STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
300 EAST 74TH OWNERS CORP.	:	DETERMINATION DTA NO. 811923
for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Years 1987 and 1988.	:	

Petitioner, 300 East 74th Owners Corp., c/o A. Mayas, American Landmark Management, 555 Madison Avenue, New York, New York 10022, filed a petition for redetermination of a deficiency or for refund of corporation franchise tax under Article 9-A of the Tax Law for the years 1987 and 1988.

A hearing was commenced before Carroll R. Jenkins, Administrative Law Judge, at the offices of the Division of Tax Appeals, Riverfront Professional Tower, 500 Federal Street, Troy, New York, on May 12, 1994 at 1:30 P.M. and continued to conclusion at the same offices on August 19, 1995 at 9:30 A.M. The last day for filing of briefs was January 24, 1995. Both parties filed their briefs within the prescribed time. The due date for issuance of this determination is measured from January 24, 1995. Petitioner appeared by Lerner, Lapidus & Franquinha, P.C. (Steven R. Lapidus, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Vera Johnson, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation, in failing to object to petitioner's method of arriving at average fair market value ("FMV") for its building on petitioner's 1986 corporation franchise tax report ("CT-3" or "report[s]") which was allegedly prepared based on a Technical ServiceMemorandum (TSB-M-85[18]C), is estopped from modifying that same valuation method purportedly used on reports filed for 1987 and 1988.

II. Whether petitioner is entitled to a refund because the Division of Taxation, in auditing

petitioner's corporation franchise tax reports for 1987 and 1988, improperly arrived at the average fair market value of petitioner's cooperative apartment building.[1]

FINDINGS OF FACT

Petitioner, 300 East 74th Owners Corp., is a New York cooperative housing corporation and owns a cooperative apartment building at 300 East 74th Street ("the building" or "the subject premises") in New York City. This cooperative was created pursuant to an offering plan providing for 98,637 shares allocated to 233 apartment units. The offering plan set forth the following price to be paid to the sponsor:

Total Cash:	$ 98,637.00
Additional Cash--Maximum Initial Price:	19,628,763.00
Mortgage Indebtedness	6,298,067.00
Total Purchase Price:	$26,025,467.00
Less: Working Capital Retained by Apartment corporation	50,000.00
Net Purchase Price of Property to Apartment Corporation:	$25,975,467.00

Petitioner claims that it computed the fair market value ("FMV") of its building on its 1986 New York corporation franchise tax report in accordance with a Technical Services Memorandum issued by the Division of Taxation ("Division") (TSB-M-85[18]C) ("the TSB Memorandum").

The TSB Memorandum provides, in pertinent part:

"Valuation of Cooperative Housing

"Section 210.1(a)(2) of Article 9-A of the Tax Law provides for a tax on total business and investment capital of a taxpayer or the portion thereof allocated to New York. For a cooperative apartment house as defined in section 216 of the Internal Revenue Code, the statute provides for a tax on capital at a rate of four-tenths of a mill (.0004).

"The statute requires the use of fair market value in the valuation of assets for the tax on capital. Fair market value is defined in Section 3-4.5 of the regulations as the price at which a willing seller, not compelled to sell, will sell and a willing

[1]At the beginning of the hearing in this matter, the Division of Taxation moved to amend its answer to include a defense of lack of timeliness of the petition. That motion was subsequently withdrawn (tr., p. 133).

purchaser, not compelled to buy, will buy. An appropriate indicator of the average fair market value of cooperative housing is the assessed value for real property tax purposes adjusted for the equalization rate.

"Where only the assessed value of the cooperative is known, average fair market value may be computed by dividing the assessed value for real property tax purposes by the equalization rate . . . [emphasis added].

"The cooperative is allowed to depreciate its costs. Thus, the values shown on the federal balance sheet are such costs less accumulated depreciation. Since this will be a constantly declining value, book value as shown on the federal balance sheet will not be allowed as an alternative determination of average fair market value [emphasis in original].

"Once a method of determining average fair market value is adopted by the taxpayer on any report and is accepted by the Tax Commission, the method may not be changed on any subsequent report without the prior consent of the Tax Commission."

Petitioner's computation of average FMV on its 1986 corporation franchise tax report was as follows (Division's Exhibit "L"):

	12/31/85	12/31/86
Total Assets from Federal Return:	$22,740,207.00	$22,217,591.00
Less: Book value of property:	($22,296,011.00)	($21,697,614.00)
Balance:	$ 444,196.00	$ 519,977.00
Plus: Actual Assessed Value 1985/86--$8,115,000 equalized at 68.29% $11,883,145.00		
1986/87--$8,635.000 equalized at 56.83%	$15,194,440.00	
Market Value:	$12,327,341.00	$15,714,417.00
Computed Average Fair Market Value: $14,020,879.00		

Petitioner opines that the computation of average fair market value on its 1987 and 1988 reports was arrived at in the same manner as is set forth above for 1986 (Division's Exhibits "H", "I" and "L"). Petitioner's New York allocation percentage for the subject years is 100 percent.

Petitioner's CT-3 filed for 1987 shows the following computation of its capital base and tax due:

Average Total Assets from Federal Return:	$22,040,287.00
Less: Real Property and securities included in previous line:	($21,398,415.00)
Balance:	$ 641,872.00

Plus: Real Property at FMV:	$16,873,215.00
Adjusted Total Assets:	$17,515,087.00
Less: Total Liabilities:	$ 6,157,665.00
Total Capital Base:	$11,357,422.00
Tax @ .0004	$ 4,543.00

Petitioner's CT-3 filed for 1988 shows the following computation of its capital base and tax due:

Average Total Assets from Federal Return:	$22,097,529.00
Less: Real Property and securities included in previous line:	($20,800,018.00)
Balance:	$ 1,297,511.00
Plus: Real Property at FMV:	$17,122,000.00
Adjusted Total Assets:	$18,419,511.00
Less: Total Liabilities:	$ 6,771,232.00
Total Capital:	$11,648,279.00
Tax @ .0004	$ 4,659.00

Petitioner's CT-3's for 1987 and 1988 did not show how it arrived at a FMV of $16,873,215.00 and $17,122,000.00, respectively, for its real property. There is no explanation for the difference in stated value on the CT-3's and petitioner's Federal corporation income tax returns (Form 1120).

Sometime in 1991, the Division conducted an audit of petitioner's corporation franchise tax reports for 1987 and 1988.[2] A letter was written to petitioner asking for additional information showing the value of the subject property, including a copy of the insurance policy on the property. In response, the auditor was provided with an insurance schedule summarizing the coverages. A copy of the policy was not provided. The insurance schedule reflected that the subject real property was insured for $23,760,000.00. No other evidence of fair market value was provided by petitioner. The Division issued a Statement of Audit Adjustment dated May 29, 1991 recomputing petitioner's taxable capital base and tax due for 1987 as follows:

Total Assets from Federal Return:	$22,040,287.00
Less: Real Property included in previous line:	$21,398,415.00

[2] At the time of the audit the statute of limitations had run for 1986, so no assessments were issued for that year (tr., pp. 188-189).

Balance:	$ 641,872.00
Plus: land and building at insured value:	$27,820,730.00
Adjusted Total Assets:	$28,462,602.00
Less: Total Liabilities:	$ 6,157,665.00
Total Capital Base:	$22,304,937.00
Tax @ .004	$8,992.00
Tax per report	4,543.00
Deficiency	4,379.00

The Division also issued a Statement of Audit Adjustment dated May 29, 1991 computing petitioner's tax for 1988 as follows:

Total Assets from Federal Return:	$22,097,529.00
Less: Real Property included in previous line:	$20,800,018.00
Balance:	$ 1,297,511.00
Plus: land and building at insured value:	$27,820,730.00

Adjusted Total Assets:	$29,118,241.00
Less: Total Liabilities:	$ 6,771,232.00
Total Capital:	$22,347,009.00
Tax @ .004	8,939.00
Tax per report	4,659.00
Deficiency	4,280.00

Both statements of audit adjustment stated as follows:

> "In determining tax on the capital base, one of the four methods of computing tax as stated in New York State Tax Law, §210(1), it is required to include real property and marketable securities at fair market value.
>
> "Fair market value is defined in New York State Tax Regulations, §3-4.5 as the price at which a willing seller, not compelled to sell, will sell, and a willing purchaser, not compelled to buy, will buy.
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> "Real property [sic] was adjusted to the insured value, since this amount more closely reflects fair market value."

The Metropolitan Transportation Business Tax Surcharge ("MTA Surcharge") during the relevant period was 17 percent of a taxpayer's New York franchise tax. The issuance of franchise tax deficiencies to petitioner resulted in issuance of a corresponding MTA Surcharge for the same years. A Statement of Audit Adjustment was issued to petitioner computing the 1987 MTA Surcharge as follows:

N.Y.S. Franchise Tax:	$8,922.00
MTA Surcharge @ 17%:	1,517.00
MTA Surcharge Reported:	772.00
Deficiency:	$ 745.00

A Statement of Audit Adjustment was also issued to petitioner computing the 1988 MTA Surcharge as follows:

N.Y.S. Franchise Tax:	$8,939.00
MTA Surcharge @ 17%:	1,520.00
MTA Surcharge Reported:	792.00
Deficiency:	$ 728.00

The Division issued a Notice of Deficiency dated May 29, 1991 asserting additional corporation franchise tax due for the year 1987 in the amount of $4,379.00, plus interest. On the same date a Notice of Deficiency was issued to petitioner asserting additional MTA Surcharge for 1987 in the amount of $745.00, plus interest.

On May 29, 1991, the Division issued a Notice of Deficiency to petitioner asserting

additional corporation franchise tax for 1988 in the amount of $4,280.00, plus interest. On the same date, the Division issued to petitioner a Notice of Deficiency asserting additional MTA Surcharge for 1988 in the amount of $728.00, plus interest.

Petitioner filed a request for conciliation conference with the Division's Bureau of Conciliation and Mediation Services ("BCMS") challenging the above notices.

On February 26, 1993, a Conciliation Order (CMS No. 117496) was issued to petitioner sustaining the notices. Petitioner thereupon filed a petition dated May 24, 1993 with the Division of Tax Appeals and the instant proceeding ensued.

Kathy Goodsell, Tax Technician II in the Division's corporation tax section, testified for the Division. She had reviewed the Division's audit records and was thoroughly familiar with their contents. Ms. Goodsell stated that the audit was conducted by Jim Bishop who is no longer with the Division. Ms. Goodsell represented the Division at the BCMS conference.

Ms. Goodsell stated that at the beginning of the audit a letter was sent to petitioner seeking additional information concerning the fair market value of the subject property. This letter included a request for a copy of the insurance policy on the building. Petitioner responded by providing a schedule summarizing the various coverage limits (Division's Exhibit "G"). This document, along with the amount set forth by petitioner on its Federal return, was used by the auditor to recompute petitioner's corporation tax liability for 1987 and 1988.

The auditor adjusted petitioner's computed "total capital" for 1987 and 1988 to include the building at the insured value plus the value of the land as reported on its Federal corporation income tax return (see, Findings of Fact "9" and "10").

Upon audit no documentation was offered to the Division to substantiate petitioner's reported fair market value. The only evidence available to the Division to show the fair market value of petitioner's property was the schedule showing insurance limits on the property and the valuation placed on the property in petitioner's Federal returns. Ms. Goodsell testified that a copy of a page from petitioner's offering plan in the Division's audit file was also relied upon as an indication of the subject property's fair market value (Division's Exhibit "K"). That page

shows a purchase price of $26,025,467.00.

Petitioner urges that the purchase price shown on its offering plan cannot be used as an indicator of FMV because it represents the price paid to the sponsor by the cooperative corporation, i.e., it is not an arm's-length transaction.

Ms. Goodsell was challenged on cross examination regarding the purchase price of $26,025,467.00 shown on petitioner's offering plan, and which she regarded as another indicator of the subject building's fair market value. Ms. Goodsell admitted that she did not know whether the full purchase price was ever actually received, but petitioner put in no evidence that it was not received. Ms. Goodsell acknowledged that she had no knowledge of whether later amendments to the offering plan reduced the purchase price, but petitioner offered no evidence to show that there were such amendments.

Ms. Goodsell also admitted she had not subpoenaed or otherwise obtained copies of petitioner's complete offering plan and all of its amendments from the New York Attorney General's office or the Secretary of State.

The Division did not audit petitioner's 1986 franchise tax report; therefore, the Division did not have an occasion to either accept or reject petitioner's CT-3 filed for 1986.

Dividing 98,637 shares in the offering plan into the total purchase price set forth on the offering plan ($26,025,467.00) results in $263.85 per share.

Stephen Godfrey, Tax Technician III in the Division's Condominium and Co-op section of the Gains Tax Unit, also testified for the Division. Mr. Godfrey is a supervisor in the Gains Tax Unit and has worked there since March 1983. Mr. Godfrey noted that, in addition to the 233 residential units in the subject building, there were also 7 stores and a parking garage. The 8th amendment to the offering plan (Division's Exhibit "P") shows the following 1982 projected rental income in the cooperative corporation's budget for these stores and garage as follows:[3]

Store # 1:	$ 17,238.25

[3]Petitioner objected to Mr. Godfrey's testimony concerning these commercial rentals. That objection was sustained. Accordingly, these figures were derived directly from the offering plan, amendment #8.

Stores # 2 & 3:	20,025.00
Store # 4:	12,739.00
Store # 5:	16,987.50
Stores # 6, 7 & 8:	40,439.26
Store # 9:	24,175.08
Store #10:	10,503.28
Parking Garage:	107,409.43
TOTAL:	$249,516.80

Mr. Godfrey stated that if there had been sales of individual residential apartments by their owners, they may not have been reported to his office. There are two cases, he said, in which the gains tax filing requirements pertain to cooperative units. One is where the holder of the unsold shares of the co-op unit is the co-op sponsor, and the other situation is where a person purchases more than one unit for possible resale, i.e., investment. In these circumstances, the sale of units for a consideration of over $1,000,000.00 must be reported to the gains tax unit. However, if an individual residence were to be sold, the owner would not be required to file a gains tax form (tr., pp. 237, 254).

Mr. Godfrey provided a copy of petitioner's offering plan which included 11 amendments (Division's Exhibit "P"). Petitioner objected to the fact that the Division did not subpoena or otherwise obtain a copy of the complete offering plan and all of its amendments from the Secretary of State.[4]

Petitioner also objected to the offering plan on the basis that it only showed facts as they existed in 1982. Petitioner was advised that if it wanted to show that the facts as shown in Exhibit "P" had changed subsequent to 1982, it was its burden to do so (tr., p. 263).

Isidor Hefter, CPA, testified for petitioner. Mr. Hefter's firm served as certified public accountants for petitioner both before and after conversion of the building to cooperative ownership.

Mr. Hefter testified that the building was converted to cooperative ownership in 1982

[4]Petitioner did not offer any additional amendments to the offering plan into evidence, and it is unclear whether any further amendments exist.

and, as part of the offering plan filed with the Attorney General, certified financial statements of assets and expenses ("certified statements") were filed with the State of New York. Mr. Hefter reviewed these certified statements for the period from 1979 through 1988.

Mr. Hefter stated that for the year 1986 his firm prepared petitioner's corporation franchise tax report in accordance with the TSB memorandum. Mr. Hefter stated that he did not receive an objection to the CT-3 from the Division.

As noted, supra, the offering plan includes copies of the certified statements by certified public accountants. These statements show rent income ("revenue") and expenses of the building for 1977, 1978, 1979, 1980, 1981 and 1982 (the latter being the year of conversion to a cooperative) for purposes of the public offering (Petitioner's Exhibits "5" through "8").

Petitioner's financial statement for 1982 reflects a land value of $4,060,730.00 and a value for the building of $19,454,590.00 (Petitioner's Exhibit "8"). The certified statements for 1987 and 1988 state the total value of the land and building, less depreciation (i.e., book value) is $21,099,216.00 and $20,500,820.00, respectively (Petitioner's Exhibits "13" and "14").

Petitioner also offered copies of certified statements of its revenues and expenses for the years 1983, 1984, 1985, 1986, 1987 and 1988 (Petitioner's Exhibits "9" through "14").

The books and records that were used to develop the certified financial statements were not made available at hearing (tr., p. 62).

Mr. Hefter reviewed the revenue and expense figures for the operation of the corporation in each of the certified statements and put them in a report at the request of petitioner's counsel.

Mr. Hefter used the actual revenue and expense figures in the certified statements for years 1978 through 1981 (the year prior to conversion).

Petitioner's counsel asked Mr. Hefter to extrapolate from the 1982 rent revenue in the certified statements what the rent revenues would be from 1983 through 1988 if the building remained as a rent-stabilized building and the landlord obtained the rent increases authorized by the rent stabilization law.

Mr. Hefter obtained the actual rent roll for April 1982 and multiplied by 12 to arrive at

total rents for 1982 as if the property had stayed rent stabilized. He applied the annual rent stabilization increase percentages to the 1982 base year rentals to arrive at what the rentals would have been on the building through 1988 had it stayed under rent stabilization. Mr. Hefter says his figures attempt to show what the rental revenue in excess of expenses, i.e., cash flow or net operating income, would be for this building had it remained rent stabilized. In coming up with these expense figures, he did not include depreciation, the purchase and servicing of air conditioners, painting of apartments, floor scraping, advertising and leasing commissions, replacement of equipment, officers, office and advisory salaries and office expenses, interest on loans and any extraordinary legal fees.

Expenses for 1982, the year of conversion, were calculated by Mr. Hefter in the same manner as income, i.e., he took the building's actual expenses for the first seven months of 1982 and then annualized them. For 1982, he computed expenses of $1,731,044.00.

For 1978 through 1981 and 1983 through 1988, Mr. Hefter merely copied expense figures from the certified statements.

Mr. Hefter's calculations show that, in 1987, if the subject building were still a rent-stabilized apartment building, it would have had rental revenue ("hypothetical revenue") in excess of expenses of $131,834.00. For 1988, if it were still a rent-stabilized building, it would have had expenses exceeding hypothetical revenue by $2,618.00. Factoring depreciation into these figures would have resulted in a hypothetical negative cash flow. All of Mr. Hefter's testimony was premised on the assumption that the subject building had remained a rent-stabilized apartment building.

Hefter testified that he prepared petitioner's 1987 and 1988 corporation franchise tax reports based on the aforementioned TSB memorandum. He said he used the assessed value for the property to arrive at fair market value because he did know of any other value (other than assessed value). He said he did not know the insured value of the property at the time the reports were prepared "nor did we request it" (tr., p. 66).

When asked on cross examination how he arrived at "revenue" of $2,678,020.00 for

1987, Mr. Hefter reiterated that he used the rentals from 1982 and multiplied those amounts by the permitted annual rent stabilization increases through 1987. From these hypothetical revenues Mr. Hefter deducted the actual expenses[5] of the cooperative for each year (tr., p. 68).

Regarding Mr. Hefter's comment that in 1988 petitioner had a negative cash flow, he was asked how that fact converted to a determination of FMV. He stated that if there is a negative cash flow, the business cannot fund its operations so that would impact adversely on the building's FMV as a rental property.[6] Mr. Hefter exhibited no reticence about deducting actual co-op expenses from hypothetical rental income in concluding that there would have been a negative cash flow for 1988.

Petitioner next called Jan A. Barenholtz. Mr. Barenholtz is a licensed real estate appraiser, consultant and broker in New York City. Mr. Barenholtz testified as to various general methods used in appraising property. Petitioner asked Mr. Barenholtz how he would appraise "rental real property located in Manhattan" (tr., pp. 79, 82).

In appraising rental property, Mr. Barenholtz would use the "income approach". He would analyze the operation of the property, analyze rental income levels and expense levels to determine income in excess of expenses, which he called net income. From this he can compute anticipated net income, i.e., "cash flow" (tr., p. 83). He would then capitalize net income by applying a multiplier of between 8 and 12 percent to net income to arrive at an estimate of fair market value (tr., pp. 90-91).

Like Mr. Hefter, Mr. Barenholtz was asked by petitioner to premise his testimony on the assumption that the subject property remained a rental property subject to rent stabilization through 1988 (tr., p. 90).

Mr. Barenholtz testified that the purchase price charged by a sponsor of a cooperative to

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[5]Except for depreciation.

[6]Except by 1988, there was no "business" to operate, the building long since having been converted to cooperative ownership.

the cooperative housing corporation would not be given "a lot of consideration" as being representative of the fair market value of property", since it is not an arm's-length transaction (tr., pp. 80-81). He also stated that the replacement cost for a building would not be an indication of FMV. Mr. Barenholtz stated that he would not "take the maximum liability of an insurance policy for the replacement of the building" as its fair market value (tr., p. 95).

Mr. Barenholtz had no opinion as to the fair market value of the subject property. Petitioner did not ask him to appraise it for purposes of this proceeding (tr., p. 112). Mr. Barenholtz was asked by petitioner to review revenue and expense figures in Mr. Hefter's report. Mr. Barenholtz said that looking at revenue in excess of expenses ("net income" or "cash flow") from 1978 to 1988 showed a volatile pattern. The trend in cash flow since 1985, he said, showed a declining trend. In fact, he said, 1988 had a negative cash flow.

He said that if he took average net income for four years, that would be "something over $100,000.00" and that could be capitalized (tr., pp. 89-90). The capitalization rate for the subject years, based on his recollection, was from 8 to 12 percent. "So if you took an average cash flow of $125,000.00 multiplied that by 10, that would suggest that the market value of the property with that kind of income stream was $1,250,000.00" (tr., p. 91). It is noted that Mr. Barenholtz did not testify that the subject building has a fair market value of $1,250,000.00. His testimony is that a hypothetical apartment building subject to rent stabilization that had the revenue and expenses set forth in Exhibit "15" would have a market value of $1,250,000.00. Petitioner did not ask Mr. Barenholtz to appraise or to give his opinion as to the fair market value of the subject property as a cooperative (tr., pp. 121-127).

As noted earlier, the building was converted to a cooperative in 1982. Mr. Hefter testified that his figures reflect actual expense numbers for the building from 1977 to 1982 (when it was a rental property) and from 1983 through 1988 (when it was a cooperative apartment building). The income numbers are actual rental income up until the conversion, and then the income numbers are projections as if the building was still rent stabilized. The Administrative Law Judge asked petitioner's counsel:

"So we're pretending . . . that the building is still rent stabilized?"

Mr. Lapidus: "Precisely."

Administrative Law Judge: "How does it [pretending] tell us what the fair market value of this building is as a cooperative . . .?"

Mr. Lapidus: "Our point is we --it doesn't tell us and we don't care because that's what the law is" (tr., p. 126).

No evidence was offered by petitioner to show the fair market value of the subject building as a cooperative.

No evidence was submitted by petitioner to show that its building was insured at 100 percent of its value, i.e., that the amount of insurance on the building represented the cost to reconstruct the building.

SUMMARY OF THE PARTIES' POSITIONS

Petitioner argues that since the method of computing FMV in the CT-3 filed for 1986 was accepted by the Division, it is estopped from adopting a new method for 1987 and 1988. This argument is based on the TSB memorandum which states, in part, that:

"Once a method of determining average fair market value is adopted by the taxpayer on any report and is accepted by the Tax Commission, the method may be changed on any subsequent report without the prior consent of the Tax Commission."

Petitioner states that that consent was never sought or given.

The Division urges that the TSB memorandum, by its terms, only applies to situations where no other methods of valuing the property are known. The Division argues that the taxpayer had other methods of valuation available for arriving at fair market value than using the building's assessed value for real property tax purposes, e.g., the value stated on its Federal Form 1120 or the property's insured value.[7]

Petitioner states that the conversion price of the property to cooperative status cannot be used as an indicator of fair market value because the transaction between the sponsor and the

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[7]Petitioner refers to the limits of liability on its insurance policy as the building's "replacement" or "reconstruction cost".

corporation is not at arm's length.

Petitioner urges further that the amount of insurance on its building represents "replacement cost" and replacement cost cannot be used as fair market value.

Petitioner also argues that the certified financial statements were on file with the Department of State and the Division's failure to subpoena or otherwise obtain them from the Department of State prior to issuing the disputed notices was arbitrary and capricious.

Petitioner also states that Real Property Tax Law § 581 specifically prohibits a political subdivision of the State from assessing the value of real property for tax purposes by using the property's value as a cooperative or its potential as a cooperative. Petitioner states that the statute (RPTL § 581) and the court cases interpreting it say that, in valuing a building, if the building would be subject to rent stabilization or rent control if it were not for the cooperative conversion, the State must value it as if it was, or is, subject to rent stabilization or rent control. This building was subject to rent stabilization before its conversion to a cooperative.

CONCLUSIONS OF LAW

A. During 1987 and 1988, sections 209(1) and 210(2) of Article 9-A of the Tax Law imposed an annual franchise tax on the total business and investment capital of corporations[8] or so much thereof as was allocated to New York.

B. Tax Law § 210(1)(b) provides, with respect to a cooperative housing corporation, as defined in section 216 of the Internal Revenue Code,[9] that the tax imposed by section 209 shall be computed at a rate of four-tenths of a mill for each dollar of the taxpayer's capital base. In arriving at the taxable capital base, Tax Law § 210(2) provides that business and investment capital shall be determined by taking the average value of assets, less certain liabilities, and for such purposes, real

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[8]Except "S" corporations.

[9]There is no dispute as to whether petitioner satisfies the definition of a cooperative housing corporation for purposes of this section of the Internal Revenue Code.

property is to be valued at fair market value. "Fair market value" is the price at which a willing seller, not compelled to sell, will sell and a willing purchaser, not compelled to buy, will buy (20 NYCRR 3-4.5).

C. During 1987 and 1988, for the privilege of exercising its corporate franchise, doing business, employing capital, of owning property or maintaining an office in the metropolitan commuter transportation district, for all or any part of a taxable year, Tax Law § 209-B imposed an additional tax surcharge on every corporation[10] computed at a rate of 17 percent of the tax imposed under Tax Law § 209.

D. Real Property Tax Law ("RPTL") § 581 prescribes the manner in which local assessors shall value certain real property. RPTL § 581(a)(1) provides real property owned or leased by a cooperative corporation or on a condominium basis shall be assessed "for purposes of this chapter" at a sum not exceeding the assessment which would be placed upon such parcel were the parcel not owned or leased by a cooperative or condominium. Real property occupied for residential purposes on a rental basis must be assessed for purposes of real property taxation without regard to the value the property might have if it were converted to cooperative ownership (RPTL § 581[3]).

E. Petitioner urges that this section expresses the State's policy concerning valuation of cooperative buildings and must be followed by the Division. According to petitioner RPTL § 581 requires that the Division value its building as if it were still a rental property subject to rent stabilization. Petitioner's whole legal argument in this case is premised

on RPTL § 581, in conjunction with TSB-M-85(18)C,[11] which states, in pertinent part, that:

> "Where only the assessed value of the cooperative is known, average fair market value may be computed by dividing the assessed value for real property tax purposes by the equalization rate . . . .
>
> * * *

[10]Except an "S" corporation.

[11]Issued November 1, 1985 and revoked by TSB-M-85(18.1)C issued December 2, 1993.

> "Once a method of determining average fair market value is adopted by the taxpayer on any report and is accepted by the Tax Commission, the method may not be changed on any subsequent report without the prior consent of the Tax Commission."

F. Petitioner's average fair market value reported on its 1987 and 1988 Federal returns was $22,040,287.00 and $22,097,529.00, respectively. Petitioner presumably had a basis for arriving at that figure. Indeed, there is some support for that figure based upon the property's insured value and the total purchase price of cooperative shares shown on the offering plan. The TSB memorandum relied on by petitioner provides that "[w]here only the assessed value of the cooperative is known" average fair market value for purposes of the franchise tax may be computed by dividing the assessed value for real property tax purposes by the equalization rate. Clearly, based on the FMV reported on petitioner's Federal returns, information, other than the property's "assessed value", was known to petitioner which could have been used to determine FMV of the subject property. That being the case, this TSB memorandum could not properly be used by petitioner to calculate the fair market value of the subject property.

Petitioner next argues that the Division's failure to object to the valuation method used in its 1986 franchise tax report estops it from objecting to its 1987 and 1988 reports. This argument is based on language in the TSB memorandum which states, in part:

> "Once a method of determining average fair market value is adopted by the taxpayer on any report and is accepted by the Tax Commission, the method may not be changed on any subsequent report without the prior consent of the Tax Commission."

If the Division had audited petitioner's 1986 CT-3 and accepted it, this language would require the taxpayer to continue using the same method unless the Division gave its prior consent to a change in method. This language does not, as petitioner urges, prohibit the Division from requiring a change in method of valuation. The prohibition here is on the taxpayer, not the Division. So even if petitioner had been entitled to adopt the method of valuation on its 1986 CT-3 set forth in the TSB memorandum, and even if it had been "accepted" by the Division, it would not have prevented the Division from auditing petitioner's

1987 and 1988 returns and asserting additional tax thereon. In any event, there are no facts in this record that the Division ever "accepted" petitioner's computation method.

G. Petitioner's argument that valuation of its real property for purposes of New York's corporation franchise tax is subject to RPTL § 581 is also without merit. There is nothing in section 581 or the cases cited by petitioner that even suggest that result. Real Property Tax Law § 581 by its terms is limited to valuation of cooperatives or condominiums "for purposes of this chapter", i.e., the Real Property Tax Law and relates to the parameters that must be followed by local assessors for purposes of the real property tax. That section merely provides that condominiums and cooperative properties shall be assessed for real property tax purposes at a sum not exceeding the assessment which would be placed upon such parcel were the parcel not owned or leased by a cooperative or condominium.

Paragraph 3 of that section provides that real property occupied for residential purposes on a rental basis must be assessed without regard to the value the property might have if it were converted to cooperative ownership (RPTL § 581[3]). This provision too only relates to valuation of such property with regard to the real property tax.

The evidence presented by petitioner was expressly limited to showing the FMV of the subject property as rental apartments subject to rent stabilization. Petitioner called an appraiser as a witness, but never asked him to appraise the property as a residential cooperative building. In fact, petitioner's counsel specifically asked this witness to assume, for purposes of his testimony, that the property was still rental apartments subject to rent control. Petitioner offered absolutely no credible evidence that would tend to show the fair market value of its real property as a cooperative.

H. Petitioner has the burden of proving that the Division's assessment is erroneous or improper (Tax Law § 1089[e]). Government agencies are presumed to act honestly and in accordance with the law (Abrahams v. New York State Tax Commission, 131 Misc 2d 594, 500 NYS2d 965; Fisch on Evidence § 1134). As the Court stated in Calder v. Graves (261 App Div 90, 24 NYS2d 797, affd 286 NY 643):

> "The action of the [State Tax] Commission in the first instance is presumed correct, and upon petitioner rested the burden of proving that such advances were loans."

The Division does not have the burden to demonstrate the propriety of its assessment (see, Matter of A & J Gifts Shop v. Chu, 145 AD2d 877, 536 NYS2d 209, lv denied 74 NY2d 603, 542 NYS2d 518; Matter of Blodnick v. New York State Tax Commn., 124 AD2d 437, 507 NYS2d 536, appeal dismissed 69 NY2d 822, 513 NYS2d 1027; Matter of Scarpulla v. State Tax Commn., 120 AD2d 842, 502 NYS2d 113) and petitioner has a heavy burden to prove the assessment erroneous (see, Matter of Executive Land Corp. v. Chu, 150 AD2d 7, 545 NYS2d 354, appeal dismissed 75 NY2d 946, 555 NYS2d 692). The allocation to petitioner of both the burden of proof and the burden of going forward is reflected in the majority opinion of the Appellate Division in Petroleum Sales and Service v. Bouchard (98 AD2d 882 [3d Dept 1983], affd 64 NY2d 671, 485 NYS2d 252).

The effect of the presumption of validity is that it shifts to the party against whom it operates not only the burden of going forward but also the burden of persuasion.

Petitioner asks that we "pretend" that the subject building is not a cooperative, but a rental property. Petitioner has directed all of its evidence to proving this fiction. Unfortunately, petitioner's real property is a cooperative and it is the property's fair market value as a cooperative that is of concern here.

Petitioner has offered no evidence to show the value of this building as a cooperative, but instead attacks the Division's use of such indicators of FMV as: (i) the fair market value stated by petitioner on its Federal income tax returns; (ii) the amount for which the building is insured; and (iii) the purchase price shown on the offering plan.

Petitioner did not offer any sound explanation for why the fair market value reported on its Federal returns was so much higher than that reported on its State franchise tax reports (Findings of Fact "6", "7"). With regard to the building's insured value, petitioner says that cannot be used as an indicator of fair market value because the insured amount represents the building's "reconstruction cost." The record does not support that conclusion, however, because petitioner offered no evidence to show that the insurance coverage on the building was at its full

value, or what it would cost to reconstruct the cooperative apartment building.

Petitioner's suggestion that the Division somehow had a duty to subpoena records of its offering plan and related documents from the Department of Law or the Secretary of State as a condition precedent to issuing an assessment has no basis in law.

Petitioner was in the best position to provide evidence of the subject real property's actual fair market value. This information could have been included with petitioner's CT-3's, but it was not. This information could have been provided to the Division's auditor, but it was not. This information could have been provided at the hearing in this matter, but it was not.

The figures used by the Division to determine the average fair market value of petitioner's cooperative were provided by petitioner. The Division used the only information available to it. Petitioner's CT-3's, its Federal returns and the summary of its insurance policy contained the only information available to the Division, because that is all the information petitioner provided. Petitioner cannot stand mute as to the fair market value of its cooperative building and then complain that the Division's figures lack precision.

While the Division's method of determining FMV may not have been precise, it was rational. The Division's figures are presumed correct. To overcome that presumption, petitioner was required to come forward at hearing with clear and convincing evidence to show why the Division's valuation of its cooperative was erroneous. In two days of hearings in this matter, petitioner did not produce any evidence to show the value of this property as a cooperative or to show that the Division's determination of fair market value as a cooperative was erroneous, unreasonable or improper. As such, petitioner has failed to meet its initial burden of going forward (Matter of Atlantic and Hudson Limited Partnership, Tax Appeals Tribunal, January 30, 1992). It has also failed to meet its ultimate burden of proof by clear and convincing evidence.

I. Since petitioner (i) has not established any error in the method used by the Division to determine the average fair market value of its residential cooperative, and (ii) has not offered any evidence of its own to show the fair market value of the subject real property as a

residential cooperative, there is no basis for modifying the Division's method of valuation or the assessments that result from it.

J. The petition of 300 East 74th Owners Corp. is in all respects denied and the notices of deficiency dated May 29, 1991 are sustained.

DATED: Troy, New York
July 20, 1995

/s/ Carroll R. Jenkins
ADMINISTRATIVE LAW JUDGE