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CAPITAL GAINS TAX - CONSIDERATION - FORECLOSURE SALE

The issues presented by this request for an advisory opinion were (a) Whether for purposes of the Capital Gains Tax, the consideration received by petitioner for the transfer of condominium units at a foreclosure proceeding sale was the bid price, or the amount of the unpaid mortgage indebtedness, and (b) Are construction costs incurred by petitioner, but not yet paid, to be included in the consideration paid by plaintiff-lender?

A sum of approximately $3 million remain unpaid on this construction mortgage at the time when the lender declared petitioner-developer in default. Of the total of 113 units constructed, ten remained unsold, These remaining units were sold at the foreclosure sale, free and clear of all liens (including the lender's mortgage lien) for a total sales price of $1,100,000. These sales proceeds were used to pay down the mortgage, leaving an approximate balance due of $1,900,000. Plaintiff filed a claim for a refund based upon capital gains taxes paid on all 133 units (including the $1,100,000 received at the foreclosure sale).

The Audit Division denied this claim on the basis that when the mortgagee is the successful bidder in an action to foreclose a mortgage, the consideration for tax purposes should include the total unpaid mortgage indebtedness as well as the amount of the construction costs incurred by petitioner, including the unpaid construction costs incurred by petitioner in the approximate sum of $580,000, which constituted additional consideration to petitioner for the transfer of the remaining ten units.

Such denial relied on Capital Gains Regulation 590.59, which provides in part that when the mortgagee is successful bidder at a mortgage foreclosure sale, the original purchase price (and consideration) will be the price paid or the amount of the judgment in foreclosure as established by the referee to be due to the mortgagee, whichever is higher.

Citing Regulation 590.10 (a), the Commission opined that "consideration includes the cancellation or discharge of an obligation.

Matter of Port Jefferson Development Corp.
Advisory Opinion, Pet, No. 950215b, 8/22/95.

CAPITAL GAINS TAX-LEASE - OPTION TO BUY

In July of 1990, petitioner entered into a lease with one Gardner Trust for a period of 49 years. Pursuant thereto. Gardner paid petitioner $499,990 for an option to purchase, which could not be exercised prior to July, 1995, with a further option to accelerate the purchase to January 1994.

The lease called for the payment of $41,000 per month for the first ten years of the term. The lease limited landlord's remedies against tenant under the lease to "tenant's estate and interest in this lease" and "no other property or assets of tenant shall be subject" to enforcement procedures with respect to tenant's liabilities under the lease.

Petitioner received such monthly payments from July 1990 to October or November 1991, when Gardner informed him of his desire to terminate the lease. Petitioner used all but about $150,000 of the option consideration to pay back taxes, repave sidewalks and to cure fire code violations as demanded by tenant.

Petitioner acknowledged in his initial Transferor Questionnaire that he owed $390,988 in Capital Gains Taxes and was allowed by the Tax Commission to pay this in 15 equal annual installments of approximately $26,000 each. As of July 1991, petitioner had paid such taxes of $2,000 plus interest of $46.000.

In December 1992, petitioner paid under protest an additional $60,423 principal and interest for the 1992 installment pursuant to the Tax Commission's demand, and in July 1993, paid $49,500 more principal and interest at the 1993 installment. The Tax Commission rejected petitioner's application for the return of these monies.

Opinion: Former Section 1440 (7) includes in its definition of "transfer of real property" situations where a lease extends an option to purchase, together with the right of use and occupancy even in leases of less than 50 years duration.

Former NYCRR 590.27 provides further that the consideration is the present value of the net rental payments under the lease, plus the consideration paid for the option. Rent payments for periods occurring after the option is no longer exercisable am not included in the calculation. If the result is over $1,000.000, then the transfer is subject to the tax.

Citing *Matter of Cheltgencort Co. v. Tax App. Tribunal*, 592 NYS2d 121 (A. D.). the Commission held that the Gains Tax is determined at the time of the transaction.

Consequently, the fact that the option could not be exercised until six years later was of no moment (*Matter of Ford Associates*, Tax App. Trib. 5/26/94 (exercised after 18 years)) as was the fact that such option could become nonexistent due to the tenant's default or failure to exercise such option.

It concluded that "whether the option is exercised is irrelevant to the taxability of the granting of the option."

The Tribunal distinguished the subject case from *Matter of Fort Tryon Apts* (DTA No. 81098, 8/10/95) where a lease provision gave a co-op corporation the potential right to cancel a lease with a sponsor.

This indicated a contemplation of the parties that the lease might be terminated and was "clearly a factor that would affect the value of the lease and should be taken into account in valuing the leasehold for gains tax purposes."

Matter of Sidney Rapoport
DTS No, 811824, 8/31/95.

CAPITAL GAINS TAX PAID BY BROKER

In a sale for over $1,000,000, involving several parcels of land, it was tentatively calculated that the Gains Tax would be approximately $76,000. The real property broker agreed to pay this tax and has acknowledged that it would not be reimbursed by purchaser for the same.

The Tax Commission stated in its advisory opinion that Section 590.9 of the Gains Tax Regulations provides in part (Tax Law Sec. 1440 [1]) that if a Transferee agrees to pay the Gains Tax for the Transferor, the same constitutes additional consideration to the Transferor.

In the instant case, the Tax Commission opined that provided that this arrangement is not formulated to relieve the Transferor from a contractual obligation to pay this tax, such payment shall not constitute additional consideration for the sale.

Matter of Schwagerl
Pet. No. M090601A, 10/30/95.