

STATE OF NEW YORK
DIVISION OF TAX APPEALS

In the Matter of the Petitions	:	
of	:	
WESTPORT REALTY COMPANY	:	DETERMINATION
for Revision of Determinations or for Refund	:	DTA NOS. 807658
of Tax on Gains Derived from Certain Real	:	AND 808183
Property Transfers under Article 31-B of the	:	
Tax Law.	:	

Petitioner, Westport Realty Company, 97-77 Queens Boulevard, Rego Park, New York 11374, filed two petitions for revision of determinations or for refund of tax on gains derived from certain real property transfers under Article 31-B of the Tax Law.

A consolidated hearing was held before Frank W. Barrie, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on June 3, 1992 at 1:15 P.M., with all briefs to be submitted by September 13, 1993.¹ Petitioner's brief was received on July 19, 1993, and the Division of Taxation's letter brief in response on August 26, 1993. Petitioner's reply brief was received on September 15, 1993. A supplemental letter brief, emphasizing the recent decision of the Tax Appeals Tribunal in Matter of Mendler (September 23, 1993), was received on January 14, 1994. The Division of Taxation's response was

received on January 25, 1994. Petitioner appeared by Graubard, Mollen, Horowitz, Pomeranz & Shapiro (Allen Greenberg, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Andrew J. Zalewski, Esq., of counsel).

¹The due dates for submission of the parties' briefs were extended (as they were in a companion matter) several times at the request of petitioner and with the agreement of the Division of Taxation. The companion matter was settled in the process and an issue which had been raised herein was also settled, as noted in Finding of Fact "18".

ISSUES

I. Whether the anticipated consideration for cooperative shares allocated to unsold units in a cooperative building, which were occupied by tenants with a continuing right to occupancy under rent laws and regulations, was properly calculated by the Division of Taxation.

II. Whether petitioner has substantiated additional expenses for capital improvements, which should be included in the calculation of original purchase price.

III. Whether, if gains tax is determined due, penalties should be abated.

FINDINGS OF FACT

Petitioner, Westport Realty Company, was the sponsor of a cooperative offering plan for the conversion of rental apartments into cooperative housing units involving a building located at 2800 Coyle Street in the Sheepshead Bay section of Brooklyn, New York. The building contained a total of 157 apartments, including a superintendent's apartment, with 13 apartments on the lobby level and 24 apartments on each of the floors one to six. Pursuant to the original Offering Plan, a total of 98,600 shares in 2800 Coyle Street Owners Corp., the cooperative housing corporation, was allocated to and among 156 residential apartments, with no shares allocated to the superintendent's apartment. By the Fourth Amendment dated July 15, 1986 to the Offering Plan, the total number of shares allocated to the apartments was reduced to 98,575.

Petitioner was described in the Offering Plan as follows:

"The Sponsor, Westport Realty Company, is a New York partnership with a place of business at 97-77 Queens Boulevard, Rego Park, New York. The partners of Sponsor are Samuel J. Lefrak and Richard Lefrak.

"Members of the Lefrak family and trusts for the benefit of several of them have been engaged in the ownership, operation and management of residential and commercial properties in the New York metropolitan area for numerous years and have participated as principals in the cooperative conversions [of five projects in Forest Hills, three in Kew Gardens, two in Brooklyn and one each in Woodside and Elmhurst].² In addition, Richard S. Lefrak was the sole stockholder of Pierrepont Realty Corp., the Sponsor of the offering plan of cooperative ownership for 35 Pierrepont Street, Brooklyn, New York.

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The street addresses for such projects have been omitted.

"Samuel J. Lefrak and Richard Lefrak are also partners of Lefrak Management Company, the company which has the laundry room concession and stockholders of Foremost Management Corp., the Managing Agent, and Westport Leasing Corp., the current Owner of the Property."

The Division of Taxation ("Division") issued two notices of determination, both dated March 6, 1989, asserting additional real property gains tax due, plus penalty and interest, as follows:

Amount Asserted As Due:

Assessment ID	Tax Period Ended	(i) Tax	(ii) Penalty and Interest	(iii) Interest	(iv) Total
L-000006162-8	April 14, 1986	\$ 34,928.00	\$56,414.00	\$11,952.10	\$103,294.10
L-000006168-2	August 8, 1986	<u>89,283.00</u>	31,249.00	21,536.65	142,068.65
	Total:	\$124,211.00			

The notice for the tax period ended April 14, 1986 showed the following calculation for tax asserted as due:

Tax per taxpayer:	\$126,256.00	
Tax per Dept. of Tax & Finance:	161,184.00	
Timely Payments/Credits:		0.00
Late Payments:	126,256.00	
Amount Previously Assessed/Refunded:		<u>0.00</u>
Balance:	\$ 34,928.00	

The notice for the tax period ended August 8, 1986 showed the following calculation for tax asserted as due:

Tax per taxpayer:		\$ 0.00
Tax per Dept. of Tax & Finance:	89,283.00	
Timely Payments/Credits:		0.00
Late Payments:	0.00	
Amount Previously Assessed/Refunded:	<u>0.00</u>	
Balance:	\$89,283.00	

A Statement of Proposed Audit Adjustment dated September 8, 1988 showed additional gains tax due of \$124,210.00, plus penalty and interest. Five schedules attached to the statement were referenced as the "explanation of adjustments". A schedule labelled "WEC & Audit Schedule", which perhaps is an abbreviation for "worksheet estimated consideration", shows the following calculation of tax per share of \$5.3980:

<u>Actual</u>	<u>Anticipated</u>	<u>Total</u>
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Cash consideration	\$2,861,178.00	\$2,765,275.00	\$5,626,453.00
Less: Grandfathered			-0-
Total Taxable Cash Consideration			\$5,626,453.00
Less: Reserve Fund	\$ 156,774.00		
Working Capital Fund	<u>35,000.00</u>		
Total Funds	\$ 191,774.00	<u>(191,774.00)</u>	
Estimated Cash Consideration			\$5,434,679.00
Mortgage Indebtedness			<u>2,000,000.00</u>
Total Taxable Consideration			\$7,434,679.00
Less: Brokerage Commissions			
Insiders (\$1,533,675.00 x .025)	\$ 38,342.00		
Outsiders (\$1,327,503.00 x .04)	53,100.00		
Anticipated (\$2,765,275.00 x .04)	<u>110,611.00</u>		
	(202,053.00)		(202,053.00)
Less: Original Purchase Price			<u>(1,911,510.00)</u>
Anticipated Gain on Taxable Sale			\$5,321,116.00
Anticipated Tax			532,112.00
Anticipated Tax Per Share			\$5.3980

The original purchase price of \$1,911,510.00 was calculated on a so-called "cacic sheet" (calculation of acquisition, capital improvements and cooping costs), another one of the five schedules attached to the statement, as follows:

Acquisition Expenses:	
Land	\$ 64,911.00
	<u>1,358,884.00³</u>
Total original purchase price	\$1,423,795.00
Capital improvements	\$ 360,685.00
Less: Disallowed improvements ⁴	<u>(184,966.00)</u>
	\$ 175,719.00
Cooping expenses	\$1,496,459.00
Less: Disallowed expenses	<u>(1,184,463.00)</u>
Total cooping expense	\$ 311,996.00

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The "cacic sheet" references a 1967 U.S. corporation tax for this amount. However, the amount shown on the tax return marked into evidence as the Division's Exhibit "P" does not seem to correspond. It is also unclear whether this amount represents the cost of the building, although it is likely that it does.

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The "cacic sheet" includes a line under capital improvements showing \$2,500.00 as "anticipated capital improvements to be substantiated" for each unsold apartment. However, no such amount was allowed in calculating capital improvements.

Total Original Purchase Price as of 2/16/88

\$1,911,510.00

A third schedule attached to the Statement of Proposed Audit Adjustment, labelled "Schedule of Capital Improvements", provides the following details of capital improvements claimed by petitioner which were disallowed:

	<u>Claimed</u>	<u>Disallowed</u>	<u>Allowed</u>
Tile and floor covering	\$ 43,834.00	\$ 17,534.00	\$ 26,303.00
Kitchen appliances (stoves)	9,276.00	7,029.00	2,247.00
Venetian blinds	4,801.00	4,801.00	--
Glass	3,032.00	2,387.00	645.00
Doors and door locks	18,172.00	7,269.00	10,903.00
Renovation costs	4,552.00	4,552.00	--
Plumbing & heating	58,656.00	23,459.00	35,197.00
Lighting fixtures	4,450.00	2,388.00	2,062.00
Air conditioners	14,181.00	14,181.00	--
Fixtures - bath & kitchen	9,060.00	1,651.00	7,409.00
Decorating & painting	37,520.00	23,956.00	13,564.00

Mail boxes	1,441.00	434.00	1,007.00
Electrical	4,109.00	1,535.00	2,574.00
Signs	287.00	287.00	--
Roof & waterproofing	22,612.00	12,487.00	10,125.00
Landscaping & brick planter	3,507.00	3,507.00	--
Woodwork & sheetrock	7,717.00	1,062.00	6,655.00
Compactors	967.00	--	967.00
Sprinklers	153.00	153.00	--
Handrails & smoke alarms	1,061.00	--	1,061.00
[Unreadable item]	<u>829.00</u>	<u>829.00</u>	--
	\$250,220.00	(\$129,501.00)	\$120,719.00
Inception through 12/31/82	<u>110,465.00</u>	<u>(55,465.00)</u>	<u>55,000.00</u>
	\$360,685.00	(\$184,966.00)	\$175,719.00

A fourth schedule attached to the Statement of Proposed Audit Adjustment, labelled "Schedule of Cooping Costs", showed the Division's calculation for allowed cooping expenses of \$311,996.00, as follows:

	<u>Claimed</u>	Adjustment (Disallowed) Additional	<u>Allowed</u>
Legal fees	\$ 45,000.00		\$ 45,000.00
Engineering fees	4,300.00		4,300.00
Filing fees	14,185.00		14,185.00
Working capital	35,000.00	\$ (35,000.00)	--
Reserve fund	156,774.00	(156,774.00)	--
Advertising	15,000.00	(15,000.00)	--
Accounting fees	1,500.00	2,000.00	3,500.00
Fee for preparation of plan	50,000.00	(17,500.00)	32,500.00
Printing	15,000.00		15,000.00
Discount on wraparound mortgage	1,000,000.00	(1,000,000.00)	
Title closing costs:			
NYC transfer tax	110,000.00	(4,825.00)	105,175.00
Mortgage recording tax	18,000.00	(115.00)	17,885.00
NYS deed stamp	23,700.00		23,700.00
Fee insurance premium	7,500.00	5,118.00	12,618.00
Mortgage insurance premium		5,936.00	5,936.00
Recording charges	500.00	3,600.00	4,100.00
Searches, corporation		423.00	423.00
Survey		675.00	675.00
NYS transfer tax		21,036.00	21,036.00
Offering expense - legal fee additional		<u>5,963.00</u>	<u>5,963.00</u>
	<u>\$1,496,459.00</u>	(\$1,184,463.00)	\$311,996.00

The "WEC [worksheet estimated consideration] & Audit Schedule" described in Finding of Fact "4" showed a balance due of \$124,210.00 computed as follows:

Anticipated Tax Per Share	\$5.3980
Number of shares taxed per audit (46,400)	

Total tax liability per audit	\$ 250,467.00
Less: Previous payments	<u>(126,257.00)</u>
Balance Due	\$ 124,210.00

As noted in Finding of Fact "1", 98,575 shares in the cooperative housing corporation were allocated to and among 156 residential apartments. As noted in Finding of Fact "8", 46,400 shares were taxed per audit. Unsold shares amounted to 52,175 shares, and the Division calculated "anticipated" cash consideration for the future sale of such shares of \$2,765,275.00 by using \$53.00 per share (52,175 shares x \$53.00 = \$2,765,275.00). Such amount per share was used by the Division because under the "Offering Plan of Cooperative Conversion of Premises known as the Westport, 2800 Coyle Street, Brooklyn, New York", which indicated an approximate date of first offering of May 31, 1985, tenants in occupancy of residential apartments could purchase the shares allocated to their respective apartment at \$53.00 per share (the so-called "insider's price").

Petitioner challenged the Division's use of the "insider price" of \$53.00 per share to calculate "anticipated" cash consideration of \$2,765,275.00 for the 52,175 unsold shares. According to the testimony of Alfred Schimmel, petitioner's well-qualified expert witness, the value of the unsold shares was \$2,155,950.00. Mr. Schimmel estimated the value of the unsold shares by three calculations:

(1) From the date of passing title to the coop corporation (April 14, 1986) and the date of the State audit (June 1987):	\$ 930,000.00
(2) From June 1987 to August 1989:	\$ 550,000.00
(3) From August 1989 until estimated sellout value:	\$ <u>675,950.00</u>
	\$2,155,950.00

During the period from the date of title passing to the coop corporation of April 14, 1986 to the date of the State audit of approximately June 1987, there were sales of 20 units as follows:

<u>Unit</u>	<u>Shares</u>	<u>Price</u>	<u>Share Price</u>	<u>Date of Sale</u>
722	1,150	\$ 60,950.00	\$ 53.00	4/15/86
607	610	32,330.00	53.00	4/25/86

610	890	47,170.00	53.00	4/25/86
625	535	28,355.00	53.00	4/25/86
703	910	48,230.00	53.00	5/01/86
604	970	51,410.00	53.00	5/01/86
407	580	30,740.00	53.00	5/01/86
708	550	29,150.00	53.00	5/01/86
422	1,090	57,770.00	53.00	5/21/86
223	515	27,295.00	53.00	5/21/86
109V	445	51,175.00	115.00	6/06/86
322V	1,070	130,540.00	122.00	7/29/86
515V	520	57,340.00	110.00	8/05/86
415	455	55,510.00	122.00	8/11/86
511	470	57,340.00	122.00	10/03/86
620	610	74,420.00	122.00	10/22/86
401V	505	61,610.00	122.00	11/05/86
105V	435	53,070.00	122.00	12/18/86
523	535	27,560.00	51.51	2/02/87
521	<u>525</u>	<u>82,950.00</u>	158.00	3/04/87
	13,370	\$1,064,915.00		

Mr. Schimmel valued the 20 units sold during this period at \$930,000.00, not the total sales price of \$1,064,915.00, because of petitioner's cost to renovate the vacant units in order to sell them. His analysis, set forth in a written appraisal dated June 1, 1992 but noted to be "as of April 14, 1986 and June 1987", was as follows:

"The first ten sales were sales to insiders who had previously subscribed for the stock but were unable to close on April 14, 1986.

"The last nine of the ten sales were sales to outsiders. Five apartments, marked 'V', had been vacant and unsold at the closing. These apartments had 5,035 shares and sold for a total of \$623,955. The average price per share was \$123.92. This figure must be adjusted for the estimated cost of renovating the units at an average cost of \$15,000 per apartment. Therefore, we deduct \$135,000 from the gross proceeds (9 x \$15,000) for an adjusted value of \$488,955. This adjusted figure brings the per share value down to \$97.11 per share.

"The first ten sales averaged \$53 per share which was the 'insiders' price. These ten sales involved 7,800 shares at the fixed insider price of \$53 per share.

"The sale of apartment 523, with 535 shares at \$27,560, is either a misprint or a special case; we have, therefore, treated it separately.

Summary

- a) The value of 7,800 shares @ \$53 = \$413,400
- b) The value of 5,035 shares @ \$97.11/share = 488,955
- c) The value of 535 shares @ \$51.51 share = 27,560

\$929,915

Say: \$930,000"

From June 1987 to August 1989 there were sales of 11 units with 5,930 shares at a total sales price of \$798,735.00. However, Mr. Schimmel again reduced such total for renovation costs, and, in addition, he "discounted for an average future time of one year at 15%" as follows:

"The total sales price for the 5,930 shares represented by the eleven sales amounted to \$798,735. We adjust this gross price for the renovation cost of \$15,000 per unit, or \$165,000. The adjusted price amounts to \$633,735. This figure is in turn discounted for an average future time of one year at 15%. Therefore:

$$\$633,735 \times .8695 = \$551,032, \text{ say } \$550,000"$$

According to the June 1992 appraisal, since late August 1989, petitioner has had no further sales of units. Mr. Schimmel valued the remaining 75 unsold apartments with 47,225 shares as follows:

"The rent for these units exceeds the maintenance by \$5,025.41 per month, or \$60,304.92 per annum. The last three sales of vacant apartments, involving 1,870 shares, sold for a total of \$245,120, or an average of \$131 per share.

"If we assume a turnover rate of 2.5 units per year until all units become vacant, it would take thirty years from 1989 to sell all the shares.

"We can now assume that the 47,225 shares would sell at an average price of \$140 per share, or \$6,625,500 over the thirty year period.

"The present value of the right to receive \$1 in fifteen years at 15% is .12289. The gross discounted value of the right to receive \$6,625,500 \times .12289 = \$814,208.

"The estimated expenses of renovating the seventy-five apartments over the thirty year period at \$15,000 per apartment = \$1,125,000 \times .12289 = \$138,251.

"The net value of the shares for the period August 1989 to the year 2019 is, therefore, \$675,957, say \$675,950."

Mr. Schimmel concluded in his appraisal that "[t]he total estimated retail sellout value for the unsold shares amounts to \$2,155,950.00."

Mr. Schimmel rejected the idea that the unsold units had value as occupied apartments. In his appraisal report, he pointed to the Tax Reform Act of 1986, the October 19, 1987 crash of the stock market and the economic recession of 1988 as major reasons for his conclusion that petitioner's unsold units, which were occupied by tenants with rights to continued occupancy

under rent laws and regulations, had little or no value until they became vacant. Mr. Schimmel provided the following historical information concerning the value of occupied units in his appraisal report:

"In the mid-1980s shares in occupied units typically sold for 25%-30% of the full retail market value as if vacant. In 1989 the value of occupied units plunged as low as 10-25% for units in good locations, with rent higher than maintenance, and as low as 5% for units with higher maintenance charges than rent. It should be noted that such 'percentages', reported by brokers in unsold units as well as newspaper articles, only refer to transactions which have taken place. Time Equities marketed thousands of shares in occupied apartments between 1987 and 1990, dropped prices to as low as 10%, and still hadn't sold a single share in an occupied apartment as of January 1991. It should be noted that a number of brokers in unsold shares who were contacted in 1989, were out of business as of August 1991.

* * *

"After discussion with sponsors and brokers, we have discovered that during the spring of 1989 a number of sponsors began using 10% of full retail market value as if vacant, a measure of the value of shares in occupied apartments for accounting purposes. This figure applies to shares with higher rent than maintenance. Recent announcements of upcoming auctions confirm this as the general asking rate. However, actual transactions may be considerably lower. Some sponsors have tried to give away shares in occupied apartments to the tenants to relieve themselves of debt. Even in buildings where there is a clear positive cash flow from the occupied units, obtaining financing continues to be difficult and banks are reluctant to become involved in the very depressed market of cooperative apartments. Even if financing were available, it would add to the carrying costs of the shares and a potential investor would require a high rate of return for risking equity and receiving few tax incentives."

How Petitioner Reported the Transactions for Gains Tax Purposes

By a letter dated March 17, 1986, prior to its transfer of the property to the cooperative housing corporation, petitioner's accountant submitted a Form TP-580, Transferor's Questionnaire, which disclosed an estimated gain of \$2,050,066.00 subject to tax of \$205,007.00 computed as follows under Option B:

	Actual to Date <u>4/10/86</u>	Estimated Additional Through <u>Completion</u>	Total Anticipated (actual plus estimated) on Sell Out
Gross Consideration	\$ -0-	\$3,944,373.00	\$3,944,373.00
Mortgage Indebtedness	-0-	<u>2,000,000.00</u>	<u>2,000,000.00</u>
Total Consideration	-0-	\$5,944,373.00	\$5,944,373.00
Less: Brokerage Fees	-0-	<u>(127,514.00)</u>	<u>(127,514.00)</u>

Consideration	-0-	\$5,816,859.00	\$5,816,859.00
Acquisition Cost	\$1,727,059.00		\$1,727,059.00
Capital Improvements	293,275.00	250,000.00	543,275.00
Cooperative Conversion Costs	<u>1,034,485.00</u>	<u>461,974.00</u>	<u>1,496,459.00</u>
Total Original Purchase Price	\$3,054,819.00	\$ 711,974.00	\$3,766,793.00
Estimated Gain Subject to NYS Gains Tax			\$2,050,066.00
Estimated NYS Gains Tax (10%) on Sell Out			\$ 205,007.00

Petitioner showed the following calculation for its acquisition cost (or original purchase price) of \$1,727,059.00 for the property:

Land	\$ 74,742.00
Building and Improvements	1,617,490.00
Miscellaneous Fixed Assets	<u>34,827.00</u>
	\$1,727,059.00

Petitioner also provided the following details concerning reported gross consideration of \$3,944,373.00:

36,385 shares allocated to 56 apartments subscribed for as of April 10, 1986	\$2,017,375.00
8,970 shares allocated to 12 vacant apartments not subscribed for x \$53.00 per share	475,410.00
52,785 shares allocated to 87 occupied apartments not yet subscribed for x \$27.50 per share	1,451,588.00
Total Consideration:	\$3,944,373.00

In addition, petitioner detailed its so-called "cooperative conversion costs" claimed of \$1,496,459.00 as follows:

	Actual to Date <u>4/10/86</u> ⁵	Estimated Additional through <u>Completion</u>	Total Anticipated (actual plus estimated) on Sell Out
Legal Fees	\$ 20,000.00	\$ 25,000.00	\$ 45,000.00
Engineering Fees	4,300.00	-0-	4,300.00
Filing Fees	10,185.00	4,000.00	14,185.00

⁵Petitioner's schedule did not provide column headings, but these headings, which were used on other schedules attached to the letter, were probably intended to be used.

Working Capital Fund	-0-	35,000.00	35,000.00
Reserve Fund	-0-	156,774.00	156,774.00
Advertising	-0-	15,000.00	15,000.00
Accounting Fees	-0-	1,500.00	1,500.00
Fee for Preparation of Plan	-0-	50,000.00	50,000.00

Printing	-0-	15,000.00	15,000.00
Title Closing Cost ⁶	-0-	159,700.00	159,700.00
Discount on Wraparound Mortgage	<u>1,000,000.00</u>	-0-	<u>1,000,000.00</u>
	\$1,034,485.00	\$461,974.00	\$1,496,459.00

Petitioner also attached the following schedules:

(a) A schedule designated "D" labelled "Schedule of Capital Improvements from the Inception Through 1985", which had column headings of (i) vendor, (ii) description and (iii) amount, and disclosed a total for "equipment & capital improvements from the inception through 1985" of \$222,817.00;

(b) A schedule designated "E" labelled "Schedule of Cooperative Conversion and Renovation Costs for the Years 1984 & 1985", which had column headings of (i) vendor,⁷ (ii) description and (iii) amount, and disclosed a total for "coop conversion & renovation costs" of \$70,458.00; and

(c) A schedule designated "A" which listed 56 transferees, with column headings and information concerning (i) apartment number, (ii) number of shares, (iii) percentage of taxable shares, (iv) allocated sales price including mortgage indebtedness, (v) allocated brokerage, (vi) allocated cost of unit, (vii) estimated gain and (viii) estimated tax due which

⁶In a footnote to the schedule, petitioner broke down its "title closing cost" as follows: City transfer tax - \$110,000.00; mortgage recording tax - \$18,000.00; State deed stamps - \$23,700.00; insurance premium - \$7,500.00; recording charges, inspection and searches - \$500.00.

⁷Many of the entries under this heading merely note "various vendors".

totalled \$76,607.00 on an estimated gain of \$766,072.00.

The Division issued a Form TP-582, Tentative Assessment and Return, dated April 11, 1986 showing a "date of anticipated transfer" of April 14, 1986. Arthur Klein, described thereon as an "authorized agent", executed an "affidavit of transferor" on April 14, 1986 on the bottom of such form. The tentative assessment was computed as zero.

Petitioner amended its preliminary filing described in Finding of Fact "12" by a letter dated April 22, 1986, subsequent to the closing date, at which time only 45 units, not 51, were transferred. In addition, petitioner reported a lower original purchase price of \$1,459,217.00 (\$64,911.00 allocated to land and \$1,394,306.00 to building and improvements) instead of the earlier reported amount of \$1,727,059.00. Petitioner reported a larger amount for capital improvements of \$638,185.00 instead of the earlier reported amount of \$543,275.00. In the amended filing, petitioner reported an estimated gain of \$1,956,035.00 with estimated gains tax on sell out of \$195,603.00 calculated as follows on a summary schedule:

	Actual to Date <u>4/14/86</u>	Estimated Additional Through <u>Completion</u>	Total Anticipated (actual plus estimated) on Sell Out
Gross Consideration	\$1,533,675.00	\$2,155,248.00 ⁸	\$3,688,923.00
Mortgage Indebtedness	<u>579,006.00</u>	<u>1,420,994.00</u>	<u>2,000,000.00</u>
Total Consideration	\$2,112,681.00	\$3,576,242.00	\$5,688,923.00
Less: Brokerage Fees	<u>52,817.00</u>	<u>86,210.00</u>	<u>139,027.00</u>

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It is noted that in both its initial filing and this amended one petitioner used a value of \$27.50 per share to value shares allocated to occupied apartments "not yet subscribed". Petitioner's accountant, Norman Greenberg, testified that he "didn't arrive at [the \$27.50 per share value]" but that it was provided to him by "management" who "are real estate oriented for 40 years." It is noted that management's reasoning was not elucidated.

Consideration

\$2,059,864.00

\$3,490,032.00

\$5,549,896.00

Acquisition Cost	\$1,459,217.00		\$1,459,217.00
Capital Improvements	360,685.00	277,500.00	638,185.00
Cooperative Conversion Costs	<u>1,034,485.00</u>	<u>461,974.00</u>	<u>1,496,459.00</u>
Total Original Purchase Price	\$2,854,387.00	\$ 739,474.00	\$3,593,861.00
Estimated Gain Subject to NYS Gains Tax			\$1,956,035.00
Estimated NYS Gains Tax (10%) on Sell Out			\$ 195,603.00

The amended filing also showed the following recalculation of consideration:

28,545 shares allocated to 45 apartments subscribed for as of April 14, 1986	\$1,533,675.00
8,970 shares allocated to 12 vacant apartments not subscribed for x \$53.00 per share	475,410.00
61,085 shares allocated to 99 occupied apartments not yet subscribed for x \$27.50 per share	1,679,838.00
Total Consideration:	\$3,688,923.00

Substantiation of Additional Capital Improvements and Expenses

As noted in Finding of Fact "5", the Division allowed only some of petitioner's claimed expenses for capital improvements. Petitioner presented the testimony of Allen Egidio, the director of operations for an entity called Foremost, which according to the witness is a subsidiary of the Lefrak organization responsible for managing Lefrak properties "after they become co-op." Mr. Egidio also testified that he is "in charge of the renovations of the apartments" and was involved in the management and renovation of the property at issue in this matter. Mr. Egidio identified representative invoices in support of his testimony that, in 1992 pricing, the cost to renovate a vacant apartment was approximately \$5,000.00. He testified that in 1987 the cost was approximately \$3,700.00. With reference to the Division's Exhibit "S", which was described in detail in Finding of Fact "6", Mr. Egidio testified as to each of the items listed thereon. He noted that there might be other "materials" substantiating expenses, but they were not presented at the hearing.

Petitioner's accountant, Norman Greenberg, testified that he extracted information from (i) the workpapers from an independent accounting firm, (ii) petitioner's tax returns and (iii) a computer printout from the Lefrak organization to ascertain petitioner's capital improvements.

However, invoices and/or cancelled checks for such expenses were not provided to substantiate capital improvement expenses in excess of those allowed by the Division.

Mr. Greenberg also defended petitioner's inclusion of \$50,000.00 as a conversion expense for services provided by Howard Boris and Arthur Cline, employees of the Lefrak organization, who appear to have been responsible for the development and implementation of the cooperative conversion at issue herein. However, no documents were provided to substantiate this amount claimed.

The parties entered into a stipulation dated June 3, 1992 which was marked into the record as the Division's Exhibit "A". Relevant portions have been incorporated herein.

In addition, a stipulation dated July 9, 1993 between the parties resolved an issue concerning the Division's disallowance of the \$1,000,000.00 discount claimed by petitioner on the wraparound mortgage. Pursuant to such stipulation, petitioner paid additional tax and interest resulting from such disallowance, and the Division abated penalties and penalty interest attributable to such additional tax.

Petitioner submitted 19 proposed findings of fact. Proposed findings of fact "1" through "6", "8", "9", "10", "13", "15", "17" and "18" are accepted and incorporated into this determination.

Proposed findings of fact "7", "12" and "19" are accepted in part. The accepted parts are incorporated into this determination. The rejected parts are as follows:

(i) Proposed finding of fact "7" includes an inexact statement that Mr. Morano or Mr. Hroncich (employees of the Division's Gains Tax Unit) made "no objections" to petitioner's use of the \$27.50 per share figure for the unsold shares. Petitioner cites the testimony of Norman Greenberg in support of this point. However, Mr. Greenberg never specifically testified concerning such point.

(ii) Proposed finding of fact "12" includes the inexact use of the word "detailed" in noting that petitioner "attached 26 pages of detailed description of expenditures constituting capital improvements and coop conversion costs" to its amended filing. Such

pages had columns for the date, the name of the vendor, a very general description and amount. For example, the first entry shows the date of 1/31/83, Kew Equipment Corp. as the vendor, "[r]eplace tile bathroom" as the description and the amount of \$71.00. No details are provided concerning the amount or type of tile, price per unit for material, cost of labor, etc.

(iii) Proposed finding of fact "19" includes the statement that "[t]he market value on April 14, 1986 of the unsold apartments was \$2,155,950", which is more in the nature of an ultimate finding of fact or a conclusion of law.

Proposed findings of fact "11", "14" and "16" are not accepted:

(i) With reference to proposed finding of fact "11", petitioner established that it submitted schedules listing the transferees (which were included in its submissions described in detail in Findings of Fact "12" and "14"), but did not establish that transferee questionnaires were submitted for each person who subscribed to purchase shares.

(ii) With reference to proposed finding of fact "14", an analysis of Exhibit "V" shows total sales of 18,475 shares to 28 apartments, for which petitioner received \$1,337,063.00 in cash during the period following the closing date of April 14, 1986 through November 23, 1987 not "17,855 shares to 27 apartments, for which it received \$1,327,503 in cash" as proposed.

(iii) With reference to proposed finding of fact "16", Findings of Fact "6" and "7" herein provide a more detailed description of expenses disallowed by the Division.

SUMMARY OF THE PARTIES' POSITIONS

Petitioner contends that it properly calculated "total consideration anticipated" under the cooperative plan in its initial gains tax filing of March 17, 1986 submitted prior to closing, and in its amended gains tax schedule reflecting the actual sales at the April 14, 1986 closing. According to petitioner, the appraisal testimony of its expert supports its initial valuation of unsold shares.

Petitioner further argues that it properly "claimed the sum of \$2,500 as the known cost of

the renovations Petitioner would have to make to an apartment to induce a prospective buyer to buy," and that the testimony of Allen Egidio, petitioner's director of operations who was in charge of apartment renovations, proved \$2,820.00 as the "renovation costs for each unsold apartment." Therefore, the Division should have allowed petitioner's claimed costs for future renovations of \$277,000.00 (111 unsold apartments times \$2,500.00). Furthermore, petitioner contends that by the testimony of Mr. Egidio, who "explained the nature of the work covered by each category" of claimed capital improvement costs, it should be allowed an additional \$99,787.00 in capital improvement costs as part of original purchase price.

In addition, petitioner claims that it should have been allowed an additional amount of \$35,739.18 as part of its acquisition cost for the building because such amount represented "additional costs capitalized". Petitioner's accountant, Norman Greenberg, testified that he prepared a schedule showing "Building Acquisition Cost" aggregating \$1,394,622.73 based upon his use of petitioner's "historical books and records and verified by its outside accountants for the preparation of Petitioner's tax returns." Petitioner claims that there was no logical reason to support the auditor's allowance of \$1,358,883.55 which Mr. Greenberg labelled on his schedule as "Cost per Books" and not the \$35,739.18 which he labelled "Additional Costs Capitalized".

Petitioner asserts that penalties should be abated because its filings were made prior to the Division's promulgation of the Safe Harbor Estimate procedure bulletin, TSB-M-86(3)R, which provided that the lower of (a) 100% of the insider offering price, or (b) 50% of the price of vacant units transferred at the initial closing should be used to estimate the consideration to be received on a non-eviction cooperative plan for unsold units. Petitioner argues that it "in no way acted contrary to the Division's published articulated policy."

Petitioner argues that Matter of Mendler (Tax Appeals Tribunal, September 23, 1993) supports its position that it was not bound to use the offering plan's insider's price in calculating anticipated consideration for unsold units which were occupied by tenants who had a continuing right to occupancy. Petitioner points to the Tribunal's decision in Mendler that "there is nothing

in this TSB that requires that the safe harbor rules for estimating consideration be followed."

The Division contends that it properly used the insider's price to estimate the consideration to be received on unsold units. Tax Law § 1442(2)(b) specifically directs the taxpayer "to refer to the cooperative offering plan in determining the anticipated total consideration to be received." Furthermore, the report of petitioner's expert "does not support the petitioner's anticipation of consideration of \$27.50 per share." The Division rejects petitioner's reliance on Matter of Mendler (*supra*):

"Unlike Mr. Mendler the taxpayer's arguments concerning anticipated consideration extend to units sold as well as units unsold by the date of the Division's audit [T]he petitioner contends that it correctly determined that the 61,085 unsold shares left after the April 14, 1986 closing . . . would sell for \$27.50 per share

". . . Mr. Shimmel's [sic] report does not support the taxpayer's arguments Mr. Shimmel [sic] acknowledges that between June 1, 1987 and August 28, 1989, there were 5,390 shares sold for \$798,735.00 or \$134.69 per share"

According to the Division, neither the Tax Law nor regulations authorize the use of present value of actual consideration anticipated. In addition, the Division's position seems to be that there is no authority to deduct anticipated capital improvement costs in calculating anticipated consideration.

Furthermore, the Division argues that petitioner failed to present "a coherent accounting" of its capital improvement costs.

CONCLUSIONS OF LAW

A. Tax Law § 1441, which became effective March 28, 1983, imposes a 10% tax upon gains derived from the transfer of real property located within New York State. The "gain" which is taxed is the difference between the "original purchase price" of the property and the "consideration" received for the property (Tax Law § 1440[3]). 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]). This 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."

B. Tax Law § 1442 concerns the payment of gains tax and provides that tax is due on the date of transfer. 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." Section 1442 provides further 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). Therefore, 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.

C. As noted in Finding of Fact "9", the Division calculated anticipated consideration for the future sale of 52,175 shares in the cooperative housing corporation which remained unsold at the time of the audit by using \$53.00 per share. This amount per share was the "insider's price" specified in the offering plan for the project at issue. As noted in Finding of Fact "12", petitioner in reporting the transaction at issue used \$27.50 per share (or ½ of the "insider's price") for shares allocated to units not yet subscribed.

The Division's use of the "insider's price" conforms to the rules set forth in TSB-M-86(3)R, the "Safe Harbor Estimate for Transfers Pursuant to Condominium and Cooperative Plans". This policy memorandum provides as follows with reference to estimating the consideration to be received pursuant to a non-eviction conversion plan:

"The Safe Harbor Estimate for a non-eviction conversion plan will be calculated by taking the lower of

"a) 100% of the total of the offering plan prices established for insiders for the Unsold Units, or

"b) 50% of the total of the vacant market value for the Unsold Units. Vacant market value will be established based on the price of vacant units transferred at the initial closing. If there are insufficient contracts for vacant units to establish vacant market value, or if circumstances indicate that the vacant units are not being transferred at market value, then the transferor must use 100% of the insider offering plan price to calculate his Safe Harbor Estimate under (a) above.

"The insider offering plan prices will be those established as of the date the initial Gains Tax submission is filed, or the date the submission is prepared, if within a reasonable time of the filing date. The vacant market value and the

number of Unsold Units will be determined at the same date."

Petitioner correctly contends that Matter of Mendler (*supra*) supports its position that it was not bound to use the offering plan's insider's price in calculating anticipated consideration for unsold units. In the Mendler decision, the Tribunal noted:

"The Division has not directed us to any official statement by it, and we have found none on our own, where the Division has established rules that are required to be followed to estimate anticipated consideration. Thus, we know of no regulation, Technical Services Bureau Memorandum or instruction to a gains tax form that tells a transferor what method must be followed to estimate the anticipated consideration. The rules contained in TSB-M-86-(3)-R, the 'Safe Harbor Estimate for Transfers Pursuant to Condominium and Cooperative Plans,' assure taxpayers that if they follow the safe harbor estimating rules, the taxpayers will not be subject to penalty and interest on underpayment (*see, Matter of Belvedere Garden Assocs.*, Tax Appeals Tribunal, June 18, 1992); however, there is nothing in this TSB that requires that the safe harbor rules for estimating consideration be followed."

Furthermore, it is noted that the policy memorandum establishing the safe harbor estimate is dated May 1, 1986, subsequent to the closing date for the project at issue.

D. Petitioner relies on an appraisal prepared by its expert witness, Alfred Schimmel, to support its estimated consideration of \$2,155,248.00 as specified in its amended filing (described in Finding of Fact "14"). Mr. Schimmel valued the unsold shares as of the date of closing (April 14, 1986) at \$2,155,950.00 by use of a methodology described in detail in Finding of Fact "10". However, Mr. Schimmel's appraisal does not shoulder petitioner's burden of proving the total consideration anticipated in April 1986. Mr. Schimmel prepared his appraisal six years after the relevant period and noted that the October 19, 1987 crash of the stock market and the economic recession of 1988 reduced the value of the unsold units. In fact, Mr. Schimmel, as noted in Finding of Fact "11", goes on at some length concerning the plunge in value of occupied units between 1987 and 1990. There is little doubt that in April 1986 petitioner anticipated a much rosier picture for the simple reason that it would not have devised the transaction at issue if it had known the market was to collapse in the future. In short, "anticipated consideration" for the unsold shares as of April 1986 was an amount in excess of Mr. Schimmel's estimate, which was affected by an awareness of the collapse in the market for cooperative apartment units and, in particular, occupied units (*cf.*, Matter of Bernstein, Tax

Appeals Tribunal, December 24, 1992, confirmed Bernstein v. Commissioner of Taxation & Fin., ___ AD2d ___, 606 NYS2d 445 [3d Dept, 1994] [wherein the Tribunal rejected the opinion of an expert because it was not based on the proper analysis]).

E. Tax Law § 1440(5)(a) defines "original purchase price", in pertinent part, as follows:

"(a) 'original purchase price' means the consideration paid or required to be paid by the transferor; (i) to acquire the interest in real property, and (ii) for any capital improvements made or required to be made to such real property, including solely those costs which are customary, reasonable, and necessary, as determined under rules and regulations prescribed by the tax commission, incurred for the construction of such improvements. Original purchase price shall also include the amounts paid by the transferor for any customary, reasonable and necessary legal, engineering and architectural fees incurred to sell the property and those customary, reasonable and necessary expenses incurred to create ownership interests in the property in cooperative or condominium form, as such fees and expenses are determined under rules and regulations prescribed by the tax commission."

Petitioner's contention that it properly claimed the sum of \$2,500.00 for renovations it "would have to make to an apartment to induce a prospective buyer to buy" is rejected. It would be purely speculative to allow as a capital improvement cost an expense which has not yet been incurred (cf., Matter of Eisner, Tax Appeals Tribunal, March 22, 1990). Furthermore, such expenses for renovations would be allowable when incurred under Option B on update, which occurs upon the sellout of each 25% of the project (cf., TSB-M-83(2)R, "Computation of Consideration and Original Purchase Price for Condominium or Cooperative Projects"). Moreover, the Division's argument is correct that petitioner failed to present "a coherent accounting" of its capital improvement costs so that no further costs are allowable. The testimony of Mr. Greenberg and Mr. Egidio, without the presentation of invoices and proof of payment in a coherent fashion, was inadequate to establish petitioner's right to additional capital improvement costs or an increased "original purchase price" for the property at issue (cf., Matter of V & V Properties, Tax Appeals Tribunal, July 16, 1992 [wherein the Tribunal noted that the taxpayer must have documents to substantiate capital improvement costs, despite the fact that construction expenses were incurred years before the gains tax law became effective]).

F. Pursuant to Tax Law § 1446(2)(a):

"Any person failing to file a tentative assessment and return or to pay any tax within the time required by [Article 31-B] shall be subject to a penalty of ten per

centum of the amount of tax due plus an interest penalty of two per centum of such amount for each month of delay or fraction thereof"

Said section goes on to provide that if the Commissioner of Taxation:

"determines that such failure or delay was due to reasonable cause and not due to willful neglect, [the commissioner] shall remit, abate or waive all of such penalty and such interest penalty."

Petitioner has the burden of proving both that the failure to pay timely the proper amount of tax was due to reasonable cause and not due to willful neglect.

First, it is observed that, as noted in Finding of Fact "12", petitioner filed a transferor's questionnaire in a timely manner. It also amended its preliminary filing in due course, as noted in Finding of Fact "14". As noted in Finding of Fact "13", the tentative assessment was computed as zero, which would seem to conflict with petitioner's other filings noted above, and such discrepancy was unexplained in the record. Although it is correct that this matter does not involve a taxpayer who has failed to file a tentative assessment and return, petitioner has not sustained its burden of proving that its failure to pay the proper amount of tax was due to reasonable cause and not due to willful neglect. The record is silent on the following crucial points:

(i) Why in 1986, at the time of the closing, did petitioner use one-half of the insider's price to estimate anticipated consideration on unsold shares?

(ii) Why was petitioner unable to substantiate with documents and in a coherent fashion its claimed costs for capital improvements?

(iii) Why was the tax of \$126,256.00 calculated by petitioner not paid timely?

In short, petitioner has not created an adequate record to justify the abatement of penalties (see, Matter of KAL Associates, Tax Appeals Tribunal, October 17, 1991).

G. The petition of Westport Realty Company is denied and the notices of determination, dated March 6, 1989, are sustained.

DATED: Troy, New York
March 14, 1994

/s/ Frank W. Barrie
ADMINISTRATIVE LAW JUDGE