STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
SHAREHOLDERS OF BEEKMAN COUNTRY CLUB, INC.	:	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.	:	

Petitioners, Shareholders of Beekman Country Club, Inc., c/o McCabe and Mack, 63 Washington Avenue, P.O. Box 509, Poughkeepsie, New York 12602-0509, 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. 807242).

A hearing was held before Jean Corigliano, Administrative Law Judge, at the offices of the Division of Tax Appeals, Riverfront Professional Tower, 500 Federal Street, Troy, New York, on October 26, 1990 at 10:00 A.M., with all briefs to be submitted by April 10, 1991. Petitioners appeared by Charles I. Schachter, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Arnold M. Glass, Esq., of counsel).

ISSUE

Whether an allocation agreement entered into by petitioners and the transferee of shares in a corporation provided a reasonable apportionment of the consideration for the interest in real property.

FINDINGS OF FACT

Pursuant to section 307(1) of the State Administrative Procedure Act and section 3000.10(d)(5) of the Tax Appeals Tribunal Rules of Practiceand Procedure, petitioners, Shareholders of Beekman Country Club, Inc., submitted 17 proposed findings of fact. Proposed findings of fact 1, 2, 3, 4, 5, 6, 7, 10, 11, 13 and 15 were accepted and substantially incorporated

into this determination. Proposed findings of fact 8, 9, 12, 16 and 17 have been expanded upon to more completely reflect the record.

The transaction at issue in this proceeding involves the transfer of a controlling interest in Beekman Country Club, Inc. (the "Corporation"). Petitioners were the holders of 100% of the outstanding shares of stock in the Corporation, as of the date of the transfer.

The Corporation operates a public golf course, restaurant and pro shop in the Town of East Fishkill, Dutchess County, New York. The Corporation's assets at the time of the transfer consisted of: 565 acres of land on which the golf course, restaurant and pro shop run by the Corporation were located, and machinery, equipment and other items of personal property, including golf carts and a sanitary sewer, water and irrigation system.

From the time the Option Agreement (referred to below) was entered into and at all relevant times thereafter, the Corporation continued to operate its business as a public golf course, restaurant and pro shop, including golf cart rentals. The Corporation's operating business generated annual revenues of at least $400,000.00 during 1985 and net profits in that year of approximately $140,000.00. In the year of the sale, 1987, the business generated annual revenues of approximately $900,000.00 and annual profits of approximately $400,000.00. At present, the transferee continues to operate the business of the Corporation in the same manner as the Corporation did prior to the sale described below, and the Corporation continues to generate substantial revenue and profits.

On November 1, 1985, petitioners entered into an Option Agreement with Empire State Land Company, Inc. (the "Transferee"). Pursuant to the Option Agreement, petitioners granted the Transferee the option to purchase 100% of the 4,217 shares of common stock in the Corporation then outstanding. The term of the option was 24 months, expiring on October 31, 1987.

Under the Option Agreement, the Transferee could exercise its option to purchase petitioners' shares in the Corporation by payment of the following amounts:

(1) $339.10 per share in cash;

(2) $1,185.67 per share in the form of a promissory note, payable in monthly installments over five years with 12% interest;

(3) $200,000.00 in satisfaction of management fees and bonuses due the management of the Corporation; and

(4) $370,000.00 for the payment in full of the mortgage then outstanding against the real property owned by the Corporation.

The exercise price was then subject to certain adjustments, to be calculated as of the date of purchase of the shares, to allow for prepaid taxes, insurances and fuel, accrued but unpaid expenses and cash in hand (but not in excess of $5,000.00), tangible personal property purchased by the Corporation between the date of the Option Agreement and the closing date and other debts and liabilities of the Corporation.

The Option Agreement did not provide any method for allocating the purchase price to be paid by the Transferee for the shares of stock in the Corporation to the various assets held by the Corporation.

On or about November 12, 1986, the Corporation and the Transferee jointly signed a document entitled "Agreement", which is referred to from here on as the "Allocation Agreement". It provides, in relevant part:

> "AGREEMENT, dated as of November 12, 1986, between BEEKMAN COUNTRY CLUB, INC., a New York Corporation, with an address in care of McCabe & Mack, Esqs., 63 Washington Street, P.O. Box 509, Poughkeepsie, New York, 12602 (the 'Transferor') and EMPIRE STATE LAND COMPANY, INC. with an address at 45 Knollwood Road, Elmsford, New York, 10523, (the 'Transferee'); for the purpose of the New York State Real Property Transfer Gains Tax;
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> The parties hereto agree as follows:
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> 1. In an option agreement between the parties dated November 1, 1985 the parties provided that the Transferee will pay the Transferor the sum of $6,429,955.09 and also will satisfy the existing first mortgage on the premises in the amount of $370,000.
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> 2. As this transfer includes other assets in addition to real property and the improvements thereon, the consideration must be reasonably allocated between the real property and the other assets.
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> 3. After examination of the schedule of the tangible personal property of the

Beekman Country Club, Inc. including but not limited to 94 golf carts, a number of tractors and other maintenance equipment and restaurant equipment, the tangible personal property is worth approximately $409,000. The reasonable value of the real property of Beekman Country Club, Inc., with the improvements thereon, as of November 1, 1985 is $6,390,955.09.

4. Nothing herein contained shall modify any term of the option agreement as to consideration to be paid or assumed."

The sole purpose of the Allocation Agreement was to provide an allocation of the consideration to be paid by the Transferee for the shares of the Corporation's stock to the real property for purposes of the New York State real property transfer gains tax. Philip Schatz, then treasurer, signed the Allocation Agreement on behalf of the Corporation. At that time, he did not understand the tax ramifications of allocating the consideration as it was done.

On November 17, 1986, transferee and transferor questionnaires were submitted on behalf of petitioners and the Transferee to the Division of Taxation ("Division") as required by Article 31-B of the Tax Law. The questionnaires stated that the gross consideration, allocated to real property and improvements, to be paid for transfer by the Transferee was $6,390,955.09. This is the same amount allocated to real property and improvements in accordance with the Allocation Agreement which was submitted with the questionnaires.

On December 4, 1986, petitioners obtained a Tentative Assessment and Return indicating that the tax to be imposed with respect to the transaction was $490,192.05.

On September 30, 1987, Harold R. Fountain of H. R. Fountain and Co., Inc. ("Fountain"), One Fountain Square, Clinton Corners, New York, prepared an appraisal (the "Appraisal") for the Corporation of the entire 565 acres owned by the Corporation. In the Appraisal, Mr. Fountain stated that, in his opinion, as of November 1, 1985, the fair market value of the property was $3,400,000.00. The fair market value of the property was determined by Fountain by adding together the value of the unimproved land, $3,100,000.00, considering its highest and best use as single residential development and the depreciated replacement value of the improvements located on the land, $296,000.00. The fair market value of land (excluding the improvements) determined by Mr. Fountain was based on the land in its unimproved state, without any required approvals for subdivision.

At hearing, Mr. Fountain was asked whether his appraisal of the real property would have been more or less had he been asked to value the property based upon its use as a golf course. He testified as follows:

> "In my opinion less. The golf course was not processing enough net income at that time to justify the values that we found for residential lands. I believe the number was something in the neighborhood of $109,000.00 net income. If you cap that into value, you are talking about a million and a half. We found that the marketplace for residences indicated $3.4 million, or more than double that. So the highest and best use was not operating as a golf course. That was not processing enough income to justify the land's value."

On October 9, 1987, petitioners submitted to the Division of Taxation revised transferor and transferee questionnaires. The transferee's questionnaire indicated that the consideration to be paid to the transferor was $6,799,955.09. The questionnaire did not allocate the consideration to real property and other assets. The transferor's questionnaire indicated that the consideration to be paid for transfer by the Transferee, allocated to real property owned by the Corporation, was to be $3,400,000.00. Included as part of the Revised Submission were: (1) a copy of the Option Agreement; (2) the Appraisal; (3) the corporation's tax returns (Federal Income Tax Form 1120 and New York State Form CT-3) for the fiscal year ending March 31, 1986, showing that the corporation's gross income for the year reported for tax purposes was $455,038.52 and its taxable income for the year (before allowance of a net operating loss carryover) was $158,273.17; and (4) financial statements of the corporation prepared by its independent accountants on a compiled basis for the fiscal year ending March 31, 1986, showing that the corporation's gross revenue for the year for accounting purposes was $662,640.96 and its net income was $158,273.17. In the Revised Submission, petitioners contended that the consideration apportioned to the real property by the original Tentative Assessment and Return and by the Allocation Agreement was inaccurate and unreasonable in that it did not reflect the true fair market value of the real property and did not properly account for the value of the corporation's operating business as a going concern.

On October 22, 1987, petitioners submitted additional documentation to the Division in support of their request for a revised Tentative Assessment and Return. This included: (1) a

copy of the financial statements of the corporation prepared by its accountant for the five-month period ending August 31, 1987, indicating that the corporation's total income for such five-month period was $575,566.00 and that its net income for such period was $281,516.00; (2) an affidavit of Calvin R. Smith, president of Cal Smith Appraisers, Inc., Pleasant Valley, New York, dated October 20, 1987, containing an itemized appraisal of all of the personal property owned by the Corporation and stating that in Mr. Smith's opinion, the personal property owned by the Corporation as of October 20, 1987 had a value of $316,148.00; and (3) an affidavit of Lee L. Archer regarding the fair and reasonable value of the water system, sewer plant and irrigation system owned by the corporation, as of November 1, 1985, and stating that the aggregate value of the water system, sewer plant and irrigation system, as of November 1, 1985, was $114,000.00.

The Division did not issue a revised Tentative Assessment and Return.

On October 27, 1987, the Transferee exercised its option to purchase all of the outstanding shares in the Corporation. The total purchase price paid for the shares was $7,245,170.09 and consisted of the following:

(1) $339.10 per share of stock, in cash;

(2) $1,185.67 per share of stock, in cash (this portion of the purchase price was paid in cash notwithstanding the provisions of the Option Agreement which called for the transferee to give a promissory note in this amount);

(3) $370,000.00 to satisfy in full the outstanding balance of the mortgage on the real property owned by the Corporation;

(4) $200,000.00 for payment of accrued management fees owed by the Corporation to its managing employees;

(5) $5,000.00 for the cash then on deposit in the Corporation's bank account;

(6) $250,253.20 as an adjustment for equipment, inventory and other assets that were purchased by the Corporation between the date of the Option Agreement and the closing date; and

(7) A credit in the amount of $10,038.20, representing the amount of a sales tax liability then owed by the Corporation.

On the closing date, petitioners paid $490,192.50 in real property transfer gains tax, that being the amount shown on the Tentative Assessment and Return. At the time of the closing, petitioners were of the opinion that the allocation of the consideration to real property and improvements, as shown on the original transferor and transferee questionnaires, was unreasonable.

On January 1, 1988, petitioners filed a claim for refund in the amount of $299,095.47, that being the difference in the tax paid and tax that would be payable if the consideration allocated to the real property owned by the corporation was $3,400,000.00.[1]

By letter dated March 29, 1988, the Division denied petitioners' refund claim. As that letter succinctly states the Division's position on this matter, the relevant paragraphs are set forth below.

> "The basis of the claim is that claimant contends an overpayment of Gains Tax was made due to an erroneous allocation of the Corporation's assets on the original filing. A value of $3,400,000 should have been allocated to the real property based upon an appraisal by H. R. Fountain and Co., Inc., rather than a value of $6,390,955.09 as assessed. The amount paid by the purchaser in excess of the appraised value of the real estate is attributable to good will and/or going concern value.
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> * * *
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> The Transferor and Transferee questionnaires submitted specifically allocated the $6,390,955.09 to the real property and improvements. Not only were the questionnaires consistent with the $6,390,955.09 purchase price, but an agreement signed by both parties (Exhibit B to the Transferor questionnaire) was submitted which reiterated the $6,390,955.09 purchase price.
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> In the instant case, there is no need to estimate value by the appraisal process. The

[1]Each of the petitioners signed a signature page which was attached to the refund claim. Petitioners and the Division agreed that the Division would retain the signature pages in its own files to be used in identifying the individual shareholders if refunds are granted in this matter. The individual names of the shareholders who filed a refund claim were not made a part of the record.

parties to the transaction have established fair market value through the process of negotiation. By the terms of their own agreement, both buyer and seller have mutually agreed that 'the reasonable value of the real property of Beekman Country Club, Inc., with the improvements thereon, as of November 1, 1985 is $6,390,955.09.' Therefore, it is our opinion that the documentation submitted establishes the value of the property to be $6,390,955.09 for Gains Tax purposes."

SUMMARY OF PETITIONERS' POSITION

Petitioners contend that the Allocation Agreement and the original transferor and transferee questionnaires do not reasonably apportion the consideration for the interest in real property. This position is premised on the grounds that: (1) the Allocation Agreement provides no substantiation for its allocation of $6,390,955.09 as the fair market value of the real property; (2) the Allocation Agreement was not the product of arms-length negotiations between the parties; (3) Mr. Schatz, acting on behalf of petitioners, did not agree with the allocated value set forth in the Allocation Agreement and did not understand the impact or importance of the Allocation Agreement at the time it was executed; and (4) the total dollar amount recited in the Allocation Agreement as being payable by the transferee to petitioners upon the sale, $6,799,955.09, was in fact inaccurate and did not reflect the actual consideration paid by the transferee, which was in excess of $7,000,000.00.

Based on their reading of the relevant tax statutes and regulations, petitioners contend that in the case of the transfer of a controlling interest in real property the method generally to be used to determine fair market value of the real property is by appraisal.

Petitioners maintain that the only reasonable apportionment of the consideration for the interest in real property owned by the corporation is the apportionment found in the revised transferor questionnaire which was based on the Appraisal, the corporation's tax returns and financial statements for the fiscal year ending March 31, 1986, the Personal Property Appraisal and the Water Systems Appraisal.

CONCLUSIONS OF LAW

A. The sale of stock by petitioners to the Transferee was a transfer for gains tax purposes because it was an "acquisition of a controlling interest in any entity with an interest in real property" (Tax Law § 1440.7). The "gain" upon which the tax is imposed "means 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).

As it is used in Article 31-B, "consideration" is defined, as relevant, as "the price paid or required to be paid for real property or any interest therein" (Tax Law § 1440.1[a]). This definition of consideration is elaborated upon in Tax Law § 1440.1(c) which provides:

> "In the case of a transfer which includes other assets which are in addition to real property or an interest therein and for which there is no reasonable apportionment of the consideration for such real property or interest, consideration means that portion of the total consideration which represents the fair market value of such real property or interest. In the case of a transfer of a controlling interest in an entity with an interest in real property, there shall be an apportionment of the fair market value of the interest in real property to the controlling interest for the purpose of ascertaining the consideration for the transfer of such controlling interest."

B. The transfer here involved the purchase by the Transferee of 100% of the stock of the Corporation, and, therefore, 100% of the fair market value of the interest in real property must be apportioned to the controlling interest to ascertain the consideration for the controlling interest in real property. Accordingly, the determinative issue to be resolved here is how to determine the fair market value of the Corporation's interest in the real property. The Division takes the position that the fair market value of the property was reasonably and properly determined by the parties through the process of negotiation as reflected in the Allocation Agreement. Petitioners take the position that the method by which the Allocation Agreement arrived at a determination of the fair market value of the real property is unreasonable.

C. To address petitioners' many arguments with regard to the reasonableness of the Allocation Agreement, it is necessary to scrutinize the Agreement itself. The Agreement makes no reference to the fact that the transaction involved a stock purchase rather than a sale of assets. It merely recites the total consideration for the transfer ($6,799,955.09, consisting of a direct payment and the satisfaction of an existing mortgage) and allocates the total consideration to the real property ($6,390,955.09) and personal property ($409,000.00). This allocation became the basis for the consideration for the real property reported on the transferor and

transferee questionnaires, which did properly describe the transaction as a transfer of a controlling interest of an entity with an interest in real property.

Petitioners' first argument is that, contrary to the Division's position, the allocation was not arrived at through the process of negotiation between the parties. Essentially what is meant by this is that the allocation was not an integral part of the contract for the sale of stock (the Option Agreement) but was a separate agreement for which there was no consideration. Even if this contention is accepted, it does not establish that the allocation was unreasonable. At least for real property gains tax purposes, petitioners and the Transferee agreed to determine the fair market value of the real property by subtracting the value of the personal property from the total consideration. Having done so, it was incumbent upon petitioners to establish that this method of determining the fair market value of the real property was unreasonable.

The total consideration recited in the Allocation Agreement was less than the actual amount of the consideration paid by the Transferee. The difference is attributable to several provisions of the Option Agreement which subjected the exercise price to certain adjustments to be calculated as of the date of the purchase of the shares (e.g., accrued expenses, cash in hand, tangible personal property acquired after the Option Agreement was entered into) and to a provision in the Option Agreement for a payment of $200,000.00 in satisfaction of management fees and bonuses. Essentially, the consideration recited in the Allocation Agreement consisted of the agreed upon price per share plus the satisfaction of an existing mortgage. As stated, this consideration was then allocated to real and personal property. Given these facts, I do not find that the difference between the final consideration paid and the amount recited in the Allocation Agreement establishes that the Agreement's determination of the fair market value of the real property was unreasonable.

D. Based upon 20 NYCRR 590.47, petitioners argue that, in the case of a sale of a controlling interest in real property, the proper method for determining the fair market value of the interest in real property is by appraisal. They then argue that since the Allocation Agreement did not determine the fair market value of the interest in real property by appraisal it

was unreasonable. 20 NYCRR 590.47 provides:

> "(a) Question: Is the price paid for the ownership interest in an entity the consideration for a controlling interest used to calculate gain?
>
> Answer: Generally, no, Section 1440(1) of the Tax Law states that: '...there shall be an apportionment of the fair market value of the interest in real property to the controlling interest to ascertain the consideration for the controlling interest.'
>
> Example: A corporation's only asset is a $4 million fair market value piece of property. If 100 percent of the stock is purchased, consideration is $4 million ($4,000,000 x 100 percent). If a 50-percent interest were acquired, only $2 million consideration is used to calculate gain.
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> (b) Question: How is fair market value determined?
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> Answer: Generally, by appraisal. It is the amount a willing buyer would pay a willing seller for the real property. It is not 'net fair market value', which deducts mortgages on the property from fair market value.
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> Thus, in the example in subdivision (a) of this section, if the property is encumbered by a $3 million mortgage, and $1 million is paid for 100 percent of the stock, the amount of consideration for the acquisition is $4 million, not $1 million."

I reject petitioners' reading of the regulation. As petitioners noted, a sale of assets usually requires the parties to allocate the sale price to the individual assets. In a stock sale, there is usually no reason to allocate the purchase price of the stock to the assets owned by the corporation. 20 NYCRR 590.47 recognizes this difference by acknowledging that in the case of a sale of a controlling interest, the determination of the fair market value allocated to the real property will generally be by appraisal. However, it does not express a preference for determination by appraisal to the exclusion of any other method of determining the fair market value of the real property. Moreover, the regulation does not suggest that any appraisal is preferable to any other method of apportionment. Petitioners submitted to the Division transferor and transferee questionnaires and an allocation agreement which apportioned the consideration for the interest in real property. The Division accepted that apportionment as reasonable. Petitioners now wish to escape the consequences of their original submission. In order to do so, it is incumbent upon them to establish that the original apportionment was unreasonable. The mere fact that appraisal was not the method used to determine the fair market value of the interest in real property for purposes of the Allocation Agreement does not

establish that the Agreement was unreasonable.

E. As evidence that the Allocation Agreement was incorrect, petitioners offer the Appraisal prepared by Mr. Fountain, financial statements and Federal income tax returns showing the revenues and profits earned by the Corporation, and appraisals of the personal property owned by the Corporation. Petitioners contend that the value of the country club as an ongoing business explains the difference between the fair market value of the real property as determined by the Allocation Agreement and as determined by the Appraisal.

I find that the Appraisal does not establish the fair market value of the real property as required by statute. The facts here are similar to those considered by the Tax Appeals Tribunal in Matter of Bridgehampton Investors Corp. (Tax Appeals Tribunal, August 11, 1988). There, the petitioner attempted to prove the fair market value of real property used as a beach and tennis club through an appraisal which employed the same method as that used by Mr. Fountain in this case; the depreciated replacement value of the improvements located on the land were added to the value of the land at its potential sales price as subdivided residential lots. The Tribunal rejected that method because it did not "reveal the fair market value of the property, the 'price at which a willing seller and a willing buyer will trade.'" (Id., quoting Black's Law Dictionary 717 [4th ed 1957]). The fact that the transfer at issue here involves a stock sale, rather than a sale of assets, does not warrant a conclusion that the method of appraisal employed by Mr. Fountain is adequate to establish the value of the real property.

Moreover, the value of the golf club as an ongoing business does not explain the difference between the original apportionment found in the Allocation Agreement and the value of the land as determined by the Appraisal. It was the opinion of petitioners' witness, Mr. Fountain, that income produced by the country club did not justify the price paid by the transferee for the corporation's stock; therefore, in his opinion, the land was more valuable as residential property. This testimony indicates that both the Appraisal, based on the value of the real property as residential property, and the value of the country club as an ongoing business are immaterial to the bargain struck by the parties.

In sum, petitioners have failed to show that the apportionment of the consideration for the Corporation's interest in real property as shown in the Allocation Agreement was unreasonable. Accordingly, they have not shown entitlement to a refund of the tax paid.

F. The petition of the Shareholders of Beekman Country Club, Inc. is denied.

DATED: Troy, New York

6/20/91

ADMINISTRATIVE LAW JUDGE