STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
VANDERVEER ASSOCIATES - NO. 5	:	DETERMINATION DTA NO. 810152
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.	:	

Petitioner, Vanderveer Associates - No. 5, c/o Edward I. Penson, Esq., 149 Wooster Street, New York, New York 10012, filed a petition for revision of a determination or for refund of tax on gains derived from certain real property transfers under Article 31-B of the Tax Law.

On February 11, 1993 and March 18, 1993, respectively, petitioner, by its representative, Warshaw, Burstein, Cohen, Schlesinger & Kuh, Esqs. (Michael A. Scheffler, Esq., of counsel) and the Division of Taxation, by its representative, William F. Collins, Esq. (Donald C. DeWitt, Esq., of counsel) consented to have the controversy determined on submission without hearing, with all briefs to be submitted by June 4, 1993. After due consideration of the record, Brian L. Friedman, Administrative Law Judge, renders the following determination.

ISSUES

I. Whether the Division of Taxation properly disallowed, in the computation of original purchase price, certain costs which petitioner contends were acquisition costs and/or costs of capital improvements.

II. Whether the Division of Taxation properly imposed penalties upon petitioner.

FINDINGS OF FACT

Petitioner submitted eight proposed findings of fact ("A" through "H"). Proposed findings of fact "A" and "C" through "H" contain legal argument, are conclusory in nature and are, therefore, not incorporated into the Findings of Fact hereinafter set forth. Proposed finding

of fact "B" has been substantially incorporated into the Findings of Fact.

On March 18, 1987, Vanderveer Associates - No. 5 ("petitioner"), a New York limited partnership, sold property known as 1402, 1404, 1406, 1408, 1410, 1412, 1414, 1416, 1418, 1420, 1405, 1421 and 1425 Brooklyn Avenue in Brooklyn, New York ("the property") to Foster Apartments Group (a New York limited partnership which was the assignee of the purchaser's rights in a contract of sale dated May 29, 1986 between petitioner, as seller, and Vanderveer Realty Company - No. 5, as purchaser).

Petitioner filed a Transferor Questionnaire (Form TP-580), sworn to on December 3, 1986, on which it reported anticipated tax due of $110,754.00. On December 15, 1986, the Division of Taxation ("Division") issued a Tentative Assessment and Return (Form TP-582), assessing tax in that amount.

By a Supplemental Return (Form TP-583), sworn to on March 13, 1987, petitioner indicated that gain subject to tax was $1,107,540.00. Pursuant to an attached affidavit of Edward I. Penson, sworn to December 3, 1986, such gain was computed as follows:

Consideration		$11,288,975.00
Less: Original Purchase Price	$2,754,077.90	
Acquisition Costs	797,671.00	
Capital Improvements	6,539,687.00	
Brokerage Fees	60,000.00	
Legal Fees	30,000.00	
Subtotal		10,181,435.90
Gain		$ 1,107,539.10

Net adjustment, per the Supplemental Return, was $513,739.34, with the resulting gain subject to tax being $593,800.66. Tax due thereon, at 10%, was $59,380.07, which amount was paid by petitioner.

Another affidavit of Edward I. Penson, sworn to March 13, 1987, indicated that the Supplemental Return was being filed because of a contract modification and because additional capital improvements had been made since the original gains tax filings.

Pursuant to an audit which commenced in April 1988, the Division, on October 30, 1989, issued a notice of determination to petitioner assessing total tax due of $215,339.50, plus penalty and interest, for a total amount due of $345,892.75. Petitioner was credited with having

paid tax in the amount of $59,380.00 (see, Finding of Fact "3").

A Conciliation Order (CMS No. 102018) dated August 9, 1991 reduced tax due to $143,439.00, plus penalty and interest computed at the applicable rate.

Pursuant to the audit performed, anticipated gain of $2,747,195.00 was determined. Total estimated consideration was found to be $10,836,841.00 (consideration per Transferor Questionnaire $11,288,975.00 - purchase price reduction per Supplemental Return $452,134.00 = $10,836,841.00). Allowed brokerage fees of $60,000.00 reduced consideration to $10,776,841.00.

Original purchase price ("OPP") was determined to be $8,029,646.00 which included original cost per contract, acquisition expenses and capital improvement costs.

Original cost per contract was $2,754,079.90 (see, Schedule B, line 4 of Transferor Questionnaire).

Petitioner claimed acquisition expenses of $797,671.00 of which $290,000.00 was disallowed. This amount, paid to Owners and Builders Realty Services, Inc. ("Owners & Builders") as a claimed brokerage fee, was denied by the Division on the basis that it was a management fee.

Capital improvement costs of $6,668,982.00 were claimed. The Division's auditor disallowed costs in the amount of $1,901,085.00 ($4,767,897.00 was allowed). The amounts of disallowed capital improvement costs were as follows:

Construction loan interest	$ 898,757.00
Real estate taxes	201,355.00
Construction period insurance	47,143.00
FHA financing fee	143,480.00
Profit and Risk to Faymor	601,380.00
Additional costs	8,970.00
	$1,901,085.00

By adding original cost per contract ($2,754,078.00), allowed acquisition expenses ($507,671.00) and allowed costs of capital improvements ($4,767,897.00), total OPP was calculated at $8,029,646.00. When subtracted from consideration ($10,776,841.00), anticipated gain on the taxable sale of $2,747,195.00 was determined with tax thereon, at 10%, in the

amount of $274,720.00. Petitioner was credited with its payment of $59,380.00, with the result being the $215,340.00 assessed per the notice of determination.

Pursuant to the Conciliation Order (see also, letter from auditor to Michael A. Scheffler of February 1, 1991 which is attached to April 28, 1993 affidavit of Edward I. Penson), tax due was recomputed from $215,340.00 to $143,439.00, adjusted as follows:

Anticipated Gain per audit	$2,747,195.00
Less: Excess Gain per TP 583	-0-
Balance	$2,747,195.00
Less Substantiated Adjustments	(719,005.00)
Corrected Gains	$2,028,819.00

Tax Due on the gain at 10%	$ 202,819.00
Tax previously paid	(59,380.00)
Tax Due	$ 143,439.00

The modification resulted from a partial allowance, by the auditor, of construction loan interest in the amount of $719,005.00.

Remaining at issue, therefore, are the following amounts which petitioner asserts were acquisition costs and/or capital improvement costs:

(a) $290,000.00 paid to Owners & Builders for brokerage and/or management fees;

(b) $201,355.00 construction period real estate taxes;

(c) $47,143.00 construction period insurance;

(d) $601,380.00 in "profit and risk" paid to Faymor Housing Corp.; and

(e) $143,480.00 in FHA financing fee paid to Citibank, N.A.

Each of these costs shall hereinafter be separately addressed. It should be noted that the Division submitted, as part of its documentary evidence, a three-page affidavit of Edward I. Penson, a general partner of petitioner. This affidavit, dated December 3, 1986, was originally submitted to the Division by petitioner in conjunction with gains tax questionnaires and had attached thereto several exhibits. Subsequently, as part of the documents submitted to the Division of Tax Appeals, petitioner provided a 17-page affidavit of Mr. Penson (along with certain attachments). Unless otherwise noted, all references to the "Penson Affidavit" shall refer to the latter affidavit which was sworn to on April 28, 1993.

Pursuant to paragraph 3 of the Penson Affidavit, petitioner acquired title to the property from Faymor Development Co., Inc. ("Faymor"), a New York corporation, on December 31, 1981. At the time of transfer, Faymor owned a 99% interest in petitioner as its sole limited partner and owned 100% of the stock of Vanderveer Estates Section 5 (Brooklyn), Inc. ("Vanderveer Estates"), the sole general partner of petitioner.

On March 17, 1982, Faymor sold all of its 99% limited partnership interest in petitioner to VV Associates - No. 5, a New York limited partnership controlled by Mr. Penson, and Vanderveer Estates sold nine-tenths of its 1% general partner interest in petitioner to

Mr. Penson and a corporation controlled by Mr. Penson (collectively, the "Penson General Partners") with Vanderveer Estates retaining a one-tenth of 1% interest as general partner.

Pursuant to pages 3 and 4 of the Purchase Agreement, dated February 18, 1982 (Exhibit "B-1" attached to December 3, 1986 affidavit of Edward I. Penson) petitioner was contemplating and apparently did obtain a building loan from Citibank, N.A., the advances under which would be insured by the U.S. Department of Housing and Urban Development ("HUD"), the building loan to be converted to permanent mortgage financing provided by the Government National Mortgage Association ("GNMA"). The proceeds of this financing were used by petitioner to do rehabilitation work pursuant to a building loan agreement between the bank and petitioner and a construction contract between Faymor Housing Corp. and petitioner.

Pursuant to the Purchase Agreement dated February 18, 1982, Owners & Builders and S. J. Seip & Co. were hired by petitioner as agents under the Construction and Management Agreement dated March 17, 1982 (attached as Exhibit "D-1" to December 3, 1986 affidavit of Edward I. Penson) and Agreement Regarding Additional Management Services (referred to in the Purchase Agreement). By this Purchase Agreement, VV Associates - No. 5 and the Penson General Partners acquired a 99.9% interest in petitioner from Faymor Development Co., Inc.

The Penson Affidavit states that in petitioner's original submission, the fees paid to Owners & Builders were incorrectly characterized as brokerage fees. On Exhibit "C" attached to the December 3, 1986 affidavit, these fees are referred to as brokerage fees.

Attached to the Penson Affidavit is a December 10, 1990 affidavit of Arnold A. Gruber, partner in the accounting firm of Marks Shron & Company. Paragraph 2 thereof, states as follows:

> "In connection with our clients' acquisition of the partnership interest (the 'Partnership Interests') in the Partnerships, fees of $250,000 and $290,000 were paid to Owners and Builders Realty, Inc. (whose name was changed to The Penson Corporation) ('O & B') for its services in connection with the acquisition of the Partnership Interests. O & B's function was to perform a due diligence review of the property owned by the Partnerships (the 'Property') and the Partnerships' books and records so that our clients could be sure that the representations made by the sellers of the Partnership Interests were correct and that it was prudent on their part to pay the purchase price requested. The fees paid to O & B had nothing to do with the on-going management of the Property or for work subsequent to the acquisition

of the Partnership Interests.

> "The fees were called 'special management fees' to differentiate them from the normal management fees for operating the property. Since these fees were in connection with the acquisition of the property, they were paid from partners' capital contributions, which were paid in over a number of years."

Pursuant to Article 4 of the February 18, 1982 Purchase Agreement, petitioner agreed that, at and after the closing, acting through VV Realty, it would retain Owners & Builders and Seip as managing agents under the Construction and Management Agreement and Agreement Regarding Additional Management Services.

Petitioner states (see, paragraph 3 of the Penson Affidavit) that the property underwent a complete rehabilitation during the period September 1982 to December 1983 under a GNMA project insured by HUD.

Paragraph 11(b)(i) of the Penson Affidavit states that the aforementioned rehabilitation project involved a major renovation to the building comprising the property, their equipment and facilities and all apartments located therein, thereby requiring the relocation of tenants for certain periods. The rehabilitation included an overhaul of the plumbing and electrical lines, installation of new boilers and associated equipment, installation of new roofs, replacement of windows and main building doors, complete refurbishment of apartments, building lobbies and hallways, installation of security systems and smoke detectors and major landscaping improvements.

In response, the Division points out that the Penson Affidavit, at page 8 thereof, admits that tenants were occupying the apartments at the time the buildings were undergoing renovation. This is the basis of the auditor's disallowance of the real estate taxes and insurance, i.e., that there was no substantiation (actually there was an admission to the contrary) that, during the construction period, the property was not in use and occupied by tenants.

In the Penson Affidavit (paragraph 11[b][iii]), Mr. Penson states that the FHA financing fee of $143,480.00 paid to Citibank, N.A. was the equivalent of points or a loan processing fee for a construction loan, which are allowable pursuant to 20 NYCRR 590.16(d). It is also alleged that this fee was allowed for Vanderveer Associates - No. 1 and that there is no basis

upon which to distinguish petitioner from Vanderveer Associates - No. 1. Petitioner states that no explanation was given for the disallowance of this fee. It should be noted that neither the audit report nor the Division's brief provide an explanation for such disallowance.

The remaining amount at issue is the $601,380.00 which has been referred to by the parties as "profit and risk" because there would be a profit to the contractor only if the building project was completed within budget. If not completed within budget, the profit was at risk because the contractor was responsible for cost overruns.

Attached to the Penson Affidavit is the cover page and page 13 of the Confidential Offering Memorandum of VV Associates - No. 5 which is the entity that purchased the limited partnership interest in petitioner from Faymor Development Co., Inc. (see, Finding of Fact "8"). On Page 13 thereof, under the heading of "Cost of Construction", it states, in part, as follows:

> "All costs of construction of the Project pursuant to the terms and conditions of the proposed Construction Contract in excess of $3,942,329, as adjusted in the manner set forth above, which are not otherwise approved by HUD, are to be paid by the General Contractor pursuant to the provisions of the proposed Construction Contract."

The offering memorandum also provides that:

> "Faymor Housing Corp., an affiliate of VES, one of the general partners of the Operating Partnership but not an affiliate of the General Partners of the Partnership, will be performing the construction work, as general contractor . . . ."

Also attached to the Penson Affidavit is the cover page and pages 10 and 11 of the Audit Guide for Auditing Development Costs of HUD Insured Multifamily Projects for Use by Independent Accountants (issued by HUD). Paragraph 13 (pages 10 and 11) provides as follows:

> "Profit and Risk Allowance. Certain sections of the National Housing Act provide for a 'Builder's/Sponsor's Profit and Risk Allowance' (BSPRA) in cases where the mortgagor and contractor have an identity of interest. In cases where BSPRA would be applicable, if there were an identity of interest, but in fact there is no identity of interest, the law provides for a 'Sponsor's Profit and Risk Allowance' (SPRA). The eligible allowances are computed as follows:
>
> "(a) BSPRA. The eligible amount is 10% (unless the Secretary has prescribed a lesser percentage on FHA Forms 3306 or 3306A) of all items on the mortgagor's certificate of actual cost excluding any costs for the acquisition of a leasehold, or any supplemental management funds claimed as a cost. NOTE: if more than 50% of the actual cost of construction is subcontracted with any one

contractor or subcontractor, or more than 75% with 3 or less contractors, BSPRA will not be applicable and SPRA should be claimed.

"(b) SPRA. The applicable percentage, generally 10% will be computed on the sum of (1) architectural fees, (2) interest and financing expenses, (3) legal and organization expenses, and (4) off-site cost, if any."

Petitioner also submitted (attached to the Penson Affidavit), FHA Form No. 2331A, Cost Certification Review Worksheet for the project entitled "Vanderveer Estates Sec. V". As item 14 thereon, Profit and Risk is stated to be $601,380.00, which amount is 10 percent of the amount of the subtotal of $6,013,797.00 listed on the line immediately above (representing the subtotal of lines 1[d] through 13).

Also, in support of its position, petitioner submitted a second affidavit from Arnold Gruber, a Certified Public Accountant and a member of the accounting firm of Marks Shron & Company, which set forth an explanation of "profit and risk", also known in GNMA projects as the "Builder's/Sponsor's Profit and Risk Allowance" or "BSPRA". Mr. Gruber states that, in all of the GNMA projects for which he provided accounting services, the BSPRA amount has been 10%. Mr. Gruber further states:

"Inasmuch as HUD, which insures the repayment by the mortgagor of the GNMA loan, has an interest in limiting the amount of said loan, it seems abundantly clear that the amount that HUD itself prescribes for the 'profit and risk' fee, or BSPRA, is a reasonable sum. The fact that the 10% figure has been used in all of the GNMA projects where I have provided accounting services is the best evidence that it is also 'customary'."

In the audit summary of the audit report, the auditor stated:

"The profit and risk that was paid to Faymor indicated that H.U.D. has included this amount as part of the profit to the owners. The general contracting fee was [sic] already been allowed."

SUMMARY OF THE PARTIES' POSITIONS

The position of petitioner may be summarized as follows:

(a) The $290,000.00 paid to Owners and Builders was paid as compensation for the due diligence it conducted on behalf of the Penson Entities in connection with their acquisition of the partnership interests in petitioner. It is, therefore, an allowable "pre-acquisition cost" pursuant to 20 NYCRR 590.15;

(b) Petitioner's contentions with respect to the FHA financing fee of $143,480.00 were previously set forth in Finding of Fact "11";

(c) Petitioner alleges that its counsel spoke to Division personnel to inquire whether the "substantial" renovation of the property would qualify for deduction of construction loan interest, real property taxes and insurance premiums paid during the construction period and that its counsel was advised that such deductions would be permitted. Petitioner also contends that its counsel was told that the fact that tenants were occupying the apartments at the time the buildings were undergoing renovation would not affect the deductions. The deductions for real estate taxes and insurance premiums claimed should be no different than deductions for construction loan interest which has been allowed;

(d) Faymor Housing Corp., the general contractor to whom the $601,380.00 was paid as "profit and risk", was a corporation controlled exclusively by Morris Kavy and his two sons and neither Edward Penson nor any of the Vanderveer Associates partnerships had any interest or control over that corporation. With respect to the profit and risk, since the contractor, not the owner, was responsible for cost overruns, it should be entitled to a fee which accounts for the added risk. HUD's guidelines prescribe 10 percent as the BSPRA amount. The amount at issue is 10 percent of the total of the hard and soft costs allowed by HUD. Given the fact that there was a considerable risk that the general contractor would lose all or a portion of its profit, 10 percent is not an unreasonable profit percentage. Petitioner also points out that the auditor allowed an "incentive fee" paid to the general contractor for completion of construction within a specified time period. This amount should not be aggregated with BSPRA in determining a reasonable and customary general contractor's fee; and

(e) Petitioner also alleges that nearly all of the costs disallowed herein were incorporated in the original purchase price for Vanderveer Associates - No. 2, Vanderveer Associates - No. 3 and Vanderveer Associates - No. 4. The Penson Entities purchased the partnership interests in Nos. 2, 3 and 4 after the permanent mortgage loan was in place

while, for Nos. 1 and 5, the partnership interests were purchased prior to completion of construction, prior to conversion of the construction loan into a permanent mortgage. Since, with respect to Nos. 2, 3 and 4, the purchases were made subject to the permanent mortgages (which were composed of all of the amounts funded under the construction loan), the principal amounts of the mortgages were deemed to be part of the consideration paid by the Penson Entities and were, therefore, parts of the original purchase price for gains tax purposes.

Petitioner further states that this transaction and the transaction in which partnership interests in Vanderveer Associates - No. 1 were acquired were virtually identical, as were the rehabilitation projects which were thereafter undertaken. Insurance premiums paid by Vanderveer Associates - No. 1 were allowed as a capital improvement cost, but such premiums were not allowed herein. The conciliation conferee cancelled penalty originally imposed upon Vanderveer Associates - No. 1, but penalty imposed upon this petitioner was not cancelled. There is absolutely no basis upon which to distinguish these petitioners.

The position of the Division may be summarized as follows:

(a) There is no item included in 20 NYCRR 590.15 as an allowable cost for "due diligence". Owners and Builders is one of the agents under the Construction and Management Agreement and Agreement Regarding Additional Management Services. In the Gruber Affidavit of December 10, 1990 (see, Finding of Fact "9"), these fees were characterized as "special management fees" and there is no evidence that the fees had any relation to the acquisition of the property;

(b) Construction period real estate taxes and construction period insurance were properly disallowed because 20 NYCRR 590.16 provides that such costs may not be included in OPP "if the real property is in use or ready for its intended use." The allowance of construction period loan interest by the auditor was not a concession, but an attempt to achieve a settlement. Therefore, it was not treated in a manner different from

construction period real estate taxes or insurance.

(c) The profit and risk was not paid as a cost of construction, but because it was not incurred as a cost of construction. It was not a customary, reasonable and necessary fee or expense properly includible in original purchase price per Tax Law § 1440(5). In addition, petitioner submitted no contractual agreement providing for this fee; and

(d) As to the distinction which petitioner attempts to draw between Vanderveer Associates - Nos. 1 and 5 (acquired prior to conversion of construction loan into permanent mortgages) and Nos. 2, 3 and 4 (acquired after conversion of the construction loans into permanent mortgages), the Division contends that no evidence concerning Nos. 2, 3 and 4 is before the Division of Tax Appeals and that such argument is, therefore, irrelevant.

CONCLUSIONS OF LAW

A. Article 31-B of the Tax Law, effective March 28, 1993, provided for the imposition of a tax, commonly known as the "gains tax", upon gains derived from the transfer of real property within New York State. Tax Law § 1440.3 defines "gain" as:

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

B. Tax Law § 1440(5)(a) provides as follows:

> "'Original purchase price' means the consideration paid or required to be paid by the transferor; (i) to acquire the interest in real property, and (ii) for any capital improvements made or required to be made to such real property, including solely those costs which are customary, reasonable, and necessary, as determined under rules and regulations prescribed by the tax commission, incurred for the construction of such improvements. Original purchase price shall also include the amounts paid by the transferor for any customary, reasonable and necessary legal, engineering and architectural fees incurred to sell the property and those customary, reasonable and necessary expenses incurred to create ownership interests in property in cooperative or condominium form, as such fees and expenses are determined under rules and regulations prescribed by the tax commission."

C. 20 NYCRR 590.15(b) provides as follows:

> "Question: What specific acquisition costs are allowable in determining the original purchase price?
>
> "Answer: Certain preacquistion costs that are directly related to the New

York real property may be included in the computation of original purchase price as acquisition cost. Such preacquistion costs include legal, architectural, and other professional fees, environmental studies, appraisals, marketing and feasibility studies, and soil tests. Payments to obtain a contract or an option (that was in fact exercised) to acquire real property may also be included. Preacquisition costs relating to real property that was not ultimately purchased may not be included in the computation of original purchase price of any related property that was purchased.

"Certain acquisition costs that are directly related to the real property are also includible in the computation of original purchase price. Generally, such costs include certain closing costs, delinquent real estate taxes and professional fees.

"The following list illustrates the specific costs which may be included in the computation of original purchase price if incurred in connection with the acquisition of the real property:

-- purchase price paid for the real property
-- mortgage recording tax paid on purchase money mortgage
-- cost of title insurance and abstract
-- cost of letter of credit used as down payment under contract to purchase
-- points paid to lender (except points will not be allowed if paid to a seller who took back a true purchase money mortgage)
-- mortgage commitment fee and/or mortgage origination fee paid to lender (except such costs will not be allowed if paid to a seller who took back a true purchase money mortgage)
-- recording and filing fees
-- title closer attendance fee
-- lease buy-outs
-- appraisal fee
-- attorney's fees, including fees paid to the lender's attorney
-- mortgage broker fee
-- costs to survey real property
-- architectural and/or engineering fee
-- feasibility and market analysis consulting fees that are allocated to the parcel purchased
-- accrued and unpaid interest due on prior existing liens against the real property that was acquired where such interest was paid by the buyer*
-- New York State Real Estate Transfer Tax*
-- New York City Real Property Transfer Tax*
-- Unpaid taxes which are a lien on the real property that was acquired and which were paid by the buyer*

*Note: The payment of such items by the buyer is deemed to be an additional consideration to the seller."

D. The principal difficulty in considering whether certain costs claimed by petitioner should be allowable in determining its original purchase price is the fact that, by virtue of the parties having consented to have the controversy determined on submission without hearing, the positions of the parties can be ascertained only from documentary evidence which includes, in

some instances, affidavits (most notably, those of Edward I. Penson and Arnold A. Gruber) and audit narratives.

With respect to the $290,000.00 paid to Owners & Builders, it must be found that the Division properly disallowed this fee as a preacquisition cost. Petitioner admits (see, paragraph 11[a] of Penson Affidavit) that in its original submission it was characterized as brokerage fees. In the same paragraph, reference is made to checks which refer to these fees as management fees. In the Purchase Agreement (see, Finding of Fact "9"), Owners & Builders was hired as an agent. Yet the affidavit of Mr. Gruber, petitioner's accountant, states that the fees were paid to Owners & Builders to review the property owned by the partnerships along with the partnerships' books and records to determine if it was prudent to purchase these partnership interests. Inasmuch as it cannot, from the evidence presented, be determined with any degree of certainty exactly why this $290,000.00 was paid to Owners & Builders, petitioner cannot be found to have sustained its burden of proof (see, 20 NYCRR 3000.10[d][4]) to show that this fee was an allowable preacquisition cost. The Division's disallowance thereof was, therefore, proper.

E. 20 NYCRR 590.16(d) provides, in pertinent part, as follows:

> "Question: What additional costs are allowed if incurred during a construction period?
>
> "Answer: Other costs that are clearly associated with construction of a real estate project can also be included as a cost of constructing a capital improvement. If the capital improvement requires a construction period, a period of time in which necessary activities are conducted to bring the improvement on the real property to that state or condition necessary for its intended use, the interest cost paid during that period on a construction loan, real property taxes, insurance or similar items are includible as a cost of construction. Amounts designated as points or loan processing fees on a construction loan also are includible in original purchase price so long as the fees were paid by the borrower for the receipt of the loan funds and were not paid for specific services.
>
> "The items listed below, if paid for by a transferor for the construction of capital improvements made to real property, during a construction period, illustrate the types of costs that may be included in determining original purchase price:
>
> -- accounting fees
> -- fees for appraisals required by construction lender
> -- interest paid during the construction period on loans where the proceeds of such loans were used to make capital improvements to real property

-- construction period real property taxes
-- mortgage recording tax (building and loan mortgage only)
-- construction period insurance
-- construction period security

"The above costs may not be included in original purchase price if the real property is in use or ready for its intended use or for real property not undergoing the activities necessary to prepare it for its use." (Emphasis added.)

Petitioner admits that tenants were occupying the apartments at the time the buildings were undergoing renovation (see, paragraph 13[c]).

20 NYCRR 590.16(e) provides, in part, as follows:

"Some construction projects are completed in sections, leaving part of the real property capable of being used independently while construction continues on other sections. For such projects, allowable construction period expenses shall cease on each part when it is substantially complete and ready for use."

Petitioner's argument that it was entitled to claim construction period real estate taxes and insurance premiums would have been more tenable had evidence been produced to show what tenants, if any, were displaced; which portions, if any, of the building were inhabitable and for what periods; and any other evidence which would properly allocate the real estate taxes and insurance premiums to actual construction periods. No such evidence was presented. The Division's disallowance of the $201,355.00 in real estate taxes and $47,143.00 in insurance premiums was, therefore, proper.

Petitioner has also raised additional issues concerning the disallowance of the real estate taxes and insurance premiums. Petitioner contends that the auditor allowed construction loan interest which, pursuant to 20 NYCRR 590.16(d), is a similar expense, i.e., if the interest expense was allowed, the real estate taxes and insurance premiums should be allowed as well. The record is not clear as to the reasons for the allowance of the interest but, regardless of the reasons, a determination contrary to the statutes and regulations is not warranted for the sake of consistency.

Petitioner also states that its counsel received verbal assurances from Division personnel that, despite the fact that the apartments were occupied, the interest, taxes and insurance costs would be allowed. Errors or misinterpretations by certain employees of the Division are not

binding on the Division (Matter of Miller, State Tax Commission, December 31, 1984, determination confirmed sub nom Jack W. Miller, Excavating Contractor v. State Tax Commn., 131 AD2d 902, 516 NYS2d 352). In addition, petitioner has not established that it reasonably relied on the alleged statements of the Division employees, thereby warranting imposition of estoppel against the Division (see, Matter of Maximilian Fur Co., Tax Appeals Tribunal, August 9, 1990; Matter of Harry's Exxon Serv. Sta., Tax Appeals Tribunal, December 6, 1988).

F. 20 NYCRR 590.16(b) provides as follows:

> "Question: What items associated with the construction of a capital improvement are included in the original purchase price?
>
> "Answer: The following list illustrates the specific costs, if paid for by a transferor, that are allowable as a cost of capital improvements made to real property for purposes of determining original purchase price. All costs must be shown to relate directly to capital improvements made to the property being transferred:
>
> -- architectural fees
> -- legal fees
> -- engineering fees
> -- surveying fees
> -- consideration paid to contractors to make the capital improvement
> -- demolition
> -- debris removal
> -- built-in appliances
> -- construction equipment rental
> -- payroll and cost of fringe benefits for construction personnel only
> -- costs of utilities for construction usage only
> -- costs of permits required by governmental bodies for constructing capital improvement
> -- security fences
> -- landscaping and site planning
> -- installation of parking lots and initial sealing
> -- excavation, grading, fill and land clearing
> -- installation of heating, ventilation, air conditioning systems
> -- waterproofing, new roof and roof replacement
> -- fixtures (permanently affixed)
> -- plumbing
> -- insulation
> -- initial painting of new buildings, structures or additions
> -- solar hearing systems
> -- security systems
> -- smoke alarm system
> -- construction material (i.e., lumber, sheet rock, flooring [including wall-to-wall carpet], bricks, concrete, tile, structural steel, etc.)
> -- sheet metal work
> -- well drilling
> -- sewage system installation

-- sandblasting
-- soil testing
-- utility installation
-- tree removal" (emphasis added).

In light of the evidence presented (see, Finding of Fact "12"), most notably the HUD Audit Guide and the affidavits of Arnold Gruber, it appears that, in the type of project at issue herein, Profit and Risk is a customary, reasonable and necessary expense associated with construction or renovation projects of this type and, since it was consideration paid to the contractor to make the capital improvement (see, 20 NYCRR 590.16[b]), it should be an allowable cost for purposes of computing OPP. However, the HUD Audit Guide states that a "Builder's/Sponsor's Profit and Risk Allowance" (BSPRA) is applicable where the mortgagor (petitioner) and contractor (Faymor) have an "identity of interest". Nowhere in the record is there an explanation of what is meant by an "identity of interest". The Audit Guide further states that, in cases where BSPRA would be applicable if there were an identity of interest, but, in fact, there is no identity of interest, the law provides for a "Sponsor's Profit and Risk Allowance" (SPRA). SPRA is also provided for in certain subcontracting situations (see, Finding of Fact "12") and petitioner has presented no evidence that these circumstances are not applicable herein. The Audit Guide provides for computation of SPRA by taking 10% of the sum of architectural fees, interest and financing expenses, legal and organizational expenses and off-site costs, if any.

Based upon the Cost Certification Review Worksheet (FHA Form No. 2331A) attached to the Penson Affidavit, SPRA in the present matter would be computed as follows:

Architectural fees	
Design	$ 113,853.00
Supervision	37,952.00
Interest	898,757.00
Financing	
Initial	143,480.00
Discount	239,133.00
Other	286,959.00
Legal	36,250.00
Organization	12,000.00
Off Site	-0-
	$1,768,384.00 Total

10% = $ 176,838.40

Absent evidence that petitioner was entitled to BSPRA, it is hereby found and determined that, in lieu thereof, an SPRA allowance of $176,838.40 is reasonable and proper.

G. While it is true, as the Division points out, that petitioner's contentions with respect to Vanderveer Associates - Nos. 2, 3 and 4 are not relevant since no evidence relating thereto is before this Administrative Law Judge, the same is not true for Vanderveer Associates - No. 1. It should be noted that a determination with respect to such petitioner is being issued simultaneously herewith (DTA No. 810151).

Petitioner contends that the FHA financing fee was allowed as to Vanderveer Associates - No. 1, but has been disallowed herein. A review of the evidence presented with respect to Vanderveer Associates - No. 1 shows that on FHA Form No. 2331A, Cost Certification Review Worksheet (attached to the Penson Affidavit), on line 10 thereof as "Financing - Initial" was the amount of $128,384.00. In the workpapers contained in the Field Audit Report, that amount was claimed as a financing expense of the capital improvements and was allowed, in full, by the auditor.

In the present matter, on line 10 of the Cost Certification Review Worksheet (also attached to the Penson Affidavit) listed as "Financing - Initial" is the amount of $143,480.00 which has been disallowed by the Division without any reason being stated therefor (see, Finding of Fact "11"). Neither the Division's answer nor its brief sets forth any explanation for the disallowance of this fee. Had the Division shown why, in its audit of Vanderveer Associates - No. 1, the fee was allowable pursuant to 20 NYCRR 590.15(b) as an acquisition cost, but is not allowable to this petitioner, i.e., had some distinction been drawn, perhaps it would have been reasonable to disallow it herein. However, a review of the evidence submitted with respect to both of these matters reveals that, with the exception of specific amounts, the transactions are, in nearly all respects, identical. Acquisition, renovation, financing, etc. were done in the same manner. The audit, too, was nearly identical; the auditor was the same for both of these petitioners.

In Matter of Orvis, Inc. (Tax Appeals Tribunal, January 14, 1993), the Tribunal stated:

> "Although we reject the principle that the Division of Taxation had the burden of proof on any of the issues raised in this matter, our cases do establish that: (1) in response to a petitioner's inquiry the Division of Taxation is obligated to describe the methodology underlying the assessment; and (2) this methodology must be rational (see, Matter of Atlantic & Hudson Ltd. Partnership, Tax Appeals Tribunal, January 30, 1992). Under this principle, we agree with the Administrative Law Judge that the Division of Taxation had the obligation in this case to describe a rational foundation for its conclusion that an assessment should be issued to petitioner for the taxes at issue (see, Matter of Brussel, Tax Appeals Tribunal, June 25, 1992)."

It must be found, therefore, that without establishing some rational basis for the differentiation made between these petitioners, the $143,480.00 must be found to be an allowable fee paid to a lender pursuant to 20 NYCRR 590.15(b).

H. With respect to penalty imposed, petitioner contends that, since penalty was cancelled by the conciliation conferee in the matter involving Vanderveer Associates - No. 1, and since that matter and the present one involve nearly identical acquisitions, renovations and audits, penalty should be cancelled for this petitioner as well.

Tax Law § 1446.2(a) provides as follows:

> "Any person failing to file a tentative assessment and return or to pay any tax within the time required by this article shall be subject to a penalty of ten per centum of the amount of tax due plus an interest penalty of two per centum of such amount for each month of delay or fraction thereof after the expiration of the first month after such return was required to be filed or such tax became due, such interest penalty shall not exceed twenty-five per centum in the aggregate. Provided, however, that the minimum penalty for each transfer of real property or partial or successive transfer of real property shall be one hundred dollars. If the commissioner of taxation and finance determines that such failure or delay was due to reasonable cause and not due to willful neglect, commissioner of taxation and finance shall remit, abate or waive all of such penalty and such interest penalty."

It is petitioner which has the burden of proving that the penalty was improperly assessed (Matter of LT & B Realty Corp. v. New York State Tax Commn., 141 AD2d 185, 535 NYS2d 121; 20 NYCRR 3000.10[d][4]). Petitioner has not sustained its burden of proof with the mere allegation that consistency requires cancellation of penalty for this petitioner because penalty was cancelled for Vanderveer Associates - No. 1. As previously stated (see, Conclusion of Law "E"), a determination contrary to statutes and regulations is not warranted for the sake of consistency. Penalty imposed herein must, therefore, be sustained.

I. The petition of Vanderveer Associates - No. 5 is granted to the extent indicated in

Conclusions of Law "F" and "G"; the Division is hereby directed to modify the notice of determination issued to petitioner on October 30, 1989, as modified by Conciliation Order CMS No. 102018, accordingly; and, except as so modified, the petition is in all other respects denied.

DATED: Troy, New York
December 6, 1993

/s/ Brian L. Friedman
ADMINISTRATIVE LAW JUDGE