STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition of 15 East 81st Associates	:	AFFIDAVIT OF MAILING
for Revision of a Determination or for Refund of Tax on Gains Derived from Certain Real Property Transfers under Article 31B of the Tax Law.	:	

State of New York :
ss.:
County of Albany :

David Parchuck/Janet M. Snay, being duly sworn, deposes and says that he/she is an employee of the State Tax Commission, that he/she is over 18 years of age, and that on the 15th day of April, 1986, he/she served the within notice of Decision by certified mail upon 15 East 81st Associates the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

15 East 81st Associates
340 E. 46th St.
New York, NY 10017

and by depositing same enclosed in a postpaid properly addressed wrapper in a post office under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the petitioner herein and that the address set forth on said wrapper is the last known address of the petitioner.

Sworn to before me this
15th day of April, 1986.

David Parchuck

Janet M. Snay
Authorized to administer oaths
pursuant to Tax Law section 174

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition of 15 East 81st Associates	:	AFFIDAVIT OF MAILING
for Revision of a Determination or for Refund of Tax on Gains Derived from Certain Real Property Transfers under Article 31B of the Tax Law.	:	

State of New York :
ss.:
County of Albany :

David Parchuck/Janet M. Snay, being duly sworn, deposes and says that he/she is an employee of the State Tax Commission, that he/she is over 18 years of age, and that on the 15th day of April, 1986, he served the within notice of Decision by certified mail upon Ronald J. Offenkrantz, the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Ronald J. Offenkrantz
Spitzer & Feldman
745 Fifth Ave.
New York, NY 10151

and by depositing same enclosed in a postpaid properly addressed wrapper in a post office under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the representative of the petitioner herein and that the address set forth on said wrapper is the last known address of the representative of the petitioner.

Sworn to before me this
15th day of April, 1986.

David Parchuck

Janet M. Snay

Authorized to administer oaths
pursuant to Tax Law section 174

STATE OF NEW YORK
STATE TAX COMMISSION
ALBANY, NEW YORK 12227

April 15, 1986

15 East 81st Associates
340 E. 46th St.
New York, NY 10017

Gentlemen:

Please take notice of the Decision of the State Tax Commission enclosed herewith.

You have now exhausted your right of review at the administrative level. Pursuant to section(s) 1444 of the Tax Law, a proceeding in court to review an adverse decision by the State Tax Commission may be instituted only under Article 78 of the Civil Practice Law and Rules, and must be commenced in the Supreme Court of the State of New York, Albany County, within 4 months from the date of this notice.

Inquiries concerning the computation of tax due or refund allowed in accordance with this decision may be addressed to:

NYS Dept. Taxation and Finance
Law Bureau - Litigation Unit
Building #9, State Campus
Albany, New York 12227
Phone # (518) 457-2070

Very truly yours,

STATE TAX COMMISSION

cc: Taxing Bureau's Representative

Petitioner's Representative:
Ronald J. Offenkrantz
Spitzer & Feldman
745 Fifth Ave.
New York, NY 10151

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition	:	
of	:	
15 EAST 81ST ASSOCIATES	:	DECISION
for Revision of a Determination or for Refund of Tax on Gains Derived from Certain Real Property Transfers under Article 31-B of the Tax Law.	:	

Petitioner, 15 East 81st Associates, 340 East 46th Street, New York, New York, 10017, 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 (File No. 57136).

A hearing was held before Dennis M. Galliher, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on September 13, 1985 at 9:00 A.M., with all briefs to be submitted by December 27, 1985. Petitioner appeared by Spitzer & Feldman, Esqs. (Ronald J. Offenkrantz, Esq. of counsel). The Audit Division appeared by John P. Dugan, Esq. (Paul A. Lefebvre, Esq., of counsel).

ISSUES

I. Whether the Audit Division properly disallowed certain items claimed by petitioner as construction period expenses disbursed in connnection with capital improvements to real property.

II. Whether the imposition of tax herein represents an impermissible retroactive application of Tax Law Article 31-B in violation of the due process clauses of the United States and New York State constitutions.

FINDINGS OF FACT

1. On April 30, 1981 petitioner, 15 East 81st Associates, a partnership, purchased premises located at 15-19 East 81st Street, New York, New York from the Catholic High School Association of New York ("the premises"). These premises, consisting of real property plus a four story building formerly used as a home for priests, were acquired by petitioner at a total cost of $2,573,784.07. It is undisputed that petitioner's intention with respect to these premises at the time of purchase was condominium development, as more specifically detailed hereinafter.

2. At the time of acquisition, the premises were zoned "R-8", which allowed a building with a volume equal to six times the land area of the underlying real estate. Petitioner anticipated adding to the square footage of the existing premises and increasing its height by four stories. Prior to the actual closing on the premises, and in line with its development plans, petitioner obtained quotes from various subcontractors, including demolition, elevator and structural firms, and from architects specializing in conversion and renovations, in order to determine the costs of the project and assess its economic feasibility.

3. The premises are located in a landmark district and thus any changes to the exterior of the building required approval in the form of a Certificate of Appropriateness from the New York City Landmark Preservation Commission ("Landmark Commission"). Petitioner's initial submission of a plan to the Landmark Commission called for the above-noted four story addition, which plan was rejected. Thereafter, petitioner submitted, in succession, a three story addition plan which was also rejected, and a two story addition plan which, after certain amendments to meet objections raised by the Landmark Commission,

was ultimately accepted. On September 1, 1981 the Landmark Commission issued to petitioner its Certificate of Appropriateness for a two story addition.

4. Notwithstanding the issuance of the Certificate of Appropriateness, new zoning regulations had been enacted affecting certain districts, including that in which the premises was located, which allowed building only to a height of sixty feet from the sidewalk. Petitioner was thereby limited to the height of the existing building, which effectively negated the planned two story addition allowed by the Landmark Commission's Certificate of Appropriateness. Petitioner, in turn, determined that developing the property, as then-limited, was not economically viable and decided to sell the premises.

5. Petitioner thereafter entered into a contract to sell the premises to Angiolina Corporation, N.V. ("Angiolina"), for a gross consideration of $4,500,000.00. Prior to the sale, the necessary transferor and transferee questionnaires with respect to the Real Property Transfer Gains Tax imposed by Tax Law Article 31-B ("Gains Tax") were filed, together with required documentation. Included among such documentation was petitioner's "Analysis of Disbursements - 12/5/80 to 2/27/84", listing the funds expended by petitioner on the premises according to date, payee, amount and explanation. On its transferor questionnaire, petitioner computed an anticipated gains tax due of $86,421.50, as follows:

	Gross Consideration	$4,500,000.00
Less:	Transferor's Brokerage Fees	(100,000.00)
Less:	Purchase Price to Acquire Property	(2,573,500.00)
Less:	Cost of Capital Improvements	(962,285.00)
	Gain Subject to Tax	$ 864,215.00
		x.10
	Anticipated Tax Due	$ 86,421.50

6. On March 14, 1984, the Audit Division issued to petitioner a Tentative Assessment and Return upon which was computed a tax due of $173,630.30. The

Audit Division's computation of tax due differs from petitioner's computation in that $872,088.00 out of petitioner's claimed $962,285.00 in costs of capital improvement were disallowed as "not capital improvements nor costs incurred to make capital improvements", thus increasing the gain subject to tax from $864,215.00 to $1,736,303.00.

7. On March 23, 1984, petitioner sold the premises to Angiolina and paid under protest the amount of tax due as computed by the Audit Division. On May 1, 1984, petitioner filed a claim for refund in the amount of $87,208.00. Petitioner asserts that each of the items of disbursement disallowed by the Audit Division (totalling $872,088.00) represented development period costs made in connection with capital improvements to the property, which costs were properly includable as part of "original purchase price" for purposes of calculating tax due under Article 31-B. By a letter dated September 18, 1984, the Audit Division denied petitioner's claim for refund.

8. The three major disallowed items of cost paid by petitioner while it owned the property were real estate taxes (totalling $203,988.98), interest on mortgage loan (totalling $619,700.79)** and multiperil property insurance (totalling $14,763.38). The balance of disallowed items, totalling $33,634.85 consisted of, inter alia, plumbing repairs, cleaning drains, rubbish removal, water and sewer fees, utilities (electricity), fuel, permits, advertising costs, roof repairs, boiler cleaning and repair, and accounting fees. Expenses allowed, by contrast, included architectural fees and certain selling expenses.

** This total includes comparatively minor amounts for travel, legal and phone expenses incurred in connection with obtaining the mortgage loan.

9. During the period of petitioner's ownership the premises remained vacant and generated no income for petitioner.

10. The interest on the mortgage loan, constituting by far the largest single item of expense disallowed by the Audit Division, represents interest paid by petitioner to First of Boston Mortgage Corporation ("FBMC") on a first mortgage loan in the amount of $1,500,000.00. The April 22, 1981 written commitment by FBMC to issue this loan provided, in part, as follows:

> "This letter will serve as the commitment of First of Boston Mortgage Corporation (FBMC) to grant a joint venture of Irving Dimson and N. Elghanayan (Borrower) a first mortgage loan in the amount of $1,500,000. The mortgage note will be written for a one-year term and call for monthly interest at the base rate of The First National Bank of Boston, as the same may be established from time to time. Base rate shall mean the rate of interest announced from time to time by The First National Bank of Boston at its Head Office as its base rate. In the event that FBMC has not issued a commitment to provide a construction loan for the renovation of the building within three months from the date of closing or if this loan has not been repaid within that time, then the rate of interest shall be at base rate of The First National Bank of Boston plus 1/2% commencing three months after the initial loan closing." (emphasis supplied).

11. Certain of petitioner's principals, in particular Mr. Barry Dimson, had a longstanding relationship with FBMC, which had provided upwards of 150 million dollars of funds through construction loans on previous projects involving Mr. Dimson. Prior to giving commitment for the loan herein, FBMC had been advised of petitioner's intended plan of condominium development and had been supplied with copies of the plans thereof. In addition to holding a first mortgage on the premises and security interests in all accompanying furniture, fixtures and equipment, the loan herein was further secured by personal guarantees of several of petitioner's principals.

12. The closing statement with respect to petitioner's purchase of the property reflects that the entire $1,500,000.00 loaned by FBMC was paid over to the seller at closing. The balance of the purchase price and the additional

monies expended on the premises by petitioner consisted of cash contributions to petitioner by its principals.

13. There appears to be no dispute that prior to the aforementioned zoning changes petitioner's intention was to develop the premises into condominiums, nor is it disputed that the disallowed sums in question were, in fact, expended by petitioner.

CONCLUSIONS OF LAW

A. That Tax Law Article 31-B ("Gains Tax") imposes a tax at the rate of ten percent upon gains derived from the transfer of real property within New York State wherein the consideration equals or exceeds one million dollars. Tax Law section 1440.3 defines "gain" as "the difference between the consideration for the transfer of real property and the original purchase price of such property, where the consideration exceeds the original purchase price."

B. That Tax Law section 1440.5, as in effect at the time of the transfer in question, defined "original purchase price" as follows:

> "'[o]riginal purchase price' means the consideration (i) paid by the transferor to acquire the interest in the real property..., plus..., the consideration by the transferor for any capital improvements made to such real property...prior to the date of transfer." (emphasis added).

C. That while petitioner's intention to develop the subject premises, as described, is not disputed, there nonetheless remains the fact that no capital improvements were made to the premises nor was there even commencement of the construction of such improvements. Petitioner's intent to develop the premises, and its efforts to secure necessary authorizations therefore, does not make the disallowed items of disbursement at issue capital improvements or costs incurred to make capital improvements. The language of the FBMC commitment, specifically that a construction loan was apparently contemplated in the future (see Finding of

Fact "10"), coupled with the fact that the entire proceeds of the instant loan were disbursed to purchase the premises (see Finding of Fact "12"), runs contra to concluding that the loan in question was a construction loan, that a construction period for capital improvements had commenced or that the loan proceeds were used to make capital improvements such that interest on the loan could be considered a cost of making capital improvements. Accordingly, the Audit Division's determination that such interest expense was not includable as part of petitioner's original purchase price for the premises under section 1440.5 was proper. Furthermore, a review of the remaining disallowed items of disbursement (e.g. real estate taxes, insurance, various repairs, etc., see Finding of Fact "8"), reveals that none of such items constitutes a capital improvement or the cost of making a capital improvement to the property. Rather, such items represent the usual ongoing expenses of property ownership. Accordingly, given the nature of the expenditures in question and the fact that capital improvements were neither made to the premises nor commenced, it follows that the disbursements at issue may not be included as part of petitioner's original purchase price pursuant to Tax Law section 1440.5.[1]

D. That the constitutionality of the laws of the State of New York and their application in particular instances is presumed at the administrative level of the State Tax Commission.

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1 Tax Law section 1440.5 was amended by L. 1984, Ch. 900 (effective September 4, 1984), such that the definition of "original purchase price" was clarified to recognize the Audit Division's interpretation that, within statutory parameters, certain so-called "soft costs" of capital improvements are includible as part of original purchase price thus ultimately reducing the amount of gain on sale (see State Executive Department Memorandum accompanying passage of L. 1984, Ch. 900, McKinney's 1984 Session Laws of New York, pp. 3458, 3461). Such amendment, however, occurred after the transaction at issue and, in any event, has no impact in this matter since capital improvements were neither commenced nor made, nor were any of the items of disbursement in the nature of capital improvements or costs of making capital improvements as opposed to being ongoing expenses of ownership.

E. That that petition of 15 East 81st Associates is hereby denied and the denial of petitioner's claim for refund is sustained.

DATED: Albany, New York

STATE TAX COMMISSION

APR 15 1986

PRESIDENT

COMMISSIONER

COMMISSIONER