STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
JOHN GALLIN & SON, INC.	:	DECISION DTA NO. 817990
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 August 1, 1996 through September 9, 1999.	:	

Petitioner John Gallin & Son, Inc., 102 Madison Avenue, New York, New York 10016, filed an exception to the determination of the Administrative Law Judge issued on January 31, 2002. Petitioner appeared by Gerard W. Cunningham, Esq. The Division of Taxation appeared by Barbara G. Billet, Esq. (Cynthia E. McDonough, Esq., of counsel).

Petitioner filed a brief in support of its exception, the Division of Taxation filed a brief in opposition and petitioner filed a reply brief. Oral argument, at petitioner's request, was heard on December 11, 2002 in Troy, New York.

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

ISSUE

Whether the installation of floor covering in connection with office renovation and reconstruction contracts entered into by petitioner constituted capital improvements to real property, thereby requiring a refund of sales tax paid by petitioner in respect of such services.

FINDINGS OF FACT

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

Petitioner, John Gallin & Son, Inc., is a 116-year-old, family-owned general contractor engaged in the business of renovating and reconstructing existing interior office space in New York City. With annual revenues of $40 to $50 million, petitioner employs an office staff of 20 to 25, 4 project managers, 12 superintendents, and 30 to 50 field laborers and carpenters.

Petitioner filed an application for credit or refund of state and local sales and use taxes dated August 23, 1999 seeking a refund of $75,000.00 in sales tax paid for the period "August 1996 through present." The refund application indicates that petitioner sought a refund of tax paid on "services and materials rendered in connection with the completion of capital improvement construction projects." The application claimed that tax was improperly paid on "such items as initial finished floor coverings as described in Section 1101(b)(9)(iii) [of the Tax Law] for tax exempt capital improvements, as well as scaffolding services provided on capital improvement projects."

Together with its refund claim, petitioner submitted invoices from subcontractors and capital improvement certificates related to some 35 jobs. Although petitioner claimed a refund of $75,000.00, the invoices submitted with the refund claim totaled $65,380.67 in sales tax paid by petitioner to its subcontractors.

By letter dated February 29, 2000, the Division of Taxation ("Division") requested additional documentation from petitioner in respect of its refund claim. Specifically, the Division requested that petitioner provide a supporting schedule summarizing the computation of

the refund claim. The Division also requested that the petitioner provide a copy of all original invoices, estimates and contracts for all "qualifying" installations of carpeting and other floor covering. The Division further advised petitioner of its position that the installation of floor covering does not qualify as a capital improvement unless such installation is the initial installation in new construction, a new addition to an existing structure or a total reconstruction of an existing building.

Petitioner did not provide any additional information and the Division issued a letter dated June 23, 2000 informing petitioner that its refund claim was denied in full.

Petitioner subsequently filed a petition with the Division of Tax Appeals in protest of the Division of Taxation's refund claim denial. The petition claimed a refund of sales tax paid to subcontractors in the amount of $75,000.00.

At hearing petitioner submitted documentation with respect to some 35 jobs[1] and claimed a refund of $69,515.46 in sales tax paid to subcontractors in connection with such jobs. With one exception, such documentation consisted of the contract (or a portion thereof) between petitioner and its customer, a capital improvement certificate related to the job in question, purchase orders from petitioner to its flooring subcontractor, invoices from the subcontractor to petitioner, and copies of checks issued to the subcontractor in payment of the invoices.

The work performed by petitioner on the 35 jobs at issue consisted of the renovation and reconstruction of office space in large, multi-story buildings in New York City. In all cases, petitioner performed its work on an existing office building; none of the jobs involved the construction of a new building or an addition to an existing building. Typically, petitioner

[1] 27 of these 35 jobs were among the jobs included in petitioner's original application for refund.

contracts with a new tenant to reconstruct the leased space to meet the tenant's specific needs. In all of the jobs in question petitioner provided such reconstruction services after a previous tenant had vacated the premises.

Most of the jobs in question involved the renovation and reconstruction of an entire floor of a building. Some of the jobs involved the reconstruction of two or three floors, while a few required work on less than an entire floor.

The first step in the reconstruction process is the demolition or gutting of the space where the reconstruction work is to be performed. Generally, this involves the removal of the previous tenant's leasehold improvements. Often the demolition work has been completed when petitioner gets involved; frequently such work has been performed under the landlord's direction. On some of the jobs at issue petitioner was responsible for the demolition. In any event, the premises are always vacant when petitioner does its work. The gutting involves the removal of everything "between the slabs." That is, all interior walls and doors are removed; all floor covering is removed; the ceiling is removed; all plumbing and HVAC is removed. When the demolition process is completed, the space has been stripped down to the concrete slab on the floor, the exterior walls of the building, and the trusses and beams which are attached to the concrete slab above. The gutting does not involve the removal of any of the structural components of the building.

Petitioner begins its renovation and reconstruction work after the gutting has been completed. Such work is performed pursuant to detailed plans and specifications prepared by architects and engineers. Petitioner generally subcontracts about 95 percent of the work on any given contract. Such work includes the installation of drywall, ceilings, doors, marble and wood

flooring, carpeting, vinyl tile, architectural woodwork, lighting and electrical fixtures, plumbing, kitchen equipment, and painting and wall covering.

On three of the jobs at issue, in addition to the sort of work described above, petitioner constructed and installed a stairway between two floors of a building by cutting a hole in the concrete slab floor. Additionally, on Job 8566, petitioner installed additional structural steel to support high density file cabinets.

As noted above, petitioner produced Certificates of Capital Improvement (Form ST-124) for 34 of the jobs at issue. These certificates were signed by petitioner's customer, who is, in nearly all cases, the tenant. Of the 34 certificates produced by petitioner, 21 indicated that the customer was a tenant of the real property, 2 indicated that the customer was the owner of the real property, and 13 of the certificates were incomplete to the extent that the customers failed to indicate in the space provided whether they were the owner or tenant of the real property. Petitioner did not introduce any of its customers' leases.

The documentation submitted indicates that the contracts for the 35 jobs in question totaled approximately $17.5 million. Twenty-two of the contracts exceeded $100,000 in amount, including six in excess of $1 million.

For 33 of the jobs at issue petitioner seeks a refund of sales tax paid to subcontractors for furnishing and installing carpeting, vinyl composite tile and vinyl base. Such carpeting, tile and base were installed pursuant to contracts generally described above.

With the exception of Job 7877 (***see***, below), petitioner established that it paid sales tax to its subcontractor in the amount claimed for the furnishing and installation of carpeting, vinyl composite tile and vinyl base.

As noted previously, petitioner's refund claim also sought a refund of tax paid for "scaffolding services." The documentation submitted by petitioner reveals invoices for the rental of scaffolding parts in connection with two contracts (Jobs 8071 and 8301). The scaffolding parts were assembled by either an employee or a subcontractor and used in the performance of these two contracts. In both jobs, the scaffolding enabled workers to perform work on or near the ceiling. The scaffolding was on wheels and was easily moved. Petitioner did not purchase any services in connection with the rental of the scaffolding parts. Petitioner paid $43.40 and $14.03 in sales tax on Jobs 8071 and 8301, respectively, for the rental of scaffolding parts.

Petitioner's charges to its customers included the payment of sales tax to its flooring subcontractors. Petitioner thus ultimately passed the cost of sales tax paid to its subcontractors on to its customers as part of the total charge.

With respect to one of the contracts at issue, Job 7877, petitioner did not submit any invoices from the flooring subcontractor or any other documentation showing that sales tax was charged to petitioner. Petitioner claimed a refund of $3,418.00 on this job. Petitioner also did not submit a capital improvement certificate for this job.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

Petitioner asserted that the furnishing and installation of carpeting, vinyl composite tile and vinyl base by its subcontractors in connection with the jobs described herein qualified for capital improvement treatment.

Primarily, the Administrative Law Judge addressed whether petitioner's floor covering was installed as "the initial finished floor covering in *new construction* or *a new addition to* or *a*

total reconstruction of existing construction" (Tax Law § 1101[b][9][iii], emphasis added). If installed in such a manner, the floor covering installation qualified as a capital improvement. In resolving this issue, the Administrative Law Judge focused on the Division's regulation implementing Tax Law § 1101(b)(9)(iii), which provides the following definitions:

> (i) *New construction of a building or structure* means the original construction of a building or structure that did not exist before such construction.
>
> (ii) *New construction of an addition to an existing building or structure* means the original construction of a new room, wing or other discrete, substantial unit of a building or structure which enlarges the exterior of the existing building or structure.
>
> (iii) *Total reconstruction of an existing building or structure* means the complete rehabilitation or replacement of most of the major structural elements of an existing building or structure, such as the roof, ceiling trusses, floor joists, walls, support columns, support beams, girders and the foundation (20 NYCRR 541.14[b][2], emphasis in original]).

The Administrative Law Judge found that the installations of floor covering at issue were not made under any of the circumstances defined in the regulation, and concluded that such installations were not capital improvements and were properly subject to tax.

The Administrative Law Judge pointed out that none of the installations involved new construction or new additions to existing construction as those terms are defined in the regulations. The Administrative Law Judge found that none of the subject floor covering installations involved the "total reconstruction of an existing building or structure," or "the complete rehabilitation or replacement of most of the major structural elements" of the buildings as required under the regulation. The Administrative Law Judge noted that most of petitioner's projects did not involve any structural work. In those four jobs in the record where petitioner did perform structural work, i.e., the installation of stairs between floors and additional steel to

support high density file cabinets, the Administrative Law Judge determined that such work did not involve the "complete rehabilitation or replacement of most of the structural elements of the building" as required under the regulation.

The Administrative Law Judge next addressed whether the Division's interpretation of Tax Law § 1101(b)(9)(iii) as set forth in its regulation was invalid.

The Administrative Law Judge noted that if reasonable, the regulations of a State agency must be upheld unless shown to be irrational and inconsistent with the statute (***Matter of Slattery Assocs. v. Tully***, 79 AD2d 761, 434 NYS2d 788, ***affd*** 54 NY2d 711, 442 NYS2d 978) or erroneous (***Matter of Koner v. Procaccino***, 39 NY2d 258, 383 NYS2d 295).

The Administrative Law Judge determined that the regulation in question is a reasonable interpretation of Tax Law § 1101(b)(9)(iii). The Administrative Law Judge found the regulation's interpretation of the statutory term "new construction" as the new construction of a building or structure to be logical. "Existing construction" clearly refers to an existing building or structure. The Administrative Law Judge stated that "new construction" must, therefore, refer to a new building or structure. Additionally, the Administrative Law Judge pointed out, the regulation's interpretation of the statutory term "new addition to existing construction" comports with the plain meaning of those words. Finally, the Administrative Law Judge found the regulation's interpretation of the statutory term "total reconstruction of existing construction" to be reasonable. This definition is in accord with the common understanding of the word "total."

The regulation in question, the Administrative Law Judge noted, is also consistent with the language of subparagraph (iii) of Tax Law § 1101(b)(9) as contrasted with the general definition of capital improvement in subparagraph (i). Significantly, the Legislature, in subparagraph (iii),

used the terms "new construction," "new addition" and "total reconstruction" in this provision, rather than the broader three-part test in subparagraph (i). By its use of these terms, the Administrative Law Judge found that the Legislature limited the kind of construction work in which floor covering will qualify as a capital improvement. The Administrative Law Judge concluded that the definition of "new construction," "new addition" and "total reconstruction" in the regulation comports with this statutory language.

Petitioner next argued that the disputed regulation improperly violates the "three prong" test in Tax Law § 1101(b)(9)(i). Petitioner claimed that in enacting Tax Law § 1101(b)(9)(iii), there is no evidence that the Legislature ever intended to redefine capital improvement. The Administrative Law Judge rejected this argument. The Administrative Law Judge pointed out that Tax Law § 1101(b)(9)(iii) defines capital improvement for floor covering. If, as petitioner argued, the regulation defined the terms in subparagraph (iii) in accordance with the general "three prong" test (subparagraph [i]), then Tax Law § 1101(b)(9)(iii) would be rendered meaningless.

Petitioner alleged that notwithstanding Tax Law § 1101(b)(9)(iii), the question of whether the installation of floor covering should be considered a capital improvement is properly determined by application of the general definition contained in Tax Law § 1101(b)(9)(i) and the related "end result" test (***see***, 20 NYCRR 527.7[b][4]). Petitioner urged that the Legislature created no new definitions whereby a capital improvement project could nonetheless be viewed as taxable for the sake of floor covering installations.

The Administrative Law Judge determined that the Legislature did, in fact, create a new definition of capital improvement specific to floor covering installations by its enactment of

subparagraph (iii) of Tax Law § 1101(b)(9). The Administrative Law Judge found that contrary to petitioner's claim, the enactment of subparagraph (iii) was not a clarifying amendment, but a substantive change in the statutory definition of capital improvement specific to floor coverings. Accordingly, the Administrative Law Judge determined that neither the general definition of subparagraph (i) nor the end result test (which applies the general definition to the overall project) apply here.

The Administrative Law Judge also rejected petitioner's claim that its rental of scaffolding is exempt from tax as a temporary facility at a construction site pursuant to 20 NYCRR 541.8. Petitioner's rental of scaffolding parts was a retail sale of tangible personal property properly subject to tax (***see***, Tax Law § 1105[a]). The Administrative Law Judge stated that capital improvement treatment is available with respect to the sale of certain services (***see***, Tax Law § 1105[c][3][iii], [5]). However, the Administrative Law Judge found that petitioner did not purchase any services in connection with its scaffolding rental. Petitioner simply rented equipment. The Administrative Law Judge held that such a rental is subject to tax even if the end result of the project is a capital improvement (***see***, 20 NYCRR 541.9, 541.10). Petitioner does not take exception to this conclusion.

Lastly, the Administrative Law Judge addressed the issue of whether petitioner's receipt of capital improvement certificates from its customers had any relevance to the subject refund claim. The Administrative Law Judge pointed out that the receipt of a capital improvement certificate under the Division's regulations relieves a vendor of liability for failure to collect tax (***see***, Tax Law § 1132[c][1]; 20 NYCRR 532.4[b][2]). In this case, the issue is whether petitioner, as a customer, properly paid tax to a vendor. The Administrative Law Judge noted that capital

improvement certificates do not alter the liability of customers (***see***, ***Matter of Saf-Tee Plumbing Corp. v. Tully***, 77 AD2d 1, 432 NYS2d 409). Accordingly, the Administrative Law Judge determined that irrespective of whether petitioner received the certificates in good faith, they are of no relevance to this matter. Petitioner does not take exception to this conclusion.

ARGUMENTS ON EXCEPTION

On exception, petitioner continues to argue that the language contained in Tax Law § 1101(b)(9)(iii), added in 1989, is merely a clarifying amendment to the general language defining a capital improvement, contained in Tax Law § 1101(b)(9)(i). Further, petitioner claims that the Division's regulation (20 NYCRR 541.14[b]) implementing Tax Law § 1101(b)(9)(iii) is illogical, invalid, overly restrictive and contrary to the statute. Petitioner continues to argue that the regulation conflicts with the "three prong" test of Tax Law § 1101(b)(9)(i). Petitioner also states that there is no evidence that the Legislature ever intended to redefine capital improvement.

In opposition, the Division states that the Administrative Law Judge correctly found that the regulation at issue is a reasonable interpretation of the statute. The Division argues that the special definition of capital improvement applicable to floor covering under Tax Law § 1101(b)(9)(iii) "provides a more restrictive, narrower standard as to when floor covering qualifies as a capital improvement than the general definition of capital improvement" (Division's brief, p. 4) noting that subparagraph (iii) disqualifies most replacements from being characterized as capital improvements.

The Division also emphasizes that petitioner's use of the "end result" test for the installation of floor covering is wrong. The Division states that under the 1989 statutory amendment and interpretative regulation, the installation of floor covering qualifies as a capital

improvement only when it is installed as the initial finished floor covering in new construction or total reconstruction of a building. The Division submits that the Administrative Law Judge properly determined that none of the installations at issue resulted in the expansion of an existing building nor was total reconstruction of a building involved.

OPINION

We agree with petitioner that Tax Law § 1101(b)(9)(iii) clarifies the statute, but the addition of subparagraph (iii) is also substantive. What it clarifies, specifically, is when a floor covering shall constitute a capital improvement. This clarification is accomplished by a *substantive change* to the statute by carving out a new definition of when floor covering shall constitute a capital improvement.

Petitioner challenges the Division's interpretation of a statute. In doing so, it must prove that its interpretation is the only reasonable interpretation, or that the Division's interpretation is unreasonable (***Matter of Grace v. New York State Tax Commn***., 37 NY2d 193, 371 NYS2d 715, ***lv denied*** 37 NY2d 708, 375 NYS2d 1027; ***Matter of Marriott Family Rests. v. Tax Appeals Tribunal***, 174 AD2d 805, 570 NYS2d 741, ***lv denied*** 78 NY2d 863, 578 NYS2d 877). Petitioner has failed to do either.

We agree with the Administrative Law Judge that the Division's regulation at 20 NYCRR 541.14(b)(2) is entirely consistent with the provisions of section 1101(b)(9)(iii), and that the Division's interpretation is reasonable. Petitioner's arguments that we should simply apply the general definition of Tax Law § 1101(b)(9)(i) defining capital improvement, and ignore the Legislature's subsequently added definition of capital improvement, which is applicable specifically to floor coverings, is contrary to the plain meaning of the statute and unreasonable.

The evidence shows that all of petitioner's jobs involved performing work on existing buildings, and none of the jobs involved the construction of a new building or an addition to an existing building. Most of the jobs involved reconstruction and renovation of an entire floor of a building after a tenant moved out. Some jobs involved two or three floors. The evidence shows that: (i) first, the floor(s) would be gutted, everything between the slabs including walls, interior doors, and floor coverings would be removed; (ii) none of the interior demolition or gutting involved removal of structural elements; and (iii) then, as relevant here, petitioner would come in and install, *inter alia*, new floor covering. Notwithstanding petitioner's arguments to the contrary, the removal of old floor coverings and installing new floor coverings constitutes a replacement. Petitioner urges that all of its work was "new construction" for its customers. It may well be new construction of a floor or of several floors, but it is not new construction that comes within the purview of Tax Law § 1101(b)(9)(iii) and 20 NYCRR 541.14(b)(2), i.e., new construction of a building or structure, new construction of an addition to an existing building or structure; or total reconstruction of an existing building or structure.

We affirm the determination of the Administrative Law Judge for the reasons stated therein. The Administrative Law Judge thoroughly and correctly addressed each of petitioner's arguments. Petitioner has offered no evidence below, nor argument on exception, that would justify our modifying the determination in any respect.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of John Gallin & Son, Inc. is denied;

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

3. The petition of John Gallin & Son, Inc. is denied; and

4. The Division of Taxation's denial of petitioner's refund claim is sustained.

DATED: Troy, New York
May 22, 2003

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

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