STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petitions	:	
of	:	DETERMINATION DTA NOS. 822850, 822851
13TH AND 14TH STREET HOLDINGS, LLC, BENJAMIN SHAOUL AND ROBERT KALINER	:	AND 822852
	:	
for Redetermination of Deficiencies or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Year 2007.	:	
	:	

Petitioners, 13th and 14th Street Holdings, LLC, Benjamin Shaoul and Robert Kaliner, filed petitions for redetermination of deficiencies or for refund of personal income tax under Article 22 of the Tax Law for the year 2007.

On September 10 and 15, 2009, respectively, the Division of Taxation, appearing by Daniel Smirlock, Esq. (Kevin R. Law, Esq., of counsel), and petitioners, appearing by Green & Seifter, Attorneys, PLLC (Philip S. Bousquet, Esq., and Paul B. Predmore, Esq., of counsel), waived a hearing and submitted these matters for determination based on documents and briefs to be submitted by March 12, 2010, which date commenced the six-month period for issuance of this determination (Tax Law § 2010[3]). After due consideration of the documents and arguments submitted, Thomas C. Sacca, Administrative Law Judge, renders the following determination.

ISSUE

Whether certain "soft costs" are to be excluded in calculating the tangible property credit component of the Brownfield Redevelopment Tax Credit for residential condominium projects under Tax Law § 21.

FINDINGS OF FACT

The parties entered into a stipulation of facts, which is the basis of the findings of fact herein.

1. Petitioner 13th and 14th Street Holdings, LLC (the Company), is a limited liability company and the owner of a parcel of real property located at 421-429, 431 and 433 East 13th Street and 420 East 14th Street in New York City (the Property). Petitioners Benjamin Shaoul and Robert Kaliner are the beneficial members of the Company.

2. Various portions of the Property were previously occupied by a lumber yard and dry cleaning facility. Upon application by the Company, the Property was determined by the New York State Department of Environmental Conservation (NYSDEC) to be a brownfield eligible for remediation under New York's Brownfield Cleanup Program. On December 31, 2007, NYSDEC issued a Certificate of Completion for the Property (the CoC) pursuant to section 27-1419 of the New York Environmental Conservation Law, as amended.

3. The Company thereafter completed the construction of an eight-story condominium building on the Property (the Facility). On the Company's 2007 New York State Partnership Return, Form IT-204, the Company claimed a brownfield redevelopment credit, Form IT-611, (under section 21 of the Tax Law) in the amount of $6,786,783.00, based on aggregate redevelopment costs of $67,867,833.00. The credit claimed by the Company was calculated by multiplying an applicable percentage of ten percent (pursuant to Tax Law § 21) by (A) site preparation costs totaling $1,481,571.00, and by (B) qualified tangible property costs of $66,386.262.00. The credits were allocated by the Company to its beneficial members, petitioners Benjamin Shaoul and Robert Kaliner.

4. The total construction cost for the Facility was $46,623,857.00. Of that total, $23,863,987.00 was for construction materials and direct labor or "hard costs," and $22,759,870.00 was for capitalized interest, insurance, design and other "soft costs."

5. Petitioner Benjamin Shaoul filed a 2007 New York Resident Income Tax Return, Form IT-201, claiming a brownfield redevelopment tax credit on Form IT-611 in the amount of $3,393,392.00, and a total refund in the amount of $3,458,835.00. Petitioner Robert Kaliner filed a 2007 New York Nonresident and Part-Year Resident Income Tax Return, Form IT-203, claiming a brownfield redevelopment tax credit on Form IT-611 in the amount of $3,393,391.00, and a total refund in the amount of $3,405,100.00.

6. After a desk audit of petitioners' 2007 returns, during which the Division of Taxation (Division) was provided with additional information pertaining to the brownfield redevelopment credit, the Division advised petitioners Benjamin Shaoul and Robert Kaliner that the refund amounts claimed by each of them on their respective 2007 New York State tax return had been adjusted. The statements of tax refund, Form DTF-753, advised petitioners Benjamin Shaoul and Robert Kaliner that their refunds had been reduced to $1,210,992.00 and $1,220,121.00, respectively. The principal adjustment, and the adjustment at issue herein, was based on adjustments made to the Company's claimed brownfield redevelopment tax credits.

7. On December 19, 2008, the Division provided the Company's representative with an explanation of the adjustments relating to the brownfield redevelopment credit. The Division's letter described three separate adjustments:

a. The Division's reduction by $112,573.00 of the site preparation credit component, on the basis that the Company claimed $1,125,730.00 of remediation costs that "were expensed under section 198 of the Internal Revenue Code and not 'properly chargeable to a capital account' as per New York State Tax Law Section 21(b)(2)" (the Site Preparation Adjustment).

b. The Division's reduction by $4,252,227.00 of the tangible property credit component, on the basis that $42,522,275.00 of costs used to calculate that component did not constitute "tangible property." The Division broke down these amounts into two separate adjustments.

(i) The first adjustment was based on the Division's contention that the cost of land in the amount of $19,762,405 "is not included in the tangible property component" (the Land Cost Adjustment).

(ii) The second adjustment was based on the Division's contention that "soft costs totaling $22,759,870.00 do not qualify as 'tangible property' because they do not become part of the dwelling per New York State Tax Law Section 21(b)(3)(B) and are not included in the tangible property component" (the Soft Cost Adjustment).

The Division allowed the remaining portion of the brownfield redevelopment credit claimed by the Company (and consequently by its beneficial members, petitioners Benjamin Shaoul and Robert Kaliner).

8. The portion of the tangible property credit component relating to the hard costs is not an issue in this proceeding. Rather, the sole issue to be determined in this proceeding is whether the Soft Cost Adjustment was properly made, and whether the tangible property credit component of the brownfield redevelopment credit is allowable with respect to "soft costs" includible in the basis of tangible property described in Tax Law § 21(b)(3)(B).

CONCLUSIONS OF LAW

A. In 2003, the New York State Legislature enacted the Brownfield Cleanup Program (BCP), which was intended to promote the cleanup, reuse and redevelopment of hazardous waste sites (***see***, L 2003, ch 1, Part H, §1). The Legislature found "that there are thousands of abandoned and likely contaminated properties that threaten the health and vitality of the communities they burden, and that these sites, known as brownfields, are also contributing to sprawl development and loss of open space" (ECL 27-1403). The BCP furnishes a state policy, funding and tax credits for the cleanup of "brownfields," areas defined broadly as "any real property, the development or reuse of which may be complicated by the presence or potential presence of a hazardous waste, petroleum, pollutant, or contaminant" (ECL 27-1405[2]).

As part of its enactment, the BCP provides a financial incentive, the brownfield redevelopment tax credit, that ranged from 10 percent to 22 percent of covered costs.[1] This tax credit consists of a "site preparation credit component," which are costs to get the site ready for cleanup and redevelopment, except for the cost of acquiring the real property (Tax Law § 21[a][2]; [b][2]); a "tangible property credit component," which consists of the cost of erecting commercial, industrial or recreational buildings (Tax Law § 21[a][3];[b][3]); and an "on-site groundwater remediation credit component" (Tax Law § 21[a][4];[b][4]).

B. Section 21(a)(1) of the Tax Law provides for the allowance of the brownfield redevelopment tax credit, in general, as follows:

> A taxpayer subject to tax under article nine, nine-A, twenty-two, thirty-two or thirty-three of this chapter shall be allowed a credit against such tax, pursuant to the provisions referenced in subdivision (f) of this section. Such credit shall be

[1]Other financial incentives included a tax credit for real property taxes for up to 10 years, calculated according to a formula that takes the number of employees at the site into account (Tax Law § 22[b]), and a one-time insurance credit (Tax Law § 23[a], [c]).

> allowed with respect to a qualified site, as such term is defined in paragraph one of subdivision (b) of this section. The amount of the credit in the taxable year shall be the sum of the credit components specified in paragraphs two, three and four of this subdivision applicable in such year.

As previously noted, section 21(a)(2) provides for a site preparation credit component while section 21(a)(4) provides an on-site groundwater remediation credit component. The component at issue herein is the tangible property credit component, found in section 21(a)(3) of the Tax Law, which provides, in part, as follows:

> The tangible property credit component shall be equal to the applicable percentage of the cost or other basis for federal income tax purposes of tangible personal property and other tangible property, including buildings and structural components of buildings, which constitute qualified tangible property. . . .

C. As originally enacted, the term "qualified tangible property" was defined as follows (Tax Law former § 21[b][3]):

> (A) is depreciable pursuant to section one hundred sixty-seven of the internal revenue code,
>
> (B) has a useful life of four years or more,
>
> (C) has been acquired by purchase as defined in section one hundred seventy-nine (d) of the internal revenue code,
>
> (D) has a situs on a qualified site in this state, and
>
> (E) is principally used by the taxpayer for industrial, commercial, recreational or environmental conservation purposes (including the commercial development of residential housing).

Under its original definition, the tangible property credit component was limited to property depreciable under federal tax law. While rental property, both residential and commercial, is depreciable once it is placed in service, residential condominiums held primarily for sale to buyers are not depreciable property (***compare*** IRC § 168[c] [which allows federal depreciation deduction for residential rental property] ***with*** IRC § 167[a] ***and*** Treas Reg 1.167[a]-2 [which disallow depreciation for inventories or stock in trade held for sale to customers]).

D. In order to correct the disparate treatment received by rental apartments and residential condominiums (and cooperative housing units) under the BCP, the Legislature amended section 21(b)(3), expanding the definition of the term "qualified tangible property" (L 2006, ch 420) by adding a second category of eligible property (2006 Chapter Amendment). Pursuant to the amendment, the term "qualified tangible property" is now defined in Tax Law § 21(b)(3) as property described in either (A) or (B) as follows:

> (A)(i) is depreciable pursuant to section one hundred sixty-seven of the internal revenue code,
>
> (ii) has a useful life of four years or more,
>
> (iii) has been acquired by purchase as defined in section one hundred seventy-nine (d) of the internal revenue code,
>
> (iv) has a situs on a qualified site in this state, and
>
> (v) is principally used by the taxpayer for industrial, commercial, recreational or environmental conservation purposes (including the commercial development of residential housing); or
>
> (B)(i) is, or when occupied becomes, part of a dwelling whose primary ownership structure is covered under either article nine-B of the real property law or meets the requirements of section 216 (b)(1) of the Internal Revenue Code;[2]
>
> (ii) has been acquired by purchase (as defined in section one hundred seventy-nine (d) of the Internal Revenue Code);
>
> (iii) has a situs on a qualified site in this state; and
>
> (iv) for purposes of this subparagraph only, and notwithstanding any other section of law to the contrary, property qualifying under this subparagraph shall be deemed to be

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[2] It is noted that Article 9-B of the Real Property Law governs condominiums, while Internal Revenue Code § 216(b)(1) describes cooperative housing corporations for federal income tax purposes.

> qualified tangible property for the purposes of paragraph one of subdivision (d) of this section; and in addition, for the purposes of this subdivision only, property qualifying under this subparagraph shall be deemed to have been placed in service for the purposes of paragraph three of subdivision (a) of this section when a certificate of occupancy is issued for such property.

E. It is the position of the Division that the term "part of the dwelling" requires that the costs incurred by a developer of a condominium project must involve a tangible item that is directly related to the actual building construction to be considered qualified tangible property for purposes of the brownfield redevelopment tax credit. The Division states that the soft costs are not directly related to the actual building construction and therefore do not fall within the definition of qualified tangible property.

Petitioners argue that the Legislature intended to expand the definition of qualified tangible property to include condominiums and cooperatives, while continuing to employ the federal tax basis of the property, which has always included soft costs. Petitioners also claim that the Division's interpretation conflicts with the clear legislative intent of the statute, a plain reading of the statute, and would create ambiguity and uncertainty in the calculation of the credit.

F. A tax credit is a particularized species of exemption from tax (***Matter of New York Fuel Terminal Corp.***, Tax Appeals Tribunal, August 27, 1998). Statutes creating exemptions from tax are to be strictly construed (***see Matter of Grace v. New York State Tax Commn.***, 37 NY2d 193, 371 NYS2d 715 [1975], ***lv denied*** 37 NY2d 708, 375 NYS2d 1027 [1975]; ***Matter of Blue Spruce Farms v. New York State Tax Commn***., 99 AD2d 867, 472 NYS2d 744 [1984], ***affd*** 64 NY2d 682, 485 NYS2d 526 [1984]). In addition, it is well established that the interpretation given to a statute by the agency authorized with its enforcement should generally be given weight and judicial deference if the interpretation is not irrational, unreasonable or inconsistent with the statute (***Matter of Trump-Equitable Fifth Avenue Co. v. Gliedman***, 62 NY2d 539, 478 NYS2d

846 [1984]). However, in addition, the statutory language providing the exemption must be construed in a practical fashion with deference to the legislative intent behind the exemption (***see Majewski v. Broadalbin-Perth Cent. School Dist.***, 91 NY2d 577, 673 NYS2d 966 [1998]; ***Matter of Qualex, Inc***., Tax Appeals Tribunal, February 23, 1995). When construing a statute the primary focus is on the intent of the Legislature in enacting the statute (McKinney's Cons Laws of NY, Book 1, Statutes § 92[a]; ***see Matter of Sutka v. Conners***, 73 NY2d 395, 541 NYS2d 191 [1989]; ***Matter of American Communications Technology v. Tax Appeals Tribunal***, 185 AD2d 79, 592 NYS2d 147 [1993], ***affd*** 83 NY2d 773, 611 NYS2d 125 [1994]). When that intent is clear from the wording of the statute itself, the inquiry ends (McKinney's Cons Laws of NY, Book 1, Statutes § 76; ***see Matter of American Communications Technology v. State of New York Tax Appeals Tribunal***). However, when there is an ambiguity in the words of the statute, the inquiry extends to other methods of ascertaining legislative intent (***see*** McKinney's Cons Laws of NY, Book 1, Statutes §§ 76, 92; ***Matter of Guardian Life Ins. Co. v. Chapman,*** 302 NY 226 [1951]; ***Matter of American Communications Technology v. State of New York Tax Appeals Tribunal***).

G. Initially it is noted that the Division's position appears to be in direct conflict with the language of the statute. Section 21(a)(3) provides that the tangible property component is to "be equal to the applicable percentage of the cost or other basis for federal income tax purposes of tangible personal property and other tangible property, including buildings and structural components of buildings, which constitute qualified tangible property." To calculate the credit a taxpayer is required to multiply the "applicable percentage" provided for in subsection (a)(5) by the taxpayer's federal tax basis in the property. Internal Revenue Code § 263A and the regulations promulgated thereunder require that taxpayers producing real property (self-constructed assets) must capitalize direct and indirect costs allocable to the property, regardless of whether the property is sold or is used in the taxpayer's trade or business (Treas Reg § 1.263A-1[a][3][ii]). The regulations contain a list of examples of the types of costs required to be capitalized, such as, direct material and labor costs, indirect labor costs, various overhead items, bidding costs, construction period interest, construction period taxes, construction period depreciation and insurance (Treas Reg § 1.263A-1[e]). Included within these costs are "soft costs," which the Division excluded from petitioners' computation of the tangible property component in recomputing the brownfield redevelopment tax credit on the Facility. It is well established that a statute is to be construed as a whole, and all parts of an act are to be read and construed together to determine the legislative intent. All parts of a statute must be harmonized with each other as well as with the general intent of the whole statute, and effect and meaning must, if possible, be given to the entire statute and every part and word thereof (McKinney's Cons Laws of NY, Book 1, Statutes, § 97, 98). To require the exclusion of the soft costs in calculating the tangible property component of the brownfield redevelopment tax credit conflicts with the statutory language of Tax Law § 21(a)(3), which employs the cost or other basis of the property for federal income tax purposes, which includes such costs. As the Division's interpretation of Tax Law § 21(b)(3)(B) is inconsistent with Tax Law § 21(a)(3), it cannot be found that the Legislature intended to exclude soft costs from the calculation of the tangible property credit component in determining the brownfield redevelopment tax credit ***(Matter of Trump-Equitable Fifth Avenue Co. v. Gliedman)***.

H. As petitioners point out, the language of Tax Law § 21 extending the tangible property credit component to condominiums and cooperative housing recognizes that each residential condominium and cooperative apartment is a separate unit that can individually be leased or sold.

The language is consistent with the concept that the amendment to the definition of qualified tangible property was intended to expand the brownfield redevelopment tax credit to include condominiums and cooperatives and was not an attempt to eliminate certain expenses from the computation of the credit.

Each condominium unit is considered a separate interest in real property (Real Property Law § 339-g). For federal income tax purposes, the tax basis of a condominium building is allocated to the building shell, the common areas and each individual unit (Treas Reg § 1.61-6). In order to determine the gain or loss on the sale of each unit, the condominium developer is required to calculate the federal income tax basis on the individual unit.

According to section 21(a)(3) and (5) of the Tax Law, the tangible property credit component is allowed and calculated based upon the taxpayer's federal income tax basis of property placed in service, by multiplying that basis by the "applicable percentage." With regard to a condominium project, the term "property" refers to each condominium unit, as that is the tangible asset that is placed in service and for which a basis is separately determined under federal law. Pursuant to Tax § 21(b)(3)(B)(iv), a condominium is "placed in service" when a certificate of occupancy is issued for that unit. The tangible property credit component is therefore calculated separately using the federal tax basis of each condominium unit at the time the certificate of occupancy is issued for that unit. As certificates of occupancy are issued on a unit-by-unit basis, condominium units within a building may be "placed in service" in different taxable years. A condominium developer, such as petitioners herein, would be able to claim a portion of the total tangible property credit component in each year in which "part of a dwelling," the individual residential units, receives a certificate of occupancy and is placed in service for tangible property credit component purposes. The tangible property credit component would be calculated on the federal tax basis of each individual unit. Under IRC § 263A, the federal tax basis would include all costs, including those designated as "soft costs." The "part of" language contained in the statute recognizes that the tangible property credit component for condominiums is calculated on a unit-by-unit basis, rather than on the building as a whole. This is consistent with Tax Law § 21(b)(3)(B)(iv), which provides, in part, that, "in addition, for purposes of this subdivision only, property qualifying under this subparagraph shall be deemed to have been placed in service for the purposes of paragraph three of subdivision (a) of this section when a certificate of occupancy is issued for such property." It follows that the property qualifying under Tax Law § 21(b)(3)(B), that is, "property which is, or when occupied becomes, part of a dwelling," must refer to a condominium unit, for which a certificate of occupancy can be issued and which is, or when occupied becomes, part of a dwelling governed by Article 9-B of the Real Property Law. A certificate of occupancy is not issued for the structural components of the building, as the Division's position implies that the phrase "property [which] . . . becomes, part of the dwelling" would require, but for each individual condominium unit.

The phrase "is, or when occupied becomes," reflects the reality that the units may not be actually occupied until after they have been sold by the developer, which could occur months or years after the certificate of occupancy is issued. The language of the statute ensures that the TPCC will be allowed for a condominium unit when its certificate of occupancy is issued, without regard to the date it becomes occupied. Thus, it is determined that the legislative intent behind the 2006 Chapter Amendment was to expand the brownfield redevelopment tax credit to include condominiums and cooperatives and not to exclude certain "soft costs" from the calculation of the tangible property credit component.

I. As previously discussed, when construing a statute the primary focus is on the intent of the Legislature in enacting the statute (McKinney's Cons Laws of NY, Book 1, Statutes § 92[a]). When that intent is clear from the wording of the statute itself, the inquiry ends (McKinney's Cons Laws of NY, Book 1, Statutes § 76). However, when there is an ambiguity in the words of the statute, the inquiry extends to other methods of ascertaining legislative intent (***see*** McKinney's Cons Laws of NY, Book 1, Statutes §§ 76, 92). Assuming, arguendo, that an ambiguity exists in the words of section 21(b)(3)(B) of the Tax Law, it is appropriate to consider legislative history, including memoranda and notes attached to enacting bills, in attempting to determine the intent of the Legislature. Such memoranda and notes are considered extremely persuasive on the question of legislative intent, and are thought to be indicative of the scope and purpose of the enacted statute (McKinney's Cons Laws of NY, Book 1, Statutes § 125[b]; ***Matter of Polan v. State of New York Insurance Department***, 3 NY3d 54, 781 NYS2d 482 [2004]).

The Legislative Memorandum in Support of the 2006 Chapter Amendment (2006 McKinney's Session Laws of NY, at 1889), describes the changes to section 21(b)(3) as follows:

> PURPOSE:
>
> To extend the existing brownfield tax credit to cooperatives and condominiums.
>
> SUMMARY OF PROVISIONS:
>
> Section one amends section 21 of the tax law to extend tax credits to certain forms of owner occupied housing. Expands the tangible property credit under section 21 of the tax law to apply to co-op and condo units.
>
> * * *
>
> PRESENT LAW:
>
> The Brownfield property tax credit provides a 12 to 22 percent rebate for qualified property expenses. Currently the credit only applies to property depreciable under

> the Internal Revenue Code. Multi-family apartment housing is appreciable under the IRC but cooperatives and condominiums are not.
>
> <u>JUSTIFICATION</u>:
>
> The Brownfield cleanup program has provided a major impetus for the redevelopment of presently contaminated and under utilized properties throughout the state. The goals of smart development and reclamation of our urban waterfronts has been greatly aided by the program. Many of the best and highest uses for these properties is for the creation of new and improved housing units. Due to a glitch in the tax law, apartment buildings are eligible for the credit but currently condominiums and cooperatives do not qualify. This bill would remedy this unfortunate consequence of the original bill and greatly aid the production of high quality owner occupied housing in our distressed urban areas and throughout the state.

There is nothing in the language of section 21, the 2006 Chapter Amendment or the legislative history that supports the Division's position that the 2006 Chapter Amendment was intended to alter the tangible property credit component as previously calculated. Prior to the amendment, section 21(a)(3) provided that to calculate the tangible property credit component, the taxpayer was required to multiply the applicable percentage provided for in subsection (a)(5) by the taxpayer's federal tax basis in the property. As previously discussed, the federal tax basis of self-constructed assets includes a broad spectrum of costs, including those characterized as soft costs (IRC § 263A; Treas Reg § 1.263A-1[a][3][ii]).

Section 21(a)(3) and its formula were not changed by the 2006 Chapter Amendment. The Legislature expressed the desire to "extend" and "expand" the "existing brownfield tax credit," using the same formula, to condominiums and cooperatives. The Legislature clearly evidenced this intent by stating in the memorandum of support that there was a "glitch in the tax law" that denied the credits to condominiums and cooperatives while at the same time allowing the credit to apartment buildings. The Legislature went on to state that the purpose of the 2008 Chapter Amendment was to "remedy this unfortunate consequence of the original bill." To accomplish this goal, the Legislature expanded the definition of "qualified tangible property" to include residential condominiums, the ownership structure of which is governed by the New York Condominium Act (Article 9-B of the Real Property Law) and cooperatives, where the ownership structure meets the requirements for cooperative housing corporations in IRC § 216(b)(1).

In enacting the 2006 Chapter Amendment, the Legislature clearly intended to place residential condominiums and cooperatives in the same position as rental apartments and other depreciable assets in calculating the tangible property credit component of the brownfield redevelopment tax credit. The Division's interpretation of the amendment runs counter to this clear legislative intent and therefore cannot be upheld.

J. The petitions of 13th and 14th Street Holdings, LLC, Benjamin Shaoul and Robert Kaliner are granted, the Division's Soft Cost Adjustment to the tangible property credit component of the brownfield redevelopment credit is reversed and petitioners Benjamin Shaoul and Robert Kaliner are entitled to the refund resulting from the reversal of the Soft Cost Adjustment.

DATED: Troy, New York
August 26, 2010

/s/ Thomas C. Sacca
ADMINISTRATIVE LAW JUDGE