

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition	:	
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of	:	
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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.	:	
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	:	
In the Matter of the Petition	:	
	:	
of	:	
	:	
IRWIN MATTES,	:	DETERMINATION
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.	:	
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	:	
In the Matter of the Petition	:	
	:	
of	:	
	:	
JOSEPH SACKS,	:	
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.	:	
	:	
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Petitioner Hydronic Fabrications, Inc., 459 Brown Court, Oceanside, New York 11572, filed a 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 a 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 a 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).

A consolidated hearing was commenced before Brian L. Friedman, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on March 3, 1986 at 1:15 P.M., was continued on April 30, 1986 at 9:15 A.M. and was continued to conclusion on August 5, 1986 at 9:15 A.M., with all briefs to be submitted by November 15, 1986. Petitioners appeared by Sidney Meyers, Esq. The Audit Division appeared by John P. Dugan, Esq. (Kevin A. Cahill, Esq., of counsel).

### ISSUES

I. Whether the Audit Division properly determined the sales tax liability of Hydronic Fabrications, Inc. for the period at issue.

II. Whether the Audit Division properly asserted penalty pursuant to Tax Law § 1145(a) against petitioners.

### FINDINGS OF FACT

1. On December 20, 1982, the Audit Division 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.

2. 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.

3. 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 §§ 1131(1) and 1133(a) during the period at issue.

4. 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.

5. Hydronic's sales invoices were divided into two groups for purposes of the audit performed herein, 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.

6. 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:

$$\begin{array}{rcl} \$ 2,211.16 \text{ (tax due per sample)} & & \\ \$149,551.28 \text{ (total dollar amount of sample)} & = & .0147852 \\ \\ .0147852 \times \$793,914.71 \text{ (total dollar amount of all invoices} & = & \$11,738.26 \\ & & \text{of \$5,000.00 or less)} \end{array}$$

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

7. 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.

8. 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 Rangesi) 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 ( $7\% \times \$75,483.81$ ).

9. 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 of 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.

10. At the hearing held herein, the Audit Division agreed to a further reduction of the assessment against petitioner Hydronic only. The agreement to a reduction was confirmed by a memorandum from the Audit Division's representative dated March 12, 1986. This reduction results from the Audit 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.<sup>1</sup>

11. Assessment of penalty was recommended because Hydronic had previously been audited relative to similar issues and, in addition, the Audit 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 evidence was offered by the Audit Division relative to the prior audit other than the fact that the matter was settled for an amount considerably less than the original assessment.

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

#### SUMMARY OF PETITIONERS' POSITION

13. (a) 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.

(b) It is petitioners' position 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

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<sup>1</sup>It should be noted that the conferee's reduction set forth in Finding 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 Audit 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.

for the office, although no evidence relative thereto was presented.

(d) Petitioners contend that acceptance of certificates of capital improvement was proper by reason of the fact that its fabricated pipe became part of capital improvements.

#### CONCLUSIONS OF LAW

A. That 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."

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.

B. That 20 NYCRR 541.2(g)(2)(ii) provides as follows:

"A capital improvement does not include:

\* \* \*

(ii) the sale of tangible personal property to a customer under contract if the contractor who sells the tangible personal property is not responsible for the affixation or installation of the tangible personal property furnished."

C. That 20 NYCRR 541.5(b)(4)(i)(b) provides that a certificate of capital improvement may not be issued by a contractor, subcontractor or any other person to a supplier on the purchase of tangible personal property. As indicated in Finding of Fact "12", supra, Hydronic did not install the fabricated pipe, but rather sold it to mechanical contractors who performed such installation. Since a certificate of capital improvement may not be issued by a contractor to a supplier, Hydronic's sales of fabricated pipe to said contractors were taxable transactions upon which Hydronic was required to collect tax.

D. That the services provided by Hydronic to its customers constituted producing or fabricating within the meaning of Tax Law § 1105(c)(2).

E. That Tax Law § 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.

F. That 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 have failed to prove that adequate records relative to the allocation of electricity purchased from LILCO were maintained whereby it could be shown that these purchases were directly and exclusively used in the production process. As such, the Audit Division properly determined that such purchases were subject to the imposition of sales tax.

G. That Tax Law § 1145(a)(1) provides that any person failing to file a return or to pay or pay over any tax to the Tax Commission within the time required shall be subject to a penalty. The fact that Hydronic maintained complete books and records for the entire audit period and made the same available to the auditor upon his request, taken together with the fact that there existed a lack of evidence that a prior audit of petitioners was premised upon the same issues as those herein which should have put petitioners on notice that they were not in compliance with the provisions of Articles 28 and 29 of the Tax Law, indicate that the failure to comply with the

aforesaid provisions was due to reasonable cause and not willful neglect and, as such, penalties imposed against petitioners must be cancelled.

H. That, as indicated in Findings of Fact "9" and "10", supra, the assessment of tax is reduced to \$73,607.70 against Hydronic and to \$69,905.00 against each of petitioners Irwin Mattes and Joseph Sacks.

I. That the petitions of Hydronic Fabrications, Inc. and Irwin Mattes and Joseph Sacks, as officers, are granted only to the extent indicated in Conclusions of Law "G" and "H"; that the Audit Division is directed to modify the notices of determination and demands for payment of sales and use taxes due issued December 20, 1982 accordingly; and that, except as so granted, the petitions are in all other respects denied.

DATED: Albany, New York  
January 7, 1988

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ADMINISTRATIVE LAW JUDGE