STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition of **HYDRONIC FABRICATIONS, INC.** for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period September 1, 1978 through August 31, 1981.	:	
In the Matter of the Petition of **IRWIN MATTES, OFFICER OF HYDRONIC FABRICATIONS, INC.** for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period September 1, 1978 through August 31, 1981.	:	DECISION DTA NOS. 800463, 800464 AND 800465
In the Matter of the Petition of **JOSEPH SACKS OFFICER HYDRONIC FABRICATIONS, INC.** for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period September 1, 1978 through August 31, 1981.	:	

Petitioner, Hydronic Fabrications, Inc., 459 Brown Court, Oceanside, New York 11572,

filed an exception to the determination of the Administrative Law Judge issued on January 7, 1988 with respect to its petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period September 1, 1978 through August 31, 1981 (File No. 800463).

Petitioner, Irwin Mattes, officer of Hydronic Fabrications, Inc., Flower Hill Road, Canaan, New York 12029, filed an exception to the determination of the Administrative Law Judge issued on January 7, 1988 with respect to his petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period September 1, 1978 through August 31, 1981 (File No. 800464).

Petitioner, Joseph Sacks, officer of Hydronic Fabrications, Inc., 15 Leonard Drive, East Rockaway, New York 11518, filed an exception to the determination of the Administrative Law Judge issued on January 7, 1988 with respect to his petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period September 1, 1978 through August 31, 1981 (File No. 800465).

Petitioners appeared by Sidney Meyers, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Kevin A. Cahill, Esq. of counsel).

Both parties submitted briefs on the exception. Oral argument, at the request of the petitioners, was heard on June 7, 1988.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUE

Whether the methodology used by the Division of Taxation to determine the sales tax

liability of Hydronic Fabrications, Inc. for the period at issue is proper.

FINDINGS OF FACT

We find the facts of this matter as stated in the Administrative Law Judge's determination and such facts are incorporated herein by this reference, except that we modify finding of fact "11" of the determination as stated below. The remaining facts may be summarized as follows.

On December 20, 1982, the Division of Taxation issued to Hydronic Fabrications, Inc. (hereinafter "Hydronic") a Notice of Determination and Demand for Payment of Sales and Use Taxes Due in the amount of $84,715.97, plus penalty and interest, for a total amount due of $135,245.69 for the period September 1, 1978 through August 31, 1981. On the same date, notices of determination and demands for payment of sales and use taxes due were issued to Irwin Mattes and to Joseph Sacks, as officers of Hydronic, each in the amount of $79,432.10, plus penalty and interest, for a total amount due of $127,027.95 for the same audit period.

On May 4, 1981, Joseph Sacks, vice-president, executed, on behalf of Hydronic, a Consent Extending Period of Limitation for Assessment of Sales and Use Taxes under Articles 28 and 29 of the Tax Law, whereby sales and use taxes for the period September 1, 1978 through August 31, 1981 could be assessed at any time on or before December 20, 1982.

At the hearing held herein, it was conceded by petitioners' representative that petitioner Irwin Mattes, president, and petitioner Joseph Sacks, vice-president, were persons required to collect and pay over sales taxes on behalf of Hydronic within the meaning and intent of Tax Law sections 1131(l) and 1133(a) during the period at issue.

For the period at issue, an audit of Hydronic was commenced in April 1981. At Hydronic's request, the actual audit did not begin until January 1982 due to the pendency of

administrative proceedings relative to a prior audit period. Hydronic furnished all books and records which were requested by the auditor and said books and records were in good condition.

Hydronic's sales invoices were divided into two groups for purposes of the audit, i.e., invoices for sales of more than $5,000.00 and invoices of $5,000.00 or less. A detailed examination of 189 invoices over $5,000.00 indicated that Hydronic was not collecting sales tax on sales of fabricating services and materials which were sold to contractors and businesses. The total amount of sales for invoices over $5,000.00 was $2,324,817.60. From these invoices, the auditor determined that Hydronic had failed to collect sales tax on taxable sales totalling $713,546.31. By applying the appropriate tax rate, sales tax on the invoices over $5,000.00 was determined to be $55,770.97.

For the period at issue, Hydronic had 516 sales invoices of $5,000.00 or less totalling $793,914.71. The auditor performed a sequential selection audit of these invoices; i.e., he examined every fifth invoice or 103 invoices in all. Sales tax of $2,211.16 was found to be due on 17 of the 103 invoices examined. Total tax due on invoices of $5,000.00 or less was determined as follows:

$ 2,211.16 (tax due per sample)
$149,551.28 (total dollar amount of sample) = .0147852

.0147852 x $793,914.71 (total dollar amount of all invoices of $5,000.00 or less) = $11,738.26

Tax due of $11,738.26 was, therefore, determined to be due on these invoices.

An analysis of Hydronic's sales tax accrual account indicated a credit balance of $12,067.48, the entire amount of which was held by the auditor to be tax due to the Department

of Taxation and Finance.

Hydronic's purchase invoices for the month of November 1980 were analyzed. The auditor determined that six vendors (Presto Sales, LILCO, Atlas Gas, Lune Electric and Ranganesi) did not charge tax on sales to Hydronic. The auditor then examined every purchase invoice from each of these vendors except Presto Sales for the entire audit period. For Presto Sales, the auditor examined invoices in the amount of $1,409.86 out of total sales to Hydronic of $26,053.45 for the period. His examination of this sample of the Presto Sales invoices resulted in a determination that 92.11 percent of these sales were taxable. By applying this percentage to total sales of $26,053.45, the auditor determined that Hydronic's purchases from Presto Sales totalling $23,997.85 were taxable. By combining this amount with purchase invoices from the other five vendors, the auditor determined that total purchases of $75,483.81 were subject to tax. Tax due was, therefore, assessed in the amount of $5,283.87 (7% x $75,483.81).

At a prehearing conference, the conferee determined that, since petitioners' books and records were complete and were made available to the auditor upon his request, it was improper for him to have performed a sequential selection audit of the invoices of $5,000.00 or less. Since his actual examination of 103 of the total 516 of these invoices resulted in tax due of $2,211.16, only this amount and not the projected amount of $11,738.26 was due on these sales. The conferee's letters to petitioners dated January 28, 1985 advised them of these reductions. The notices of determination and demands issued to each petitioner must, therefore, be reduced by $9,527.10.

At the hearing held herein, the Division of Taxation agreed to a further reduction of the

assessment against petitioner Hydronic only. The agreement to a reduction was confirmed by a memorandum from the Division's representative dated March 12, 1986. This reduction results from the Division's agreement that it was improper for the auditor to have determined a percentage of total sales by Presto Sales to Hydronic which were subject to sales tax when all invoices were available for inspection by the auditor. Since he examined Presto Sales invoices in the amount of $1,409.86 and did not examine the total amount of these invoices ($26,053.45), tax due on these purchases must be reduced from $1,679.85 (7% of $26,053.45) to $98.68 (7% of $1,409.86) for a total reduction of $1,581.17.[1]

Finding of fact "11" is modified to read as follows:

> Assessment of penalty was recommended because Hydronic had previously been audited relative to similar issues including the fact that petitioners were improperly accepting capital improvement certificates. In addition, the Division asserted that, because of the accrual account credit balance, petitioners were aware that additional sales taxes should have been paid over to the Department of Taxation and Finance. No other evidence was offered by the Division relative to the prior audit except that the matter was settled for an amount considerably less than the original assessment.

Hydronic fabricates pipe according to the specifications of its customers, the majority of whom are mechanical contractors. Hydronic does not install the pipe.

OPINION

Petitioners contend that the sales tax accrual account balance represented sales tax billed to customers which was not remitted to Hydronic and that petitioners should not, therefore, be required to pay over tax which had not been collected.

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[1]It should be noted that the conferee's reduction set forth in Findings of Fact "9" should have reduced the assessment against Hydronic to $75,188.87 and against petitioners Mattes and Sacks to $69,905.00 and not the amounts set forth in the letters of January 28, 1985 ($75,359.77 for Hydronic and $70,075.90 for Mattes and Sacks). The Division's memorandum to amend the assessment against Hydronic was, therefore, also in error since it was based upon the conferee's reduction. As a result of these reductions, the amounts of tax remaining at issue are $73,607.70 for Hydronic and $69,905.00 for each of petitioners Irwin Mattes and Joseph Sacks.

Petitioners also assert that approximately 75 percent of its electricity purchases from LILCO should be exempt from sales tax because these purchases were directly related to production. It was further asserted that there were separate electricity meters for the factory and for the office, although no evidence relative thereto was presented.

Petitioners finally assert that acceptance of certificates of capital improvement was proper by reason of the fact that its fabricated pipe became part of capital improvements.

The Division asserts that the audit methodology was proper in all respects and that the tax liability should be sustained.

The Administrative Law Judge determined that the Division's audit methodology was proper, and that the Division properly treated as taxable certain sales asserted to be exempt by petitioner. The Administrative Law Judge sustained the assessment but cancelled the penalty.

We affirm the determination of the Administrative Law Judge.

We deal first with the sales tax accrual amount.

20 NYCRR 532.1(a)(2) provides as follows:

> "Where a vendor makes a sale for which payment is not received at the time of delivery, such sale must be reported on the return covering the period in which the sale is made. Thus, if the sale is a taxable sale, the full amount of tax must be remitted with the return whether or not any money was collected at the time of sale." (Emphasis added.)

Petitioners' contention that the sales tax accrual account balance did not have to be remitted due to the fact that it represented sales tax billed to customers who failed to pay said amounts to Hydronic is, therefore, without merit.

We deal next with petitioners' allegation that the audit was not in accord with principles laid down by the Court of Appeals in Chartair, Inc. v. State Tax Commn. (65 AD2d 44) in that since petitioner had full and adequate books and records, the Division erred in not doing a

detailed examination of all sales invoices under $5,000 and all purchase invoices from Presto Sales, Inc.

These issues were addressed at the hearing before the Administrative Law Judge and appropriate adjustments were made by the Administrative Law Judge to reduce the liability to the sales invoices and purchase invoices actually examined by the Division. Since all sales invoices over $5,000 were actually examined no adjustments to that part of the assessment which flows from such analyses was required. We do not view the failure to fully audit all sales invoices under $5,000 and purchase invoices from Presto Sales, Inc. to impair the validity of the detailed and full audit carried out by the Division with respect to the remainder of petitioners' books and records. Contrary to petitioners' assertion, neither Chartair (supra) nor its progeny lead to such a result.

We deal next with those sales made by petitioners which petitioners claim are exempt as capital improvements.

Section 1132(c) of the Tax Law, in effect for the period at issue, provided, in pertinent part, that:

> "[I]t shall be presumed that all receipts for property or services ... are subject to tax until the contrary is established, and the burden of proving that any receipt ... is not taxable hereunder shall be upon the person required to collect tax or the customer. Unless (1) a vendor shall have taken from the purchaser a certificate in such form as the tax commission may prescribe...to the effect that the property or service was purchased for resale or for some use by reason of which the sale is exempt from tax under section eleven hundred fifteen.. the sale shall be deemed a taxable sale at retail. Where such a certificate or statement has been furnished to the vendor, the burden of proving that the receipt ... is not taxable hereunder shall be solely upon the customer." (Emphasis added.)

Section 1115(a)(17) of the Tax Law exempts from the imposition of sales tax, tangible personal property sold by a contractor, subcontractor or repairman to a person for whom he is

adding to, or improving real property, property or land by a capital improvement if such tangible personal property is to become an integral component part of such property or real property. It is conceded that petitioners are not contractors within the meaning of the statute. Petitioners rely on Saf-Tee Plumbing Corp. v. State Tax Commn. (77 AD2d 1) and argue that they accepted certificates of capital improvement in good faith. However, as this Tribunal stated in Matter of Neal Andrews, Ltd., Tax Appeals Tribunal, October 6, 1988, the test for these capital improvement certificates, prior to the revision of the form in April, 1982, is whether under all the facts and circumstances of the case the petitioner, in good faith, accepted the capital improvement certificates. Under the circumstances herein we conclude petitioners' actions did not meet the "good faith" test since as a result of a prior audit petitioners were put on notice concerning the proper method of treating these transactions under the Tax Law.

We deal finally with the application of sales tax to electricity purchased by petitioners for use in fabricating operation.

Tax Law section 1115(c) provides that fuel, gas, electricity, refrigeration and steam and like services are exempt from sales and use taxes when used directly and exclusively in the production for sale of tangible personal property.

20 NYCRR 528.22(c) provides, in pertinent part, as follows:

> "Directly and exclusively. (1) Directly means the fuel, gas, electricity, refrigeration and steam and like services, and must during the production phase of a process, either:
>
> (i) operate exempt production machinery or equipment, or
> (ii) create conditions necessary for production, or
> (iii) perform an actual part of the production process.
>
> * * *
>
> (2) Usage in activities collateral to the actual production process is not deemed to be used directly in production.

(3)(i) Exclusively means that the fuel, gas, electricity, refrigeration and steam and like services are used in total (100%) in the production process.

(ii) Because fuel, gas, electricity, refrigeration and steam when purchased by the user are normally received in bulk or in a continuous flow and a portion thereof is used for purposes which would make the exemption inapplicable to such purchases, the user may claim a refund or credit for the tax paid only on that portion used or consumed directly and exclusively in production.

* * *

(iv) The user must maintain adequate records with respect to the allocation of fuel, gas, electricity, refrigeration and steam used directly and exclusively in production and for nonexempt purposes."

Petitioners here did not introduce any evidence that separate electricity meters for the factory and the office were maintained, nor did they offer any other evidence sufficient to prove the amount of electricity used directly and exclusively in exempt production (20 NYCRR 528.22[c][v]). In the absence of such evidence the Division was correct in assessing sales tax on all purchases of electricity.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exceptions of the petitioners, Hydronic Fabrications, Inc. and Irwin Mattes and Joseph Sacks, as officers, are denied;

2. The determination of the Administrative Law Judge is affirmed; and

3. The petitions of Hydronic Fabrications, Inc. and Irwin Mattes and Joseph Sacks are denied.

Dated: Albany, New York
12/01/1988

John P. Dugan
President

Francis R. Koenig
Commissioner