STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
STRATAGEM DEVELOPMENT CORPORATION	:	DETERMINATION DTA NO. 812315
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, Stratagem Development Corporation, 50 West 55th Street, New York, New York 10019, 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.

On August 3, 1994 and August 10, 1994, respectively, petitioner, by its representative, Ferber Greilsheimer Chan & Essner (Allen P. Essner, Esq., of counsel), and the Division of Taxation by William F. Collins, Esq. (Laura J. Witkowski, Esq., of counsel) consented to have the matter determined on submission without a hearing based upon documents and briefs to be submitted by February 6, 1995. Documentary evidence was submitted by the Division of Taxation on September 29, 1994. Petitioner submitted a memorandum of law and exhibits on November 15, 1994. The Division of Taxation submitted a letter in lieu of a brief on December 28, 1994. Petitioner's reply brief was filed on February 6, 1995, which date began the six-month period for the issuance of this determination. After review of the entire record, Brian L. Friedman, Administrative Law Judge, renders the following determination.

ISSUES

I. Whether the November 17, 1989 transactions entered into by petitioner whereby it assigned its option to purchase certain real propertyin consideration of the sum of $2,500,000.00 constituted a transfer of an interest in real property subject to gains tax under Article 31-B of the Tax Law.

II. If so, whether penalty assessed should be abated.

FINDINGS OF FACT

On March 22, 1985, Fidelity Service Corporation ("FSC"), Heron International P.L.C. and East 55th Street Holdings Limited ("Holdings") entered into a Phase II Joint Venture Agreement for the development of an office and commercial building located at 56 through 64 East 55th Street, New York, New York.

Pursuant to paragraph 30 thereof, Holdings was granted an option to purchase this property or a portion thereof from FSC in the event that FSC had not commenced construction of the Phase II Building within four years from the date of the agreement, or March 22, 1989. The Phase II Joint Venture Agreement further provided that the option to purchase would expire if not exercised within 18 months of the date in which it became exercisable (therefore, the option was exercisable from March 22, 1989 until September 21, 1990).

Holdings assigned its interest under the Phase II Joint Venture Agreement to Stratagem Development Corporation ("petitioner") by instrument dated May 14, 1985.

On November 17, 1989, FSC assigned its interest in the Phase II Joint Venture Agreement and the Phase II Property to Heron Properties, Inc., the indirect parent of FSC.

On November 17, 1989, an Assignment of Option Agreement was executed by petitioner and Heron Properties, Inc. whereby petitioner assigned all of its right, title and interest in and to the option to purchase the Phase II Property to Heron Properties, Inc. for the sum of $2,500,000.00.

Preamble Clause E of the Assignment of Option Agreement stated as follows:

> "The Option to Purchase which was not exercisable until March 22, 1989 is now capable of being exercised and it is of material benefit to Assignee to acquire such option."

The Assignee under this agreement was Heron Properties, Inc. Paragraph 4 of the Assignment of Option Agreement provided:

> "Notwithstanding any provisions to the contrary contained herein, the Option to Purchase is hereby merged with Assignee's interest in the Phase II Site, and is terminated and of no further force or effect."

Paragraph 6 of the Assignment of Option Agreement stated:

"Subject to this Assignment of Option Agreement, the Phase II Joint Venture Agreement, including the Option to Purchase, are and shall remain in full force and effect."

Also on November 17, 1989, a document entitled "Amendment to Phase II Joint Venture Agreement" was executed by, among others, the five owning corporations, Heron Properties, Inc. and petitioner. Paragraph 9 provided as follows:

"Option to Purchase. In the event Heron has not commenced construction of the Phase II building by November 30, 1990, Stratagem shall have the option to purchase the Phase II Site at a purchase price equal to the Development Cost, with respect to Heron's acquiring and holding of the Phase II Site, through the date of sale to Stratagem. This option shall be exercised by notice from Stratagem to Heron fixing a closing date (which shall be between 30 and 90 days after the date of the notice). Heron shall within 10 days thereafter cause its auditors to compute Heron's Development Cost and certify the same to Holdings. The provisions of paragraph 13(c) of the Phase II Joint Venture Agreement shall be applicable to the foregoing certification. The foregoing option shall expire (a) if not exercised within six months of the date it becomes exercisable or (b) if exercised and Stratagem does not close the purchase of the Phase II Site within ninety days of such exercise, notwithstanding Heron having been ready, willing and able to do so. Notwithstanding the foregoing in all other respects this Agreement shall continue in full force and effect."

A letter dated November 27, 1989 (on the letterhead of Heron Financial Corporation) was sent to petitioner which stated as follows:

"To expedite matters, we enclose a signed Transfer Tax Return for you to complete, sign and file as soon as possible. Our tax counsel prepared this form assuming Stratagem had no tax basis in the Option Agreement. In addition, Stratagem is required to file a Form TP-580, Transferor's New York State Real Property Transfer Gains Tax Questionnaire, attached to which must be the Form TP-581, Transferee's Questionnaire. We have caused the Transferee's Questionnaire to be completed, signed and notarized and we enclose that form so that you can attach it to the Transferor's Questionnaire and file them together."

Attached to the letter were an executed transferee questionnaire (Form TP-581) and a combined real property transfer gains tax affidavit (Form TP-584).

The affidavit of Fred Havenbrook, Tax Technician II, of the Division's Real Property Transfer Gains Tax Unit (see, Division's Exhibit "F") stated that by letter dated November 9, 1990, the transferee (Heron Properties, Inc.) had informed the Division that, at the time of the November 17, 1989 transactions, it had appeared to the transferee that the transaction was subject to gains tax and real estate transfer tax. Accordingly, Heron Properties, Inc. had prepared and submitted the required documents (see, Finding of Fact "6") to petitioner for its

signature and filing, but was concerned that petitioner had failed to file these documents with the Division.

The affidavit further states that, as a result of the letter from Heron Properties, Inc., communications between the Division and petitioner commenced and, by letter dated January 23, 1991, Mr. Havenbrook advised petitioner's representatives as follows:

> "After review of the information packet you sent, dated January 14, 1991, the Department has determined that there was a transfer of an interest in real property subject to tax under Article 31-B of the Tax Law.
>
> Please send in the completed Form TP-580 Gains Tax Questionnaire, along with documentation for any claimed original purchase price (legal fees, etc.).
>
> Please send the requested questionnaire/documentation, within 10 days of the date of this letter, to the attention of the undersigned at 75 Watervliet Ave., Albany, NY 12206."

The affidavit of Fred Havenbrook also stated that, as a courtesy to petitioner, a meeting with petitioner's representative, was held at the Division's offices in Albany, New York on March 27, 1991 (see, Exhibit "7" attached to affidavit), the purpose of which was to permit petitioner to present an argument as to why the November 17, 1989 transaction should not be subject to gains tax.

Mr. Havenbrook's affidavit stated that, at the conclusion of the meeting, the Division's position remained unchanged. However, the Division's representatives at the meeting agreed to inquire as to whether petitioner could file a request for an advisory opinion with the Division's Technical Services Bureau while the case was under audit. Petitioner's representatives were subsequently informed that such a request could be filed and that the Division would hold off on issuing an assessment for two weeks in order to permit time for making the request. When petitioner failed to make the request within the two-week period, Mr. Havenbrook's supervisor instructed him to prepare and issue the assessment.

On April 26, 1991, the Division issued a Notice of Determination to petitioner in the amount of $250,000.00, plus penalty and interest, for a total amount due of $378,820.56.

An attachment to the Notice of Determination explained:

"As previously set forth in our letter, dated December 10, 1990, no filing was made

for the Assignment of Option Agreement, dated November 17, 1989, for Phase II Property at 56-64 East 55th Street, NY, NY.

It has been the determination by the Tax Department that the subject transfer is a taxable event in accordance with Article 31-B of the Tax Law, and taxes, plus penalties and interest are due.

Consideration	$2,500,000.00
Tax at 10% of the above	$250,000.00"

SUMMARY OF PARTIES' POSITIONS

The bases of petitioner's contention that the transaction is not subject to gains tax are as follows:

a. The November 17, 1989 transactions related to a restructuring of certain existing rights and obligations among all parties to a joint venture pursuant to a Phase II Joint Venture Agreement dated March 22, 1985;

b. Although the Assignment of Option Agreement, on its face, provides for an assignment by petitioner of its option to purchase the real property in exchange for a payment of $2.5 million, the Phase II Joint Venture Amendment executed on the same date provides for the continuation of the same option on the identical terms as previously existed, but with a delayed effective date of November 30, 1990. In addition, the Assignment of Option Agreement, in section 6 thereof, stated that the option to purchase in the Phase II Joint Venture Agreement shall remain in full force and effect. Therefore, the November 17, 1989 transaction was merely a postponement for a one-year period of petitioner's previously existing option;

c. The transactions effected by the Phase II Joint Venture Amendment and the Assignments of Option Agreement did not effect either a transfer of title to any real property or a change in any joint venturer's percentage ownership in the joint venture or in the underlying real property. Therefore, the transactions were not a transfer of real property within Tax Law § 1440 or 20 NYCRR 590.4.

d. Although there are no statutes, regulations, rulings or cases which specifically relate to the application of the gains tax to payments received in consideration for the postponement of an option exercise date, this transaction most closely resembles the facts described in 20 NYCRR 590.13 (relating to consideration for the postponement of a closing date). This regulation provides that gains tax will not be imposed if three conditions are satisfied; petitioner maintains that all three have been satisfied herein;

e. The Division's reliance on Matter of 58 Realopp Corp. (Tax Appeals Tribunal, January 30, 1992) is misplaced. In that case, it is clear that the option had been terminated and a new one was created. In the present matter, at a time when the option was still exercisable, petitioner agreed to a postponement in the exercise date of the option;

f. This is not a case of an option holder seeking to extend an option expiration date. Instead, it is a case of a property owner seeking to postpone the option exercise date in order not to lose its property to the option holder; and

g. With respect to penalty, petitioner contends that, in view of the similarity between the present matter and the scenario contained in 20 NYCRR 590.13, the position taken by petitioner was reasonable and penalty should, therefore, be cancelled.

The position of the Division of Taxation may be summarized as follows:

a. An assignment of an option to purchase without use or occupancy is taxable pursuant to 20 NYCRR former 590.57. The Assignment of Option Agreement clearly and unequivocally states that the agreement is for an assignment and transfer by petitioner of its rights, title and interest in the option to purchase the Phase II Property in return for $2,500,000.00;

b. The Division contends that 20 NYCRR 590.13 is not applicable herein since there was no contract of sale with a set closing date in existence. If found to be applicable, however, the Division asserts that, under the provisions of the regulation, the monies received by petitioner are deemed to be consideration received for a transfer of an interest in real property unless and until petitioner establishes that the three exclusionary requirements of the regulation have been satisfied. The Assignment of Option Agreement does not state that the payment is for an extension of the closing date of the option. Instead, the document states that it is for the assignment of the currently exercisable option to purchase the real property;

c. The Division maintains that 20 NYCRR 590.13 is inapplicable because there existed two separate and distinct agreements; this was not a matter of simply modifying the terms of a single contract of sale by extending the closing date;

d. If it should be determined that the $2,500,000.00 payment is for a time delay pursuant to 20 NYCRR 590.13, petitioner has failed to establish that the amount remitted for the delay is reasonable. Based upon the evidence presented, it is not possible to determine whether the amount was reasonable;

e. As to the third requirement of 20 NYCRR 590.13, the transferee (Heron Properties, Inc.) executed the gains tax questionnaires as if the transaction was subject to tax;

f. Citing Matter of 58 Realopp Corp. (supra) the Division contends that if this was actually a case where petitioner was seeking to extend the expiration date of an option which it already held, petitioner would have been the party making the payment to obtain the extra time. In this case, petitioner was the party receiving the payment; and

g. As to penalty, petitioner willfully ignored the documents forwarded to it by Heron Properties, Inc. and rejected Heron's request to submit the documents to the Division. In addition, it made no attempt to ascertain the validity of its own contrary position. Despite being granted time to request an advisory opinion prior to issuance of the assessment, petitioner failed to make the request within the time allotted. Furthermore, petitioner admits in its brief that there are no regulations, rulings or case law which directly address the transaction at issue; therefore, it should have requested the Division's guidance with respect to its position.

CONCLUSIONS OF LAW

A. Tax Law § 1441 imposes a 10 percent tax on "gains derived from the transfer of real property within the state."

The "[t]ransfer of real property" includes the transfer or transfers of any interest in real property by any method including assignment of a contract or an option to purchase real property (Tax Law § 1440[7]).

B. In determining whether a transaction is subject to taxation, the statute which levies a tax is construed in favor of the taxpayer (Matter of Bredero Vast Gold v. Tax Commn. of the State of New York, 146 AD2d 155, 539 NYS2d 823, 825, appeal dismissed 74 NY2d 791, 545 NYS2d 105). However, in deciding what constitutes a "transfer of real property," the courts have recognized that "the statute employs an expansive definition designed to maximize revenues" (id., 539 NYS2d at 825).

C. To prevail over the administrative construction of a statute, the petitioner must establish not only that its interpretation of the law is a plausible one, but also that its interpretation is the only reasonable construction (Matter of Dental Society v. New York State Tax Commn., 110 AD2d 988, 487 NYS2d 894 affd 66 NY2d 939, 498 NYS2d 797; Matter of Lakeland Farms Co. v. State Tax Commn., 40 AD2d 15, 336 NYS2d 972).

D. Petitioner contends that the present matter closely resembles the facts described in 20 NYCRR 590.13 relating to the postponement of a closing date. This regulation provides as follows:

> "Question: When a transferor agrees to extend the closing date of the contract in return for an additional sum of money, is that additional sum included as consideration?
>
> Answer: Yes, unless the following three criteria are met:
>
> (1) The agreement between the parties must state that the payment is for the time delay (similar to the allocation that must be made when personal property is also transferred).
>
> (2) The amount of money must be reasonable for the length of delay.
>
> (3) The transferee must complete the questionnaire consistent with the view that the payment is not for real property; thus, he may not include such payment in consideration and may not include such payment in his original purchase price for the property."

In response, the Division contends that the basic tenet underlying the applicability of the regulation is that there be one contract of sale which is simply modified by a subsequent agreement to extend the closing date. In the present matter, there existed two separate and distinct agreements which, therefore, renders the regulation inapplicable.

Petitioner consistently maintains that the essence of the November 17, 1989 transactions was to provide for a continuation of the very same option on identically the same terms as existed under the Phase II Joint Venture Agreement, but with a postponed exercise date, i.e., November 30, 1990. Therefore, petitioner contends that the option was never surrendered or terminated, but merely modified for the benefit of both parties. In support of its position, petitioner points to paragraph 6 of the Option Agreement (see, Finding of Fact "4") which states that the option to purchase shall remain in full force and effect.

It must be pointed out herein that the Option Agreement, in paragraph 4 thereof (see, Finding of Fact "4") contains a total contradiction to the provisions of paragraph 6. Paragraph 4 states, unequivocally, that "the Option to Purchase is hereby merged with Assignee's interest in the Phase II site, and is terminated and of no further force or effect" (emphasis added).

Paragraph 4 of the Option Agreement merely states what, after consideration of all of the evidence presented, seems quite clear, i.e., the option to purchase was, in fact, surrendered or terminated as the Division maintains. This is true for the following reasons:

> (1) From November 17, 1989 (the date of execution of the Assignment of Option Agreement and the Amendment to Phase II Joint Venture Agreement) until November 30, 1990, petitioner no longer possessed an option to purchase. Petitioner correctly points out, in its reply memorandum (at page 4 thereof), that, not wanting to lose the property as a result of petitioner's likely exercise of the option, the property owner proposed and petitioner accepted a modification of the option pursuant to which the property owner would have an additional period of time to fulfill the required conditions before the option would again be exercisable. The only way to accomplish this, however, was to extinguish the present option which was then exercisable and create a new option which could only be exercised at a future date.
>
> Obviously, the construction of the Phase II building (see, Findings of Fact "1" and "5") by Heron Properties, Inc. was the event which would render petitioner's option a nullity. It must be assumed that as of November 17, 1989, construction of the building had not yet begun; otherwise, there was no need for Heron Properties, Inc. to pay petitioner $2,500,000.00. If Heron Properties, Inc. had no intention of commencing construction, there was also no need to pay this money. Clearly, then,

Heron Properties, Inc. believed, with some degree of certainty, that it could begin construction prior to November 30, 1990 and, by doing so, would permanently extinguish petitioner's option to purchase. So, for the sum of $2,500,000.00, Heron Properties, Inc. temporarily (for approximately one year) extinguished what it reasonably believed it could permanently extinguish within the year or, in other words, it simply bought time to enable itself to permanently keep title to the Phase II property;

(2) The provisions of the options to purchase were not identical. The initial option was exercisable for a period of 18 months; the second option expired within 6 months of the date on which it became exercisable. The first option pertained to the entire Phase II site or a portion thereof; the second pertained to the entire site. The closing date under the March 22, 1985 option had to be fixed between 30 and 60 days after giving notice of intent to exercise the option; the November 17, 1989 option provided that the closing date must be fixed between 30 and 90 days after the date of the notice; and

(3) Paragraph 4 of the Option Agreement clearly stated that the original option to purchase was terminated and of no further force or effect.

Accordingly, it cannot be found that the provisions of 20 NYCRR 590.13 are applicable herein since the November 17, 1989 transactions did not extend a closing date. An existing option to purchase was terminated (or surrendered) and a new one was created. Even if this regulation was found to apply to the present matter, petitioner has failed to prove that the three criteria, set forth in the regulation, were met. As the Division correctly points out, the Assignment of Option Agreement does not state that the payment of the $2,500,00.00 was for a time delay. The currently exercisable option was, in fact, assigned to Heron Properties, Inc. As to the amount of money received ($2,500,000.00), petitioner has failed to prove that it was reasonable for the length of delay. While it states, in its brief, that the property is valued in excess of $20,000,000.00, no proof has been introduced to substantiate that contention. Moreover, petitioner has failed to show that the sum of $2,500,000.00 was a reasonable sum for what amounts to a potential surrender of its option to purchase the property. Finally, as to the third criterion, the evidence is clear that Heron Properties, Inc. considered the transactions to be taxable (see, Finding of Fact "6"). The third requirement for nontaxability under 20 NYCRR 590.13 has also, therefore, not been met.

E. The Division, in support of its position, cites to Matter of 58 Realopp Corp. (Tax Appeals Tribunal, January 30, 1992) wherein that petitioner claimed that a second option to

purchase real property was simply a modification of the first. The Tribunal upheld the determination of the Administrative Law Judge which found that the first option had lapsed and that a second option had been created.

It must initially be noted that the issue in Matter of 58 Realopp Corp (supra) was quite different from the issue being addressed herein. In the Realopp case, the issue was whether the petitioner was entitled to an exemption under Tax Law § 1443(6), i.e., whether the transfer was pursuant to a written contract entered into on or before the effective date of Article 31-B of the Tax Law (March 28, 1983). In Realopp, the initial option to purchase agreement was entered into on March 16, 1981 and had to be exercised by September 15, 1982; a second agreement was executed on July 25, 1983. Petitioner contended that the initial option (executed before the effective date of the imposition of gains tax) remained in effect and that the modifications made in the July 25, 1983 agreement were insubstantial. As previously noted, the Tribunal rejected petitioner's contentions.

In the Realopp case, the initial option had clearly lapsed prior to the execution of the second option. Therefore, the Administrative Law Judge determined (and the Tribunal affirmed) that a new option, entered into after the effective date of Article 31-B, had been created.

In the present matter, as petitioner correctly asserts, the second transaction (which petitioner categorizes as a postponement and which the Division maintains was the creation of a second option) occurred at a time when the original option was still exercisable. Nevertheless, having previously determined (see, Conclusion of Law "C") that the November 17, 1989 transactions created a new option to purchase, the distinction drawn by petitioner is seemingly irrelevant. That is to say that, while in Realopp it was certainly far clearer that there was a new option created because the first option had lapsed nearly a year before the execution of the second one, the mere fact that, in the present matter, the initial option was still exercisable does not change the result. Therefore, Realopp, while it may provide some guidance (as the Division asserts), is not controlling since it has heretofore been determined that, based upon other factors,

a second option to purchase was created in the present case.

F. 20 NYCRR 590.58 (formerly 590.57 during the period at issue), relating to the assignment of an option without use or occupancy, provides as follows:

"Question: Is an assignment of a naked option taxable?

Answer: Yes. For purposes of determining if the $1 million threshold is met and for purposes of filing requirements, consideration includes the amount received for the option plus the amount to be paid for the real property pursuant to the option."

In this case, petitioner, on November 17, 1989, assigned an existing and exercisable option to purchase the Phase II property to Heron Properties, Inc. in return for receipt of the sum of $2,500,000.00 (see, Finding of Fact "4"). At the same time, it executed an Amendment to Phase II Joint Venture Agreement (see, Finding of Fact "5") pursuant to which petitioner was granted an option to purchase this same real property at a future date (November 30, 1990) if Heron Properties, Inc. had not commenced construction of the Phase II building on the property by that date. Pursuant to 20 NYCRR 590.58, this is a transaction which is subject to the imposition of gains tax. Accordingly, the Division's assessment of tax thereon was proper.

G. With respect to the imposition of penalties, Tax Law § 1446(2)(a) imposes a penalty against any transferor who fails to file a tentative assessment and return or pay tax within the time required by Article 31-B. Abatement or waiver of this penalty is permitted if it can be determined that petitioner's failure to comply was due to reasonable cause and not due to willful neglect.

The reasonableness of a taxpayer's failure to pay the tax must be evaluated in light of the Division's articulated policy (see, Matter of Benaquista, Polsinelli & Sera Sini Mgt. Corp. v. Commr. of Taxation & Finance of the State of New York, 191 AD2d 80, 598 NYS2d 829, 832) and the extent of the taxpayer's efforts to ascertain its tax liability (Matter of KAL Associates, Tax Appeals Tribunal, October 17, 1991). In determining reasonable cause, all of the actions of the taxpayer are considered relevant (Matter of LT&B Realty Corp. v. New York State Tax Commn., 141 AD2d 185, 535 NYS2d 121).

In its brief, petitioner states that "in view of the strong similarity between the facts in this

case and Regulation Section 590.13, it is clear that Respondent's imposition of a penalty in this case was inappropriate." The "strong similarity" argument has been rejected (see, Conclusion of Law "D"). More importantly, however, the evidence reflects that petitioner made no attempt to ascertain the Division's policy (despite being granted time to request an advisory opinion prior to the issuance of the assessment) at any time prior or subsequent to the November 17, 1989 transactions. In addition, petitioner was put on notice of the potential taxability of these transactions (see, Findings of Fact"6" and "7") through the documentation furnished to petitioner by Heron Properties, Inc. It was only after the Division initiated communication with petitioner that discussions ensued.

In Matter of River Terrace Associates (Tax Appeals Tribunal, October 22, 1992), the Tribunal stated:

> "To summarize, in light of the statutory language, explanatory information promulgated by the Department of Taxation and Finance, and the availability of Tax Department personnel to answer questions, make private letter rulings, and issue advisory opinions, we find petitioner's use of its own interpretation of the law, without any contact or discussion of its position with the Department, to be unreasonable. Therefore, we determine that penalties and interest should not be waived."

While there were, apparently, few if any promulgations directly dealing with this particular subject matter, this record is wholly devoid of any indication that petitioner sought out the Division's assistance in determining if liability for tax existed. Petitioner bears the burden of proving that penalty was improperly imposed (see, 20 NYCRR 3000.10[d][4]) and it has demonstrated no basis upon which it can be found that reasonable cause existed for its failure to file a tentative assessment and return or pay the tax. Penalties are, therefore, sustained.

H. The petition of Stratagem Development Corporation is denied and the Notice of Determination issued April 26, 1991 is sustained in its entirety.

DATED: Troy, New York
July 27, 1995

/s/ Brian L. Friedman
ADMINISTRATIVE LAW JUDGE