STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
LEONARD SPODEK	:	DETERMINATION DTA NO. 808960
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, Leonard Spodek, 777 East 21st Street, Brooklyn, New York 11210, 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.

A hearing was held before Jean Corigliano, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on October 29, 1991 at 1:15 P.M. The Division of Taxation submitted a letter brief on December 16, 1991. Petitioner submitted a letter brief on January 2, 1992. Petitioner appeared by Leonard Goldstein, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Kenneth J. Schultz, Esq., of counsel).

ISSUES

I. Whether the Commissioner of Taxation and Finance properly determined that the transfers by petitioner of certain parcels of real property were formulated for the purpose of avoiding the gains tax.

II. Whether, if the transfers were so formulated, the Commissioner of Taxation and Finance was authorized by section 1448(1) of the Tax Law to reallocate the prices paid for each parcel of real property.

FINDINGS OF FACT

Petitioner, Leonard Spodek, was the owner of five individual properties located in Brooklyn, New York.[1] A multi-unit apartment building was situated on each property. The properties were not contiguous or adjacent, although all were located in Brooklyn.

On or about December 14, 1987, transferor and transferee questionnaires were submitted to the Division of Taxation ("Division") for each of the five properties. The questionnaires indicated that each property was to be sold to a single transferee, DAO Corporation ("DAO"), on December 1, 1988. A contract of sale for each property was submitted with each set of questionnaires. The stated consideration for each property pursuant to the questionnaires and contracts was $995,000.00.

On or about December 17, 1987, the Division issued five tentative assessments and returns, asserting no gains tax due on any of the five transactions. By letter dated February 5, 1988, the Division advised petitioner that the tentative assessments were issued in error and requested that they be returned to the Division.

Apparently, the Division contacted the parties and requested documentation regarding the assessed valuation of the properties. With a cover letter dated March 1, 1988, petitioner returned the original tentative assessments to the Division and provided copies of five documents, each entitled "Tax Commission of the City of New York Application for Correction of Tentative Assessed Valuation for Rent Producing Properties Assessed for Less than $750,000.00". These applications showed the actual and transitional assessments for each of the five properties owned by petitioner.

Each of the five sales contracts submitted with the questionnaires contained a provision relating the final purchase price of each building to that building's rent rolls. Paragraph 31,

[1] Petitioner owned each property either individually or through his wife, Rosalind Spodek, or through one of several business entities. He was, however, the beneficial owner of each property.

subparagraph (a), of the contract for sale of 985 Ocean Avenue, Brooklyn, New York, states:

> "31. Rent Roll. (a) If the rent roll for the Premises as of the Closing Date is less than $120,000, the purchase price to be paid by Purchaser hereunder shall be reduced by five times the amount by which $120,000 exceeds the rent roll for the Premises on the Closing Date. Any reduction in the purchase price as a result of this Paragraph 31(a) shall be split equally between the cash portion of the purchase price and the amount of the Purchase Money Mortgage."

Each of the other four sales contracts contains identical language varying only with regard to the amount of the rent roll associated with each building.

As shown in the documents submitted to the Division, the purchase price, actual assessed valuation and minimum rent roll for each of the five properties were as follows:

Property	Purchase Price	Assessed Value	Rent Roll
305 Ocean Avenue Brooklyn, New York	$995,000	$425,000	$250,000
180 East 18th Street Brooklyn, New York	$995,000	$242,000	$160,000
985 Ocean Avenue Brooklyn, New York	$995,000	$410,000	$120,000
400 East 21st Street Brooklyn, New York	$995,000	$525,000	$240,000
2416 Newkirk Avenue Brooklyn, New York	$995,000	$430,000	$215,000
Totals	$4,975,000.00	$2,032,000.00	$985,000.00

Based on its review of the documents submitted by petitioner, the Division determined that the purchase prices cited in the sales contracts did not accurately reflect the true market value of each property. The Division then reallocated the purchase prices based upon a comparison of the rent rolls.[2] As a result the Division determined that the consideration for three properties exceeded $1,000,000.00. The consideration for 305 Ocean Avenue was determined to be $1,263,650.00; the consideration for 2416 Newkirk Avenue was determined to

[2]To calculate the fair market value of each property, the Division divided the rent roll for each property by total rent roll. The resulting percentages were applied to the total purchase price for all properties ($4,975,000.00) to determine the consideration for each property.

be $1,084,550.00; and the consideration for 400 East 21st Street was determined to be $1,213,900.00. The considerations for the transfers of 180 East 18th Street and 985 Ocean Avenue were determined to be less than $1,000,000.00. On March 18, 1988, the Division issued a schedule of adjustments to petitioner reflecting the reallocated purchase prices.

The Division issued a Tentative Assessment and Return for the transfer of 305 Ocean Avenue, dated August 1, 1988, asserting gains tax due of $58,876.00. No gains tax was asserted in connection with the transfer of 180 East 18th Street since the consideration for the transfer was determined by the Division to be less than $1,000,000.00.

As a result of continuing negotiations between petitioner and the transferee, only two of the original five properties were transferred. 305 Ocean Drive was transferred, and the price paid at the time of the closing

was $845,000.00. 180 East 18th Street was transferred and the price paid at the time of the closing of was $995,000.00.

With a cover letter dated July 12, 1988, petitioner submitted a revised transferor questionnaire for 305 Ocean Avenue, reporting consideration of $1,263,650.00 and a gains tax due on the transfer of $58,877.00. This amount was remitted to the Division at the time of the closing.

Petitioner submitted a claim for refund of the full amount of the gains tax paid on the transfer of 305 Ocean Avenue, claiming that the actual amount of the consideration for the transfer was $845,000.00.

By letter dated June 14, 1989, the Division agreed to grant petitioner a partial refund of the tax paid. Based on the $150,000.00 reduction in the purchase price of 305 Ocean Avenue, the Division reduced the reallocated consideration from $1,263,650.00 to $1,113,650.00 and agreed to a refund in the amount of $15,000.00 plus interest.

Petitioner challenged the Division's denial of the full amount of the refund claim. Following a conference in the Bureau of Conciliation and Mediation Services, the Division recalculated the gains tax due on the transfer of 305 Ocean Avenue as follows:

Total consideration received	$1,840,000.00
(305 Ocean Avenue and 180 East 18th Street)	
Combined rent rolls	410,000.00
Rent roll: 305 Ocean Avenue	250,000.00
Rent roll: 180 East 18th Street	160,000.00
Rent roll percentage allocated to 305 Ocean Avenue	60.9756
Consideration allocated to 305 Ocean Avenue	1,121,951.00
(60.9756% x $1,840,000.00)	
Original purchase price: 305 Ocean Avenue	674,881.00
Gain	447,070.00
Tax due on gain	44,707.00
Tax paid	58,876.90
Refund due	$14,169.90

The Division issued a Conciliation Order dated September 28, 1990, granting petitioner a refund of $14,169.90 plus interest. As petitioner was previously granted a refund of $15,000.00, the Division asserts that petitioner is not entitled to a further refund.

Petitioner buys, sells and manages real property and has done so since 1970. In the past 20 years, he has bought and sold in excess of 100 parcels. At the time the subject transfers occurred, petitioner owned in excess of 28 separate properties in Brooklyn, New York, the majority of them being multi-unit apartment buildings.

Petitioner purchased 305 Ocean Avenue in December 1985 for $455,000.00. The building is located across the street from Prospect Park in a neighborhood that petitioner described as dilapidated and ridden with drugs and crime. The building was built in 1917 and was not kept in good repair. As a result, it had numerous code violations and was the object of tenant strikes. In contrast, 180 East 18th Street was built in 1940 and upgraded through the years with new windows, pipes, boiler and trash compactor. Petitioner considers the neighborhood of 180 East 18th Street to be a stable residential area.

According to petitioner, the contract prices for the five original properties reflected the state of the New York real estate market in the mid-1980's and had no relationship to the rent rolls or the assessed value of the buildings. He testified that the $1,000,000.00 gains tax exemption entered into the sales negotiations as a factor which he used to <u>increase</u> the sales prices. Petitioner stated that in his estimation none of the buildings was worth the agreed upon

$995,000.00 contract price. However, he convinced the buyer that each property was worth more than $1,000,000.00 and that he was willing to sell for less in order to avoid paying the tax on gains. He described this sales pitch as a psychological ploy. With regard to the significance the gains tax played in negotiating the sales prices of the buildings, petitioner testified:

> "I arrived at a nine ninety-five number telling them that this would save me -- instead of going over a million dollars. I feel the piece is worth more than a million dollars. But you know what, I'll settle for nine ninety-five. I don't want to go into a Cuomo area. I got to pay tax. I'll take less for the building, but the building is really worth a million and a half." (Transcript at p. 85.)

As evidence that none of the buildings was worth $995,000.00, petitioner pointed to the fact that only one of the four buildings sold for that price: 180 East 18th Street. When the New York City real estate market dropped in the late 1980's, the potential buyer repudiated the sales contracts on three of the five properties which were part of the original transaction. The price for 305 Ocean Avenue was reduced to $845,000.00 when the potential buyer learned that it was the object of tenant strikes that reduced rent collections.

Petitioner testified that the price of each of the original five properties was separately negotiated based on different factors. He conceded that the original agreed upon price for 305 Ocean Avenue was determined by the rent rolls. As he stated:

> "305 Ocean Avenue was sold on a [sic] operational basis. That even though it was a crime-ridden area and the rent-roll is high, that based on the rent-roll and even plugging in expenses if you collected the rent, there would be a bottom line of ninety thousand, ninety-five thousand, and he capped the bottom line and that's how he came up to a number." (Transcript at 80.)

According to petitioner, the price for 180 East 18th Street was agreed upon based on its potential value as a cooperative apartment building and not on its existing rent rolls.

CONCLUSIONS OF LAW

A. Tax Law § 1441 imposes a 10% tax upon gains derived from the transfer of real property located within New York State. Tax Law § 1443(1) provides an exemption from gains tax if the consideration for the transfer is less than $1,000,000.00. It is this exemption which petitioner lays claim to.

It is obvious that in many circumstances a willing buyer and seller will have the power to structure an agreement so as to avoid the gains tax. Where a sale includes several properties with market values above and below one million dollars, the consideration for the more valuable properties can be reduced by the simple expedient of increasing the consideration for the less valuable property. It is this scenario, among others, which section 1448(1) of the Tax Law seeks to address. It states, as material here:

> "Where the tax commission finds that the transfer of any real property or an interest therein has been so formulated that the primary purpose of such formulation is the avoidance or evasion of the tax imposed by this article, rather than for an adequate business purpose, the tax commission shall treat such transfer as subject to the tax imposed by this article."[3] (Emphasis added.)

The apparent legislative purpose of this provision was to use broadly inclusive language to defeat tax avoidance schemes (cf., Matter of Von-Mar Realty Co., Tax Appeals Tribunal, December 19, 1991).

B. Here, the Division was presented with five identical sales contracts for the sale of five different properties by one transferor to one

transferee. The contract price for each property was identical, $995,000.00, and the prices appeared to have little relationship to either the assessed valuation of the properties or their respective rent rolls. For example, the assessed valuation of 2416 Newkirk Avenue was $188,000.00 greater than 180 East 18th Street's assessed valuation and its rent roll was higher (by $55,000.00), yet the contract price for each property was the same. In light of these facts, the Division's determination that the prices agreed to for the five properties were for the purpose of avoiding the real property gains tax and not for an adequate business purpose appears neither arbitrary nor irrational.

As noted, the $1,000,000.00 threshold creates an exemption from the gains tax for

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[3] Effective September 1, 1987, the former State Tax Commission was abolished; accordingly, when the term State Tax Commission is used in the Tax Law, it shall be deemed to refer to the Commissioner of Taxation and Finance, except where the term is used in a manner relating to the administrative hearing process (L 1987, ch 401, § 17).

properties with a consideration of less than $1,000,000.00. It is well-established that statutes creating exemptions from tax are to be strictly construed, and the burden is upon the taxpayer to demonstrate entitlement to the exemption by the standard of clear and convincing evidence (Matter of Blue Spruce Farms v. New York State Tax Commn., 99 AD2d 867, 472 NYS2d 744, affd 64 NY2d 682, 485 NYS2d 526).

Petitioner claims that the final purchase prices of 305 Ocean Avenue and 180 East 18th Street ($845,000.00 and $995,000.00, respectively) represent their true fair market value (i.e., the price at which a willing seller and a willing buyer agreed to trade). However, petitioner's testimony indicates that the prices for these properties were negotiated with an eye on the gains tax. According to his own testimony, petitioner induced the buyer to purchase these five properties, at a price of $995,000.00 each, by convincing the buyer that the sales prices were formulated so as to avoid the gains tax. He now reverses that proposition and claims that the gains tax was used merely as a sales ploy to raise the purchase price of the properties. As evidence that the consideration for each property was less than one million dollars, petitioner points to the reduction in the price of 305 Ocean Avenue and the cancellation of the sales of three of the properties. Even taking this change of events into account, the fact remains that avoidance of the gains tax was a factor in the negotiated agreements reached by petitioner and the transferee. To establish entitlement to the exemption on transfers of less than $1,000,000.00 petitioner was required to prove by clear and convincing evidence that the actual fair market value of each property was less than $1,000,000.00 and that the purchase prices were not part of a plan formulated to avoid payment of gains tax. Petitioner's testimony, although remarkably candid, was not sufficient to establish these vital facts.

C. Petitioner claims that the use of the rent rolls to reallocate the purchase prices of these properties is arbitrary and capricious, since, in his estimation, the rent rolls were not related to the agreed upon prices. The Division argues that it is authorized by section 1448(1) of the Tax Law to reallocate the consideration for the transfers as it did here. I can find no support in the statutory language for the Division's position.

Where the Commissioner of Taxation and Finance finds that a transfer of real property has been formulated in such a manner that the primary purpose of the formulation is to avoid the gains tax, he is directed by section 1448(1) "to treat such transfer as subject to the tax imposed by [article 31-B]". The language of this provision is clear and unambiguous; therefore, it would be improper to engage in a search for legislative intent (see, McKinney's Cons Laws of NY, Book 1, Statutes § 76). The statute does not authorize the Commissioner to redetermine the consideration, or reallocate the consideration for more than one property, to bring the consideration above the $1,000,000.00 exemption. Where the facts show that the taxpayer has formulated a plan to avoid gains tax, the transfer of real property becomes subject to the gains tax. The gain is calculated on the basis of the actual consideration; however, the taxpayer forfeits whatever exemption he might otherwise have claimed.

D. Applying the statute here subjects the gain on the transfer of 305 Ocean Avenue to the 10% real property transfer gains tax. The consideration for the transfer was $845,000.00. The Division is directed to recalculate the gain and the refund due petitioner accordingly.

E. The only issue presented to the Division of Tax Appeals was whether petitioner is entitled to a refund of gains tax paid on the transfer of 305 Ocean Avenue. The Division never assessed tax on the transfer of 180 East 18th Street; therefore, this determination does not consider whether that transfer might have been deemed subject to tax.

F. The petition of Leonard Spodek is granted to the extent indicated in Conclusion of Law "D", and in all other respects, the petition is denied.

DATED: Troy, New York

ADMINISTRATIVE LAW JUDGE