STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition

of

JONATHAN AND BETH COHEN

for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Years 2011 and 2014.

DETERMINATION
DTA NO. 828668

In the Matter of the Petition

of

BRAD BLUMENFELD AND FRANCIE SWIFT

for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Years 2011 and 2014.

DETERMINATION
DTA NO. 828669

In the Matter of the Petition

of

DAVID BLUMENFELD

for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Years 2011 and 2014.

DETERMINATION
DTA NO. 828670

In the Matter of the Petition

of

EDWARD AND SUSAN BLUMENFELD

for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Years 2011 and 2014.

DETERMINATION
DTA NO. 828671

Petitioners Brad Blumenfeld and Francie Swift, David Blumenfeld, Edward and Susan Blumenfeld, and Jonathan and Beth Cohen filed petitions for redetermination of a deficiency or for refund of personal income tax under article 22 of the Tax Law for the years 2011 and 2014.

On February 19, and 20, 2020, respectively, petitioners, appearing by Julia J. Martin, Esq., and the Division of Taxation, appearing by Amanda Hiller, Esq. (Tobias A. Lake, Esq., of counsel), waived a hearing and submitted these consolidated matters for determination based on documents and briefs to be submitted by June 8, 2020, which date commenced the six-month period for the issuance of this determination. After due consideration of the documents and arguments submitted, Jessica DiFiore, Administrative Law Judge, renders the following determination.

ISSUE

Whether the leasing incentive fee should be included in the tangible property credit component of the brownfield redevelopment tax credit provided pursuant to Tax Law § 21 for 2011.

FINDINGS OF FACT

The parties entered into a stipulation of facts, which has been incorporated into the findings of fact below.

1. Tiago Holdings, LLC (Tiago), a New York limited liability company, was formed for the purpose of developing a commercial project in New York City referred to as the East River Plaza (the Project). The Project was accepted into the New York State Department of Environmental Services Brownfield Program on June 15, 2005, when the New York State Department of Environmental Conservation (DEC) and Tiago entered into a Brownfield Cleanup Agreement (BCA).

2. At all relevant times, petitioners Brad Blumenfeld and Francie Swift, David Blumenfeld, Edward and Susan Blumenfeld, and Jonathan and Beth Cohen, possessed an ownership interest in BDG DWD Associates, LLC (BDG), which possessed an 88.0107% ownership interest in DWD Associates, LLC (DWD), which possessed a 47.5% ownership interest in Tiago.

3. Prior to entering into the BCA with the DEC, in May 2004, another member not relevant here was joined as a partner in Tiago. In connection with this addition, the Tiago members entered into a fee agreement on the same day providing, among other things, that DWD would receive fees for the Project. This fee agreement was then incorporated into Tiago's relevant operating agreement.

4. The fee agreement provided four different fees that were payable in connection with the Project: the financing fee, the initial development fee, the leasing incentive fee, and the site management fee. DWD received a leasing incentive fee equal to one and one-quarter percent of the total budgeted cost for the development of the Project.

5. The fee agreement and the relevant operating agreement for Tiago do not describe the purpose of the leasing incentive fee. It is not clear from the fee agreement and the relevant operating agreement what work was required by DWD in order for it to receive the leasing incentive fee. The fee agreement and the relevant operating agreement also do not explain how the leasing incentive fee provides a direct benefit to the property involved in the Project.

6. It is not clear from the fee agreement or the operating agreement that the leasing incentive fee is directly related to the cost of construction or an integral part of construction similar to engineering fees, architectural fees or the other indirect costs that qualify for the tangible property credit component (TPCC) of the brownfield redevelopment tax credit (brownfield credit) provided pursuant to Tax Law § 21.

7. The operating agreement does provide that DWD and the other managing member shall "jointly conduct, direct and exercise full control over the activities of [Tiago]." It also states that the two managing members will make all decisions affecting Tiago's business, such as decisions relating to spending money, acquiring assets, or incurring debt.

8. The operating agreement also requires that Tiago find a contractor. It states that Tiago may delegate to the contractor the authority to develop and construct the Project, obtain the necessary licenses and permits for the design, construction and occupancy of the Project, and to select, hire, engage, administer, monitor and supervise the services of all architects, engineers, contractors, materialmen, suppliers and consultants with respect to the design, development and construction of the Project.

9. On December 28, 2007, DEC issued a Certificate of Completion to Tiago pursuant to Environmental Conservation Law (ECL) § 27-1419 for the Project, granting restricted residential and commercial uses for the relevant real property.

10. In 2011, Tiago placed equipment, land improvements and a building associated with the Project in service, for a total amount in cost or other basis of property of $12,000,266.00.

11. On its 2011 federal income tax return, form 1065, schedule L, line 9a, Tiago capitalized such costs.

12. Included in this $12,000,266.00 of capitalized costs was $5,747,571.00 attributable to the leasing incentive fee paid by Tiago to DWD. Tiago's accountants treated the leasing incentive fee as indirect costs for the development of the Project.

13. Tiago allocated the TPCC of the brownfield credit to its members and, ultimately, petitioners. Petitioners filed claims for brownfield redevelopment tax credit, form IT-611, with each of their amended resident income tax returns, IT-201-X, for 2011 as follows:

Petitioner(s)	Claimed brownfield credit
Brad Blumenfeld & Francie Swift	$206,439.00
David Blumenfeld	$208,499.00
Edward & Susan Blumenfeld	$412,878.00
Jonathan & Beth Cohen	$104,249.00

14. The Division of Taxation (Division) conducted an audit of Tiago's 2011 federal income tax return (return). On August 11, 2015, the Division sent Tiago a letter regarding its 2011 claim for the brownfield credit. The letter stated that additional information was required to complete the audit review of the brownfield credit. The information sought included a detailed description of the leasing incentive fee totaling $5,747,571.00 that was claimed as a cost

in the TPCC of the brownfield credit.[1] The Division requested the specific activities performed by DWD for the fees charged, the number of DWD employees that worked on the activities and those employees' names, social security numbers, time worked and wages paid. The Division also requested any written agreements and/or contracts between DWD and Tiago, a list of all expenses that DWD incurred for this fee and how the leasing incentive fee qualified to be claimed in the TPCC. None of the information requested other than the fee agreement and the operating agreement was submitted for the record.

15. After the audit of Tiago's return, the Division determined that the costs attributable to the leasing incentive fee did not qualify for the TPCC of the brownfield credit because they are "costs related to marketing, selling, and advertising" under Internal Revenue Code (IRC) § 263A, do not meet one or more of the necessary criteria of "qualified tangible property" as defined in Tax Law § 21 (b) (3), and were not "placed in service" as required by Tax Law § 21 (a) (3).

16. As a result of this determination, the Division disallowed the leasing incentive fee of $5,747,571.00, and on April 2, 2016, the Division issued letters to petitioners notifying them of the reduction of their brownfield credit as follows:[2]

Petitioner(s)	Reduction in brownfield credit
Brad Blumenfeld & Francie Swift	$98,876.00 ($206,439.00 to $107,563.00)

[1] In its letter, the Division breaks down the items claimed as costs included in the TPCC. It lists a leasing fee, leasing incentive fee, and site management fee. A review of the record shows that the "leasing fee" paid was part of the leasing incentive fee at issue here.

[2] It is not clear from the record why the initial amount of the credit claimed provided in the letters from the Division is different from the credit amounts claimed by three of the four petitioners in their claims for brownfield redevelopment tax credit, form IT-611, attached to their income tax returns.

David Blumenfeld	$87,889.00 ($183,500.00 to $95,612.00)
Edward & Susan Blumenfeld	$197,750.00 (412,786.00 to $215,127.00)
Jonathan & Beth Cohen	$43,945.00 ($91,751.00 to $47,806.00)

17. Thereafter, for reasons not contained in the record, the Division sent petitioners letters dated April 22, 2016 that were identical to the April 2, 2016 letters.

18. Petitioners timely filed their petitions on April 19, 2018, seeking refunds for the portion of the TPCC of the brownfield credit they claimed on their 2011 and 2014 income tax returns that was disallowed. Petitioners are no longer pursuing their claims related to 2014.[3]

19. Once the parties agreed to proceed with this matter by submission, the Division was required to submit its documents by March 6, 2020. Petitioners were then required to submit their documents and brief in support by April 3, 2020, on which date the record closed.

20. In support of their position, the petitioners submitted the affidavit of David Kaplan, General Counsel of Blumenfeld Development Group, Ltd. (Blumenfeld). In his role as General Counsel to Blumenfeld, he also served as legal counsel to the single-purpose project entities that are affiliates of Blumenfeld, including BDG and DWD.

Mr. Kaplan stated that he assisted with negotiating the terms of the fee agreement on behalf of DWD. He asserted that the fee agreement was intended to clearly define the fees that

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[3] In the stipulation of facts submitted by the parties, the parties stipulated that Tiago withdrew its claims related to the 2014 tax year. As Tiago is not a party to this proceeding, and petitioners possessed an ownership interest in BDG, which possessed an ownership interest in DWD, which possessed an ownership interest in Tiago (***see*** finding of fact 2), it is determined that petitioners withdrew their claims for 2014.

would be paid to the members of Tiago as compensation for work performed on the Project. Mr. Kaplan claimed that the leasing incentive fee was payable to DWD to compensate DWD for the work the members of Tiago anticipated would be required to bring the Project to completion. He concluded that accordingly, the nature of the leasing incentive fee was that of a development fee.

Mr. Kaplan also averred that the leasing incentive fee was not intended to compensate DWD for marketing, selling, advertising, or distribution costs. Mr. Kaplan stated that the leasing incentive fee directly benefited and was incurred by reason of the Project.

21. The Division submitted 3 proposed findings of fact with its brief. In accordance with State Administrative Procedure Act § 307 (1), they have been modified to more accurately reflect the record.

SUMMARY OF THE PARTIES' POSITIONS

22. Petitioners argue that the leasing incentive fee was paid to DWD as compensation for development work performed for the direct benefit of the Project. Petitioners assert that because development fees are included in indirect costs required to be capitalized, petitioners included the leasing incentive fee of $5,747,571.00 in those costs capitalized to the basis of the property on Tiago's 2011 federal income tax return and therefore, they should be included in the basis of the property in determining the TPCC of the brownfield credit.

Petitioners also contend that because the leasing incentive fee was properly included in the basis of the property, the next question is whether that property meets the definition of "qualified tangible property" pursuant to Tax Law § 21 (b) (3). Petitioners assert that the Tax Law does not require that individual costs meet the criteria for qualified tangible property, only that the property itself meet such criteria. Petitioners argue that the depreciable property into

which the leasing incentive fee was capitalized meets the criteria to constitute qualified tangible property.

23. The Division argues that the leasing incentive fee does not qualify as an indirect cost that should have been capitalized because that fee was not contingent upon any work being performed by DWD. The Division points to the relevant operating agreement and asserts that it does not require any specific action by DWD prior to receipt of the leasing incentive. The Division alleges that while no action is required by DWD, the same operating agreement does require the hiring of a contractor to develop and construct the Project, and, among other things, administer, monitor and supervise the services of architects, engineers, contractors and consultants with respect to the design, development and construction of the Project. The Division also argues that the fee agreement indicates that the leasing incentive fee is related to marketing, selling, advertising or distribution.

The Division contends that even assuming the leasing incentive fee was properly capitalized, it still fails to meet all of the other criteria of "qualifying tangible property." The Division also asserts that the 2015 amendments to Tax Law § 21 (b) (3) adding related party service fees to the determination of the cost or other basis of the property do not apply to petitioners' claims.

24. In response, petitioners state that, read together, the fee agreement and the operating agreement establish that DWD was tasked with developing the Project. Petitioners argue that the leasing incentive fee was required to be capitalized, and was, therefore, properly included in the TPCC. Petitioners acknowledge that the 2015 amendments to Tax Law § 21 (b) (3) do not apply to the Project.

Petitioners also assert that the Division's interpretation of Tax Law § 21 should not be afforded any deference as this is an issue of statutory interpretation. Petitioners further assert that even if the Division is entitled to some deference, they have met their burden of proof and have overcome such deference.

With its reply, petitioners submitted the affidavit of Richard Chera, a New York City commercial real estate developer.

CONCLUSIONS OF LAW

A. In 2003, the New York State Legislature enacted the Brownfield Cleanup Program (BCP), to promote the cleanup, reuse and redevelopment of abandoned and likely contaminated properties, known as brownfields (***see*** ECL § 27-1403). As defined during the relevant tax year, a "brownfield site" was "any real property, the redevelopment or reuse of which may be complicated by the presence or potential presence of a contaminant" (ECL former § 27-1405 [2]).

B. As part of its enactment and as a financial incentive for applicants, the BCP established the brownfield credit (***see*** Tax Law § 21). Under the brownfield credit, a taxpayer subject to tax under article twenty-two is permitted a credit against such tax for a qualified site (***see*** Tax Law former § 21 [a] [1]). A "qualified site" is a site for which a taxpayer has received a certificate of completion (certificate) from the commissioner of environmental conservation pursuant to ECL § 27-1419 (***see*** Tax Law § 21 [b] [1]). DEC issues a certificate once the site has been remediated pursuant to the applicable requirements (***see*** ECL former § 27-1419 [3]; ***Lighthouse Pointe Property Associates LLC v New York State Dept. of Environmental Conservation***, 14 NY3d 161, 166 [2010]). The certificate includes information determined by

the Division, including, among other things, the applicable percentage to be used in determining the TPCC of the brownfield credit (***see id.***).

C. The amount of the brownfield credit for a taxable year is the sum of the "site preparation credit component" (costs to get the site ready for cleanup and redevelopment, except the cost of acquiring the real property) (Tax Law § 21 [a] [2]), the "tangible property credit component" (the cost of erecting commercial, industrial or recreational buildings) (Tax Law former § 21 [a] [3]), and the "on-site groundwater remediation credit component" (Tax Law § 21 [a] [4]), applicable in such year (Tax Law § 21 [a]).

D. The TPCC as defined in Tax Law former § 21 (a) (3) is 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 . . . ."

The TPCC can be claimed beginning in the taxable year in which the qualified tangible property is first placed in service on a qualified site, and can be claimed for up to ten years after the date of the issuance of a certificate of completion (***see*** Tax Law former § 21 [a] [3]). To calculate the TPCC, a taxpayer must multiply the "applicable percentage," here 18% (***see*** Tax Law former § 21 [a] [5]), by the taxpayer's "cost or other basis for federal income tax purposes" of the property (Tax Law former § 21 [a] [3]). The "cost or other basis for federal income tax purposes" of the property is established by IRC § 263A and the regulations promulgated thereunder.

E. The federal income tax law separates business expenses from capital expenditures (***see Robinson Knife Mfg. Co., Inc. v C.I.R.***, 600 F.3d 121, 125 [2d Cir 2010]). Taxpayers may deduct "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business" (***see*** IRC § 162 [a]). By contrast, no immediate deduction is

permitted for capital expenditures, which are defined as "[a]ny amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate" (IRC § 263 [a] [1]; ***Robinson Knife Mfg. Co.***, 600 F.3d at 125). Capital expenditures are capitalized, which means they are charged to the basis of the relevant property (***see*** Treas Reg § 1.263A-1 [c] [3]). Costs that are capitalized can be recovered through depreciation, amortization, cost of goods sold or by an adjustment to basis at the time the property is used, sold, placed in service, or otherwise disposed of by the taxpayer (***see*** Treas Reg § 1.263A-1 [c] [4]).

F. Internal Revenue Code § 263A and the regulations promulgated thereunder require taxpayers that produce real property to capitalize direct costs allocable to the property and the property's proper share of indirect costs (***see*** Treas Reg § 1.263A-1 [a] [3] [i], [ii]; ***Ashkouri v Commissioner of Internal Revenue***, T.C. Memo. 2019-95, 2019 WL 3433087, *9 [2019]). "Produce" includes "construct, build, install, manufacture, develop or improve" (IRC § 263A [g] [1]). Development activities include performing engineering and feasibility studies or drafting architectural plans even though such activities have no immediate tangible impact on the property (***see Von-Lusk v Commissioner***, 104 T.C. 207, 1995 WL 39379, * 216 [1995]).

Direct costs include direct material costs for those materials that become an integral part of the property produced or materials that are consumed in the production and direct labor costs, such as basic compensation, overtime pay, and sick leave pay (***see*** Treas Reg § 1.263A-1 [e] [2]). As relevant here, indirect costs are properly allocable to property produced when the costs directly benefit or are incurred by reason of the performance of production (***see*** Treas Reg § 1.263A-1 [e] [3]). Costs included in this description are those where the underlying expense "must be a but-for cause of the taxpayer's production activities" (***Robinson Knife Mfg. Co.***, 600

F.3d at 131-132). Examples of indirect costs required to be capitalized include officers' compensation, storage costs for storing property, rental costs for renting equipment, insurance, utilities, and engineering and design costs (***see*** Treas Reg § 1.263A-1 [e] [3]).

G. Petitioners assert that, read together, the fee agreement and operating agreement establish that the leasing incentive fee was a development fee. Petitioners are correct that development fees are included within those indirect costs that are required to be capitalized (***see Von-Lusk***, 104 T.C. 207) and, therefore, included in "the cost or other basis" of the property for which the TPCC is claimed (***see*** Tax Law § 21; IRC § 263A). However, petitioners have failed to substantiate their claim that the leasing incentive fee paid to DWD by Tiago constituted a development fee, or any other indirect cost that would be properly allocable to the property.

The fee agreement and operating agreement alone are not sufficient to establish the leasing incentive fee was a development fee. Other than a general statement from an attorney for one of Tiago's members that asserts the fee was payable to compensate DWD for the work Tiago anticipated would be required to complete the Project (***see*** finding of fact 20), petitioners have not produced any evidence that the lease incentive fee paid by Tiago was for development of the Project, or anything else (***see*** finding of fact 14). Accordingly, the Division's disallowance of the leasing incentive fee of $5,747,571.00 in determining the TPCC of the brownfield credit was proper.

H. Assuming, arguendo, that petitioners had established that the leasing incentive fee was properly capitalized in the basis of the relevant real property, the Division incorrectly asserts that nonetheless, the leasing incentive fee would not qualify as part of the TPCC because it does not meet the definition of "qualified tangible property." When presented with questions of statutory interpretation, the text of the statute is the best indicator of legislative intent and clear

language should be construed to give effect to its plain meaning (***see Matter of the Walt Disney Company and Consolidated Subsidiaries***, Tax Appeals Tribunal, August 6, 2020). Where "'the question is one of pure statutory reading and analysis, dependent only on accurate apprehension of legislative intent, there is little basis to rely on any special competence or expertise of the administrative agency'" (***Matter of DaimlerChrysler Corp. v Spitzer***, 7 NY3d 653, 660 [2006] [internal quotations omitted]).

Here, a plain reading of Tax Law former § 21 (a) (3) makes clear that once "the cost or other basis for federal income tax purposes" of the property is determined, the analysis shifts to whether the property itself meets the definition of "qualified tangible property" as defined in Tax Law former § 21 (b) (3), not whether the underlying costs meet such definition. Whether or not the relevant property qualifies as "qualified tangible property" is not at issue here and will not be addressed.

I. Petitioners submitted the affidavit of Richard Chera for consideration with its reply brief on June 8, 2020. As the record in this matter was closed on April 3, 2020 (***see*** finding of fact 19), the affidavit of Richard Chera will not be considered (***see Matter of March***, Tax Appeals Tribunal, November 26, 2018).

J. The petitions of Jonathan and Beth Cohen, Brad Blumenfeld and Francie Swift, David Blumenfeld, and Edward and Susan Blumenfeld are denied and the Division's denials of petitioners' refund claims for tax year 2011 are sustained.

DATED: Albany, New York
December 3, 2020

/s/ Jessica DiFiore______________
ADMINISTRATIVE LAW JUDGE