STATE OF NEW YORK

DIVISION OF TAX APPEALS

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| In the Matter of the Petition | : | |
| of | : | |
| FORT TRYON APARTMENTS | : | DETERMINATION<br>DTA NO. 810198 |
| 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, Fort Tryon Apartments, 4611 12th Avenue, Brooklyn, New York 11219, 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 Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on August 31, 1993 at 1:15 P.M., with all briefs and documents to be submitted by January 15, 1994, which commenced the six-month period for issuing this determination. Petitioner filed its brief on November 26, 1993. The Division of Taxation filed a letter brief on December 29, 1993. Petitioner appeared by N. C. Caller, P.C. (Carl Caller, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Michael J. Glannon, Esq., of counsel).

ISSUES

I. Whether the economic gain attributed to a lease, from a cooperative housing corporation to a sponsor, of the garage area, is consideration for the transfer of certain real property subject to real property transfer gains tax.

II. Whether the Division properly determined the value of the lease.

FINDINGS OF FACT

Petitioner, Fort Tryon Apartments ("Fort Tryon"), was a New York general partnership having its office in Brooklyn, New York. It was the sponsor of a plan to convert an apartment building located at 245-303 Bennett Avenue a/k/a 4489-4521 Broadway, New York, New York

to cooperative ownership.

The Cooperative Offering Plan stated that it was a non-eviction plan and that a non-purchasing tenant would not be evicted by reason of the conversion to cooperative ownership. The Introduction of the Cooperative Offering Plan explained that "[a]t Closing, the Apartment Corporation will acquire fee title to the land, the building and other improvements thereon." It also explained that the purchaser of a cooperative apartment buys shares of the apartment corporation which owns the building in which the apartment is located. The owner of shares is entitled to a proprietary lease and has the right to vote annually for the board of directors who are responsible for the affairs of the apartment corporation and supervision of the operation of the building. A lessee is directed to pay a proportionate share of the apartment corporation's cash requirements for the operation and maintenance of the building and creation of a reserve for contingencies. There were a total of 114,032 shares being offered which were allocated to 350 apartments in the building.

The Cooperative Offering Plan contained a section entitled "The Commercial Lease" which provided, in part, for the rental of the garage space in the apartment building as follows:

> "On or prior to the Closing Date, the Apartment Corporation, as Landlord, will enter into a lease (the 'Commercial Lease') with the Sponsor, or an entity designated by the Sponsor, as tenant (the 'Tenant'), for the garage space. The Commercial Lease will provide for an initial annual rent of $30,000 payable in equal monthly installments of $2,500 and will permit the garage area to be used for any lawful purpose.
>
> "The term of the Commercial Lease will commence on the Closing Date and will expire on the day prior to the forty-seventh anniversary of the Closing Date."

The Cooperative Offering Plan explained that the subtenants occupying the garage area would pay rent for the garage area directly to the tenant. Further, the annual rental which the tenant pays the landlord, which was initially set at $30,000.00 per year, was to increase every fifth year "in the same proportion as the maintenance payable by shareholders to the Apartment Corporation increases over the immediately prior period." The Cooperative Offering Plan then explained that, in all events, the annual rental which was to be paid by the tenant would not exceed 70% of the rental income which was paid by the subtenants to the tenant. According to

the Cooperative Offering Plan, the current rental income from the garage was approximately $90,000.00 per year.

The last paragraph of The Commercial Lease section of the Cooperative Offering Plan stated the following:

> "Section 608 of the federal Condominium and Cooperative Abuse Relief of 1980 (15 U.S.C. §3607) provides that certain contracts between a cooperative and a sponsor or an affiliate of a sponsor may be terminated without penalty by the vote of the owners of not less than two-thirds of all of the units in the cooperative other than units owned by the sponsor or by an affiliate of the sponsor. Such vote must occur only during the two-year period beginning on the date on which (i) the sponsor (or its successor) ceases to be in 'special developer control' of the cooperative or (ii) the sponsor (or its successor) owns 25 percent or less of the units in the project, whichever occurs first. The Department of Law has advised the Sponsor that the provisions of the Act, particularly Section 608 (15 U.S.C. §3607), MAY POSSIBLY APPLY TO THE COMMERCIAL LEASE discussed above. Sponsor disagrees strongly with this position, and in no way concedes the applicability of Section 608 to this lease, or to the management agreement discussed further in this Plan, by providing this disclosure. Sponsor further points out that the price for shares offered to initial tenant-purchasers and other offerees are premised on the continuing existence of the commercial lease and management agreement contemplated between the Apartment Corporation and the Sponsor. Without such lease or agreement, the prices for shares would be higher than set forth in this Plan."

Petitioner filed a Transferor Questionnaire which stated that 114,032 shares were being offered. The shares were allocated as follows: 20,856 shares were subscribed for at a price of $3,106,100.00; 82,981 shares were allocated to occupied unsold apartments and were valued at $100.00 per share; and 10,195 shares were allocated to vacant apartments and were valued at $200.00 per share. In addition, the cooperative corporation would have an indebtedness of approximately $5,455,000.00. The foregoing amounts were reduced by the amount to be contributed to the reserve fund of $342,096.00 and the amount to be contributed to the working capital fund of $15,000.00, resulting in an anticipated gross consideration of $18,541,104.00. Petitioner did not treat the commercial lease as part of the consideration for the transfer.

The closing took place on December 8, 1986. The Closing Statement describes the transaction, in part, as follows:

> "In connection with the conversion to cooperative ownership of the premises located at 243-303 Bennett Avenue a/k/a 4489-4521 Broadway, New York, New York (the 'Premises'), Transferor conveyed fee title to the Premises to Transferee by bargain and sale deed with covenant against grantor's acts dated December 8,

1986."

Fort Tryon Apartments Corp., as landlord, and petitioner, as tenant, executed a document entitled "Commercial Lease" dated December 8, 1986 which leased the garage space in the building 245-303 Bennett Avenue a/k/a 4489-4521 Broadway, New York, New York. The lease term was set as "one day less than forty-seven (47) years, commencing on the date hereof and ending on December 1, 2033, unless sooner terminated as hereinafter provided." The lease does not contain a provision for its termination by the tenant-shareholder in less than 47 years.

On the basis of a field audit, the Division of Taxation ("Division") issued a Notice of Determination, dated May 14, 1990, to petitioner, Fort Tryon Apartments. The notice assessed real property gains tax due of $74,988.43, plus interest of $22,451.14 and penalty of $26,245.95, for a current balance due of $123,685.52. After the Notice of Determination was issued, the matter proceeded to a conciliation conference. In a Conciliation Order dated August 30, 1991, the amount of tax asserted due was reduced to $52,468.00, plus penalty and interest. To the extent at issue herein, the asserted deficiency of tax is based on the Division's position that the economic gain attributable to the lease of the garage space of a building is additional consideration for the transfer of real property subject to the real property transfer gains tax. In order to determine the amount of the consideration, the Division estimated, on the basis of the rent roll for the garage area, that the income from the garage was $100,000.00 per year. Since petitioner pays $30,000.00 per year to the cooperative corporation for maintenance charges, the consideration for the garage area was based on the net income of $70,000.00 for the first year of the lease. The Division's calculation of the present value of the lease then proceeded as if the income from the lease increased at a rate of 10% per year for each of the remaining years of the lease.[1] The Division's calculation resulted in the determination that the

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[1]A notation at the top of the page in the Division's exhibit showing payments and present value of the lease states that there were yearly increases of 5%. After the hearing, it was explained that this was a misstatement.

present value of the lease was $2,990,909.09.

At the hearing, petitioner raised a number of arguments. Initially, petitioner asserted that when it transferred the building to the cooperative corporation, it retained the right to collect the rent from the parking garage. According to petitioner, reservation of the interest did not constitute additional consideration since it is merely the reservation of an item which was not transferred to the cooperative corporation.

Petitioner also raised a number of arguments with respect to the way the lease was valued. Initially, petitioner pointed out that the Division's schedule of present value was erroneous on its face since it called for increases of 5% each year and the auditor calculated an increase of 10% each year. Secondly, petitioner submitted that the projection of 5% increases over 47 years was unrealistic since this lease is governed by rent stabilization which increases only in accordance with the rent guidelines. Petitioner also contended that the assumption that it collected rents of $100,000.00 per year was erroneous. According to petitioner, there was a substantial amount of uncollected rent because there were some people who did not pay and then left the apartment. Lastly, petitioner maintained that the Division's computation is erroneous because the auditor did not factor in the contingency that the lease could be cancelled.

Petitioner submitted a series of documents in support of its position. One document was a schedule of garage rents collected from December 1986 through May 1993. This document shows the amount collected less the sales tax which was included in the total amount collected.

Petitioner offered a schedule which had columns for year of the lease (numbered 1 through 47), collections, lease payment, net (collections minus lease payment) and present value. The amounts listed under collections correspond to the actual amounts of rent collected, less sales tax, during the first six years of the lease. Thereafter, petitioner estimated an increase in collection of 3% in each year of the lease. Petitioner used 3% for increases because the garage is occupied by tenants who are subject to rent control laws and the increases over the past few years have not exceeded 3%. Lease payments started out at $30,000.00 and increased

in steps at the rate of 8% once every five years.[2] The rate of 8% was used because it corresponded with the actual increase in lease payments which occurred at the end of the first five years. The lease payments were computed in five-year increments because the lease provided that every five years the cooperative corporation may increase the rent.

After the hearing, petitioner submitted three documents in support of its position. One document was an affidavit which stated, in part, that on February 1, 1993 a majority of the shareholders of the Fort Tryon Apartments Corp. voted to terminate the garage lease held by the sponsor.

Petitioner also offered an appraisal of the Commercial Lease, dated September 24, 1993, from a licensed New York State real estate broker who is engaged in buying, selling and managing income properties in New York City. The appraisal noted that the lease called for annual rentals of $30,000.00 in equal monthly installments of $2,500.00. It was the appraiser's understanding that the lessor would increase the rent every fifth year in the same proportion as the maintenance payable by shareholders to the apartment corporation increased over the immediately prior period.

The appraiser also noted that the lessor is entitled to the rents from the users of the garage spaces.

The appraiser pointed out that petitioner's representative, Mr. Caller, provided him with a projection of future collections from the users of the garage spaces and the rental payments to be made by the lessee to the lessor. Mr. Caller also provided the appraiser with the present value of the collections. Finally, the appraiser stated that he was informed that the lease is subject to cancellation by the lessor when the tenant-shareholders take control of the board of directors, and that this will occur five years after the inception of the lease.

On the basis of the foregoing, the appraiser presented the following analysis:

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[2]At the hearing, petitioner stated that the lease payments increased by 7.4% every five years (tr., p. 37). It is assumed that this was an inadvertent misstatement.

"CONCLUSION

"Based upon the projections presented, and considering the cancellation contingency, I have determined the value of the [l]ease to be $327,375.73.

"This analysis is based on the following:

"The value of the [l]ease for the first 5 years is: $198,778.95. The projected value for the remaining period has been projected based on estimates of the collections and lease payments over the remaining term. This projected sum is approximately $491,063.60. Based on my analysis of the lease terms, I concluded that the Lessor had every reason to cancel the lease since the Lessor would derive a much greater income by cancelling the [l]ease than by continuing the lease. Accordingly, I discounted the remaining projected value by 2/3rds. In consideration of the cancellation contingency, the projected value has been discounted to be 2/3rds of this amount, which is approximately $327,375.73."

The last document offered by petitioner was a memorandum of law which stated that the rent stabilization law applies to garage spaces.

SUMMARY OF THE PARTIES' POSITIONS

Petitioner submitted a brief which argued that the Division's valuation of the lease was unwarranted, that the appraiser's valuation of $327,375.73 is more credible, and that the Division failed to consider the rent stabilization laws as they apply to leases.

In response, the Division submitted a letter brief which argued that Matter of Cheltoncort Co. v. Tax Appeals Tribunal (185 AD2d 49, 592 NYS2d 121) supports the Division's position that the economic gain from the lease was subject to tax and that the audit methodology was appropriate.

CONCLUSIONS OF LAW

A. At hearing, petitioner initially argued that the garage space was not sold but was retained by the sponsor, and therefore, it was not part of the consideration for the transfer.

B. The foregoing argument is not supported by the record. The Cooperative Offering Plan contemplates that "the Apartment Corporation will acquire fee title to the land, the building and other improvements thereon." The Closing Statement states that the transferor, that is petitioner, "conveyed fee title to the Premises to Transferee." It is clear from the foregoing that petitioner transferred its entire interest in the building to the cooperative housing corporation and then took back a lease in the garage space under apparently favorable terms.

Although the two transactions were closely juxtaposed in time, they were discrete transactions and the lease was not reserved (see, Matter of Cheltoncort Co., Tax Appeals Tribunal, December 5, 1991, confirmed 185 AD2d 49, 592 NYS2d 121). It is noted that if the garage space were reserved, there would have been no reason for petitioner to enter into a commercial lease for the rental of the same property.

C. The next question presented is the valuation of the lease. Before the specific points raised by petitioner are addressed, it would be useful to consider certain principles.

In Matter of Cheltoncort Co. (supra), the Tax Appeals Tribunal considered, among other things, the Division's calculation of the value of a lease which, like here, was given by a cooperative corporation to the sponsor of the cooperative conversion. The lease was for seven stores which were located on the ground floor of the building.

The Division determined that the difference between the rent received and the rent paid under the master lease constituted additional consideration. The petitioner argued that this was irrational because it failed to consider that, after the lease was entered into, certain stores were vacant. The Tribunal disagreed with petitioner's argument and explained its position as follows:

> "In determining the value of the lease in question, the Division essentially took the difference between the rent required to be paid to the cooperative housing corporation under the lease and the rent to be received from the sub-tenants of the seven stores as they were in existence at the time that the gains tax assessment was submitted for review, projected those rents for the full term of 49 years and reduced that sum to its present value. We conclude that the Division properly valued the lease based on the facts as they existed at the time that petitioner transferred its building to the cooperative housing corporation. The gains tax is imposed on the transfer of real property (Tax Law § 1441). In calculating the amount of tax due upon a taxable transaction, the value of the consideration has to be determined at the time of the transfer in order to finally fix the tax owed. Subsequent events do not alter the value that the consideration had at the time of the transfer. Thus, the fact that petitioner now claims that there are vacancies is irrelevant to the valuation of the consideration at the time of the transfer. Therefore, we conclude that the Division properly valued the amount of the lease."

On the Article 78 proceeding which followed, the court agreed with the Tribunal's approach and stated:

> "We are similarly unpersuaded by petitioners' claim that the method used by the Division to determine their tax was flawed because it did not consider the expenses of operation or the prospect of vacancy. As the Tribunal noted, 'the value of the consideration has to be determined at the time of the transfer in order to finally fix

> the tax owed. Subsequent events do not alter the value that the consideration had at the time of the transfer' (see, 20 NYCRR 590.26)." (Matter of Cheltoncort Co. v. Tax Appeals Tribunal, supra, 592 NYS2d at 123).

Using the language of Matter of Cheltoncort Co. as guidance, the specific objections raised by petitioner may be reviewed.

D. Petitioner objects to the Division's projected value because it failed to consider the fact that the lease could be cancelled by the cooperative corporation after five years. This argument is buttressed by an affidavit which shows that, in fact, the lease was cancelled after five years.

E. The foregoing argument lacks merit. The value of the consideration is determined at the time of the transfer. The Cooperative Offering Plan notes that the Department of Law took the position that the owners of the apartments might be able to cancel the lease under certain circumstances. However, petitioner strongly disagreed with this position, stating in the offering plan it "in no way concedes" its applicability to the lease at issue (see, Finding of Fact "5"). Accordingly, at the time of the transfer, the parties did not contemplate the lease terminating before 47 years and the Division properly declined to consider this factor in its computation.

F. Petitioner argues that the Division should not have relied on the rent rolls and that it failed to consider the fact that not all tenants of the parking spaces paid their rent as required. This argument is analogous to the argument, which was rejected in Cheltoncort, that the Division should have considered the fact that certain stores were vacant. Again, as noted in Cheltoncort, the value of the lease is determined at the time of the transfer. At the time of the transfer, the parking tenants had not defaulted on their payments. Hence, the failure of certain tenants to pay may not be considered here. Similarly, the schedule of rents collected, showing collections after the transfer has no value.

G. Petitioner objects to the Division's compounding of the revenues at a rate of 10% per annum. Petitioner submits that compounding at a rate of 3% is more accurate because the parking spaces were subject to rent control and because increases over the last few years have not exceeded 3%.

In response, the Division states only that its methodology for determining gain was endorsed by the court in Cheltoncort.

H. An examination of the Cheltoncort case shows that while the general methodology followed by the Division is the same as that presented here, no issue was raised or discussed in that case regarding the rate of compounding. Thus, no explanation has been presented by the Division as to why compounding income at a rate of 10% is warranted.

I. The Division has not disputed petitioner's assertion that the parking spaces were subject to rent control. Since such services may be regulated (see, 9 NYCRR 2520.6[r][3]; Matter of Sterling Ridge Realty Co. v. New York State Div. of Housing & Community Renewal, 185 AD2d 354, 586 NYS2d 312), said claim is accepted. However, this factor only establishes an outer limit on the rate at which revenues could increase. It does not establish what the appropriate rate of compounding revenues should be.

J. The methodology followed by petitioner appears to be different from that presented in Cheltoncort insofar as there is a separate analysis of revenues and expenses. However, petitioner's approach is acceptable because it is just a different way of calculating the same item. Although the premise offered by petitioner for the appropriate rates of compounding may be questioned, it is the only rationale in the record. The rates of compounding of revenues and expenses proposed by petitioner is accepted. Accordingly, the Division is directed to recalculate the value of the lease by compounding revenues at a rate of 3% per annum and increasing expenses at a rate of 8% once every five years. It is noted that the starting point for revenues should be $100,000.00 since subsequent failures to collect rent are not considered. For the same reason, no adjustment should be made for the possibility of the lease being cancelled.

K. The petition of Fort Tryon Apartments is granted to the extent of Conclusion of Law "J" and the Division is directed to recompute the Notice of Determination, dated May 14, 1990, accordingly; except as so granted, the petition is otherwise denied and the Notice of Determination, as modified by the Conciliation Order and as adjusted herein, is sustained.

DATED: Troy, New York
July 14, 1994

/s/ Arthur S. Bray
ADMINISTRATIVE LAW JUDGE