NEW YORK CITY TAX APPEALS TRIBUNAL
ADMINISTRATIVE LAW JUDGE DIVISION

In the Matter of the Petition	:	
	:	**DETERMINATION**
of	:	
	:	**TAT(H)11-20(CR)**
York Avenue Tennis, LLC.	:	

Bunning, A.L.J.:

Petitioner York Avenue Tennis, LLC filed a petition for redetermination of a deficiency (Petition) of New York City (City) Commercial Rent and Occupancy Tax (CRT) for the three annual periods ending May 31, 2008, May 31, 2009, and May 31, 2010 (the Tax Years) under Title 11, Chapter 7 of the Administrative Code of the City of New York (Administrative Code) asserted in a Notice of Deficiency issued by the City Department of Finance (Respondent) on September 12, 2011.

On July 25, 2013, the parties submitted a stipulation of facts, including exhibits (Stipulation), in which they agreed to have this matter determined on submission without hearing, pursuant to Section 1-09(f) of the City Tax Appeals Tribunal (Tribunal) Rules of Practice and Procedure (Rules). Petitioner and Respondent filed briefs, the last of which was filed on May 5, 2014.

Kenneth D. Friedman, Esq., of Manatt, Phelps & Phillips LLP represented Petitioner, and Frances J. Henn, Esq., Assistant Corporation Counsel of the City Law Department, represented Respondent.

ISSUES

1. Whether Petitioner is liable for additional CRT for the Tax Years because where rent is computed as the greater of a minimum annual rent or a percentage of gross receipts, and only the minimum annual rent is paid, the CRT base is the minimum annual rent rather than 15% of gross receipts, Administrative Code § 11-704.g.

2. Whether the imposition of penalties for negligence and substantial understatement, computed pursuant to Administrative Code §§ 715(d)(1) and (2) and (j), is appropriate.

FINDINGS OF FACT

Petitioner is a limited liability corporation organized under the laws of the State of New York. Petitioner entered into a license agreement with the City Department of Parks and Recreation (Parks) on August 3, 2007 with respect to the operation and management of the indoor tennis facility and clubhouse located at 488 E. 60th Street in the Borough of Manhattan (Agreement). The Agreement provided that Petitioner was to pay Parks a license fee computed as the higher of a minimum annual rent or 35% of Petitioner's gross receipts.

Petitioner and Parks entered into a First Amendment to the Agreement dated November 16, 2009. Pursuant to the amendment, beginning September 1, 2009, from May to August of each year, Petitioner was to pay the greater of a minimum annual rent or 25% of Petitioner's gross receipts, and was to pay the greater of a minimum annual rent or 35% of its gross receipts for the remaining months of the year.

The Agreement provided that minimum annual rent was $1,700,000, $1,785,000 and $1,874,250, respectively, in each of the Tax Years. The gross receipts for these years totaled $4,218,118, $3,856,213, and $4,320,213, respectively. Thus in each year, the minimum annual rent was greater than the amount of rent determined by gross receipts, and Petitioner accordingly paid the minimum annual rent. Petitioner never paid rent based on a percentage of gross receipts during the Tax Years.

Petitioner filed Commercial Rent Tax returns (Form CR-A) for each of the Tax Years. For each year, Petitioner paid CRT computed using a tax base of 15% of gross receipts, rather than the minimum annual rent actually paid. For the annual period ended May 31, 2008, gross receipts were $4,218,118. Petitioner computed CRT by taking 15% of $4,218,118, applied the 35% exclusion,[1] and the 6% CRT rate to arrive at tax of $24,676.02.[2] Similar computations were used to arrive at tax of $29,500.02 for the period ended May 31, 2009, and $25,273.26 for the period ended May 31, 2010.

Respondent performed a field audit of Petitioner's CRT returns for each of the Tax Years. Following that examination, Respondent issued a Notice of Determination dated September 12, 2011 asserting that additional tax, interest, and penalty were due for each year. Respondent took the position that the entire amount of minimum annual rent paid pursuant to the Agreement was subject to CRT, rather than just the 15% of gross receipts which Petitioner reported. Respondent issued a Notice of Determination dated September 12, 2011 , which asserted that the following additional amounts were due (including interest computed through October 31,

[1]Administrative Code § 11-704(h)(2)(iii).

[2]The computation rounded 15% of receipts to $632,718 and rounded 15% of that number to $411,267.

2011):

Tax Period Ended	Tax	Interest	Penalty	Total
5/31/08	$41,892.83	$11,220.72	$11,894.28	$65,007.83
5/31/09	$40,483.27	$7,335.51	$9,740.25	$57,559.03
5/31/10	$48,085.59	$4,409.85	$9,417.76	$61,913.20
TOTALS	$130,461.69	$22,966.08	$31,052.29	$184,480.06

Petitioner timely filed the Petition with the Tribunal on November 2, 2011. Respondent timely filed an answer to the Petition, dated January 5, 2012.

Attached to the Stipulation is the affidavit of Petitioner's certified public accountant, sworn to July 24, 2013, which states that he "relied on the Instructions to the CRT tax forms issued by the [New York City] Department [of Finance] when computing the CRT for the tax periods in question."

Also attached to the Stipulation are copies of correspondence from Petitioner's attorneys to Respondent's auditors explaining the basis for Petitioner's position and its interpretation of the legal authorities in support.

STATEMENT OF POSITIONS

The parties agree that Petitioner is liable for CRT for license fees paid pursuant to the Agreement. The dispute is how

the CRT is to be computed.

Petitioner asserts that although the minimum annual rent was paid each year because the gross receipts were not high enough to trigger the percentage rent, the statutory limitation of Administrative Code § 11-704.g applies so that the tax base for CRT purposes is 15% of the gross receipts rather than the greater amount of minimum annual rent actually paid. Petitioner contrasts its situation with the rent formulas presented in the regulation and case law where the taxpayer paid a minimum rent plus a percentage of gross receipts, resulting in the statutory limitation applying only to the percentage rent, and not to the minimum rent. Petitioner argues in the alternative that if that position is incorrect, it should not be subject to penalties because it acted reasonably and in good faith.

Respondent asserts that because Petitioner paid the minimum annual rent in each of the Tax Years, the entire amount of the minimum rent was subject to CRT and the 15% statutory limitation never came into play. Respondent contends that the penalties are appropriate because there is no authority for Petitioner's position.

CONCLUSIONS OF LAW

Section 11-702 of the Administrative Code imposes CRT on the base rent paid by every tenant of taxable premises. Section 11-701.7 defines "base rent" as the "rent paid for each taxable premises by a tenant . . . ." "Rent" is defined in Administrative Code § 11-701.6 as "[t]he consideration paid or required to be paid by a tenant for the use or occupancy of premises . . . ." Section 11-701.5 defines "taxable premises" as "[a]ny premises in the city

occupied, used or intended to be occupied or used for the purpose of carrying on or exercising any trade, business, profession, vocation or commercial activity . . . ."

Where rent is computed as a percentage of the tenant's gross receipts, a special rule applies. Administrative Code § 11-704.g provides:

> Whenever the rent paid by a tenant for his or her occupancy of taxable premises is measured in whole or in part by the gross receipts from the tenant's sales within such place, the tenant's rent, to the extent paid on the basis of such gross receipts, shall be deemed not to exceed fifteen percent of such gross receipts.

The relevant regulation, City Commercial Rent Tax Regulation (19 RCNY) § 7-01(7)(i), restates the statutory rule and provides two examples:

> This 15 percent limitation applies where the rental agreement provides for a rent based wholly or partly on a percentage of sales receipts and the stated percentage exceeds 15 percent. The maximum rent in such cases is the higher of 15 percent of gross receipts or the fixed rental plus 15 percent of sales subject to the percentage.[3]
> To illustrate: (A) A tenant leases a store for an annual rental of 25 percent of his gross receipts from sales. The gross receipts for the year total $200,000 and the tenant pays his landlord $50,000. The rent subject to tax is $30,000 (15 percent of $200,000).

[3]The instructions to the CRT return (Forms CR-Q and CR-A) are consistent with the regulation. They provide, as set forth in the affidavit of Petitioner's certified public accountant, "Where the rent paid by a tenant for the occupancy of taxable premises is measured in whole or in part by the gross receipts from the sales within the premises, the rent, for purposes of computing the Commercial Rent Tax is the actual percentage of gross receipts due the landlord, but not in excess of 15% of gross receipts." (Emphasis supplied.)

> (B) A tenant leases a store for an annual rental of $50,000 plus 25 percent of his gross receipts from sales in excess of $200,000. The gross receipts for the year total $300,000 and the tenant pays his landlord $75,000. The rent subject to tax is $65,000 ($50,000 fixed rental plus 15 percent of sales over $200,000).

Petitioner contends that the formula in the Agreement does not fall within the scope of the examples in the regulation because the examples deal with situations where there is either no fixed minimum rent (Example A) or the rent is the sum of a fixed rent plus a percentage of gross receipts (Example B). Petitioner seeks to contrast Example B with the Agreement's provision that rent is to be the greater of a fixed annual amount or a percentage of gross receipts.[4] Petitioner cites *Matter of Square Plus Operating Corp.* (TAT No. 90-1221 [NYC Tax Appeals Tribunal, October 29, 1992], *affd* 212 AD2d 448 [1st Dep't 1995],*lv denied*, 87 NY2d 804 [1995]) as an example of rent computed as the sum of a fixed amount plus a percentage of gross receipts. Petitioner concludes that because the Agreement phrases the rent computation differently, *Square Plus* and Example B do not apply. Petitioner argues that its CRT liability should be computed based only on 15% of the gross receipts, even though it paid the higher minimum rent in each of the Tax Years.

Petitioner misreads the statute, the regulation, the *Square Plus* decision, and the instructions to the CRT return. As Petitioner notes, the statute is to be interpreted according to its plain language, and because it is neither special nor technical,

[4]Petitioner argues that the rent it paid "is not a guaranteed minimum plus a portion based on gross receipts. Instead, the franchise fee is an either/or proposition that must be determined by measuring York's gross receipts for the operating year in question." (Petitioner's Opening Brief at p. 10, emphasis in original.)

there is no need for deference to Respondent's position. (*Matter of SIN, Inc. v Department of Fin. of City of N.Y.*, 71 NY2d 616 [1988]; *see also*, *Matter of American Airlines, Inc.*, TAT(E)05-29(HO) [NYC Tax Appeals Tribunal June 29, 2009].) However, the statute unambiguously provides that the 15% limitation applies only when a taxpayer is paying percentage rent; it does not reduce the CRT tax base to reflect receipts when the taxpayer is paying minimum rent. The regulation and instructions to the CRT return mirror this rule.

Administrative Code § 11-704.g provides that the 15% limitation applies to rent "to the extent paid on the basis of such gross receipts[.]" City Commercial Rent Tax Regulation § 7.01(7)(i) states that "[t]he maximum rent in such cases [where percentage rent applies] is the higher of 15 percent of gross receipts or the fixed rental plus 15 percent of sales subject to the percentage." This means that minimum rent is entirely taxable and the 15% limitation applies only to the extent that there is additional rent (beyond the minimum) based on a computation of gross receipts at a percentage higher than 15%. Where, as here, only a minimum rent was paid, the entire amount is subject to CRT. The percentage formula and thus the statute's 15% limitation never come into play. (Administrative Code § 11-704.g; 19 RCNY § 7-01(7)(i).)

The fact that the rent in this case is computed by comparing the greater of a fixed amount and a percentage of gross receipts does not change this result. Any rent formula that involves a minimum annual rent and a percentage of gross receipts necessarily requires a computation of gross receipts to compare to the minimum amount to determine the total amount of rent to be paid. However, this does not mean that only 15% of receipts are included in the

CRT base. Minimum rent is fully subject to CRT.

Petitioner's argument that the examples in the regulation and *Square Plus* are different from this case is unavailing. In *Square Plus*, rent was computed as a percentage of gross receipts, with an annual minimum rent. Thus it was not a case of minimum rent plus a percentage of sales above this amount. It was, like this case, an agreement to pay the greater of a minimum annual rent or a percentage of gross receipts. The First Department held that the statutory provision at issue here "applies only to that portion of the rent paid and calculated solely on the basis of gross receipts . . . . The section does not apply to the guaranteed minimum portion of such rent, as clearly illustrated by example (B) of the regulations at 19 RCNY § 7-01(7)(i) . . . ."

Thus, *Square Plus* resolves this issue and holds that Example B of the regulation governs the case here. Because Petitioner paid the minimum annual rent and did not pay a percentage of receipts during the Tax Year, Administrative Code § 11-704.g and 19 RCNY § 7-01(7)(i) were not triggered.

The instructions to the CRT return say the same thing. To the extent rent is computed as a percentage of sales, "the rent, for purposes of computing the Commercial Rent Tax is <u>the actual percentage of gross receipts due the landlord</u>, but not in excess of 15% of gross receipts". (Emphasis supplied.) The use of the words "due the landlord" leaves no doubt that the actual rent paid is the starting point for the computation of the CRT base.

Despite the fact that Petitioner's position was not accepted here, this is not an appropriate case for penalties because the facts support Petitioner's claim that it acted reasonably and in

good faith. Respondent imposed the negligence penalty consisting of 5% of the tax plus 50% of the interest under Administrative Code § 11-715(d)(1) and (2), and the 10% substantial understatement penalty provided by Administrative Code § 11-715(j). By its terms, the negligence penalty is to be imposed if "any part of an underpayment of tax is due to negligence or intentional disregard of this chapter or any rules or regulations hereunder (without intent to defraud) . . . ."

Section 11-715(j) provides that a substantial understatement of tax exists where the amount of the understatement exceeds the greater of ten percent of the tax required to be shown on the final return or five thousand dollars. The amount of the understatement is to be reduced by any portion of the understatement for which there is substantial authority for the position, or the relevant facts affecting the tax treatment were adequately disclosed on the return or a statement attached to the return. The penalty may be waived "on a showing by the taxpayer that there was reasonable cause for the understatement (or part thereof) and that the taxpayer acted in good faith."

The relevant facts were not disclosed on the return or an attachment and Petitioner does not suggest that they were. Instead, Petitioner argues that it acted with reasonable cause and in good faith.

The Administrative Code does not define "negligence" or "intentional disregard." However, analogous federal tax authority provides guidance. The accuracy-related penalty of Internal Revenue Code ("IRC") § 6662 is imposed where an underpayment is attributable to certain types of misconduct including "negligence or disregard of rules or regulations." IRC § 6662(c) provides that

"'negligence' includes any failure to make a reasonable attempt to comply with the provisions of this title, and the term 'disregard' includes any careless, reckless, or intentional disregard."

Negligence has been defined by the U.S. Tax Court as a lack of due care or failure to do what a reasonable and prudent person would do under similar circumstances. *(Van Alen v Commr.*, TC Memo 2013-235 [Tax Ct. 1982] and cases cited therein.)

City Commercial Rent Tax Regulation § 7-17(b)(5) provides that "reasonable cause" may include

> any other cause for delinquency which appears to a person of ordinary prudence and intelligence as a reasonable cause for delay in filing a return and which clearly indicates an absence of gross negligence or willful intent to disobey the taxing statutes. Past performance should be taken into account. Ignorance of the law, however, will not be considered reasonable cause.

Petitioner did not disregard or ignore the CRT provisions. It was aware of the statute and the regulation and its advisors apparently studied them in coming to the conclusion that it was subject to the percentage rent provisions. That position was not successful here, but it appears to have been made reasonably and in good faith. The record is replete with correspondence from Petitioner's attorneys to Respondent's auditors explaining Petitioner's interpretation of the law. Petitioner submitted the affidavit of a certified public accountant who stated that he relied on the instructions to the CRT forms and believed that he followed them in preparing the CRT returns at issue here. The United States Supreme Court recognized in *United States v Boyle* (469 U.S. 241 [1985]) that reasonable cause may be based on a taxpayer's following a tax expert's erroneous advice.

Respondent argues that *Matter of J. Henry Schroder Bank & Trust Co.* (TAT(H)93-117(CR) [NYC Tax Appeals Tribunal August 31, 1995]) supports the imposition of penalties. This decision of an administrative law judge is not precedent here (City Charter § 168.d; Tribunal Rules § 1-12(e)(2)). Further, it is distinguishable because in that case there was authority in the form of case law expressly holding that the amounts excluded from rent were required to be included and there were no facts to demonstrate the taxpayer's reliance on the advice of counsel.

Based on these facts, it is found that the Petitioner acted reasonably and in good faith and that the penalties should accordingly be abated.

ACCORDINGLY, IT IS CONCLUDED THAT Petitioner is liable for additional CRT as asserted by Respondent. Penalties are abated. The Petition is granted with respect to penalties and otherwise denied. The penalties asserted in the Notice of Determination, dated September 12, 2011 are cancelled and the Notice of Determination is otherwise sustained.

DATED: June 3, 2014
New York, New York

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David Bunning
Administrative Law Judge