STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :

of :

MALRATH REAL ESTATE DEVELOPMENT CORP.: :

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. :

In the Matter of the Petition :

of :

MICHAEL MALARKEY :

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. :

DETERMINATION
DTA NO. 815683
AND 815684

Petitioners, Malrath Real Estate Development Corp., 709 Taft Avenue, Endicott, New York 13760-7202, and Michael Malarkey, 715 Columbus Avenue, Endicott, New York 13760, filed petitions for revision of determinations or for refund of tax on gains derived from certain real property transfers under Article 31-B of the Tax Law.

A consolidated hearing was held before Brian L. Friedman, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on October 8, 1997 at 1:15 P.M., with all briefs to be submitted by May 8, 1998, which date began the six-month period for the issuance of this determination. Petitioners appeared by Hinman, Howard &

Kattell, LLP (Frederick A. Griffen, Esq., of counsel). The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Michael J. Glannon, Esq., of counsel).

ISSUES

I. Whether, certain sales made by petitioner Malrath Real Estate Development Corp. ("Malrath") should be exempt from the imposition of the tax on gains derived from certain real property transfers ("gains tax") by virtue of the fact that the parcels of real estate were sold with residential homes thereon.

II. Whether Malrath's transfer of three lots to certain investors or co-venturers in the subdivision were exempt from the imposition of gains tax as transfers to persons with a prior beneficial interest.

III. Whether the Division of Taxation erred in not allowing certain additional costs in determining gain subject to tax.

IV. Whether certain lots which were traded to third parties by Malrath for other lots should be excluded from aggregation with other lots sold for purposes of computing gains tax liability.

V. Whether two lots in another subdivision which were sold by Malrath should be excluded from aggregation for gains tax purposes.

VI. Whether penalty imposed upon the assessments of gains tax should be abated.

VII. Whether petitioner Michael Malarkey timely filed a request for a conciliation conference with the Bureau of Conciliation and Mediation Services.

VIII. Whether the Division of Taxation erroneously assessed petitioner Michael Malarkey for gains tax owed by Malrath since the consideration for sales occurring after April 19, 1989

(the effective date of Tax Law § 1440[8], and [9] which imposed personal liability upon a responsible officer of a corporation) was less than $1,000,000.00.

FINDINGS OF FACT

On February 13, 1998, petitioners submitted, along with their brief, 54 proposed findings of fact. In its brief submitted on April 6, 1998, the Division of Taxation responded to petitioners' proposed findings of fact. Each of petitioners' proposed findings of fact has been substantially incorporated into the following Findings of Fact, except:

(a) Proposed findings of fact "3", "5" and "12" have been modified to more accurately reflect the record;

(b) Proposed findings of fact "13", "43" , "44", "46", "47" and "51" are rejected as being conclusory in nature;

(c) That portion of proposed finding of fact "18" which states that other lots were transferred to purchasers solely for financing is rejected as being conclusory in nature and not supported by the record. The remainder of proposed finding of fact "18", i.e., the list of lots, is also rejected because, absent the language pertaining to financing, it is irrelevant.

1. On January 9, 1995, the Division of Taxation ("Division") issued a Notice of Determination to Malrath which assessed gains tax in the amount of $78,798.00, plus penalty and interest, for a total amount due of $130,714.93 for the period ended December 14, 1990. The Notice of Determination was issued to Malrath at its address of 709 Taft Avenue, Endicott, New York 13760-7202.

2. A Notice of Determination dated January 19, 1995 was issued by the Division to Michael Malarkey at 715 Columbus Avenue, Endicott, New York 13760-2221. This Notice of

Determination assessed the same amount of gains tax as was assessed against Malrath ($78,798.00), plus penalty and interest, for a total amount due of $130,969.56. The notice stated that petitioner Michael Malarkey was being assessed as an officer or responsible person of Malrath.

3. Michael Malarkey incorporated Malrath in 1986. At all times since its incorporation, he has been its sole officer, director and stockholder. Prior to 1986, Mr. Malarkey was engaged in the business of remodeling and building homes. The homes were built on land owned by third parties.

4. In 1986, Malrath purchased a tract of land located on upper Taft Avenue in Endicott, New York (Broome County). The land, known as Felicia Estates, was comprised of some 43 to 47 acres of land and was purchased by Malrath for $250,000.00.

5. Malrath subdivided the land into 20-acre parcels. Plot plans were prepared and zoning permits were obtained by Malrath. Originally, Felicia Estates consisted of 110 lots; however, the frontage of some of the lots was increased so the total number of lots was between 95 and 99. Sewer and water lines were installed inside the lots approximately 20 feet from the front property line. In some instances, Malrath put in a foundation on the lots as sales materialized. Malrath also built roads and curbs and installed lines for electric, cable, telephone and gas.

6. A few of the lots were sold to other builders. However, Mr. Malarkey approved these builders and their building plans, and he oversaw the construction of the foundations on these lots.

7. Malrath built approximately 60 to 70 percent of the total homes in Felicia Estates. In order to obtain financing to purchase the lot and have Malrath build the residential home, some of the buyers were required to present proof that a foundation had been constructed and that a

current survey had been prepared. Each of these tasks was performed by Malrath prior to the transfer of title to the purchaser.

In January 1988, Malrath executed a Declaration of Restrictions "in order to insure the most beneficial development of said area mainly as a residential subdivision and to prevent any such use thereof as might tend to diminish the valuable or pleasurable enjoyment thereof." Pursuant to this Declaration of Restrictions, no building or improvement of any kind could be erected or maintained on the premises until the plans for the design and location were first submitted to and approved by Malrath.

8. Letters were submitted from two purchasers, Gary T. Crooks and Robert P. Tenant, who indicated that in order to obtain financing, the lots were transferred to these purchasers before building of the homes thereon. The letters further stated that Malarkey Building and Remodeling (Mike Malarkey) was the general contractor in charge of the building of the homes and that this company did, in fact, build the homes. Petitioner Michael Malarkey asked other purchasers to write similar letters, but they indicated that they did not want to get involved in a tax issue.

9. Lots 52 and 71 were traded in August and November 1989, respectively, for other parcels of real estate. Lot 52 was traded for a lot approximately 1 ½ miles from Felicia Estaes; lot 71 was traded by Malrath in return for some land in Owego, New York. As of the date of the hearing, Malrath had not sold either of the lots which were acquired in these exchanges. The prices assigned to the lots which were traded by Malrath, i.e., lots 52 and 71, were determined by Bruce O. Becker, attorney for Malrath. Michael Malarkey stated that he did not know how the attorney determined these prices.

10. Helen Russ was a real estate agent who built houses on speculation and then sold them to third persons. Malrath sold lots 23, 24 and 34 in Felicia Estates to Helen Russ. Pursuant to

the contracts of sale for each of these lots, Malrath was to act as the general contractor for the house constructions in return for a fee ($5,000.00 for lots 23 and 24; $4,000.00 for lot 34). For lot 23, the contract of sale also provided that Malrath was to supply all of the subcontractors for the construction of the home on the lot. The contracts of sale relating to lots 23 and 24 provided that before any contract was entered into between Ms. Russ and a contractor unrelated to Malrath, she was to give the first option to Malrath or its designee (Mr. Malarkey) to build the residence.

Helen Russ obtained construction loans from Endicott Lumber and Box Company. In return for the funds advanced to her, Ms. Russ agreed to purchase all of the building materials from the company. In order for Endicott Lumber and Box Company to provide Helen Russ with financing, the lot had to be in her name. Prior to transferring the lot to Ms. Russ, Malrath approved the plans, excavated the lot, put in the foundation and obtained a survey. Additionally, 75 to 85% of the house was framed before the lot was transferred to Helen Russ.

11. Malrath also took advantage of the financing made available by Endicott Lumber and Box Company for homes which it built prior to entering into a contract of sale with third parties. In order to obtain the financing, Malrath transferred the lots to Michael Malarkey individually. Lots 19, 41, 45, 48, 12 and 13 were transferred to Michael Malarkey by Malrath for purposes of obtaining financing from Endicott Lumber and Box Company. These lots were originally included in the assessment by the Division's auditor but were later omitted since they were transferred solely to obtain financing.

12. Felicia Estates West was a second parcel of land purchased by Malrath on August 14, 1989 for approximately $50,000.00. The parcel was owned by the same party (Gerald Talandis) who sold Felicia Estates to Malrath in 1986. Felicia Estates West consisted of approximately 14

acres. Felicia Estates West adjoins Felicia Estates, they share a common street, Donna Avenue. Felicia Estates West required the same permits and subdivision requirements as Felicia Estates. Michael Malarkey testified that at the time Malrath purchased Felicia Estates in 1986, there were no plans or intentions to purchase the land subsequently named Felicia Estates West. The sale of lots 126 and 129 in Felicia Estates West by Malrath were included in the assessment of gains tax by the Division.

13. In 1987, Malrath entered into agreements with John Crooks, Michael Frey and Donald Mastro whereby each of those individuals invested the sum of $30,000.00 with Malrath in return for which each was to receive the sum of $750.00 for each lot sold by Malrath up to a total of 50 lots and, in addition thereto, was to receive an inside lot of his choice. Each of these investors received his lot (Mastro received lot 28; Frey received lot 25; and Crooks received lot 97). Upon the sale of the 50 lots pursuant to the agreement with each of the investors, Malrath was to pay each the sum of $750.00 per lot or $37,500.00 in total. When Malrath fell behind in these payments, two of the investors (Frey and Mastro) commenced a lawsuit in the Supreme Court, County of Broome, against Malrath and on May 11, 1994, judgment was entered in favor of the plaintiffs in the amount of $42,000.00 ($21,000.00 per plaintiff), plus interest at the statutory rate.

14. On the original assessment, tax in the amount of $1,642.20 was assessed on Malrath's sale of lot 97; tax in the amount of $1,742.20 was assessed on each of the sales of lots 28 and 25. Subsequently, the tax on lot 97 was reduced to $899.56 and tax on each of lots 28 and 25 was reduced to $974.56 was by the Conciliation Conferee (***see***, Finding of Fact "22 "). On the closing statements relating to the transfer of these lots by Malrath to the three investors, Attorney Becker assigned a consideration of $29,000.00 for lot 97 transferred to Crooks and a

consideration of $30,000.00 for each of lots 28 and 25 transferred to Mastro and Frey, respectively. Michael Malarkey stated that he did not know the manner in which the prices for these lots were arrived at by his attorney.

15. William Starring, CPA, was in charge of Malrath's accounting matters from the start of Malrath's existence in 1986. The attorney for Malarath, Bruce O. Becker, referred Michael Malarkey to Mr. Starring. The offices of Messrs. Becker and Starring were located in the same building. Michael Malarkey stated that Attorney Becker was noted for his expertise in matters of construction and in all matters relating thereto, including taxation. Michael Malarkey also stated that William Starring was hired by Malrath because Mr. Malarkey was told that he was an expert in the fields of construction, development and subdivision. Mr. Starring assisted in organizing Malrath and he assisted in preparing all corporate tax returns.

16. Upon the sale of each parcel by Malrath, Messrs. Becker and Starring would prepare a closing statement which reflected various payment including amounts due to Dolores O'Hora, the holder of the mortgage on Felicia Estates. Mr. Starring kept a cumulative total of lots sold by Malrath including all of the information contained on the closing statements.

17. Michael Malarkey stated that prior to the audit of Malrath which commenced in 1994, he never heard of or knew anything about the gains tax or "Cuomo tax." He stated that he expected William Starring to be aware of and to provide for payment of all taxes.

18. In a letter from Attorney Bruce O. Becker to William Starring, CPA, dated October 26, 1992, Mr. Becker stated that he had done some research on the "Cuomo tax" and that based on the regulations and the law, he felt that Malrath had some liability for the tax. The letter stated that "[s]ales of lots with houses are exempt from the tax." The last sentence of the letter

stated , "Sorry about this." There is no indication on the letter that a copy was sent to either petitioner.

19. When the audit commenced, petitioner Michael Malarkey conferred with William Starring. Mr. Malarkey stated that, at this time, he was unaware of the letter from Bruce Becker to William Starring. He stated that he first became aware of the letter when the auditor informed him of its existence and then provided him with a copy. Prior to receiving a copy from the auditor, neither Mr. Becker nor Mr. Starring informed him that such a letter had been written.

20. Attorney Bruce O. Becker performed all legal duties regarding Malrath including determining what taxes were due and owing by the corporation. In 1994, when petitioners were advised of the audit, Mr. Malarkey conferred with Attorney Becker. He indicated to petitioner Michael Malarkey that he did not know if Malrath was subject to the gains tax. Mr. Malarkey stated that Mr. Becker never mentioned his October 26, 1992 letter to William Starring, CPA.

21. Malrath did receive the Notice of Determination issued by the Division on January 9, 1995 (***see***, Finding of Fact "1"). It was immediately turned over to Malrath's attorney for a response.

22. In response to the Notice of Determination issued by the Division to Malrath, a Request for Conciliation Conference was timely filed. The Report of Tax Conferences, prepared by the conciliation conferee subsequent to a conciliation conference held on October 11, 1996, indicates that the tax due was revised from the original assessment of $78,798.00 to $58,401.80 as the result of a meeting held on April 26, 1995. The report states that additional costs were allowed in calculating the revised tax. At the conciliation conference, the consideration on lots 25, 28, and 97 was reduced to $28,000.00 per lot on the transfers to the investors. An exemption of 25% of the tax on those lots was granted due to a "beneficial interest" in the lots. Finally, the

consideration for lot 47 was reduced to $3,500.00. Accordingly, the Conciliation Order (CMS No. 14530) issued January 31, 1997, recomputed total tax due to $57,077.26, plus penalty and interest computed at the applicable rate. This recomputation was the result of the conciliation conferee's determination that, from February 18, 1988 through September 21, 1993, Malrath sold a total of 48 lots with a total consideration received of $1,400,300.00. Malrath's original purchase price was found to be $816, 281.76, with a resulting gain of $584,018.24.

23. As to petitioner Michael Malarkey, no response to the Notice of Determination dated January 19, 1995 was received by the Division until a Request for Conciliation Conference was received on October 24, 1996 (the Request for Conciliation Conference was sent by certified mail on October 22, 1996). Attached thereto is a letter from the Division's auditor, George Mastrianni, to Frederick Griffen, Esq., petitioners' representative, which states that, in response to questions raised at a meeting between Messrs. Mastrianni and Griffen in July 1996, Mr. Mastrianni was enclosing a copy of the Notice of Determination issued to Michael Malarkey as well as a copy of certain mailing records purporting to show that the notice was mailed by certified mail to Mr. Malarkey on January 19, 1995. Also attached to the Request for Conciliation Conference is a letter to Mr. Griffen from Michael Malarkey, dated September 18, 1996, in which he states that he never received a "90-day letter" from the Division.

24. On December 6, 1996, the Division's Bureau of Conciliation and Mediation Services issued a Conciliation Order Dismissing Request (CMS No. 158045) which stated that since the notice was issued on January 19, 1995, but the request was mot mailed until October 22, 1996, or in excess of 90 days, the request for a conciliation conference was denied. On February 26, 1997, the Division of Tax Appeals received a timely petition from Michael Malarkey seeking administrative review of the conciliation order.

25. At the hearing, the Division submitted the affidavits of Geraldine Mahon and James Baisley, employees of the Division, as well as a copy of the certified mail record containing a list of the notices of determination allegedly issued by the Division on January 19, 1995, including one addressed to petitioner Michael Malarkey.

26. Geraldine Mahon, Principal Clerk of the Division's CARTS Control Unit (CARTS is an acronym for Case and Resource Tracking System and refers to the Divison's computer system for generating statutory notices, among other things), states that she supervises the processing of notices of deficiency and notices of determination prior to their shipment to the Division's Mechanical Section for mailing. Ms. Mahon receives a computer printout, entitled Assessments Receivable, Certified Record for Non-Presort Mail, which the Division refers to as its "certified mail record" ("CMR"). The statutory notices listed on the CMR and generated by CARTS are also forwarded to Ms. Mahon's unit. The computer generated notices are predated with the anticipated date of mailing and each notice is assigned a "certified control number." The certified control numbers are recorded on the CMR under the heading "CERTIFIED NO."

The CMR for the notices issued on January 19, 1995, including the notice issued to Michael Malarkey, consisted of 12 fan-folded (connected) pages. Ms. Mahon states that all pages of a CMR are connected when the document is delivered into the possession of the United States Postal Service ("USPS"). The pages remain connected when the postmarked document is returned to her office after mailing and they stay connected unless she requests that they be separated.

27. On the CMR issued by the Division on January 19, 1995, including the Notice of Determination issued to Michael Malarkey, the certified control numbers run consecutively and

there are no deletions. Each of the pages consists of 11 entries, with the exception of page 12 which contains 10 entries.

In the upper left-hand corner of the CMR, on page 1, the date 01/09/95 was manually changed to 1-19-95. The original date, 01/09/95, was the date that the CMR was printed. The CMR is printed approximately 10 days in advance of the anticipated date of mailing of the particular notices so that there is sufficient lead time for the notices to be manually reviewed and then processed for postage, etc. by the Mechanical Section. The handwritten date change on te CMR was made by personnel in the Division's mail room, who changed the date so that it conformed to the actual date that the notices and the CMR were delivered into possession of the USPS.

28. Each statutory notice is placed in an envelope by Division personnel and the envelopes are then delivered into the possession of a USPS representative who then affixes his or her initials or signature and a U.S. postmark to the pages of the CMR. In the present matter, the USPS representative initialed page 12 of the CMR, circled the "Total Pieces and Amounts Listed" and affixed a postmark to each page of the CMR. On page 11 of the CMR, it indicates that a Notice of Determination, Notice Number L010003896, was sent to Malarkey-Michael, 715 Columbus Ave., Endicott, NY 13760-2221, by certified mail using control number P 911 205 160. The U.S. postmark on each page of the CMR confirms, according to Ms. Mahon's affidavit, that the notice was sent on January 19, 1995. While some of the U.S. postmarks on the various pages of the CMR are illegible (the postmark on page 11, the page containing the notice issued to petitioner Michael Malarkey, was placed on the far right-hand portion of the CMR and only a portion thereof is visible), it is clear that there is, in fact, a U.S. postmark on each page.

Ms. Mahon states that in the regular course of business and as a common office practice, the Division does not request, demand or retain return receipts from certified or registered mail. She indicates that the procedures followed and described in her affidavit were the normal and regular procedures of the CARTS Control Unit on January 19, 1995.

29. The affidavit of James Baisley, Chief Processing Clerk, in the Division's Mail Processing Center, states his regular duties include the overall supervision of the entire Mail Processing Center staff, including the staff that delivers outgoing mail to branch offices of the USPS. After a notice is placed in the "Outgoing Certified Mail" basket in the Mail Processing Center, a member of Mr. Baisley's staff weighs and seals each envelope and affixes postage and fee amounts to them. A mail processing clerk counts the envelopes and verifies the names and certified mail numbers against the information on the CMR.

Mr. Baisley states that a member of his staff delivers the CMR and the stamped envelopes to the Roessleville Branch of the USPS where a postal employee affixes a postmark or his or her signature or both to the CMR indicating receipt by the USPS. In the present case, the postal employee affixed a postmark to each page of the CMR, circled the total number of pieces and initialed the CMR to indicate that this was the total number of pieces received by the USPS. Mr. Baisley states that his knowledge that the postal employee circled the "total number of pieces" for the purpose of indicating that 131 pieces were received by the USPS is based on the fact that the Division's Mail Processing Center specifically requested that postal employees either circle the number of pieces received or indicate the total number of pieces received by writing the number of pieces received on the CMR.

30. Mr. Baisley states that the CMR is the Division's record of receipt by the Roessleville Branch of the USPS for pieces of certified mail. In the ordinary course of business and pursuant

to the practices and procedures of the Mail Processing Center, the CMR is picked up at the USPS the following day and delivered to the originating office by a member of Mr. Baisley's staff.

Mr. Baisley read and reviewed the affidavit of Ms. Mahon and the exhibits attached to the affidavit and states that he can determine that on January 19, 1995, an employee of the Mail Processing Center delivered a piece of certified mail addressed to Malarkey-Michael, 715 Columbus Ave., Endicott, NY 13860-2221, to the Roessleville Branch of the USPS in Albany, New York in a sealed postpaid envelope for delivery by certified mail. Based upon his review of the CMR, Mr. Baisley states that he can determine that a member of his staff obtained a copy of the CMR with the postmarks, delivered to and accepted by the USPS on January 19, 1995, for the records of the CARTS Control Unit.

31. Mr. Baisley indicates that the procedures described in his affidavit are the regualr procedures followed by the Mail Processing Center staff in the ordinary course of business when handling items to be sent by certified mail and, furthermore, that such procedures were followed in mailing the notice to petitioner Michael Malarkey on January 19, 1995.

32. With respect to the issuance and mailing of the Notice of Determination to Michael Malarkey, this petitioner points out the following:

(a) The CMR , on the last page thereof, does not have either a signature of a postal employee with the number of pieces marked or have filled in the "Total Pieces Received at Post Office";

(b) The Division does not retain or request return receipts from certified or registered mail; and

(c) Page 11 of the CMR, the page containing petitioner Michael Malarkey's name, does not have a full postmark.

33. At the hearing, the Division acknowledged that the effective date of the statute which imposed personal liability for gains tax upon a responsible person or officer was April 19, 1989. Accordingly, the Division conceded that petitioner Michael Malarkey would be liable for gains tax due from Malrath only for periods subsequent to that effective date. As a result, the Division agrees that the assessment against petitioner Michael Malarkey must be reduced to $39,883.78, plus penalty and interest.

As previously noted (***see***, Finding of Fact "21"), the total assessment being asserted by the Division against petitioner Malrath is $55,077.26, plus penalty and interest.

SUMMARY OF THE PARTIES' POSITIONS

34. Petitioners contend as follows:

(a) The lots transferred by Malrath to third parties solely for the purpose of obtaining financing (these lots are lot nos. 9, 16, 28, 29, 30, 42, 49, 92 and 66) should not have been aggregated and should be exempt from tax as transfers improved or partially improved with residential dwellings pursuant to Tax Law § 1440(7);

(b) Lots 28, 25 and 97 should not be aggregated since the co-venturers had a beneficial interest in the lots of 100%, not 25% as allowed by the conferee.

(c) The agreement with the co-venturers results in these co-venturers, along with Malrath, being the transferors for the first 50 lots. Accordingly, the consideration attributable to Malrath should be reduced;

(d) The lots traded for other parcels of real property (lots 52 and 71) should not be aggregated for purposes of computing gains tax liability since Malrath realized no economic gain from the parcels received and the trade or

exchange was a mere change in form or identity;

(e) Lots 126 and 129 in Felicia Estates West should not be aggregated for purposes of computing gains tax liability since these lots were acquired three years after the purchase of Felicia Estates and, at the time of Malrath's purchase of Felicia Estates, there was no plan or intent to purchase Felicia Estates West;

(f) Penalty should be abated on the assessments against petitioners since there was reasonable cause based upon reliance on professional advice;

(g) Petitioner Michael Malarkey's request for a conciliation conference should be deemed timely since the Division has failed to prove proper issuance of the Notice of Determination; and

(h) The Division has conceded that, by virtue of the fact that the effective date of Tax Law § 1440(8) and (9) which imposed personal liability for gains tax upon responsible persons or officers was April 19, 1989, there should be no liability for tax by petitioner Michael Malarkey since the total sales made by Malrath subsequent to April 19, 1989 was less than $1,000,000.00.

35. The position of the Division of Taxation is as follows:

(a) The lots which Malrath maintains should not be aggregated because they were transferred solely for purposes of obtaining financing, do not qualify for the exemption pursuant to Tax Law § 1440(7) since it has not established that any of the lots contained finished residential homes prior to transfer;

(b) Malrath is not entitled to more than the 25% allowance granted by the conciliation conferee since just 25% of the consideration for the lots constituted a mere change in ownership which would not be subject to tax;

(c) The trading of lots 52 and 71 by Malrath for other parcels of real property were transfers of interests in real property and were, therefore, properly subject to tax;

(d) Lots 126 and 129 from Felicia Estates West were properly aggregated with the lots sold from Felicia Estates since they were purchased from the same seller, were contiguous to the Felicia Estates lots and were used for the same purpose of development;

(e) Malrath has not shown reasonable cause for abatement of penalties. It has failed to prove that its representatives were experts in real property and tax matters and that petitioners were not aware of the existence of the gains tax since Michael Malarkey had been in the building industry for years;

(f) Petitioner Michael Malarkey failed to timely protest the Notice of Determination issued to him by the Division and, accordingly, the assessment against him became fixed and final. The Division has proven that the Notice of Determination was properly sent by certified mail to Mr. Malarkey at his home address;

(g) The gains tax liability of petitioner Michael Malarkey is based upon sales made by Malrath, the consideration for which was in excess of $1,000,000.00. The fact that the consideration from sales occurring after April 19, 1989 was less than $1,000,00.00 is irrelevant. It was the transfer

of real property by Malrath which gave rise to Mr. Malarkey's personal liability.

CONCLUSIONS OF LAW

A. Tax Law § 1441 imposes a tax at the rate of 10% upon gains derived from the transfer of real property within New York State. Tax Law § 1443(1) provides that a partial or total exemption shall be allowed if the consideration is less than $1,000,000.00.

B. Tax Law § 1440(7) defines the term "transfer of real property" to mean "the transfer or transfers of any interest in real property by any method, including but not limited to sale."

The third sentence of Tax Law § 1440 (former [7]), in effect during the periods at issue, provided:

> Transfers of real property shall also include partial or successive transfers, unless the transferor or transferors furnish a sworn statement that such transfers are not pursuant to an agreement or plan to effectuate by partial or successive transfers a transfer which would otherwise be include in the coverage of this article . . . provided that the subdividing of real property and the sale of such subdivided parcels improved with residences to transferees for use as their residences, other than transfers pursuant to a cooperative or condominium plan, shall not be deemed a single transfer of real property.

C. Petitioners contend that lots 9, 16, 28, 29, 30, 42, 49, 92 and 66 should not be aggregated, for purposes of computing gains tax liability, because, before these lots were transferred, they contained improvements such as roads, curbs, utilities or hookups for utilities, a foundation and partial framing. For purposes of obtaining financing, title to the property had to be in the name of the individual purchasers. However, at the time of transfer of title to the purchasers, Malrath had complete control over the building of the residential homes and was to be the general contractor. Petitioners' position is without merit.

In ***Matter of Starburst Development Co., Inc.*** (Tax Appeals Tribunal, May 5, 1994), the

Tribunal affirmed the Administrative Law Judge who held that the statute required that the real property be improved with a residence prior to its transfer. The Tribunal noted that the consideration for the transfer is fixed at the moment that the taxable event occurs, i.e., the transfer of the real property. The Tribunal also stated, "If in drafting this very specific exception to aggregation, the Legislature intended to include parcels to be improved with residences, as well as parcels improved with residences, we believe the statutory language would indicate this intention."

In their brief, petitioners cite to ***Matter of Deerwood Estates, Ltd.*** (Tax Appeals Tribunal, November 17, 1994) for the proposition that the exclusion set forth in Tax Law § 1440 (former [7]) would apply even though the lots were transferred prior to the homes being built thereon. Petitioners are incorrect. ***Deerwood Estates*** examined the intent of the transferor to transfer lots pursuant to a plan to dispose of the entire parcel in order to ascertain whether aggregation was proper. The Tribunal, noting that the plan in **Deerwood** was to transfer lots in a subdivision improved with residences, stated that transfers of effectuating such a plan *would* "fall under the clause in section 1440(7) excepting the transfer of lots improved with residences to transferees for use as such from aggregation." But, in **Deerwood**, the parcels were not transferred pursuant to that plan. Nowhere did the Tribunal state that the exception would apply even though the transfers were made *prior* to the building of the residences.

Petitioners' citation to ***Deegan Development Group, Inc***. (Advisory Opinion, TSB-A-93[20]R) is also misplaced. This Advisory Opinion relates to instances where the owner of the real property transfers the property to the developer to facilitate financing for the benefit of the owner and the developer is obligated, upon completion of the project, to transfer the property back to the owner. In that case, the developer would not be viewed, for gains tax purposes, as

having owned or transferred the beneficial interest in the property. Since these are not the facts in the present matter, this Advisory Opinion is of no relevance.

D. At he conciliation conference, the conferee reduced the consideration received by Malrath on the sale of lots 28, 25 and 97 by $5,000.00 to $28,000.00 per lot on the transfers to the investors. It must be noted that in the original assessment, the consideration for lots 28 and 25 was listed as $30,000.00 and the consideration for lot 97 was $29,000.00. Apparently, the consideration was not, in fact, reduced by $5,000.00; on the revised assessment, original purchase price was increased from $12,578.00 per lot to $17,005.87 per lot which reduced the gain and, accordingly, reduced the tax on each of these lots. The Report of Tax Conferences also indicated that the conferee granted an exemption of 25% of the tax on these lots due to a "beneficial interest" in the lots. Even petitioners, in their brief, acknowledge that the basis of this allowance is unknown to them.

Now, however, petitioners maintain that such "beneficial interest" is 100%, not 25%, and, as a result, the lots should be excluded from aggregation. In response, the Division states that only 25% of the consideration for the lots constituted a change in form of ownership which would not be subject to tax and that no further reduction is warranted.

The parties, perhaps due to the conciliation conferee's granting of the 25% exemption (the basis for which is unknown), seem to agree that there was a transfer of ownership regarding the three lots which were given by Malrath to the investors. The evidence presented herein does not substantiate that fact, however. Pursuant to the agreements with the three investors, each was to advance to Malrath the sum of $30,000.00 which sums were to be used by Malrath for development of the property (Felicia Estates). In return, each investor was to receive the sum of $750.00 for each lot sold by Malrath up to a maximum of 50 lots, plus each investor was to

receive, without additional consideration, such investor's choice of one interior lot. There is no provision in the agreement, nor is it stated in the court decision (***see***, Finding of Fact "13") that an investor became a part owner in the lots acquired by the other investors. The court decision even states that the agreement provides that it was not to be construed that a general partnership was to be created between the parties or that the investors would be given a lien or security interest in the property. Morever, the court decision stated, "There was no testimony by any of the parties that the word 'interest' was ever mentioned throughout negotiation of the agreements."

How and why the conciliation conferee granted a 25% exemption is unclear. There is certainly no evidence that Malrath and the three investors agreed to or did, in fact, hold title in the three lots (lots 28, 25 and 97) in any joint or common manner. The only evidence in the record is that Malrath did, pursuant to the terms of the agreement, transfer a lot to each of the three investors. These three individuals were *only* investors; they did not acquire ownership of the property and, therefore, could not have had a change in the form of ownership when they received the property. Petitioners' contention that the investors had a 100% beneficial interest in the lots is totally unsupported by the record. The conferee allowed Malrath a 25% exemption. Its claim that it was entitled to 100%, absent any evidence to substantiate that claim must, therefore, be denied.

E. Petitioners contend that total tax should be reduced by the amount of $4,430.00. In their brief, petitioners have set forth calculations which purport to substantiate this amount. The agreement with the investors (Crooks, Mastro and Frey) provided that each was to receive the sum of $750.00 for each lot sold by Malrath up to a maximum of 50 lots (48 lots were sold). Therefore, Malrath was obligated to pay the investors $108,000.00 ($750.00 x 3 x 48 lots).

Initially, petitioners maintain that the total consideration for all 48 lots ($1,400,300.00) should be reduced by $79,000.00. It is unclear how this number was arrived at; perhaps, petitioners actually meant to contend that $89,000.00 should be removed from the consideration, since this was the total consideration assigned to the lots (lot 97 - $29,000.00; lot 28 - $30,000.00; and lot 25 - $30,000.00). In any event, as provided in Conclusion of Law "D", petitioners have not shown the they are entitled to any additional reduction in consideraton other than that previously granted by the conciliation conferee.

The reconstructed consideration of $1,321,300.00 ($1,400,300.00 - $79,000.00) should then, according to petitioners, be divided into $108,000.00, the total amount paid to the investors pursuant to the agreement. The result ($108,000.00 ÷ $1,321,300.00 = .0817), petitioners state, should then be multiplied by the tax as recomputed by the conferee ($57,077.26) minus the tax attributable to the three lots ($2,849.00), or $54,228.00 x .0817 = $4,430.00. Petitioners cite no statutory authority for this computation other than a general statement that the investors, or co-venturers as petitioners refer to them, were the transferors, along with Malrath, of the 48 lots from which they received their $750.00 per investor per lot as provided by the agreement. As the Division correctly points out, it was Malrath which received the consideration upon the transfer of these lots. Each of the investors gave Malrath $30,000.00 pursuant to the terms of the agreement. While Malrath did distribute a portion of the consideration to the investors, it does not alter the fact that Malrath alone received the consideration from the sale of these lots. There is absolutely nothing in this record to indicate that these investors (or co-venturers) took title to these 48 lots or had any interest in the lots, other than entitlement to $750.00 each upon the sale thereof. That being the case, petitioners' argument that the consideration from the sale of the 48 lots should be reduced by the $108,000.00 received by the investors and, accordingly, that the tax

imposed upon Malrath should be proportionately reduced by $4,430.00 is totally without merit and must be denied.

F. Malrath next argues that lots 52 and 71 should not be aggregated with the other lots sold by Malrath since they were traded for other lots from third parties which remained unsold in Malrath's inventory. In its brief, Malrath admits that "the literal language of the Statute would indicate such a trade falls within the term 'exchange'," it nevertheless maintains that the statute never intended to include such trades since there was no economic gain to Malrath and such an exchange could be considered a mere change in form or identity.

Tax Law § 1440 (former [7]) provided that the term "transfer of real property" means "the transfer or transfers of any interest in real property by any method, including but not limited to sale, [or] *exchange. . . .*" In the present matter, there was clearly an exchange of one parcel of real property for another.

Tax Law § 1443(5) provides that a total or partial exemption shall be allowed "[i]f a transfer of real property, however effected, consists of a mere change of identity or form of ownership or organization, where there is no change in beneficial interest." Examples of types of transactions covered by this statute are transfers by a person to a partnership in exchange for an interest in the partnership or transfers by a corporation to its shareholders who will hold the real property as tenants in common in the same pro rata share as they own the corporation (**see**, 20 NYCRR 590.51[a]). Here, there was not a change in the form of ownership, but a change in the actual parcel of real property owned. The fact that Malrath did not sell the parcel acquired in the trade is of no consequence. It disposed of a parcel of real property and, instead of receiving cash consideration, it agreed to take back title to another parcel of real estate as consideration. This is

an "exchange" which, pursuant to Tax Law § 1440 (former [7]) is subject to imposition of the gains tax.

G. Malrath contends that the consideration received from the sale of Lots 126 and 129, from Felicia Estates West, should not be aggregated with the consideration which it received from the sale of the lots in Felicia Estates. This is true, Malrath argues, because Felicia Estates West was acquired by Malrath three years after it had acquired Felicia Estates and, at the time of its purchase of Felicia Estates i n 1986, there was no intent or plan to purchase the second parcel (Felicia Estates West).

Both Felicia Estates and Felicia Estates West were purchased by Malrath from the same seller, Gerald Kalandis. The lots at issue were contiguous to the Felicia Estates lots and were used for the same purpose, i.e., development and sale as residential lots.

As petitioner correctly points out, the Tribunal, in ***Matter of Deerwood Estates, Ltd.*** (***supra***), recognized that in determining whether lots have been transferred pursuant to a plan to dispose of an entire parcel, it is relevant to consider petitioner's intent. 20 NYCRR 590.43(a) provides that :

> [w]hether the sales are pursuant to a plan or agreement depends on the intent of the transferor at the time of each transfer. The department will examine the transferor's intention, as manifested by his actions and the facts and circumstances surrounding the transfers, to ensure the transfers should not be aggregated.

In response , the Division states that Malrath has not provided documentation or proof establishing that the consideration from the sale of the two lots in Felicia Estates West should not be aggregated with the consideration received from the sale of the lots in Felicia Estates. In ***Matter of Starburst Development Co., Inc***.(***supra***), the Tribunal stated;

> The correct application of the aggregation clause has been succinctly stated as follows: where 'property is subdivided pursuant to an overall subdivision plan that envisions the sale of the entire property in the form of many smaller parcels, such sales are subject to aggregation for the purposes of the real property transfer gains tax' (***Matter of Benacquista, Polsinelli & Serafini Mgt. Corp v. Commr. of Taxation &Fin.***, 191 AD2d 80, 598 NYS2d 829,831).

A simple declaration denying the existence of a plan or agreement, in and of itself, is not sufficient to prove that aggregation was improper. In ***Executive Land Corp. V. Chu*** (150 AD2d 7, 545 NYS2d 354, ***appeal dismissed*** 75 NY2d 946, 555 NYS2d 692, the Court stated:

> The plaintiff's interpretation of [Tax Law § 1440(7)] is incorrect as it would allow any transferor to claim exclusion from the gains tax simply by stating that he is not acting pursuant to a plan to avoid the tax. That is not a rational interpretation of the statute, nor of its clear underlying legislative purpose (***Executive Land Corp. V. Chu***, ***supra***, 545 NYS2d at 357).

In the present matter, while Felicia Estates West was not acquired by Malrath until three years after its acquisition of Felicia Estates (***see***, Findings of Fact "4" and "12"), the parcels were contiguous , were acquired from the same transferor and were utilized by the transferee (Malrath) for the identical purpose. Absent other evidence in addition to a mere general denial by Michael Malarkey that there was no plan or intent, at the time of Malrath's purchase of the initial parcel in 1986, to purchase the second parcel, it cannot be found that petitioners have satisfactorily proven that there existed no such plan or intent to purchase, develop and sell the real property from both parcels. Accordingly, the Division's aggregation of lots 126 and 129 with the lots of Felicia Estates cannot be found to have been improper.

H. Petitioners assert that penalties imposed upon the assessments should be abated. Tax Law § 1146(2)(a) provides, in part, as follows:

> Any transferor failing to file a return or to pay any tax within the time required by this article shall be subject to a penalty . . . . If the tax commission determines that such failure or delay was due to reasonable

> cause and not due to willful neglect, it shall remit, abate or waive all of such penalty and such interest penalty.

In ***LT&B Realty Corp. V. New York State Tax Commn.*** (141 AD2d 185, 535 NYS2d 121) the Court held that consulting with and following the advice of a tax professional does not per se constitute reasonable cause which would insulate a taxpayer from penalties for failure to file a return or pay tax. The Court stated that, rather than to adopt a rule which would permit consulting with a tax professional to act as immunity to penalties, it is better to consider the particular facts of each case for a determination of reasonable cause. The actions of the particular taxpayer must be evaluated in light of the information available at the time of the transaction (***Matter of 61 East 86th Street Equities Group,*** Tax Appeals Tribunal, January 21, 1993).

An examination into the facts and circumstances of this particular matter leads to the conclusion that reliance on the advice of petitioners' attorney and accountant was reasonable. Petitioner Michael Malarkey's testimony that Attorney Bruce O. Becker was noted for his expertise in matters of construction and in all matters relating thereto, including taxation, was completely credible. He stated that this attorney referred him to an accountant, William Starring, whose office was located in the same building. Attorney Becker informed him that Mr. Starring was an expert in the fields of construction, development and subdivision. Mr. Starring assisted in organizing Malrath in 1986 and he assisted in the preparation of all corporate tax returns. Contrary to the Division's assertions in its brief, the fact that Michael Malarkey had been in the building industry for a number of years does not logically indicate that he would be aware of the gains tax since there is no evidence that he had ever been involved in developing a large tract of land which, upon its sale, would result in the imposition of this tax. In 1986, when Malrath

purchased Felicia Estates, the gains tax had existed for only three years (it was added by chapter 15 of the Laws of 1983). In Broome County where petitioners were located, it is unlikely that the $1,000,000.00 threshold was reached in a significant number of real estate transfers during the three years following the enactment of this statute. However, there are other relevant facts which warrant a finding of reasonable cause under the facts and circumstances herein.

The letter from Attorney Becker to the accountant, William Starring on October 26, 1992 (***see***, Finding of Fact "18") is evidence that both the attorney and accountant were unsure as to Malrath's liability for gains tax. From the letter it certainly appears that neither had advised Malrath of potential liability prior to October 1992 and it must be noted that there is no indication that a copy of the letter was ever sent to petitioners. Petitioner Michael Malarkey's testimony was credible that he never received a copy of the letter until it was furnished to him by the Division's auditor.

Perhaps petitioners relied on the advice and expertise of two individuals who did not possess the requisite qualifications. However, under the facts and circumstances herein, petitioners' reliance must be found to have been reasonable. Accordingly, penalties imposed upon the assessments against petitioners must be abated.

I. Petitioner Michael Malarkey contends that the Division did not properly issue the Notice of Determination, dated January 19, 1995, to him and that his Request for Conciliation Conference, mailed on October 22, 1996, must, therefore, be deemed timely. Petitioners' contention is without merit.

Tax Law § 1444 provides that a Notice of Determination shall finally and irrevocably fix tax owing unless the person against whom it is assessed applies within 90 days to the Division of Tax Appeals for a hearing (***cf.***, ***Matter of Air Flex Custom Furniture***, Tax Appeals Tribuanl,

November 25, 1992). The taxpayer has the option of protesting the notice by requesting a conciliation conference with the Bureau of Conciliation and Mediation Services in lieu of filing a petition for a hearing with the Division of Tax Appeals if the 90-day period to petition for a hearing has not elapsed (Tax Law § 170[3-a][a]; 20 NYCRR 4000.3[a]; 4000.5[c]).

In this case, petitioner Michael Malarkey requested a conciliation conference. However, it was mailed some 21 months after issuance of the Notice of Determination. The filing of a petition or request for conciliation conference within the 90-day time frame is a prerequisite to the jurisdiction of the Division of Tax Appeals.

When the timeliness of a petition or a request for conciliation conference is at issue, the Division has the burden of demonstrating proper mailing (***Matter of Air Flex Custom Furniture, supra***; ***Matter of Katz***, Tax Appeals Tribunal, November 14, 1991). To show that the notice was properly mailed to the taxpayer by certified or registered mail, the Division must provide evidence as to the general mailing procedure of such notice and provide proof that this procedure was followed when mailing the notice in question (***Matter of MacLean v. Procaccino***, 53 AD2d 965, 386 NYS2d 111, 112; ***Matter of Katz***, ***supra; Matter of Novar TV & Air Conditioner Sales & Serv***., Tax Appeals Tribunal, May 23, 1991). A properly completed Postal Service Form 3877 constitutes direct documentary evidence of the date and fact of mailing (***Matter of Air Flex Custom Furniture***, ***supra***). However , failure to produce a Form 3877 may not be fatal if there is other evidence to prove that the notice was properly delivered to the Postal Service for mailing. The certified mail record used by the Division contains most of the significant elements of the Postal Service Form 3877 and serves the same purpose.

Here, the Division established a standard mailing procedure through the Mahon and Baisley affidavits and further established that such procedures were followed in mailing the

Notice of Determination to Michael Malarkey. The certified mail record ("CMR") consisted of 12 fan-folded pages. The certified control numbers run consecutively and there were no deletions. Ms. Mahon's affidavit explains the reason why the date 01/09/95 was manually changed to 1-19-95. On page 11 of the CMR, it indicates that a Notice of Determination, Notice Number L010003896, was sent to Malarkey-Michael, 715 Columbus Ave., Endicott, NY 13760-2221, by certified mail using control number P 911 205 160. The U.S. postmark on each page of the CMR confirms, according to Ms. Mahon's affidavit, that the notice was sent on January 19, 1995. While it is true that some of the postmarks are illegible or only partially visible, this is not a fatal flaw since it is obvious that there was, in fact , a postmark placed on each page. Moreover, the postmarks on the first and last pages are legible and the integrity of the document, as a whole, is not in question.

Petitioner points to the fact that the CMR, on the last page thereof, does not have either a signature of a postal employee with the number of pieces marked or does not have filled in the "Total Pieces Received at Post Office." In this case, however, the affidavit of James Baisley, Chief Processing Clerk in the Division's Mail Processing Center, states that the postal employee affixed a postmark to each page of the CMR, circled the total number of pieces and initialed the CMR to indicate that this was the total number of pieces received by the Postal Service. Mr. Baisley stated that to his knowledge that the postal employee circled the "total number of pieces" for the purpose of indicating that 131 pieces were received by the Postal Service is based on the fact that the Mail Processing Center specifically requested that the postal employee either circle the number of pieces received or indicate the total number of pieces received by writing the number of pieces received on the CMR. The fact that the CMR does not contain a full signature and does not have the "Total Pieces Received at Post Office" filled in does not alter the fact,

based upon Mr. Baisley's affidavit, that the Division's standard procedure allowed for one of two alternate procedures. The circled number along with the initials of the postal employee are clear indications, based upon the Baisley affidavit, that the standard procedure of the Division was followed and that 131 pieces of mail (including the Notice of Determination addressed to petitioner Michael Malarkey) were received by the Postal Service for mailing. Therefore, the affidavits and CMR demonstrate proper issuance and mailing to this petitioner on January 19, 1995 (***see***, ***Matter of Roland***, Tax Appeals Tribunal, February 22, 1996; ***Matter of Huang***, Tax Appeals Tribunal, April 27, 1995).

As a result, it is hereby determined that petitioner Michael Malarkey failed to timely protest the Notice of Determination. Accordingly, the assessment against him, as reduced to $39,883.78, plus interest, in accordance with the Division's concession that this petitioner is liable for tax due from Malrath only for periods subsequent to April 19, 1989, is finally and irrevocably fixed.

J. Finally, petitioner Michael Malarkey asserts that, by virtue of the fact that the effective date of Tax Law § 1440(8) and (9), which imposed personal liability for gains tax upon responsible persons, officers or employees, was April 19, 1989, there should be no liability whatsoever imposed upon petitioner, since total sales by Malrath after April 19, 1989 was less than $1,000,000.00. There appear to be no cases, and petitioner admits that he knows of no reported cases, involving this issue which then becomes one of first impression.

As the Division correctly asserts, the imposition of gains tax arose from the transfer of real property by Malrath. Tax Law § 1440 (8) and (9) simply provided additional sources from which to collect the gains tax, i.e., it imposed personal liability upon responsible persons, officers or employees in cases where the actual transferor (in this case, the corporation) failed to properly

pay its gains tax liability. Once the $1,000,000.00 threshold has been met by the corporation, the personal liability attaches. However, since the effective date of the statute which imposed such personal liability was April 19, 1995, the responsible person (in this case, Michael Malarkey) cannot be assessed for taxes owed on transfers prior to that date. As stated in Conclusion of Law "I", petitioner Michael Malarkey's liability is irrevocably fixed at $39,883.78, plus interest.

K. The petition of Malrath Real Estate Development Corp. is granted to the extent indicated in Conclusion of Law "H"; the Division of Taxation is hereby directed to modify the Notice of Determination issue to this petitioner on January 9, 1995 accordingly; and, except as so granted, the petition is in all other respects denied.

L. The petition of Michael Malarkey is granted to the extent indicated in Conclusions of Law "H" and "J"; the Division of Taxation is hereby directed to modify the Notice of Determination issued to this petitioner on January 19, 1995 accordingly; and, except as so granted, is in all other respects denied.

DATED: Troy, New York
November 5, 1998

/s/ Brian L. Friedman
ADMINISTRATIVE LAW JUDGE