STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:
of	:
SIDAN REALTY CORP.	:DETERMINATION DTA NO. 812314
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, Sidan Realty Corp., c/o Kestenbaum & Mark, 40 Cutter Mill Road, Great Neck, New York 11021, 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 Marilyn Mann Faulkner, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on September 13, 1994 at 10:00 A.M., with all briefs due by February 15, 1995, which commenced the six-month period for issuance of this determination. Petitioner, represented by Kestenbaum & Mark, Esqs. (Bernard S. Mark, Esq., of counsel), filed a brief on December 1, 1994. The Division of Taxation, represented by William F. Collins, Esq. (Laura J. Witkowski, Esq., of counsel), filed a brief on January 6, 1995. Petitioner filed a reply brief on February 6, 1995.

ISSUES

I. Whether, for transfer gains tax purposes, the $1,500,000.00 purchase price for a swim club is included as part

of the original purchase price for real property.

II. Whether the payment of real estate taxes at closing can be included as part of petitioner's original purchase price.

III. Whether a cleaning fee paid to prepare condominium units for sale can be considered part of the construction costs includible in the original purchase price.

IV. Whether expenses incurred prior to the sale of condominium units to repair breakage due to vandalism, touch up paint, purchase brooms, and perform other "punch-list" tasks constitute capital improvement costs or maintenance and repair costs.

V. Whether the Division of Taxation properly disallowed portions of a mortgage broker fee and mortgage commitment fee on the ground that they were incurred to refinance the original mortgage used to acquire the real property.

FINDINGS OF FACT

In 1986, Sidney Steinberg and Anthony Clemenza formed petitioner, Sidan Realty Corp., for the purpose of developing and constructing new housing. Mr. Clemenza and Mr. Steinberg each owned 50% of the business; Mr. Steinberg was a director and president of the corporation and Mr. Clemenza held the offices of secretary and treasurer.

Petitioner negotiated with Abe Maibach, who represented 8060 Property Partnership and Brook Sun & Swim Club, Inc., for the sale of certain adjacent properties in Brooklyn. On January 2, 1986, petitioner entered into an agreement with Brook Sun & Swim Club, Inc. for the sale of "property and business

located at premises 8102 Avenue L, Brooklyn, New York." In that agreement, the "property" sold was described as follows:

> "The swimming club, pool, recreation center and the business operated in connection therewith, including all of the structures, improvements and erections thereon, including pool, restaurant, locker rooms and showers, office building and auditorium located thereat and all machinery, fixtures and equipment which are part of the structures, improvements and erections at said premises, together with the good will and telephone service, excluding however the real property and all personal property and movable equipment utilized in connection with such operation, consisting of lockers, benches, chairs, tables, beach umbrellas, play and athletic equipment, beach chairs, chaise lounges, mats, office furniture, equipment and desks . . ." (emphasis added).

The contract was signed by Abe Maibach, as president of Brook Sun & Swim Club, Inc.

According to the agreement, the purchase price was $1,500,000.00 and the closing was to occur one week after Labor Day of 1986. A rider was attached to the agreement, signed on January 2, 1986 by Anthony Clemenza, representing Sidan Realty Corp., and Abe Maibach, individually and as president of Brook Sun & Swim Club, Inc. and general partner of 8060 Property Partnership. The supplemental rider referred to contracts and agreements among Brook Sun & Swim Club, Inc., Abe Maibach, 8060 Property Partnership and Sidan Realty Corp. Paragraph 12 of the rider read as follows:

> "The contacts [sic] and agreements referred to herein are a group of four (4) in number and cover three lots in Block 8058, seven lots in Block 8058 and one lot in Block 8060 . . . and the business of Brook Sun & Swim Club, Inc."

The rider further provided that the four contracts were each contingent on the other; that a default or breach of one

contract would be deemed a default and breach of all four contracts; and that the purchaser was not required to take title unless it could take title under all four contracts.

The Division of Taxation ("Division") submitted into evidence three contracts for sale of property signed on September 10, 1986. One contract was between 8060 Property Partnership and Sidan Realty Corp. for the sale of one lot, upon which the Brook Sun & Swim Club was located, for the sum of $1,300,000.00. The contract was signed by Abe Maibach, as partner of 8060 Property Partnership. Schedule A attached to the contract described the location of the real property and included as part of the description of the property "the buildings and improvements thereon erected." A rider, also attached to that contract, provided that the seller could continue operation of the swim club through the 1986 summer season and that it could retain ownership of all personal property and equipment "utilized in connection with such operation, consisting of lockers, benches, chairs, tables, beach umbrellas, play and athletic equipment, beach chairs, deck chairs, chaise lounges, mats, etc. . . . ."[1]

Another contract involved the sale of three lots of unimproved real estate that had been operated as a parking lot. The seller was 8060 Property Partnership and the purchase price was $210,000.00. The third contract involved the sale of seven

[1]Thereafter, Sun & Swim Club auctioned off the club furnishings including diving boards, slides, chlorinators and structural items such as the hurricane fencing and cyclone fence, gas pumps, air conditioners, storm windows and doors, lighting and turnstile gates.

lots, also unimproved land operated as a parking lot, by Abe Maibach[2] to petitioner for $490,000.00.[3]

Petitioner purchased all the properties with the purpose of constructing new condominium housing. It had no intention of operating a swim club. It purchased the swim club with the intention of converting the land use to newly-constructed condominiums where the pool and recreation building could be retained for the use of condominium owners. The swim club property contained a recreational and office building, tennis courts, handball courts, and other structures. Petitioner constructed housing in the locations of the tennis and handball courts, kept the recreational building for the use of condominium owners and replaced the pool with a new pool in a slightly different location, which was more suitable under its construction plan.

Mr. Steinberg testified that in negotiating the price for the properties he concluded that the value of the improvements on the real estate of the Brook Sun & Swim Club was $1,250,000.00 and the value of the land plus improvements was $3,500,000.00. These improvements included the buildings and

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[2]Abe Maibach was a nominee for nine other individuals in the sale of these seven lots. He was also a partner of 8060 Property Partnership, and a shareholder and president of the Brook Sun & Swim Club, Inc.

[3]The only deeds recorded with respect to these four transactions were the three contracts involving the purchase of the unimproved lots that had been used as parking lots and the purchase of the parcel upon which the swim club was located. There was no deed recorded concerning the $1,500,000.00 contract with Brook Sun & Swim Club, Inc.

all the equipment and swimming pool. According to his testimony, the $1,500,000.00 purchase contract with Brook Sun & Swim Club was for the purchase of those improvements.

In a letter, dated May 30, 1991, responding to the auditor's inquiries, petitioner claimed that it purchased the swim club for the sole purpose of acquiring the land. It stated that after much negotiation the seller presented the four contracts asserting that the only way it would sell the property was in this manner. Petitioner claimed that it had to "accede to this method of purchase, even though all parties knew and understood that Sidan would demolish the existing structures immediately after taking title and had no intention of operating a swim club."

After the construction of the project and the sale of condominium units, petitioner filed a 50% update questionnaire dated September of 1989. The Division requested additional documents in the course of performing a desk audit.

The Division issued a Schedule of Adjustments, dated June 10, 1991, disallowing several items claimed by petitioner as part of its original purchase price. Because the desk audit took approximately two years to complete, the adjustments were based on a 75% update of units sold from February 3, 1988 through May 30, 1991. Among the items disallowed were the (1) $1,500,000.00 purchase price for Brook Sun & Swim Club on the ground that the amount was for the purchase of the goodwill of the business or the business itself and not for the purchase of real property, (2) the capitalization of real estate taxes of

$10,662.00, (3) a mortgage commitment fee of $31,111.00 and mortgage broker fee of $15,972.00, and (4) an $18,500.00 cleaning fee and $139,980.00 expense that petitioner claimed were capital improvement expenses.

At the hearing held on September 13, 1994, the Division's auditor testified that she disallowed a mortgage commitment fee in the amount of $6,520.00 for nonsubstantiation. She also disallowed a mortgage commitment fee in the amount of $31,111.00 because that portion of the total $112,000.00 fee represented the $2,500,000.00 of a $9,000,000.00 loan from Dime Savings Bank used to refinance a loan from National Westminster Bank to acquire the property. She also disallowed a $15,972.00 mortgage broker fee on the same ground. She stated that because she had already allowed closing costs to borrow approximately $2,000,000.00 on the acquisition of the property in 1989, the disallowed broker fee and commitment fee were duplicative.

The closing statement concerning the four contracts indicates a bank loan from National Westminster Bank in the amount of $2,053,138.13 to petitioner for the acquisition of the properties.[4] In January of 1987, Sidney Steinberg, Anthony Clemenza and James Clemenza took out an 18-month loan from Dime Savings Bank. Mr. Steinberg testified that the Dime Savings

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[4]The closing statement indicates a loan to petitioner from National Westminster Bank USA for $2,053,138.13 less $553,138.13 for the satisfaction of an existing mortgage. Of the balance, $215,000.00 was used to pay for the seven lots purchased for $490,000.00, and $1,285,000.00 was used for the purchase of the swim club. No other documentation of the loan was submitted into evidence. Therefore, the record is silent as to how this loan was secured and if or when it was paid off.

Bank loan was a $9,000,000.00 construction loan, only $2,500,000.00 of which petitioner actually drew down on. He stated that the $2,500,000.00 was collateralized by the land.

Dime Savings Bank sent to Messrs. Steinberg, Anthony Clemenza and James Clemenza a commitment letter, dated January 21, 1987, stating that it had approved their "request for a construction loan . . . secured by a first mortgage" on the premises. The premises were described in paragraph G and included the real property described in the three contracts. Paragraph H of the commitment letter described the purpose of the loan as follows:

> "Two Million Five Hundred Thousand Dollars ($2,500,000) shall be disbursed at the Closing and shall be applied for the acquisition of the Premises. All future advances will be based upon work completed and in place as further defined in the General Terms and Conditions."

The General Terms and Conditions provided that the loan was secured by a first mortgage lien on the premises.

Mr. Steinberg testified that the $2,500,000.00 was used for construction and that this loan was "the only way [they] were able to build the buildings." On cross-examination, Mr. Steinberg testified as follows:

> Q. "On the second page in paragraph H it states that 'the purpose of the loan, 2.5 million, shall be disbursed at closing and shall be applied for an acquisition of the premises.' What does that statement mean, then?"
>
> A. "What is the date on that?"
>
> Q. "January 21st, 1987."
>
> A. "When did we purchase the -- when did we close?"

Q. "September 8th was the closing date."

A. "How could we borrow money three, four months later to pay for the land?"

Q. "That's what I am asking you."

A. "We already paid for the land. That's the way they just write it up in their commitment letter, but that has nothing to do with the acquisition. We already had the land, we already acquired it. They just used the land as collateral. It had nothing to do with the acquisition."

Q. "So, basically, you are stating in your testimony that this document means something other than what it says here?"

A. "Yes. They write it the way they want to sometimes. It had nothing to do with the acquisition."

Q. "What was the 2.5 million dollars used for?"

A. "That was construction. In the beginning we sold a lot of houses and we needed money for construction, and we took the 2 and a half million dollars toward construction." (Tr., pp. 160-162.)

When questioned by the Administrative Law Judge concerning the first loan on the properties, Mr. Steinberg testified as follows:

Q. "I just want a point of clarification on this. You took out a prior loan to purchase the property; is that true?"

A. "Yes."

Q. "So, you had a mortgage on the property?"

A. "We had no mortgage on the property."

Q. "You paid cash?"

A. "Right." (Tr., p. 163.)

Mr. Steinberg also testified that after the $9,000,000.00 loan was acquired, a second loan in the amount of $4,500,000.00 was obtained from National Westminster Bank and was

collateralized with the assignment of sales contracts. Mr. Steinberg noted that this second financing was acquired in lieu of drawing down on the balance of the $9,000,000.00 loan because the second loan avoided a mortgage tax, inspection fees and other expenses they would have incurred if they borrowed on the remainder of the Dime Savings Bank loan. Because the second loan was collateralized with the assignment of sales contracts and not with real property, petitioner saved money by avoiding the mortgage tax and inspection fees.

The Division's auditor disallowed two expenses as maintenance and repair expenses and rejected petitioner's claim that they represented capital improvement expenses. In response to the auditor's inquiries, petitioner identified an $18,500.00 expense for cleaning condo units prior to occupancy and a $139,980.00 expense for "glass breakage, brooms, paint and locksmith." Petitioner stated that the latter category included:

> "Vandalism Theft -- Appliances, Wiring, Plumbing, etc.
> Glass Breakage
> Punch list, paint touchup and general repairs
> Locksmith"

At hearing, Mr. Steinberg testified that these costs were incurred as part of the construction costs to prepare the units for sale. He stated that after units were constructed, the units were cleaned resulting in the $18,500.00 expense. He further testified that the $139,980.00 expense was incurred because of breakage and vandalism during the course of construction prior to the actual sale of the units. He

testified that the units were not completely finished until prospective buyers obtained mortgage approval, at which point the units were completed according to a punch list that included touch-up paint, locksmith repairs, the installation of vanities and toilets, and repairs due to vandalism to walls, locks, wiring or glass in the units. This category also included the purchase of brooms to sweep the units.

The Division issued three notices of determination for the total amount of transfer gains tax due of $279,631.98, plus interest. One notice was dated August 22, 1991 for the tax periods ending February 3, 1988 through July 18, 1988 in the amount of $121,527.91, plus interest, for the total amount of $169,919.60. A second notice was dated October 15, 1991 for the tax periods ending July 19, 1988 through March 27, 1989 in the amount of $90,745.34, plus interest, for the total amount of $122,714.05. A third notice was dated August 22, 1991 for the tax periods ending April 10, 1989 through May 30, 1991 in the amount of $67,358.73, plus interest, for the total amount of $75,355.73.

After a conciliation conference, the conferee issued a Conciliation Order, dated July 30, 1993, sustaining the statutory notices.

Sidan Realty Corp. filed a petition, dated October 18, 1993, asserting that it acquired the swim club for the purpose of acquiring the real property and not for the purpose of acquiring a swim club operation and that, therefore, the cost of the swim club should be allowed as part of the original purchase

price. Petitioner also argued that the Division erred in disallowing "other various costs incurred which were attendant to the acquisition of petitioner's interest in real property (including the fees and costs to refinance the acquisition mortgage)."

The Division filed an answer, dated December 27, 1993, alleging, inter alia, that the costs to acquire the swim club were related to the purchase of an ongoing business and its goodwill and not to an interest in real property; and that petitioner had not met its burden of proving that the notices of determination were erroneous or improper.

Petitioner filed an amended petition, dated July 22, 1994, alleging overstatement of the consideration received. The Division filed an amended answer, dated August 11, 1994. By stipulation, dated September 13, 1994, the parties agreed that issues concerning the amount of consideration received that were raised in the amended petition were no longer being contested.

SUMMARY OF THE PARTIES' POSITIONS

Petitioner argues that the $1,500,000.00 contract for the purchase of the swim club was for the purchase of the buildings, structures and improvements on the real property and not for the swim club business, which it had no intention of operating. Thus, contends petitioner, because buildings and improvements are real property under the gains tax law, it was entitled to include the $1,500,000.00 as part of the original purchase price for calculating gain on the sale of the condominium units. Petitioner further argues that the mortgage commitment fee and

broker fee should be allowed in full because the $9,000,000.00 loan was not a refinancing of the original mortgage but instead was used for the construction of individual units. Petitioner contends that the real estate taxes paid as an adjustment to the purchase price were real estate taxes previously paid by the seller as a lien on the property and therefore are includible as part of the original purchase price. With respect to the disallowed cleaning fee of $18,500.00 and the $139,980.00 expense, petitioner argues that these expenses were incurred to complete construction of individual units prior to the actual sale of the units and, therefore, are capital improvement expenditures for purposes of the transfer gains tax.[5]

The Division argues that an examination of the sales contracts indicates that petitioner bought the real property and all buildings and improvements in the sale contract for $1,300,000.00 and bought the swim club business "together with the goodwill", excluding all real and personal property, in the sale contract for $1,500,000.00. The Division asserts that Mr. Steinberg's testimony that petitioner had no intention to purchase the business is contradicted by the contracts. The Division further argues that the disallowed mortgage commitment and broker fees were associated with the refinancing of a $2,000,000.00 loan which petitioner had previously taken out to acquire the property in 1986. The Division contends that

[5]Although petitioner, during the course of the hearing, appeared to challenge other adjustments made by the Division's auditor, only the issues identified above were argued in its brief. Therefore, petitioner has waived any other issues it may have contested during the hearing.

Mr. Steinberg's testimony that the $9,000,000.00 loan was a construction loan with the land as collateral is unsubstantiated, conflicts with the commitment letter sent by Dime Savings Bank, and should be given no weight.

With respect to the capitalized real estate taxes, the Division asserts that this amount did not meet the requirements of 20 NYCRR 590.15(b), which provides that unpaid taxes which are a lien on the property when acquired may be included in the computation of the original purchase price. Finally, the Division argues that the $18,500.00 cleaning fee and the $139,980.00 expense are not costs associated with capital improvements under the regulation's definitions and instead constitute "repair costs associated

with keeping the property in a condition of fitness, readiness and/or safety."

CONCLUSIONS OF LAW

A. Tax Law § 1441 imposes a tax on gains derived from the transfer of real property at the rate of 10% of the gain. Tax Law § 1440(3) defines "gain" as the difference between the consideration for the transfer of real property and the original purchase price. Under the statute, the 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 . . ." (Tax Law § 1440[former (5)(a)]; emphasis added).

Real property is defined under the statute as every estate or right in "lands, tenements or hereditaments, including buildings, structures and other improvements thereon" (Tax Law § 1440[6]). The regulations set forth further descriptions, with illustrative examples, concerning what constitutes acquisition costs and capital improvements that would reduce the "gain" subject to tax (20 NYCRR 490.15; 590.16, 590.17).

Petitioner contends that it is clear from the sale contract that the intent of the parties was to sell real property, including the pool, buildings and structures, owned by the swim club and not the business or goodwill. It claims that this intent is supported by the terms of the contract which allowed the seller to retain all personal property in connection with the operation of the swim club and auction off that property. Petitioner also notes that Mr. Steinberg, an experienced real estate developer, valued the land and improvements of the swim club at $3,500,000.00 in negotiating the price of the sales.

The Division contends that, notwithstanding petitioner's claims, there were two contracts relating to the swim club: one which provided for the sale of the land "including all buildings and improvements thereon", as described in the attached Schedule A, and the second contract provided for the sale of the business of the swim club.

In a recent Tax Appeals Tribunal decision, issued after the

filing of the parties' briefs in this case, the Tribunal rejected a similar claim by a taxpayer (Matter of Seaside Development Corp., Tax Appeals Tribunal, March 23, 1995). In that case, the taxpayer claimed that in order to purchase certain property it was compelled to enter into several contracts which separated the sale of real property and the business located on the real property. The taxpayer asserted that it had no intention of running the business, but purchased it in order to obtain the real property on which it was located. The Tribunal affirmed the reasoning of the Administrative Law Judge who held that the intended use of the property cannot vary the terms of the contracts and that even though the contracts were mutually dependent, this factor does not change the taxpayer's agreement to the structure of the transaction as the separate sales of real and personal property. Thus, notwithstanding petitioner's intention at the time of purchase, the terms of the contract may not be varied.

Unlike Seaside Development however, in this case, the $1,500,000.00 contract for the purchase of the swim club included real property as well as the swim club business. In the swim club contract, petitioner agreed to purchase the "swimming club, pool, recreation center and business operated in connection therewith, including all structures and improvements"; namely, pool, restaurant, locker rooms and showers, office building and auditorium, and all machinery, fixtures and equipment which were part of the structures. The Division argues that because the $1,300,000.00 purchase contract

for the land on which the swim club was located included, in Schedule A, the real property "with the buildings and improvements thereon", only the business was sold in the contract with the swim club.

In order to resolve the apparent discrepancy between the two contracts, it would have been helpful to have evidence concerning the relationship between the two apparently different but related sellers in these two contracts. In the $1,300,000.00 contract, the seller was listed as 8060 Property Partnership, whereas the seller in the $1,500,000.00 contract was Brook Sun & Swim Club, Inc. Therefore, because the partnership may not have had any ownership rights to the swim club's buildings and improvements, the buildings and improvements referred to in the $1,300,000.00 contract with 8060 Property Partnership might not have been the same items referred to in the $1,500,000.00 contract with the swim club. Unfortunately, the record is silent as to whether 8060 Property Partnership owned the buildings and structures used in the swim club operation. Such information could have clarified the conflicting terms in the two contracts.

In any event, given the greater specificity of the swim club contract, which identified the improvements and structures sold, it would appear that part of the $1,500,000.00 purchase price was for real property related to the business. However, there is insufficient evidence to draw any conclusion as to how to apportion the amount paid for the real property sold in the swim club contract (e.g., buildings, pool, etc.) and the amount paid

for the business (including goodwill) (cf., Matter of Beekman Country Club, Tax Appeals Tribunal, April 16, 1992, confirmed 199 AD2d 640, 604 NYS2d 989). The swim club contract does not make any apportionments and Mr. Steinberg's testimony was insufficient to establish how this apportionment should be made. Petitioner has the burden of overcoming a tax assessment (Executive Land Corp. v. Chu, 150 AD2d 7, 545 NYS2d 354, 356, appeal dismissed 75 NY2d 946, 555 NYS2d 692) and, in this respect, petitioner has not met its burden of proof on this issue. The $1,500,000.00 paid in accordance with the terms of the swim club contract included payment for the business which may not be included in the original purchase price (see, Matter of Seaside Development Corp., supra). Inasmuch as there is no basis upon which to determine the value of that business versus the value of any real property sold in that contract, no adjustment can be made to the $1,500,000.00 disallowance.

B. The next adjustment petitioner challenges is the disallowance of $10,662.00 in real estate taxes listed on the closing statements for the properties. Petitioner argues that it "paid real estate taxes by way of an adjustment on the purchase price, which real estate taxes were previously paid by the Seller as a lien on the property" (Petitioner's brief, p. 11). There is no testimony in the record to support this statement. Petitioner claims that such expense should be included as part of the original purchase price under the regulations (20 NYCRR 590.15). The Division argues that the only real estate taxes allowed under 20 NYCRR 590.15(b) on

acquisition of real property are liens on the property which are paid by the purchaser and reported as additional consideration to the seller. The Division claimed that this amount was not reported as payment of a lien or as additional consideration to the seller and therefore does not qualify under the regulations to be included in the original purchase price.

The regulations provide that certain acquisition costs are includible in the computation of original purchase price including delinquent real estate taxes or "unpaid taxes which are a lien on the real property that was acquired and which were paid by the buyer" (20 NYCRR 590.15[b]). The regulations also indicate that the payment of taxes by the buyer is deemed to be additional consideration to the seller. 20 NYCRR 590.15(a) provides that:

> "[i]f a transferor cancelled or discharged any indebtedness of his seller when he acquired the real property, the amount of the indebtedness cancelled or discharged would also be included in his original purchase price."

Again, there is no evidence in the record that the real estate taxes listed on the closing statement were unpaid taxes constituting a lien on the property or were reported as additional consideration to the seller. Therefore, there is no basis for reversing the Division's adjustment for this amount.

C. The Division disallowed a portion of petitioner's mortgage broker fee ($15,972.00) and mortgage commitment fee ($31,111.00) with respect to the $9,000,000.00 loan from Dime Savings Bank on the ground that that portion represented a refinancing of $2,500,000.00 of the original loan to purchase

the properties. The Division's auditor based her conclusion on paragraph "H" of the commitment letter, dated January 21, 1987, from Dime Savings Bank in which it stated the purpose of the loan. In that paragraph, the bank noted that $2,500,000.00 would be disbursed at the closing and "shall be applied for the acquisition of the premises", and that all future advances would be based on "work completed and in place." Mr. Steinberg testified that the $2,500,000.00 was necessary for the construction of buildings, and that the money was not used to acquire the land but that the land was used as collateral. The Division argues that Mr. Steinberg's testimony explaining the meaning of paragraph "H" is "disjointed, vague, and unsubstantiated by any documentary evidence" and was in direct conflict with the commitment letter. Citing Matter of Albe Realty Co. (Tax Appeals Tribunal, March 26, 1992, confirmed 194 AD2d 838, 598 NYS2d 602, lv denied 82 NY2d 657, 604 NYS2d 556) and Matter of V & V Properties (Tax Appeals Tribunal, July 16, 1992), the Division contends that the $2,500,000.00 loan constituted a refinancing of a prior loan to acquire the property and, therefore, is not a customary, reasonable and necessary cost pursuant to 20 NYCRR 590.15.

Under the case law cited by the Division and regulations, it is clear that if the $2,500,000.00 was borrowed to refinance a loan used to acquire the real property in the first instance, the commitment fees and broker fees related to that amount may not be part of the calculation of the original purchase price because they were not expenses necessary to create ownership

interest in the property (20 NYCRR 590.15[b]). The issue in this case is an evidentiary one -- whether the $2,500,000.00 was used for construction or constituted a refinancing of the original loan used to acquire the real property.

On audit, it was reasonable for the Division to determine that the $2,500,000.00 was used to refinance the original loan to purchase the real property based on the wording of paragraph "H" in the commitment letter and the fact that the loan was secured by a first lien on the real property.[6] Once it is established that the Division acted

reasonably, it is incumbent on petitioner to come forward with evidence to show that the Division was incorrect (see, Matter of Atlantic & Hudson Limited Partnership, Tax Appeals Tribunal, January 30, 1992). Petitioner has not carried its burden on this issue. Mr. Steinberg's testimony that the $2,500,000.00 was used for construction and not to refinance the original loan is incomplete to prove petitioner's case without an explanation as to what transpired with respect to the original loan. Mr. Steinberg's testimony shed no light on the fate of the original loan. Instead, he testified that a loan was taken out to acquire the property but that the parties had no mortgage on the property because they paid cash. There was no attempt to explain or clarify the apparent inconsistency in this statement.

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[6]Although the first loan was for approximately $2,000,000.00 and not $2,500,000.00, it is reasonable to assume that the $2,500,000.00 could have been used to cover interest or a prepayment penalty. No evidence was submitted on this issue to contradict this assumption.

Moreover, the original petition stated that it was challenging the Division's disallowances, including "various costs incurred which were attendant to the acquisition of petitioner's interest in real property (including the fees and costs to refinance the acquisition mortgage)." This statement appears to be inconsistent with petitioner's theory in its brief and further indicates that evidence concerning the fate of the first loan to acquire the property is critical to resolving these apparent contradictions and gaps in petitioner's case.

In general, the record is silent as to how the first loan from National Westminster Bank was secured, whether this loan was paid off before the second financing with Dime Savings Bank, or whether the National Westminster Bank agreed to give Dime Savings Bank a priority lien on the real property.

Without such critical information, there is no basis to conclude that the Division was incorrect in its disallowance of these amounts.

D. Finally, petitioner claims that the Division incorrectly disallowed an $18,500.00 cleaning expense and a $139,980.00 expense listed under the category "glass breakage, brooms, paint and locksmith". Petitioner claimed these expenses are capital improvement expenses. The Division disallowed these expenses as maintenance or repair expenses incurred to maintain the property in a condition of fitness, readiness and/or safety (see, 20 NYCRR 590.17[f]).

The Division correctly disallowed the cleaning expenses

inasmuch as they do not relate to any capital improvements to the property (see, 20 NYCRR 590.17[b]). However, the $139,980.00 expenses are allowable inasmuch as they relate to capital improvements to the units prior to their initial transfer. The regulations list examples of the type of costs that are related to capital improvements. These examples include debris removal, fixtures (permanently affixed), built-in appliances, plumbing, initial painting of new buildings, structures or additions, and construction material (i.e., lumber, sheet rock, flooring) (20 NYCRR 590.17[b]).

At the hearing, Mr. Steinberg gave credible testimony to explain the nature of these expenses. He indicated that there was an ongoing problem of vandalism during construction that resulted in the replacement of glass, locks, walls, wiring, plumbing, etc. The fact that the repairs due to vandalism were made just prior to sale does not preclude the inclusion of these costs as costs related to capital improvements. During the course of construction, windows, walls, plumbing or fixtures may sustain damage requiring replacement, repair or repainting. Given this context, it would be illogical to categorize these costs as maintenance and repair expenses. These costs are part of the construction costs relating to the initial sale of these units. In these circumstances, "paint touchup" was part of the initial painting of the units and the regulations should not be read so rigidly or literally as to preclude these expenses.

Moreover, Mr. Steinberg testified that many of the units were not completed until the prospective buyer obtained a

mortgage approval. At this point, the units were completed in accordance with a punch list that included installation of vanities and toilets, as well as replacement of locks, glass, wiring, and plumbing due to vandalism. The inclusion of the cost of brooms is also allowable as necessary for debris removal related to capital improvements. Thus, given the context in which these costs were incurred, they should be included as part of the original purchase price.

E. The petition of Sidan Realty Corp. is granted to the extent indicated in Conclusion of Law "D" and is in all other respects denied. The three notices of determination, dated August 22, 1991 and October 15, 1991, are modified as indicated in Conclusion of Law "D", and are otherwise sustained.

DATED: Troy, New York
August 10, 1995

/s/ Marilyn Mann Faulkner

ADMINISTRATIVE LAW JUDGE