STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
VANDERVEER ASSOCIATES - NO. 1	:	DETERMINATION DTA NO. 810151
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, Vanderveer Associates - No. 1, c/o Edward I. Penson, Esq., 149 Wooster 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.

On February 11, 1993 and March 18, 1993, respectively, petitioner, by its representative, Warshaw, Burstein, Cohen, Schlesinger & Kuh, Esqs. (Michael A. Scheffler, Esq., of counsel) and the Division of Taxation, by its representative, William F. Collins, Esq. (Donald C. DeWitt, Esq., of counsel) consented to have the controversy determined on submission without hearing, with all briefs to be submitted by June 4, 1993. After due consideration of the record, Brian L. Friedman, Administrative Law Judge, renders the following determination.

ISSUE

Whether the Division of Taxation properly disallowed, in the computation of original purchase price, certain costs which petitioner contends were acquisition costs and/or costs of capital improvements.

FINDINGS OF FACT

Petitioner submitted eight proposed findings of fact ("A" through "H"). Proposed findings of fact "A" and "C" through "H" contain legalargument, are conclusory in nature and are, therefore, not incorporated into the Findings of Fact hereinafter set forth. Proposed finding

of fact "B" is irrelevant to the present matter and is also, therefore, rejected.[1]

On March 18, 1987, Vanderveer Associates - No. 1 ("petitioner"), a New York limited partnership, sold property known as 1402, 1404, 1406, 1408, 1410, 1412, 1414 and 1416 New York Avenue, 3101 and 3103 Foster Avenue and 3102 and 3104 Newkirk Avenue in Brooklyn, New York ("the property") to Foster Apartments Group (a New York limited partnership which was the assignee of the purchaser's rights in a contract of sale dated May 29, 1986 between Vanderveer Associates - No. 1, as seller, and Vanderveer Realty Company - No. 1, as purchaser).

Petitioner filed a Transferor Questionnaire (Form TP-580), sworn to on December 3, 1986, on which it reported anticipated tax due of $44,032.57. On December 15, 1986, the Division of Taxation ("Division") issued a Tentative Assessment and Return (Form TP-582), assessing tax in the amount of $44,032.57.

By a Supplemental Return (form TP-583), sworn to on March 13, 1987, petitioner indicated that, pursuant to a contract modification which reduced the purchase price of the property by $404,000.00 and by virtue of additional capital improvements having been made to the property, there was no longer any gain subject to tax. Attached to the Supplemental Return were an affidavit of Edward I. Penson, a general partner of petitioner; a

contract modification dated March 17, 1987 and a listing of capital improvements totalling $72,968.17 (payments for at least 7 of the 8 improvements were made during January or February 1987).

Pursuant to an audit which commenced in April 1988, the Division, on October 30, 1989, issued a notice of determination to petitioner assessing total tax due of $179,658.00, plus

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[1]It should be noted that, along with the proposed findings of fact, petitioner also submitted six proposed conclusions of law. Since rulings on proposed conclusions of law are not required (State Administrative Procedure Act § 307[1]), they shall not be addressed herein.

penalty and interest.[2]

A Conciliation Order (CMS No. 102019) dated August 9, 1991 reduced tax due to $120,156.00 plus interest (penalty imposed pursuant to the notice of determination was cancelled).

Pursuant to the audit performed, anticipated gain of $1,796,580.00 was determined. Cash consideration of $9,701,687.00 was determined by subtracting the contract modifications ($404,000.00) from the consideration set forth on the transferor questionnaire ($ 10,105,687.00). Allowed brokerage fees of $60,000.00 reduced consideration to $9,641,687.00.

Original purchase price ("OPP") was determined to be $7,845,107.00 (this amount includes the original cost per contract, acquisition expenses, capital improvement costs and cooping expenses).

Original cost per contract was $2,924,914.30 (see, Schedule B, line 4 of Transferor Questionnaire).

Petitioner claimed acquisition expenses of $790,690.00, of which costs totalling $305,450.00 were disallowed by the auditor. Broker's fees of $250,000.00 were disallowed in their entirety on the basis that such fees were actually management fees. Legal fees of $18,500.00 were disallowed (legal fees of $14,500.00 were allowed) on the basis that such fees were paid for legal services furnished in connection with the public offering of limited partnership interests in petitioner, not for acquisition of an interest in real property. Claimed accounting services of $6,950.00 were disallowed in their entirety for the same reason, i.e., that petitioner did not establish that the fees were paid as part of the acquisition of an interest in real

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[2]The notice of determination reflects a payment or credit of $44,032.00. However, the Division's brief, on page 3 thereof, indicates that the tax due pursuant to the Tentative Assessment was never paid. Since petitioner did not claim such payment in its petition or in any of its documentation submitted subsequent thereto, it shall be presumed that this payment or credit was erroneously reflected on the notice of determination.

property. The audit report (Schedule 1) also reflected an additional disallowance of $30,000.00 in broker's fees although there is no apparent explanation therefor.

Capital improvements cost in the amount of $5,835,700.00 were claimed by petitioner. The auditor disallowed capital improvement costs of $1,430,747.00. Interest on a construction loan ($697,969.00) and construction period real estate taxes ($181,876.00) were disallowed in their entirety. "Profit & Risk" payments to Faymor Housing Corporation in the amount of $536,488.00 were disallowed in their entirety on the basis that these payments were not made for construction and were not a customary and reasonable project cost. Certain additional costs ($2,806.00 for office furniture and $11,608.00 for refrigerators and stoves) were also disallowed. By virtue of these disallowances, capital improvement costs, as determined by the auditor, were found to be $4,404,953.00.

By adding original cost per contract ($2,924,914.00), allowed acquisition expenses ($485,240.00), allowed costs of capital improvements ($4,404,953.00) and cooping expenses ($30,000.00 legal expenses), the auditor determined total OPP to be $7,845,107.00. When subtracted from consideration ($9,641,687.00), anticipated gains on taxable sale of $1,796,580.00 was calculated with tax thereon, at 10%, in the amount of $179,658.00, the amount originally assessed per the notice of determination.

Pursuant to the Conciliation Order (see also, letter of February 1, 1991 from auditor to Michael A. Scheffler, Esq., petitioner's representative, which is attached to affidavit of petitioner's general partner, Edward I. Penson, Esq.), tax due was recomputed from $179,658.00 to $120,156.00 which was determined as follows:

Anticipated Gain per audit	$1,796,580.00
Less: Excess Gain per TP 583	(36,642.00)
Balance	$1,759,938.00
Less Substantiated Adjustments	(558,375.00)
Corrected Gains	$1,201,563.00
Tax Due on the gain at 10%	$ 120,156.00
Tax previously paid	- 0 -
Tax Due	$ 120,156.00

The allowance of the $36,642.00 was based upon petitioner having filed a supplemental return

and the adjustment of $558,375.00 was apparently an allowance, for some portion of the construction period, of construction loan interest.

Remaining at issue, therefore, are the following amounts which petitioner asserts were acquisition costs and/or capital improvement costs:

(a) $250,000.00 paid to Owners & Builders Realty Services, Inc. for brokerage and/or management fees;

(b) $18,500.00 in legal fees paid to Faust, Rabbach & Sweet;

(c) $6,950.00 in accounting fees paid to Marks Shron & Company;

(d) $181,876.00 in construction period real estate taxes;

(e) $536,488.00 in "profit and risk" paid to Faymor Housing Corp.;

(f) $72,968.17 in capital improvements as set forth on the Supplemental Return; and

(g) $24,057.00 in understated capital improvements.

Each of these costs shall hereinafter be separately addressed. It should be noted that the Division submitted, as part of its documentary evidence, a three-page affidavit of Edward I. Penson, a general partner of petitioner. This affidavit, dated December 3, 1986, was submitted to the Division in conjunction with gains tax questionnaires and had attached thereto several exhibits. Subsequently, as part of the documents submitted to the Division of Tax Appeals, petitioner provided an 18-page affidavit of Mr. Penson (along with certain attachments). Unless otherwise noted, all references to the "Penson Affidavit" shall refer to the latter affidavit which was sworn to on April 28, 1993.

Pursuant to paragraph 3 of the Penson Affidavit, petitioner acquired title to the property from Faymor Development Co., Inc. ("Faymor"), a New York corporation, on December 31, 1981. At the time of transfer, Faymor owned a 99% interest in petitioner as its sole limited partner and owned 100% of the stock of Vanderveer Estates Section 1 (Newkirk), Inc. ("Vanderveer Estates"), the sole general partner of petitioner.

On March 17, 1982, Faymor sold all of its 99% limited partnership interest in petitioner to VV Associates - No. 1, a New York limited partnership controlled by Mr. Penson, and

Vanderveer Estates sold nine-tenths of its 1% general partner interest in petitioner to Mr. Penson and a corporation controlled by Mr. Penson (collectively, the "Penson General Partners") with Vanderveer Estates retaining a one-tenth of 1% interest as general partner.

Pursuant to pages 3 and 4 of the Purchase Agreement, dated February 18, 1982 (Exhibit "B-1" attached to December 3, 1986 affidavit of Edward I. Penson) petitioner was contemplating and apparently did obtain a building loan from Citibank, N.A., the advances under which would be insured by the U.S. Department of Housing and Urban Development ("HUD"), the building loan to be converted to permanent mortgage financing provided by the Government National Mortgage Association ("GNMA"). The proceeds of this financing were used by petitioner to do rehabilitation work pursuant to a building loan agreement between the bank and petitioner and a construction contract between Faymor Housing Corp. and petitioner.

Pursuant to the Purchase Agreement dated February 18, 1982, Owners & Builders Realty Services, Inc. ("O & B") and S. J. Seip & Co. were hired by petitioner as agents under the Construction and Management Agreement dated March 17, 1982 (attached as Exhibit "D-1" to December 3, 1986 affidavit of Edward I. Penson) and the Agreement Regarding Additional Management Services (referred to in the Purchase Agreement). By this Purchase Agreement, VV Associates - No. 1 and the Penson General Partners acquired a 99.9% interest in petitioner from Faymor Development Co., Inc.

The Penson Affidavit states that in petitioner's original submission, these fees paid to O & B were incorrectly characterized as brokerage fees. On Exhibit "C" attached to the December 3, 1986 affidavit, these fees are referred to as brokerage fees.

Attached to the Penson Affidavit is a December 10, 1990 affidavit of Arnold A. Gruber, a partner in the accounting firm of Marks Shron & Company. Paragraph 2 of Mr. Gruber's affidavit states as follows:

> "In connection with our clients' acquisition of the partnership interest (the 'Partnership Interests') in the Partnerships, fees of $250,000 and $290,000 were paid to Owners and Builders Realty, Inc. (whose name was changed to The Penson Corporation) ('O & B') for its services in connection with the acquisition of the Partnership Interests. O & B's function was to perform a due diligence review of the property owned by the Partnerships (the 'Property') and the Partnerships' books

> and records so that our clients could be sure that the representations made by the sellers of the Partnership Interests were correct and that it was prudent on their part to pay the purchase price requested. The fees paid to O & B had nothing to do with the on-going management of the Property or for work subsequent to the acquisition of the Partnership Interests.
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> "The fees were called 'special management fees' to differentiate them from the normal management fees for operating the property. Since these fees were in connection with the acquisition of the property, they were paid from partners' capital contributions, which were paid in over a number of years."

Pursuant to Article 4 of the February 18, 1982 Purchase Agreement, petitioner agreed that, at and after the closing, acting through VV Realty, it would retain O & B and Seip as managing agents under the Construction and Management Agreement and Agreement Regarding Additional Management Services.

As to the $18,500.00 paid to Faust, Rabbach & Sweet, the Penson affidavit states that:

> "These fees were paid for legal services furnished in connection with the public offering of limited partnership interests in VV Associates - No. 1 that provided the funds needed to purchase from Faymor the limited partnership interest in petitioner."

The $6,950.00 paid to Mark Shron & Company was, according to the Penson Affidavit, paid for due diligence services furnished in connection with the acquisition by the Penson Entities of the partnership interests in petitioner and should, therefore, have been allowed by the auditor.

Petitioner states (see, paragraph 3 of the Penson Affidavit) that the property underwent a complete rehabilitation during the period September 1982 to December 1983 under a GNMA project insured by the HUD.

Paragraph 11(d)(i) of the Penson Affidavit states that the aforementioned rehabilitation project involved a major renovation to the building comprising the property, their equipment and facilities and all apartments located therein, thereby requiring the relocation of tenants for certain periods. The rehabilitation included an overhaul of the plumbing and electrical lines, installation of new boilers and associated equipment, installation of new roofs, replacement of windows and main building doors, complete refurbishment of apartments, building lobbies and hallways, installation of security systems and smoke detectors and major landscaping

improvements.

In response, the Division points out that the Penson Affidavit, at page 10 thereof, admits that tenants were occupying the apartments at the time the buildings were undergoing renovation. This is the basis of the auditor's disallowance of the real estate taxes, i.e., that there was no substantiation (actually there was an admission to the contrary) that, during the construction period, the property was not in use and occupied by tenants.

In the Penson Affidavit, no mention is made of the $72,968.00 in capital improvements as set forth on the Supplemental Return or of the $24,057.00 in understated capital improvements. The Division's brief states that an adjustment was made, as a result of the BCMS conference, to reflect the additional capital improvements reported on the Supplemental Return. A review of the Supplemental Return and the adjustment made (see, Finding of Fact "6") reveals that the Division is correct, that the proper adjustments were made and the additional capital improvements were allowed per the reduction in gains tax asserted to be due.

It must be pointed out that the Transferor Questionnaire, in line 6 of Schedule B, indicates $5,859,757.00 in capital improvements, not $5,835,700.00 as petitioner states ($5,835,700.00 + $24,057.00 [the alleged understatement] = $5,859,757.00). In the audit report, claimed capital improvements of $5,835,700.00 are listed thereon (the auditor disallowed $1,430,747.00 of such expenses). This record contains no evidence of what alleged capital improvement expenditures this amount ($24,057.00) represents.

The remaining amount at issue is the $536,488.00 which has been referred to by the parties as "profit and risk" because there would be a profit to the contractor only if the building project was completed within budget. If not completed within budget, the profit was at risk because the contractor was responsible for cost overruns.

Attached to the Penson Affidavit is the cover page and pages 10 and 11 of the Confidential Offering Memorandum of VV Associates - No. 1 which is the entity that purchased the limited partnership interest in petitioner from Faymor Development Co., Inc. (see, Finding of Fact "8"). On Page 10 thereof, under the heading of "Cost of Construction", it

states, in part, as follows:

> "All costs of construction of the Development pursuant to the terms and conditions of the Construction Contract in excess of $3,526,773, as adjusted in the manner set forth above, which are not otherwise approved by HUD, are to be paid by the General Contractor pursuant to the provisions of the Construction Contract."

The offering memorandum (also on page 10, under the heading "Cost of Construction") provides in addition that:

> "Faymor Housing Corp., an affiliate of VES, one of the general partners of the Operating Partnership but not an affiliate of the General Partners of the Partnership, will perform the construction work, as General Contractor, ..."

Also attached to Penson Affidavit is the cover page and pages 10 and 11 of the Audit Guide for Auditing Development Costs of HUD Insured Multifamily Projects for Use by Independent Accountants (issued by the HUD). Paragraph 13 (pages 10 and 11) provides as follows:

> "Profit and Risk Allowance. Certain sections of the National Housing Act provide for a 'Builder's/Sponsor's Profit and Risk Allowance' (BSPRA) in cases where the mortgagor and contractor have an identity of interest. In cases where BSPRA would be applicable, if there were an identity of interest, but in fact there is no identity of interest, the law provides for a 'Sponsor's Profit and Risk Allowance' (SPRA). The eligible allowances are computed as follows:
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> "(a) BSPRA. The eligible amount is 10% (unless the Secretary has prescribed a lesser percentage on FHA Forms 3306 or 3306A) of all items on the mortgagor's certificate of actual cost excluding any costs for the acquisition of a leasehold, or any supplemental management funds claimed as a cost. NOTE: if more than 50% of the actual cost of construction is subcontracted with any one contractor or subcontractor, or more than 75% with 3 or less contractors, BSPRA will not be applicable and SPRA should be claimed.
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> "(b) SPRA. The applicable percentage, generally 10% will be computed on the sum of (1) architectural fees, (2) interest and financing expenses, (3) legal and organization expenses, and (4) off-site cost, if any."

Petitioner also submitted (attached to the Penson Affidavit), FHA Form No. 2331A, Cost Certification Review Worksheet for the project entitled "Vanderveer Estates Sec. I". As item 14 thereon, Profit and Risk is stated to be $536,488.00, which amount is 10 percent of the amount of the subtotal of $5,364,879.00 listed on the line immediately above (representing the subtotal of lines 1[d] through 13).

Also, in support of its position, petitioner submitted an affidavit from Arnold Gruber, a

Certified Public Accountant and a member of the accounting firm of Marks Shron & Company, which sets forth an explanation of "profit and risk", also known in GNMA projects as the "Builder's/Sponsor's Profit and Risk Allowance" or "BSPRA". Mr. Gruber states that, in all of the GNMA projects for which he provided accounting services, the BSPRA amount has been 10%. Mr. Gruber further states:

> "Inasmuch as HUD, which insures the repayment by the mortgagor of the GNMA loan, has an interest in limiting the amount of said loan, it seems abundantly clear that the amount that HUD itself prescribes for the 'profit and risk' fee, or BSPRA, is a reasonable sum. The fact that the 10% figure has been used in all of the GNMA projects where I have provided accounting services is the best evidence that it is also customary."

In the audit summary of the audit report, the auditor stated:

> "The profit and risk is a cost built-in the contractwhich [sic] will be distributed to the sponsor at the end of the renovation. Since no contractual agreement was submitted for the above cost the amount seems excessive and customary [sic] with the industry. Under the cost certification submitted to H.U.D. the general contractor fee was allowed."

SUMMARY OF THE PARTIES' POSITIONS

The position of petitioner may be summarized as follows:

(a) The $250,000.00 paid to Owners and Builders was paid as compensation for the due diligence it conducted on behalf of the Penson Entities in connection with their acquisition of the partnership interests in petitioner. It is, therefore, an allowable "pre-acquisition cost" pursuant to 20 NYCRR 590.15;

(b) The legal fees of $18,500.00 paid to Faust, Rabbach & Sweet were paid for legal services furnished in connection with the public offering of limited partnership interests in VV Associates - No. 1 which provided the funds necessary to purchase, from Faymor Development Company, the limited partnership interest in petitioner. Petitioner further contends that since fees paid to Dreyer & Traub by Vanderveer Associates - No. 5 were allowed as an acquisition cost in the conciliation order issued in that matter, these fees should also be allowed since Dreyer & Traub performed the same services for Vanderveer Associates - No. 5 as Faust, Rabbach & Sweet performed for petitioner;

(c) Accounting fees paid to Marks Shron & Company in the amount of $6,950.00

were paid for due diligence services furnished in connection with the acquisition by the Pension Entities of the partnership interests in petitioner. Petitioner also states that the fees paid to Marks Shron & Company for the exact type of services were allowed in the conciliation order issued with respect to Vanderveer Associates - No. 5;

(d) Petitioner's counsel spoke to Division personnel to inquire whether the "substantial" renovation of the property would qualify for deduction of construction loan interest, real property taxes and insurance premiums paid during the construction period and its counsel was advised that such deductions would be permitted. Petitioner also contends that its counsel was told that the fact that tenants were occupying the apartments at the time the buildings were undergoing renovation would not affect the deductions. The deductions for real estate taxes claimed ($181,876.00), urges petitioner, should be no different than deductions for construction loan interest and insurance premiums which have been allowed;

(e) Faymor Housing Corp., the general contractor to whom the $536,488.00 was paid as "profit and risk", was a corporation controlled exclusively by Morris Kavy and his two sons and neither Edward Penson nor any of the Vanderveer Associates partnerships had any interest or control over that corporation. With respect to the profit and risk, petitioner maintains that, since the contractor, not the owner, was responsible for cost overruns, it should be entitled to a fee which accounts for the added risk. HUD's guidelines prescribe 10 percent as the BSPRA amount. The amount at issue is 10 percent of the total of the hard and soft costs allowed by HUD. Given the fact that there was a considerable risk that the general contractor would lose all or a portion of its profit, 10 percent is not an unreasonable profit percentage. Petitioner also points out that the auditor allowed an "incentive fee" paid to the general contractor for completion of construction within a specified time period. This amount should not be aggregated with BSPRA in determining a reasonable and customary general contractor's fee;

(f) The Penson Affidavit does not address the $72,968.00 in capital improvements per

the Supplemental Return and the $24,057.00 in capital improvements which petitioner contends were understated. In Rider A to its petition (in paragraph 1[d] thereof), petitioner states:

> "The amount shown as the Capital Improvements that we claimed, $5,835,700.00, is too low because it does not include the additional capital improvements shown on the Supplemental Return in the amount of $72,968.00 and it also incorrectly understates the amount that we claimed by $24,057.00. Therefore, the correct figure for the total Capital Improvements that we claimed is $5,932,725.00."

No additional evidence with respect to these amounts was presented; and

(g) Petitioner also alleges that nearly all of the costs disallowed herein were incorporated in the original purchase price for Vanderveer Associates - No. 2, Vanderveer Associates - No. 3 and Vanderveer Associates - No. 4. The Penson Entities purchased the partnership interests in Nos. 2, 3 and 4 after the permanent mortgage loan was in place while, for Nos. 1 and 5, the partnership interests were purchased prior to completion of construction, prior to conversion of the construction loan into a permanent mortgage. Since, with respect to Nos. 2, 3 and 4, the purchases were made subject to the permanent mortgages (which were composed of all of the amounts funded under the construction loan), the principal amounts of the mortgages were deemed to be part of the consideration paid by the Penson Entities and were, therefore, parts of the original purchase price for gains tax purposes.

The position of the Division may be summarized as follows:

(a) There is no item included in 20 NYCRR 590.15 as an allowable cost for "due diligence". Owners and Builders is one of the agents under the Construction and Management Agreement and Agreement Regarding Additional Management Services. In the Gruber Affidavit of December 10, 1990 (see, Finding of Fact "9"), these fees were characterized as "special management fees" and there is no evidence that the fees had any relation to the acquisition of the property;

(b) Petitioner admits that the legal fees of $18,500.00 were paid for services furnished

in connection with the public offering of limited partnership interests in VV Associates - No. 1 to provide funds needed to purchase, from Faymor, the limited partnership interest in petitioner. Therefore, they were not paid for the acquisition of an interest in real property or as part of the cost of acquiring a purchase money mortgage and, as such, they were properly disallowed;

(c) Petitioner has provided no evidence that the accounting fees ($6,950.00) were paid as part of the acquisition of an interest in real property;

(d) As to the $72,968.00 in additional capital improvements per the Supplemental Return, the adjustments contained in the Conciliation Order reflect these amounts;

(e) The $24,057.00 in understated capital improvements reflects the difference in the amount claimed on petitioner's Transferor Questionnaire and the amounts set forth on the auditor's worksheets. Petitioner has shown no error, i.e., it has not provided any evidence as to what items, if any, the auditor omitted from his workpapers;

(f) The construction period real estate taxes ($181,876.00) were disallowed because 20 NYCRR 590.16 provides that these taxes may not be included in determining original purchase price if the real property is in use or ready for its intended use. The allowance of construction period interest by the auditor was not a concession, but an attempt to achieve a settlement. Therefore, the auditor did not treat construction period interest in a manner different from construction period real estate taxes;

(g) The profit and risk was not paid as a cost of construction, but because it was not incurred as a cost of construction. It was not a customary, reasonable and necessary fee or expense properly includible in original purchase price per Tax Law § 1440(5). In addition, petitioner submitted no contractual agreement providing for this fee;

(h) With respect to the distinction which petitioner attempts to draw between Vanderveer Associates - No. 1 and No. 5 (acquired prior to conversion of construction loan into permanent mortgage) and Nos. 2, 3 and 4 (acquired after construction loan converted to permanent mortgage), the Division contends that no evidence concerning

Nos. 2, 3 and 4 is before the Division of Tax Appeals, and such argument is, therefore, irrelevant.

CONCLUSIONS OF LAW

A. Article 31-B of the Tax Law, effective March 28, 1993, provided for the imposition of a tax, commonly known as the "gains tax", upon gains derived from the transfer of real property within New York State. Tax Law § 1440.3 defines "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."

B. Tax Law § 1440(5)(a) provides 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. 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 property in cooperative or condominium form, as such fees and expenses are determined under rules and regulations prescribed by the tax commission."

C. 20 NYCRR 590.15(b) provides as follows:

> "Question: What specific acquisition costs are allowable in determining the original purchase price?
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> "Answer: Certain preacquistion costs that are directly related to the New York real property may be included in the computation of original purchase price as acquisition cost. Such preacquistion costs include legal, architectural, and other professional fees, environmental studies, appraisals, marketing and feasibility studies, and soil tests. Payments to obtain a contract or an option (that was in fact exercised) to acquire real property may also be included. Preacquisition costs relating to real property that was not ultimately purchased may not be included in the computation of original purchase price of any related property that was purchased.
>
> "Certain acquisition costs that are directly related to the real property are also includible in the computation of original purchase price. Generally, such costs include certain closing costs, delinquent real estate taxes and professional fees.
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> "The following list illustrates the specific costs which may be included in the computation of original purchase price if incurred in connection with the acquisition of the real property:
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> -- purchase price paid for the real property

-- mortgage recording tax paid on purchase money mortgage
-- cost of title insurance and abstract
-- cost of letter of credit used as down payment under contract to purchase
-- points paid to lender (except points will not be allowed if paid to a seller who took back a true purchase money mortgage)
-- mortgage commitment fee and/or mortgage origination fee paid to lender (except such costs will not be allowed if paid to a seller who took back a true purchase money mortgage)
-- recording and filing fees
-- title closer attendance fee
-- lease buy-outs
-- appraisal fee
-- attorney's fees, including fees paid to the lender's attorney
-- mortgage broker fee
-- costs to survey real property
-- architectural and/or engineering fee
-- feasibility and market analysis consulting fees that are allocated to the parcel purchased
-- accrued and unpaid interest due on prior existing liens against the real property that was acquired where such interest was paid by the buyer*
-- New York State Real Estate Transfer Tax*
-- New York City Real Property Transfer Tax*
-- Unpaid taxes which are a lien on the real property that was acquired and which were paid by the buyer*

*Note: The payment of such items by the buyer is deemed to be an additional consideration to the seller."

D. The principal difficulty in considering whether certain costs claimed by petitioner should be allowable in determining its original purchase price is the fact that, by virtue of the parties having consented to have the controversy determined on submission without hearing, the positions of the parties can be ascertained only from documentary evidence which includes, in some instances, affidavits (most notably, those of Edward I. Penson and Arnold A. Gruber) and audit narratives.

With respect to the $250,000.00 paid to O & B, it must be found that the Division properly disallowed this fee as a preacquisition cost. Petitioner admits (see, paragraph 11[a] of Penson Affidavit) that in its original submission this fee was characterized as brokerage fees. In the same paragraph, reference is made to checks which refer to these fees as management fees. In the Purchase Agreement (see, Finding of Fact "9"), O & B was hired as an agent. Yet the affidavit of Mr. Gruber, petitioner's accountant, states that the fees were paid to O & B to review the property owned by the partnerships along with the partnerships' books and records to

determine if it was prudent to purchase these partnership interests. Inasmuch as it cannot, from the evidence presented, be determined, with any degree of certainty, exactly why this $250,000.00 was paid to O & B, petitioner cannot be found to have sustained its burden of proof (see, 20 NYCRR 3000.10[d][4]) to show that this fee was an allowable preacquisition cost. The Division's disallowance thereof was, therefore, proper.

As to the legal fees paid to Faust, Rabbach & Sweet ($18,500.00), petitioner asserts in the Penson Affidavit that the fees were paid for legal services furnished in connection with the public offering of limited partnership interests in VV Associates - No. 1 which provided the funds necessary to purchase, from Faymor Development Company, the limited partnership interest in petitioner. As stated in 20 NYCRR 590.15(b), in order to be includible in the computation of OPP as a preacquisition cost, such cost must be "directly related to the New York real property." While it can be argued that the preparation for the public offering of limited partnership interest in VV Associates - No. 1 was done with the acquisition of the real property in mind, it was not directly related thereto. In Matter of Albe Realty Co. (Tax Appeals Tribunal, March 26, 1992, confirmed ___ AD2d ___, 598 NYS2d 602), the Tribunal affirmed the Division's disallowance of certain mortgage costs on a mortgage obtained four months prior to a cooperative conversion since the mortgage "was not a necessary expense incurred to create an ownership interest in the cooperative housing corporation." While that case involved different facts than presented herein, the Tribunal's analysis is useful in consideration of the matter at issue. It must be found, therefore, that the Division properly disallowed the $18,500.00 in legal fees.

The $6,950.00 in accounting fees paid to Marks Shron & Company, it is contended, were paid for "due diligence" services furnished in connection with the Penson Entities of the partnership interests in petitioner. Petitioner has presented no evidence as to the actual services performed and how, if at all, such services were directly related to the acquisition of the real property. Since petitioner failed to sustain its burden of proof with regard to showing how such accounting services were directly related to the acquisition of the real property, disallowance

thereof by the Division was proper.

Petitioner contends that the legal fees and accounting fees were allowed by the Division in its audit of Vanderveer Associates - No. 5. Since allowance of such fees was not at issue in that matter, it cannot be determined whether the fees were charged for the same services as are at issue herein. Mere allegations that such was the case are insufficient to warrant allowance in the present matter.

E. 20 NYCRR 590.16(d) provides, in pertinent part, as follows:

> "Question: What additional costs are allowed if incurred during a construction period?
>
> "Answer: Other 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. Amounts designated as points or loan processing fees on a construction loan also are includible in original purchase price so long as the fees were paid by the borrower for the receipt of the loan funds and were not paid for specific services.
>
> "The items listed below, if paid for by a transferor for the construction of capital improvements made to real property, during a construction period, illustrate the types of costs that may be included in determining original purchase price:
>
> -- accounting fees
> -- fees for appraisals required by construction lender
> -- interest paid during the construction period on loans where the proceeds of such loans were used to make capital improvements to real property
> -- construction period real property taxes
> -- mortgage recording tax (building and loan mortgage only)
> -- construction period insurance
> -- construction period security
>
> "The above costs may not be included in original purchase price if the real property is in use or ready for its intended use or for real property not undergoing the activities necessary to prepare it for its use." (Emphasis added.)

Petitioner admits that tenants were occupying the apartments at the time the buildings were undergoing renovation (see, paragraph "15[d]", supra).

20 NYCRR 590.16(e) provides, in part, as follows:

> "Some construction projects are completed in sections, leaving part of the real property capable of being used independently while construction continues on other sections. For such projects, allowable construction period expenses shall cease on

each part when it is substantially complete and ready for use."

Petitioner's argument that it was entitled to claim construction period real estate taxes would have been more tenable had evidence been produced to show what tenants, if any, were displaced; which portions, if any, of the building were inhabitable, and for what periods; and any other evidence which would properly allocate the real estate taxes to actual construction periods. No such evidence was presented. The Division's disallowance of the $181,876.00 in real estate taxes was, therefore, proper.

Petitioner has also raised additional issues concerning the disallowance of the real estate taxes. Petitioner contends that the auditor allowed construction loan interest and insurance premiums which, pursuant to 20 NYCRR 590.16(d), are similar expenses, i.e., if the interest and insurance expenses were allowed, the real estate taxes should be allowed as well. The record is not clear as to the reasons for the allowance of the interest and insurance but, regardless of the reasons, a determination contrary to the statutes and regulations is not warranted merely for the sake of consistency.

Petitioner also states that its counsel received verbal assurances from Division personnel that, despite the fact that the apartments were occupied, the real estate taxes would be an allowable cost. Errors or misinterpretations by certain employees of the Division are not binding on the Division (Matter of Miller, State Tax Commission, December 31, 1984, determination confirmed sub nom Jack W. Miller, Excavating Contractor v. State Tax Commn., 131 AD2d 902, 516 NYS2d 352). In addition, petitioner has not established that it reasonably relied on the alleged statements of the Division employees, thereby warranting imposition of estoppel against the Division (see, Matter of Maximilian Fur Co., Tax Appeals Tribunal, August 9, 1990; Matter of Harry's Exxon Serv. Sta., Tax Appeals Tribunal, December 6, 1988).

F. As indicated in Finding of Fact "13", the Conciliation Order properly credited petitioner with the additional capital improvements claimed on the Supplemental Return. Accordingly, no additional adjustment with respect to this amount ($72,968.00) is warranted.

As for the alleged understatement of capital improvement costs in the amount of

$24,057.00 (see, Finding of Fact "13" and paragraph "15[f]", supra), petitioner has produced no evidence to show what this amount represents or that it is entitled to any additional allowances therefor. The Division's disallowance of these claimed additional capital improvement costs is, therefore, proper.

G. 20 NYCRR 590.16(b) provides as follows:

> "Question: What items associated with the construction of a capital improvement are included in the original purchase price?
>
> "Answer: The following list illustrates the specific costs, if paid for by a transferor, that are allowable as a cost of capital improvements made to real property for purposes of determining original purchase price. All costs must be shown to relate directly to capital improvements made to the property being transferred:
>
> -- architectural fees
> -- legal fees
> -- engineering fees
> -- surveying fees
> -- consideration paid to contractors to make the capital improvement
> -- demolition
> -- debris removal
> -- built-in appliances
> -- construction equipment rental
> -- payroll and cost of fringe benefits for construction personnel only
> -- costs of utilities for construction usage only
> -- costs of permits required by governmental bodies for constructing capital improvement
> -- security fences
> -- landscaping and site planning
> -- installation of parking lots and initial sealing
> -- excavation, grading, fill and land clearing
> -- installation of heating, ventilation, air conditioning systems
> -- waterproofing, new roof and roof replacement
> -- fixtures (permanently affixed)
> -- plumbing
> -- insulation
> -- initial painting of new buildings, structures or additions
> -- solar hearing systems
> -- security systems
> -- smoke alarm system
> -- construction material (i.e., lumber, sheet rock, flooring [including wall-to-wall carpet], bricks, concrete, tile, structural steel, etc.)
> -- sheet metal work
> -- well drilling
> -- sewage system installation
> -- sandblasting
> -- soil testing
> -- utility installation
> -- tree removal" (emphasis added).

It appears from the evidence presented, most notably the HUD Audit Guide and the affidavits of Arnold Gruber, C.P.A., that Profit and Risk is a customary, reasonable and necessary expense associated with construction or renovation projects of this type. However, the HUD Audit Guide (see, Finding of Fact "14") states that a "Builder's/Sponsor's Profit and Risk Allowance" (BSPRA) is applicable where the mortgagor (petitioner) and contractor (Faymor) have an "identity of interest". Nowhere in the record is there an explanation of what is meant by an "identity of interest". The Audit Guide further states that, in cases where BSPRA would be applicable if there were an identity of interest, but, in fact, there is no identity of interest, the law provides for a "Sponsor's Profit and Risk Allowance" (SPRA). SPRA is also provided for in certain subcontracting situations (see, Finding of Fact "14") and petitioner has presented no evidence that these circumstances are not applicable herein. The Audit Guide provides for computation of SPRA by taking 10% of the sum of architectural fees, interest and financing expenses, legal and organizational expenses and off-site costs, if any.

Based upon the Cost Certification Review Worksheet (FHA Form No. 2331A) attached to the Penson Affidavit, SPRA in the present matter would be computed as follows:

Architectural fees	
Design	$ 99,704.00
Supervision	33,234.00
Interest	697,969.00

Financing	
Initial 1.5%	128,384.00
Discount 2.5%	213,973.00
Comm. Fee 3.0%	256,767.00
Legal	36,250.00
Organization	12,000.00
Off Site	-0-
	$1,478,281.00 Total

10% = $ 147,828.10

Absent evidence that petitioner was entitled to BSPRA, it is hereby found and determined that, in lieu thereof, an SPRA allowance of $147,828.10 is reasonable and proper.

H. Petitioner's contentions with respect to Vanderveer Associates - Nos. 2, 3 and 4 shall not be addressed herein since no evidence relating thereto is before this Administrative Law Judge.

I. The petition of Vanderveer Associates - No. 1 is granted to the extent indicated in Conclusion of Law "G"; the Division is hereby directed to modify the notice of determination issued to petitioner on October 30, 1989, as modified by Conciliation Order CMS No. 102019, accordingly; and, except as so modified, the petition is in all other respects denied.

DATED: Troy, New York
December 6, 1993

/s/ Brian L. Friedman
ADMINISTRATIVE LAW JUDGE