STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
V & V PROPERTIES	:	DECISION DTA No. 801487
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 V & V Properties, 86-01 114th Street, Richmond Hill, New York 11418 filed an exception to the determination of the Administrative Law Judge issued on July 3, 1991 with respect to its 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. Petitioner appeared by Lapatin, Lewis & Kaplan, P.C. (Benjamin Lewis, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Paul A. Lefebvre, Esq., of counsel).

Petitioner submitted a brief in support of its exception. The Division of Taxation submitted a letter in lieu of a formal brief in response. Oral argument, requested by petitioner, was heard on January 17, 1992.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUES

I. Whether petitioner transferred 100% of its partnership interest to Lucio Petrocelli.

II. Whether the "kicker" payment in the amount of $1,125,000.00 is part of the total consideration received by petitioner on its transfer of its partnership interest.

III. Whether petitioner is allowed to include, as part of its original purchase price, costs incurred in its condominium conversion.

IV. Whether petitioner is allowed to include, as part of its original purchase price, costs it incurred to refinance and protect title to the property.

V. Whether petitioner is allowed to include, as part of its original purchase price, the costs incurred by its assumption of all liabilities and debts of Kord, the previous owner of the property.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for findings of fact "7" and "22" which have been modified. The Administrative Law Judge's findings of fact and the modified findings of fact are set forth below.

On June 18, 1984, the Division of Taxation (hereinafter the "Division") issued to petitioner, V & V Properties ("V & V"), a Notice of Determination of Real Property Transfer Gains Tax Due under Tax Law Article 31-B (more commonly known as the "gains tax"). This notice assessed gains tax liability in the amount of $750,000.00, plus penalty and interest, based upon the Division's position that a controlling interest in V & V had been transferred to one Lucio Petrocelli on July 28, 1983, and that such transfer was a taxable transaction. Since petitioner did not comply with the pre-transfer filing provisions (see, Tax Law § 1447), and since full documentation as to petitioner's original purchase price was not subsequently supplied to the Division as requested, per letters issued as early as January 1984 and thereafter, the Division made no allowance for original purchase price and simply calculated gain as being equal to the $7,500,000.00 amount of consideration allegedly received, with tax due computed as 10 percent thereof ($750,000.00).

Based upon additional information provided by petitioner during the course of these proceedings, the Division has twice revised and reduced its initial calculation of tax due.

The Division first recalculated consideration received and original purchase price as follows:

Consideration:

$ 250,000.00	Cash Deposit
$5,245,000.00	Cash received before July 29, 1983
$2,000,000.00	Third mortgage to Litas
	"Kicker" consideration at 10% of
$1,739,000.00	condominium sales
$9,234,000.00	Total

Original Purchase Price:

$4,800,000.00	Mortgage
$ 135,000.00	Accrued interest
$ 94,000.00	Back taxes
$ 34,000.00	O'Hara buyout
$ 196,000.00	Dinolfo buyout
$ 17,830.00	Capital improvement receipts
$ 195,000.00	Sewage treatment facility
$5,471,830.00	Total

Comparing the above two totals ($9,234,000.00 less $5,471,830.00) results in a gain of $3,762,170.00 and a revised tax due of $376,217.00, plus penalty and interest.

The Division's second revision to liability was based upon additional information provided. Specifically, the parties agreed that the maximum additional "kicker" consideration received on condominium unit sales was $1,125,000.00. This agreement reduces total consideration to $8,620,000.00 which, when compared to an original purchase price of $5,471,830.00, leaves a gain of $3,148,170.00, and a revised tax due of $314,817.00, plus penalty and interest.

V & V was an Illinois limited partnership formed in 1968. At the time of formation, one Vytautus Vebeliunas was the partnership's sole general partner. In 1975, Mr. Vebeliunas

continued to be V & V's sole general partner, with V & V having approximately 70 limited partners, most of whom were small, individual investors. In 1975, Litas Investing Co., Inc. ("Litas"), a New York corporation having approximately 500 shareholders, was one of V & V's limited partners. Mr. Vebeliunas was, and continues to be, a principal of Litas. The date when Litas became a limited partner in V & V and its initial percentage of interest therein was not specified in the record.

The real property involved herein was an apartment complex known as Hidden Hollow Garden Apartments ("Hidden Hollow"). Hidden Hollow consisted of 18 two-story buildings, housing a total of 280 garden apartment units, located on approximately 37.1 acres of land in Wappingers Falls, Dutchess County, New York. In addition to the 18 two-story residence buildings at Hidden Hollow, the complex also included a combination clubhouse and office building, a shed for storage of swimming pool equipment, and a barn used for maintenance equipment storage. Other improvements at the complex included a 30' by 100' swimming pool, two "doubles" tennis courts, a children's playground, parking areas and landscaping.

Prior to December of 1975, Hidden Hollow had been developed, constructed, owned and operated by a New York general partnership known as Kord Company ("Kord"). In 1973, Kord's six partners were the following individuals: Charles Dinolfo, Joseph Dinolfo, Laurence Kleinman, John Reventas, James O'Hara and Neil Saltzman. In 1973 and 1974, the six individual partners of Kord were also the principals of Dutchess 3 Realty Corp. ("Dutchess 3"), a New York corporation. During 1973 and 1974, Dutchess 3 obtained from Citibank four construction loans for the Hidden Hollow project totalling $4,800,000.00 (the "Citibank construction loans"). These loans were secured by mortgages on Hidden Hollow.

V & V's Acquisition of Hidden Hollow through Kord

In December 1975, the Hidden Hollow project was in severe financial difficulty. The Citibank construction loans were in default and Citibank was threatening to foreclose on the mortgages. Around December 1975, after obtaining Citibank's approval, V & V began negotiations for the acquisition of Hidden Hollow from Kord, including V & V's participation in

the project. V & V's objective at and after that time was to complete construction of the Hidden Hollow project, under Citibank's supervision, to stabilize the rent roll, and eventually to sell the apartment units as condominiums.

We modify the Administrative Law Judge's finding of fact "7" to read as follows:

> Pursuant to an agreement dated December 26, 1975, V & V was to become a general partner in Kord, acquiring a 49% interest therein. Pursuant to the terms of the December 26, 1975 agreement, V & V was to convey to Kord's partners 38 investment units in V & V valued at $10,000.00 each. V & V and Kord's partners also agreed that V & V was to assume the following liabilities:
>
> (a) the Citibank construction loans of $4,800,000.00, plus accrued interest;[1]
> (b) a truck loan of $5,477.00 owed to Citibank; (c) a loan of $55,000.00 owed to County Trust Co.;
> (d) accounts payable of $40,700.00 owed to building contractors;
> (e) tenants' rent security of $21,254.00;
> (f) outstanding real estate taxes of $94,000.00; and
> (g) a short-term loan of $30,000.00 owed to Citibank.
>
> An agreement between Kord and Citibank, dated April 20, 1976, outlines the principal sum of $4,800,000.00 plus accrued interest for which Kord was liable. Such agreement states, in pertinent part, as follows:
>
> > "[t]he time of payment of the principal sum of $4,800,000 evidenced by the Note and accured [sic] by the Mortgage shall be and hereby is extended so that the said principal sum shall be due and payable on June 1, 1978 . . . . The interest on said principal sum to April 1, 1976, computed as provided in the Note, without compounding, amounting to $348,693.00 ('Past Due Interest'), shall be payable with the principal, except as hereinafter provided" (Exhibit 5 [5], ¶ 2, p. 3).
>
> Paragraph 13 of said agreement sets forth the exception to paragraph 2 above. Such paragraph, in pertinent part, states:
>
> > "[i]f the full principal sum of $4,800,000 shall be paid on June 1, 1978 as herein required, then payment of the Past Due Interest remaining unpaid and any interest accrued hereunder and then unpaid shall be deferred by the Mortgagee for five years,
> >
> > providing that payment thereof shall be secured by a mortgage of said premises which shall be subject and subordinate to any institutional first mortgage obtained by the Mortgagor and

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[1] As of April 1, 1976, Citibank determined that the accrued interest on the construction loans totalled $348,693.00.

> which shall be recorded at the expense of the Mortgagor" (Exhibit 5 [5], ¶ 13, p. 9).
>
> Therefore, even if Kord paid the principal sum in full by June 1, 1978, it would still be liable to pay for the $348,693.00 in interest accrued as of April 1, 1976, although such interest payments would not be due at the time that it paid the principal sum, but rather five years later.[2]

The December 26, 1975 agreement described above was subsequently modified by an agreement dated May 21, 1976. The modified agreement called for V & V to receive a 50% interest in Kord in exchange for infusing $225,000.00 in cash into the partnership and assuming liability for real estate taxes of $94,000.00 and accrued interest of $135,000.00 (accrued after April 1, 1976) owed to Citibank on the Citibank construction loans. The May 21, 1976 agreement also modified the December 26, 1975 agreement with respect to the other liabilities that V & V had agreed to assume under the earlier agreement. More specifically, pursuant to the May 21, 1976 agreement, V & V directly assumed only the liabilities owed by Kord to Citibank, and did not assume the other liabilities referred to in the December 26, 1975 agreement. Petitioner alleged, however, that the other liabilities remained as liens against Hidden Hollow which were paid by V & V out of the operating cash flow of the project. Finally, the May 21, 1976 agreement also called for V & V to satisfy certain loans in the aggregate amount of $40,000.00 made by Litas to two of Kord's partners, to wit, Charles Dinolfo and John Reventas.

V & V also purchased the interest in Kord held by James O'Hara, as such had devolved to Mr. O'Hara's wife upon his death. Documents in evidence list the contract purchase price for such interest to be $40,000.00, and petitioner alleges it paid such amount. The Division asserts, by contrast, that petitioner has documented only $34,560.00 as the amount actually paid.

Pursuant to an agreement dated March 10, 1977, the agreements of December 26, 1975 and May 21, 1976 were further modified. Pursuant to the March 10, 1977 agreement,

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[2] We modified finding of fact "7" of the Administrative Law Judge's determination by adding the last three paragraphs to the original finding of fact "7" to reflect the record in more detail.

V & V noted an increase in its interest in Kord to 60%, and recognized that the sum of $25,000.00 had been "previously advanced to Charles Dinolfo and John Reventas." While this agreement specifies V & V's right to be repaid this $25,000.00 amount before any partnership payments to Messrs. Dinolfo and Reventas, the agreement does not specify the nature or purpose of the $25,000.00 advance. The agreement, however, specifies at paragraph 3 (see Exhibit 20[2]) that the increase in V & V's ownership interest in Kord from 50% to 60% results from the purchase of the O'Hara interest as described above (as opposed to resulting from the $25,000.00 amount advanced to Dinolfo and Reventas).

Pursuant to an agreement dated February 21, 1979, V & V allegedly paid, inter alia, an additional $50,000.00 to Dinolfo and Reventas, and also forgave indebtedness of $6,000.00 owed by Reventas, in exchange for Dinolfo's and Reventas' remaining interests in Kord. The Division maintains there is no evidence proving such payments were in fact made, and argues that a subsequent agreement dated November 1, 1979, calling for (inter alia) a payment of $112,000.00 to Dinolfo and Reventas plus relief from $6,000.00 of debt owed by Reventas as described, superceded the February 21, 1979 agreement as to the amount actually paid. Petitioner also maintains that the 38 investment units in V & V initially to be conveyed by V & V to the Kord partners pursuant to the December 26, 1975 agreement were eventually repurchased by V & V at $10,000.00 per unit. The Division challenges this allegation as unproven.

On or about February 22, 1979, an amended business certificate was filed in the Dutchess County Clerk's Office indicating the withdrawal of Dinolfo and Reventas from Kord, thus leaving V & V as the sole surviving participant doing business under the name of Kord Company. An indenture subsequently executed on August 14, 1979 transferred Hidden Hollow from Kord to V & V. This indenture was recorded in the Dutchess County Clerk's Office on August 20, 1979.

Petitioner summarizes the total consideration paid by V & V to acquire Hidden Hollow through Kord to be $6,071,123.98, consisting of the following amounts:

(a) $380,000.00; investment units in V & V, valued as $10,000.00 each, as repurchased;

(b) $4,800,000.00; Citibank construction loans;

(c) $5,477.00; truck loan from Citibank;

(d) $55,000.00; loan from County Trust Company;

(e) $40,700.00; accounts payable to building contractors;

(f) $21,254.00; tenants' rent security;

(g) $30,000.00; short-term loan from Citibank;

(h) $348,693.00; accrued interest as of April 1, 1976 on Citibank construction loans;

(i) $135,000.00; additional accrued interest (post 4/1/76) on Citibank construction loans;

(j) $94,000.00; real estate taxes;

(k) $40,000.00; satisfaction of loans owed by Charles Dinolfo and John Reventas to Litas;

(l) $40,000.00; payment to purchase James O'Hara's interest;

(m) $75,000.00; payments of $25,000.00 and $50,000.00 made to Charles Dinolfo and John Reventas; and

(n) $6,000.00; forgiven loan owed by John Reventas.

Capital Improvements
Direct Costs and Additional Construction Period Costs

Citibank closely monitored V & V's activities in connection with the Hidden Hollow project. Initially, V & V was required to obtain Citibank approval for all disbursements for expenditures, including both operating expenses and capital expenses. The nature of a given expense was allegedly agreed upon between the resident manager at Hidden Hollow and a Citibank representative. V & V was also required to submit financial statements on the project for Citibank's review. These financial statements were prepared for V & V by one Joseph Polito, a public accountant, pursuant to the Citibank requirement.

Petitioner alleged, via Mr. Vebeliunas' testimony, that when V & V began its acquisition of Hidden Hollow in December 1975, the complex was approximately 60% completed and had an occupancy level of approximately 40%. Petitioner also alleged that, from the period 1976 through 1978, a "construction crew" was maintained at Hidden Hollow which fluctuated in number from 10 to 20 employees. Certificates of occupancy for 14 of the residential buildings had been issued by 1974 with 2 additional certificates issued in 1977.[3] Mr. Vebeliunas testified that "upon our taking control of it all, the structures were under roof and inside panelings were done but a lot of finish work, carpeting, stairways, and some windows had to be removed and replaced. We had to finish interiors, some exterior, make the project habitable." Paragraph 2 of the May 21, 1976 amended buy-in agreement provides that "[a]n inventory of the vacant apartments reflects a certain amount of missing equipment and substantial repair required (emphasis added). Cost estimates and a "summary of necessary improvements" dated June 14, 1976 and prepared by A.K. Guidelis, Architect (see Exhibit "6 [5]"), lists an estimated cost of $593,300.00 for items such as painting, caulking, installing gutters, installing flashing, insulating water pipes, exterior site regrading and landscaping, and replacing wooden siding with vinyl, as recommended.

In 1976, petitioner allegedly incurred capital improvement costs of $283,610.00 consisting of the following amounts:

(a) $109,379.00 in direct capital improvement costs to complete the project;

(b) $129,600.00 in interest on Citibank construction loans;

(c) $10,685.00 in property taxes;

(d) $14,154.00 in school taxes;

(e) $6,992.00 in property insurance; and

(f) $12,800.00 for guaranty fee on Citibank construction loans.

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[3] The record does not specify when (or if) certificates of occupancy were issued for the remaining two buildings.

The dollar amounts of Items (b) through (f) represent 40% of the total annual amount of each of such enumerated costs, apparently based on petitioner's estimate that Hidden Hollow was 60% completed at the time of petitioner's acquisition thereof. The Division challenges the propriety of including these amounts in original purchase price, alleging a lack of proof that all of the amounts listed in item "a" actually constituted capital improvements. The Division also argues there is insufficient proof that a construction period was ongoing, and alternatively, alleges a lack of proof as to the actual percentage of the project which was in fact still under construction and which could be the subject to an allocation.

In 1977, V & V allegedly incurred capital improvement costs of $375,288.00, similar in nature to those for 1977, as follows:

(a) $159,661.00 in direct capital improvement costs to complete the project;

(b) $172,800.00 in interest on Citibank construction loans;

(c) $10,065.00 in property taxes;

(d) $14,154.00 in school taxes;

(e) $5,808.00 in property insurance; and

(f) $12,800.00 for guaranty fee on Citibank construction loans.

As above, items (b) through (f) herein represent 40% of the total annual costs of such enumerated items. So too, the Division challenges all of the items upon the grounds described above.

V & V also incurred an additional capital improvement cost in 1977, involving the construction of a waste treatment plant for the project. Petitioner claims capital costs of $195,000.00 plus $17,598.15 consisting of the following items:

(a) $195,000.00 paid to the construction company under the construction contract for the treatment facility;

(b) $50.00 for title and recording fees;

(c) $15,000.00 in architect's fees;

(d) $1,048.00 in attorneys' fees; and

(e) $1,500.00 in mortgage taxes.

The Division, by contrast, has allowed the amount specified at (a) above, but has denied the following three items as not allowable expenses and has denied the final item as unsubstantiated.

In 1978, V & V allegedly incurred capital improvements of $429,136.00 consisting of the following amounts:

(a) $213,167.00 in direct capital improvements to complete the project;

(b) $172,800.00 in interest on Citibank construction loans;

(c) $10,065.00 in property taxes;

(d) $14,154.00 in school taxes;

(e) $6,150.00 in property insurance; and

(f) $12,800.00 for guaranty fee on Citibank construction loans.

As above, items (b) through (f) represent 40% of the total cost of such enumerated items. So too, the Division challenges these items as described.

The Division, after review, allowed in total $17,830.00 as capital improvement costs out of the amounts described above as direct capital improvements. However, no listing of the specific items allowed as capital improvements was provided. Petitioner's evidentiary submission on these costs consisted of three file folders full of invoices and bills organized in no particular order and with no specific summarization or explanation of such items save for the general assertion that all of such amounts constituted direct capital improvement expenditures includable in the original purchase price ("OPP"). Included among the folders of invoices alleged to represent capital expenditures were payments for paint (and painting), carpet (and installation), and snow removal as well as some invoices with no description at all.

Costs of Refinancing and Protecting Title

Although the financial situation improved under V & V's management, Hidden Hollow continued to face serious financial difficulties. In January 1979, Citibank filed a mortgage foreclosure action with respect to the Citibank construction loans against Kord and V & V, among others, in the Supreme Court of New York, Dutchess County. To prevent a foreclosure, on January 17, 1979, Kord (i.e., V & V d/b/a Kord) filed a petition under Chapter 12 of the Bankruptcy Code. By order dated February 22, 1979, this Chapter 12 petition was dismissed.

We modify the Administrative Law Judge's finding of fact "22" to read as follows:

> By an agreement dated February 1, 1979, Citibank granted Kord an option to pay $3,750,000.00 in settlement of the mortgage debt if payment were made by July 5, 1979 (Exhibit 12, ¶ 2, p. 5). However, if such option was not exercised, Citibank would obtain title to Hidden Hollow. In turn, V & V approached approximately 25 lending institutions, including Consolidated Capital Income Trust ("CCIT"), to obtain financing. On or about June 28, 1979, Mr. Vebeliunas submitted a loan application to CCIT on behalf of V & V seeking a $3,750,000.00 loan. On July 2, 1979, CCIT issued its loan commitment letter to V & V, and the transaction closed on July 5, 1979. The CCIT loan was originally due for payment on July 4, 1980. However, the payment date was extended to July 4, 1981 and, again, to July 4, 1982.[4]

In June 1981, V & V instituted an action against CCIT in the United States District Court in the Southern District of New York seeking a declaration that the CCIT loan was usurious and an injunction against collection thereof. However, CCIT filed a counterclaim and the action resulted in a judgment of foreclosure in favor of CCIT. V & V appealed this judgment, which was ultimately affirmed by the Second Circuit Court of Appeals in or about June 1983. To prevent foreclosure, in or about June 1983, V & V filed a petition under Chapter 11 of the Bankruptcy Code.

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[4] We modified the Administrative Law Judge's finding of fact "22" by adding (at the end of the first sentence in the original finding of fact "22") a citation to the Exhibit which discusses this provision of the February 1, 1979 agreement.

From 1979 to 1981, V & V incurred costs of $447,245.00 in obtaining the CCIT financing and, in connection therewith, in protecting its title in the property, consisting of the following amounts:

(a) $112,500.00; fee to CCIT;

(b) $18,350.00; attorneys' fees to Weil, Gotshal, et al.;

(c) $7,500.00; attorneys' fees to Valdas Duoba;

(d) $7,423.00; title insurance and recording fees;

(e) $50.00; title closer's fee;

(f) $5,172.00; fees to Citibank;

(g) $20,000.00; mortgage broker commitment;

(h) $112,500.00; extension fee (3 points) to CCIT as noted;

(i) $161,250.00; second extension fee (4 points) to CCIT as described; and

(j) $2,500.00; appraisal fee in connection with refinancing.

The Division does not deny that such costs were incurred; the Division however denies that such expenses are allowable costs in determining original purchase price.

From about 1981 to 1983, V & V incurred $150,346.00 in costs to protect its title to Hidden Hollow against foreclosure consisting of the following amounts:

(a) $30,831.00 in legal fees to Anderson, Russell, Kill & Olick for representation against CCIT;

(b) $114,515.00 in legal fees to Alan Rubin for representation against CCIT and to prevent additional brokerage fees; and

(c) $5,000.00 in legal fees to Angel and Frankel in connection with the Chapter 11 filing.

As above, the Division does not contest that these costs were incurred; rather, the Division denies that such costs are allowable in computing original purchase price.

Capital Improvements - Condominium Conversion Costs

In 1982 and 1983, V & V also incurred costs of $50,000.00 in converting Hidden Hollow into condominiums, which costs consisted of the following amounts: (a) $10,000.00, State of New York condominium filing fee; and (b) $40,000.00 in legal fees. The Division admits that the $10,000.00 cost was incurred but denies the $40,000.00 cost as unsubstantiated.

The sum of the foregoing amounts described above leaves V & V's claimed original purchase price for Hidden Hollow as $8,036,907.00.

V & V to Petrocelli Transaction

The transfer at issue herein, i.e., Lucio Petrocelli's acquisition of an interest in V & V, was undertaken to save the project from foreclosure by CCIT. In this transaction V & V, with the assistance of Carl Turner Associates, sought and found a new general partner to infuse additional capital into the project and also to assist in obtaining refinancing for the debt then held by and owed to CCIT.

On June 20, 1983, V & V and Lucio Petrocelli executed an agreement to purchase, and subsequently executed an amendment thereto, under which the stated "purchase price" to be paid by Petrocelli for his interest in V & V was $7,500,000.00 plus an additional 10% of sales amount, described as follows:

(a) $250,000.00 deposit;

(b) $5,000.00 broker's fee;

(c) $5,245,000.00 to be paid upon execution of an amendment to V & V's limited partnership agreement (recognizing Petrocelli's admission to the partnership);

(d) $2,000,000.00 "purchase money mortgage" in favor of Litas; and

(e) additional consideration to Litas equal to 10% of the gross consideration received in connection with the sale or transfer of the premises or of the individual units as condominiums.

The June 20, 1983 agreement, as amended (see Exhibit "18") further stated that "[V & V] acknowledges that this amendment provides for the complete equity sale of the limited partnership assets . . . ."

In a letter dated May 31, 1984 (Exhibit "6 [27]") summarizing some of the events surrounding the CCIT problems, Mr. Vebeliunas relates the following:

> "Finally, on the last hour, a deal was consummated with a certain Louis [sic] Petrocelli, who bought the project for $7 million in mortgages, plus 10% participation on net sales from the condo units."

Exhibit 64, by which the amount of "kicker" consideration was admitted and agreed, by stipulation, to be $1,125,000.00, provides at paragraph 3-a as follows:

> "Litas and V & V agree to exchange General Releases as to any and all claims arising from the sale by Litas of its interest in V & V to Lucio Petrocelli on July 28, 1983." (Emphasis added.)

Under the terms of the June 20, 1983 purchase agreement, as amended, Mr. Petrocelli was described as the sole general partner entitled to receive 75% of V & V's net profits, and Litas was described as the sole limited partner entitled to receive the remaining 25% of V & V's net profits. A July 28, 1983 amendment to the limited partnership agreement provides that Mr. Petrocelli shall infuse $7,500,000.00, with the limited partner (Litas) to make no additional capital contribution.

V & V and Mr. Petrocelli intended that V & V's new first mortgage obtained to refinance the CCIT loan would be paid out of the sales of the first 140 condominium units at Hidden Hollow. Under the Petrocelli agreement, Litas (through V & V) would be paid out of unit sales to the extent of the $2,000,000.00 first mortgage and, in addition, would receive up to a maximum of 10% of the gross sales proceeds. As phrased, if the project was successful and over 140 units were sold, the agreement provided for payment in the form of $15,000.00 to Litas for each condominium sold over the first 140 units, up to a maximum of $2,000,000.00, with an additional $12,500.00 per unit for each condominium unit sold over the first 140 units up to a maximum of 10% of the gross sales proceeds. The parties have stipulated that, pursuant to the agreement, Litas received a total of $3,125,000.00 in additional payments. This amount

was comprised of the $2,000,000.00 stream of payments (for the mortgage) with the $1,125,000.00 balance representing 10% of the gross sales proceeds on the condominium units. These payments were received upon condominium sales at Hidden Hollow as follows:

Date	$2,000,000 Payments	$1,125,000 Payments (10% "Kicker Portion")
3/23/84	$ 30,000	$ 32,142.86
3/31/84	60,000	64,285.72
4/3/84	30,000	32,142.86
4/9/84	210,000	225,000.00
4/14/84	150,000	160,714.30
4/19/84	210,000	225,000.02
4/27/84	45,000	48,214.29
4/28/84	75,000	80,357.15
5/5/84	60,000	64,285.72
5/19/84	120,000	128,571.44
5/19/84	30,000	32,142.86
5/20/84	30,000	32,142.86
5/29/84	15,000	--
6/27/84	300,000	--
7/25/84	255,000	--
After 7/25/84	380,000	--
Total	$2,000,000	$1,25,000.08

In 1982, V & V engaged Carl Turner Associates to act as a broker in obtaining refinancing for the CCIT loan. V & V paid a brokerage fee of $95,000.00 for Carl Turner Associates' services in locating Mr. Petrocelli in connection with the infusion of additional capital in V & V and refinancing of the CCIT loan as described hereinabove.

In July 1981, one George R. Basciani, M.A.I., of the Albert Appraisal Company, Inc., prepared an appraisal report of Hidden Hollow for V & V. According to this report, the 1979 fair market value of Hidden Hollow was $4,800,000.00; the 1981 fair market value was $5,150,000.00; and the 1983 fair market value was $7,000,000.00 to $8,000,000.00.

OPINION

In his determination below, the Administrative Law Judge determined that petitioner, in fact, transferred a 100% interest to Lucio Petrocelli and that the consideration received for such transfer was $8,525,000.00. The Administrative Law Judge reached this conclusion by finding that the consideration called for a payment of $7,495,000.00 plus 10% of gross sales (the

"kicker" payment) for the interest acquired by Petrocelli which was stipulated to by the parties to be in the amount of $1,125,000.00. The Administrative Law Judge allowed petitioner to reduce its consideration by $95,000.00, which amount was paid to Carl Turner Associates for its services rendered to petitioner as the broker in the transfer of the subject interest, which results in a total consideration of $8,525,000.00.

With respect to the original purchase price, the Administrative Law Judge disallowed petitioner's claimed condominium conversion costs since such costs were not properly includable in its original purchase price pursuant to the statute at the time of the transfer. Moreover, the Administrative Law Judge also disallowed costs incurred by petitioner in refinancing and protecting title to the subject property since he concluded that there is no statutory or other entitlement to include such items as part of its original purchase price.

Turning to petitioner's claimed capital improvement costs, the Administrative Law Judge sustained the Division's disallowance of all but $17,830.00 in direct capital improvement costs plus $195,000.00 for the construction of the waste treatment facility. The Administrative Law Judge concluded that, based on the evidence submitted, petitioner did not prove that it was entitled to any more costs than what the Division allowed.

The last of the cost issues involves petitioner's costs of acquiring Hidden Hollow Apartments through Kord. There are several items which petitioner sought to include as acquisition costs, however, the Division limited such costs to: (1) petitioner's assumption of Citibank construction loans in the amount of $4,800,000.00, (2) accrued interest on the construction loans assumed by petitioner in the amount of $135,000.00, and (3) real estate taxes in the amount of $94,000.00. In his determination, the Administrative Law Judge also allowed costs for: (1) the cost of acquisition per the May 21, 1976 agreement in the amount of $265,000.00, (2) petitioner's assumption of a short-term Citibank loan in the amount of $30,000.00, (3) $118,000.00 for amounts paid to Messrs. Dinolfo and Reventas, and (4) $44,650.00 paid to Mr. O'Hara for his interest in the partnership. The Administrative Law Judge disallowed the $348,693.00 in accrued interest assumed by petitioner on the ground that the evidence did not clearly establish

that the interest was, in fact, paid. The total of all allowable acquisition costs, as outlined above, equals $5,486,560.00. Adding total acquisition costs to the amounts allowed by the Division for capital improvements and costs incurred for the treatment facility results in a total original purchase price of $5,699,390.00.

The Administrative Law Judge then concluded that the amount of consideration, $8,525,000.00, less the original purchase price of $5,699,390.00, resulted in a gain of $2,825,610.00 and, thus, a gains tax liability of $282,561.00.

With respect to the time at which interest began to accrue for petitioner's failure to timely pay its gains tax liability, the Administrative Law Judge reasoned that since the "kicker" consideration represented contingent consideration, unknown in amount until actually received by petitioner, interest on tax due for such amount properly runs only from such dates of receipt.

Lastly, the Administrative Law Judge upheld the amounts for penalty imposed by the Division upon petitioner.

On exception, petitioner contends that the "kicker" payments constituted an alternative method to provide for the distribution of partnership profits and are not part of the consideration received by petitioner.

Further, petitioner states that the refinancing costs and expenses incurred in protecting and defending title to the property in a foreclosure action have historically been treated as capital costs with respect to Federal income taxation and, therefore, should be included as part of its original purchase price. Moreover, petitioner argues that its costs incurred in the conversion of the units to condominiums are also capital in nature and should be allowed to constitute part of its original purchase price. Lastly, petitioner contends that all debts and liabilities of Kord assumed by petitioner should be included as part of the original purchase price.

In response, the Division argues that the condominium conversion costs and refinancing costs sought by petitioner were properly disallowed by the Administrative Law Judge as these costs were not acquisition costs, nor were they costs related to capital improvements.

Secondly, the Division agrees with the Administrative Law Judge's conclusion that both the amount of the County Trust Co. loan and the $348,693.00 alleged as accrued interest on the Citibank loans were costs properly disallowed, absent proof that the County Trust Co. loan was against the real estate and absent proof that the accrued interest had actually been paid by petitioner.

Further, the Division contends that:

> "[t]he Audit Division and the Administrative Law Judge can only work from the documentation submitted by the petitioner. The Administrative Law Judge's analysis of the evidence offered is the most rational reading of the various documents and it would be impossible for the petitioner to assert that there is clear and convincing evidence to the contrary" (Division's letter in lieu of brief, p. 3).

Lastly, the Division states that including the "kicker" as part of the consideration received by petitioner does not result in such amount being taxed twice. The Division argues that the partnership is allowed to include the "kicker" amount as part of its original purchase price and, thus, such amount will, in effect, reduce the gain on the subsequent sales of the condominium units.

We modify the determination of the Administrative Law Judge for the reasons set forth below.

The first issue to be discussed is whether petitioner transferred 100% of its interest to Lucio Petrocelli. Other than objecting to the Administrative Law Judge's conclusion that, in fact, a 100% interest was transferred, petitioner does not argue why we should decide that it was only a transfer of a 75% interest. Similarly, the Division does not address this issue in its letter in lieu of a brief. Because we find this issue to be irrelevant to our resolution of this case, and because

the record on this point is unclear,[5] we will not make a determination regarding the actual percentage of interest transferred.

We find the determinative question to be whether the amount of the "kicker" payment was properly included as part of the consideration, not whether the consideration was paid for a 75% or a 100% interest. Tax Law § 1440(1) defines consideration, in pertinent part, as "the price paid or required to be paid for real property or any interest therein . . . ." In looking at the purchase agreement, clause (A) outlines the purchase price required to be paid by the seller. Specifically, at subdivision (4) it states that:

> "[a]s additional consideration, the Purchaser shall pay an amount equal to 10 percent of the gross consideration received in connection with the sale or transfer of the premises conveyed hereunder or the individual units of the condominium, which comprise the premises. Said payments to be made according to the terms set forth in the mortgage referred to above" (Exhibit "18," Amendment To Agreement To Purchase, p. 2, emphasis added).

It is clear from the words of the purchase agreement that the "kicker" payment received by petitioner in this case was intended to be part of the purchase price for the transfer of the real property. Therefore, such amount was properly included as part of the consideration received by petitioner.

Petitioner argues that the "kicker" payment represents guaranteed payments to the partners of the partnership. We note that for purposes of the gains tax, we focus on whether the amount was paid for the transfer of real property. Federal income tax ramifications resulting to the

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[5]In the partnership agreement (Exhibit "56"), it appears that Petrocelli has a 75% interest in the partnership and Litas has a 25% interest in the partnership. However, according to the purchase agreement (Exhibit "18"), clause (H):

> "[t]he Seller acknowledges that this amendment provides for the complete equity sale of the limited partnership assets and that the sole obligations from the general partner to the limited partner shall be the payment of the purchase money mortgage and the payment of the 10 percent of gross sales price on a per unit basis as set forth above" (Exhibit "18," Amendment to Agreement to Purchase, p. 4).

This clause (H) appears to dispose of the limited partnership, leaving it no assets subsequent to the limited partner's receipt of its 10% gross sales price, i.e., the "kicker" payment. Therefore, Petrocelli would have a 100% interest in the partnership. Yet, this purchase agreement conflicts with the partnership agreement which outlines Petrocelli's interest in the partnership at 75% and Litas' interest as 25%.

partnership on the subject transaction are not dispositive of this question (see, Matter of SKS Assocs., Tax Appeals Tribunal, September 12, 1991).

Lastly, we must address whether certain costs incurred by petitioner can be included as part of its original purchase price. Former Tax Law § 1440 defines, 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" (Former Tax Law § 1440[5]).

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

> "(a) '[o]riginal 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 the property in cooperative or condominium form, as such fees and expenses are determined under rules and regulations prescribed by the tax commission" (Tax Law § 1140[5][a]).

In its brief, petitioner argues that the new subdivision 5 added to section 1440 by the Laws of 1984 was merely a clarification of the prior existing subdivision and not a substantive change. Therefore, petitioner argues that such change should be applied retroactively instead of prospectively only, and that the costs it incurred to convert the property to a condominium should be added to its original purchase price. We disagree.

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."

Further, although petitioner argues that this change merely codified the Division's prior policy, petitioner has not directed us to any articulation of this prior policy by the Division. In light of these factors, we conclude that the change made to Tax Law § 1440(5) was substantive rather than clarifying and, thus, applies prospectively to petitioner. Therefore, petitioner is not entitled to include, as part of its original purchase price, the costs it incurred in the condominium conversion.

We also note that, contrary to petitioner's assertion, the courts have recognized that not every cost incurred by a transferor is allowable for gains tax purposes to reduce the taxable gain (see, Matter of 1230 Park Assocs. v. Commissioner of Taxation, 170 AD2d 842, 566 NYS2d 957, lv denied 78 NY2d 859, 575 NYS2d 455; Matter of Maltone v. Department of Taxation & Fin., 144 AD2d 150, 534 NYS2d 478).

The next cost which petitioner argues should constitute part of its original purchase price are the costs it incurred in refinancing and protecting title to the property. As set forth above, Tax Law § 1440(5) states that original purchase price includes only those costs which were paid to acquire the interest in real property or costs paid for any capital improvements made to the property. Costs incurred to refinance the property and to protect title to the property in a foreclosure action do not fall within either of these two categories. Therefore, such costs were properly disallowed.[6]

Although not specifically objected to in its exception, petitioner argues in its brief that the Administrative Law Judge erred in not allowing numerous construction costs incurred by

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[6]Petitioner argues that the costs incurred to: (1) refinance the property, (2) protect title to the property, and (3) convert the property into condominiums are all costs historically treated as capital costs in the field of income taxation and, thus, should be included in the cost of the property for purposes of computing the gain. We note that the treatment of these items for Federal income taxation purposes is based on a statutory scheme that is significantly different than that of the gains tax. Therefore, the Federal income tax treatment is wholly independent and not determinative of the treatment of such items under the applicable gains tax statutes (see, Matter of SKS Assocs., supra).

petitioner subsequent to its acquisition of Hidden Hollow Apartments. Petitioner admits that it did not have the documentation to support the costs it sought to include as part of its original purchase price. Petitioner states that:

> "[i]t would be capricious on the part of the department, and the trial judge, to expect the production of the underlying documents so many years after the costs were incurred" (Petitioner's brief on exception, p. 5).

We disagree. In order for petitioner to be entitled to include these costs as part of its original purchase price, it is essential that petitioner be able to show the amounts of the costs incurred as well as what the costs represent. In view of the fact that petitioner did not keep such records, the Administrative Law Judge properly upheld the Division's disallowance of such unsubstantiated costs.

The last item of costs which petitioner argues it should be allowed to include as part of its original purchase price are the costs incurred by its assumption of all liabilities and debts of Kord. 20 NYCRR 590.15 is instructive with respect to this issue. This particular regulation discusses specific acquisition costs which are allowable in determining original purchase price. 20 NYCRR 590.15 states, in pertinent part, that:

> "[t]he price paid to acquire an interest in real property includes the amount of money, property or any other thing of value provided or given up to acquire the interest in real property including the amount of any mortgage, lien or other encumbrance on the real property which was assumed or taken subject to."

The liabilities and debts assumed by petitioner remaining at issue in this case are a $55,000.00 County Trust Co. loan and a $348,693.00 debt constituting accrued interest on the Citibank loans. Since petitioner failed to prove that the County Trust Co. loan was assumed as part of its consideration to acquire the interest in real property, as opposed to acquiring tangible personal property, such cost was properly disallowed by the Division.

The Administrative Law Judge disallowed the amount of accrued interest on the Citibank loan because he stated that there existed no evidence to demonstrate that such amount was paid by petitioner and, further, that there was some evidence that would show that, in fact, such

amount had been compromised or even settled with the bank (see, Exhibit "12," ¶ 2, p. 5). We note that Tax Law § 1440(5) states that original purchase price includes "any consideration paid or required to be paid by the transferor." Therefore, whether petitioner has paid this amount is not determinative, but rather, the determinative factor is whether petitioner was required to pay this amount at the time the transfer occurred.[7] Subsequent events do not affect the amount of liability assumed by petitioner at the time it acquired the property. Since petitioner did assume the responsibility to pay the amount of $348,693.00 in accrued interest at the time the transaction occurred (see, Exhibit "5 [5]," ¶ 2, p. 3), it is entitled to include such amount as part of its original purchase price.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of V & V Properties is granted to the extent that petitioner may include the amount of $348,693.00 as part of its original purchase price, but is otherwise denied;

2. The determination of the Administrative Law Judge is modified to the extent indicated in paragraph "1" above, but is otherwise sustained;

3. The petition of V & V Properties is granted to the extent indicated in the Administrative Law Judge's determination and paragraph "1" above, but is otherwise denied; and

[7]Our conclusion, which determines the amount incurred to acquire an interest in real property at the time of the subject acquisition for purposes of establishing original purchase price, is consistent with our conclusion that the amount of consideration received for the transfer of real property must be determined at the time that the transfer occurred, and that the consideration cannot be reduced based on subsequent events (Matter of Cheltoncort Co., Tax Appeals Tribunal, December 5, 1991; Matter of Perry Thompson Third Co., Tax Appeals Tribunal, December 5, 1991).

4. The Division of Taxation is directed to modify the Notice of Determination of Real Property Transfer Gains Tax Due, dated June 18, 1984, in accordance with the Administrative Law Judge's determination and paragraph "1" above, but such notice is otherwise sustained.

DATED: Troy, New York
July 16, 1992

/s/John P. Dugan
John P. Dugan
President

/s/Francis R. Koenig
Francis R. Koenig
Commissioner

/s/Maria T. Jones
Maria T. Jones
Commissioner