

TAX SECTION

New York State Bar Association

Committee on Sales, Property and
Miscellaneous Taxes

April 21, 1989

Table of Contents

Cover Letter:.....	i
Relating to Income and Expense Statements.....	1
A. Accounting Methodology.....	2
B. Reserves for Replacements.....	3
C. Filing deadline.....	3
D. Rent Roll.....	4
E. Penalties.....	5
F. Confidentiality.....	7
G. Petitions for Hearings.....	7
H. Net Leases.....	8
I. Separate Owners of Land and Building.....	9
J. Other Matters.....	9

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April 24, 1989

DELIVER

The Honorable Maria T. Jones
 Deputy Commissioner for Legal Affairs
 New York City Department of Finance
 345 Adams Street
 Brooklyn, New York 11201

Re: Proposed Regulations Relating
 to the Filing of Income and
Expense Statements

Dear Deputy Commissioner Jones:

Enclosed is a report by the Committee on Sales, Property and Miscellaneous Taxes on the Proposed Regulations Relating to the Filing of Income and Expense Statements for Real Property. The principal draftsmen of this Report are Arthur R. Rosen and Ronald A. Morris.

The report generally commends the proposed regulations and recommends that some provisions be amended to clarify ambiguities and to ease burdensome requirements. In addition, the report recommends some substantive changes, two of which warrant special mention:

(1) The Administrative Code appears to contemplate that penalties will be imposed only in cases of non-filing or in cases where false statements of material facts are willfully made. The penalty provisions in the proposed regulations, however, go much further in the latter case and seem unwarranted.

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In light of the severe penalties that may be imposed, the Report recommends that the enumerated acts in the proposed regulations should result in the imposition of a penalty only if the acts are willful, constitute the making of a false statement or omission of material fact, and remain uncorrected after the owner is notified of the specific failure. In addition, the proposed regulations should be amended to reflect a policy of notification and a reasonable period, say 30 days, within which the owner may correct the statement.

(2) Owners with fiscal years ending on July 31 have only one month in which to prepare the statements required to be filed on September 1, whereas owners with calendar years have eight months. We recommend changes in both the regulations and the Administrative Code to rectify the burden on owners whose fiscal years end on June 30 or July 31.

Sincerely,

Wm. L. Burke

WLB/JAPP

Enclosure

cc: Irwin M. Slomka, Esq.,
Director, Tax Law Division

NEW YORK STATE BAR ASSOCIATION

TAX SECTION REPORT #611

LETTER DATED APRIL 24, 1989 TO MARIA T. JONES, DEPUTY
COMMISSIONER FOR LEGAL AFFAIRS, NEW YORK CITY DEPARTMENT OF
FINANCE, ENCLOSING REPORT ON NEW YORK CITY PROPOSED REGULATIONS
RELATING TO FILING OF INCOME AND EXPENSES FOR REAL PROPERTY.

Report on New York City Proposed Regulations
Relating to Income and Expense Statements

New York State Bar Association
Tax Section

Committee on Sales, Property and
Miscellaneous Taxes*

April 21, 1989

* This report was prepared by Arthur R. Rosen and Ronald A. Morris; helpful comments were contributed by Robert J. Levinsohn

Report on New York City Proposed Regulations
Relating to Income and Expense Statements

In 1987, the New York City Administrative Code was amended by the addition of a provision (§11-208.1) requiring most owners of income-producing real property to file annual income and expense statements relating to the operation of their properties. The statements are to be filed with the Department of Finance which presumably will use the information in appraising and assessing real property for ad valorem tax purposes. The Department of Finance initially issued a series of "Questions and Answers" relating to the filing of the statements and has recently issued proposed regulations relating to the same matters. This report presents several comments relating to the proposed regulations.

Generally, the proposed regulations incorporate the principles suggested by the Questions and Answers, being more specific in some areas and less specific in others. In addition, the proposed regulations provide for hearings regarding the imposition of penalties -- a matter not addressed in the Questions and Answers.

Although the proposed regulations are generally consistent with the requirements set forth in the Administrative Code, in several areas it may be possible to clarify ambiguities in language and to ease burdensome requirements that serve no obvious purpose.

A. Accounting Methodology. The proposed regulations (§2.5(c)(4)) state that "failure to define the accounting basis (cash or accrual)1' on which the statement is prepared may result in a determination that the statement has not been properly filed, but nowhere is there an express requirement that the income and expense statement be filed on a consistent accounting method, whether cash or accrual or other. Moreover, in listing expense items (§1.3(b)), reference is generally made to "amounts paid or accrued," but in the listing of income items (§1.3(a)), terms such as "actual rent paid" and "actual amounts paid" are employed. If the latter references are intended to place certain items on the cash method, there will be a mismatching of income and expense items. We assume, however, that the objective is to require income and expense items to be treated consistently. The regulations, therefore, should contain an express requirement that the filer of the statement indicate whether the method employed as to both income and expense items is cash or accrual; and all references in the regulations to amounts "paid" should be changed to "paid or accrued."

B. Reserves for Replacements. The proposed regulations (§1.3(b)(5) and (b)(14)) provide that capital improvements and depreciation may not be included as expense items, but the expense item designated "repairs and maintenance" may include "reserve accounts for replacements when pro-rated on a yearly basis." The placement of this provision suggests that the allowable "reserves" include only reserves for items that would be considered repairs and maintenance. The words, however, are far from clear. The term "reserve accounts" also suggests that an amount may be listed as an expense before any amount is paid or accrued under traditional accounting concepts. Because we do not understand what is meant by the reference to "reserve accounts," we suggest that the provision be clarified and that examples be provided.

C. Filing deadline. The proposed regulations (§§2.1 and 2.3) are consistent with the Administrative Code in requiring all owners to file income and expense statements on or before each September 1, providing information relating to the most recent fiscal or calendar year ending before the immediately preceding August 1. Owners with calendar years, therefore, have eight months to prepare their statements. Owners with fiscal years ending July 31, however, have only one month to prepare their statements. This results in an extremely onerous burden for such owners.

The Administrative Code authorizes the Commissioner of Finance to extend the time for filing by 30 days. We recommend that the Commissioner exercise this authority by providing, in the regulations, that owners with fiscal years ending in June or July not be required to file their income and expense statements until October 1. Further, to ensure that all owners will have at least three months to prepare their statements, we also recommend that the Commissioner seek a legislative amendment that would provide that the statements due on September 1 relate to calendar or fiscal years ending before the immediately preceding June 1, rather than August 1 as under current law.

D. Rent Roll. The proposed regulations (§2.3(c)) require owners of income-producing properties (other than totally residential property) to file detailed "rent roll" information for the month of April of the year covered by the statement for any property whose assessed value exceeds \$1 million. The potential value of this information seems not to warrant the intrusion into the owner's business affairs. At the very least, the owner should be permitted to delete the names of tenants and other data of a confidential nature. Further, information relating to one specific month may be aberrational and not representative. In light of the potential for error that arises when one item is singled out for special scrutiny over a limited period of time, it seems to us that some special showing should be made to justify the required filing. To our knowledge, no such

showing has yet been made for the one-month rent roll information. If the information is nevertheless considered to be important, perhaps the owner can be allowed to select a month for which the rent roll is representative of the property's operations for the year.

E. Penalties. The Administrative Code provides for penalties that are quite severe for failing to file income and expense statements: 3% to 5% of the property's assessed value plus denial of the right to appeal the tentative assessment placed on the property. In addition, the Code (§11-208.1) requires that the statements contain the following declaration: "I certify that all information contained in this statement is true and correct to the best of my knowledge and belief. I understand that the willful making of any false statement of material fact herein will subject me to the provisions of law relevant to the making and filing of false instruments and will render this statement null and void." Under the Code, therefore, it seems that penalties should be imposed only if (a) no statement is filed or (b) a statement is filed containing a false material fact, willfully made.

In contrast to the Code provisions, the proposed regulations (§2.5(a)) provide that "The filing of a defective . . . statement . . . may be treated as if no statement . . . were filed" (emphasis added). The proposed regulations (§2.5(b) and (c)) then provide a listing of actions that "shall result in a determination that an income and expense statement has not been properly filed" and a listing of actions that "may result in a determination that an income and expense statement has not been properly filed" (emphasis added).

Among the actions that shall result in the determination that a statement was improperly filed and that thus may result in penalties are: failure to define the accounting period, failure to provide a complete and itemized list of income and expense data, and failure to use forms prepared by the Department of Finance. Included in the actions that may result in the determination that a statement was improperly filed and that thus may result in penalties are: failure to provide valid notarization, failure to provide square footage, and failure to define the accounting basis (cash or accrual).

Since the Code provides for the imposition of penalties in cases of nonfiling or in cases of willfully filing false statements of material facts, it seems improper for penalties to be imposed where a statement is filed, but contains an inadvertent omission or contains an omission that is easily cured, for example, if the owner neglects to define the accounting period or fails to supply the square footage.

In light of the severe penalties that may be imposed, we recommend that the enumerated acts in the proposed regulations should result in the imposition of a penalty only if the acts are willful, constitute the making of a false statement or omission of a material fact, and remain uncorrected after the owner is notified of the specific failure. The proposed regulations should be amended to reflect a policy of notification and a reasonable period, say 30 days, within which the owner may correct the statement.

In addition, the language in section 2.5(a) should conform to that in §2.5(b) and (c); since the former section refers to "defective" statements which result in penalties being imposed, while the latter two provisions list actions that result in statements that have "not been properly filed." Presumably "defective" is meant to be equated with "not properly filed"; if this is so, the provisions should be clarified by the use of the same terminology in each subsection.

F. Confidentiality. The Administrative Code and the proposed regulations (Article 6) provide for confidentiality of information submitted in the statements. Hearing determinations, which in this case relate solely to penalty issues, should be published, but all references to the parties, property, and other identifying data should be deleted. Such publication would afford helpful guidance to other property owners regarding their obligation to file the required statements.

G. Petitions for Hearings. The proposed regulations (§4.2) require that petitions for hearings be filed within 30 days from the date of the notice of failure to comply with the filing requirements; the petition must be on a form provided by the Department of Finance. Although thirty days is a short period (compared to most other tax-related periods), we understand the need to resolve these issues expeditiously; but the use of the official form should be directory, not mandatory.

H. Net Leases. The proposed regulations (§2.4) provide that net lessees may file income and expense statements. This provision raises several issues.

1. One provision of the proposed regulations (§2.4 (a)) states that a statement filed "by a net lessee will be accepted as a proper filing for that property if the filing contains complete information relating to the operation of the property." Yet another provision (§2.4(b)) states that the filing of a statement "by a net lessee shall not relieve the fee owner who fails to file an income and expense statement from the penalties imposed in . . . the regulations." These two provisions appear to be inconsistent. Moreover, if the net lessee's statement is acceptable as a filing for the property, it seems pointless to require a separate filing by the owner in all cases, particularly if the lessee has provided "complete information relating to the operation of the property." If a filing by the fee owner is nevertheless considered important, then the fee owner and the net lessee should be permitted to join in a single filing if they so desire.
2. The proposed regulations (§2.4(a)) state that a net lessee who properly files a statement will not be included on the list (provided to the Tax Commission) of the owners who have not filed statements and who are thus prohibited from appealing their tentative assessments to the Tax Commission. The proposed regulations do not state, however, that net lessees who do not file will be included on such a list. If this is the intention of the drafters of the proposed regulations, it should be explicitly stated. We

recommend, however, in light of the purpose of the filing requirements (furnishing of information to the Department of Finance), that net lessees not be prohibited from appealing tentative assessments to the Tax Commission if either the owner or the net lessee has properly filed a statement relating to the property.

I. Separate Owners of Land and Building. The proposed regulations (§2.4(e)) provide that in the case of a ground lease where the lessee is the owner of the building, the land owner and the building owner must each file a separate statement. We recommend that a statement filed jointly by the land owner and the building owner be permitted, if the two owners elect to make a joint filing. The Department of Finance will not be deprived of any information and the burden on the owners will be eased.

J. Other Matters.

1. Owners should be guaranteed a minimum amount of time between the issuance of a notice of hearing and the hearing (see §4.12).
2. The five-day period to correct the record should be measured from the receipt of the record, not from the conclusion of the hearing (see §4.17).
3. The regulations should be effective with respect to statements required to be filed after a specific date (see Article 7).