STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
BELHARA ASSOCIATES LIMITED PARTNERSHIP	:	DETERMINATION DTA NO. 809542
for Revision of a Determination or for Refund of Taxes on Gains Derived from Certain Real Property Transfers under Article 31-B of the Tax Law.	: :	

Petitioner, Belhara Associates Limited Partnership, c/o Raynes Equities, Inc., 645 Madison Avenue, 21st Floor, New York, New York 10022, filed a petition for revision of a determination or for refund of taxes on gains derived from certain real property transfers under Article 31-B of the Tax Law.

On May 24, 1993 and June 3, 1993, respectively, petitioner by its representative, James L. Tenzer, Esq., and the Division of Taxation by William F. Collins, Esq. (Andrew J. Zalewski, Esq., of counsel), executed a consent to to have the controversy determined on submission without hearing. The Division of Taxation submitted documents on July 6, 1993. Petitioner submitted documents and a brief on August 6, 1993. The Division of Taxation submitted a brief on September 2, 1993, and petitioner submitted a reply brief on September 27, 1993. After due consideration of the record, Jean Corigliano, Administrative Law Judge, renders the following determination.

ISSUES

I. Whether the Division of Taxation erroneously calculated the "original purchase price" of the property transferred by petitioner to the cooperative housing cooperation when it refused to "step-up" petitioner'sacquisition cost to the fair market value of the property on the date of transfer.

II. Whether a purchase money mortgage received by petitioner at the time of closing should have been excluded from the calculation of consideration on the ground that the sales

contract between petitioner and the cooperative housing corporation was executed before the effective date of article 31-B.

III. Whether the Division of Taxation's refusal to step up petitioner's original purchase price to fair market value and its inclusion of the purchase money mortgage in consideration violate petitioner's constitutional right to equal protection of the law.

IV. Whether petitioner should be allowed to include in original purchase price certain expenses it describes as "conversion period interest" and "conversion period real property taxes".

V. Whether the Division of Taxation properly computed the taxable gain on petitioner's transfer of cooperative units.

VI. Whether the Division of Taxation properly computed interest on the asserted deficiency.

VII. Whether petitioner demonstrated reasonable cause to abate penalties imposed under Tax Law § 1446.

FINDINGS OF FACT

The Division of Taxation ("Division") issued to petitioner, Belhara Associates Limited Partnership ("Belhara"), a Notice of Determination dated March 3, 1989, assessing real property gains tax for the period ended October 1, 1984 of $53,782.00 plus interest. No penalties were imposed on the tax due. The notice also assessed tax for the period ended February 8, 1986 of $4,681.00 plus penalty and interest.

Belhara was the sponsor of a plan to convert the premises located at 350 East 77th Street, New York, New York to cooperative ownership. On June 15, 1982, Belhara entered into an Agreement of Sale to acquire all of the partnership interests of 350 East 77th Street Associates, a general partnership. The principal asset of 350 East 77th Street Associates was the real property located at 350 East 77th Street. Paragraph 2 of the Agreement of Sale states: "Sellers hereby agree to sell to Buyer and Buyer hereby agrees to purchase from Sellers all of the Partnership Interests on the Closing Date for an aggregate purchase price of $3,048,000.00."

Also on June 15, 1982, Belhara entered into a contract for the sale of 350 East 77th Street to 350 East 77th Street Corporation, a cooperative housing corporation. The contract of sale contains the following provisions:

"3. (a) The consideration to be paid by Buyer to Seller is as follows:

"(i) an amount equal to the aggregate cash proceeds obtained by the Buyer through the sale of its shares under the Plan, less $50,000, the Working Capital Fund to be retained by the Seller (increased or decreased by closing adjustments) as set forth in paragraph 7;

"(ii) an amount equal to any money forfeited by defaulting subscribers under the Plan;

"(iii) an amount equal to the sum of $1,100,000, to be paid by Buyer executing and delivering to Seller a Purchase Money Note in the amount which shall be secured by the Purchase Money Mortgage as described in Section L of the Plan.

"(b) In addition to the net cash proceeds to be paid to Seller by Buyer pursuant to subparagraph (a), Buyer shall transfer to Seller the Following:

(i) the shares of the Buyer allocated to apartments under the Plan which have not been purchased or paid for as of the Closing Date under the Plan, which shares shall be duly issued to Seller or Seller's designee(s), and the proprietary leases appurtenant thereto;

(ii) by Buyer taking title subject to the wraparound mortgage to be in effect on the Closing Date as described in Section L of the Plan, in the amounts then outstanding on the closing Date."

In October 1982, 350 East 77th Street Corporation submitted a cooperative conversion plan to the office of the Attorney General. The original Cooperative Offering Plan (the "Plan") called for the sale of 84 units by transfer of 14,909 shares of stock. As amended the final Plan called for the sale of 86 units by the transfer of 15,334 shares of stock. The Plan was approved and declared effective as of January 11, 1984.

On or about March 15, 1984, Belhara transferred its partnership interests in 350 East 77th Street Associates to 350 East 77th Street Corporation. The purchase price paid to Belhara by the cooperative housing corporation, included the following:

"(a) the aggregate cash proceeds obtained by the Apartment Corporation in connection with the sale of its shares to individual purchasers as of March 15, 1984 pursuant to individual subscription agreements (5,701 shares sold for a total of $1,054,535) less the $287,500 working capital fund retained at the closing by the Apartment Corporation (the "Working Capital Fund"), and less additional offering

expenses incurred in connection with the sales and closing (including printing and advertising expenses, professional and legal fees, offering plan registration fees, broker's fees, gains tax and transfer tax expenses, marketing fees and title expenses), as provided for in the Contract of Exchange between Sponsor and Apartment Corporation dated as of June 15, 1982 and as amended by Supplemental Agreement dated as of March 15, 1984 (the "Contract") and

(b) the Unsold Shares (9,633 shares valued at $1,733,940) and their appurtenant proprietary leases; and

(c) the Apartment Corporation taking subject to a purchase money mortgage on the closing date with Sponsor in the principal amount of $1,100,000 ('the Mortgage')."

The Division submitted in evidence a set of transferor and transferee questionnaires filed by Belhara and 350 East 77th Street Corporation upon the transfer of the real property by Belhara to the cooperative housing corporation and a second transferor questionnaire filed by Belhara. The date of filing of these questionnaires is not known, but it is assumed that they were timely filed as there is no evidence in the record to the contrary. Belhara's transferor questionnaire included sales of cooperative units made under purchase agreements signed through January 29, 1984.

Attached to Belhara's transferor questionnaire were a number of schedules (denominated by Belhara as Exhibits A through I), showing the method used by Belhara to calculate the gain subject to tax, using the Option B method of filing to calculate tax due.[1] Gross consideration

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[1]Prior to approximately August of 1986, the Division had allowed two acceptable methods of calculating gains tax liability upon transfers of cooperative apartment units. These two methods, known as Option A and Option B, may summarily be described as follows:

<u>Option A</u>: Gain is computed based upon the actual consideration received on each unit transfer less the amount of total original purchase price apportioned to each such unit (including actual brokerage fees, advertising expenses, vacancy preparation costs and other selling expenses incurred). An update of the figures was required on four specific occasions (being respectively when 25%, 50%, 75% and 100% of the units had been transferred), or more frequently if requested by the Division.

<u>Option B</u>: Gain is computed based upon the total <u>anticipated</u> (i.e., actual plus estimated future) consideration as apportioned to each unit less the total (i.e., actual plus estimated future) original purchase price apportioned to each unit. This method essentially allowed an apportionment of anticipated gain to each unit. Updates were required at the same sellout plateaus (or more frequently upon Division request) as

as reported by Belhara consisted of (1) the total "anticipated cash portion of purchase price for shares" (Exhibit D) in the amount of $3,333,855.00 plus the amount of the purchase money mortgage, $1,100,000.00, yielding gross consideration of $4,433,855.00.

Belhara calculated the original purchase price of the property as follows:

PURCHASE PRICE PAID TO ACQUIRE REAL PROPERTY:	
Acquisition Price	$ 3,048,000
Mortgage Costs and Fees	17,143
Attorneys' Fees	36,046
Title Costs and Fees	15,000
Filing and Registration Fees	6,784
Appraisal, Etc. Fees	3,000
Real Property Transfer Tax	60,960
Mortgage Recording Tax	24,750
Total Purchase Price	$ ~~3,211,683~~

Belhara attached to the questionnaire a statement of brokerage fees "anticipated under the plan" amounting to $200,031.00. This was signed by Martin J. Raynes, the president of the brokerage firm acting as selling agent for the cooperative housing corporation. Mr. Raynes was also a general partner of Belhara.

Belhara calculated the total anticipated gain subject to tax as follows:

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for Option A.

Commencing in or about August of 1986, the Division eliminated Option A as an acceptable method of calculation. In addition, new filing procedures were established whereunder standards were set for estimating anticipated consideration under a cooperative conversion plan. These standards for estimation, when applied, would result in a so-called "safe harbor" estimate of anticipated consideration and treatment as though the transferor's estimate of consideration exactly equalled the actual consideration ultimately received. In ultimate effect, compliance with the "safe harbor" method would avoid imposition of penalty and interest on any underpayment of gains tax on unit transfers (to the extent such underpayment represented the excess of actual consideration over the safe harbor estimate of consideration). This August 1986 change resulted, in essence, in the only acceptable method of computation being a modified Option B computation including guidelines for computing the safe harbor amounts. Updating was optional at the 25% plateau, and was required at the 50%, 75% and 100% plateaus (see generally TSB-M-83-[2]-R, TSB-M-86-[2]-R and TSB-M-86-[3]-R).

Gross Consideration	$4,433,855.00	
Brokerage fees	(200,031.00)	
Total consideration		4,233,031.00
Purchase price to acquire	3,211,683.00	
Capital improvements	476,907.00	
Original purchase price		(3,688,590.00)
Gain subject to tax		$ 545,234.00

Exhibit A of Belhara's filing shows the transfer of 46 units through the end of January 1984 (prior to or shortly after the Plan was approved). Six of these units (the "grandfathered units") were transferred before March 28, 1983, the effective date of the gains tax law. Belhara apportioned the total consideration and purchase price to each of the 46 units based on a formula which it described as follows:

> "The method of apportionment utilizing a fixed common denominator is based upon fair market value (FMV).
>
> "FMV is based upon the actual sales prices of units for which purchase agreements have been executed and accepted and current prices for unsold units.
>
> "The . . . FMV factors for each individual unit [are] based upon a fraction the numerator of which is the FMV of such unit and the fixed common denominator of which is the aggregate FMV of all the units."

The calculation described above yielded what Belhara described as a "percentage of interest" for each unit. The total percentage of interest of all units sold as of the initial filing (excluding the grandfathered units) was .376861. The application of this figure yielded the following computation of gains tax due on units sold as of the end of January 1984:

Gross consideration to transferor		$ 1,670,947.00
Brokerage fees	(75,384.00)	
Consideration	1,595,563.00	
Original purchase price	(1,390,086.00)	
Gain subject to tax	205,477.00	
Anticipated tax due	20,548.00	

Belhara did not offer the basis for its estimate of the fair market value of each unit. However, it is noted that the Fifth Amendment to the Plan lists the units sold as of the Plan's effective date. The actual purchase prices of those units, 31 in all, correspond to the fair market value of the same units as shown in Exhibit H of Belhara's filing. On the other hand, the

purchase prices shown in the original Plan are consistently higher than the fair market values estimated by Belhara. For example, Unit number 6H is shown in the offering plan with a purchase price to rent controlled tenants of $38,200.00 and to nontenants of $87,860.00. The fair market value of 6H was estimated as $34,380.00. Unit 6H is not one of those sold as of the Fifth Amendment to the Plan.

The Division began an audit of the cooperative conversion in February 1987. The audit was completed in about September of 1988. Based on the records made available to it by Belhara's representatives, the Division calculated the original purchase price of the property as follows:

Cost to acquire real property		$3,048,000.00
Other acquisition costs:		
Legal fees	33,906.00	
End loan commitment	17,143.00	
sub-total		51,049.00
Capital improvements:		
Accounting fees	16,970.00	
Developer's fees	42,286.00	
Engineer	3,013.00	
Renovations (through 1986)	14,139.00	
sub-total		76,408.00
Conversion costs		
Legal fees	60,545.00	
Filing fees	6,790.00	
Printing	11,655.00	
sub-total		78,990.00
Original Purchase Price		$3,254,447.00

The Division determined that there were 86 units in the cooperative conversion plan and 15,344 shares of stock attributable to all units. The total anticipated consideration for all units was determined to be $4,088,700.00. The basis for this figure is not clear from the record. It was apparently based on a review of Belhara's own records; however, there are no documents in the record showing exactly which records were reviewed, although there is evidence that the auditor reviewed records provided by Belhara's representative. A worksheet submitted by the Division shows the sale of 47 units subject to gains tax through the period ended February 8,

1986 at a total purchase price of $1,498,775.00. The price for each unit corresponds to the fair market values and prices shown in Belhara's transferor questionnaire. The anticipated consideration for 7,165 unsold shares is shown as $2,589,992.00, but the basis for this figure is unknown. The six grandfathered units represented 955 shares of stock, or 6.4888 percent of the total shares. Consideration received on these units was determined to be $207,455.00; thus, the total anticipated consideration from the sale of cooperative units subject to gains tax was determined to be $3,881,245.00 (compared to petitioner's estimate of $3,333,855.00 based on the fair market values). The Division added to this $1,028,623.00, representing the purchase money mortgage received by Belhara, adjusted to reflect the amount of the mortgage apportioned to the grandfathered units. This yielded gross consideration of $4,909,868.00, an amount that was then reduced by $2,274.00 representing lost rents. Total gross consideration was thus determined to be $4,907,594.00.

The Division reduced the gross consideration by brokerage fees in the amount of $16,238.00 and a capital reserve fund of $268,845.00 (again, adjustments were made to account for the pre-gains tax units), resulting in net consideration of $4,622,511.00. The original purchase price of $3,254,447.00 (Finding of Fact "13 ") was adjusted to reflect the transfer of units not subject to gains tax, resulting in an original purchase price of $3,043,272.00. The original purchase price was subtracted from net consideration to calculate gain subject to the gains tax of $1,579,239.00 and anticipated tax of $157,924.00. The tax was divided by total number of shares subject to gains tax to calculate tax per share of $11.0136.

The total number of shares sold through the period ended October 1, 1984 was determined to be 6,749 (44% of the total shares), with a tax due on the transfers of $74,330.00 based on tax of $11.0136 per share. Tax paid by Belhara was subtracted from tax due to determine additional tax due for the period ended October 1, 1984 of $53,782.00. The Division determined that an additional 425 shares of stock were sold as of February 8, 1986, with a tax due on these transfers of $4,681.00 plus penalty and interest calculated from February 8, 1986. The Division issued to Belhara a Statement of Proposed Audit Adjustment dated August 19,

1988, showing this determination of tax due.

An audit summary prepared by the Division contains the following statement: "Taxpayer requested that the tax be paid in installments. See AU200 attached." A handwritten statement which appears in the same summary indicates that the Division calculated additional tax due on "Sales To investor" and amounts due under an installment method of payment. The Division issued to Belhara a Statement of Proposed Audit Adjustment showing that calculation. This statement shows total tax due on "Sales [of] Bulk Shares" of $78,912.00, based on the sale of 7,165 such shares with a tax due of $11.0136 per share. The same statement indicates that four payments totalling $62,192.00 were made on February 13, 1985, January 3, 1986, January 3, 1987 and January 1988. It further indicates that four installment payments remained owing, together totalling $16,720.00. There is no evidence in the record that an assessment was issued with respect to the installment payments shown as due on this statement. The transfer of these 7,165 shares is not a subject of this proceeding.

To summarize, the Division's audit resulted in the following adjustments and disallowances:

(1) Two updates were made to Belhara's original filing. The Division calculated gains tax due on units sold as of April 10, 1984. As a result, the Division determined tax due on the transfer of 45 units, while Belhara's filing calculated tax due on the transfer of 40 units. The Division calculated interest from October 1, 1984. The Division also determined tax due on the transfer of two additional units on February 8, 1986 and calculated interest from that date. It imposed penalties on the tax assessed on the sale of these two units. There is no evidence in the record that Belhara updated its original filing to report the transfer of these units.

(2) The Division determined that the anticipated cash consideration on the sale of all units was $4,088,700.00. Thus, Belhara's estimate of gross consideration from the sale of units, $3,333,855.00, was increased by $754,845.00.

(3) The Division reduced brokerage fees claimed by Belhara from $200,031.00 to $17,365.00.

(4) The Division disallowed the following acquisition costs as claimed by Belhara:

Title Insurance	$ 9,482.00
State real property transfer tax	3,353.00
City real property transfer tax	70,249.00
Mortgage recording tax	14,299.00
Title searches	322.00
Survey	79.00
Recording fees	200.00
Legal fees	11,302.00
Total	$109,286.00

(5) The Division disallowed three items included by Belhara in its computation of the cost of capital improvements: conversion period interest in the amount of $83,992.00, conversion period taxes in the amount of $9,865.00, and selling expenses in the amount of $5,198.00.

(6) With respect to conversion costs claimed by Belhara, the Division disallowed legal fees of $20,182.00 and a market survey of $3,226.00.

The Division issued a Conciliation Order dated February 8, 1991, reducing the total tax deficiency asserted to $56,839.37. The reduction was based on additional documentation provided by Belhara.

SUMMARY OF PETITIONER'S POSITION

In its brief, petitioner recalculated the gain from the transfer of real property and, pursuant to that recalculation, claims an overpayment of gains tax in the amount of $99,461.00. Petitioner's calculations begin with the assertion that the gross consideration for the conversion was $3,888,475.00, consisting of the following: (1) cash in the amount of $1,054,535.00 received at closing from the sale of 5,701 shares of stock; (2) the purchase money mortgage note of $1,100,000.00 issued to Belhara by the cooperative housing corporation; and (3) the fair market value of unsold shares of stock of $1,733,940.00 (9,633 shares valued at $180.00 per share).[2]

Net consideration as calculated by petitioner for purposes of calculating the gains tax is as

[2]These amounts are taken from the Closing Statement (see Finding of Fact "4").

follows:

6 "Grandfather units"	$ 207,455.00	
"Taxable units"	3,881,245.00	
Purchase money mortgage (exempt)	0.00	
Gross consideration	$4,088,700.00	
Less: Brokerage commissions		
Grandfathered units	$ 1,127.00	
Taxable units	17,365.00	(18,492.00)
Less: Reserve fund		(287,500.00)
Net Consideration		$3,782,708.00

Petitioner next calculates its original purchase price to acquire the real property. Its starting point for doing so is the original purchase price as determined by the Division, $3,254,447.00 (the amount paid by Belhara to acquire the partnership interests of 350 East Associates minus acquisition expenses, capital improvements and conversion costs). Petitioner adds to this amount $840,000.00, which is the difference between its own calculation of gross consideration pursuant to the closing statement ($3,888,475.00) and the amount it paid to acquire its interest in the real property ($3,048,000.00). In essence, petitioner "stepped up" its acquisition costs to the fair market value of the property on the date it was transferred to the cooperative housing corporation.[3] Petitioner then adds to the stepped up original purchase price amounts which purportedly represent interest paid during the conversion period of $83,992.00, real property taxes paid during the conversion period of $9,865.00 and legal fees of $31,484.00. Total original purchase price as calculated by petitioner is $4,220,263.00.

Finally, petitioner subtracts net consideration from original purchase price to calculate a loss of $131,563.00, and no gains tax due.

Petitioner alleges in its brief that it is entitled to a refund of $99,461.00 based upon the

[3] N.B. By stepping-up the acquisition cost to fair market value of $3,888,475.00, petitioner includes the face value of the purchase money mortgage it received in its own original purchase price.

contention that no gains tax is due on the transfer and that Belhara paid gains tax of $99,461.00. It arrives at this amount by adding the amount paid with its original filing, $20,548.00, to amounts it alleges it paid under the installment method of payment, $78,912.00 as shown on the Statement of Proposed Audit Adjustment (see Finding of Fact "16").

CONCLUSIONS OF LAW

A. Petitioner's first argument is that the Division incorrectly calculated petitioner's original purchase price for 350 East 77th Street. Petitioner's position is that its original purchase price for the real property should be stepped up to the fair market value of the property on the date of transfer from itself, the realty transferor, to 350 77th Street East Corporation, the cooperative housing corporation. Petitioner bases its argument, in part, on the fact that the contract of sale between itself and 350 East 77th Street Corporation, the cooperative housing corporation, was executed on June 15, 1982, before the gains tax law became effective (although the actual transfer did not occur until after that effective date). In support of this position, petitioner argues that it is the Division's "practice" to allow such a step-up in what petitioner deems to be analogous situations.

Petitioner submitted eight hypothetical situations to the Division and asked a question with regard to each.[4] A description of one such hypothetical and the Division's response will serve to explain petitioner's position here. In that hypothetical, certain individuals purchase a property for $100.00 and immediately transfer their individual interests to a partnership. The partnership transfers the property to a corporation in exchange for stock. The transfer occurs before the effective date of the gains tax law, and the fair market value of the stock at that time is $10,000,000.00. After the effective date of the gains tax law, the partnership sells the stock to a third party for $10,000,000.00. According to the Division, the original purchase price of the real property is $10,000,000.00. Petitioner claims that the transfer of its partnership interest

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[4]The parties stipulated that the eight hypotheticals are interrogatories that were submitted to the Division in another proceeding. The Division's responses to the interrogatories were also provided in that proceeding. The Division made no objection to having the interrogatories and the Division's responses to them received in evidence in this proceeding.

in the real property located at 350 East 77th Street to the cooperative housing corporation is analogous to the hypothetical partnership's transfer of property to the corporation in exchange for stock, where the original purchase price of the property in the hypothetical is equal to the fair market value of the stock at the time of the transfer.

Petitioner's position is rejected. Petitioner's step-up argument requires that the cooperative conversion plan be viewed as two separate transactions: a transfer of real property by petitioner to the cooperative

housing corporation in exchange for stock and the transfer of shares of stock to the individual unit purchasers. This is the case in the hypothetical situation advanced by petitioner as being like its own. However, as the Division accurately notes in its brief, the New York State Court of Appeals and the Tax Appeals Tribunal have consistently recognized the unique nature of the transfer of real property by conversion of that property to cooperative ownership and have held that the tax is imposed on cooperative conversions as a single transaction, effectively ignoring the transfer from the sponsor to the cooperative housing corporation (see, Matter of Mayblum v. Chu, 67 NY2d 1008, 503 NYS2d 316; Matter of 1230 Park Assoc. v. Commr. of Taxation and Fin., 170 AD2d 842, 566 NYS2d 957, lv denied 78 NY2d 859, 575 NYS2d 455; Matter of 61 East 86th Street Equities Group, Tax Appeals Tribunal, January 21, 1993).

An argument like petitioner's was considered and rejected by the Tax Appeals Tribunal in Matter of Normandy Associates (Tax Appeals Tribunal, March 23, 1989).

> "[T]he gains tax . . . treats the transfer of shares by the realty transferor to unit purchasers as the taxable event. . . . [T]he gain on these transfers is measured by the difference between the consideration for the shares and the realty transferor's original purchase price in the real property prior to its transfer to the cooperative housing corporation. This scheme in effect ignores the realty transferor's transfer to the cooperative housing corporation and instead treats the realty transferor as if it were directly transferring its interest in the real property to the unit purchasers. Under this scheme the gains tax is imposed on the entire cooperative conversion plan, encompassing the real property prior to its transfer to the cooperative housing corporation and the sale of shares by the realty transferor subsequent to the property's conversion to cooperative ownership. The transfer to the cooperative corporation is then treated merely as a conduit which allows the transformation of the real property into shares allocated to units." (Emphasis added.)

In Matter of Birchwood Associates (Tax Appeals Tribunal, July 27, 1989) the Tribunal explicitly rejected the realty transferor's argument for a step-up from the original purchase price of the property to its fair market value on the date of transfer to the cooperative housing corporation. In sum, petitioner's argument for a step-up in its original purchase price of the real property is contrary to the existing case law.

B. Petitioner next argues that the mortgage note it received under the terms of the contract executed on June 15, 1982 is "grandfathered consideration" exempt from gains tax. It argues that the mortgage received from the cooperative housing corporation should be excluded from consideration on the basis that the mortgage was paid pursuant to a contract entered into before the effective date of the gains tax law.

Consideration, as defined in Tax Law § 1440(a), means "any price paid or required to be paid . . . whether paid by money, property or any other thing of value and including the amount of any mortgage". Therefore, the Division properly included the mortgage in its computation of consideration. In fact, in its original filing, petitioner also included the mortgage in its computation of consideration. The Division apportioned the consideration to the total shares of cooperative stock (see, 20 NYCRR 590.36); consequently, the portion of the mortgage apportioned to the grandfathered shares was not included in the computation of gain.

The Division's method of apportioning the amount of the mortgage to shares of stock sold before and after the effective date of the gains tax was explicitly endorsed in Matter of Birchwood (supra), where the Tribunal rejected the petitioner's claim that a mortgage given by the cooperative housing unit to petitioner prior to the effective date of the gains tax should be allocated entirely to the pre-gains tax period. As the Division notes, the decision in Birchwood dictates that petitioner's argument be rejected. Nonetheless, petitioner's argument for apportioning the entire face value of the mortgage to the pre-gains tax period will be addressed here.

Petitioner argues that there is no legitimate difference between a bargain lease, a lease in which the rental value to the lessor is less than the fair market value of the leased property, and

a mortgage, since "[a] 'bargain lease' is every bit as much an encumbrance on the property as is a mortgage." (Petitioner's Brief, p. 18). Petitioner states that the Division deems the consideration for a bargain lease to be received in its entirety at the time of the conveyance of the lease, a statement which will be assumed to be true for the purposes of this discussion. Even assuming these facts, however, petitioner does not make a persuasive argument for treating a mortgage and a bargain lease in an identical fashion. There is no question that a bargain lease given by a cooperative corporation to a sponsor at the time of the transfer of real property to the corporation is deemed to be a part of the consideration received by the sponsor (see, Matter of Cheltoncort v. Tax Appeals Tribunal, 185 AD2d 49, 592 NYS2d 121). In a bargain lease, the cooperative housing corporation is the lessor or grantor of the lease, while the sponsor is the lessee. The lease payments from the sponsor to the cooperative housing corporation will be made over the term of the lease. The consideration received by the sponsor (the realty transferor for purposes of the gains tax) is the difference between the fair market value of the lease and the rent charged to the sponsor. This consideration, the benefit of a favorable lease, is received by the sponsor at the time the lease is executed. In contrast, a mortgage involves a payment by the cooperative housing corporation to the sponsor. It is not unreasonable for the Division to apportion the mortgage to the shares of stock in the same way that it apportions other payments to the sponsor. Thus, there is a rational basis for treating a mortgage different from a bargain lease.

Petitioner has not offered any independent rationale for treating the mortgage as consideration received in its entirety before the effective date of the gains tax. Accordingly, the Division's apportionment of the mortgage is sustained.

C. Petitioner claims that the denial of the step-up in purchase price and the apportionment of the mortgage violates petitioner's right to equal protection of the law. In its brief, petitioner states:

> "Respondent's position with respect to the non-taxability of realty transfers to such corporations provide no rational justification for different rules relating to the computation of 'original purchase price' or 'consideration.' There is nothing in Mayblum v. Chu . . . or 1230 Park Associates . . . which compel or authorize the

> Respondent to deny the 'step-up' and 'grandfather' rules in non-taxable transfers involving a corporation that qualified to sell its stock to tenant-shareholders, while applying those rules in all other non-taxable transfers." (Petitioner's Brief, p. 19).

Apparently, petitioner is arguing that treating transfers pursuant to a cooperative conversion plan differently from transfers pursuant to other kinds of plans for the transfer of subdivided realty violates the equal protection clauses of the United States and New York State constitutions. This argument was made and rejected by the New York State Court of Appeals in Matter of Trump v. Chu (65 NY2d 20, 489 NYS2d 455, appeal dismissed 475 US 915). Moreover, petitioner has not established that treating a bargain lease different from a mortgage is palpably arbitrary or amounts to invidious discrimination (id.).

D. Petitioner contends that the Division erred by failing to include interest charges in the amount of $83,992.00 and taxes in the amount of $9,865.00 in the calculation of original purchase price.

Former Tax Law § 1440 defines original purchase price in pertinent part, as follows:

> "the consideration (i) paid by the transferor to acquire the interest in the real property or (ii) in the case of property acquired through gift or inheritance, the consideration paid by the last transferor who paid consideration to acquire the interest in the real property; plus in both cases the consideration by the transferor for any capital improvements made to such real property (including in the case of clause [ii] above, those by the last transferor who paid consideration) prior to the date of transfer" (Tax Law former § 1440[5]).

The above subdivision was repealed by the Laws of 1984 (ch 900, § 3, eff September 4, 1984) and was substituted with the following definition of original purchase price, in pertinent part, as:

> "(a) '[o]riginal 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" (Tax Law § 1440[5][a]).

In Matter of V&V Properties (Tax Appeals Tribunal, July 16, 1992), the Tribunal held that the amended statute was not merely a clarification of the former subdivision, but a substantive change in the law. As a consequence, it held that the inclusion of condominium conversion costs in the calculation of original purchase price is applicable only to conversions taking place after the effective date of the amendment. Moreover, original purchase price does not include all monies expended in the process of converting real property to cooperative ownership (see, Matter of 1230 Park Assocs. v. Commissioner of Taxation, 170 AD2d 842, 566 NYS2d 957, lv denied 78 NY2d 859, 575 NYS2d 455; Matter of Maltone v. Department of Taxation & Fin., 144 AD2d 150, 534 NYS2d 478). Petitioner has not explained what it means by "conversion period interest". The $83,992.00 amount was included in petitioner's calculation of the cost of capital improvements, as were "conversion period taxes" in the amount of $9,865.00. These amounts were disallowed by the Division on audit. However, the record is bereft of any evidence relating to these claimed expense. Inasmuch as petitioner failed to explain and document the expenses it claims should be included in original purchase price, the Division's calculations are sustained.

E. Petitioner states that the Division's method of calculating the gain on the overall conversion is incorrect. According to petitioner, it correctly calculated the gains tax based on the Option B method of filing, while the Division used a "hybrid" method of calculating the gain and the tax due.

On audit, the Division appears to have used the Option B method, calculating the gain based on the total anticipated consideration as apportioned to each unit less the amount of the total original purchase price apportioned to each unit. The tax was assessed based on the actual number of units sold as of October 1, 1984 and February 8, 1986.

Petitioner claims that the Division's method of calculating the gain "results in a gross distortion of the 'gain' on Taxable Units" (Petitioner's Reply Brief, p. 16). It has failed to explain this statement. Moreover, petitioner has not established that the Division's calculation of gain was erroneous or that its methodology for apportioning the gain to each unit sold is

incorrect.

F. Petitioner argues that the Division incorrectly computed interest on the asserted deficiency of tax. Petitioner states: "the additional Gains Tax, if any, is attributable solely to the units sold after the seventy-five percent (75%) project sellout" (Petitioner's Brief, p. 26). Based on this erroneous statement, petitioner argues that the Division incorrectly computed interest on units not required to be reported until the time of the 75% update filing. The Division assessed gains tax based on the actual number of shares sold through the period ended October 1, 1984 and calculated interest from that date. The number of shares sold at that point was less than 50% of the total number of shares in the offering plan. It then assessed tax due on the sale of shares attributable to two additional units sold on February 8, 1986 and calculated interest from that date. There is no support in the record for petitioner's claim that the assessment of tax on units transferred before October 1, 1984 includes units which petitioner was not required to report until the 75% update filing. Moreover, there is no evidence in the record that petitioner filed any documents at the 75% sellout stage.

G. Tax Law § 1446(2)(a) provides for the imposition of a penalty when any person fails to file a tentative assessment and return or to pay any tax within the period required under article 31-B. The penalty so imposed may be abated if it is determined that the failure was due to reasonable cause and not due to willful neglect (Tax Law § 1446[2][a]).

Petitioner states that the evidence in this proceeding establishes reasonable cause. It makes the following allegations: (1) that it voluntarily, properly and timely notified the Division of anticipated unit transfers; (2) that it acted in good faith based on a reasonable interpretation of the gains tax law; and (3) that it cooperated with the Division throughout the audit.

Most of petitioner's arguments with regard to reasonable cause are irrelevant and will not be summarized here. The Division did not impose penalty on the tax assessed for the period ended October 1, 1984, apparently agreeing with petitioner that the transferor questionnaire was timely filed and that petitioner made a reasonable attempt to ascertain its gains tax liability. Penalty was assessed on the tax assessed for the period ended February 8, 1986. Since there is

no evidence in the record that petitioner reported the sale of these units to the Division, I assume that the penalty was imposed for failure to timely file a required form. Petitioner has not established that it had reasonable cause for doing so. All of its arguments are related to the positions taken at hearing and have no connection to positions taken in the original filing.

H. The petition of Belhara Associates Limited Partnership, Inc. is denied and the Notice of Determination dated March 3, 1989, as modified by the Conciliation Order, is sustained.

DATED: Troy, New York
March 10, 1994

/s/ Jean Corigliano
ADMINISTRATIVE LAW JUDGE