STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
SOGL ASSOCIATES	:	DETERMINATION DTA NO. 809356
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, SOGL Associates, c/o John A. Souto Co., Inc., 144 Bleecker Street, New York, New York 10012, filed a petition for revision of a determination or for refund of tax on gains derived from certain real property transfers under Article 31-B of the Tax Law.

A hearing was held before Joseph W. Pinto, Jr., Administrative Law Judge, at the offices of the Division of Tax Appeals on September 9, 1992 at 1:15 P.M., with all submissions made by February 19, 1993. Petitioner appeared by John A. Souto. The Division of Taxation appeared by William F. Collins, Esq. (Kenneth J. Schultz, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation properly modified petitioner's original acquisition costs, capital improvement costs and costs of cooperative conversion in its recomputation of petitioner's original purchase price.

II. Whether petitioner has established reasonable cause for its failure to pay the tax allegedly due.

FINDINGS OF FACT

On March 16, 1989, the Division of Taxation ("Division") issued to petitioner, SOGL Associates, a Notice of Determination for real property gains tax for tax due of $105,314.00, penalty of $36,859.90 and interest of $61,167.02, for a total assessment of $203,390.92. Additionally, on the same notice, tax was assessed for the period ended July 1, 1986 in the sum of $16,058.00, penalty of $5,620.30 and interest of $4,071.60, for a total due of $25,749.90.

The assessments for both years totalled $229,090.82.

The notice indicated that the assessments were reached as a result of a "recent field audit conducted by our New York District Office."

Although there was initially a question of petitioner's timely filing of a request for a conciliation conference with the Bureau of Conciliation and Mediation Services ("BCMS"), that issue has been resolved. However, no conference was ever held in this matter prior to formal hearing.

Petitioner was the sponsor of a plan to convert to cooperative ownership real property located at 240-242 West 23rd Street, New York, New York. The transfer of title to the premises from SOGL Associates to 240 West 23rd Owners Corp. (the "CHC") took place on February 10, 1984 and was adjourned and concluded on February 14, 1984. (Sixth Amendment to the Offering Plan.) However, no closing statement was ever produced on audit or at any time prior to or at hearing.

It was never established in the record whether or not petitioner filed returns for real property gains tax upon the transfer of shares in the cooperative conversion. The field audit report stated only that no tax was ever paid by petitioner. This fact was never challenged or controverted by petitioner.

Several months prior to the closing of title, a Certificate of Occupancy was issued by the City of New York for the premises at 240 West 23rd Street stating that said property "conforms substantially to the approved plans and specifications and to the requirements of all applicable laws, rules, and regulations for the uses and occupancies specified herein." The Certificate of Occupancy was dated October 19, 1983.

Upon audit, petitioner was asked to substantiate various elements of its original purchase price, including acquisition expenses, capital improvements, and cooping expenses. The auditor examined the documents provided by petitioner and made several adjustments. Petitioner had asserted an original acquisition cost of $597,270.00, capital improvements of $2,046,080.00 and cooping expenses of $1,339,070.00. However, on audit, the Division

allowed only $488,650.00, $1,973,095.00 and $647,158.00 for those same items, respectively.

(a) The Division allocated $2,962,500.00 for actual cash consideration which was taken directly from a schedule of unit sales. The anticipated consideration was gleaned from the Offering Plan, $255,142.00, yielding total consideration of $3,217,642.00. There were no grandfathered units, but $5,000.00 was allowed for reserve and working funds, leaving cash consideration of $3,212,642.00. The original mortgage indebtedness was $1,200,000.00 which, when added to the cash consideration, yielded total taxable consideration of $4,412,642.00. Another $121,013.00 was allowed for brokerage commissions,[1] leaving a balance of $4,291,629.00.

(b) The original purchase price was erroneously increased by 5% due to a misallocation for commercial space which did not exist in the building. Therefore, the original purchase price as calculated,

$3,108,903.00, had to be diminished by 5% or $155,445.00. This yielded an original purchase price of $2,953,458.00.

(c) Therefore, an original purchase price of $2,953,458.00 was subtracted from the balance listed in "6(a)" above leaving an anticipated gain of $1,338,171.00, an anticipated tax of $133,817.00 or $133.817 per share (1,000 total shares in Offering Plan). Since only 907 shares had been sold at the time of the audit, the tax on those totalled $121,372.00 (907 x $133.817).

With regard to the modifications made by the Division to original purchase price under original acquisition costs, $4,300.00 was disallowed in legal fees because they were for the preparation of partnership papers; also, $104,320.00 in relocation of tenants costs were reallocated to cooping costs and reduced to $95,000.00 for lack of substantiation.

In the area of pre-closing capital improvements, the Division disallowed $87,707.00

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[1]The anticipated broker's commission on the one unsold unit should have been $15,309.00 (6% x $255,142.00) not $12,900.00 as allowed. The Division conceded this at hearing and in its brief.

because of lack of substantiation. Those costs were as follows:

a) real estate taxes	$ 4,999.00
b) professional fees	23,930.00
c) architects fees	13,376.00
d) repairs and maintenance	7,334.00
e) insurance	34,164.00
f) utilities	7,264.00
g) filing fees	5,367.00
Sub Total	$ 96,434.00
less allowance for construction loan interest and closing costs	8,727.00
Total	$ 87,707.00

The Division also made adjustments to capital improvement costs which were incurred post-closing. The Division allowed $11,022.00 more than claimed by petitioner. When this figure was subtracted from the $87,707.00 disallowed for pre-closing capital improvements, the result was a total disallowance of $76,685.00 for capital improvements.

In the area of cooping expenses there were three categories: pre-closing, at closing and post-closing. The Division disallowed $602,379.00 in pre-closing cooping expenses for the reason that there was never any substantiation shown or the expenses were not allowable. The great majority of the claimed expenses were loan interest payments.

At closing, the Division reduced expenses by $117,422.00. One large expense disallowed was the interest on an alleged construction loan which was never substantiated to the Division. There were also satisfactions of mechanics' liens and a cash settlement on a heating system.

The Division disallowed $57,111.00 in post-closing cooping expenses comprised entirely of interest on construction loans which were incurred after the construction period had ended.

The Division considered the construction period to have ended when the building was substantially completed and ready to be occupied. The Division used the issuance of the Certificate of Occupancy as an indication of the state of readiness.

Although petitioner did not receive a BCMS conference, it did have an informal conference at its place of business with two auditors, at which time nothing was produced to substantiate the disallowed expenses. On subsequent occasions prior to hearing, petitioner was offered opportunities to produce records but failed to do so.

Petitioner claimed that most of its records were lost when it moved to new offices.

At hearing, petitioner produced 100 checks payable to one Boris Teichman issued between September 1983 and July 1985. But no invoices were produced to demonstrate what the checks were for. As a result, the Division allowed only $75,766.00 of these costs for which it had seen substantiating documentation. It could not be determined which of the checks submitted in evidence represented allowed expenses.

Petitioner also produced an inspection report completed in September 1984 by DDC Consultants, Inc. of Upper Montclair, New Jersey, which indicated many deficiencies in the building. Petitioner asserted that said report clearly indicated that much work remained to be done and that, in fact, the construction period should have been construed to run long after December 31, 1983.

Petitioner also submitted a "punch list of problems" brought to his attention by the CHC, dated October 4, 1985. Petitioner said this was evidence of the non-completion of the building and, therefore, the ongoing construction period.

Petitioner also submitted a settlement agreement between himself and the owners' corporation, dated April 14, 1987, which finally settled petitioner's dispute with the owners' corporation and obligated petitioner to make payment of $230,000.00 to the owners' corporation for, among other things, repairs and maintenance. Petitioner interpreted this settlement as further proof that the construction period went well beyond December 31, 1983.

Petitioner claimed nine mortgages on the property and included them and their interest cost in the original purchase price. However, the Division disallowed these mortgages due to petitioner's failure to produce records which indicated what the proceeds were used for. Petitioner testified that they could only have been used for construction, but offered nothing further to substantiate its claim.

SUMMARY OF THE PARTIES' POSITIONS

Petitioner contends that it is at a disadvantage because it lost its records in an office move. However, it argues that the Division's acceptance of a Certificate of Occupancy as

defining the end of a construction period is arbitrary and capricious. Petitioner points out that the Division allowed some expenses after December 31, 1983 but not others and this was arbitrary and evidence that the issuance of the Certificate of Occupancy was not the end of the construction period. Petitioner claims that the Division did not understand the transaction due to its complexity and therefore it should be assumed the assessment is erroneous.

Petitioner also contends that the Division's failure to produce the auditor at hearing was damaging to petitioner's case because it could not cross-examine the person who disallowed its expenses.

The Division contends that the costs incurred after December 31, 1983 were costs of carrying the completed units and therefore were properly disallowed. The Division says that various expenses were double-counted and that petitioner has failed to establish through probative evidence that it is entitled to further expenses.

CONCLUSIONS OF LAW

A. Tax Law Article 31-B, effective March 28, 1983, provides for the imposition of a tax at the rate of 10%, commonly known as the "gains tax", upon gains derived from the transfer of real property within New York State. Tax Law § 1440.3 defines "gains" 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."

B. The distinct problem in the instant matter is petitioner's inability to prove the truth and validity of its positions due to its inability to produce any records. In fact, petitioner was even unable to produce the Closing Statement from the February 1984 transfer to the cooperative housing corporation. There was no documentation concerning the mortgages petitioner wishes to include as construction loans, the interest from which would thereby be properly included in original purchase price if incurred during the construction period (20 NYCRR 590.16[d]; see, Matter of Mattone v. Dept. of Taxation & Fin., 144 AD2d 150, 534 NYS2d 478). As pointed out in testimony at hearing, some interest expense was disallowed because it was on funds used to acquire the property, an improper and excludable cost (20 NYCRR 590.15[c]; see, Matter of

Mattone v. Dept. of Taxation & Fin., supra).

Further, the costs of carrying completed units, including interest costs, are not allowable expenses in the reduction of gain and the Division, without any proof to the contrary, properly disallowed such claimed interest expense after the construction period (Matter of Mattone v. Dept. of Taxation & Fin., supra; Matter of 1230 Park Associates, Tax Appeals Tribunal, July 27, 1989, confirmed 170 AD2d 842, 566 NYS2d 957, lv denied 78 NY2d 859, 575 NYS2d 455).

This brings us to petitioner's argument that the construction period, as determined by the Division, was arbitrary. However, since the Certificate of Occupancy was issued on October 19, 1983 and certifies that an inspection by the City of New York indicated that the premises conformed "substantially to the approved plans and specifications made to the requirements of all applicable laws, rules and regulations for the uses and occupancies specified" in the certificate, i.e., apartments, the Division's reliance on same cannot be said to be arbitrary. The regulations essentially described the same circumstances as the Certificate of Occupancy (20 NYCRR 590.16[e]) when they define the construction period as ending when the real property is ready to be placed in service or is ready for sale. Clearly, this was the case herein, when the transfer occurred on February 14, 1989. The Division allowed some final improvements which were demonstrated to it through adequate documentation, but it was not reasonable for petitioner to believe that expenses it incurred for years after the closing, which appear to be common repairs and maintenance, would be allowed as expenses includable in its original purchase price.

The suit with the cooperative housing corporation leading to a substantial payment by petitioner to the CHC and the other expenses claimed (but not documented by petitioner) must be categorized as carrying costs relating to completed units, not allowable expenses included in the original purchase price (Matter of Mattone v. Dept. of Taxation & Fin., supra; Matter of 1230 Park Associates, supra).

Since the burden of proof was upon petitioner to establish its claims before this forum (20

NYCRR 3000.10[d][4]), its failure to produce specific evidence to support its claims was fatal. Its claim that the Division did not understand the transfer in issue may be true, but that was clearly petitioner's own fault for not supplying the substantiating records necessary for an understanding of the transaction. It was charged with the responsibility of keeping its records and casually "mislaid" the records under audit (Tax Law § 1448.3).

Petitioner's argument that the Division damaged its case by not producing the auditor is without merit. The auditor's supervisor appeared and capably answered questions concerning the audit, of which he had in-depth knowledge. Further, there is no authority for the position that the Division must produce the auditor (Mira Oil Company v. Chu, 114 AD2d 619, 494 NYS2d 458, lv denied 68 NY2d 602, 505 NYS2d 1026). Further, petitioner could have subpoenaed the auditor pursuant to 20 NYCRR 3000.6(c) but did not do so. Therefore, it is determined that the failure of the Division to produce the auditor was neither required nor fatal to petitioner's case.

C. The penalties and additional interest assessed must be sustained due to petitioner's failure to show that its failure to pay the tax was due to reasonable cause and not willful neglect. Simply alleging the loss of one's records pertaining to a transaction under audit in a move to new offices does not constitute such reasonable cause (Tax Law § 1446.2[a]; 20 NYCRR 590.71[b]). "[S]uch a statement, without additional evidence or testimony linking the moves to the inability to produce supporting documents, is insufficient to support a finding of reasonable cause and the absence of willful neglect" (Matter of Aberbach Enterprises, Ltd., Tax Appeals Tribunal, August 6, 1992).

D. The Division is directed to make the modifications on its computations resulting from the anticipated commission discussed in Finding of Fact "6(a)".

E. The petition of SOGL Associates is granted to the extent set forth in Conclusion of Law "D", but in all other respects the petition is denied and the Notice of Determination dated March 6, 1989 is sustained.

DATED: Troy, New York
August 12, 1993

/s/ Joseph W. Pinto, Jr.
ADMINISTRATIVE LAW JUDGE