STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
HERSHEY ENERGY SYSTEMS	:	DETERMINATION
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 December 1, 1981 through November 30, 1984.	:	

Petitioner, Hershey Energy Systems, 642 Kreag Road, Pittsford, New York 14534, 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 December 1, 1981 through November 30, 1984 (File No. 801921).

A hearing was held before Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, 259 Monroe Avenue, Rochester, New York, on December 2, 1987 at 1:15 P.M., with all briefs to be filed by May 2, 1988. Petitioner appeared by D. Alan Hershey, President. The Audit Division appeared by William F. Collins, Esq. (Michael B. Infantino, Esq., of counsel).

ISSUES

I. Whether petitioner is liable for payment of sales tax on its purchase of a computer system, where the seller failed to collect the tax at the time of purchase.

II. Whether sales invoices issued by petitioner to one of its suppliers represented taxable sales of repair services.

III. Whether petitioner has shown any error in the Audit Division's calculation of petitioner's sales and purchases.

IV. Whether petitioner has established that it is entitled to certain tax credits for merchandise returned to its suppliers or for uncollectible debts due from its customers.

FINDINGS OF FACT

1. Petitioner, Hershey Energy Systems ("Hershey"), sold and installed computerized energy conservation systems. These items were installed on and became an integral part of its customers' heating and cooling systems.

2. As the result of an audit, the Division of Taxation ("Division"), on March 20, 1985, issued to Hershey a Notice of Determination and Demand for Payment of Sales and Use Taxes Due for the period December 1, 1981 through November 30, 1984, assessing taxes of $38,294.21 plus minimum interest.

3. Following a Tax Appeals Bureau conference and several meetings between Hershey

and the auditor at which Hershey provided additional information, the Division agreed to reduce the assessment to $7,289.66.

4. The revised assessment resulted from an auditor's analysis of Hershey's sales and purchases.

(a) The auditor reviewed Hershey's sales invoices to determine whether sales tax had been charged and collected on all taxable items. Sales constituting capital improvements and substantiated sales to tax exempt organizations were deemed nontaxable. All other sales were deemed taxable. This analysis disclosed unreported taxable sales of $12,932.47 with a tax due on that amount of $905.27.

(b) The auditor examined sales and purchase invoices to determine whether Hershey had paid sales tax on its purchases of taxable items. In the auditor's report and in later references to this portion of the audit, the tax assessed as a result of this review was denominated as "use" tax.

(i) The auditor determined that Hershey failed to pay sales tax on its purchase of computer equipment used by Hershey in the operation of its own business. This equipment was purchased from Detection Systems, Inc. ("DSI"). Tax determined to be due on this purchase was $472.40.

(ii) DSI was one of Hershey's major suppliers of equipment and materials for installation in Hershey's energy conservation systems. A review of all DSI sales invoices disclosed purchases by Hershey from DSI totaling $209,433.41. From this amount, the auditor subtracted $71,890.50, representing nontaxable purchases of equipment to be incorporated into capital improvements sold to tax exempt organizations. The remainder was further reduced by $5,966.00, representing purchases used on the Borden Can project. These purchases were considered nontaxable because Hershey collected sales tax on the entire charge to Borden Can; therefore, Hershey's purchases were treated as purchases for resale. Finally, a reduction of $16,900.00 was allowed for purchased equipment later returned to DSI. The remaining purchases subject to sales tax amounted to $114,676.91 with a tax due on that amount of $8,027.38.

(iii) The auditor determined that Hershey's taxable purchases from all other suppliers amounted to $56,009.54 with a tax due on that amount of $3,920.67.

(iv) The auditor aggregated tax owed by Hershey on its own purchases, arriving at a total "use" tax due of $12,420.45. From this, she subtracted "use" tax paid by Hershey of $8,150.73, obtaining an additional tax due of $4,269.72.

(c) The final area of the audit concerned an ongoing dispute between Hershey and DSI. In that dispute, Hershey claimed that DSI equipment proved defective after installation, forcing Hershey to perform corrective work and repairs on the energy conservation systems Hershey sold to its clients. In order to cover its own costs, Hershey billed DSI for repair services. DSI never recognized an obligation to pay this debt, and it never paid any monies to Hershey as a result of Hershey's sales invoices. Hershey and DSI began litigating this dispute. At the time of hearing, the matter had not been resolved. On audit, the auditor determined that Hershey had issued sales invoices to DSI, totaling $237,412.50 and she treated the total amount as retail sales of repair services subject to sales tax. The auditor later concluded that $207,203.00 of this total was not subject to sales tax because Hershey did not report that amount as gross receipts on its Federal

income tax return or show it as sales on its financial statements. Because the remaining $30,209.50 appeared on Hershey's books as part of its accounts receivable and presumably was reported as gross sales on Hershey's Federal income tax return[1], that amount was treated as a taxable sale with a tax due of $2,114.67.

5. Hershey's legal arguments and factual allegations challenging the audit results may be summarized as follows:

(a) Hershey's review of its own sales invoices disclosed a sales tax liability of $881.59. No rationale was offered to explain the $23.68 difference between Hershey's result and that of the Division.

(b) Hershey contends that DSI was responsible for collecting any sales tax due on Hershey's purchase of a computer system. Accordingly, it is Hershey's position that DSI is liable for tax due on that transaction of $472.40.

(c) Hershey claims that its purchases from DSI totaled $183,962.51, rather than the $209,433.41 asserted by the Division. It bases its claim upon figures taken from its own purchase orders. In support of its position, Hershey submitted a schedule listing: the name of each project on which DSI equipment was installed; the total amount Hershey charged for the project; the total amount due to DSI for equipment used on each project as shown on Hershey's purchase orders; the inventory number of each purchase order; and the date of each purchase order. Hershey maintains that its purchase orders are a more accurate statement of its purchases than DSI's sales invoices. Hershey's explanation of the differences between the purchase orders and sales invoices is somewhat unclear. Apparently, Hershey considered itself liable to pay only for that equipment which was actually installed on a project. Hershey believed itself not to be liable for any additional equipment it received from DSI, although that equipment was not actually returned to DSI.

(d) In addition to those reductions from DSI purchases allowed by the Division (see Finding of Fact "4(b)(ii)"), Hershey contends that it is entitled to subtract an additional $41,500.00. This amount represents payments withheld by Hershey on the basis of its claim that the equipment purchased from DSI was defective. Hershey submitted DSI credit invoices, establishing that some defective equipment was replaced by DSI. The auditor gave Hershey credit for $16,900.00 worth of returned equipment, and Hershey presented no evidence to show that it returned additional equipment which was not replaced.

(e) Hershey maintains that its billings to DSI, totaling $237,412.50, do not represent taxable sales of repair services. Hershey claims that DSI promised to give Hershey a corrective work order for $30,000.00 for repairs Hershey made to its customers' energy conservation systems. As Hershey performed repairs, it billed DSI for its costs. DSI never provided Hershey with a corrective work order in any amount and never paid the amounts claimed on the invoices. Hershey, at first, recorded the amounts it billed as gross sales, thus, $30,209.50 appeared as gross sales in Hershey's books and records. As Hershey performed corrective work to its customers' equipment, it continued to bill DSI, although it no longer showed those billings as sales in its

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[1]The Division conceded that Hershey never received any payments of these disputed invoices. As the Federal income tax returns for the years in issue were not offered into evidence, Hershey's precise treatment of the $30,209.50 is not known.

own books.

6. By its perfected petition, Hershey claimed that it was entitled to a tax credit in the aggregate amount of $2,247.99. The claim for credit was based primarily on two grounds. First, Hershey claimed a credit of $2,905.00 for tax due on purchases of $41,500.00 from DSI (although Hershey paid neither the purchase price nor the tax due). Second, Hershey claimed a credit of $968.26 on the basis of an unsatisfied debt owed to Hershey by one of its customers, Batavia Industrial Center. As a contractor, Hershey paid sales tax upon its purchase of equipment which was installed as a capital improvement to property owned by Batavia Industrial Center.

7. By a letter to the administrative law judge following the hearing, Hershey claimed an additional tax credit of $789.46. This was based upon Hershey's claim that it purchased equipment from a supplier named Tour and Andersson, paying a sales tax of $789.46, and later returned that equipment. The invoice submitted in support of this claim shows a credit to Hershey from Tour and Andersson of $11,277.93. On its face, the invoice does not appear to represent a credit for returned merchandise; rather, it appears to show a customer discount of $11,277.93. Hershey presented no evidence to establish that a tax was paid on this purchase. The Tour and Andersson invoice was not included in the audit; therefore, it did not form a part of the basis for the Division's determination of additional tax due.

CONCLUSIONS OF LAW

A. Where an audit of the taxpayer's records discloses that a return filed pursuant to Article 28 of the Tax Law is incorrect or insufficient, the Division is authorized to determine the amount of tax due from such information as may be available to it (Tax Law § 1138[a][1]). The assessment at issue arose from a detailed audit of petitioner's sales and purchase invoices and those of its suppliers. As the audit properly proceeded under the statutory authority granted to the Division by Tax Law § 1138(a)(1), the burden of proof was upon petitioner to overcome the tax assessment (Matter of Allied New York Services v. Tully, 83 AD2d 727).

B. Hershey has presented no rationale or documentation to support its assertion that additional tax due on sales to its customers was $23.68 less than the amount asserted by the Division. Accordingly, the Division's determination of sales tax due of $905.27 is sustained.

C. Hershey concedes that it failed to pay any sales tax on its purchase of a computer system from DSI; however, it argues that liability for collection and payment of that tax was upon the seller. Where a customer has failed to pay a tax imposed under Article 28 of the Tax Law to a person required to collect the tax, the Tax Law imposes a duty upon the customer to pay the tax directly to the Commissioner of Taxation and Finance (Tax Law § 1133[b]). As Hershey did not pay the sales tax due upon its purchase of the computer system, it is liable for the tax due in the amount of $472.40.

D. Hershey has failed to produce evidence establishing that its purchases from DSI were less than the amounts shown on the DSI sales invoices. Evidence submitted to support this contention consisted primarily of a summary schedule prepared by Hershey. Such a document amounts to little more than a reassertion of petitioner's claim. Furthermore, testimony presented to explain the differences between the purchase orders and sales invoices indicated that Hershey actually received all equipment shown on the DSI invoices. Therefore, it is concluded that Hershey's purchases from DSI totaled $209,433.41 as asserted by the Division.

E. Hershey asserts that it is not liable for payment of sales tax on its billings to DSI because the sales invoices do not actually represent sales to DSI. Based on those sales invoices, the Division concluded that Hershey had performed repair services for DSI, charging DSI a total of $237,412.50 for those services. Initially, the Division found the entire amount to be subject to the sales tax imposed upon the services of installing, maintaining, servicing or repairing tangible personal property (Tax Law § 1105[c][3]). Its position was that Hershey was liable for payment of the tax, although it could later apply for a credit or refund of tax paid at such time as the account had "been actually charged off for Federal income tax purposes" (20 NYCRR 534.7[d]). It later reduced the amount it considered taxable to $30,209.50, the amount treated by Hershey as sales in its own books, financial statements and Federal income tax returns. Its position remains the same regarding the reduced amount. The issue raised here is whether the sales invoices represent taxable sales from Hershey to DSI. It is concluded that they do not.

20 NYCRR 525.2(a)(2), which describes the nature of the sales tax, provides some guidance in determining the nature of the transactions at issue.

> "The sales tax is a 'transactions tax,' liability for the tax occurring at the time of the transaction. Generally speaking, the taxed transaction is an act resulting in the receipt of consideration for the transfer of title, or possession or both to property or rendition of services from one person to another. The time or method of payment is immaterial, since the tax becomes due at the time of transfer of property or rendition of service."

The evidence presented at hearing leads to the conclusion that, while sales invoices were issued, there was no "taxed transaction". Two facts are considered determinative in arriving at this conclusion. First, there was no evidence that DSI provided Hershey with a promise to pay for the repair services for which it was billed. Second, the equipment on which the services were performed was owned either by Hershey or by Hershey's clients; it was not owned by DSI. It appears that Hershey chose to bill DSI as a method of recovering losses which it believed it had incurred as a result of DSI's failure to perform its own obligations. Hershey acted unilaterally in billing DSI for services rendered to Hershey's customers. Since DSI did not promise to pay for those services and the services were not rendered to DSI, there were no taxable sales of services to DSI. Accordingly, sales tax of $2,114.67 assessed on the basis of the invoices to DSI will be cancelled.

F. Hershey's claim that it is entitled to subtract $41,500.00 from its DSI purchases is not supported by the evidence. The record establishes that Hershey received the equipment in accordance with its agreement to purchase such material from DSI. Hershey's later refusal to pay DSI for that equipment had no effect on the taxable status of the transaction. Furthermore, the credit invoices submitted by Hershey merely establish that DSI replaced certain defective equipment. There is no evidence that Hershey received a refund on that returned equipment.

G. Hershey has not shown that it is entitled to the other credits claimed. Tax Law § 1105(c)(3)(iii) excludes from the imposition of sales tax receipts from the sale of the service of installing property which, when installed, constitutes an addition or capital improvement to real property, property or land. The contractor who is making the capital improvement must pay a tax on the cost of materials to him, as he is considered to be the ultimate consumer of the tangible personal property (20 NYCRR 527.7[b][5]). Accordingly, Hershey was liable for the payment of sales tax on its purchase of materials for use in performing capital improvements to property owned by Batavia Industrial Center. As Hershey was the ultimate consumer of the materials, the

failure of Batavia Industrial Center to pay Hershey for services rendered does not form a basis for providing Hershey with a refund or credit of sales taxes paid by Hershey. Regarding the credit claimed on the DSI purchases of $41,500.00, Hershey has not shown that tax was ever paid on these purchases; therefore, it cannot be entitled to a credit. Finally, the Tour and Andersson invoice submitted by Hershey did not show that Hershey paid a tax on its purchase of equipment totaling $11,277.93, nor did it show that such equipment was returned for a credit. Consequently, Hershey has not established its entitlement to a credit for taxes paid on equipment later returned.

H. The Division has agreed that the tax assessed in its notice of determination of March 20, 1985 should be reduced to $7,289.66. The Division is directed to reduce this amount by $2,114.67, in accordance with Conclusion of Law "E".

I. The petition of Hershey Energy Systems is granted to the extent indicated in Conclusions of Law "E" and "H"; the Notice of Determination and Demand for Payment of Sales and Use Taxes Due, issued on March 20, 1985, shall be modified accordingly; and in all other respects the petition is denied.

DATED: Albany, New York

September 15, 1988

/s/ Arthur Bray_____
ADMINISTRATIVE LAW JUDGE