STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
ROBERT E. REID, SR. (DECEASED)	:	DETERMINATION DTA NO. 815380
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, Robert E. Reid, Sr., c/o LaVonne Reid, Executrix, P.O. Box 667, Shoreham, New York 11786, 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 Roberta Moseley Nero, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on June 6, 1997 at 10:15 A.M., with all briefs to be submitted by October 10, 1997, which date began the six-month period for the issuance of this determination. Petitioner appeared by Coopers & Lybrand L.L.P. (Ellen Kon Gursky and Diane A. Reach, Esqs., of counsel, and John B. Rice, CPA). The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Michael J. Glannon , Esq., of counsel).

ISSUE

Whether petitioner, a 50% shareholder in a private water company, may include the costs of capital improvements made to real property through the use of a financing mechanism known as Contributions in Aid of Construction in his original purchase price when calculating the

amount of real property transfer gains tax due at the time of the transfer of the ownership of the company.

FINDINGS OF FACT

1. Petitioner's liability in this matter is attributable to his being a 50% owner of Shorewood Water Corp. ("Shorewood") prior to a May 4, 1993 transfer of ownership of 100% of the stock of Shorewood to the Suffolk County Water Authority ("SCWA"). The other 50% owner at the time, who also transferred his stock, was Mr. Edward Baisch. At issue is whether the stockholders of Shorewood may include the amount of capital improvements made through the use of a financing mechanism known as Contributions in Aid of Construction ("CIAC") in their original purchase price when calculating the amount of real property transfer gains tax due at the time of the transfer of ownership. The parties stipulated on the record that $14,240,835.00 in capital improvements were made to the property transferred.[1]

2. Testifying on behalf of petitioner was Mr. Albert A. Natoli. Mr. Natoli is an attorney and is currently a sole practitioner in New York City. His credentials include a bachelor of mechanical engineering, a master of science degree in management, a law degree and a professional engineering licence. Mr. Natoli worked for the New York State Public Service Commission ("PSC") for 11 years. During his career with the PSC, one position involved having a staff of engineers who were in charge of regulating over 100 privately owned water suppliers in New York State. This included regulation of the companies' finances, rate design, quality of service and various other service and rate issues. After leaving the PSC he went to work in litigation at the New York City Energy Office where his duties included handling and intervening

[1]The auditor's report in this matter also reflects that $14,240,835.00 in capital improvements were made to the property transferred.

in rate applications. In private practice he works in the areas of water and telecommunications public service law. He has been involved in special financings for water companies, tax exempt bond issuances, preparing rates in rate litigation cases and has appeared before the PSC for the purpose of obtaining approval for different types of applications and contracts for water companies. He also has represented water companies with respect to management audits done by the PSC and has advised water companies on management practices. Mr. Natoli was qualified as an expert in the areas of public utilities law, financings, rate regulations and management practices as those areas are applied to water companies.

Mr. Natoli has also had a direct relationship with petitioner in this case. He knew petitioner since around 1974 or 1975 when the PSC audited Shorewood. From 1985 until Shorewood was sold in 1993 he was Shorewood's utility counsel and as such represented Shorewood with regard to a rate application, assisted in obtaining financing for Shorewood, completed two tax exempt bond issues, reviewed contracts, worked with Shorewood to improve its books and records and advised Shorewood on various general practice issues. Mr. Natoli became familiar with the books and records of Shorewood as a necessity in performing these functions. Mr. Natoli also represented Private Water Services ("Private")[2] for a short time. He did not work directly on transactions between Shorewood and Private, but was familiar with how transactions were handled between the two companies since their relationship had been audited by the PSC on several occasions.

Also testifying on behalf of petitioner was Mr. Thomas Ginocchio. Mr. Ginocchio is currently vice president of finances for DVC Industries in Bay Shore, New York. Mr. Ginocchio

[2]The relationship of Private to Shorewood is discussed in findings of fact "6" through "8".

is a CPA who has prepared income tax, sales tax, gains tax and related returns. Mr. Ginocchio was chief financial officer of Private from September of 1989 through May of 1995. As chief financial officer he was responsible for the payroll and employee insurance programs and the processing of bills to vendors and invoices to customers. He also prepared the income and sales tax returns for the company. From February until June of 1993 Mr. Ginocchio worked as a consultant for Shorewood. He was "in charge of getting documentation, schedules and exhibits for the contract between Shorewood and Suffolk County Water Authority." (Tr., p. 100.) He also helped the company's accountants prepare the final financial statements and tax returns, including the gains tax questionnaires at issue.

Both Mr. Natoli and Mr. Ginocchio exhibited detailed knowledge of the operations of Shorewood and the relationship between Shorewood and Private. The testimony of these two witnesses has been incorporated into findings of fact "3" through "8".

3. Shorewood was a privately owned water company that provided water transmission to customers and sold the rights for water services in Suffolk County, New York. Shorewood had two types of customers. The first were regular utility customers (i.e., individual customers who would get water from Shorewood and pay Shorewood based on the amount of water used, registered by a meter installed in their houses). The second type of customers, the transactions with whom are central to the present matter, were generally real estate developers.

When a developer was interested in acquiring rights to receive water for a subdivision, the developer would contact Shorewood with details as to the extent of the project and how the streets were to be laid out. Shorewood would provide an estimate of the cost of the capital improvements required in order to provide water service and this estimate would become the basis of an agreement between Shorewood and the developer. Pursuant to such agreements the

developer would deposit the amount of the estimate with Shorewood for the purpose of financing the capital improvements necessary to provide water services to the customer. This mechanism to provide for the financing of the necessary capital improvements is what is known as CIAC.

4. Petitioner submitted an agreement between Shorewood and Ashley Estates, Ltd. dated September 4, 1986 as a sample of these types of agreements. Pursuant to the agreement Shorewood agreed to "furnish, lay and connect" a six-inch main and two fire hydrants and to provide water service to the customers on the line, including making the necessary connections. With regard to the financing of the required capital improvements, the agreement provided:

> "SECOND: The applicant will deposit with the Company pursuant to the provisions of this agreement, the sum of $32,637.50 to cover the estimated cost of furnishing, laying and connecting the said facilities, including hydrants. If the actual cost of the extension is less than the estimated cost, the Company will refund the difference to the Applicant. The actual cost of the extension will be retained and the Company will refund to the Applicant three and one-half times the first year's revenue received by the Company from each hydrant and bona fide customer connected with the main laid in accordance with this agreement, said refunds shall not exceed the amount paid by the Applicant; provided, however, if the entire cost has not been refunded to the Applicant at the end of ten years from the date water service is first rendered, no further refunds will be made. All pipes shall be maintained by the Company." (Petitioner's Ex. 4.)

Regarding the ownership of the capital improvements, the agreement provides:

> "THIRD: The payment made by the Applicant and the laying of said main pursuant to this agreement shall not in any way vest in the Applicant any title or interest in or to said main or any part thereof, but said main and all parts thereof, including any connections or attachments thereto shall be and remain the property of the Company and the Applicant shall execute and deliver an Easement Contract to the Company." (Petitioner's Ex. 4.)

5. As a water company, Shorewood was a utility regulated by the PSC. In particular, the structuring of its financing and the substance of the developer agreements had to be in conformance with PSC requirements. There were various financing mechanisms available to

Shorewood to finance the capital improvements necessary to expand its provision of water services. However, having opted to utilize the CIAC arrangement, Shorewood was not allowed to include the amount of the CIAC in its rate base. Other types of financing, for example certain bond issues or retained earnings, could have been included in the rate base. Furthermore, while the developers were in actuality purchasing the rights to water service for their developments, Shorewood, pursuant to PSC requirements, was allowed to charge the developers only the actual cost of the capital improvements required to provide water service. In accordance with this policy are the refund provisions of the developer agreements which are required by the PSC. The first type of refund provides that if the actual cost of the capital improvements is less than the estimated costs on deposit with Shorewood, the excess must be returned to the developer. The second type of refund allows for the developer to actually recoup some or all of the expense of the capital improvements depending on the revenues Shorewood derived from the new customers generated by the project. Shorewood was allowed to include any amounts refunded pursuant to these provisions in its rate base. The Division allowed as a capital improvement amounts Shorewood had refunded to developers pursuant to these provisions.

6. Shorewood was a small private water company.[3] In order to perform its obligations under such contracts, it would engage the service of another company to actually install and maintain the water systems. Shorewood worked with Private on a regular basis. Private's business consisted primarily of installing and maintaining water systems for Shorewood and other water companies. The business arrangement with Shorewood was that Private would supply the materials, equipment and personnel necessary for the installation and maintenance of

[3]At the time the ownership of Shorewood was transferred in 1994, Shorewood had grown to approximately 5,000 customers and had six full time employees, including the two principals.

the systems. Shorewood would contact Private with the details about the project. Private would: construct necessary elevations; if there was an existing road, cut up the road; excavate (mains are usually installed more than four feet below the surface); and lay the pipe for the main and for whatever connections were necessary to reach customers' houses and fire hydrant hook-ups.

When houses in the development were built, Private would connect the new water mains with the existing water mains, test the water mains and, if everything was in proper working order, backfill over the trenches and repave if required. Private also serviced and maintained these installations at the direction of Shorewood.

7. There were no written agreements in the normal course of business between Shorewood and Private.[4] When a project was completed Private would send Shorewood an invoice for the work done, which Shorewood would pay by check. It was apparently thought that written agreements were unnecessary due to the close relationship of the companies. This relationship was primarily based on the fact that Private was owned by petitioner's son. There were also some part-time employees that worked for both companies.

Petitioner submitted two sample invoices on Private letterhead to Shorewood for work done at Wading River Estates. The first of these is dated June 19, 1989, has an invoice number of 1-89, and sets forth a detailed list of the materials used for this specific site. The total for the invoice is listed as $120,097.00 and there is a handwritten notation indicating payment on June 27, 1989 of $120,000.00 with check number 18498. Attached to this invoice is a photocopy of canceled check number 18498, from a Shorewood account, made out to Private in the amount of $120,000.00. It also indicates that the check was paid by Marine Midland on June 28, 1989.

[4]Written contracts could be used when, for example, a project was funded by a bond issue and the bond holder required a written contract.

The second invoice is dated July 28, 1989, has an invoice number of "Final", and sets forth a detailed list of the materials used for this specific site, including those from the previous invoice. The total for the invoice is listed as $204,729.73 less invoice number one for a balance due of $84,632.73, and there is a handwritten notation indicating payment on August 3, 1989 by check number 18583. Attached to this invoice is a photocopy of canceled check number 18583 from a Shorewood account made out to Private in the amount of $84,632.73. It also indicates that the check was paid by Marine Midland on August 4, 1989.

Petitioner also submitted a Continuing Property Record which is the record of the capital improvements utilized in preparing the real property gains tax questionnaires filed. This record indicates that $14,240,836.53 was the original cost of all the capital improvements. The last two pages of the document contained a detailed report for standpipes and illustrate that Private is listed with dates, amounts and invoice numbers. Since the total amount of the capital improvements listed on the Continuing Property Record equals the amount of capital improvements determined by the auditor, it appears that none of the capital improvements were paid for directly by the developers.

8. Once the capital improvements were completed, Shorewood owned such improvements and was responsible for the maintenance and repairs of the facilities. This is evidenced by paragraph three of the agreement submitted (*see*, Finding of Fact "4"), by the fact that Shorewood paid taxes for the property,[5] and by the fact that Shorewood would have been entitled to an award in a condemnation proceeding. Shorewood's ownership of the capital improvements

[5]Petitioner submitted tax bills, photocopies of canceled checks and a letter from the New York State Office of Real Property Services explaining the taxation of special franchise property as evidence that Shorewood paid real estate taxes on the capital improvements.

is also evidenced by the fact that the majority of the interest in property conveyed in the transaction that is the subject of this proceeding consists of the capital improvements.

9. By letter dated March 9, 1993, in anticipation of the transfer of the controlling interest in Shorewood to SCWA, Shorewood filed with the Division of Taxation ("Division") two real property transfer gains tax questionnaires (one for itself as transferor and one for SCWA as transferee) with attachments. Both forms list the location of the property to be transferred as:

> "7 REAL ESTATE PARCELS WHERE WELLS & PUMPS ARE LOCATED ON WITHIN THE GRANTED FRANCHISE AREAS IN SHOREHAM, RIDGE, AND WADING RIVER" (Division's Exhibit D, Exhibit C).

Both forms also list a gross consideration of $13,700,000.00. Shorewood's transferor questionnaire listed the price paid to acquire the property at $57,650.00 and the cost of capital improvements to the property as approximately $14,240,835.00.[6] The cost of acquiring the property and the cost of capital improvements added together constituted the original purchase price ("OPP") of the property. When the OPP was subtracted from the gross consideration, the result was a loss of $540,837.00 on the transfer. Therefore, there was no anticipated tax due on the transfer.

10. The Division responded with a tentative assessment and return dated April 7, 1993 showing a total due of $865,454.90 on the transfer, and enclosing a copy of the audit workpapers. The tentative assessment was based on two adjustments. The first adjustment was a reduction of $6,413,030.00 in the OPP as calculated by the shareholders. It was the Division's position that this amount represented CIACs which were made by home owners and developers to Shorewood to enable extensions of water services, and that Shorewood had not paid for capital

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[6]The amount listed on the questionnaire was actually $14,240,837.00. The proper amount of capital improvements as found by the auditor and stipulated to by the parties was $14,240,835.00.

improvements. The audit work papers explained that the problem with the CIACs was that such arrangements:

> "TRANSFER[S] THE FINANCIAL BURDEN OF FURNISHING, LAYING AND CONNECTING TO SHOREWOOD'S WATER FACILITIES TO THE DEVELOPERS. AND PURSUANT TO GAINS TAX REGULATION 590.16(b), ONLY COSTS PAID FOR BY A TRANSFEROR ARE ALLOWABLE AS CAPITAL IMPROVEMENTS. THEREFORE, FILED [sic] AUDIT PROPOSES TO OFFSET ANY UNREIMBURSED C.I.A.C. TO THE DEVELOPERS AS A REDUCTION TO THE OPP CLAIMED BY THE TAXPAYER." (Division's Exhibit G.)

The second adjustment increased the original consideration allocated to the real property by $2,840,004.00. This was because the Division disagreed with how the shareholders calculated the fair market value of the real property by using replacement cost and not deducting depreciation. Therefore, the portion of the allocation of the gross consideration attributable to real property, and, therefore, subject to tax, was less than it should have been.

11. The shareholders of Shorewood apparently responded by submitting payment for the full amount listed on the tentative assessment and explaining that a mistake had been made by listing Shorewood as the transferor, since petitioner and Mr. Baisch should have been listed as the transferors.

12. The Division responded by letter dated May 23, 1994, acknowledging receipt of the tentative assessment and payment and explaining that it had treated the shareholders' previous submission as an amended filing and had corrected the transferor names to those of the individual shareholders instead of Shorewood. A new tentative assessment was enclosed in the name of petitioner and Edward A. Baisch, showing an amount previously paid of $865,454.90 and a total due of zero. The shareholders were also informed that they had two years, or until May 14, 1995, to file a request for a refund.

13. Petitioner filed a request for a refund dated December 23, 1993 in the amount of $432,727.45[7], that was received by the Division on January 6, 1994. By letter dated November 21, 1994, the Division informed petitioner that his refund claim had been denied in full and he had 90 days to file either a request for a conciliation conference with the Division's Bureau of Conciliation Services or a petition with the Division of Tax Appeals.

14. Petitioner filed a request for conciliation conference and a conciliation order was issued on July 5, 1996 granting a partial refund in the amount of $142,000.00. This refund was granted on the issue of the calculation of gross consideration. The amount remaining at issue was $290,727.45 which is the total amount of the refund claim attributable to the issue of the Division's increasing petitioner's OPP by subtracting the CIAC payments from the cost of capital improvements as calculated by the shareholders. The petition in this matter was received by the Division of Tax Appeals on October 2, 1996. The amount at issue was listed as $290,727.45.

SUMMARY OF THE PARTIES' POSITIONS

15. Petitioner argues that the relevant statute and regulations provide that the cost of capital improvements paid for by the transferor are includable in OPP. Since Shorewood paid for these capital improvements through paying Private by check, these amounts are includable in OPP. Petitioner attempts to distinguish the case of ***Matter of Cahill*** (Tax Appeals Tribunal, October 28, 1993) by pointing out that in ***Cahill*** the petitioners did not directly pay for the capital improvements, rather the funds were disbursed directly by the City of Binghamton. In the alternative petitioner argues, even if it is required that petitioner prove Shorewood bore the cost of the improvements it paid for, petitioner has proven that in this case. Shorewood was required

[7]The shareholders paid $865,454.90 in real estate transfer gains tax on the transaction at issue. There were two 50% shareholders at the time the transfer of the total ownership of Shorewood took place, petitioner and Mr. Baisch. Petitioner's request for refund represents his 50% of the tax paid.

under the terms of the agreements with the developers to pay the developers back. Furthermore, since the financing mechanism utilized was CIACs, Shorewood was not allowed to add these to Shorewood's rate base and therefore, it was indirectly paying for the capital improvements. Finally, petitioner points out that funds borrowed for capital improvements, even if not totally repaid, can be included in OPP and that the CIAC payments at issue are the equivalent of borrowed funds.

16. The Division argues that for the cost of the capital improvements to be included in the OPP, they must have been paid for by the transferor. The Division maintains that the principal announced in the ***Cahill*** case was that to add the cost of capital improvements to OPP, the transferor must actually be out of pocket for the cost of the capital improvement expenses. The Division contends that in this case it was the developers pursuant to the agreement who were out of pocket for these expenses, not Shorewood. The Division states in its brief that the auditor allowed as capital improvement costs any amount of the CIACs that was actually refunded pursuant to the agreement. The Division points out that the PSC does not allow unrefunded CIACs to be included as part of Shorewood's rate base, simply because Shorewood did not bear the cost of the improvements. The Division asserts that Shorewood's situation is different from that of borrowed financing situations mentioned by petitioner because the ownership of the funds deposited pursuant to the agreement remained with the developers, as evidenced by the provision that required any unused funds to be returned to the developers. The Division argues that petitioner's assertion that Shorewood was required to repay the CIACs is incorrect. Shorewood merely had to refund a portion of the CIAC depending on revenues. The Division asserts that Shorewood merely acted as a bookkeeper and kept the developers' funds on deposit. The Division argues that the parol evidence rule should apply "to limit the testimony to the extent it

disagrees with the unambiguous language of the documentary evidence" (Division's brief, p. 6). Finally, the Division argues that petitioner will not be treated unfairly in this situation because he received consideration for the capital improvements and did not bear the expense of making such capital improvements.

17. Petitioner responded by arguing that there is no requirement in the statute or regulations that the cost of the improvements be borne by the transferor, only that they be paid by the transferor. Petitioner also argues that the Division has incorrectly read the Tax Appeals Tribunal decision in the ***Matter of Cahill***. Petitioner asserts that in this instance, unlike ***Cahill***, Shorewood paid the costs for the capital improvements and there was no requirement enunciated in ***Cahill*** that required Shorewood to prove it bore the costs of the improvements. In any event, petitioner asserts that it did bear the economic risks of the improvements in that it owned the improvements, was required to keep the improvements in repair and paid property taxes on the improvements. Furthermore, if the improvements were not completed, Shorewood could have been required to refund both the used and unused portions of the deposit to the developers. Petitioner argues that Shorewood was not a bookkeeper as asserted by the Division. There is nothing in the agreement or the testimony supporting the Division's assertion that the ownership of the funds remained with the developers. Petitioner asserts that had revenues been high enough it would have been obligated to refund the entire amount of the CIAC. Finally, petitioner asserts that the testimony offered did not contradict or change the agreement in any way, the Division did not object to the testimony at the hearing nor did it attempt to challenge the testimony by cross-examination. Therefore, the testimony should not be limited by the parol evidence rule.

CONCLUSIONS OF LAW

A. Tax Law § 1441 imposes the "gains tax" (Tax Law Article 31-B, Tax on Gains Derived From Certain Real Property Transfers)[8] as follows:

> "A tax is hereby imposed on gains derived from the transfer of real property within the state. The tax shall be at a rate of ten percent of the gain." (Tax Law § 1441.)

Transfer of real property is defined in Tax Law § 1440(7)(a) as:

> "the transfer of any interest in real property by any method, including but not limited to sale, . . . or acquisition of a controlling interest in any entity with an interest in real property." (Tax Law § 1440[7][a].)

Gain is defined in Tax Law § 1440(3) 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." (Tax Law § 1440[3].)

Original purchase price, as relevant, is defined in Tax Law § 1440(5)(a) as:

> "(i) 'Original purchase price' means the consideration paid or required to be paid by the transferor (A) to acquire the interest in real property, and (B) for any capital improvements made or required to be made to such real property . . . . (Tax Law § 1440[5][a].)

The relevant language of the applicable regulation, 20 NYCRR former 590.14, mirrors that of the statute regarding the definition of original purchase price. 20 NYCRR former 590.16[9] further defines capital improvement through a series of questions and answers which, as relevant to this matter, provide:

> "(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 to real property which:

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[8]The real property transfer gains tax imposed by Article 31-B of the Tax Law was repealed on July 13, 1996. The repeal applies to transfers of real property that occur on or after June 15, 1996 (L 1996, ch 309, §§ 171-180).

[9] This provision has been renumbered and is currently 20 NYCRR 590.17.

"(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 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:

* * *

"-- consideration paid to contractors to make the capital improvement" (20 NYCRR former 590.16[a], [b]).

B. Since 100% of the ownership in Shorewood was being transferred to SCWA, and since Shorewood had an interest in real property, the shareholders of Shorewood, as transferors, and SCWA, as transferee, correctly filed gains tax questionnaires. Listed on the questionnaire filed by petitioner was an amount of approximately $14,240,837.00[10] as the cost of capital improvements to the property. The auditor found that $14,240,835.00 in capital improvements had been made to the property being transferred, and the parties stipulated to this fact on the record at the hearing. Therefore the only question remaining is whether Shorewood "paid" for those improvements.

C. The first issue to be addressed is one of proof. The Division, citing ***Matter of Landmark Dining Systems v. Tax Appeals Tribunal*** (224 AD2d 785, 637 NYS2d 524) and ***Matter of Emery Air Freight Corp. v. New York State Tax Appeals Tribunal*** (188 AD2d 772, 591 NYS2d 264) argues that the parol evidence rule should limit the testimony of petitioner's

[10]See, footnote "7".

witnesses where such testimony conflicts with the unambiguous language of the documents submitted. The Division does not indicate any particular testimony that it finds objectionable. My review of the testimony offered by petitioner does not indicate any conflict between the testimony and the written documents submitted. Nor does the testimony seek to expand the documents. The agreement in evidence was between Shorewood and a developer. In the agreement Shorewood agrees to provide water service and the capital improvements necessary to establish water service, and the developer agrees to deposit the amount required to make the capital improvements subject to certain refund positions. The testimony offered by petitioner's witnesses primarily explains the mechanics of how Shorewood met its obligations under the contract. Evidence offered to show that Shorewood hired Private to actually complete the work and evidence as to how Private was paid constitutes a group of transactions separate and apart from the agreement between Shorewood and the developers. Therefore, introduction of this evidence is not limited by the parol evidence rule. The only other testimony that the Division might be objecting to was the testimony to the effect that the PSC required certain provisions to be included in the agreements. Again, this testimony does not conflict with or expand the terms of the agreement and is not limited by the parol evidence rule.

Petitioner's assertion that the Division did not object to the testimony at hearing, or even attempt to challenge the testimony on cross-examination is correct. Indeed, the Division's position, starting with the audit workpapers, through the hearing and its post-hearing brief, is that since petitioner did not actually bear the burden of the costs of the capital improvements, those costs cannot be included in petitioner's OPP. The Division throughout these proceedings, while never conceding that the capital improvements were paid for utilizing Shorewood checks, has never questioned petitioner's assertions on these issues. Furthermore, the sample documentation

submitted by petitioner, together with the testimonial evidence from two people unquestionably familiar with the workings of Shorewood, meets petitioner's burden of proof in establishing that Shorewood provided the payments for the capital improvements. The remaining issue to be addressed is the meaning of the phrase "consideration paid or required to be paid by the transferor . . . for any capital improvements made or required to be made to such real property" in Tax Law § 1440(5)(a).

D. The issue is one of statutory and regulatory interpretation as to whether the application of the law in this case by the Division comports with the intent of the statute. When the issue to be decided is whether the taxpayer is entitled to an exclusion or exemption from tax, the taxpayer is required to prove that its interpretation of the statute is the only reasonable interpretation, or that the Division's interpretation is unreasonable. (***Matter of Blue Spruce Farms v. New York State Tax Commn.***, 99 AD2d 867, 472 NYS2d 744, ***affd*** 64 NY2d 682, 485 NYS2d 526; ***Matter of Grace v. State Tax Commn.***, 37 NY2d 193, 371 NYS2d 715). Petitioner in this case has shown that the Division's interpretation of the statute is unreasonable.

When construing a statute the primary focus is on the intent of the Legislature in enacting the statute (McKinney's Cons Laws of NY, Book 1, Statutes § 92[a]; ***see***, ***Matter of Sutka v. Connors***, 73 NY2d 395, 541 NYS2d 191; ***Matter of American Communications Technology v. State of New York Tax Appeals Tribunal***, 185 AD2d 79, 592 NYS2d 147, ***affd*** 83 NY2d 773, 611 NYS2d 125). When that intent is clear from the wording of the statue itself, the inquiry ends (McKinney's Cons Laws of NY, Book 1, Statutes § 76; ***see, Matter of American Communications Technology v. State of New York Tax Appeals Tribunal***, ***supra***).

There is no ambiguity in the statutory language in this matter. The statute and the regulations provide that the cost of capital improvements paid for by the transferor are includable

in the calculation of OPP, which in turn means deductible from gross consideration in reaching consideration subject to tax. The Division states that because Shorewood did not bear the costs of the capital improvements in this case, that Shorewood did not pay for such improvements. I cannot read that additional requirement into the statute. To pay is to:

> "discharge a debt by tender of payment due; to deliver to a creditor the value of a debt, either in money or in goods, for his acceptance. U.C.C. §§ 2-511, 3-604. To compensate for goods, services or labor." (Black's Law Dictionary 1016 [Fifth ed].)

There is no doubt that Shorewood paid for the capital improvements to the property in the traditional meaning of the term. To pay simply means to compensate, it does not carry with it the connotation argued by the Division that the funds used for such compensation must not come from an outside source.

E. The Division points to the decision of the Tax Appeals Tribunal in ***Matter of Cahill*** (Tax Appeals Tribunal, October 28, 1993) in support of its position that not only must the capital improvements be paid for by the transferor, but the cost of the capital improvements must be borne by the transferor. Petitioner points to the same Tax Appeals Tribunal decision in support of its position that since it paid the contractor to do the work that constituted the capital improvements, the cost must be included in OPP and the question of who bore the cost of the improvements is irrelevant.

Cahill involved a structure which had previously served as City Hall for the city of Binghamton, New York and was on the State and Federal historic registers. Certain private parties acquired a lease on the premises with the intent of operating a hotel once improvements were made. As part of the effort to save the structure certain public funds were obtained to assist with making the improvements. The City of Binghamton directly paid $500,000.00 of the public

funds to the contractors for the capital improvements. When ownership of the lease was transferred by the parties, the petitioners in ***Cahill*** argued that these capital improvements should be included in their OPP. The Division argued that the petitioners had not paid for the improvements. The Tribunal held:

> "the statute is quite clear in its requirement that the consideration be 'paid . . . by the transferor'(Tax Law § 1440[5][a]). Applying the wording of the statute to the facts at hand, it is clear that the Federal and State grant monies 'were disbursed by the City of Binghamton,' thus, they were not 'paid . . . by the transferor,' i.e., petitioners, as required by section 1440(5)(a) and, therefore, do not qualify as consideration for capital improvements (Determination, conclusion of law 'E')." (***Matter of Cahill***, ***supra***.)

Thus, the Tax Appeals Tribunal decided ***Cahill*** on the grounds that since the City of Binghamton disbursed the funds, the petitioners had not paid for the capital improvements. Contrary to the Division's understanding of the case, the Tax Appeals Tribunal did not base its decision on the fact that the capital improvements were made with government funds, or any other funds from an outside source. The Tax Appeals Tribunal in reaching its decision did not address the Division's argument that a taxpayer must incur expenses in order to deduct such expenses, and, in footnote 25, specifically stated that:

> "The facts in this case do not require us to reach the issue of whether the transferor must be the source as well as the disburser of the funds." (***Matter of Cahill***, ***supra***.)

Since the issue was not addressed, ***Cahill*** does not completely support petitioner's position either. However, the decision was based upon the fact that the transferor had not directly paid the contractors for the capital improvements. Petitioner in this matter directly paid the contractor for the capital improvements. That fact combined with the discussion of the meaning of the term "paid" in Conclusion of Law "D", requires the conclusion that Shorewood paid for the capital improvements in question within the meaning of Tax Law § 1440(5) and the interpretation of

that statute as set forth in ***Cahill***. Therefore, petitioner was entitled to include the costs of the capital improvements in his OPP.

F. The determination that the requirements of the statute have been met since petitioner directly paid for the capital improvements renders the issue of whether petitioner actually bore the burden of the costs for the improvements moot. Therefore the parties' arguments on that issue will not be addressed.

G. The petition of Robert E. Reid, Sr. (Deceased) is granted, and the remainder[11] of petitioner's refund claim dated December 23, 1993 in the amount of $290,727.45, plus appropriate interest, is granted.

DATED: Troy, New York
March 26, 1998

/s/ Roberta Moseley Nero
ADMINISTRATIVE LAW JUDGE

[11]As noted in Finding of Fact "14", a refund of $142,000.00 was previously granted by conciliation order on a separate issue not part of these proceedings.