

STATE OF NEW YORK
DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
WATERMAN INVESTMENT COMPANY	:	DETERMINATION
for Revision of a Determination or for Refund	:	DTA NO. 813224
of Tax on Gains Derived from Certain Real	:	
Property Transfers under Article 31-B of the	:	
Tax Law for the year 1990.	:	

Petitioner, Waterman Investment Company, c/o George H. Waterman, III, 55 Wooster Street, New York, NY 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 for the year 1990.

A hearing was held before Joseph W. Pinto, Jr., Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on November 13, 1995 at 9:15 A.M., with all briefs submitted by March 8, 1996, which date began the six-month period for the issuance of this determination. Petitioner appeared by Peter D. Oram, Esq. The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Peter T. Gumaer, Esq., of counsel).

ISSUE

I. Whether the Division properly excluded from original purchase price the June 1983 acquisition by Kalakar Corporation of a fractional interest in petitioner from Gwendolyn Waterman.

II. In the alternative, if the the acquisition of Gwendolyn Waterman's interest should have been included in original purchase price, whether the record supports an increase in the original purchase price of \$115,013, or \$55,749.00 more than Gwendolyn Waterman's acquisition cost of \$59,264.00.

III. Whether the Division properly excluded from original purchase price certain landscaping and other improvement costs alleged to have been incurred in the acquisition and improvement of the property in issue.

IV. Whether the handwritten invoices prepared and submitted at hearing by George H. Waterman, III for personal physical labor and for his services as general contractor as well as the invoice for legal services rendered were properly excluded from original purchase price by the Division.

FINDINGS OF FACT

1. Petitioner sold certain real property located on Fishers Island, New York on or about September 27, 1990. In the form TP-580, New York State Real Property Transfer Gains Affidavit, filed by petitioner prior to the sale, it stated gross consideration to be \$1,800,000.00, brokerage fees of \$180,000.00, original purchase price of \$729,000.00 and gain subject to tax of \$890,931.00. Petitioner claimed tax due on the transfer of \$89,093.00.

2. The Division issued to petitioner a tentative assessment of gains tax due prior to the transfer which made some modifications to original purchase price which resulted in gains tax due of \$123,862.30, which petitioner paid. However, after additional review of substantiating documentation, the Division issued to petitioner a Notice of Determination for additional real property gains tax due of \$19,662.00 plus interest.

3. Prior to a conference in the Bureau of Conciliation and Mediation Services, the Division reviewed additional documentation submitted by petitioner and redetermined the gain on the transfer in issue to be \$1,235,901.52, which resulted in the cancellation of the taxes assessed in the Notice of Determination and an overpayment of \$272.15.

4. Consistent with the Division's adjustment, a Conciliation Order was issued, dated July 8, 1994, which cancelled the Division's notice and allowed petitioner's refund claim to the extent of \$272.15.

5. Petitioner filed a petition for refund of \$34,497.05 based upon what it characterized as the Division's failure to allow certain acquisition costs, a step up in basis due to the

acquisition of additional interests in the property and certain expenditures it made to improve the property.

6. Between the date of the conference, June 15, 1993, and the date petitioner submitted its final documentation herein, the Division has reviewed voluminous documentation with regard to the all the issues raised by petitioner. Based upon its review, the Division has authorized the payment of an additional refund of \$395.73, raising the total refund to \$667.88.

7. Waterman Investment Company ("WIC"), a partnership, by agreement dated August 28, 1981, acquired a 79.03 percent interest in the subject property for the sum of \$185,000.00. The remainder interests were held by the Linda Low Trust, for the benefit of George Waterman's children, and Gwendolyn Waterman. The Linda Low Trust and Gwendolyn Waterman received 7.6% and 25.24%, respectively, in parcel number 2, or the main house. The other two parcels, 1 and 3, were conveyed to Kalakar Corporation (parcel 3 after certain improvements were made).

The WIC Agreement referred to above stated in paragraph "8" thereof:

"8. The parties hereto hereby appoint George H. Waterman, III, with full power of substitution, the authorized signatory for the partnership to conduct all partnership business and bind the members of the partnership as to partnership matters. The members of the partnership are the only owners as described herein of the Waterman Investment Co. property. The parties hereto agree that Exchange Escrow Trust, GDW, the Linda H. Low Trust, GHW, III and Kalakar constitute the partners in WIC for so long as each such partner shall own an interest in the property and that the partnership is a general partnership and each general partner shall have all the rights of a general partner under the New York partnership law with each partner having the full power to bind the partnership on partnership business. The partnership shall not terminate on the death or incompetence of any individual member, but the legal representative(s) thereof shall continue as a partner in such fiduciary capacity subject to all the terms hereof. Kalakar Corporation shall have a greater partnership interest in WIC on conveyance to it of parcel 1 from Exchange Escrow Trust in substitution for the partnership interest held by Exchange Escrow Trust."

8. Pursuant to the terms of a Redemption of Interest Agreement, dated June 10, 1983, Gwendolyn Waterman withdrew from the partnership (WIC), surrendering her interest therein, and was given a 36.6 percent interest in parcel "2", valued at \$100,588.00, which she immediately transferred to Kalakar Corporation. Kalakar Corporation was controlled by another corporation which was controlled by George Waterman III. In return she received other

real property from Kalakar of equal value, in accordance with a real estate exchange agreement. Therefore, the exchange was a "net wash" to Kalakar and George Waterman III, as explained by Mr. Waterman in his testimony.

9. The Real Estate Exchange Agreement, dated June 8, 1983, between Gwendolyn Waterman and Kalakar Corporation, recited her interest in parcel "2" as 36.6%, with a dollar value of \$100,588.00. In furtherance of a divorce agreement between Gwendolyn Waterman and George Waterman, Gwendolyn Waterman conveyed her 36.6% interest in parcel "2" to Kalakar Corporation, controlled by George Waterman, in exchange for Kalakar property of equal value located in Vermont and New Mexico. In essence, the transaction between Kalakar and Mrs. Waterman was a like kind exchange between a corporation ultimately controlled by George Waterman III and his wife pursuant to a divorce settlement and resulted in a shifting of partnership interests from one partner to another.

10. As of the date of the transfer, the property in issue was 100% owned by Waterman Investment Company, which was comprised of only Kalakar Corporation and the Linda Low Trust. The pre-transfer filing indicated that all the parties to the Waterman Investment Company agreement of August 28, 1981 were either Waterman family members or entities controlled or beneficially owned by the Waterman family. The expressed purpose for this was to have one entity, Waterman Investment Company, with record title despite shifting interests between family members or entities beneficially owned by them.

Kalakar's interest in the property at the time of the sale, 94.24%, was garnered from an initial interest in parcel "2" and "3" pursuant to agreement; acquisition costs paid to other parties to the WIC Agreement; the acquisition of Gwendolyn Waterman's interest in parcel "2" upon George Waterman's divorce from Gwendolyn Waterman in 1983; the 1984 acquisition from George Waterman III of an additional one quarter interest in parcel "2"; a second acquisition in 1984 of a six percent interest in parcel "2" for accepting the obligation to repay the Trust's money held by the Escrow Agent pursuant to the Agreement; and in 1989, before

parcel "1" was sold, Kalakar accepted George Waterman's remaining interest in parcel "2" for a partial interest in parcel "1".

11. Petitioner made several submissions of documentation to the Division which it felt accurately showed the capital improvement expenditures made by it during a period of time between 1979 and 1990. After each of its submissions, petitioner received a response from the Division which examined and then determined which expenditures it could accept as capital improvements or costs directly related to capital improvements. As of the date of the conference, the Division allowed a total of \$384,098.48 in capital improvement costs. This took into account the purchase price of \$143,000.00, other acquisition costs of \$65,637.00, improvements to the main house and cottage of \$171,257.48 and legal costs of \$4,204.00.

12. Immediately prior to the conference, petitioner submitted a memorandum with documentation, dated June 8, 1993, addressed to Ms. Mary Ann Witkowski, totalling seventeen pages, which set forth numerous capital improvement expenses. On July 20, 1993, Ms. Nancy Boice, Division advocate at the conference, responded to each and every item listed by petitioner in its memorandum. Ms. Boice rejected certain costs for the following reasons: (1) the documentation did not give a description that verified the expenditure was for the property in question; (2) other costs were disallowed because the documentation did not give enough description to determine if the cost was allowable; (3) some costs were listed without any documentation; (4) other costs were disallowed because they were accompanied by a schedule denoting the check number, names and amounts which were determined to be insufficient documentation to determine if the costs were allowable capital improvements; some of the costs were determined to be repairs, maintenance and personal property; other costs were attributed to the Windmill property which was not the realty transferred herein; there were duplicate costs; and items were included which were not allowable selling expenses.

On July 23, 1993, petitioner made a partial response to Ms. Boice's determination which explained why it sought to take expenses incurred prior to the acquisition in 1981, saying that

the improvements were done pursuant to an oral agreement among close family members. Petitioner took issue with the Division's rejection of renovation costs incurred in 1983 for wallpapering, electrical switches and receptacles and lighting fixtures. In addition, petitioner contended that the expenditure for cypress gutters added to the house in 1985 should have been allowed as a capital improvement.

13. Petitioner submitted a more detailed response to Ms. Boice's initial determination of July 20, 1993 on February 4, 1994, some six months later, which included additional documentation and written explanations of the expenditures. In addition, there was a legal memorandum included which discussed the issue of a step-up in basis for the interest exchanged by Gwendolyn Waterman and Kalakar Corporation.

14. Following petitioner's final submission to Ms. Boice on February 5, 1994, she reviewed all that had been given to her and submitted her final figures to the conferee as set forth above in finding of fact "3". In summary, she allowed \$180,000.00 for brokerage commission, \$384,098.48 for original purchase price, resulting in a gain of \$1,235,901.52, yielding a tax of \$123,590.15 and a refund owed of \$272.15. The conciliation order reiterated the same figures as this Division submission.

15. In order to clarify her final determination submitted to the conferee, Ms. Boice prepared a memorandum for Mr. Gumaer, the Division's representative, dated June 29, 1995, which set forth in great detail those expenditures challenged by petitioner. Because of their importance to the issues herein, critical portions of that memorandum have been appended hereto as "Appendix A".

16. In an affidavit prepared by George H. Waterman, III, dated July 21, 1995, Mr. Waterman explained why he believed that another \$143,190.43 of capital improvements should have been allowed. Mr. Waterman stated in the memorandum that:

"[t]his memorandum was written prior to the assembly of the checks making up the complete claim for landscaping improvement costs in number 4 document listed below, amounting to \$55,000 after an allowance for normal lawn and leaf raking maintenance costs, reduced for the ten percent of the landscaping costs I have allocated to the windmill portion of the property sold separately and previously to the sale of the main house and adjacent cottage in 1990 and the

\$9,010 in landscaping costs included in document number 3 below, second total, accounts for the difference of \$39,596 between the above total claim of \$173,583 in additional costs and the \$143,190 claim in document number 1."

17. A second seven page document attached to Mr. Waterman's affidavit was a compilation of checks written by Mr. Waterman for improvement and landscaping costs. In addition Mr. Waterman included a summary of landscaping costs of Potowomut Investment Co., Waterman Management Corp., Kalakar and George Waterman III for the years 1978 through 1990.

18. At hearing, petitioner submitted the same twelve page exhibit which it had attached to its petition. It also submitted substantiation related to this exhibit. One submission, Petitioner's exhibit number "2", was entirely related to expenses incurred in the years 1979 and 1980 for remodeling and landscaping. Another submission, contained checks from Potowomut Investment Company, George H. Waterman III and Kalakar Corporation in payment of invoices for expenditures concerning the main house on Fishers Island. In addition, petitioner submitted documentation which allegedly represented landscaping costs for the Fishers Island property between 1979 and 1990. It contained numerous checks and ledger sheets from the books of Potowomut Investment Company, Kalakar Corporation and Waterman Management Corporation which were stated to be for landscaping improvements to the property.

19. At hearing, petitioner submitted three unpaid invoices for legal services of Peter D. Oram, Esq., \$17,000.00; personal labor of George H. Waterman III for landscaping work, billed at \$10.00 per hour over a 12-year period for 3,300 hours, \$33,000.00; and a bill for general contracting services by George H. Waterman III for the same 12-year period, 1978-1990, in the sum of \$45,000.00. Each of these invoices was prepared immediately before the hearing and all were handwritten by George H. Waterman III.

20. Following the hearing, with the consent of the Administrative Law Judge, petitioner submitted an affidavit of George H. Waterman III, dated November 28, 1995, and additional documentation to substantiate further the improvement expenditures, legal fees, general contracting fees, personal labor fees, the issue of step-up in basis due to the transfer of

Gwendolyn Waterman's interest to Kalakar Corporation, the disallowed expenditures listed in the Memorandum of Ms. Boice, dated June 29, 1995, architectural and engineering expenses and other landscaping and improvement costs.

21. The Division responded to petitioner's affidavit and documentation, addressing each of the expenditures asserted by petitioner. Essentially, the Division rejected the expenditures on the following grounds:

- a) the expenditure was for personal property;
- b) the related job was not a capital improvement;
- c) the expenditure was for maintenance not a capital improvement;
- d) the listed cost was a duplicate;
- e) no documentation was provided to substantiate the cost;
- f) no description of the expenditure was provided;
- g) the expenditure related to the Windmill property.

In addition, the architectural bills submitted were disallowed because the back up documentation did not provide an adequate description or they were related to the Windmill property.

The legal bill from the law firm of Nicholas Doman was disallowed because the amount of the bill was not substantiated and there was no proof that it was paid. Similarly, the expenditure for legal services of Howard Koff, Esq. was not documented.

The Division rejected the expense claimed for transfer taxes because the regulations do not allow same as a selling expense.

The Division rejected George Waterman III's bill for general contracting and landscaping because they had not been paid and the Division had no way of knowing if the amount was reasonable, what the services were, if they were necessary or if Mr. Waterman was qualified or in the business to provide the services.

The legal bill prepared by Mr. Waterman on behalf of Mr. Oram was also rejected by the Division because there was insufficient documentation, no proof of payment, and it appeared to

be for services rendered in connection with the current legal proceedings as opposed to the sale of the property.

The Division's review resulted in an additional allowance of \$3,957.32, based upon the June 6, 1979 invoice from A.J. Gada in the sum of \$3,150.00 and \$807.32 for a built-in dishwasher from FINY Electronics. This yielded an additional refund of \$395.73. Added to the previously determined refund/overpayment of \$272.15, the total refund allowed by the Division was \$667.88.

The Division also noted discrepancies in the affidavit and exhibits submitted by petitioner after the hearing. The Division noted that the expenditures related to the main house were stated to be \$99,691.42 but were documented only to the extent of \$99,140. The stated total of expenditures with regard to the cottage was listed as \$11,423.45 while the exhibits only documented \$8,263.35.

STATEMENT OF THE PARTIES' POSITIONS

22. Petitioner argues that the June 1983 acquisition by Kalakar from Gwendolyn Waterman was the acquisition of a fractional interest in real property and not consideration for an interest less than a controlling interest in an entity which held real property. Therefore, petitioner believes that such consideration should be a part of petitioner's original purchase price.

23. Petitioner argues that its submissions justify further capital improvement expenditures and also the amounts paid to George H. Waterman III and Mr. Oram, for general contracting and landscaping services to the former and legal services for the latter.

24. Finally, petitioner claims that the Division is taxing it on a gain it did not realize by not allowing all the expenditures petitioner has claimed during this proceeding.

25. The Division argues that it properly determined that Kalakar's acquisition of Gwendolyn Waterman's interest in the petitioner was not includible in petitioner's original purchase price.

Further, the Division contends that it properly excluded those expenditures which were characterized by petitioner as capital improvement expenditures or proper selling expenses for the reasons stated by it in the facts above. Further, the Division maintains that the three bills prepared and submitted by petitioner at hearing should be disallowed because they were unpaid, were manufactured evidence and were patently self-serving.

CONCLUSIONS OF LAW

A. Tax Law § 1441 imposes a 10% tax upon gains derived from the transfer of real property located within New York State. Tax Law § 1443(1) provides for an exemption from gains tax when the consideration is less than \$1,000,000.00.

B. Tax Law § former 1440.7 defined "transfer of real property," in part, as follows:

"'Transfer of real property' means the transfer or transfers of any interest in real property by any method, including but not limited to sale, exchange, assignment, surrender, mortgage foreclosure, transfer in lieu of foreclosure, option, trust indenture, taking by eminent domain, conveyance upon liquidation or by a receiver, or transfer or acquisition of a controlling interest in any entity with an interest in real property Transfer of real property shall also include partial or successive transfers, unless the transferor or transferors furnish a sworn statement that such transfers are not pursuant to an agreement or plan to effectuate by partial or successive transfers a transfer which would otherwise be included in the coverage of this article" (Emphasis added.)

The term "controlling interest" is defined in Tax Law § 1440.2, in relevant part, to mean:

"(ii) in the case of a partnership . . . fifty percent or more of the capital, profits or beneficial interest in such partnership"

The property in issue was acquired by Waterman Investment Company on August 28, 1981 and it remained the record owner until the sale in 1990 which gave rise to the gains tax in issue herein. The acquisition was pursuant to the terms of the Waterman Investment Company Agreement, dated August 28, 1981, between seven different parties, including Gwendolyn Waterman.

On June 10, 1983, pursuant to a redemption agreement, the partnership conveyed a 36.6 percent interest in parcel "2", valued at \$100,588.00, to Gwendolyn Waterman, in consideration of her withdrawal from the partnership. She immediately transferred the interest to Kalakar Corporation and received real property in Vermont and New Mexico of equal value, pursuant to

an exchange agreement, dated June 8, 1983. These transactions stemmed from a divorce settlement between George and Gwendolyn Waterman.

The salient facts are indisputable, i.e., that Waterman Investment Co., in consideration of Gwendolyn Waterman's assignment of her interest in Waterman Investment Company, transferred a 36.6 percent interest in some of its property to Gwendolyn Waterman and then reacquired it through one of its partners, Kalakar Corporation, an entity controlled by George Waterman III. Kalakar exchanged interests in other properties it held to the extent of the value of Gwendolyn Waterman's 36.6 percent interest in parcel "2".

In order for the acquisition of Gwendolyn Waterman's interest in the partnership, Waterman Investment Co., to be considered a "transfer of real property", it must be an "acquisition of a controlling interest in any entity with an interest in real property." Tax Law § former 1440.7. WIC's acquisition of Gwendolyn Waterman's interest was not such an acquisition since her interest was not a controlling interest in WIC as that term is defined in Tax Law § 1440.2:

" . . . in the case of a partnership, . . . fifty percent or more of the capital, profits or beneficial interest in such partnership. . . ."

The regulations at 20 NYCRR former 590.44(a) state, in pertinent part, as follows:

"In the case of a partnership . . . the acquisition occurs when a person or group of persons, acting in concert, acquires a total of 50 percent or more of the capital, profits or beneficial interest in such entity."

Further, Kalakar Corporation's acquisition of Gwendolyn Waterman's interest in the real property was not the acquisition of a controlling interest since in and of itself her interest was not a controlling interest, and it could not be aggregated with the acquisition of any prior interest because the prior acquisition by Kalakar was pursuant to the 1981 Waterman Investment Company Agreement.

The regulation at 20 NYCRR former 590.45(c) provided that for purposes of determining whether a controlling interest is acquired, only acquisitions of interests occurring after March 28, 1983 are added together. That was not the case herein, where Kalakar acquired its prior interest in 1981. Therefore, assuming arguendo that Kalakar had a controlling interest in

Waterman Investment Company prior to its acquisition of Gwendolyn Waterman's interest, it could not have acquired an additional controlling interest when it acquired her interest. Id.

Petitioner argues for a step-up in its original purchase price based upon Kalakar's acquisition of Gwendolyn Waterman's interest. However, it has already been determined that the acquisition was not that of a controlling interest, therefore no step-up in original purchase price is warranted. The regulation at 20 NYCRR former 590.49(b) specifically provided:

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

In Matter of Calverton Property Company, Tax Appeals Tribunal, December 15, 1994, the Tribunal said:

"Where a partner or partners acquire less than a controlling interest in a partnership, the entity (and thereby the individual partners) may not step-up its basis in the original purchase price of the real property."

Likewise, in Matter of SKS Associates T/A Fardale Gardens, Tax Appeals Tribunal, September 12, 1991, the Tribunal was unequivocal when it said:

"In the absence of a taxable event the regulation at 20 NYCRR 590.49(b) explicitly disallows the entity a step-up in its original purchase price in the real property."

For all of the above reasons petitioner's request for a step-up in its basis due to the acquisition by Kalakar is denied.

Petitioner's argument that there was no transfer of a partnership interest only an acquisition of property by Kalakar ignores the facts, law and regulations. Petitioner does not address the central issue, i.e., that WIC transferred a valued interest in its capital to Gwendolyn Waterman in consideration of her partnership interest. Gwendolyn Waterman simultaneously transferred that interest to Kalakar, another partner in WIC. As petitioner pointed out, the partners in WIC determined their shares in the partnership by the amount of capital they brought to the partnership. Kalakar's acquisition of a 36.6 percent interest in parcel "2" increased its share in the partnership, but it was not the acquisition of a controlling interest, and therefore not a taxable event which would have justified a step-up in basis as discussed above. Further, it was not a purchase of additional property by WIC which should be added back to OPP, as

petitioner argues, but the acquisition of an additional interest by Kalakar in the partnership property as structured by Mr. Waterman in furtherance of his divorce settlement. In return, Gwendolyn Waterman received a valued interest and ultimately real property of equal value. Therefore, it can not be characterized as the purchase of real property by WIC and added to OPP. It was the mere shifting of interests in the partnership which did not amount to either the acquisition of a controlling interest or the purchase of additional property.

In an attempt to justify adding the value of Gwendolyn Waterman's 36.6% interest in parcel "2" to OPP, petitioner reasons that Kalakar had to purchase it from her and that said consideration should be added to OPP. However, as a transfer, it should not be aggregated with any other transfer because of the exemption set forth in Tax Law § 1440.7(b)(i).

Kalakar was owned by an entity which was controlled by George Waterman III. To settle his divorce from Gwendolyn Waterman, he exchanged properties owned by Kalakar of equal value to her interest in parcel "2" in order to eliminate her ownership in WIC. The reality of the transaction was an exchange of Kalakar-owned property by George Waterman III and Gwendolyn Waterman effecting a transfer of her interest in WIC to Kalakar. Therefore, Kalakar, a corporation controlled by George Waterman III, traded properties of equal value, a "net wash" in Mr. Waterman's own words, thereby shifting interests in the WIC general partnership, but not constituting the acquisition of a controlling interest which would have justified a step-up in basis.

C. The second issue to be determined is whether certain claimed capital improvement costs should be included in the original purchase price. 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, when the consideration exceeds the original purchase price."

The Commissioner's regulations define "original purchase price" as follows:

"Generally, the original purchase price of real property is the consideration paid or required to be paid to acquire the real property plus the consideration paid or required to be paid for the construction of any capital improvements made or required to be made to the real property plus certain fees incurred to sell the property" (20 NYCRR former 590.14).

With respect to the specific items which were disallowed as capital improvements, it should be kept in mind that the burden of proof was upon petitioners to establish their claims (20 NYCRR 3000.10[d][4]).

Petitioner has submitted literally hundreds of checks, journals, check registers and invoices over the past several years to substantiate what it considers to be either legitimate selling expenses or capital improvements or costs directly attributable to capital improvements incurred by it over the term of years it has owned the property, from 1981 to 1990 and some expenditures made prior to its ownership. The Division has reviewed the documentation on several occasions, and made specific determinations as to the propriety of each of the expenditures. (See, e.g., Appendix A). The Division has accepted \$384,098.48 in costs determined to be valid original purchase price expenditures.

With regard to the capital improvements, the regulations define capital improvement as an improvement, modification, betterment or addition to real property which is intended to be permanently affixed to the real property and which has a useful life substantially beyond the year following installation. (20 NYCRR former 590.16[a]). The regulations provide a partial list of items which, if associated with the construction of a capital improvement, are included in the original purchase price. However, the regulation states that the cost is only allowable if shown to relate directly to the capital improvements made to the property being transferred. (20 NYCRR former 590.16[b]).

On the other hand, the regulations specifically stated that expenses which were incurred to repair and maintain the property in a condition of fitness, readiness and/or safety, or to preserve such condition, are not allowable. (20 NYCRR former 590.16[f]). That there is room for discretion is clear from the regulation when it stated that "in some cases involving real property, certain expenses are treated as repairs and in other cases may be considered a capital improvement. Id.

The Division herein exercised its discretion liberally in allowing \$384,098.48 in OPP. Petitioner has not demonstrated that the assessment or audit (the original assessment upon

which real property gains tax was paid, as opposed to the assessment cancelled at conference) was in error. Further, the Division has carefully analyzed and reviewed the documentation and claims made by petitioner, as demonstrated by Appendix A, and its determinations on same are hereby confirmed.

The Tax Appeals Tribunal reviewed the standards to be met by each of the parties and that which is invoked by the issuance of an assessment in its decision of Atlantic & Hudson Limited Partnership (Tax Appeals Tribunal, January 30, 1992):

"Although a determination of tax must have a rational basis in order to be sustained upon review (see, Matter of Grecian Sq. v. New York State Tax Commn., 119 AD2d 948, 501 NYS2d 219), the presumption of correctness raised by the issuance of the assessment, in itself, provides the rational basis, so long as no evidence is introduced challenging the assessment (see, Matter of Tavalacci v. State Tax Commn., 77 AD2d 759, 431 NYS2d 174; Matter of Leogrande, Tax Appeals Tribunal, July 18, 1991). Evidence that both rebuts the presumption of correctness and indicates the irrationality of the audit may appear: on the face of the audit as described by the Division through testimony or documentation (see, Matter of Snyder v. State Tax Commn., 114 AD2d 567, 494 NYS2d 183; Matter of Fortunato, Tax Appeals Tribunal, February 22, 1990); from factors underlying the audit which are developed by the petitioner at hearing (see, Matter of Ristorante Puglia, Ltd. v. Chu, 102 AD2d 348, 478 NYS2d 91; Matter of Fokos Lounge, Tax Appeals Tribunal, March 7, 1991 [where the petitioner proved that its utility meter readings bore no relationship to its level of business activity]); or in the inability of the Division to identify the bases of the audit methodology in response to questions posed at the hearing (see, Matter of Basileo, Tax Appeals Tribunal, May 9, 1991; Matter of Fokos Lounge, Tax Appeals Tribunal, March 7, 1991; Matter of Shop Rite Wines & Liqs., Tax Appeals Tribunal, February 22, 1991; Matter of Fashana, Tax Appeals Tribunal, September 21, 1989). However, where, as here, petitioner has failed to make any inquiry into the audit method or calculation, the presumption of correctness raised by the issuance of the assessment provides the rational basis for the assessment. To hold otherwise would be in irreconcilable conflict with the principles that the Division does not have the burden to demonstrate the propriety of its assessment (see, Matter of A & J Gifts Shop v. Chu, 145 AD2d 877, 536 NYS2d 209, lv denied 74 NY2d 603, 542 NYS2d 518; Matter of Blodnick v. New York State Tax Commn., 124 AD2d 437, 507 NYS2d 536, appeal dismissed 69 NY2d 822, 513 NYS2d 1027; Matter of Scarpulla v. State Tax Commn., 120 AD2d 842, 502 NYS2d 113) and that the petitioner has a heavy burden to prove the assessment erroneous (see, Matter of Executive Land Corp. v. Chu, 150 AD2d 7, 545 NYS2d 354, appeal dismissed 75 NY2d 946, 555 NYS2d 692)."

Petitioner has not met its burden of proving that the Division's adjustments were in error (20 NYCRR 3000.10[d][4]). The evidence submitted to contradict the propriety of the Division's determination was not adequate and did not demonstrate that the Division's audit methodology or conclusions were in error. Tax Law § 1448.3 provides that every transferor

who is subject to tax is required to keep complete records of acquisitions and transfers of interests in real property and controlling interest. The law also requires that the taxpayer keep records of the costs and dates of improvements which reflect the acquisition or transfer of an interest in real property. This section further provides that such records shall be made available for inspection and examination at any time upon demand by the Division. Petitioner herein did not comply with this statutory requirement.

After carefully reviewing all the materials submitted by petitioner at and after hearing, the testimony of George Waterman III, and each of the responses of the Division to all the submissions made by petitioner since the audit began, it hereby is determined that the Division's audit results were arrived at after a careful analysis of each of petitioner's submissions and were grounded in a rational basis which petitioner has not demonstrated to be in error. As stated above, the burden on petitioner to show that the Division's audit was without a rational basis or in error is very heavy. (Matter of Executive Land Corp. v. Chu, *supra*). The party challenging the assessment bears the burden of establishing, by clear and convincing evidence, that the tax was erroneous. (Matter of George E. Bello, 623 NYS2d 363, 213 AD2d 754). As stated above, in the definition of "original purchase price" contained in Tax Law § 1440.5(a), the Division is vested with the authority to determine which capital improvement costs are customary, reasonable and necessary, and also the customary, reasonable and necessary legal, engineering and architectural fees incurred to sell the property.

Petitioner's documentation was fragmented, incomplete, haphazard in organization and often not shown to be related to capital projects. Its summary totals were not consistent with documentation submitted, raising a credibility issue as well as an adequacy issue. Therefore, petitioner has not met its burden of proof and is only entitled to the refund of \$667.88, as explained in finding of fact "21" above.

Further, the three unpaid bills prepared and submitted at hearing were highly suspect. Handwritten at the hearing by George Waterman III, admittedly not paid and not supported by source documentation, the bills cannot be accepted as valid costs includible in OPP as that term

is defined in the statute or regulations. The legal costs associated with the sale of the property were already credited to petitioner, as stated by the auditor, and the additional costs incurred for challenging the tax are not acceptable. The personal labor charges of Mr. Waterman were not substantiated and appear to be maintenance in nature. Mr. Waterman's testimony was not credible given its lack of specificity, clarity and broad-brush estimates of time devoted to personal labor on Fishers Island. Finally, the general contracting charge submitted by Mr. Waterman is totally without factual basis. There was no proof in the record that he ever intended to charge such a fee during the years he owned the property or that the fee set forth on the bill was reasonable or that George Waterman III was qualified to be a general contractor. At best, the circumstances raise serious doubt as to the veracity of the claimed services. It seems self-serving and less than genuine to prepare and submit such a bill at hearing, years after the sale of the property, to substantiate an increase in OPP, where one of the central issues at the hearing is substantiation of costs. Very little weight can be accorded such documentation given petitioner's inability to produce any further source documentation regarding the charges, a duty and burden solely its own. Therefore, the Division's refusal to accept said bills is sustained.

D. The petition of Waterman Investment Company is granted to the extent set forth in Conclusion of Law "C" above, consistent with the allowances made by the Division, but in all other respects it is denied.

DATED: Troy, New York
September 5, 1996

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

APPENDIX A

"The documentation did not give enough description to determine if the following costs were allowable:

<u>Item #</u>	<u>Date</u>	<u>Payee</u>	<u>Amount</u>
11	11/16/79	A.J. Gada (Agree per 2/94 letter out)	\$ 344.80
21	12/10/80	A.J. Gada (Still no description of services)	581.80
22	12/31/81	Improvement reimbursed by trust 5/7/82 (Still no description of services)	1,977.00
102	06/08/91	H. Harlow }	1,000.00
103	06/15/81	H. Harlow } (Not in labor agreements)	1,000.00
107	06/24/81	H. Harlow }	1,300.00
110	07/07/81	G. C. Witmore Co. (Agreed out per 2/94 letter)	213.00
126	10/02/81	Poquonnock Welding (Agfeed out per 2/94 letter)	244.54
154	05/13/85	Fishers' Island Ferry (Windmill) C. Rowley (Was working on Windmill Contract, did verify work @ main house)	225.20 1,810.00
183	07/16/87	Gates & Beckwith (Agreed out per 2/94 letter)	216.87
192	07/88	Bouton Services (Repairs cut 974.95, allowed 128)	974.95
205A	1980	R.R. Long (Still no description of services)	342.25
208	03/05/81	R.R. Long (Still no description of services)	380.70
216	10/31/81	R.R. Long	354.20
221	07/13/82	J.V. Righter (5,831.50) (Still no documentation)	560.02
266	10/14/90	B. Clausen (Agreed out per 2/94 letter)	300.00

The following costs were listed but **NO** documentation was submitted:

<u>Item #</u>	<u>Date</u>	<u>Payee</u>	<u>Amount</u>
	08/30/80	Finy Electronics (Still no documentation)	\$ 116.90
	10/14/80	A.J. Gada (Agreed out per 2/94 letter)	292.24
94	04/30/81	A.J. Gada (4071 Agreed out per 2/94 letter; 828 still not documented)	4,919.00
108	07/02/81	H. Brasses (No documentation)	49.00
124	07/22/81	Finy Electronics }	632.55
132	12/01/81	V.G. Nason's & Sons } (Still not documented)	19.08
133	12/01/81	P.E. Guerin Inc. } (-agreed-)	89.55
	12/31/81	Fishers' Island Ferry (Not documented)	15.50
141A	07/13/82	Parson's Weatherstripping (repairs)	364.00
145	03/10/92	W.H. Jason Co. (Not documented)	297.00
168	1985	H. Harlow (Still not documented)	553.80
170	1985	H. Harlow (Still not documented)	342.00
171	1985	Rex Lumber (Still not documented)	422.16
176	08/01/86	Gates & Beckwith	337.58
180	12/31/86	R.E. Wall (1,473.69 Agreedout)	1,307.01
182	12/18/87	R.E. Wall (1,242.91 Maint & personal property)	1,409.59
190	06/07/88	Bouton Services (Agreed out)	457.68
197	1988	Gruskin Hardware	72.89
199	1988	M. Bancroft (Still not documented)	755.97
200	1988	Barton (Bouton)?	536.62
201	02/17/89	Bouton Services (Agreed 764.46 out, 1,075 out windmill)	1,840.54

<u>Item #</u>	<u>Date</u>	<u>Payee</u>	<u>Amount</u>
203A,B,	10/09/90	Bouton Services (P.P. & Maint ?)	762.76
	1990	Fishers' Island Elec. Co.	
	1990	Barton Refrigeration } (Still	263.56
220		GHW Exhibit I, J.V. Righter } no	3,512.50
246	1989	Chandler Palmer & King } documentation)	1,303.56
247	12/89	Decor Arts (Agreed out)	1,500.00
249	07/07/79	A.J. Gada (Still not documented)	1,012.00
268		Mathews & Ham	
269-271	10/90	Peter Oram/Law Firm of Nicholas Doman	1,503.18
272	10/16/90	Howard Koff (Still no documentation)	250.00

The following costs were claimed only accompanied by a schedule denoting the check numbers, names & amounts. This is not sufficient documentation to determine if the costs are allowable capital improvements. Accordingly the following are disallowed in full for lack of documentation: (As supported by TSB-D-92 (19)-R, copy enclosed.)

<u>Year</u>	<u>Category</u>	<u>Amount</u>
1978	Main House*	\$ 587.70
1979	Main House*	2,502.12
1980	Main House*	3,401.90
1981	Main House*	3,352.61
	Main House*	5,129.37
1982	Main House*	1,178.64
1978	Landscaping*	1,480.41
1979	Landscaping*	1,245.75
1980	Landscaping*	1,945.74
1981	Landscaping*	2,092.27
1982	Landscaping*	2,128.00

* Not documented as capital improvements; repairs & maintenance.

The following have been disallowed as a review of the documentation revealed that these costs would be classified as repairs, maintenance and personal property which are not allowable as capital improvements:

<u>Item #</u>	<u>Date</u>	<u>Payee</u>	<u>Amount</u>
4	06/29/79	Shipman's Fire Eg. (Personal property)	\$ 87.87
6	09/11/79	P. Liebbich (Personal property)	38.52
8	10/12/79	A.J. Gada (1,049.80) Agreed Disallowed	624.40
12	11/16/79	A.J. Gada (Maintenance)	385.00
13	12/11/79	A.J. Gada Tax (on capital improvement?)	155.00
18	03/20/80	A.J. Gada (Maintenance)	47.22
26	10/10/79	Finy Electronics (Maintenance)	870.10
27	11/15/79	Ricci-Cavallaro (maintenance)	159.87
32	02/14/80	Ascutney Forge	
37	04/23/90	A. Secondino & Son (Repairs)	2,155.89

<u>Item #</u>	<u>Date</u>	<u>Payee</u>	<u>Amount</u>
38	04/29/80	Finy Electronics (Maintenance)	62.06
39	05/20/80	Finy Electronics (Personal property)	1,000.00
40	06/02/80	Ascutney Forge (Tools/personal property)	80.22
41	06/16/80	A.J. Gada (261.21) (maintenance)	204.32
42	06/18/80	Finy Electronics (Personal property)	1,344.91
43	06/18/80	Finy Electronics (Agreed out)	77.04
44	07/11/80	T. Boodly (Maintenance)	345.49
45	07/18/80	T. Boodly "	346.14
46	07/26/80	T. Boodly "	240.67
47	07/29/80	Gruskin Hardware "	506.17
48	07/29/80	A.J. Gada	
49	07/31/90	T. Boodle (Maintenance)	252.25
50	08/08/80	T. Boodle "	320.00
51	08/15/80	T. Boodle "	322.87
52	08/30/80	Finy Electronics "	
<u>Item #</u>	<u>Date</u>	<u>Payee</u>	<u>Amount</u>
53	09/12/80	T. Boodle "	235.00
54	09/12/80	T. Boodle "	345.20
55	09/12/80	Noank Shipyard Renov. "	74.93
56	09/18/80	T. Boodle "	345.94
57	09/16/80	T. Boodle "	85.07
58	09/24/80	T. Boodle "	372.29
59	10/03/80	T. Boodle "	393.22
60	10/10/80	T. Boodle "	355.20
61	10/15/80	A.J. Gada (Couldn't verify documentation)	142.35
62	10/80	A.J. Gada (Maintenance)	216.16
63	10/20/80	Shipman's Fire Equipment (Personal property)	213.00
64	10/20/80	T. Boodle (Maintenance)	125.51
66	12/08/80	T. Boodle "	237.54
69	12/12/80	T. Boodle "	100.00
	1981	T. Boodle "	320.00
	1981	T. Boodle "	240.00
74	01/26/81	E. Cohen (Personal property)	486.00
83	03/02/91	Finy Electronics (1,679.94) (Personal property)	900.94
88	03/29/81	F. Vuono (Repair & maintenance)	1,285.00
98	05/06/81	Finy Electronics (518.00) (Couldn't document)	19.00
111	07/07/81	A.J. Gada (1,319.00) (Duplicate)	1,011.38
113	07/22/81	J. Parvo (Disallow 95%, only 5% capital improvement)	2,850.00
115	07/23/81	Finy Electronics	536.15
118	07/31/81	Finy Electronics (1,685.70)	381.95
119	08/12/81	J. Parvo See 113 explanation above	2,850.00
120	08/25/81	J. Parvo See 113 explanation above	1,837.50
125	10/02/81	Bartol Refrigeration (Personal property, maint)	744.70
127	10/09/81	M. Hampton (Maintenance)	5,377.24
128	10/06/81	M. Hampton "	84.60
135	01/02/82	M. Hampton "	1,826.75
136	02/28/82	M. Hampton "	553.58
138	04/30/82	F. Senechal "	1,667.00
139	05/02/82	F. Senechal "	2,000.00
140	06/25/82	F. Senechal "	1,730.00

141	06/29/82	F. Senechal "	122.30
151	06/31/83	F. Senechal (No breakdown, couldn't allocate)	2,800.00
152	08/19/83	Wallpapers East Inc.	
158	06/14/84	H. Harlow	202.00
	09/03/85	R.E. Wall (Personal property)	580.50
	04/13/86	F. Senechal	1,530.00
173	04/14/86	M. Hampton (Allowed portion for bathroom)	1,815.15
174	04/20/86	F. Senechal (Allowed portion for bathroom)	2,000.00
175	07/16/86	F. Senechal (Allowed portion for bathroom)	2,500.00
177	08/14/86	M. Hampton (Allowed portion for bathroom)	1,534.72
178	12/19/86	Fortier Communication (Personal property)	742.05
179	12/31/86	M. Hampton (Maintenance)	1,200.00
184	05/22/87	F. Senechal "	2,000.00
185	08/06/87	F. Senechal "	2,202.00
186	10/06/87	F. Senechal "	2,000.00
187	12/31/87	F. Senechal "	2,000.00
188	01/25/88	F. Senechal "	652.00
189	05/13/88	Bouton Services (644.49 maintenance, 1316.76 not documented)	1,961.25
191	06/88	R.G. Ahman (Personal property)	125.72
194	10/05/88	Bouton Services (Couldn't verify)	391.52
196	1988	F. Senechal (Maintenance)	2,852.00
198A	08/04/88	F. Senechal "	1,452.00
256C	04/27/82	Comrie's Landscaping "	26.70

The following costs have been disallowed as they were identified as costs which are related to the Windmill transfer which has been determined to an exempt transfer:

<u>Item #</u>	<u>Date</u>	<u>Payee</u>	<u>Amount</u>
1	10/12/79	A.J. Gada (Document didn't verify)	\$2,200.00
195	12/18/88	Bouton Services (Dup 201)	3,225.00
205A	1980	R.R. Long (387.25) (Couldn't verify)	45.00
IV	12/02/82	Susan Plimpton (Agreed out)	606.80
236	02/26/85	Chandler, Palmer & King (Agreed out)	190.00
237	11/06/85	P. Walker, M. Schwartz (Per TP allocation)}	
238	1985	P. Walker, M. Schwartz }	1,073.66
240	12/18/87	P. Walker, M. Schwartz }	
241	05/16/88	Chandler, Palmer & King}	
243	09/21/88	Chandler, Palmer & King} (141.90 per TP	141.90
245	12/89	Chandler, Palmer & King} allocation)	
242	08/05/99	Design Work (Not documented)	225.00

The following costs have been disallowed for the reasons stated:

<u>Item #</u>	<u>Date</u>	<u>Payee</u>	<u>Amount</u>
14	01/14/80	A.J. Gada (Duplicate costs in contract)	\$ 557.74
267	1990	Ticor Title (Not an allowable selling expense)	7,257.00

<u>Item #</u>	<u>Date</u>	<u>Payee</u>	<u>Amount</u>
239	06/30/87	A.H. Shurtz (Not an allowable selling expense)	150.00
244	12/31/88	A.H. Shurtz (Not an allowable selling expense)	150.00
	10/28	Biser, Gibble & Quinn, Engineer (Included in 7,093.01 already allowed)	333.07
		Biser, Gibble & Quinn, Engineer (Included in 7,093.01 already allowed)"	1,770.00