See the section of the Plan entitled 'Counsel's Tax Opinion' for further discussion of Section 216 of the Internal Revenue Code and tenant-stockholder tax deductions.)
>
> To achieve this goal, the Apartment Corporation and the General Partner of Sponsor will enter into a lease for the Store (hereinafter the 'Master Lease'). (See section of the Plan entitled 'Store Lease' for more details.)"

The offering plan also provided that under the master lease, the sponsor as tenant was to pay the apartment corporation as landlord a rent

equal to 18% of the apartment corporation's annual gross income. The sponsor/tenant was to be entitled to receive and retain all rent from any subtenants of the store which was expected to be more than the rent payable to the apartment corporation. The offering plan clearly set forth that the master lease was intended to provide the sponsor with additional profit and was not entered into through arms-length negotiations, but rather was prepared by sponsor's counsel.

Although there was originally an issue with regard to the payment of gains tax on the transfer of each of the cooperative units, that issue has been settled and the only issue remaining is with regard to any tax which may be due on the value of the lease which was concededly part of the consideration given by the apartment corporation to the sponsor.

SUMMARY OF THE PARTIES' POSITIONS

Petitioner argues that the lease in issue is a nontaxable lease specifically exempted from

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[1]A total of 1,000 shares of capital stock of the apartment corporation were allocated in blocks to the seven residential floors of the building. There is one apartment per floor. The stock was initially offered for sale at $1,155.00 per share.

taxation under Tax Law § 1440.7 and that the Division's argument that it is taxing the value of the lease to the sponsor as opposed to the lease itself is contrary to the purposes for which the exemption was provided, and also that a lease of such short duration is impossible to value accurately. Specifically, petitioner concedes that the lease may have value but that it is too short to value with any degree of accuracy that would be fair to petitioner.

The Division asserts that it is not taxing the lease, but the consideration the sponsor derived from the transfer of its building to 14 Jay Street Owners Corporation. It argues that the courts have clearly said that gains tax:

> "is imposed by the statute upon the overall cooperative plan.... That the overall transaction [is] taxable.... For purposes of computation of the tax, the cooperative conversion is treated as a single transfer" (Mayblum v. Chu, 67 NY2d 1008).

The Division contends that the value of the lease was something of value which would fall within the definition of consideration set forth in Tax Law § 1440(1)(a).

CONCLUSIONS OF LAW

A. Tax Law § 1441 imposes a tax on gains derived from the transfer of real property within the State. Further, Tax Law § 1440.7 provides that:

> "[t]ransfer of an interest in real property shall include the creation of a leasehold or sublease only where (i) the sum of the term of the lease or sublease and any options for renewal exceeds forty-nine years, (ii) substantial capital improvements are or may be made by or for the benefit of the lessee or sublessee, and (iii) the lease or sublease is for substantially all of the premises constituting the real property." (Emphasis added.)

Since the parties concede these three elements are not present in the instant action, the lease is not a transfer of real property and not subject to the gains tax. However, the Division argues that the value of the lease, and petitioner concedes that it does have value, should be taxed under Tax Law § 1440.1(a) which provides that "consideration" means "the price paid or required to be paid for real property or any interest therein...." The same section provides that consideration also includes "any price paid or required to be paid...or any other thing of value...."

B. The issue therefore becomes the value which has been ascribed to the lease by the Division in calculating its Notice of Determination of Tax Due Under Gains Tax Law. The

only value mentioned in the record was that stated by the representative for the Division who, in his opening statement and statement of position, indicates a tax on the value of the lease in the sum of $9,510.00. There was no testimony of the auditor with regard to the computation of the tax, only an unsworn statement by the Division's representative that an estimated basis was used to calculate the value of the lease and the resulting tax. Further, no audit report was submitted into the record to explain the basis for the calculations and resulting tax.

C. The Rules of Practice and Procedure of the Tax Appeals Tribunal set forth at 20 NYCRR 3000.10(d)(4) state as follows:

> "The burden of proof shall be upon the petitioner except as otherwise provided by law."

No such specific provision with regard to the burden of proof exists in the Gains Tax Law, Article 31-B of the Tax Law, as it does under Article 22 income tax, Tax Law § 689(e), and corporation franchise tax, Tax Law § 1089(e).

Although it is not found that the burden of proof has shifted to the Division in this case, it is determined that a notice of deficiency that has no rational basis must be set aside (Matter of Donahue v. Chu, 104 AD2d 523, 479 NYS2d 889, 892; Rosenthal v. State Tax Commission, 102 AD2d 325, 477 NYS 767, 769).

The Tax Appeals Tribunal enunciated its policy with regard to such situations in Matter of Stephen Fortunato (Tax Appeals Tribunal, February 22, 1990):

> "It has been held that a presumption of correctness arises with respect to a notice of deficiency properly issued under the Tax Law and that a petitioner who fails to present any proof as to the incorrectness of the deficiency surrenders to this presumption (Matter of Tavolacci v. State Tax Commn., 77 AD2d 759, 431 NYS2d 174, 175). Although this is also the general rule under federal law, there is an exception that requires the government to, in certain circumstances, make an initial showing that the assessment has a rational basis before the presumption of correctness arises (see, Anastasato v. Commr., 794 F2d 884, 86-2 USTC ¶ 9529; Llorente v. Commr., 649 F2d 152, 81-1 USTC ¶ 9446; Weimerskirch v. Commr., 596 F2d 358, 79-1 USTC ¶ 9359). Where this exception applies and the government fails to affirmatively demonstrate the rational basis for the assessment, the assessment may be found to be arbitrary even though the taxpayer does not prove that the amount of the assessment is incorrect (Llorente v. Commr., supra; Weimerskirch v. Commr., supra)."

That policy is applicable herein. The Division failed to establish that the assessment had

a rational basis even though it was aware at hearing that petitioner had directly challenged the value ascribed to the lease by its auditor. In light of the Division's failure to provide any evidence establishing a rational basis for its valuation of the lease and the resulting tax, that portion of the assessment ascribed to the lease is cancelled.

D. The petition of Atlantic & Hudson Limited Partnership is granted to the extent set forth in Conclusion of Law "C" above; in all other respects the petition is denied.

DATED: Troy, New York

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ADMINISTRATIVE LAW JUDGE