STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
ARTEX SYSTEMS, INC. AND GRANT Z. KAFAROWSKI, AS OFFICER	:	DECISION DTA No. 812476
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 June 1, 1990 through August 31, 1992.	:	

Petitioners Artex Systems, Inc. and Grant Z. Kafarowski, as officer, 523 Bowes Road, P.O. Box 149, Concord, Ontario, Canada L4K1B2, filed an exception to the determination of the Administrative Law Judge issued on November 9, 1995. Petitioners appeared by Cunningham & Lee (Gerard W. Cunningham, Esq., of counsel). The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (John E. Matthews, Esq., of counsel).

Petitioners filed a brief on exception. The Division of Taxation filed a brief in opposition to petitioners' exception. Petitioners filed a reply brief. Petitioners' request for oral argument was denied.

The Tax Appeals Tribunal renders the following decision per curiam.

ISSUE

Whether petitioners have established that the Division of Taxation included in its calculation of taxable receipts for the audit period certain receipts not subject to the sales tax.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

Petitioner Artex Systems, Inc. ("Artex") is a designer, manufacturer and installer of various architectural wall systems. Petitioner Grant Kafarowski started the company in 1962

and has been Artex's president since then. Artex is a Canadian corporation located in Ontario, Canada.

Following a field audit of Artex's business operations and sales tax returns, the Division of Taxation ("Division") issued to each petitioner a separate notice of determination for the period June 1, 1990 through August 31, 1992 assessing sales and use taxes in the amount of $270,032.83, plus penalty and interest.

The Division issued to petitioners separate conciliation orders, dated October 1, 1993, sustaining the full amount of the tax assessment but cancelling all penalties. Petitioners then filed a joint petition contesting the full amount of the tax assessed. Petitioners paid all or part of the assessment after the conciliation orders were issued (the exact amount of the payment is unknown); consequently, cancellation of part or all of the assessment may result in a refund to petitioners.[1]

Artex is primarily a subcontractor in the construction industry. It has fabricated and installed the outside facade for major building projects in Canada, the United States, and the United Kingdom. The tax assessment at issue here resulted from work performed by Artex on one particular project in New York State, the Regent Hotel (later known as The Four Seasons) in New York City.

The construction manager of the Regent Hotel was Tishman Construction Corporation ("Tishman") and the architect was Pei, Cobb, Freed & Partners. On January 9, 1990, Artex submitted to Tishman a quotation (or bid) to supply "F.O.B. truck at designated marshalling yard exterior stone clad precast panels all for the sum of $5,393,000.00" (Letter from J. D. Farwell, vice-president of Artex, to Joseph Cascino of Tishman Realty, January 9, 1990).

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[1]At hearing, the parties were asked whether they could stipulate to the amount of the payment. The Division's representative stated that he was not sure of the relevance of that information, but he agreed that a payment had been made to stop the running of interest. Petitioners' representative offered to place a copy of the cancelled check in evidence, but this was never done. Based on the attorneys' comments, it may be presumed that the full amount of the tax assessment was paid, but this is not an absolute certainty.

Tishman and Artex executed a contract, all or parts of which were revised on February 6, 1990, February 8, 1990, August 10, 1990, August 28, 1990, October 15, 1990, November 1, 1990 and January 4, 1991, respectively. Petitioners offered in evidence what appears to be the final version of the contract. The front page states:

> "The Principal by and through its Agent, the Construction Manager, hereby gives to the Vendor an order for and the Vendor agrees to provide at the above Project, the materials described below, on the conditions stated below and on the reverse side hereof. *F.O.B. staging yard Stone Faced Precast Concrete in accordance with the following Contract Documents . . . ."

The "Stone Faced Precast Concrete" was described by petitioners as precast concrete panels faced with a limestone veneer. Some of the panels were solid. Others contained openings for window and doors. Still others were shaped in the form of design moldings. Tishman purchased the limestone veneer in France. Artex cut and shaped the limestone and installed it as a veneer on the precast concrete panels.

Among the contract documents was Rider "A" which set forth with specificity the scope of the work to be performed by Artex. It contains this provision:

> "Notwithstanding anything in the other Contract Documents to the contrary, all provisions of this addendum shall supersede any conflicting provisions of other Documents. All other provisions of the Contract shall remain in full force and effect."

The section of Rider "A" detailing the scope of work to be performed by Artex is just over four pages long. The scope of work provision begins with this statement:

> "Without restricting the generality of work which shall be performed within the Contract Price, it is clearly understood and agreed that the Contractor shall provide all material, labor, trucking, engineering, in plant caulking, protection (to staging area), shop drawings, taxes, insurance, etc., necessary for the furnishing of all specified and related work contained herein in accordance with the Contract Drawings, Specifications, Addenda and Riders, all of which become part of this Contract."

As pertinent to this proceeding, the items to be provided by Artex were as follows:

(a) the engineering and design of the stone faced precast concrete panels in accordance with the architect's concept and subject to the architect's approval;

(b) the fabrication of the panels, including all material, labor and in-plant caulking;

(c) the provision of shop drawings and calculations demonstrating the structural adequacy of the precast system and attachment devices prepared by a professional engineer licensed in New York;

(d) the design, fabrication and drilling of stone holes and installing of stainless steel pins to attach the limestone veneer panels to the precast concrete;

(e) all supports and anchorage for installation of the stone faced panels;

(f) the services of a qualified representative, approved by Tishman, on the site project for the visual inspection of the panels and the installation of the panels for the first two weeks of the erection and on a periodic basis thereafter;

(g) delivery of the panels in accordance with a schedule to be agreed on by the parties;

(h) additional freight charges of $35,000.00 for the transportation of the limestone, purchased in France by Tishman, from Montreal to Toronto; and

(i) a mock-up to include two spandrels, two column covers, two corners and two windows.

On the front page of the contract was a breakdown of the contract price as follows:

"STONE FACED PRECAST CONCRETE

AMOUNT:	$5,428,000.00
TAX (on material portion)	265,000.00
DUTY:	122,000.00
TOTAL: (U.S. Dollars)	$5,815,000.00"

On audit, the auditor was provided with 23 sales invoices, each of which described the contract work as: "To supply only Limestone faced precast concrete." Upon review of the letter of January 9, 1990 from Artex to Tishman, the contract, change orders and the sales invoices, the Division determined that the contract was one for the sale of tangible personal property (stone faced precast concrete panels) and that all receipts relating to the contract were subject to sales tax.

To determine taxable receipts, the auditor initially created a worksheet listing 52 invoices with a reference number for each, the invoice date and number, the invoice amount, the taxable

amount (in the auditor's estimation), tax paid as shown on the invoice, additional tax due per the auditor, and a description of the work or materials charged for as described on the invoice. The auditor's description of the work done falls into these categories: (1) handling of rejected pieces of limestone; (2) charges for lack of production due to lack of limestone; (3) cutting of limestone pieces; (4) container demurrage charges; (5) repair of a trailer; (6) manufacture and delivery of window panels; (7) finishing and cutting of limestone for the mock-up; (8) handling charge for rejected limestone pieces; (9) supply of limestone-faced precast concrete; and (10) supplying extra hardware and inserts. The worksheet shows that the auditor determined that the entire charge as shown on each invoice was taxable.[2] In his testimony, the auditor explained that he was later informed that some of the invoices were, in fact, change orders. These change orders added to the amount of the total contract price by charging for items or services not previously included in the contract amount of $5,815,000.00; however, the change orders submitted by Artex were subject to Tishman's approval. After Tishman agreed to the change order, the amount of the change order was included in a sales invoice. The auditor eliminated all of the change orders from his calculation of taxable receipts, and this is reflected on the worksheet where the change orders have been crossed out. However, since the amounts of the change orders were included in the sales invoices after Tishman's approval was received, the charges shown on the change orders were reflected in the auditor's calculation of taxable receipts.

The auditor calculated taxable receipts on the Tishman project based upon the 23 sales invoices provided to him by petitioners. Invoice 4728, dated December 18, 1991, is typical of the 23 sales invoice used by the auditor. Like the other invoices, it shows a calculation of balance due from Tishman beginning each time with the total value of the contract ($5,815,000.00) and adding the value of change orders, approved and pending, to compute the total adjusted contract price. This is followed by a statement of the value of work completed to

[2]There is one exception to this statement. The worksheet shows an invoice amount of $578,232.34 for invoice number 4705 and a taxable amount of $502,527.34. There is no explanation for the difference. Other workpapers show that the entire amount of the invoice was determined to be subject to tax.

date, less previous billings, to compute the gross amount due on the invoice. The gross invoice amount is reduced by a 10% retention to calculate a net balance due on the invoice. The auditor determined taxable receipts by aggregating the net balance due as shown on each of the 23 sales invoices issued during the audit period.

On each of the sales invoices entered into evidence (18 of the 23 relied on by the auditor), there is a handwritten notation which shows a calculation of the amount of New York State sales tax remitted under the contract. On invoice 4728, the calculation, beginning with the amount of sales tax included in the contract price, $265,000.00, is as follows:

"NYS Tax 265,000.00
Job 90.2% complete

NYS Tax	239,030.00
remitted to date	226,840.00
	12,190.00"

Based upon 23 sales invoices provided by petitioners, the Division determined that total charges subject to sales tax amounted to $6,269,864.76. Based on a tax rate of 8.25%, the tax due on that amount would be $517,263.83. The auditor found that Artex had reported purchases subject to use tax of $3,294,179.00; however, he was unable to verify that payments had been made on three invoices (invoice numbers 4749, 4697 and 4758) with a total value of $413,783.76. Tax paid by Artex was determined to be $247,231.00 and additional tax due was determined to be $270,032.83.

Both the exact amount of Artex's sales tax payments and Artex's method of computing tax shown on its sales tax returns are in dispute.

Petitioners placed in evidence copies of cancelled checks, made payable to New York State, which show that Artex made payments of sales tax during the audit period in the amount of $271,770.00. Petitioners claim that all of these payments relate to the Regent Hotel project and that credit should be given for their having paid sales taxes relating to that project in the same amount.

In an affidavit, the auditor stated that Artex was collecting and remitting sales tax for other projects in addition to the Regent Hotel project and that he was unable "to verify that

petitioner paid tax in connection with the Tishman project for [invoice numbers 4749 and 4697)." As a consequence, the auditor concluded that Artex had not paid any sales tax on charges included on those invoices. In an answering affidavit, Mr. Kafarowski stated that the auditor's statements are not true and noted that there is no evidence in the record to support his allegation that Artex was collecting and remitting sales tax on projects other than the Tishman project.

Invoice number 4749 was placed in evidence. It shows New York State sales tax paid on the charges shown on that invoice as $2,650.00. A cancelled check dated March 4, 1992, in the amount of $2,650.00, correlates with invoice number 4749. Invoice 4697 was not placed in evidence. Summary worksheets of both parties show the date of that invoice as January 23, 1991. A cancelled check in the amount of $19,610.00, dated February 6, 1991, was placed in evidence. It verifies that a payment was made to New York State on this date. Petitioners also proved, through submission of a cancelled check, that a payment of $2,279.00 was made to New York State on August 7, 1990. This payment does not appear to relate to any one of the 23 sales invoices relied on by the auditor in determining taxable sales.

Explaining the method used by Artex to calculate the tax reported to New York, the auditor testified that Artex maintained an accrual account for "use" taxes. The same point is made on the cover page of the audit report which indicates that Artex reported no gross sales, no taxable sales and purchases subject to use tax of $3,294,179.00. These statements are contradicted by page 5 of the "Field Audit Report-Attachment Sheet" which contains this statement: "It should be noted that the vendor did not report gross sales on his sales tax returns. Purchases subject to use tax were erroneously reported as taxable sales." Artex's sales tax returns were not offered into evidence. The documentary evidence indicates that Artex collected sales tax from Tishman and remitted the tax collected to New York.

Artex's billings to Tishman were prepared by Artex's vice-president, James D. Farwell, who explained through his testimony the billing documents showing the amount and nature of Artex's charges to Tishman. In addition to the sales invoices relied on by the auditor to

calculate sales tax, Artex prepared and submitted to Tishman monthly requisitions on forms prepared by Tishman. Attached to each requisition was a packet of documents including all or some of the following: (1) a summary sheet; (2) an affidavit averring that Tishman paid Artex in full in accordance with Tishman's current obligation under the contract; (3) an original copy of an Artex sales invoice; (4) a spreadsheet entitled "SUBCONTRACTOR WORKSHEET - SCHEDULE OF VALUES; (5) a worksheet listing pending change orders; and (6) a bill of sale with a schedule showing the actual number of pieces of precast concrete panelling sold and delivered to Tishman. Petitioners placed in evidence 25 packets of original documents for the Regent Hotel. They were provided to Artex by the present owners of the hotel. These 25 packets include requisition numbers 1 through 6, 6 (there are two requisitions with this number) through 13, 15 through 18, 38 through 42, a second requisition numbered 42, and one unnumbered requisition dated July 26, 1993. Other than the last two packets, they cover the period August 1990 through September 1992. The last two packets (the second requisition numbered 42 and the unnumbered requisition) are both dated July 1993 and contain final negotiations between Artex and Tishman or the owners of the Four Seasons Hotel regarding possible payments still owed to Artex.

The auditor stated in an affidavit, notarized on December 14, 1994, that "petitioner never provided me with either the originals or copies of the documents which have been offered into evidence as Exhibit 13" -- the requisitions and attached documents. However, at hearing, the auditor removed from his files a packet of documents which he identified as a "cost summary analysis" provided to him by petitioner on audit. It is a copy of requisition number 41, dated July 15, 1992, with the documents attached thereto. This packet of documents was placed in evidence as Petitioner's Exhibit "1". The auditor stated that he did not consider any of these documents in arriving at a final determination of tax due.

The first requisition numbered 42 is for the quarter ending August 31, 1992 (the end of the audit period). It contains a subcontractor worksheet which shows, among other things, a breakdown of the original contract price of $5,815,000.00 as follows:

Engineering and Design	$ 200,000.00
Florida Mock-up	50,000.00
Site Hardware (Inserts)	100,000.00
Forming	150,000.00
Production of Units	3,720,000.00
Shipping, Duty & Brokerage	1,170,000.00
New York State Taxes	270,000.00
Miscell. Finishing, Site Trips	120,000.00
Limestone Contingency	0.00
Extra Container Shipping Allowance	35,000.00

Each of the other requisition packets contains a subcontractor worksheet showing a similar breakdown of the contract price (numbers 1 through 3 are slightly different). In addition to a breakdown of the contract price, each subcontractor worksheet shows the value of the work completed to the date of the monthly requisition. There is a column on each worksheet reserved for Tishman's calculation of work completed to date. The figures in this column indicate Tishman's agreement or disagreement with Artex's computations.

There is a fair degree of consistency between the requisitions and the sales invoices relied on by the auditor to determine taxable sales.

For the most part, the invoice dates correlate with the dates on the requisitions. There are exceptions where there are duplicate requisition numbers (number 6), missing requisitions (number 14) and missing invoices (only 18 of the 23 invoices relied on by the auditor were entered in evidence). There is a discrepancy between the dates of the invoices and the requisitions for the months of June, July and August 1991.

The front page of each requisition shows a running calculation of the total amount of the contract calculated by adding the amount of the contract ($5,815,000.00) to change orders issued to the date of the requisition, plus pending change orders. Each sales invoice shows the same calculation, and the monthly calculations on the sales invoices and requisitions are generally consistent even where the date of each is different (e.g., the sales invoice dated August 18, 1991 and the requisition dated August 30, 1991 have the same calculation of the total adjusted contract amount of $6,182,972.53).

Many of the requisition packets contain an itemization of the number of panels delivered to Tishman to date and the number remaining to be delivered. The calculation of work completed to the date of the requisition reflects actual work done rather than an agreed upon percentage of the overall sale. For example, $50,000.00 of the contract price was allocated to the Florida Mock-up. Requisition number 3 shows that this work was completed by October 1990 and the total value of $50,000.00 appears as completed work on the contract cost breakdown sheet attached to requisition number 3. In the same vein, requisition number 5 shows that a value of $150,000.00 was allocated to the forming (wooden forms used to shape the concrete) and that 6 forms at a value of $69,230.00 were completed by December 1990. The next month, 7 forms were completed at a value of $80,269.50, and by April 1991, all work in this category was completed at a value of $150,000.00.

Mr. Farwell testified regarding the manner in which the parties calculated a sales tax of $270,000.00 as part of the contract price. He stated that Artex determined the total value of the precast concrete panels as follows:

Materials	$1,100,000.00
Labor	1,225,000.00
Overhead on Plant Labor	380,000.00
Sub-total	2,705,000.00
Firm Overhead	1,080,000.00
Total Canadian Dollars	$3,785,000.00

Mr. Farwell stated that overhead on plant labor consisted of amounts necessary to cover workers' compensation payments, health insurance, unemployment insurance and expenses of that nature. Firm overhead included fixed expenses of the firm, such as building costs, plus profit. The calculations were originally made in Canadian dollars and then converted to United States dollars of $3,293,000.00. A tax rate of 8¼ percent was applied to the result to calculate sales taxes of $271,670.00. The parties agreed to include in the contract price sales tax in the amount of $265,000.00; however, documents submitted by petitioners show that the actual amount of tax collected from Tishman and paid to New York State was $271,770.00.

It is petitioners' contention that the only receipts subject to sales tax are those representing materials, labor and overhead as shown above. They claim that all other items are for the sale of services or other items not subject to New York sales tax. Petitioners' evidence and arguments with regard to each item shown on the subcontractor worksheet will be examined separately.

(a) The contract required Artex to engineer a design for the precast concrete panels in accordance with the architect's plans and specifications. In addition, Artex was required to produce hundreds of pages of shop drawings and structural engineering calculations for review and approval by the architect, engineer and others. The amount attributed to the provision of these services according to the subcontractor worksheet(s) was $200,000.00. Petitioners claim that these engineering services were not subject to sales tax.

(b) Artex produced what has been referred to as a Florida Mock-up, as provided for in section (c)(15) of Rider "A" of the contract. The "mock-up" actually consisted of a precast concrete panel which was over two stories high (approximately 30 feet). It was shipped from Canada to a testing facility in Florida where it was subjected to various tests to ensure that the panels would withstand stress from the building, wind and water. Under the terms of the contract, the costs of shipping the panels to Florida, including customs duties, were included in the contract price. The tests were conducted during the period November 30, 1990 through December 19, 1990 by an independent laboratory. The panel was destroyed in Florida when the testing was completed. The subcontractor worksheet allocates $50,000.00 of the total contract price to the Florida Mock-up. The concrete panel plus two barrels of loose hardware were shipped to Miami, Florida by Artex via Kalybaba Trucking, Inc. of Jordan, Ontario, Canada. Documents placed in evidence include a Kalybaba sales invoice, dated November 2, 1990, in the amount of $14,000.00 for shipment of two loads from Ontario, Canada to Miami, Florida.

(c) Artex provided the hardware needed to install the precast concrete panels, although it did not perform the installation work. Artex did not include the charge for this hardware in its calculation of taxable receipts.

(d) The concrete panels were formed, in part, by pouring the concrete into wooden forms designed and built by Artex for this purpose. After the forms were used, they were discarded. Artex did not include the charge for the forms in its calculation of taxable receipts, apparently on the theory that the forms were not transferred to Tishman.

(e) Petitioners submitted four packets of shipping documents (including the documents evidencing the shipment made to Florida). These documents include carbon copies of checks made payable to Kalybaba, Kalybaba sales invoices and shipping documents. They establish that between November 2, 1990 and April 18, 1991 Kalybaba provided transportation services to Artex consisting of shipping precast concrete panels and related hardware to Tishman in New York or Florida. The total charge to Artex for these services was $63,692.67.

(f) The first page of the contract shows that the sum of $122,000.00 was included in the contract price for customs duties. In addition, Artex retained the services of a customs broker to calculate the amount of Customs duties owed to the United States government.

(g) The first page of the contract also shows that the parties agreed to include sales tax in the total contract price. At the time the final version of the contract was executed, the amount agreed to was $265,000.00. The amount of sales tax actually collected by Artex and remitted to New York was $271,770.00.

(h) The contract includes an allowance of $35,000.00 for additional freight charges from Montreal to Toronto. Tishman purchased the limestone used to fashion the limestone veneer in France. Artex agreed to arrange for shipment of the limestone from Montreal to Toronto. The allowance of $35,000.00 was intended to cover Artex's costs and was contingent upon Artex taking responsibility for these arrangements. The allowance was included in the total contract price.

Mr. Farwell testified that change orders agreed to by both parties added $639,594.60 to the total contract price of $5,815,000.00. Thus, the total paid to Artex under the contract was $6,454,594.60. Mr. Farwell testified that it was his understanding that the auditor included the full amount of the change orders in his calculation of taxable sales. However, the auditor's

workpapers show that he calculated taxable sales for the audit period of $6,269,864.76, $184,699.90 less than the total value of the contract. It may be that some of the change orders were paid after the end of the audit period and not included in the auditor's calculations; however, the record is unclear on this point.

One of the terms of the contract called for Artex to retain the services of a professional engineer licensed in New York State to perform certain calculations and to approve Artex's engineering designs. Artex retained the services of Raphael Bassan, a consulting engineer, to satisfy this contract term. During the period May 1990 through January 1993, Artex paid Mr. Bassan $45,330.00 for his services. In addition to approving Artex's designs, those services included on-site inspection of the installation of the precast concrete panels. Under the original contract terms, an Artex representative was to be on-site for the first two weeks of the installation and periodically thereafter. The parties later agreed to have Mr. Bassan present during most of the installation period. Mr. Farwell testified that additional charges for Mr. Bassan's fees appear as part of the change orders included in the auditor's determination of taxable sales. However, the change orders evidencing the extension of Mr. Bassan's services were not placed in evidence and petitioners did not point to any documentary evidence which would enable one to determine which portion of Mr. Bassan's overall fee was allocated to overseeing installation of the panels.

OPINION

The Administrative Law Judge determined that the Division's audit was not so inadequate as to require the cancellation of the entire assessment. She found that the audit was based on a review of the books and records provided by petitioners. The auditor did not use an indirect audit methodology. Accordingly, the Administrative Law Judge found that the evidence did not show that "either the methodology employed or the determination that the contract was one for the sale of tangible personal property was irrational or unreasonable" (Determination, conclusion of law "A"). She also found that Artex's sales records consisted of the contract of

sale, the sales invoices, change orders and the requisitions, and that all of these documents were to be considered in determining the taxable status of Artex's charges to Tishman.

The Administrative Law Judge found that petitioners had proven that various individual items of the project should not have been found subject to sales tax. She found that sales tax in the amount of $271,770.00 was separately stated as a component of the total contract amount and should not have been included in taxable receipts. Petitioners were also to be credited for payments to the Division in this amount. Customs duties in the amount of $122,000.00 were separately stated on the face of the contract and should not have been included in taxable receipts. The Administrative Law Judge also determined that since the Florida mock-up was manufactured in Canada and delivered in Florida, the receipts for the sale of the mock-up in the amount of $50,000.00 were not subject to New York sales tax. Finally, the Administrative Law Judge found that the $35,000.00 allowance paid for transportation of the limestone from Montreal to Toronto should not have been included in taxable receipts.

All other receipts under the contract were found to be taxable. The Administrative Law Judge found the design and engineering services, shop drawings, engineering calculations, specially constructed forms for shaping the panels and the hardware for installing them to be "integral components of the process of producing the precast concrete panels. The separate statement of these charges could not transform expense items into nontaxable services" (Determination, conclusion of law "D"). Likewise, the services of the New York engineer to oversee the installation were considered an item of expense incurred by petitioners in producing the panels. The Administrative Law Judge also found that, with respect to this engineer, there was no evidence of his services having been separately billed.

In regard to the transportation costs for transporting the precast panels from Ontario to New York, the Administrative Law Judge found that such costs were not separately stated on a bill rendered to Tishman and the contract did not allocate a portion of the total amount to transportation. The Administrative Law Judge determined that:

> "[t]he requisitions lump together 'shipping, duty and brokerage' charges. Petitioners have not offered any reliable methodology which

> would enable me to segregate shipping charges from charges for customs duty and brokerage fees. The Kalybaba invoices show the expense incurred by Artex for transportation, prior to September 1, 1991. They do not show the amount charged Tishman for transportation. Petitioners have not suggested a method by which the shipping costs can be computed from the requisitions, the sales invoices, the contract or any combination of the three . . . . Consequently, petitioners have not shown that they were entitled to exclude transportation costs from taxable receipts" (Determination, conclusion of law "D").

Petitioners have taken exception to each of the holdings which the Administrative Law Judge made against them and have raised a new argument on exception. We will address each of petitioners' arguments separately.

Petitioners' primary argument is that the audit methodology employed by the auditor was so erroneous and contrary to the law that the entire audit must be cancelled. Petitioners have cited to numerous cases supporting the proposition that the Division is required to request a taxpayer's books and records and use those records in determining the tax liability. In this case, petitioners argue, the auditor did not thoroughly examine their books and records presented and, as a result, made so many mistakes that the entire audit was flawed and must be cancelled. The Division, on the other hand, points out that the cases cited by petitioners involved situations where the Division resorted to external indices to estimate tax due after a finding that books and records were inadequate to conduct a complete audit which was not the case here.

We affirm the Administrative Law Judge on this issue. Petitioners, in making this argument, have ignored the fact that in each of the cases they cited, the Division failed to rely on the taxpayer's books and records and made an estimated assessment. In the present case, the auditor did not find petitioners' books and records inadequate to conduct a complete audit and there was no resort to external indices to arrive at the final tax liability. In fact, the tax liability was derived solely from a review of petitioners' records. The auditor reviewed all the sales invoices provided by petitioners, along with the contract, and determined that all receipts were for the sale of tangible personal property. The methodology used was sound and there has been no evidence produced to indicate that the determination of the auditor was irrational or unreasonable. The problem with the audit was not so much the utilization of a flawed

methodology but rather a misapplication or misinterpretation of the law in a few instances. The remedy in such a situation is not to cancel the entire assessment, but to give credit to petitioners for those errors which they can prove. However, contrary to petitioners' argument, it is their burden to show that the amount of tax assessed was erroneous (Matter of Surface Line Operators Fraternal Org. v. Tully, 85 AD2d 858, 446 NYS2d 451).

Petitioners argue that the mistakes of the auditor as found by the Administrative Law Judge exhibited such a lack of understanding on the part of the auditor that the entire audit must be set aside and, as a result, that they are not required to prove the exact amount of tax due on the remaining items. This argument proceeds from an invalid assumption, i.e., that the audit was fundamentally flawed. In fact, out of a project costing over $6,000,000.00, the auditor erroneously subjected $500,000.00 to tax. This represents only 8% of the total. This hardly represents an audit so fundamentally flawed that it warrants cancellation, nor does it relieve petitioners of their burden of proving wherein the rest of the audit was erroneous.

Petitioners also cite to Matter of Bernstein-on-Essex St. (Tax Appeals Tribunal, December 3, 1992) and Matter of Auriemma (Tax Appeals Tribunal, September 17, 1992) for the proposition that an auditor cannot merely assume everything is taxable by relying on the presumption of taxability contained in Tax Law § 1132(c) which states, in pertinent part, that "it shall be presumed that all receipts for property or services . . . are subject to tax until the contrary is established . . . ." However, as pointed out by the Division, those cases are distinguishable from the present case. First, they both involved estimated taxes derived from external indices after a finding that the books and records of the petitioners were inadequate to conduct a complete audit. Second, in each case, although the auditor knew the methodology was flawed by knowingly including some nontaxable sales, the auditor in each case chose instead to rely on Tax Law § 1132(c). Here, the auditor made a judgment call that the entire contract was for a sale of tangible personal property based on his review of the records presented to him. Finally, in both Bernstein and Auriemma, the remedy was not a cancellation of the entire audit. Rather, only those portions of the audit that were flawed because of the

auditor's improper reliance on Tax Law § 1132(c) were cancelled. In sum, petitioners have not established a valid reason supporting the cancellation of the audit in its entirety. Therefore, we will focus on the individual portions of the audit to which petitioners have taken exception.

Petitioners argue that the contract with Tishman called for the performance of a combination of taxable and nontaxable services and sales, and that each of these sales of property or services should be separately assessed, depending on their taxability. Tax Law § 1101(b)(3) defines the term "receipt" as the "amount of the sale price of any property and the charge for any service taxable under [article 28] . . . without any deduction for expenses . . . ." This definition is explained further in 20 NYCRR 526.5(e) which provides that "[a]ll expenses . . . incurred by a vendor in making a sale, regardless of their taxable status and regardless of whether they are billed to a customer are not deductible from the receipts." We have previously held in Matter of Zagoren Group (Tax Appeals Tribunal, May 19, 1994) that the receipts from the sale of tangible personal property cannot be broken down into the taxable and nontaxable services involved in the production of the tangible personal property. As the Administrative Law Judge stated in her determination in the instant case, "[t]he separate statement of these charges could not transform expense items into nontaxable services" (Determination, conclusion of law "D").

Specifically, petitioners argue that the services provided by the New York licensed engineer in reviewing the structural adequacy of the panels and overseeing their installation was not subject to tax. The Administrative Law Judge concluded that the services of the engineer were taxable for two reasons. The primary reason was that "these services were an item of expense incurred by Artex in producing the panels" (Determination, conclusion of law "D"). Alternatively, she found that there was no evidence of a separate billing to Tishman for the engineer's services. His services appear to have been included in the general category of engineering services. On exception, petitioners do not address the primary reason for finding the engineer's services subject to taxation. That is, as we discussed above, the service was an item of expense incurred in producing the panels and, accordingly, cannot be separately stated

and thus rendered nontaxable. We agree with the Administrative Law Judge that for this reason alone the services should be subject to tax. The secondary reason given by the Administrative Law Judge, and the one excepted to by petitioners, is equally valid. Even if the New York engineer's services were not an expense item, there is no evidence of a separately stated charge on an invoice or requisition to Tishman. Rather, it was lumped in with the $200,000.00 charge for engineering and design services, charges we have already found to be taxable as an expense of production. The Administrative Law Judge gave detailed reasons for her conclusion on this issue and we see no reason to overturn that conclusion.

In a related issue, petitioners argue that the transportation costs for transporting the panels from Canada to New York should not be subject to tax. The Administrative Law Judge found that these costs were not separately stated on a bill to Tishman and the contract did not allocate a portion of the total amount to transportation. Rather, the transportation amount was lumped in with the category "shipping, duty and brokerage." On exception, however, petitioners have proposed an alternative means of estimating the amount of the transportation costs by subtracting out customs duties and deriving a percentage to apply to total transportation costs to arrive at an estimate of pre-September 1, 1991 transportation costs which should not be subject to tax. We reject petitioners' new argument for the reason that Tax Law § 1101(b)(former [3]) required a specific, separate statement of the transportation cost in the contract and on the bill rendered to the customer. There was no separate statement of the transportation cost on any bill rendered to Tishman, and an after-the-fact estimate is simply not the same as the specifically stated charge required by the former law to be on the invoice. Therefore, since the Administrative Law Judge otherwise correctly and adequately addressed this issue, we find no basis in the record before us for modifying the Administrative Law Judge's determination with respect to this issue.

Petitioners have raised a new issue on exception which was not addressed below. In order to analyze this new argument, some background discussion is in order. As mentioned in the findings of fact, throughout the term of the project, additional work was added to the

contract. These additions to the amount of the total contract price were effected through the use of change orders. The change orders were submitted by Artex and were subject to approval by Tishman. After Tishman agreed to the change order, the amount of the change order was included in a sales invoice. On audit, the auditor reviewed the sales invoices to determine taxability and derive a total amount for taxable receipts. The auditor was informed that there were change orders included in the invoices he reviewed. Thus, there were instances where the same item could have been subjected to tax twice; once as an amount taken from the change order and again as an amount taken from the sales invoice on which it was eventually included. To avoid this double taxation, the auditor eliminated all of the change orders from his calculation of taxable receipts. In this way, the amount of the change orders was taxed only once as an amount taken from the sales invoice.

On exception, petitioners have proposed that $381,829.15 in change orders taken from requisition number 42 should not have been subjected to tax. However, petitioners have given no reason to explain why these items should not be subject to tax. The only explanation stated in their brief is as follows:

> "None of the receipts from these services are subject to sales tax. However, as found by the Administrative Law Judge, 'the charges shown on the change orders were reflected in the auditor's calculation of taxable receipts.' (See ALJ Determination, Findings of Fact 10)
>
> "In spite of such documentary proof, and such finding of fact, the Administrative Law Judge failed to include this sum in her Determination reducing the auditor's calculation of taxable receipts. This was either an oversight or error, and must be rectified by the Tax Appeals Tribunal" (Petitioners' Brief in Support, p. 19.)

Petitioners have failed to cite any case law or statute to support their contention that the change orders should not be included in taxable receipts. They appear to argue that the facts as found by the Administrative Law Judge, and adopted by us, indicate that the change orders were subjected to tax twice and should now be eliminated. However, as the auditor's testimony made clear, the double inclusion of the change orders was already eliminated on audit when the auditor was informed that there were change orders included among the sales invoices and that the amounts of these change orders were later reflected on the sales invoices. We, therefore,

find no reason to make any further adjustments to the assessment beyond those already made by the Administrative Law Judge.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Artex Systems, Inc. and Grant Z. Kafarowski, as officer, is denied;

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

3. The petition of Artex Systems, Inc. and Grant Z. Kafarowski, as officer, is granted to the extent indicated in conclusion of law "C" of the Administrative Law Judge's determination, but is otherwise denied; and

4. The notices of determination issued against petitioners for the period June 1, 1990 through August 31, 1992 (as modified by the conciliation orders) are modified in accordance with paragraph "3" above, but are otherwise sustained, and the Division of Taxation shall determine any refund due consistent with this decision.

DATED: Troy, New York
February 20, 1997

/s/Donald C. DeWitt
Donald C. DeWitt
President

/s/Carroll R. Jenkins
Carroll R. Jenkins
Commissioner

/s/Joseph W. Pinto, Jr.
Joseph W. Pinto, Jr.
Commissioner