STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
EAST 61ST STREET COMPANY	:	DETERMINATION DTA NO. 811470
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, East 61st Street Company, c/o Donald Trump, 725 Fifth Avenue, New York, New York 10022, 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.

A hearing was held before Frank W. Barrie, Administrative Law Judge, at the offices of the Division of Tax Appeals, Riverfront Professional Tower, 500 Federal Street, Troy, New York, on September 9, 1993 at 1:15 P.M. Briefs were received as follows: petitioner's brief, on November 8, 1993; the Division of Taxation's answering brief, on December 9, 1993; and petitioner's reply brief, on January 10, 1994. Petitioner appeared by Jack Mitnick, C.P.A. The Division of Taxation appeared by William F. Collins, Esq. (Donald C. DeWitt, Esq., of counsel).

ISSUES

I. Whether petitioner substantiated entitlement to more than the 50% allowed by the auditor on amounts claimed by petitioner for (i) accounting fees, (ii) development manager fees, (iii) costs incurred to "buy down" interest rates on purchasers' mortgages, and (iv) project overhead costs so that its "original purchase price" should be correspondingly increased.

II. Whether petitioner substantiated that it paid construction period interest during the period after the transfer of the property to the cooperative housing corporation so that its "original purchase price" should be correspondingly increased.

III. Whether costs incurred to purchase tax abatements should be included in the calculation

of petitioner's "original purchase price".

IV. Whether maintenance fees paid by petitioner to the cooperative housing corporation with respect to unsold units should be included in the calculation of petitioner's "original purchase price".

V. Whether the Division of Taxation properly disallowed petitioner's costs allocated to the renovation of certain townhouses and the construction of commercial space from inclusion in petitioner's "original purchase price".

VI. Whether the Division of Taxation properly disallowed the special additional recording tax of ¼% from inclusion in petitioner's "original purchase price" because such amount could be used as a credit against income tax liability.

VII. Whether petitioner has established that penalties should be abated.

FINDINGS OF FACT

The Division of Taxation ("Division") issued a Notice of Determination dated May 21, 1990 against petitioner, East 61st Street Company, asserting additional real property transfer gains tax due of $690,138.00, plus penalty and interest, as follows:

Tax Period Ended	Tax Asserted Due	Interest	Penalty	Number of Taxable Shares Sold
3/1/84	$ 90,570.00	$ 77,349.86	$ 31,699.50	9,714
4/1/84	255,702.00	213,969.90	89,495.70	27,425
6/1/84	100,807.00	80,982.48	35,282.00	10,812

5/1/85	113,525.00	71,347.60	39,733.75	12,176
6/1/86	86,729.00	38,267.71	30,355.00	9,302
3/1/87	42,805.00	14,659.96	14,981.00	4,591
Totals	$690,138.00	$496,577.51	$241,546.95	74,020

Petitioner is a partnership made up of three partners: Donald Trump, a 90% partner; Robert Trump, a 5% partner; and Louise Sunshine, a 5% partner. Petitioner was responsible for the development of the luxury cooperative apartment project known as Trump Plaza on the east side of Manhattan at 167 East 61st Street, where units sold ranged in price from $243,000.00 for a unit on a lower floor to $950,000.00 for a penthouse unit.

The cooperative offering plan[1] for Trump Plaza, which noted that "[t]he approximate date of first offering of this Plan is December 10, 1982", referred to petitioner as the "sponsor-seller" under the plan. The Trump Corporation, located at 730 Fifth Avenue in Manhattan, was petitioner's so-called "selling-agent" under the plan.

The project consisted of a "tower building" which is described in petitioner's Exhibit "1" as consisting of:

> "[A] sub-cellar, a cellar, a lobby level and 38 floors. The sub-cellar and cellar will contain, in part, a garage with a capacity for approximately 128 automobiles. The lobby level will contain the building lobby and commercial space. Of the floors above the lobby level, the first will contain mechanical equipment and one residential apartment that will be occupied by the superintendent of the Property, the next 35 will contain a total of 175 residential apartments and the two highest will contain mechanical equipment. Each Townhouse consists of a cellar, a ground floor and three floors above the ground floor. There will be a total of four residential apartments in each Townhouse, one on each floor (other than the cellar). Thus, there will be a
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> total of 184[2] residential apartments at the Property" (emphasis added).

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[1]Petitioner introduced into evidence a small portion of the offering plan as its Exhibit "1", consisting of photocopies of only nine pages. In fact, this was the only exhibit introduced into the record by petitioner.

[2]As noted in Finding of Fact "5", there were 175 units covered by the offering plan. The nine-unit difference between the 175 units and the 184 units noted above appears to consist of eight units in the brownstones and the superintendent's unit. Petitioner's Exhibit "1" includes a section entitled "ground lease" which provides that, on the closing date, the cooperative housing corporation "will enter into a master lease of the commercial and retail portions of the Tower

The offering plan noted that "[c]onstruction of the Tower Building, and the renovation of the Townhouses, are scheduled to be substantially completed on or about January 1, 1984 . . . ."

The nature of the project was somewhat unusual. Petitioner acquired a 99-year leasehold on the west side of Third Avenue between 61st and 62nd Street in Manhattan from a Donald S. Ruth. Petitioner conveyed its rights under the leasehold to Trump Plaza Owners, Inc., the cooperative housing corporation, in exchange for cash and unsold shares on March 1, 1984 after construction was completed (or sufficiently completed so that units could be sold). At the end of the 99-year lease, the property will revert back to Mr. Ruth so that the cooperative housing corporation will have to negotiate a new lease or purchase the property.

The auditor's worksheet labeled "WEC & Audit Schedule" shows her computation of "estimated consideration" (emphasis added to show meaning of "WEC", i.e., "worksheet of estimated consideration") to be received

by petitioner of $94,188,048.00 and of "anticipated gain on taxable sales" of $45,904,019.00. Gains tax due of $662,703.00[3] was calculated as follows:

Actual cash consideration	$76,034,328.00
Add: mortgage indebtedness	
Actual: $20,000,000.00 x 90.7686%	18,153,720.00
Total estimated consideration	$94,188,048.00

Building, together with the Townhouses, to The Trump Corporation." Therefore, it would appear that the eight units in the townhouses were leased away. Provisions of the offering plan concerning payments under this lease (if any) by The Trump Corporation to the cooperative housing corporation were not included in the record.

[3]A Conciliation Order dated September 11, 1992 shows tax due decreased from $690,138.00, plus penalty and interest, as noted in Finding of Fact "1", to $662,703.00, plus penalty and interest. The worksheet described above bears a date of October 17, 1991 (subsequent to the date of the Notice of Determination) as well as an unexplained additional date of July 15, 1992 next to the word "revised". It is noted that the Division did not present any witness to explain the audit. Furthermore, petitioner's representative objected to the Division including a "Report of Tax Conference" in its Exhibit "E", which the Division, in response, withdrew from its exhibit so that the record does not disclose the specific basis for the decrease in tax asserted as due by the conferee.

Less: (i) Fund reserved for housing corporation	(181,537.00)
(ii) Brokerage commissions	(5,249,295.00)
Balance	$88,757,216.00
Less: original purchase price	(42,853,197.00)
Anticipated gain on taxable sale	$45,904,019.00
Tax 10%	$ 4,590,402.00
Less: previous payments	(3,927,699.00)
Balance due	$ 662,703.00

The percentage of 90.7686%, used to allocate the underlying mortgage indebtedness of $20,000,000.00 assumed by the cooperative housing corporation, represents the percentage of "units sold per audit", which was calculated as follows:

	No. of Shares	Percentage	Units
Total per offering plan	81,548	100%	175
Less: grandfathered	5,245	6.4318%	13

Total taxable units	76,303	93.5682%	162
Units sold per audit	74,020	90.7686%	159
Units available for future taxable sale	2,283	2.7996%	3

Mr. Mitnick, petitioner's representative who is an attorney as well as a certified public accountant, testified on behalf of petitioner and noted that "to date there are five unsold apartments" (tr., p. 27). The variance between Mr. Mitnick's testimony and the auditor's calculation, which shows three unsold units, was not addressed by either party. A close review of the nine pages included in the Division's Exhibit "E" labeled "Schedule of Closed Apartments as of December 31, 1986" shows the typed names of purchasers for 164 units. In addition, the names of purchasers, with the number of shares and purchase prices, are pencilled in, presumably by the Division's auditor, next to seven units: 18C, 19A, 19C, 22C, 23C, 24C and 27C, respectively. The schedule shows four units unsold: 21C (681 shares); 32C (791 shares); 36B (415 shares) and 36C (831 shares). Consequently, a review of the relevant documents in the record shows four unsold units, in contrast to Mr. Mitnick's five unsold units and the three unsold units used in the auditor's calculation. The total unsold shares for the four unsold units noted on the schedule is 2,718. If the number of unsold shares calculated by the auditor of 2,283 is subtracted from 2,718, the difference is 435. It is noted that unit 36B appears to have allocated to it 415 shares. Perhaps this unit was sold after the auditor analyzed the schedule in Exhibit "E". If that was the case, then the difference of 20 shares might be explained by an undisclosed arithmetic error. In any event, the minimal presentation[4] by each party does not provide a way to do anything more than speculate in this regard.

As noted in Finding of Fact "5", the Division's auditor subtracted $42,853,197.00 as petitioner's "original purchase price" from her calculation of "consideration" to compute the gain subject to tax. The Division did not introduce into the record an auditor's worksheet

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[4]The minimal presentation may be the result of the parties believing that the matter was going to be settled on the day of hearing. The start of the hearing was delayed for approximately one hour at the request of the parties to permit them to negotiate a settlement, which proved unsuccessful.

known as the "CACIC worksheet" (an abbreviation for computation of acquisition, capital improvements and conversion costs) to show how original purchase price was computed. However, Exhibit "E" includes a handwritten Schedule "A" dated October 28, in an undisclosed year, showing so-called "Total Adjusted Hard and Soft Costs" of $48,581,100.00 calculated as follows:

Hard costs claimed as of 12/31/86 - construction		$44,921,702.00
Less: Interest	$ 4,328,149.00	
Taxes	4,117,308.00	
	(8,445,457.00)	
Plus: Water & Sewage	104,684.00	
		(8,340,773.00)
Adjusted Hard Costs or Construction Costs		$36,580,929.00
Soft costs claimed as of 12/31/86 - project		$19,685,394.00
Less: Interest	$ 2,459,017.00	
Taxes	467,207.00	
Tax Abatement	195,468.00	
Sales Promotion	4,043,801.00	
Leasing Commission	3,600,790.00	
Rent & Occupancy	16,933.00	
Leasehold Costs	2,106,721.00	
Accounting Fees	76,270.00	

Development Manager	257,752.00	
Miscellaneous	68,995.00	
Buy downs	196,859.00	
	(13,489,813.00)	
Plus: Interest	5,403,714.00	
Taxes	400,876.00	
		(7,685,223.00)
Adjusted Soft Costs or Project Costs		$12,000,171.00
Total Adjusted Hard and Soft Costs		$48,581,100.00

On a handwritten Schedule "B" also dated October 28, in an undisclosed year, the auditor computed total original purchase price of $42,853,197.00 for shares sold (which corresponds to the amount used in Finding of Fact "5") as follows:

Townhouse:
Hard cost - Brownstone renovation $ 672,224.00 = 1.8376%
Total hard costs $36,580,929.00

Soft costs $12,000,171.00 x 1.8376% = $220,515.00

Total townhouse costs:

hard	$ 672,224.00
soft	220,515.00
	$ 892,739.00

Total hard and soft	$48,581,100.00
Less: townhouse	(892,739.00)
	$47,688,361.00

Commercial space allocation $47,688,361.00 x 1%[5] = $476,884.00

Total hard & soft costs	$48,581,100.00
Less: Townhouse allocation	(892,739.00)
Commercial allocation	(476,884.00)
Total Soft & Hard Costs	
Allocated to Shares	$47,221,477.00 x 90.7686% sold

Total OPP/shares sold = $42,853,197.00

A notation on the Schedule "A", described in Finding of Fact "7", indicates that the amounts subtracted from "soft costs claimed" for (i) "accounting fees" of $76,270.00, (ii) "development manager" of $257,752.00, (iii) "miscellaneous" of $68,995.00 and (iv) "buy

[5]It is unknown why 1% was used to allocate costs to the commercial space. Petitioner, however, did not raise this as an issue.

downs" of $196,859.00 were the result of the auditor allowing only "50% of cost from 3/31/84[6] to 12/31/86." Another notation on the Schedule "A" indicates that the amounts subtracted from "soft costs claimed" for (i) "rent & occupancy" of $16,933.00 and (ii) "leasehold costs" of $2,106,721.00 resulted from the auditor allowing such costs "only til 3/31/84".

As noted in footnote "3", a Conciliation Order dated September 11, 1992 reduced tax asserted as due to $662,703.00, and the calculation of such reduced amount of tax due was detailed in Finding of Fact "5" which shows that an original purchase price of $42,853,197.00 was used in the calculation. Included in Exhibit "E" is a schedule labeled "Adjustment of Allocation of Mortgage Recording Tax" which shows "total original purchase price allowed" of $42,328,637.00, which is less than the original purchase price of $42,853,197.00 used to calculate tax due of $662,703.00 as asserted in the Conciliation Order. This schedule shows the following calculation:

Mortgage recording tax New York City = 2.25

N.Y. City	$1.25	
Basic	.50	
Additional	.25	
Special additional	.25	- full credit on NY State
	$2.25	income tax

Therefore the special additional must be removed from total costs - as follows.

$\frac{\$ .25}{\$2.25}$ = 11.1111% as applied to total mortgage tax paid

Mortgage tax paid		$ 1,180,000.00
		.11
To be removed from costs		129,800.00
Total costs allowed for apartments	47,039,029.00	
Less mortgage tax credit		129,800.00
Total cost allowed	46,909,229.00	
Taxable per audit	90.2352	
Total original purchase price allowed	42,328,637.00	

[6]It is unknown why the auditor used the March 31, 1984 date when Mr. Mitnick testified that the closing was on March 1, 1984.

The schedule then includes the following "revision" dated September 20, 1989 which used an increased allocation percentage of 90.7686 which corresponds to the percentage used in Finding of Fact "5":

$47,039,029.00
129,800.00
$46,909,229.00
x 90.7686
$42,578,850.00

It is observed that even the "revised" original purchase price of $42,578,850.00 is less than the amount used by the conferee and, therefore, it does not appear that, in fact, petitioner's original purchase price was reduced in an amount equal to the special additional recording tax.

Included in the Division's Exhibit "E" is a Form DTF-940, "Advocate's Comments on Conciliation Conference" which notes that the "advocate", who was also an auditor in this matter, agreed with the findings of the conferee. She included the following "comments":

> "Due to the lack of substantiation by the taxpayer, only 50% of the accounting fees, develop. manager fees, miscellaneous and buy down costs from 4/1/84 - 12/31/86 were allowed. Also, at audit, the construction period interest was only substantiated till 3/31/84 and was allowed."

Petitioner's presentation consisted of the testimony of its representative, Jack Mitnick, who testified that he was "involved as the accountant for this project from its inception, prior to the formation of the partnership itself, through today" (tr., p. 24).

Mr. Mitnick testified that on March 1, 1984 when the building was conveyed to the cooperative housing corporation, Trump Plaza Owners, Inc., it was not physically completed:

> "The units that were closed . . . were completed units . . . . The unsold units are not completed until purchasers have made various finishing selections . . . . As a consequence, a significant amount of construction costs remain to be expended and were, in fact, expended after the initial closing" (tr., pp. 31-32).

Mr. Mitnick challenged the disallowance of interest of $1,383,452.00[7] because "the construction

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[7]As noted in Finding of Fact "7", the auditor allowed interest of $5,403,714.00 in calculating petitioner's "total adjusted hard and soft costs" or original purchase price. However, petitioner had included an interest amount of $4,328,149.00 in its hard costs and of $2,459,017.00 in its soft costs which total $6,787,166.00. The difference between this total and the amount allowed of $5,403,714.00 is $1,383,452.00, the amount of interest disallowed by the auditor which petitioner argues represents interest paid on construction loan(s) after the initial closing date.

financing continues in place until such time as sufficient sales proceeds are generated to pay off the construction loan."

Mr. Mitnick provided no details or documentary evidence concerning the construction loans on which interest of $1,383,452.00 was allegedly paid subsequent to the closing on March 1, 1984. Most importantly, he did not provide any details concerning the amount of the construction loan outstanding, although it is possible to determine the dollar cost of work performed after the closing. A close review of the Division's Exhibit "E" discloses that a summary of construction costs (listing costs to September 30, 1986) shows a total amount of $44,860,673.00 and a summary of

construction costs to March 31, 1984 shows a total amount of $37,663,994.00. The difference of $7,196,679.00 presumably represents construction costs expended in the period April 1, 1984 to September 30, 1986.

With regard to the other items which the auditor disallowed in her calculation of petitioner's original purchase price, as detailed in Finding of Fact "7", and which petitioner contested, Mr. Mitnick testified as follows:

(i) Tax abatements of $195,468.00 represent amounts paid to certain unspecified "outerborough developers" for "tax abatements under 421-A or the J51 program," which petitioner "transferred" to its development site on the east side of Manhattan as well as filing costs paid to New York City for "certain abatements" (tr., p. 33). Mr. Mitnick emphasized that the benefits from the tax abatements "runs entirely to the condo [sic] corporation" and lowers "the monthly carrying costs . . . and therefore [lowers] the monthly maintenance charges paid by the apartment purchasers" (tr., pp. 33-34);

(ii) Leasehold costs[8] of $2,106,721.00 "represents condo [sic] carrying charges paid by

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However, petitioner provided no details concerning such interest payments.

[8]As noted in Finding of Fact "8", the auditor subtracted "leasehold costs" of $2,106,721.00 because she allowed such costs "only til 3/31/84". Consequently, it appears that Mr. Mitnick

the [petitioner] to the condo [sic] corporation with respect to unsold units" (tr., p. 34);

(iii) Accounting fees of $76,270.00 were paid by petitioner to "the project accountant that was put in place by the lender, Manufacturers Hanover Trust Company . . . to verify that only costs of the project . . . were paid out of the loan proceeds (tr., p. 35);

(iv) Development manager fees of $257,752.00 were paid by petitioner to "[a]n independent construction manager [HRH Construction] . . . to have his [sic] personnel on the premises until the completion of construction work" (tr., p. 35);

(v) Miscellaneous costs of $68,995.00 represent project overhead "from the initial closing until the end of 1986 when construction was completed" including items such as "[c]ost of blueprints, supplies, other items that were incurred by the project manager on site, and which had to be paid over and above their fees" (tr., pp. 36-37);

(vi) Buy downs of $196,859.00 represent "fees . . . paid [by petitioner] to mortgage lenders providing end loans to the purchasers of cooperative apartments . . . to reduce the interest rate" (tr., p. 36);

(vii) Hard and soft costs of $892,739.00 allocated to renovation of the townhouses and of $476,884.00 allocated to construction of the commercial space should have been included in original purchase price as part of the overall project costs; and

(viii) Special additional recording tax of $129,800.00 was "a cost of the project" (tr., p. 40).

On cross-examination, Mr. Mitnick noted that the special additional recording tax of $129,800.00 was reflected as a credit on petitioner's partnership return and "was passed through to the partners and would have been claimed on the individual returns of the partners."

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might have misunderstood the nature of this item. Perhaps these costs relate to the unusual lease arrangement with Donald S. Ruth, who owns the land upon which the project was constructed. It seems possible that "leasehold costs" relate to payments made to Mr. Ruth pursuant to the 99-year ground lease covering the property which he holds. However, given the minimal nature of petitioner's presentation, this remains mere speculation.

Mr. Mitnick has prepared Donald Trump's income tax returns for the last 20 years and testified that Mr. Trump had no income tax due against which the credit "could have been applied" (tr., p. 41). As for the other two partners, he could not "state . . . whether the credit was availed of" (tr., p. 40).

Mr. Mitnick testified that the amount of the tax abatement cost of $195,000.00 was not in dispute. He also testified that petitioner "substantiated" during the audit the leasehold costs of $2,106,721.00. According to Mr. Mitnick, accounting fees of $76,270.00, development manager fees of $257,752.00, project overhead (miscellaneous) costs of $68,995.00, and buy downs of $196,859.00 were all "costs incurred and verified[9] by the auditor, but only allowed to the extent [of] the fifty percent of the actual cost" (tr., p. 34).

Petitioner did not introduce any specific evidence concerning the steps it took to ensure that it properly reported and paid gains tax on the transaction at issue.

SUMMARY OF THE PARTIES' POSITIONS

Petitioner argues that during audit it properly substantiated costs that should have been included in the calculation of original purchase price. For example, the cost for the services of the development manager were substantiated on audit but disallowed arbitrarily to the extent of 50% of the amount paid after March 31, 1984. According to petitioner, "the timing of the payment should not have any effect on its inclusion in the cost of capital improvements" (petitioner's brief, p. 3).

Petitioner, in support of its position, cites the regulations (i) at 20 NYCRR 590.16(b), which sets forth "items associated with the construction of a capital improvement . . . included in original purchase price", and (ii) at 20 NYCRR 590.16(d), which sets forth additional costs such as interest on a construction loan which may "be included as a cost of constructing a capital improvement."

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[9]However, Finding of Fact "10" shows that the auditor's position was quite different. She noted her disallowance of these amounts because they were not "substantiated" by the taxpayer.

Petitioner further argues that:

> "[t]he costs of the improvements to the realty include the full cost of construction of the building, including the non-residential (commercial) portion thereof, as well as the cost of the contiguous townhouses which were simultaneously conveyed to the transferee pursuant to the Co-Op Plan" (petitioner's brief, p. 4).

Petitioner analogized to common areas such as "basement space, common heating area, the lobby, the hallway" which have no shares allocated to them but the cost to construct such spaces are "part of the cost of the project" (tr., p. 44).

Petitioner asserts that it did not negligently or willfully understate its liability, and "after the proper allowance of costs", any additional tax "will be de minimus" (petitioner's brief, p. 5).

The Division conceded that it "is not disputing the amounts of the expenditures at issue as claimed by the petitioner" (Division's brief, p. 6). Its position with regard to the various items which petitioner claims should be part of the calculation of "original purchase price" is as follows:

(i) Construction loan interest "was disallowed because it was not paid during the construction period, as that term is defined in the Regulations [at 20 NYCRR 590.16(d)]" (Division's brief, p. 7). The Division asserts that the Division reasonably used March 1, 1984 as the date the project was substantially complete and ready for use and ready for sale because shortly after that date "more than one-half [of the shares] were sold" (Division's brief, p. 9). Furthermore, "petitioner presented no convincing evidence as to the actual stage of completion of the unsold units on March 1, 1984 to show that the construction period should have extended beyond that date" (Division's brief, p. 10).

(ii) There is no authority in the law or regulations to include the cost to obtain tax abatement certificates in original purchase price. 20 NYCRR 590.15(c) specifically disallows a tax abatement fee as part of original purchase price.

(iii) Matter of 1230 Park Assoc. v. Commr. of Taxation & Fin. (170 AD2d 842, 566 NYS2d 957, lv denied 78 NY2d 858, 575 NYS2d 455) confirmed the Tax Appeals Tribunal's decision that "carrying charges" were not part of original purchase price.

(iv) Petitioner failed to document the nature of the accounting fees, development

manager fees, miscellaneous fees and buy downs "except in the most general terms" (Division's brief, p. 12). They may well be indirect project costs that are not includible in the cost of the capital improvement. The Division also argues that it "is possible that the Division should have disallowed all of these expenses incurred subsequent to March 1, 1984" because the construction period may properly be treated as having ended on that date. Furthermore, petitioner failed to specify the nature of the "miscellaneous" expenses and there is no authority for the inclusion of "buy downs" or incentives for purchasers to buy shares in original purchase price.

(v) There is no authority for including the costs of capital improvement of the commercial space and the townhouses as part of original purchase price because "[n]o shares were allocated to the townhouses or the commercial space" (Division's brief, p. 15).

(vi) Pursuant to Tax Law § 606(f)(2), petitioner's 90% partner, Donald Trump, may carry over the tax credit for the special additional recording tax to a future year. Therefore, "the failure to disallow it as part of the original purchase price will produce a windfall not authorized by the Tax Law" (Division's brief, p. 17).

Finally, the Division contends that petitioner failed to even allege facts which would justify an abatement of penalty.

Petitioner, in its reply brief, emphasized that it expended $7,000,000.00 in construction costs after the closing date so that the construction period continued after such date.

CONCLUSIONS OF LAW

A. Tax Law § 1441, which became effective March 28, 1983, imposes a 10% tax upon gains derived from the transfer of real property located within New York State. The "gain" which is taxed is the difference between the "original purchase price" for the property and the "consideration" received for the property (Tax Law § 1440[3]).

B. Tax Law former § 1440 defined, in pertinent part, original purchase price as:

"the consideration (i) paid by the transferor to acquire the interest in the real property or (ii) in the case of property acquired through gift or inheritance, the

> consideration paid by the last transferor who paid consideration to acquire the interest in the real property; plus in both cases the consideration by the transferor for any capital improvements made to such real property (including in the case of clause [ii] above, those by the last transferor who paid consideration) prior to the date of transfer" (Tax Law former § 1440[5]; emphasis added).

The above subdivision was repealed by the Laws of 1984 (ch 900, § 3, eff September 4, 1984) and was substituted with the following more liberal definition of original purchase price, in pertinent part, as:

> "(a) '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" (Tax Law § 1440[5][a]).

In Matter of V & V Properties (Tax Appeals Tribunal, July 16, 1992), the Tribunal decided that the above change to the definition of "original purchase price" was a substantive change and not merely a clarification of the prior subdivision:

> "The Memorandum of the Governor's Program Bill, Gains Tax, 1984 (Bill Jacket, L 1984, ch 900) indicates that the new subdivision 5 added to section 1440 was a substantive change. In this memorandum under the headnote Substantive Proposals, it is stated, in pertinent part, that:
>
> > '[t]he proposal to allow customary, reasonable and necessary legal, architectural, and engineering costs, related to the sale of the property, and costs of creating cooperative and condominium ownership interests as an additional offset to taxable gain would impose the gains tax more accurately on the economic gain derived from a transfer.'"

Consequently, in V & V Properties (supra), the Tribunal decided that the taxpayer therein was "not entitled to include, as part of its original purchase price, the costs it incurred in the condominium conversion" because the transfer occurred prior to the effective date of the change.

C. As noted in Finding of Fact "4", the closing for the project at issue, i.e., the date on which petitioner transferred shares to Trump Plaza Owners, Inc., the cooperative housing

corporation, was March 1, 1984, prior to the effective date of September 4, 1984. Furthermore, as noted in Finding of Fact "1", prior to September 4, 1984, 47,951 taxable shares had been sold, or 65% of the total taxable sales. Consequently, it is the more limiting definition of original purchase price that is applicable herein. This is so despite the failure of the parties to cite the former statutory provision (see, Matter of Chamberlin, Tax Appeals Tribunal, January 30, 1992 [wherein the Tribunal decided that the Administrative Law Judge may address the proper legal grounds for audit action even if the parties do not address or cite them]).

D. Tax Law former § 1440 did not include legal, engineering and architectural fees incurred to sell the real property or expenses incurred to create ownership interests in the real property in cooperative form in "original purchase price". Rather, the applicable statutory provision limited "original purchase price" to (1) the consideration paid by the sponsor/seller to acquire its interest in the real property and (2) the consideration paid by the sponsor/seller for any capital improvements made to the real property prior to the date of transfer.

E. Consequently, costs incurred to "buy down" interest rates on purchasers' mortgages, costs incurred to purchase tax abatements and carrying charges or maintenance fees paid by petitioner to the cooperative housing corporation with respect to unsold units are clearly not covered by the former definition of "original purchase price". Furthermore, even if some of these costs were expended after the effective date of the more liberal definition of original purchase price, the record does not disclose what portion of such claimed costs were expended after such date. Moreover, in 1230 Park Assoc. v. Commr. of Taxation & Fin. (170 AD2d 842, 566 NYS2d 957, lv denied 78 NY2d 858, 575 NYS2d 455), the court confirmed the Tax Appeals Tribunal's decision that maintenance and management charges on unsold shares are "not an expense incurred to create ownership in cooperative form" (id., 566 NYS2d at 959). In addition, even the more liberal definition of original purchase price would not encompass costs incurred to "buy down" interest rates on purchasers' mortgages or costs incurred to purchase tax abatements (see, 20 NYCRR 590.17). This regulation explicates allowable selling expenses which may be included in original purchase price. Since Tax Law § 1440(5)(a) expressly

vested such explicative powers in the Tax Commission (now, the Commissioner of Taxation and Finance), the regulation is determinative (see, Mattone v. Dept. of Taxation & Fin., 144 AD2d 150, 534 NYS2d 478).

F. The current regulations, which became effective September 24, 1985, include a provision at 20 NYCRR 590.16 concerning "consideration paid for any capital improvement." Although the expanded statutory definition of original purchase price, which became effective September 4, 1984, included a specific direction that the Tax Commission prescribe rules and regulations to determine "costs which are customary, reasonable, and necessary" for any capital improvements made, the particular regulation concerning "consideration paid for any capital improvement" merely republished, in the form of a regulation, a provision which was originally published by the Division in its Publication 588, "Questions and Answers - Gains Tax on Real Property Transfers" dated November 1984.[10] Furthermore, the statutory provision which was substituted for the earlier definition of "original purchase price" did not substantively alter the provision at issue. It merely noted that capital improvement costs to be included must be "customary, reasonable, and necessary" as determined by the Division's regulatory authority. As a result, because the relevant regulation merely codified the Division's previous policy, it may be applied retroactively (see, Matter of Schoonmaker, Tax Appeals Tribunal, March 25, 1993).

G. 20 NYCRR 590.16, in relevant part, provides as follows:

"(a) Question: How is the term capital improvement defined?

"Answer: A capital improvement is, for the most part, an improvement, a modification, a betterment, or an addition made to real property which:

"(1) is intended to be permanently affixed to the real property; and

"(2) has a useful life substantially beyond the year following installation.

"(b) Question: What items associated with the construction of a capital improvement are included in original purchase price?

"Answer: The following list illustrates the specific costs, if paid for by a

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[10]The two are the same word for word except for the regulation's elaboration on indirect project costs which may be included in original purchase price.

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
-- cost 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 heating 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

* * *

"(d) 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 are also 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.

"Indirect project costs may also be included in original purchase price if they are specifically identified with a project. Indirect project costs are indirect costs incurred after the acquisition of the property, such as construction administration costs, legal fees, and various office costs (cost accounting expenses, design costs, and other expenses of departments providing services to projects), that clearly relate to projects under construction. The full amount of indirect project costs that clearly relate to a specific project, such as costs associated with a field office at a project site and the administrative personnel that staff the office, may be added to the cost of the capital improvement. However, indirect project costs which relate to numerous projects must be allocated in a rational manner to the projects to which the costs relate based on the nature of activity that gave rise to the costs.

"Indirect project costs that do not clearly pertain to projects under construction and all general and administrative costs cannot be added to the cost of capital improvement. General and administrative costs include such costs as corporate management salaries, general accounting expenses, corporate office expenses, general legal fees, and similar costs which are generally incurred by all enterprises in the conduct of business" (emphasis added).

Under this regulation, accounting fees, development manager fees, project overhead costs, interest paid on loans where the proceeds of such loans were used to make capital improvements to the real property, and mortgage recording tax may be included in "original purchase price".

H. However, the Division is correct that petitioner has failed to substantiate its entitlement to the allowance of any such additional amounts in its "original purchase price" for the basic reason that it has not established that the "construction period" continued to run after

the date of the closing on March 1, 1984. Petitioner's contention that "the timing of the payment should not have any effect on its inclusion in the cost of capital improvements" is incorrect to the extent that such payments relate to expenses incurred in periods after the construction period ended as defined by the regulations.

The regulation which explicates what is meant by "consideration paid for any capital improvement" provides the following guidance on determining when a construction period begins and ends:

> "(e) Question: When does a construction period begin and end?
>
> "Answer: A construction period usually begins on the date on which construction, development, erection or complete renovation of all or part of the real property begins, and ends on the date that the real property or other improvement is ready to be placed in service or is ready for sale. The construction period is not considered to have begun solely because a plan of construction has been prepared or a building permit has been obtained. Rather, the construction period generally will be considered to have commenced when the plan of construction is essentially implemented.
>
> "For example, in the case of the demolition of existing structures, the construction period is considered to commence when the demolition begins if the demolition is undertaken to prepare the site for construction. The construction period will not be considered to have begun solely because of the demolition of existing structures if the demolition is not undertaken as part of a continuing plan of construction of the real property.
>
> "The construction period ends when the real property is substantially complete and ready to be placed in service. 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. A construction period for a project may be suspended before a project is completed for various reasons, such as insufficient sales or insufficient rental demands. In such a case, the construction period has ended, and the costs allowed during a construction period will no longer be allowed" (20 NYCRR 590.16[e]; emphasis added).

The vague testimony of Mr. Mitnick was inadequate to establish that the Division acted improperly by treating the closing date of March 1, 1984 as the date on which the construction period ended. The regulation does provide for the situation where a construction project is "completed in sections, leaving part of the real property capable of being used independently while construction continues on other sections" as emphasized above. However, petitioner failed to provide specific evidence that would match the additional costs claimed with the

uncompleted sections. It would appear that the auditor's allowance of 50% of such costs was her reasonable attempt to allow for such costs.

I. As noted in footnote "2", on the closing date "the commercial and retail portions of the Tower Building, together with the Townhouses" were leased back to The Trump Corporation, petitioner's selling agent, by Trump Plaza Owners, Inc., the cooperative housing corporation. However, there is no evidence in the record to show that the lease had any value in excess of the costs to construct "the commercial and retail portions of the Tower Building, together with the Townhouses." Therefore, the leaseback of the townhouses and the commercial space to petitioner's selling agent may be viewed as "consideration" to petitioner which "washes" the costs allocated to the renovation of the townhouses and the construction of the commercial space. As a result, petitioner's original purchase price should not be increased by its costs to renovate the townhouses and construct the commercial space (see, Matter of Cheltoncort Co. v. Tax Appeals Tribunal, 185 AD2d 49, 592 NYS2d 121).

J. The Division also properly disallowed the special additional recording tax of ¼% from inclusion in petitioner's "original purchase price" because such amount may be used as a credit against income tax liability by petitioner's partners, if not in the year it was paid, then as a carryover in a future year (Tax Law § 606[f][2]).

K. Pursuant to Tax Law former § 1446(2)(a):

> "Any transferor failing . . . to pay any tax within the time required by [Article 31-B] 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 [which may not exceed 25%]."

Said section goes on to provide that if the Commissioner of Taxation:

> "determines that such failure or delay was due to reasonable cause and not due to willful neglect, [the commissioner] shall remit, abate or waive all of such penalty and such interest penalty."

Petitioner has the burden of proving both that the failure to timely pay the proper amount of tax was due to reasonable cause and not due to willful neglect so that the 35% penalty which was imposed herein may be remitted. Petitioner's mere allegation that its failure was due to reasonable cause and not due to willful neglect is inadequate to shoulder such burden. There is

nothing in the record, other than the fact that petitioner relied on an attorney/CPA for gains tax advice (which may be implied from Mr. Mitnick's testimony), relevant to the issue of penalty. Consequently, the imposition of penalty is upheld (see, 1230 Park Assoc. v. Commr. of Taxation & Fin., supra; Matter of Aire Bon Associates, Tax Appeals Tribunal, April 18, 1991).

L. The petition of East 61st Street Company is denied, and the Notice of Determination dated May 21, 1990, as modified by the Conciliation Order dated September 11, 1992, is sustained.

DATED: Troy, New York
July 13, 1994

/s/ Frank W. Barrie
ADMINISTRATIVE LAW JUDGE