STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petitions	:	
of	:	
	:	
31/32 LEXINGTON ASSOCIATES	:	DETERMINATION
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	:	DTA NOS. 813845 AND 814194
	:	

Petitioner, 31/32 Lexington Associates, c/o Philips International, 417 Fifth Avenue, New York, New York 10016, filed petitions 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 January 18, 1996 and January 22, 1996, respectively, petitioner by its representative, Babcock MacLean, Esq., and the Division of Taxation by its representative, Steven U. Teitelbaum, Esq. (Herbert M. Friedman, Jr., Esq., of counsel) waived a hearing and agreed to submit this case for determination, with all documents and briefs to be filed by May 27, 1996, which date commenced the six-month period for the issuance of this determination. The Division's documents were submitted on February 23, 1996. Petitioner's documents and brief were received on April 1, 1996. The Division's answering brief and petitioner's reply brief were received on May 2, 1996 and May 28, 1996,[1] respectively.

After due consideration of the entire record, Frank W. Barrie, Administrative Law Judge, renders the following determination.

ISSUE

Whether the Division of Taxation, in calculating consideration for the transfer of a certain interest in real property, properly included the face value of a purchase money mortgage despite

[1]Petitioner's reply brief was timely filed because it was mailed before the due date.

its subsequent devaluation, so that the Division's denial of petitioner's refund claims was justified.

FINDINGS OF FACT

1. The record on submission is extremely bare. It does not include a copy of the transferor questionnaire filed by 31/32 Lexington Associates to report its anticipated transfer of the property at issue, 205-215 Lexington Avenue in New York City ("Manhattan property"). Rather, Exhibit "M" of the Division of Taxation ("Division") is a photocopy of a transferee questionnaire filed by Philip Pilevsky, c/o Philips International,[2] dated March 22, 1988. Mr. Pilevsky apparently purchased the property at issue from petitioner. This transferee questionnaire reported the anticipated transfer on May 26, 1988 of the Manhattan property by a transferor identified as Lexington Associates, presumably petitioner, 31/32 Lexington Associates, for consideration to be paid by Philip Pilevsky of $45,100,000.00. Mr. Pilevsky reported that the type of interest to be acquired from petitioner in the Manhattan property was (i) a fee interest and (ii) a leasehold assignment or surrender.

2. The Division's Exhibit "L" is a photocopy of a transferor questionnaire filed by Philip Pilevsky, c/o Philips International, dated April 1988 (without a specific day designated). This transferor questionnaire reported the anticipated transfer on May 26, 1988 of the Manhattan property to a transferee identified as 205-15 Lex Associates. Mr. Pilevsky reported that the type of interest to be transferred in the Manhattan property was a "contract assignment". Consequently, it appears that Mr. Pilevsky flipped his contract to purchase the Manhattan property from petitioner over to an entity known as 205-15 Lex Associates.

3. Petitioner's Exhibit "1" is a short affidavit dated March 28, 1996 of David Werner, who described himself as "a general partner" in petitioner. According to Mr. Werner, petitioner "transferred an interest in 205 and 215 Lexington Avenue . . . to 205-15 Lex Associates . . . on or about May 26, 1988." Mr. Werner provided few details concerning the transaction at issue, and he did not provide any details concerning Mr. Pilevsky's flipping of his apparent contract rights to purchase the property from petitioner to the entity described as 205-15 Lex Associates.

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[2]It is observed that petitioner's address shown at the beginning of this determination is also in care of Philips International.

It is also unknown if Philip Pilevsky or Philips International also had an ownership interest in petitioner. In brief, the facts concerning the sophisticated and complex real estate transaction at issue are difficult to determine given the limited record on submission.

4. The transferee questionnaire filed by Philip Pilevsky (Division's Exhibit "M") shows consideration to be paid to petitioner by Mr. Pilevsky of $45,100,000.00. In addition, Mr. Pilevsky reported brokerage fees to be paid by him to a real estate broker of $450,000.00. In comparison, the transferor questionnaire filed by Philip Pilevsky (Division's Exhibit "L") shows consideration to be paid to Mr. Pilevsky by 205-15 Lex Associates, c/o Arnold Schotsky, Esq., of the Long Island law firm of Gandin, Schotsky & Rappaport, of $49,100,000.00. Mr. Pilevsky reported a gain subject to tax of $3,915,000.00 after deducting original purchase price of $45,185,000.00 calculated as follows:

Purchase price paid to acquire real property	$45,100,000.00
Legal expenses to acquire property	45,000.00
Legal expenses to sell property	40,000.00
Original purchase price	$45,185.000.00

Consideration to be received from 205-15 Lex Associates of $49,100,000.00 less original purchase price of $45,185,000.00 equals a gain subject to real property transfer gains tax of $3,915,000.00, with anticipated tax due of $391,500.00 (10% of $3,915,000.00).

5. The Division also submitted for review a photocopy of a supplemental return dated April 26, 1988 filed by Mr. Pilevsky as transferor of the property at issue to 205-15 Lex Associates (Division's Exhibit "P"). By this supplemental return, Mr. Pilevsky chose to defer payment of the gains tax due. It appears he elected to pay the tax in equal installments payable on the anniversary date of the transfer for the length of the term of a certain purchase money mortgage, which was apparently used to finance the transaction at issue. However, a copy of the purchase money mortgage was not submitted for review.

6. The Division's "Exhibit D" is a claim for refund of gains tax paid of $313,200.00 dated May 24, 1993, which was filed by David Werner in his capacity of partner of an entity described as "31/21 Lex Associates, a New York partnership". It appears that "Lex" was used erroneously instead of "Lexington" in the description of the entity seeking the refund claim.

The petition referred to "31/21 Lexington Associates". This refund claim noted the following minimal facts:

> "Seller [presumably petitioner] transferred an interest in [the Manhattan property] to Buyer [presumably Mr. Pilevsky] on or about May 26, 1988.
>
> "No cash was received by Seller at the time of the transfer. Seller took back Buyer's second mortgage on the Property, as security for Buyer's obligation to pay the purchase price over a five-year period. Pursuant to the applicable provisions of the New York State real property gains tax, an election was made by Seller to pay the gains tax in installments. The scheduled payments of gains tax were made timely by Seller."

7. This refund claim dated May 24, 1993 shows tax installments paid on 5/17/89, 5/2/90, 5/20/91 and 5/27/92, which totalled $313,200.00. Petitioner's second refund claim dated May 11, 1995 (Division's Exhibit "I") seeks a refund of a fifth installment payment made on May 26, 1993 of $78,300.00. The two refund claims total $391,500.00, which corresponds to the amount of gains tax reported due by Mr. Pilevsky on his transfer of the Manhattan property to 205-15 Lex Associates. There is nothing in the record to explain why petitioner paid the amount of tax calculated due by Mr. Pilevsky instead of the amount of tax due on its transfer of the Manhattan property to Mr. Pilevsky. Since the consideration to be paid to petitioner by Mr. Pilevsky was approximately $4,000,000.00 less than the consideration Mr. Pilevsky was to receive from 205-15 Lex Associates, as noted in Finding of Fact "4", petitioner's gains tax liability would have been an amount less than $391,500.00. There is no information in the record concerning petitioner's acquisition of the Manhattan property, and its "original purchase price" cannot be determined. Consequently, petitioner's actual gains tax liability on the transfer of the Manhattan property to Mr. Pilevsky is uncertain.

8. Pursuant to an order of the United States Bankruptcy Court dated June 22, 1993 (petitioner's Exhibit "3"), the reorganization of 205-15 Lex Associates under Chapter 11 of the Bankruptcy Code was confirmed. Under the reorganization plan (petitioner's Exhibit "2"), petitioner released and discharged its "Second Mortgagee Claim" against 205-15 Lex Associates in exchange for a payment of $200,000.00. In addition, the Manhattan property was reconveyed

to an entity known as 205/215 Lexington Limited Partnership, which apparently was the first mortgagee on the Manhattan property.

9. In its refund claims, petitioner asserts that it "will realize no gain upon the sale of the Property to Buyer" because of the bankruptcy of 205-15 Lex Associates. However, the record does not, in fact, disclose the total payments made by 205-15 Lex Associates to petitioner.

10. By a letter dated July 30, 1993 (Division's Exhibit "E"), petitioner's refund claim dated May 25, 1993 in the amount of $313,200.00 was denied because "[t]he tax was properly calculated on the date of transfer" (emphasis in original). By a letter dated May 24, 1995 (Division's Exhibit "J"), petitioner's refund claim dated May 12, 1995 in the amount of $78,300.00 was also denied for the same reason.

SUMMARY OF THE PARTIES' POSITIONS

11. Petitioner argues that denying its refund claims "is contrary to the Tax Law and to basic principles of fairness and common sense" (Petitioner's brief, p. 1). According to petitioner, the gains tax is imposed only on "actual economic gain" (Petitioner's brief, p. 8). It supports this statement by citing to "litigation in the bankruptcy context" where the gains tax has been viewed not as a stamp tax but rather as an income tax, or a tax imposed on economic gain (Petitioner's brief, p. 4). Petitioner also cites to the amendment of the gains tax law in 1993 which deemed "consideration" to be limited to the fair market value of the property transferred to a lender in foreclosure proceedings or a transfer in lieu of foreclosure. Further, petitioner maintains that to "tax a real estate transaction even where gain is not derived, would be defective under the Equal Protection Clause" (emphasis in original) (Petitioner's brief, p. 7).

12. The Division counters that in computing consideration the face amount of a mortgage at the time of transfer is properly used, citing the Tax Appeals Tribunal decision in Matter of Normandy Associates (March 23, 1989). Subsequent events "which may effect the transferor's actual receipt of [a gain]" are irrelevant (Division's brief, p. 4). The Division also points out that the Tax Appeals Tribunal rejected an equal protection argument, similar to the one made by petitioner, in Matter of Rapoport (August 31, 1995).

13. In its reply brief, petitioner maintains that in the cases cited by the Division in its brief, the Tax Appeals Tribunal did not address the situation where "a seller of real property has been taxed on a gain which he did not receive because the purchaser went into bankruptcy" (Petitioner's reply brief, p. 2).

CONCLUSIONS OF LAW

A. Tax Law former § 1441,[3] which became effective March 28, 1983, imposes a 10% tax upon gains derived from the transfer of real property located within New York State.

B. Tax Law former § 1440(3) defined "gain" as the:

> "difference between the consideration for the transfer of real property and the original purchase price of such property, where the consideration exceeds the original purchase price."

Tax Law former § 1440(5)(a)(i) defined "original purchase price" to mean:

> "the consideration paid or required to be paid by the transferor (A) to acquire the interest in real property, and (B) for any capital improvements made or required to be made to such real property . . . ."

"Consideration", in turn, is defined by Tax Law § 1440(1)(a) to mean:

> "the price paid or required to be paid, for real property or any interest therein. . . . Consideration includes any price paid or required to be paid, whether expressed in a deed and whether paid or required to be paid by money, property or any other thing of value and including the amount of any mortgage, purchase money mortgage, lien or encumbrance, whether the underlying indebtedness is assumed or taken subject to."

C. Petitioner is wrong that gains tax may be imposed only in the case of an actual gain. Rather, gains tax has been imposed in situations of speculative profit and in situations where real estate transactions have soured. In Matter of Brockman (Tax Appeals Tribunal, April 4, 1996), arguments similar to those which petitioner has made in this matter were all rejected.

In Brockman, the major portion of the sales price was financed by a purchase money note and mortgage from the buyer in the amount of $8,500,000.00. The buyer never made any payments on this note and mortgage, and a foreclosure proceeding was instituted. Like petitioner, the Brockmans contended that because they suffered a loss, the imposition of gains

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[3]The Real Property Transfer Gains Tax imposed by Article 31-B of the Tax Law was repealed on July 13, 1996. The repeal applies to transfers of real property that occur on or after June 15, 1996. (See, sections 171 through 180 of chapter 309 of the Laws of 1996.)

tax was not rational and violated their equal protection rights. The Tribunal, in affirming the administrative law judge, denied the Brockmans' claims for refund of gains tax and held them liable for gains tax totalling $193,121.00 on the real estate transaction that had eventually soured.

In its decision in Brockman, the Tribunal emphasized that subsequent events do not alter the value that the consideration had at the time of the transfer citing its earlier decision in Matter of Starburst Dev. Co. (Tax Appeals Tribunal, May 5, 1994) where the Tribunal stated:

> "the moment that the taxable event occurs, i.e., the transfer of the real property, is the temporal restriction underlying the entire gains tax. Consistent with this interpretation, we have held that the consideration for the transfer is fixed at this moment and is not reduced by subsequent events. . . . To deviate from this theory, as petitioner suggests, and exclude transactions from the definition of transfer of real property based on subsequent events would, in our view, be contrary to the entire scheme of the tax."

The Tribunal in Brockman further noted that the Appellate Division had recently sustained its conclusion that the amount of gains tax due is finally determined by the amount of consideration paid or required to be paid on the date of the transfer (see, Matter of Wanat v. Tax Appeals Tribunal, __ AD2d __ , 638 NYS2d 251, lv denied __ NY2d __ , __ NYS2d __ [May 7, 1996], confirming Matter of Wanat, Tax Appeals Tribunal, September 15, 1994; Matter of South Suffolk Recreation Ventures v. Tax Appeals Tribunal, __ AD2d __, 638 NYS2d 515, lv denied __ NY2d __, __ NYS2d ___ [May 7, 1996], confirming Matter of South Suffolk Recreation Ventures, Tax Appeals Tribunal, November 3, 1994). In Wanat, which is particularly on point, the Tribunal had decided that the amount of the consideration calculated at the time of the transfer is not affected by the transferee's later default on a note and mortgage.

D. Petitioner's contention that the amendment of the gains tax law in 1993, which deemed "consideration" to be limited to the fair market value of the property transferred to a lender in foreclosure proceedings, means that gains tax may be imposed only on an actual gain is rejected. Laws of 1993 (ch 57, § 60) added a paragraph (d) to the definition of "consideration" at Tax Law § 1440(1) so as to limit "consideration" with respect to a foreclosure transfer (or a deed-in-lieu) to the fair market value of the real property that is transferred.

Moreover, this amendment applies to transactions occurring on or after April 15, 1993, pursuant to Laws of 1993 (ch 57, § 418[8]).

E. The Legislature has manifested no intent to ignore a transaction for purposes of gains tax due to subsequent events. Rather, under Tax Law former § 1440(7), the Legislature's definition of "transfer of real property" is extremely broad, and such definition evidences no intent on the part of the Legislature to ignore a transaction as a sale because the sale later turned sour, and the seller failed to profit as planned (cf., Matter of Shechter, Tax Appeals Tribunal, October 13, 1994 [wherein the Tribunal noted that the Legislature evidenced its intent to "look through" an entity to determine the beneficial owners of property by the way it defined "interest in property"]).

F. It is further noted that petitioner is correct that the real property transfer gains tax is not viewed as a stamp tax, but rather as a tax on income in the context of bankruptcy litigation (see, In re Fifth Avenue Associates, L.P., 963 F2d 503, cert denied 506 US 947, 121 L Ed 2d 302). Further, such tax is entitled to a priority status under 11 USC § 507(a)(8)(A) as "a tax on or measured by income or gross receipts" (see, In Re Williams, 173 Bankr 459, affd 188 Bankr 331). However, the conclusion that gains tax due is calculated at the time of transfer and may not be reduced by subsequent events does not mean that it is not "a tax on or measured by income or gross receipts" (see, Matter of Brockman, supra).

G. Finally, petitioner's argument that its right to equal protection of the law is violated, by holding it liable for gains tax on a transaction that later soured, is also rejected. The Tribunal addressed this issue in Matter of Brockman (supra) as follows:

> "Neither the Federal nor the State constitution require that all taxpayers be treated identically; they only require that those similarly situated be treated uniformly (see, Matter of Foss v. City of Rochester, 65 NY2d 247, 491 NYS2d 128; Matter of Executive Land Corp. v. Chu, 150 AD2d 7, 545 NYS2d 354). Requiring petitioners to pay the gains tax does not violate their constitutional rights because petitioners are being treated the same as all other similarly situated taxpayers -- they are required to calculate the tax based upon the value of the consideration at the time of the transfer (see, Matter of Rapoport, Tax Appeals Tribunal, August 31, 1995)."

H. The petitions of 31/32 Lexington Associates are denied, and the Division of Taxation's denial of petitioner's refund claims is sustained.

DATED: Troy, New York
November 14, 1996

/s/ Frank W. Barrie
ADMINISTRATIVE LAW JUDGE