STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:
of	:
INDECK ENERGY SERVICES OF OSWEGO, INC. AND AT&T CREDIT CORPORATION	:DETERMINATION DTA NO. 812722
	:
for Revision of Determinations or for Refunds of Real Estate Transfer Tax under Article 31 of the Tax Law and Tax on Gains Derived from Certain Real Property Transfers under Article 31-B of the Tax Law.	:

Petitioners, Indeck Energy Services of Oswego, Inc., 1130 Lake Cook Road, Suite 300, Buffalo Grove, Illinois 60089-1976, and AT&T Credit Corporation, 44 Whippany Road, Morristown, New Jersey 07960, filed a petition for revision of determinations or for refunds of real estate transfer tax under Article 31 of the Tax Law and tax on gains derived from certain real property transfers under Article 31-B of the Tax Law.

A hearing was held before Carroll R. Jenkins, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on January 17, 1995 at 9:30 A.M. Petitioners appeared by Sidley & Austin (Paul R. Wysocki, Esq., and Bridget R. O'Neill, Esq., of counsel) and by Michael J. Guerriero, Esq. The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Andrew J. Zalewski, Esq., of counsel).

Petitioners and the Division of Taxation filed briefs on March 16, 1995 and April 21, 1995, respectively. Petitioners filed a reply brief on May 18, 1995, which began the six-month statutory period for issuance of a determination. On September 13, 1995, this proceeding was transferred to Jean Corigliano, Administrative Law Judge, who renders the following determination.

ISSUES

I. Whether a power generation system installed by a lessee for its own benefit is real property as defined in Tax Law § 1440(6).

II. Whether, if it is not in itself real property, a power generation system installed by a lessee is a capital improvement to real property.

III. Whether the consideration for the transfer of a controlling interest in an entity with an interest in real property includes amounts paid by the transferee to satisfy assessments of tax.

IV. Whether petitioners have established that penalty should be abated for reasonable cause.

FINDINGS OF FACT

On February 29, 1988, International Paper Company ("International Paper") entered into an agreement to supply Niagara Mohawk Power Corporation ("NIMO") with electricity (the "Power Sale Agreement").

On December 27, 1988, petitioner Indeck Energy Services of Oswego, Inc. ("Indeck") and National Energy Production Corporation entered into a contract for the construction of a thermal and electrical energy cogeneration facility to be located in Oswego, New York.

The major items of the cogeneration facility were: (1) a General Electric Frame 6 combustion gas turbine generator; (2) a General Electric steam turbine generator; (3) a heat recovery steam generator; (4) a surface condenser; and (5) a cooling tower. These items of the cogeneration facility shall be referred to collectively as the "System".

The cogeneration facility is located on three acres of land located in Oswego, New York. The land was leased by Indeck from International Paper for an initial term of 20 years at a rent of $1.00 per year (the "Land Lease"). The Land Lease is dated November 16, 1988 and was executed on January 25, 1989.

On January 25, 1989, International Paper assigned its Power Sale Agreement with NIMO to Indeck. Indeck assigned its interest in the Power Sale Agreement to Indeck Limited Partnership ("the Partnership") on March 14, 1989. NIMO consented to the assignment and assumption by the Partnership.

Indeck and International Paper entered into a Steam Supply Agreement on March 2, 1989, for a term of 20 years, renewable with the mutual consent of the parties for five-year periods. The Land Lease, which is also for a term of 20 years, is automatically renewable for five-year periods upon the renewal of the Steam Supply Agreement. Under the terms of the Land Lease, the lease converts to a fixed 15-year term if International Paper terminates operations or eliminates its need for the steam before the end of the 20-year lease term.

On April 3, 1989, Indeck entered into an agreement with the County of Oswego Industrial Development Agency ("IDA") for the construction of a cogeneration plant in Oswego, New York. The IDA is a county industrial development agency created in accordance with New York General Municipal Law § 850, et seq. The IDA passed a resolution, on February 28, 1989, to issue and sell its taxable industrial development bonds in an aggregate principal amount not to exceed $43,600,000.00 in order to finance the cogeneration plant. The bonds were never issued.

Indeck assigned its Land Lease with International Paper to the IDA on May 1, 1989. The IDA subleased to Indeck the premises which were the subject of the Land Lease at an annual rent of $1.00. The sublease required Indeck to use the leased premises to construct and operate a cogeneration system and for no other purpose. All of the terms and provisions contained in the Land Lease were incorporated into the sublease.

Indeck assigned all of its assets to the Partnership on March 14, 1990. Among the assets enumerated in the assignment and assumption agreement were the following: (1) "a net 50.4 MW combined-cycle natural gas-fired cogeneration facility" located on land in Oswego, New York (referred to as the "Site"); (2) any interest in the Site; and (3) "all buildings, structures or improvements erected or to be erected at the Site and all alterations thereto or replacements thereof."

On March 16, 1990, petitioner AT&T Credit Corporation ("AT&T") acquired a 47% aggregate partnership percentage in the Partnership from Indeck for $16,000,000.00. By supplemental agreement dated June 23, 1990, AT&T acquired a second 51% partnership percentage in the Partnership from Indeck for

$11,300,000.00.

The First Amendment of the First Amended and Restated Agreement of Limited Partnership recited AT&T's share of the nonrecourse debt of the partnership as 98%.

On or about December 28, 1990, Indeck and AT&T filed New York State transferor and transferee questionnaires with the Division of Taxation ("Division"), reporting the transfer of a controlling interest in an entity with an interest in real property. The consideration to be paid for the transfer was reported as $1,004,353.00. The only amount included in original purchase price by Indeck was the cost of capital improvements totalling $602,694.00. Indeck calculated a gain subject to tax of $401,659.00 and enclosed a check in the amount of $44,237.31, representing gains tax in the amount of $40,165.90 and real estate transfer tax in the amount of $4,017.41. Indeck requested an abatement of interest and penalties for late filing on the basis that the failure to file was for reasonable cause and was based on a good-faith belief that the transfer was not subject to either the gains or transfer taxes.

With the filing of the questionnaires, Indeck filed a Combined Real Property Transfer Gains Tax Affidavit and Real Estate Transfer Tax Return. In an attachment to that form, Indeck explained its apportionment of the consideration paid for partnership interests to the real property. Total consideration paid for all partnership interests was $68,264,000.00, consisting of AT&T's allocated share of partnership debt of $40,964,000.00 plus consideration paid of $27,300,000.00.

The percentage of partnership property attributed to real property was based on a cost analysis performed by the Partnership's accountants. That analysis was summarized as follows:

> "The portion of the total Project cost of 43,032,053.00 attributable to property classified as Section 1250 property under the Internal Revenue Code of 1986, as amended, is $633,121.00 or 1.47128%."

The percentage calculated was applied to total consideration for all partnership interests to compute consideration attributable to real property of $1,004,353.00.

The Division conducted an audit of Indeck's gains tax filings, requesting additional information which was provided by Indeck. By letter dated March 29, 1991, Indeck's attorney provided the Division with information regarding project costs. Also, Indeck provided the Division with a letter from Marshall and Stevens, Incorporated, appraisers and valuation consultants, who determined that "on an allocated basis . . . the fair market value of the real property as a part of the Project is $1,118,000.00."

On audit, the Division took the position that the cogeneration facility, including the items referred to as the System in Finding of Fact "3", constitutes real property within the meaning of Article 31-B of the Tax Law. The Division determined that the total cost of the cogeneration project was $43,032,00.00. Of this amount, $607,089.00 was apportioned to various items of tangible personal property. The remaining $42,424,911.00 was determined to be "Cost of real property items" or the original purchase price of the real property. The

Division then calculated a percentage of 1.586354 representing a ratio of the fair market value of the partnership interest at the time of the transfer to the original purchase price of the real property ($68,264,000.00 ÷ $42,424,911.00). This percentage was applied to the original purchase price of the real property to calculate the amount of the total consideration attributable to the real property, $67,300,927.26. Gain subject to tax was then calculated as follows:

"Consideration	$67,300,927.26
Original Purchase Price	$42,424,911.00
Gain subject to tax	$24,876,016.26
	x .98 (percentage transferred)
	$24,378,495.93
Tax due (.10 x gain)	$ 2,437,849.59"

The Division issued a Tentative Assessment and Return, dated February 6, 1992, asserting additional gains tax due of $2,437,849.50, plus penalty and interest, for a total amount due of $3,684,341.45.

On or about March 16, 1992, the Division issued to Indeck a Notice and Demand (L-005379624-3) for gains tax due in the amount of $2,437,849.59, plus penalty and interest. On or about March 26, 1992, AT&T paid $3,764,867.80 to the State of New York in accordance with the Notice and Demand.

On May 20, 1992, AT&T filed a Claim for Refund of Real Property Transfer Gains Tax in the amount of $3,805,024.70. AT&T filed the claim because it paid the tax assessed against Indeck pursuant to the Notice and Demand. In its claim for refund, AT&T took the position that additional gains tax was not due on the transfer of partnership interests. AT&T characterized the System as "trade fixtures" rather than real property. This claim was assigned number R-2008 by the Division.

On or about November 18, 1992, the Division issued to Indeck a Statement of Proposed Audit Adjustment. The Division again recalculated the gains tax due on the transfer, increasing its original assessment by $286,060.00. This increase was based upon a disallowance of various project costs originally included in original purchase price and a reduction in items originally classified as tangible personal property. The statement of audit changes contained a paragraph denying AT&T's claim for a refund. The grounds for denial were set forth, in part, as follows:

> "It is the position of the Department of Taxation and Finance that the Indeck-Oswego Cogeneration Facility is real property within the meaning of Section 1440(6) of the Tax Law, and the improvements thereon are capital improvements to real property" (citations omitted).

On January 19, 1993, the Division issued to Indeck a Notice of Determination assessing gains tax of $286,060.00, plus penalty and interest. By letter dated April 16, 1993, the Division informed the attorney for Indeck that this Notice of Determination inadvertently "omitted the language denying Refund Claim R-2008, which was included in the Statement of Proposed Audit Adjustment." The letter continues as follows:

> "Since the intention and effect of the Notice of Determination was to deny Refund Claim R-2008 as well as assess additional tax due, it is our position that any appeal of Assessment L-006929619 [the January 19, 1993 notice] with the Bureau of Conciliation and Mediation Services or the Division of Tax Appeals,

prior to April 19, 1993, will also serve as an appeal of the denial of Refund Claim R-2008 within the time required by Section 1445(2) of the Tax Law."[1]

On April 14, 1993, Indeck filed a Request for a Conciliation Conference in protest of the January 19, 1993 Notice of Determination of additional gains tax due. In accordance with the Division's letter, this request was deemed a timely appeal of the Division's denial of AT&T's refund claim.

On or about February 18, 1992, the Division issued to Indeck a Notice of Determination assessing additional real estate transfer tax of $265,186.59, plus penalty and interest. Indeck filed a Request for a Conciliation Conference to protest this notice on May 18, 1992. On April 8, 1993, the Division issued a Notice of Determination to Indeck for additional real estate transfer tax of $1,590.00, plus penalty and interest. On April 14, 1993, Indeck filed a Request for a Conciliation Conference to protest this notice.

The Division issued a series of notices and demands which correspond to the notices of determination under review here. The parties stipulated that the following notices and demands were issued:

Notice Number	Date	Taxpayer	Tax Article	Tax Amount
L-00692619	4/30/93	Indeck	31-B	$286,060.00
L-00692619	6/29/93	AT&T	31-B	$286,060.00

[1] The parties stipulated that the Notice of Determination issued on January 19, 1993 denied AT&T's claim for refund. The contents of the Division's letter is included here to clarify the record.

L-005316722	9/14/93	AT&T	31	$265,186.59
L-007148398	9/14/93	AT&T	31	$ 1,590.00

On July 8, 1993, AT&T filed a Statement of Disagreement and a Request for a Conciliation Conference in connection with the Division's

Notice and Demand asserting additional gains tax due of $286,060.00 (L-006929619).

On September 9, 1993, the requested conciliation conferences were held before Thomas E. Drake, Conciliation Conferee. As a result of that conference, the Division issued three conciliation orders sustaining the notices of determination issued to Indeck and denying AT&T's request for a refund of gains tax paid. The conciliation orders were dated December 31, 1993.

On March 10, 1994, AT&T paid the following amounts:

L-006929619-3	$442,764.18
L-005316722-9	$458,992.70
L-007148398-5	$ 2,754.74

AT&T and Indeck filed a joint petition with the Division of Tax Appeals on March 29, 1994.

The Division filed an answer to the petition dated May 23, 1994. In paragraph 13 of its answer, the Division asserted that its notices of determination failed to include in consideration gains tax paid by AT&T on behalf of Indeck. The Division requested that the Division of Tax Appeals exercise its statutory authority to determine a greater amount of tax due than that asserted in the notices of determination based on petitioners' concession that AT&T actually paid all assessments issued.

Petitioners' first witness was Darla A. Pishko, an employee of AT&T working in the Capital Markets Division ("AT&T Capital"). Among Ms. Pishko's responsibilities are: ascertaining the technical and physical characteristics of potential investments; analyzing the long-term profitability of the projects based on those characteristics; and monitoring the operation of a project including both physical and financial performance over the lifetime of the investment.

Ms. Pishko described a combined cycle cogeneration facility as a power generation system that combines the gas turbine and steam turbine cycles to formulate a more efficient manner of utilizing fuel for the generation of power. According to Ms. Pishko, the profitability of the Oswego facility depends on its ability to qualify as a cogeneration facility under the Public Utility Regulatory Policies Act of 1978 ("PURPA") (Pub L 95-617). Ms. Pishko testified that any facility which used oil or natural gas to generate power was required to sell steam as part of the production and to supply the steam host a steady stream of steam. According to Ms. Pishko, Indeck's Steam Supply Agreement with International Paper was a condition of maintaining its status as a qualified facility under PURPA.

Ms. Pishko testified that the profitability of the Indeck-Oswego facility is "driven largely from the benefits resulting from the power purchase agreement with NIMO" (tr., p. 30). She testified that if petitioners were to lose their steam host and thus their qualification under PURPA, the Power Sale Agreement would become "null and void", leaving Indeck with no customer for its power.

Ms. Pishko testified that there is a market for used power generation equipment like that installed in the Indeck-Oswego facility. She also stated that if Indeck lost its customers, Indeck would consider disassembling and removing the equipment.

The Power Sale Agreement executed by International Paper, as seller, and assigned to Indeck reflects the conditions described in Ms. Pishko's testimony. Under the terms of that agreement, the seller represents that prior to the commencement of operation of the power plant it will become a qualifying facility under PURPA and a cogeneration facility as defined in Public Service Law § 2.2-a. Prior to the commencement of operation of the power plant, the seller was required to provide NIMO with evidence that the power plant was a qualifying facility. Moreover, the seller was required to provide NIMO with an executed fuel supply contract coterminous with the Power Sale Agreement. Failure of the seller to comply with this term of the contract provision provided grounds for NIMO to deem the contract null and void without any liability to NIMO.

The rates to be paid by NIMO under the Power Sale Agreement are those:

> "duly approved by the [New York State Public Service] COMMISSION applicable for payments to qualifying on-site generation suppliers, as defined in the Public Service Law, whose sales of capacity and energy to

> NIAGARA are made under the terms of such tariff" (Power Sale Agreement, ¶ NINTH).

If Indeck fails to maintain its status as a qualifying facility during the term of the agreement "then NIAGARA shall pay SELLER pursuant to the rates contained in NIAGARA's Service Classification No. 6 exclusive of any New York State minimum payment" (Power Sale Agreement, ¶ FIRST).[2]

Under the terms of the Steam Supply Agreement, Indeck (referred to in the agreement as the "Service Company") agreed to supply steam to International Paper (referred to in the agreement as the "Customer") from the cogeneration facility located in Oswego, New York (referred to as the "System") and described in Exhibit A of the Steam Supply Agreement. Exhibit A is entitled "DESCRIPTION OF EQUIPMENT". As pertinent here, it describes the System as follows:

> "The Facility will be a combined cycle in which the gas turbine generator sequentially produces both electrical power and
>
> waste heat. The waste heat produces steam in a waste heat recovery boiler which generates process steam and steam for a condensing steam turbine to generator produce additional electrical power.
>
> * * *
>
> "The Facility will consist of the following major components:
>
> "One Gas Turbine Generator
> "One Steam Turbine Generator
> "One Waste Heat Boiler, double pressure type
> "One 13.8 kV to 115 kV 50 MW Electric Power Substation
> "One Central Distributed Digital Control System

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[2] There is no evidence in the record concerning the rate applicable under the two different circumstances, i.e., with or without the steam host.

* * *

> "All the major components will be housed in a building which will be a steel frame structure with metal siding.
>
> "The #2 fuel oil tank will be diked and located away from the building.
>
> "The three-celled cooling tower shall be erected on a concrete basin containing the circulating water pumps.
>
> "A water treatment system will be provided to process potable water from the city supply into boiler feedwater . . . .
>
> "Other auxiliary systems to be provided to support the power production . . . ."

Section 5 of the Steam Supply Agreement, entitled "Ownership of Property", provides as follows:

> "Service Company shall own the System, whether located on or off the Project Site, throughout the term of this Agreement. <u>The System shall remain personal property and no item thereof shall become a fixture of the Project Site, notwithstanding its installation on or attachment to real property or any improvement located thereon</u>. Plates or markings may be affixed to or placed on the System by Service Company to indicate its ownership thereof. <u>Upon the expiration of this Agreement, Service Company, at the option and expense of Service Company, can enter the Project Site and disconnect and/or remove the System unless Customer purchases pursuant to Section 14b</u>. Service Company shall act reasonably so as not to unduly interfere with Customer's operations at the Project Site in the course of such removal" (emphasis added).

Section 14 of the Steam Supply Agreement provides that at the expiration of the initial term of the agreement or at the end of the renewal period, the Customer and Service Company will have several options. The customer will have the option of renewing the agreement (Section 14[a]) or purchasing "the entire System at fair market value" to be determined by appraisal under a procedure provided for (Section 14[b]). In the event the

Customer elects not to renew or purchase, section 14(c) provides the Service Company with the option to continue operating the System using any of Customer's equipment that had previously been used in connection with the operation of the System or "to remove all or part of the System from the Project Site as stated in Section 5.0."

Section 15 of the Steam Supply Agreement provides that the Service Company shall have the right to terminate the agreement before the System is placed in service under certain circumstances. One of those circumstances is described as follows:

> "There is any change in law, regulation or policy that, in the opinion of Service Company, materially affects the economic viability of Service Company's undertakings pursuant to this Agreement."

Section 9 of the Steam Supply Agreement sets forth the agreed-upon terms and conditions for purchase and sale of steam. Section 9.2 provides:

> "<u>Minimum Purchase</u>" In order to maintain qualified facility (QF) status for the System under the Public Utilities Regulatory Policies Act of 1978 ('PURPA'), the Customer shall take and purchase a minimum of 260 million pounds of steam during each calendar year. In the event that maintenance of QF status requires the purchase of more than 260 million pounds of steam per year or requires such minimum purchases to be made at a periodic rate over such year, or both, Service Company shall have the option to require Customer to comply with such requirements up to Customer's then total yearly requirements for steam."

Section 9.4 of the Steam Supply Agreement sets forth the procedures to be followed if International Paper permanently terminates manufacturing or otherwise terminates its operations so that it no longer requires steam. The parties agree to use their best efforts to mitigate the impacts of early termination by taking several steps. International Paper agrees to use its best efforts to sell or lease its manufacturing plant provided that the purchaser must assume the minimum steam requirements under the agreement. Both International Paper and Indeck agree to seek a substitute outlet for the steam "to meet the Qualified Facility requirement" (Steam Supply Agreement, § 9.4[a]). If early termination cannot be avoided and neither of the two options is available, Indeck:

> "may, at its sole option, seek to secure a timely waiver of the Steam usage requirement for Qualified Facilities from the appropriate state and federal authorities to allow the plant to continue in operation as a Qualified Facility or a nonregulated electric power producer in a manner which will not affect the existing Power Sale Agreement" (_id_., § 9.4[c]).

The Land Lease contains a purchase option which allows Indeck the option to purchase the land leased from International Paper under certain terms and conditions. The right became exercisable under three conditions: (1) expiration of the lease, (2) expiration of the Steam Supply Agreement, and (3) termination of the Steam Supply Agreement occasioned by default of International Paper. The purchase price of the land was to be the fair market value, determined by appraisal under a procedure agreed to in the Land Lease.

The Land Lease contains these provisions describing the leased premises:

> "The Lessor and the Lessee have entered this date an energy services agreement ('Steam Supply Agreement') pursuant to which Lessee will design, construct, own and maintain a cogeneration system that will supply Lessor with thermal energy and supply third party with electrical energy pursuant to a power purchase contract

(the 'System'). The land to be leased hereunder is the land on which the System will be built.

* * *

"1.1 Lease. Upon the terms and conditions set forth, the Lessor leases to the Lessee and the Lessee leases from the Lessor, the land located in Oswego, New York more particularly described on the attached Exhibit A . . . ."

Article II of the Land Lease provides that if the Steam Supply Agreement terminates during a renewal period or if the agreement is not renewed then the lease will renew automatically for successive five-year terms at a rent to be agreed on by the parties. This provision goes on to state:

"If the parties shall not agree within period of thirty days,
the rent shall be the fair market rental value of the Premises . . . . For purposes of the preceding sentence, the fair market value of the Premises shall be the fair market rental value of the Premises only, without consideration of the existence of the System on the Premises or the proximity of the Premises and the System to Lessor's manufacturing facility" (emphasis added).

Article X of the Land Lease contains this provision:

"10.3 Surrender of Premises. At the expiration of the term of this Lease (including renewal terms, if any) or upon earlier termination, Lessee shall surrender the Premises, including the System if Lessor elects to purchase the System under the terms of the Steam Supply Agreement or, excluding the System, if Lessor elects not to purchase the System under the Steam Supply Contract. At the expiration of this lease or if Lessor demands that Lessee surrender the Premises pursuant to Section 9.2(b), if Lessor does not purchase the system, Lessee shall have a reasonable time to enter on the Premises and dismantle and remove the System from the Premises at Lessee's cost without liability to Lessor in any suit, action or other proceeding except as provided in any other agreement pursuant to Lessee's occupation of premises" (emphasis added).

Petitioners submitted the affidavit of Edward W. Andrews, Jr., president of AT&T Capital. As relevant here, he averred as follows:

> "8. Section 5 of the Steam Supply Agreement provides that the Partnership owns the System and that the System shall remain personal property. Under this provision of the Steam Supply Agreement, the Partnership has the right to remove the System from the premises. This is important to the Partnership in the event IPC [International Paper], the steam host, ceases to operate or no longer requires the steam. The Partnership could not economically operate the System without a steam host.
>
> "9. The economic value to the Partnership derives from the efficient operation of the System and the resultant sale of the electricity and the steam to NIMO and IPC respectively.
>
> "10. The land lease contains no stated price for either the option to purchase or for any rent renewals. The land lease provides that the option price for any rent renewals are to be determined, in the absence of the mutual consent of the parties, at the fair market value of the premises only, without consideration given to the System. The option to purchase and lease renewals have little value to the Partnership."

In connection with this proceeding, Indeck commissioned the services of HDR Engineering, Inc. ("HDR") to prepare an estimate of the cost of dismantling and moving the power plant equipment located in Oswego, New York. HDR was also asked to render an expert opinion on whether dismantling and moving the equipment would be economically and physically feasible. HDR completed a written report which concluded that most of the plant equipment is not permanently affixed to the real property and could be removed from the Site and installed and operated elsewhere. HDR was involved in the Oswego project as independent engineer from May of 1989, shortly after construction began. HDR had been retained by the bank financing the construction project as its independent engineer. HDR's purpose was to monitor construction to determine whether it was proceeding on schedule and to verify contractor invoices.

The HDR report was authored by David Logeais, who was employed by HDR as a project manager during the time that HDR was involved in the Indeck-Oswego project. As project manager, he was involved in many aspects of engineering consulting work relating to power and energy. He has experience in both the installation and dismantling of power generation plants.

Mr. Logeais described the installation of a gas turbine generator similar to the one installed at the Indeck-Oswego facility as follows:

> "The [gas turbine] at Indeck Energy Services of Oswego facility arrives at the job -- well, it's manufactured in a manufacturing plant, and is basically mounted on skids, which is like a structural industrial framework or a base. A unit of this size generally arrives in two or three different modules, so those would be shipped either by rail or by truck to the job site. They are off-loaded from the carrier and installed or set on concrete foundations which have been specially prepared for the equipment. The equipment is bolted down to the foundations, various interconnections are made between the modules. There is wiring, electric wiring to be connected. There is piping which carries fuel, compressed water and steam that needs to be connected between the modules, and there are some physical interconnections between the modules as well. For instance, this is a gas turbine generator. A generator arrives separately from the gas turbine, so basically the shaft of the gas turbine has to be connected to the shaft of the generator.
>
> * * *
>
> "[T]he concrete foundation, the equipment is bolted down to the foundation; it's physically bolted to the foundation. There are large anchor bolts which are generally embedded in the concrete that the foundation is built of, so you have anchor bolts that are protruding from the foundation. The equipment has corresponding holes in its skids, and the installation consists of lowering it over these bolts and bolting it down. There is an alignment and level process, of

course, that is required, but fundamentally it's bolted down to the foundation" (tr., pp. 43-44).

According to Mr. Logeais, the removal of the power generating plant would be the opposite of the installation process. The dismantling would require the unbolting of equipment, the disconnection of electrical wires and the cutting of welded pipes. The large modular equipment would be lifted out of the building that housed it with large cranes. Since the building itself is a modular construction, roof panels could be unbolted and removed to allow equipment to be lifted through the top of the building, and the roof panels could then be reinstalled. Some equipment would be lifted with hydraulic jacks and then rolled off the foundation.

Mr. Logeais stated that before start-up of the plant, but after the building was completed, the HRSG (heat recovery system generator) was modified by lowering a new module system through the roof of the building and placing it in the HRSG.

Mr. Logeais testified that he was personally involved in the dismantling and removal of a gas turbine generator 2½ times the size of the one owned by the Partnership. The turbine was owned by Gulf States Utilities and located on the Gulf Coast. The utility company decided, for economic reasons, to move the turbine to Baton Rouge, Louisiana. The company purchased a HRSG from Mr. Logeais's employer at the time and installed it at the same site as the relocated gas turbine creating a cogeneration cycle. Mr. Logeais was unaware of any instance of removal of a cooling tower. He stated that he knew of boilers that have been moved and that a HRSG is a specialized type of boiler. He was not aware of an instance where a HRSG was moved.

The useful life of cogeneration equipment was estimated by Mr. Logeais to be longer than 15 to 20 years. He also testified that there is an active market for used generation equipment, several trade publications where such equipment is advertised and trade brokers who specialize in used power generating equipment.

In his report Mr. Logeais estimated the cost of dismantling and moving power plant equipment which met the following criteria:

> "1. It is not permanently affixed to the real estate.
>
> "2. Is physically and practically capable of being moved.
>
> "3. Would have practical and economic usefulness at another site" (HDR Report, p. 1).

Mr. Logeais estimated that the following equipment could be dismantled and moved at a total cost of $2,120,646.00: gas turbine, steam turbine, HRSG, condenser, dearator, BLR blowdown tank, cooling tower, HVAC system, 121kV switchgear, 480V switchgear, transformers, MCC's, air compressors, circulating water pumps, raw water pumps, DA makeup pumps, LP feed pumps, DCS, HP feed pumps, demineralizer, acid skid/tank, caustic skid/tank, HRSG platforms, bridge crane. Total costs included estimates for construction management, engineering and a 20% contingency.

Mr. Logeais's estimate assumed that dismantling costs would be 75% of the original installation costs for the gas turbine, steam turbine, HRSG and condenser; 90% for the cooling towers; and 50% for the remaining equipment. He assumed the new plant site to be located within 300 miles of the current site and the "relocated plant is essentially a duplicate of the current one" (HDR Report, p. 2). Finally, he assumed the raw water characteristics of the new site to be similar enough to those of the current site to allow use of the demineralizer system with no modification. The percentages determined by Mr. Logeais were based on his professional opinion of what the costs would be to dismantle the equipment.

In Mr. Logeais's opinion, the cogeneration equipment could be removed without physical damage to the equipment or to the concrete foundations to which it is bolted. The only damage would be the obvious damage caused by cutting welds in pipes.

Almost all of the equipment included in Mr. Logeais's estimate was manufactured in discrete modules, i.e., complete stand-alone assemblies that were shipped to the Site for installation. The cooling tower was the exception to this. It was assembled on site and not modularized. Dismantling it would involve disassembling it into its component pieces. The cost of dismantling the tower was estimated to be $71,000.00. The process of dismantling it is described in the HDR Report as follows:

> "Because the cooling tower is too large to be shipped in a single piece it was originally assembled on the job site. It is assembled on top of concrete foundations containing an integral basin to contain circulating water which is being cooled in the tower. Assembly consists of bolting together a prefabricated and precut structural steel framework. Into this framework are installed large volumes of PVC fill. A corrugated metal siding is installed around the outside. Large electrical fans with plastic fan ducts

> are installed on top of the cooling tower. Prefabricated walkways and ladders are bolted into place and finally water and electrical supplies are connected. In order to relocate the cooling tower it would be disassembled into component parts, which would then be crated, banded or otherwise packaged for shipment" (HDR Report, p. 12.).

Photographs of the cooling tower during construction show a steel framed structure with corrugated metal siding. To a layperson's eye, it looks like a rectangular building.

Petitioners and the Division entered into a stipulation of facts containing 37 separately numbered paragraphs. The stipulated facts have been substantially incorporated into this determination.

SUMMARY OF THE PARTIES' POSITIONS

Petitioners claim that the System is not a capital improvement as that term is used in Article 31-B of the Tax Law because it is not permanently affixed to the real property and was never intended to be a permanent installation. Based on this claim, petitioners argue that the consideration paid for the controlling interest in the Partnership does not include the value of the System. According to petitioners, the value of the Partnership's interest in real property is confined to the value of the remaining rental payments and the value of the option to purchase the premises on which the System is located. It is petitioners' position that since the value of both of those items is less than $1,000,000.00, the transfer is not subject to gains tax. Petitioners seek abatement of all penalties on the ground that its position that the System is not a capital improvement is based on substantial legal authority.

In its Statement of Proposed Audit Adjustment, the Division cited to Regulations 590.6(a) and 590.28(c) as the basis for its determination that the "Indeck-Oswego Cogeneration Facility is real property within the meaning of Section 1440(6) of the Tax Law." The Division explained its position as follows:

> "Regulation 590.28(c) provides that the original purchase price of a lessee for his leasehold interest includes '. . . the costs of any <u>capital improvements</u> made by the lessee . . . .' Regulation 590.28(c) does not distinguish between improvements intended to remain with the freehold after the lease is terminated and improvements which may be removed. In both cases, leasehold improvements made by the lessee are considered capital improvements to real property and, as such, may be considered as real property in character for purposes of Article 31-b [sic] of the Tax Law" (emphasis added).

In its brief, the Division argues that the System meets the definition of real property as defined in Tax Law § 1440(6) and, for that reason, its transfer is subject to gains tax.

Assuming arguendo that the System is includable in the calculation of gain subject to tax only if it is a capital improvement, the Division asserts that it is such an improvement.

The Division requests a determination that a greater amount of tax is due than asserted in the notices of determination. The basis for the additional amount is 20 NYCRR 590.9, which provides that if an agreement is negotiated between transferor and transferee whereby the transferee agrees to pay the gains tax the payment constitutes additional consideration to the transferor.

The Division asserts that petitioners have not shown that their position is supported by substantial legal authority or that they reasonably relied on the advice of tax experts. Therefore, it is the Division's contention that reasonable cause does not exist, and the abatement of penalty is unwarranted.

CONCLUSIONS OF LAW

A. Tax Law § 1441(a) imposes a 10% tax "on gains derived from the transfer of real property" in New York State. A transfer of real property includes the "acquisition of a controlling interest in any entity with an interest in real property" (Tax Law § 1440[7]). "'Interest' when used in connection with real property includes, but is not limited to, title in fee, a leasehold interest . . . [and] an option or contract to purchase real property" (Tax Law § 1440[4]). The Partnership did not have a title in fee to the Oswego property; it had both a leasehold interest (the Land Lease) and an option to purchase the land, both of which were interests in real property. Consequently, AT&T's acquisition of a controlling interest in the Partnership was unquestionably a transfer for gains tax purposes.

B. For gains tax purposes, "'[g]ain' means the difference between the consideration for the transfer of real property and the original purchase price of such property" (Tax Law § 1440[3]). As pertinent here, the original purchase price is "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" (Tax Law § 1440[5][former (a)]). To determine the gain subject to tax in this proceeding, it is necessary to first determine the original purchase price paid by the Partnership for its interest in real property, including any capital improvements. The consideration paid by AT&T for the transfer must then be determined in accordance with Tax Law § 1440(1)(c) which provides:

> "In the case of a transfer of a controlling interest in an entity with an interest in real property, there shall be an apportionment of <u>the fair market value of the interest in real property to the controlling interest</u> for the purpose of ascertaining the consideration for the transfer of such controlling interest".

20 NYCRR former 590.49, in effect at the time of the transfer, explains that the fair market value of the interest in real property is determined, essentially, by stepping up the original purchase price as held by the entity at the time of the acquisition. It provides:

> "(a) <u>Question</u>: What is the original purchase price used by the transferor to calculate gain?
>
> "<u>Answer</u>: Generally, it is the original purchase price of the real property as held by the entity, apportioned to the interest the transferor is transferring.
>
> "<u>Example 1</u>: Assume Corporation T only owns a parcel of real property with an original purchase price of $2,500,000, including capital improvements to date.
>
> If individual R sells 100 percent of the stock to F, his original purchase price is $2,500,000. This produces the same result as if Corporation T had sold the property to F. If R instead sells 60 percent of the stock to F, then R's original purchase price is $1,500,000 (60 percent x $2,500,000).
>
> "(b) <u>Question</u>: Is the original purchase price of

the real property as held by the entity stepped-up upon the acquisition of a controlling interest?

"<u>Answer</u>: Yes. In the case of an acquisition of a controlling interest, where the mere change exemption was not applied, the original purchase price in the real property as held by the entity may be stepped-up to reflect the consideration recognized on the transfer of the ownership interest.

"If less than a controlling interest were acquired, the entity may not step-up its original purchase price in the property.

"<u>Example 2</u>: Assume the same facts in example 1 of this section and that R sells 100 percent of the stock to F for $6,000,000, which represents the fair market value of the real property. Since F has acquired a controlling interest in Corporation T, F's original purchase price (and Corporation T's original purchase price) is now $6,000,000. If F had acquired a 60-percent interest for $3,600,000, Corporation T's original purchase price would be partially stepped-up to $4,600,000 ($1,000,000, interest retained, plus $3,600,000)."

To make the required apportionment in this case, the Division determined that the Partnership's original purchase price for its interest in real property included the cost of the System because the Division considered the System to be a capital improvement to the real property pursuant to 20 NYCRR former 590.28(c) and real property within the meaning of Tax Law § 1440(6). It apportioned the fair market value of the Partnership's interest in real property to the controlling interest transferred to AT&T by multiplying the Partnership's original purchase price (including the System) by a fraction, the numerator of which was the consideration paid for the controlling interest and the denominator of which was the original purchase price of the System.

C. Petitioners argue that the System is not an "interest in real property" as that term is defined in the gains tax law because it is not a capital improvement to the real property. It also takes the position that the Land Lease is not an interest in real property subject to gains tax. Tax Law § 1440(former [7]) provides that the creation of a leasehold or sublease is subject to the gains tax only where three separate conditions are met. As pertinent, it states:

> "Transfer of an interest in real property shall include the creation of a leasehold or sublease <u>only</u> where (i) the sum of the term of the lease or sublease and any options for renewal exceeds forty-nine years, (ii) <u>substantial capital improvements are or may be made by or for the benefit of the lessee or sublessee</u>, and (iii) the lease or sublease is for substantially all of the premises constituting the real property" (Tax Law 1440[former (7)]; emphasis added).

According to petitioners, (1) the Land Lease is for a term of less than 49 years and (2) there are no substantial capital improvements to the premises; therefore, creation of the leasehold did not create a taxable interest in real property. Finally, petitioners argue that the fair market value of the Land Lease and the option to purchase the Oswego property have a fair market value of less than $1,000,000.00, exempting the entire transaction from the gains tax.

The Division maintains that even if the System is not a capital improvement, it is nonetheless "real property" as that term is used in Article 31-B. If so, the Partnership's interest in real property included the System, as well as the leasehold interest and the option to purchase the land. Since determining this issue in the Division's favor would be dispositive of the case, I will consider its arguments first.

D. In support of its position, the Division relies on Tax Law § 1440(6), which defines real property as follows:

> "'Real property' means every estate or right, legal or equitable, present or future, vested or contingent, in lands, tenements or hereditaments, including buildings, structures and other improvements thereon and leaseholds" (emphasis added).

The Division notes that the courts have adopted an expansive definition of the term "transfer of real property" designed to maximize the State's revenues (see, Matter of Bredero Vast Goed, N.V. v. Tax Commn., 146 AD2d 155, 539 NYS2d 823, appeal dismissed 74 NY2d 791, 545 NYS2d 105). Based on this precedent, it argues that "in the case at hand it is necessary to utilize a broad construction of the statute as a narrow construction would 'thwart the legislative design'" (Division's brief, p. 8.) It is the Division's position that any improvement to land is included in the statutory definition of real property. Since the System is such an improvement, the Division contends that the cost of the System is properly included in the Partnership's original purchase price. In the alternative, the Division takes the position that the System is a capital improvement.

E. For the reasons stated below, I conclude that the Partnership's interest in the System may be considered an interest in real property only if the System is determined to be a capital improvement.

In construing a statute, all sections of the legislative enactment are to be read together to determine the legislative intent and all parts of the statute must be harmonized with one another (Levine v. Bornstein, 4 NY2d 241, 173 NYS2d 599; McKinney's Cons Laws of NY, Book 1, Statutes §§ 97, 98). In every section of Article 31-B where a leasehold interest is addressed, it is placed in its own category. "Leaseholds" are included within the definition of real property as a category separate and distinct from "lands, tenements or hereditaments, including buildings, structures and other improvements thereon" (Tax Law § 1440[6]; emphasis added). An improvement is not a third category of "real property", with lands and leaseholds making up the other two categories. Rather, real property consists of land with the improvements on it "and leaseholds". Tax Law § 1440(4) includes a "leasehold interest" within the definition of an interest in real property. However, Tax Law § 1440(former [7]) provides that the creation of lease or sublease is a taxable transfer of real property only where: (1) the lease is for longer than 49 years; (2) substantial capital improvements are or will be made; and (3) the lease is for substantially all of the property constituting the real property. The Division's position is that any improvement to the leasehold premises (in this case, the land since the lease is strictly a land lease) is "real property" whether the improvement was intended to be permanent or not. In accordance with this interpretation of the statute, the creation of a lease or sublease would be subject to gains tax only if the statutory criteria are met, but the transfer of a leasehold interest pursuant to an entity transfer would always be subject to gains tax, regardless of the term of the lease or whether substantial capital improvements were made to the leasehold. The Legislature cannot have intended such a disparate result based only on the manner of transfer. Moreover, 20 NYCRR former 590.28(c), specifically referred to by the Division in its Statement of Audit Adjustment, states that the original purchase price of a lessee for his leasehold interest includes:

> "costs incurred by the lessee to acquire the leasehold interest . . ., consideration paid for an option to renew the lease or purchase the underlying property, and the costs of any capital improvements made by the lessee" (emphasis added).

I can find no basis in the statute or regulations to read Tax Law § 1440(6), as the Division does, to include within the definition of real property "leaseholds and improvements thereto".

The Division also contends that the definition of real property found in the Real Property Tax Law ("RPTL") should be considered to determine whether the System is real property under the Gains Tax Law. As a general principle, the definition of real property found in the Real Property Tax Law is not relevant to the taxes imposed by the Tax Law (see, Matter of Merit Oil of New York v. New York State Tax Commn., 124 AD2d 326, 508 NYS2d 107; Matter of Rosenberg v. State Tax Commn., 101 AD2d 645, 475 NYS2d 554; Matter of Broadway Home Sales Corp. v. State Tax Commn., 67 AD2d 1029, 413 NYS2d 231, lv denied 46 NY2d 713, 416 NYS2d 1027). The definition of real property found in Article 31-B is considerably different from the 10-paragraph definition found in the RPTL. Where the Legislature intended to incorporate the RPTL definition of real property into the Tax Law, it did so explicitly (see, Tax Law § 1105[c][3][iii]). The Article 31-B definition of real property does not refer to the RPTL, and there is no indication in Article 31-B that the Legislature intended the RPTL to be used as a guide to interpret Article 31-B. I can think of no way to reconcile the Division's interpretation of the term "real property" as used in section 1440(6) with the provisions of Tax Law § 1440(4) and (former [7]). The Division has not attempted such a reconciliation. In sum, I find that the System was not, in and of itself, real property as that term is defined in Tax Law § 1440(6).

F. In accordance with Tax Law § 1440(5)(former [a]) and the regulations, the Partnership's original purchase price included the price paid by Indeck to acquire the leasehold interest and the option to purchase the underlying property and the costs of any capital improvements. The central issue then is whether the System was a capital improvement. Article 31-B does not contain a statutory definition of a capital improvement. However, the Division has promulgated a definition in its regulations interpreting Tax Law § 1440(5)(former [a]). 20 NYCRR former 590.16(a) (currently 590.17[a]) provides:

> "Question: How is the term capital improvement defined?
>
> "Answer: A capital improvement is, for the most part, an improvement, a modification, a betterment, or an addition made to real property which:
>
> "(1) is intended to be permanently affixed to the real property; and
>
> "(2) has a useful life substantially beyond the year following installation."

I agree with the Division that the statutory definition of a capital improvement found in Article 28, governing sales and use taxes (Tax Law § 1101[a][9]), does not dictate what is a capital improvement for purposes of the gains tax. If the Legislature intended to incorporate the sales tax definition into the gains tax, it could have done so explicitly, as it did when it chose to define real property by reference to the RPTL in section 1105(c)(3)(iii) of Article 28. The governing definition in this proceeding is that found in the Commissioner's gains tax regulations (20 NYCRR former 590.16[a]).

There is no question that the System "has a useful life substantially beyond the year following installation" (20 NYCRR former 590.16[a]). Its useful life was estimated to be longer than 20 years, perhaps twice as long as that. Therefore, the first of the two conditions for determining what is a capital improvement has been satisfied.

In order to find that the System is a capital improvement, it must also be found that it was "intended to be permanently affixed to the real property" (20 NYCRR former 590.16[a]). This second requirement is very similar to the third prong of the definition of capital improvement found in the Sales Tax Law. To qualify as a capital improvement under Article 28, it must be established that the subject property "[i]s intended to become a permanent installation" (Tax Law § 1101[b][9][i][C]). Accordingly, those cases which specifically consider this requirement provide useful guidance. Petitioner cites to two such cases, <u>Matter of Emery Air Freight v. New York State Tax</u>

Appeals Tribunal (188 AD2d 772, 591 NYS2d 264) and Matter of Merit Oil v. New York State Tax Commn. (124 AD2d 326, 508 NYS2d 107). In both cases, the court cites to the general principle that "in situations where the petitioner reserves the right to remove installed property from leased premises, a finding of permanency is unlikely" (Matter of Emery Air Freight v. New York State Tax Appeals Tribunal (supra, 591 NYS2d at 265, citing Matter of Glenville Cablesystems Corp. v. State Tax Commn., 142 AD2d 851, 852, 531 NYS2d 137; Matter of Merit Oil v. New York State Tax Commn., supra). In both cases, the court looked to the lease agreements to determine whether the taxpayer reserved the right to remove the installed property from the leased premises. I will do the same.

The Land Lease and Steam Supply Agreement are interrelated. The Land Lease provides:

> "The Lessor and the Lessee have entered this date an energy services agreement ('Steam Supply Agreement') pursuant to which Lessee will design, construct, own and maintain a cogeneration system that will supply Lessor with thermal energy and supply third party with electrical energy pursuant to a power purchase contract ('the System'). The land to be leased hereunder is the land on which the System will be built" (Land Lease, p. 1).

There are several provisions in both the Steam Supply Agreement and the Land Lease which indicate that lessor and lessee did not intend the System to be "permanently affixed to the real property" (20 NYCRR former 590.16[a]). Section 5 of the Steam Supply Agreement states:

> "Service Company shall own the System . . . . The System shall remain personal property and no item thereof shall become a fixture of the Project Site, notwithstanding its installation on or attachment to

> real property . . . . Upon the expiration of this Agreement, Service Company, at the option and expense of Service Company, can enter the Project Site and disconnect and/or remove the System unless Customer purchases pursuant to Section 14b."

In the event International Paper elects not to purchase the System as provided for in section 14b, Indeck reserved the right "to remove all or part of the System from the Project Site" (Steam Supply Agreement, § 14[c]). The Land Lease agreement provides that at the expiration of the lease, "Lessee shall have a reasonable time to enter on the Premises and dismantle and remove the System from the Premises at Lessee's cost" (Land Lease, § 10.3).

The Division notes that the Steam Supply Agreement does not require Indeck to remove the System at the end of the lease term, but provides it with an option of doing so. It argues this is evidence that the installation of the System was intended to be permanent. I find this argument unpersuasive. The clear language of the contracts establishes that the System was intended by the parties to remain the personal property of the Partnership and that the Partnership reserved the right to remove the System at the end of the lease term. Providing International Paper with an option to purchase the System is further evidence that the parties viewed the System as the personal property of the Partnership, rather than a capital improvement to the real property.

Petitioners established that there is a genuine economic motive for the provisions in the agreements whereby the Partnership reserves its right to remove the System. In the

Power Sale Agreement with NIMO, Indeck represented that it would become a qualifying facility under PURPA before commencement of operation. Ms. Pishko testified that maintaining a steam host is a condition of the Partnership's maintenance of its status as a qualifying facility. Petitioners' claim that Indeck reserved the right to remove the System to guard against the financial loss which would result from loss of its steam host and/or its contract with NIMO was entirely credible.

The Division asserts that section 9.4(c) of the Steam Supply Agreement "contradicts Ms. Pishko's claim that the loss of International Paper as a steam host would result in the voiding of the power sale agreement with NIMO" (Division's brief, p. 19). That provision allows Indeck to seek a waiver of the steam usage requirements from the appropriate authorities which would allow it to continue to operate as a qualified facility or a nonregulated power producer in a way that will not affect the Power Sale Agreement with NIMO. There is no evidence in the record regarding Indeck's chances of receiving such a waiver or of the possibility of its operating profitably without qualified facility status. To the contrary, all of the evidence indicates that the Partnership's economic viability is dependent upon its status as a qualifying facility under Federal and State law. The minimum steam purchase requirements (Steam Supply Agreement, § 9.2) are established by reference to PURPA, and they demonstrate the importance to the Partnership of maintaining its status as a qualifying facility. In case of a termination of the operations of International Paper, section 9.4(a) of the

Steam Supply Agreement requires International Paper to use its best efforts to sell or lease its plant provided that the purchaser must assume the minimum steam purchase requirements under the agreement. Both International Paper and the Partnership agree to search for a substitute to meet the qualified facility requirement. Only if these alternatives fail may the Partnership seek a waiver of the steam usage requirement. These provisions supply further evidence that the economic viability of the Oswego facility is dependent upon the Partnership's ability to operate within the Federal and State regulatory scheme, i.e., to have and keep a steam host.

Ms. Pishko credibly testified that the System could be removed from the premises and either used in another location or resold. She also testified that there is a market for used power generating equipment like that installed at the Oswego facility. The HDR Report and Mr. Logeais's testimony established that the System, with an approximate value of $43,000,000.00, could be dismantled and moved at a cost of about $2,300,000.00. Mr. Logeais has extensive experience in engineering activities related to power and energy. He personally has been involved in a project that involved dismantling and moving a gas turbine generator 2½ times the size of the generator which makes up a part of the System. Based on his expertise and experience, he determined that the equipment that comprises the System is not permanently affixed to the real estate, is physically and practically capable of being moved and would have practical and economic usefulness at another site.

None of petitioners' factual evidence was effectively refuted by the Division. Consequently, I find that the dismantling and removal of the System is economically and physically feasible. In their brief, petitioners discuss the status of the System as a "trade fixture" under New York law. While the cases cited by petitioners offer interesting points of comparison with Article 31-B of the Tax Law, I do not find it necessary to look so far afield for guidance. The Commissioner's regulations clearly state that a capital improvement is an improvement or addition to real property which "is intended to be permanently affixed to the real property" (20 NYCRR former 590.16[a]). Here, there is no affirmative evidence that the System was intended to be permanently affixed. The Land Lease and Steam Supply Agreement prove that the System is the personal property of the Partnership and that the Partnership reserved the right to remove the System from the premises. Petitioners' evidence established that there were sound business and economic motives for the reservation of the right to remove the System, that the System could be dismantled and removed without damage to it or the real property to which it was affixed, and that the cost of moving the System is justified by the value of the System. Accordingly, I find that the System is not a capital improvement pursuant to Tax Law § 1440(former [5][a]) and, therefore, the costs of purchasing and installing the System are not includible in Indeck's original purchase price or in the consideration for the transfer of a controlling interest in the Partnership pursuant to Tax Law

§ 1440(1)(c).

G. Petitioners' other arguments are confusing and in conflict with the evidence in the record. Although petitioners did not consider the System to be a capital improvement, it is apparent that capital improvements were made to the real property. Mr. Logeais testified that the System was affixed to concrete foundations, which I assume were permanently affixed to the real property. The System was connected to wires, steel pins and pipes, all of which appear to be permanent installations. In addition, there were buildings and other structures on the property which presumably did not meet Mr. Logeais's criteria for items included in his report. By their own filings, petitioners conceded that the consideration for the transfer attributable to real property amounted to $1,004,353.00 and that there was a gain subject to tax of $401,165.00. For the first time in their brief, petitioners contend that the consideration for the transfer attributable to the real property is less than $1,000,000.00. Petitioners did not make this assertion at hearing or in their petition. No facts were brought out at hearing which would imply that such a position was being taken. These arguments raise issues of fact as well as law. For that reason, I will treat petitioners' arguments in the brief as a motion to amend the pleadings, and I deny that motion.

H. Tax Law former § 1402, in effect at the time of the transfer of a controlling interest, imposed a tax on the conveyance of real property or an interest therein. Section

1401(d)(iii) of the real estate transfer tax, defining consideration for purposes of Article 31, is similar to section 1440(1)(c) of the Gains Tax Law. It states that in an entity transfer "consideration shall mean the fair market value of the real property or interest therein, apportioned based on the percentage of the ownership interest transferred or acquired in the entity." The additional consideration determined by the Division under Article 31 is premised on the contention that the System constitutes "real property" in accordance with Article 31. For the reasons stated above, I find that the Partnership's interest in real property did not include the value of the System.

I. Tax Law § 1444(3)(a)(2) provides:

> "If a taxpayer files with the division of tax appeals a petition for review of taxes determined or claimed to be due under this article, the division of tax appeals shall have the power to determine a greater amount of tax to be due . . . if a claim therefor is asserted at or before the hearing under rules of the division of tax appeals."

Under the authority of this provision, the Division asserts that additional gains tax is due pursuant to 20 NYCRR 590.9. As relevant, it provides:

> "Question: If an agreement is negotiated between a transferor and transferee whereby the transferee agrees to pay the gains tax for the transferor, does such payment constitute additional consideration to the transferor?
>
> "Answer: Yes. The consideration for the transfer is the price paid or required to be paid for the real property or any interest therein, and includes the cancellation or discharge of an indebtedness or obligation. Since the transferor is personally liable for payment of the gains tax, payment of the tax by the transferee constitutes additional consideration to the transferor" (emphasis added).

There is no evidence that an agreement was negotiated between Indeck and AT&T whereby AT&T agreed to pay the gains tax for Indeck. It would seem that AT&T as a transferee is personally liable for payment of the tax under Tax Law § 1447(3)(a) because of the failure of the transferor and transferee to make the required filings before, or within 15 days after, the transfer. The Division issued notices and demands to AT&T for gains tax also assessed against Indeck, indicating that it saw some relationship between Tax Law § 1447(3)(a) and AT&T's liability. The Division did not discuss any statutory authority that would explain the issuance of those notices. Because the facts adduced do not show an "agreement" within the language of 20 NYCRR 590.9 and because the Division has provided little explanation for its position, I deem it inappropriate for the Division of Tax Appeals to exercise the authority provided it by Tax Law § 1444(3)(a)(2).

J. Petitioners claim that their position regarding the status of the System as real or personal property is based on substantial authority, so that their failure to pay the gains tax assessed by the Division is the result of reasonable cause and not of willful neglect. Here, petitioners failed to make the required gains tax filings and to pay the gains tax at the time of the transfer, or within 15 days thereafter, in accordance with Tax Law § 1442. Accordingly, a penalty was properly imposed on the amount of gains tax Indeck reported to be due with its late filings. Petitioner has not shown reasonable cause for this failure to comply with the Tax Law.

I find petitioners' position regarding the System's status as a capital improvement to be reasonable and consistent with 20 NYCRR former 590.16(a). In its brief, petitioners cited to and analyzed New York State law on "trade fixtures" to support its contention that the System did not become real property after being installed on the real property. Although I found it unnecessary to refer to this authority in making a determination on the central issue of this proceeding, I find that it lends support to petitioners' contention that its position is supported by substantial legal authority.

K. The petition of Indeck Energy Services of Oswego, Inc. and AT&T Credit Corporation is granted to the extent indicated in Conclusions of Law "F" and "H"; AT&T's request for a refund of tax paid (claim R-2008) is granted; amounts paid pursuant to notices L-006929619-3, L-005316722-9 and L-007148398-5 shall also be refunded; any penalty and interest imposed as a result of the late filing and payment of the real estate transfer tax and real property gains tax filings is sustained.

DATED: Troy, New York
November 9, 1995

/s/ Jean Corigliano

ADMINISTRATIVE LAW JUDGE