

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
ZECKENDORF COLUMBUS CO.	:	DECISION
for Revision of a Determination or for Refund of Tax on	:	DTA No. 812021
Gains Derived from Certain Real Property Transfers	:	
under Article 31-B of the Tax Law.	:	

The Division of Taxation and petitioner Zeckendorf Columbus Co., 245 Park Avenue, 16th Floor, New York, New York 10167, each filed an exception to the determination of the Administrative Law Judge issued on May 11, 1995. Petitioner appeared by Roberts & Holland (Carolyn Joy Lee and Joseph Lipari, Esqs., of counsel). The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (David C. Gannon, Esq., of counsel).

The Division of Taxation filed a brief in support of its exception. Petitioner filed a brief in support of its exception and in opposition to the Division of Taxation's exception. The Division of Taxation filed a brief in opposition to petitioner's exception and in reply to petitioner's brief in opposition to the Division of Taxation's exception. Petitioner filed a brief in reply to the Division of Taxation's brief in opposition to its exception. Oral argument was heard on May 9, 1996.

The Tax Appeals Tribunal renders the following decision per curiam.

ISSUES

- I. Whether certain interest expenses incurred by petitioner are includible in its original purchase price as consideration paid for capital improvements.
- II. Whether payments of real estate transfer taxes made by individual condominium unit transferees should have been added to the consideration petitioner received for the sales of the condominium units.

III. Whether penalties imposed may be abated or cancelled on the ground that any failure to pay the full amount of gains tax was due to reasonable cause and not due to willful neglect.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

Petitioner, Zeckendorf Columbus Co., and the Division of Taxation ("Division") stipulated to certain facts which have been incorporated into these Findings of Fact.

For the most part, the facts are not in dispute and were established through stipulation, field audit reports and the testimony of Jerome Socher, who has worked for petitioner as an accountant for approximately 17 years. Mr. Socher has over 20 years of experience as an accountant working primarily in real estate development. He was involved in every financial aspect of the condominium development project which is the subject of this proceeding, and he represented petitioner at each stage of the audit of its gains tax filings.

Petitioner was a Manhattan real estate developer which was involved in a number of condominium projects. Early in 1983, petitioner began negotiations to acquire real property on the corner of 79th Street and Columbus Avenue in Manhattan with the sole intention of demolishing the existing structures and constructing a building containing commercial space and residential condominium units. The development project was known as the Park Belvedere. Petitioner wanted to move quickly on this project because it had determined that market conditions on the West Side of Manhattan were very strong at this time.

As Mr. Socher described it, the development of the Park Belvedere required an assemblage of components before petitioner could obtain financing for the project. Early in 1983, petitioner acquired a contract to purchase the land on which a new building was to be erected. With the land, petitioner acquired the right to build approximately 120,000 square feet of allowable floor area at the maximum floor-area ratio ("FAR"). From the owners of neighboring buildings, petitioner procured development rights, also known as air rights, which permitted it to build

another 80,000 FAR square feet. Petitioner's sole reason for acquiring the development rights was to gain the ability to construct a larger building than it could have constructed without such rights.

To obtain a demolition permit from New York City, petitioner had to provide proof that the existing building was empty. Petitioner acquired the remaining leasehold terms of the commercial tenants in the building in order to obtain the demolition permit and accelerate the commencement of construction. The value petitioner acquired by buying out the tenants was the ability to commence construction without delay.

Petitioner paid \$6,131,374.00 to acquire the land, \$1,775,000.00 for the development rights and a total of \$1,618,198.00 for the leaseholds or tenant buyouts. The portion of the costs to develop Park Belvedere attributable to the residential condominium units in the building is 91.165 percent. Thus, the costs to acquire the land, the development rights and the leaseholds, attributable to the residential condominium units, were as follows:

Land	\$5,589,668.00
Development rights	1,618,179.00
Leaseholds	1,475,230.00

After acquiring the contract to purchase the real property, the development rights and the tenant buyout agreements and preparing a construction budget, petitioner went to the banks to obtain what Mr. Socher labelled "construction loans". He explained the loans as follows:

"[B]anks wanted, especially at that time, to know they were going to get out. This was not a permanent type of financing; it was a construction loan with a period of time that they would be paid off their loan and get a one percent over prime on that or whatever interest it was." (Tr., p. 17.)

The amount of the financing needed for the project was determined by petitioner in consultation with its lenders based on the projected costs associated with the project.

Among the costs taken into consideration by both petitioner, as developer, and its lenders was the projected interest cost to carry the land and to carry the interest expenses on expenditures for the development rights and the tenant buyouts during the construction period.

The interest on the loans was considered by petitioner and the lenders to be a key cost of the building project. Mr. Socher testified that it is one of the most important costs since interest rates can vary during the course of construction making it impossible to know the actual interest expense until the project is completed. Because of this, Mr. Socher stated, completing the project as soon as possible is the key to success in developing.

According to Mr. Socher's testimony, the banks extended petitioner the money to acquire the land, the development rights and the leaseholds on the initial day of the loan. After that, the banks would advance funds to pay construction costs and associated development expenses until the building was completed. As the units were sold, the bank loans were paid down until the entire amount was paid.

Petitioner obtained two loans to finance the Park Belvedere project--a \$36,000,000.00 loan from Manufacturers Hanover and a \$5,000,000.00 loan from Lincoln Savings Bank. These loans were secured by a recorded mortgage, and petitioner paid mortgage recording tax of approximately \$900,000.00 upon recording of that mortgage. The mortgage recording tax paid by petitioner included a special additional mortgage recording tax in the amount of \$93,471.00.

On petitioner's sales of the residential condominium units to unit purchasers, the condominium offering plan specified that the New York City transfer taxes and New York State documentary stamp taxes (also real estate transfer taxes) on the sales were to be paid by the purchaser. The relevant provisions of the offering plan state as follows:

"(e) New York City Real Property Transfer Taxes, currently one percent (1%) of the purchase price of a Residential Unit when the purchase price is less than \$500,000 and two [percent] (2%) of the purchase price of a Residential Unit when the purchase price is \$500,000 or greater, will be the sole responsibility of the Purchaser. The City of New York Department of Finance has taken the position that when Purchaser assumes the obligation to pay the New York City Real Property Transfer Tax, the amount of such tax will be included in the consideration subject to tax. The steps to compute the tax are:

"(1) Multiply the purchase price by the City tax rate to compute a tentative tax.

"(2) Add the tentative tax to the purchase price.

"(3) Multiply that sum by the City rate.

"Example:

Purchase price = \$600,000

(1) $\$600,000 \times 2\% = \$12,000.00$

(2) $\$600,000 + \$12,000 = \$612,000.00$

(3) $\$612,000 \times 2\% = \$12,240.00$; and

"(f) New York State Documentary Stamp Taxes, presently \$4.00 per \$1,000.00 of the Purchase Price of a Residential Unit less existing and continuing mortgages, will be the sole responsibility of the Purchaser."

It is common in sales of New York City residential condominium units pursuant to condominium offering plans for the purchaser to pay the State and City real estate transfer taxes.

Petitioner complied with the gains tax pre-transfer audit procedure, and during the course of the pre-transfer audit made certain adjustments to its calculation of original purchase price ("OPP") as required by the Division. Specifically, petitioner was not allowed to include in OPP construction period interest attributed to land or the amount of the special additional mortgage recording tax.

Petitioner's pre-transfer audit filing disclosed that the purchasers of petitioner's condominium units were paying the New York City and State transfer taxes on such sales, but the Division did not at this time instruct petitioner to treat those payments as consideration.

Petitioner sold all of the residential condominium units sometime after May 1985. All of the revenues derived by petitioner from the residential units were derived from sales of the units, and all sales were subject to the gains tax. There were no rentals of residential units.

As the result of a field audit on the entire project after sellout, the Division issued to petitioner a Notice of Determination dated June 27, 1991 assessing real property transfer gains tax under Article 31-B of the Tax Law in the amount of \$190,817.66. The Division also imposed a 35 percent penalty on the tax due and assessed interest.

On audit, the total OPP allowed by the auditor was \$40,795,378.00. Regarding interest expenses disallowed by the auditor in the calculation of OPP, the parties stipulated as follows:

"Out of the total construction period interest expense incurred by the taxpayer and disallowed by the auditor, \$705,088.00 is attributable to land."

"Out of the total construction period interest expense incurred by Petitioner and disallowed by the auditor, \$321,015.00 is attributable to development rights."

"Out of the total construction period interest expense incurred by Petitioner and disallowed by the auditor, \$1,488,877.00 is attributable to the lease buyouts."

The field audit of petitioner was on the entire project. The auditor reviewed all books and records associated with the Park Belvedere conversion. Apparently, petitioner did not maintain a separate accounting of interest expenses attributable to the development rights, tenant buyouts and land treating them all as construction period interest. Since the auditor determined that these were not includible in original purchase price, it was necessary for her to calculate the amount of each of those interest expenses (and to give petitioner credit for interest expenses attributable to the land already accounted for in the pre-transfer audit). The methodology the auditor used was somewhat complex, although it appears from Mr. Socher's testimony that he did understand the actual calculations utilized by the auditor in arriving at her determination. Since the parties have stipulated to the amounts in issue, there is no need to set forth the numerics here.

The auditor disallowed the special additional mortgage recording tax, in the amount of \$93,471.00, in computing OPP.

The total consideration determined by the auditor was \$61,596,299.00. The auditor included in consideration the transfer taxes paid by condominium unit purchasers. The aggregate amount of transfer taxes paid by the condominium unit purchasers was \$850,442.00. This total is comprised of New York State real estate transfer tax of \$242,983.00 and New York City real estate transfer tax of \$607,459.00.

In computing their Federal taxable income, petitioner's partners did not take a current deduction for any portion of the construction period interest expense, but instead capitalized such expense and amortized it over the sales of condominium units or, if shorter, the 10-year amortization period prescribed in the Internal Revenue Code. This treatment was required by Federal law for the pertinent years.

Petitioner submitted in evidence a copy of "Statement of Financial Accounting Standards No. 34, Capitalization of Interest Costs" ("FASB") (Financial Accounting Standards Board, October 1979). It establishes financial standards for capitalizing interest cost as part of the historical cost of acquiring certain assets. Point 11 of the FASB states:

"Land that is not undergoing activities necessary to get it ready for its intended use is not a qualifying asset. If activities are undertaken for the purpose of developing land for a particular use, the expenditures to acquire the land qualify for interest capitalization while those activities are in progress. The interest cost capitalized on those expenditures is a cost of acquiring the asset that results from those activities. If the resulting asset is a structure, such as a plant or a shopping center, interest capitalized on the land expenditures is part of the acquisition cost of the structure. If the resulting asset is developed land, such as land that is to be sold as developed lots, interest capitalized on the land expenditures is part of the acquisition cost of the developed land."

Mr. Socher testified that in the pre-transfer audit filings, he allocated roughly \$1,500,000.00 to interest expenses attributable to the land at the direction of the Division. He also stated that the Division was aware of the costs associated with the acquisition of development rights and other expenses and raised no questions regarding their inclusion in original purchase price at that time. Mr. Socher had no conversations during the course of the pre-transfer audit regarding the special additional mortgage recording tax and treated it as he did the mortgage recording tax. Regarding the addback of transfer taxes paid by the condominium unit purchasers, Mr. Socher testified that, in transfers involving other condominium projects in later years, he was instructed to add the amount of the transfer tax to consideration, but he was not instructed to make the addback at the time of the Park Belvedere pre-transfer audit. The

auditor never provided petitioner with any written guidelines or policy statements to explain the adjustments she made to petitioner's gains tax filings.

In incurring costs to acquire land, buy out tenants and acquire development rights, and in incurring interest expenses to carry such acquisition costs during the construction period, petitioner was following a common pattern of property development in New York City.

The gains tax paid by petitioner upon the sales of the residential condominium units constituted approximately 90 percent of the gains tax the Division asserts as due.

PROPOSED FINDINGS OF FACT

Petitioner submitted 29 proposed findings of fact. The Division did not raise an objection to any of them. Proposed findings of fact "1" through "10", "13", "14", "15", "17" through "27" and "29" were adopted and substantially incorporated into the Findings of Fact above. Proposed findings of fact "11" and "12" were adopted, with some modification, as Findings of Fact "7" and "12". Petitioner refers to the bank loans it received as "construction loans" and "construction financing". Since interest on a "construction loan" is includible in OPP under 20 NYCRR former 590.16(d), referring to the loans in this manner gives the impression of pre-judging a legal issue. For that reason, petitioner's language has been modified. Proposed finding of fact "16" has been rejected as it asks for the finding of a conclusion of law. Findings of Fact "9", "10" and "11" relate to proposed finding of fact "16" and summarize Mr. Socher's testimony without reaching an ultimate conclusion of law. Proposed finding of fact "28" was accepted with some modification to more accurately reflect the record and incorporated into Findings of Fact "20" and "25".

OPINION

In the determination below, the Administrative Law Judge found that the interest expenses incurred by petitioner on the loan to acquire the land, the development rights and the tenant buyouts were includible in OPP as costs associated with the construction of a capital improvement under 20 NYCRR former 590.16(d), and that 20 NYCRR former 590.15(c), which

disallows such interest costs as costs to acquire real property, was not applicable to this case. Specifically, the Administrative Law Judge determined that interest paid on a loan to acquire real property which was the subject of a capital improvement was "similar" to interest paid on a construction loan, real property taxes and insurance and, thus, was allowable as a "customary, reasonable, and necessary" cost for the construction of a capital improvement under Tax Law § 1440(5)(former [a]). The Administrative Law Judge also found that a 1993 amendment to Tax Law § 1440(5)(a) was not intended to change existing law or policy, but only to clarify and codify the existing regulation. Alternatively, the Administrative Law Judge found that, even if interest expense on a loan to acquire property were not found to be includible in OPP, the interest expense on the loan related to the acquisition of development rights and the lease buyouts was closely associated with construction costs and, thus, properly includible in OPP.

The Administrative Law Judge determined that special additional mortgage recording tax was includible in OPP under the former regulations in the category of "mortgage recording tax," which was allowable under both 20 NYCRR 590.15 and 20 NYCRR 590.16. No exception has been taken to this conclusion.

On the issue of whether real estate transfer taxes paid by the buyer were deemed to be additional consideration to the seller, the Administrative Law Judge concluded that:

"[t]he obligation to pay the real estate transfer tax is placed initially on the grantor. The liability for the tax becomes joint and several only if the grantor does not pay the tax. In this case, the condominium unit purchasers agreed to pay the City and State transfer taxes as a condition of purchase. By their agreement, they assumed an obligation which, in the first instance, was that of petitioner. Consequently, petitioner was required to include in the calculation of consideration the amount of the tax paid by the transferees" (Determination, conclusion of law "G".)

On the issue of abatement of penalties, the Administrative Law Judge held that, had she found the subject interest expenses to not be includible in OPP, she would have sustained the penalty on the portion of the tax associated with the interest on acquiring the land because petitioner was directly advised on pre-transfer audit to exclude this amount. She would not have

sustained the penalty on the portion of the tax associated with the interest on the loan used for acquisition of the development rights and the lease buyouts because the auditor did not advise petitioner to exclude such amounts, and inclusion was reasonable under the circumstances.

Petitioner's failure to include the transfer taxes in consideration was in direct contravention of the regulations, and, therefore, the Administrative Law Judge sustained the penalties on that portion of the assessment.

On exception, the Division argues, with respect to the acquisition loan interest issue, that 20 NYCRR former 590.15(c) specifically excludes interest on a loan used to acquire real property from OPP. Acquisition of real property would also include acquisition of development rights and leasehold buyouts under Tax Law § 1440(4). The Division notes that the Tribunal has made it clear that such interest expense is not allowable as part of OPP, citing to Matter of 61 East 86th St. Equities Group (Tax Appeals Tribunal, January 21, 1993) and Matter of Mattone v. State of New York Dept. of Taxation & Fin. (144 AD2d 150, 534 NYS2d 478). The Division argues that the only interest expenses allowable in OPP under 20 NYCRR former 590.16 are those incurred in connection with construction loans. The Division also contends that the 1993 amendment to Tax Law § 1440(5) expanded the definition of OPP to include acquisition loan interest incurred during a construction period and, thus, such an item of interest was not allowable prior to the amendment. The Division also maintains that, in relying on 20 NYCRR former 590.16, the Administrative Law Judge focused on the wrong regulation. The correct regulation governing this case, according to the Division, is 20 NYCRR former 590.15.

With respect to penalties, the Division argues that, because petitioner "has failed to cite any gains tax case law in support of its legal interpretations which it followed in this case . . ." (Division's Brief in Support, p. 11), penalties should be sustained for failure to establish reasonable cause.

In reply, petitioner maintains that the Administrative Law Judge correctly decided that the interest expense in issue was a construction-related expense and, thus, properly includible in

OPP. Petitioner argues that no prior cases have specifically addressed the issue of whether such interest can be part of the cost of a capital improvement and, therefore, the cases cited by the Division are irrelevant. Petitioner also argues that exclusion of acquisition loan interest from OPP is inconsistent with the treatment given to other construction-period costs related to land, such as property taxes and insurance, which are includible in OPP during a construction period. Petitioner also contends that such treatment is inconsistent with that of other disciplines such as accounting and Federal income taxation. Petitioner maintains that the 1993 amendment to the law is irrelevant because "it is not appropriate to interpret the law in effect at the time of petitioner's sales by referring to amendments made by a subsequent Legislature . . ." (Petitioner's Brief in Support, p. 28). Finally, petitioner contends that, even if the interest incurred with respect to the land acquisition is not includible in OPP, the interest incurred with respect to the acquisition of development rights and the leasehold buyouts should be includible.

With respect to penalties, petitioner argues that all penalties should be abated because:

"The asserted deficiency relates not to failures of proof, record-keeping or compliance, but to difficult issues of legal interpretation, including complex and sophisticated allocations of interest expense for which there still is no official guidance or support" (Petitioner's Brief in Support, p. 51).

On exception, petitioner objects to the Administrative Law Judge's conclusion that petitioner was required to include the transfer taxes paid by the condominium buyers in the consideration. Petitioner maintains that this is a common industry practice. Petitioner argues that the liability of the grantor and grantee is joint and several and the Division could pursue either party for the tax and, thus, payment of such tax is an obligation of both parties and not just an obligation of the grantor.

The Division replies that, despite whether it is common practice for the grantee to pay the transfer tax, the payment of the transfer tax remains the obligation of the grantor regardless of the contract language to the contrary and, therefore, the grantee's assumption of the grantor's liability is additional consideration to the grantor.

Article 31-B¹ of the Tax Law provided for the imposition of a tax at the rate of 10 percent upon gains derived from the transfer of real property within the State of New York (Tax Law § 1441). Tax Law § 1440(3) defined "gain" as:

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

Tax Law § 1440(5)(former [a]), in effect at the time of the transfers in issue, provided, in pertinent part, as follows:

"'Original purchase price' means the consideration paid or required to be paid by the transferor; (i) to acquire the interest in real property, and (ii) for any capital improvements made or required to be made to such

real property, including solely those costs which are customary, reasonable, and necessary, as determined under rules and regulations prescribed by the tax commission, incurred for the construction of such improvements."

Tax Law § 1440 was amended by the Laws of 1993, and, as pertinent to this issue, provided as follows:

"[o]riginal purchase price shall also include any interest paid or required to be paid by the transferor on a loan which was used to acquire the real property; provided that such amount of interest shall be limited to the interest which accrues during a construction period, as defined under rules and regulations prescribed by the commissioner, and which is attributable to that portion of the real property which is the subject of the construction of a capital improvement during such construction period" (Tax Law § 1440[5][former (a)], added by L 1993, ch 57, § 61).

In explaining consideration paid to acquire an interest in real property, 20 NYCRR 590.15(former [c]) provided the following with respect to the specific costs not allowable as a cost to acquire property as part of the original purchase price:

"[t]he following costs are not allowable as a cost to acquire real property for purposes of determining original purchase price:
-- Interest paid on a loan where the proceeds of such loan were used to acquire the real property or interest therein."

¹The real property transfer gains tax imposed by Tax Law Article 31-B 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).

20 NYCRR former 590.16(d) set forth additional costs associated with construction of a capital improvement allowed to be included in OPP as follows:

"[o]ther costs that are clearly associated with construction of a real estate project can also be included as a cost of constructing a capital improvement. If the capital improvement requires a construction period, a period of time in which necessary activities are conducted to bring the improvement on the real property to that state or condition necessary for its intended use, the interest cost paid during that period on a construction loan, real property taxes, insurance or similar items are includible as a cost of construction."

In 1994, 20 NYCRR 590.15(c) was amended in keeping with the amendment to Tax Law § 1440(5) to add the following exception to the rule that interest paid on a loan to acquire real property was not includible in OPP:

"[h]owever, effective for transfers occurring on or after April 15, 1993, and to the extent that such loan . . . was attributable to the acquisition of the real property, such interest paid or required to be paid which accrues during a construction period and which is attributable to that portion of the real property which was the subject of the capital improvement, is includible as a cost of a capital improvement."

20 NYCRR 590.16(d) was renumbered 20 NYCRR 590.17(d) and added similar language under the section on allowable costs for a capital improvement during a construction period.

The Division argues that the relevant regulation to be used in this case is 20 NYCRR former 590.15(c) which sets forth what is and is not includible in OPP as a cost to acquire real property. Petitioner, on the other hand, maintains that the governing regulation is 20 NYCRR former 590.16(d) which deals with what costs are allowed as costs of construction of a capital improvement. This latter approach was the one taken by the Administrative Law Judge in her determination. In fact, both sections of the regulations must be read together. They were both promulgated pursuant to one section of the Tax Law. Tax Law § 1440(former [5]) was intended to fulfill one purpose; that is, to define what is and is not included in the category of "original purchase price." The specific details of what items were to be included were left to the Commissioner of Taxation and Finance. Thus, 20 NYCRR former 590.15 and 20 NYCRR former 590.16, along with several other sections, were promulgated to accomplish this purpose.

For purposes of this matter, Tax Law § 1440(5)(former [a]) delineated two categories of items which were to be included in OPP -- consideration paid to acquire the property and consideration paid for capital improvements made to the property. The regulations followed this pattern with a separate section for each category; however, the fundamental purpose of the regulations was the same, i.e., to determine what items were or were not to be included in OPP. As the Court in Matter of Mattone v. State of New York Dept. of Taxation & Fin. (supra) held:

"[u]nder these rules, interest charges and real estate taxes incurred in connection with the construction of capital improvements are included in the transferor's original purchase price while interest charges on funds used to acquire real property and real estate taxes incurred while simply carrying property are not" (Matter of Mattone v. State of New York Dept. of Taxation & Fin., supra, 534 NYS2d at 479).

With respect to interest paid on a loan used to acquire an interest in real property, during the years in issue both the regulation and the Court in Mattone made clear that such costs were not allowable as part of OPP. Therefore, we must use as the starting point in the analysis the general rule set forth in 20 NYCRR former 590.15(c) that interest paid on a loan used to acquire real property is not includible in OPP. Then, to achieve the result sought by petitioner, there must be an exception to this rule. Since there is no exception to the rule provided in 20 NYCRR former 590.15(c), then we look to 20 NYCRR former 590.16. Petitioner argues that acquisition interest incurred during a construction period should be considered a capital improvement cost. It maintains that such interest costs are the same as real property taxes or insurance expenses which are allowed as capital improvement costs during a construction period. The Administrative Law Judge also found in her determination that such interest costs could be included as costs of a capital improvement under the "similar items" language of 20 NYCRR former 590.16(d).

The problem of the approach advocated by petitioner and adopted in the determination below is that it ignores the clear rule of the prior regulation that acquisition interest costs may not be included in OPP. The law and the regulations during the period in issue made a clear

distinction between acquisition costs and capital improvement costs. One type of cost cannot be transformed into another type merely because it is incurred during a construction period, especially where another related regulation has specifically disallowed the inclusion of that cost in OPP. There is simply no support offered for the proposition that the "similar items" language of 20 NYCRR former 590.16(d) was intended, or could be interpreted, to provide an exception to the clear language of 20 NYCRR former 590.15(c).

A question arises over whether there is an inconsistency between the treatment given in the regulations to acquisition loan interest, which is not includible in OPP, and other costs, such as real property taxes and insurance, which are includible when incurred during a construction period. The answer to this question is that there is a distinction between these two types of costs. Acquisition costs are one-time expenses incurred to acquire the land and, once paid off, such as with a mortgage, they are not incurred again. These costs serve one and only one purpose and that is to acquire the land. Once the acquisition is accomplished, these costs have no further relevance. Property taxes and insurance are not acquisition costs, they are ongoing expenses of owning and using property. They are generally never paid off so long as the property is owned and being used. Thus, it is rational to include these costs as part of capital improvement costs incurred during a construction period because it is necessary to insure the property during construction and it is necessary to pay taxes on the property during construction. Thus, these costs are related to other direct construction costs because they are costs for the use of the property during the construction period. Interest paid on an acquisition loan is not a cost for the use of the property, it is a cost of paying a debt incurred to acquire the property. Thus, it is an acquisition cost and not related to the capital improvement in the way that taxes and insurance are.

Petitioner notes that this specific issue has not been addressed before by this Tribunal or the courts. This is true to a point; however, in similar if not identical cases, attempts to transform

acquisition interest costs into other types of costs which are includible in OPP were rejected. As previously mentioned, the Court in Mattone specifically held that interest charges on funds used to acquire real property are not included in the transferor's OPP and that the Commissioner's regulations were a rational interpretation of the statute.

In Matter of 61 East 86th St. Equities Group (supra), petitioner argued that acquisition interest expense should be considered an expense incurred to create an ownership in cooperative form and, thus, includible in OPP. We held as follows:

"[w]e reject the validity of petitioner's argument because the debt obligation, and its attendant interest expense, was incurred to acquire the real property, not to allow its conversion to cooperative ownership. Interest charges on funds used to acquire real property are not allowable as part of the transferor's original purchase price (Matter of Mattone v. State of New York Dept. of Taxation & Fin., supra).

"Petitioner claims that another basis for allowing the interest carry as an acquisition cost is that interest carry is analogous to interest incurred during a construction period (20 NYCRR 590.16[d]), since both are directly related to improvement of the property -- construction in a physical manner, and interest carry in an intangible manner, i.e., cooperative shares. We reject this argument for a number of reasons. First, the expense in question is still acquisition interest no matter how petitioner seeks to characterize it. Second, this argument was already rejected in Matter of Mattone v. State of New York Dept. of Taxation & Fin. (supra)" (emphasis added).

Thus, acquisition interest remains an acquisition cost regardless of how one attempts to classify it, whether as a cooperative conversion cost or, as here, as a capital improvement cost.

Petitioner also argues that the treatment given to the costs in issue here is inconsistent with the treatment given them in other disciplines, such as Federal taxation. As we have held in the past, treatment of costs in other disciplines is not dispositive of the treatment for gains tax purposes (e.g., Matter of V & V Properties, Tax Appeals Tribunal, July 16, 1992). Since our analysis shows that it is unnecessary to go beyond the gains tax statutes and regulations to resolve this case, there is no reason to depart from our long-standing policy in this case.

The Division contends that reference to the amended statute demonstrates that there was a change in the law which supports its interpretation of the original statute and the regulation. As can be seen from the analysis set forth above, there is no need to refer to the amended statute to derive the meaning and intent of the former statute and regulations.

For all of these reasons, we reverse the Administrative Law Judge's determination on the issue of whether interest paid on a loan used to acquire real property was includible in OPP during the period in issue and hold that such interest was not includible in OPP.

In the alternative, petitioner argues that, even if the specific portion of the interest on the loan allocated to the purchase of the land were found to not be includible in OPP, then the portions allocated to acquisition of the development rights and the leasehold buyouts should be includible because they are more closely related to the construction of the capital improvement. We reverse the Administrative Law Judge with respect to this issue as well. Petitioner maintains that it was necessary to acquire the development rights and the leaseholds in order to commence construction of the new building. However, the same could be said with respect to acquisition of the land itself. It was necessary to acquire the land in order to start a new building on it. Such a necessity does not convert the cost of acquiring the land into a cost of construction of a capital improvement and it does not automatically convert any other acquisition costs into capital improvement costs. The question thus becomes whether the acquisition of the development rights and the leasehold buyouts were acquisitions of real property or an interest therein so that the interest paid on a loan used to acquire the development rights and leaseholds was not allowable in determining OPP.

Tax Law § 1440(4) defined an interest in real property as follows:

"'Interest' when used in connection with real property includes, but is not limited to, title in fee, a leasehold interest, a beneficial interest, an encumbrance, a transfer of development rights or any other interest with the right to use or occupancy of real property . . ."
(emphasis added).

Thus, acquisition of the development rights and the leaseholds was a cost to acquire real property or an interest therein and, as a result, the interest paid on the loan used to acquire these rights and interests was not includible in OPP. This interpretation is in line with the New York case law which, with respect to development rights or air rights as were purchased in this case, recognizes that "ownership of airspace is a valuable property interest" (Wing Ming Prop. (U.S.A.) v. Mott Operating Corp., 148 Misc 2d 680, 561 NYS2d 337, 340, affd 172 AD2d 301, 568 NYS2d 605, affd 79 NY2d 1021, 584 NYS2d 427; see, Newport Assocs. v. Solow, 30 NY2d 263, 332 NYS2d 617, cert denied 410 US 931, 35 L Ed 2d 593).

"Moreover, air rights . . . have historically been conceived as one of the bundle of rights associated with ownership of the land rather than with ownership of the structures erected on the land. Air rights are incident to the ownership of the surface property -- the right of one who owns land to utilize the space above it" (Macmillan, Inc. v. CF Lex Assocs., 56 NY2d 386, 452 NYS2d 377, 380).

Likewise, with respect to leaseholds, the Court of Appeals has held the "fundamental purpose [of a lease] remains to serve as a vehicle for the conveyance of an interest in real property" (219 Broadway Corp. v. Alexander's, Inc., 46 NY2d 506, 414 NYS2d 889, 891). The case cited by petitioner (Houston Chronicle Publ. Co. v. United States, 481 F2d 1240, 73-2 USTC ¶ 9537, cert denied 414 US 1129, 38 L Ed 2d 754) seems at first glance to say the purchase of a leasehold is more closely related to construction costs, but this is for amortization under the Internal Revenue Code. The gains tax is different, as we have said previously, and the principles do not necessarily translate easily. Tax Law § 1440(former [5]) referred to costs to acquire an interest in real property. It did not make a distinction between land and leasehold or land and building as the Code does for amortization purposes. In fact, the Houston Chronicle court distinguished the case from situations where, such as here, the taxpayer purchased the fee interest with the specific intent of immediately demolishing the building. We find, accordingly, that the acquisition of the development rights and the leasehold buyouts were acquisitions of interests in real property and, for the same reasons as we held the interest for the portion of the

loan used to acquire the property itself to not be included in OPP, we also find the interest for the portions of the loan used to acquire the development rights and leasehold buyouts not to be included in OPP.

With respect to petitioner's exception on the issue of whether payments of real estate transfer taxes made by the individual condominium unit transferees should have been added to the consideration petitioner received for the sales of the units, we agree with the Administrative Law Judge that Tax Law § 1404(former [a]) clearly places the liability for the transfer tax solely on the grantor. It is only after the grantor has failed to pay that the liability becomes joint and several. Since the Administrative Law Judge thoroughly and correctly addressed this issue, we find no basis for modifying the determination with respect to this issue.

With respect to the penalty issue, penalties sustained by the Administrative Law Judge are affirmed for the reasons set forth in the determination. In addition, penalty on the portion of the assessment related to interest expense on the loan used to acquire the land is sustained. Penalty on the portion of the assessment related to the interest expense on the loan used to acquire the development rights and the leasehold interests is cancelled. Penalty on the portion of the assessment related to petitioner's failure to include the transfer taxes in its calculation of consideration is sustained.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Zeckendorf Columbus Co. is denied;
2. The exception of the Division of Taxation to conclusions of law "B," "C" and "E" of the Administrative Law Judge's determination is granted, but the exception is otherwise denied;
3. The determination of the Administrative Law Judge is reversed with respect to conclusions of law "B," "C" and "E," but is otherwise sustained;
4. The petition of Zeckendorf Columbus Co. is granted only to the extent indicated in conclusions of law "F" and "H" of the Administrative Law Judge's determination, but is otherwise denied; and

5. The Notice of Determination dated June 27, 1991 is to be modified in accordance with paragraphs "3" and "4" above, but is otherwise sustained.

DATED: Troy, New York
February 27, 1997

/s/Donald C. DeWitt
Donald C. DeWitt
President

/s/Carroll R. Jenkins
Carroll R. Jenkins
Commissioner

/s/Joseph W. Pinto, Jr.
Joseph W. Pinto, Jr.
Commissioner