STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition of TRI-COUNTY POOL CORP. 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, 1983 through May 31, 1985.	:	
In the Matter of the Petition of DONALD FARACI OFFICER OF TRI-COUNTY POOL CORP. 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, 1983 through May 31, 1985.	:	DETERMINATION
In the Matter of the Petition of of ANTHONY PHELPS OFFICER OF TRI-COUNTY POOL CORP. 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, 1983 through May 31, 1985.	:	

Petitioner Tri-County Pool Corp., 475 Front Street, Hempstead, New York 11550, 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 June 1, 1983 through May 31, 1985 (File No. 805451).

Petitioner Donald Faraci, Officer of Tri-County Pool Corp., 475 Front Street, Hempstead, New York 11550, filed a petition for revision of adetermination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period June 1, 1983 through May 31, 1985

(File No. 805445).

Petitioner Anthony Phelps, 5145 Thyme Drive, Palm Beach Gardens, Florida 33419-3527, 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 June 1, 1983 through May 31, 1985 (File No. 805321).

A hearing was held before Robert F. Mulligan, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on December 13, 1989 at 10:45 A.M., with all briefs to be filed by April 6, 1990. Petitioner Donald Faraci appeared pro se, and on behalf of petitioner Tri-County Pool Corp. Petitioner Anthony Phelps appeared by Saltzman, Holloran & Kaplan, P.C. (William T. Holloran, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Angelo A. Scopellito, Esq., of counsel, with Gary Palmer, Esq., on the brief).

ISSUES

I. Whether a sales tax audit based primarily on two Federal corporate income tax returns and 37 pool installation contracts properly determined sales and use taxes due from petitioner Tri-County Pool Corp.

II. Whether petitioners Donald Faraci and Anthony Phelps were persons required to collect tax on behalf of Tri-County Pool Corp. and thereby were personally liable for taxes due.

FINDINGS OF FACT

Petitioner Tri-County Pool Corp. ("Tri-County") was incorporated in 1981 and during the period at issue was engaged in the business of selling and installing in-ground swimming pools. Tri-County's place of business was located at 4 Duffy Avenue, Hicksville, New York. It ceased doing business in or about May 1985.

The Audit

(a) An audit of Tri-County was commenced by the Nassau District Office in April 1986. The only records made available to the auditor were Federal income tax returns for the fiscal years ending February 29, 1984 and February 28, 1985, and 37 contracts for vinyl in-ground pools. Despite the auditor's request, Tri-County was unable to produce a general ledger, sales

journal, cash receipts journal, cancelled checks, or bank statements.

(b) Audited gross sales were computed to be $1,658,188.00, based on the Federal income tax returns and sales tax returns. Gross sales per sales tax returns were reconciled to gross sales per Federal income tax returns and found to be in substantial agreement.

(c) No taxable sales had been shown on the sales tax returns.

Review of the 37 contracts (all of which covered the period February through October 1984) totalling $319,925.00 indicated capital improvement sales of $307,230.00 or 96.032%. The remaining sales, totalling $12,695.00 or 3.968%, were deemed to be repairs.[1] The auditor then deducted the substantiated capital improvement sales from audited gross sales per the Federal income tax returns and this resulted in additional taxable sales of $1,350,958.00.

(d) After applying the appropriate tax rate, a sales tax deficiency of $111,454.03 was computed.

(e) The auditor determined that Tri-County had failed to adequately substantiate that tax had been paid on purchases incorporated into capital improvements. A ratio of materials to capital improvements was calculated as follows: The materials portion of cost of goods sold per the Federal income tax return for the fiscal year ending February 29, 1984 of $542,100.00[2] was divided by sales per the Federal income tax return for the same year of $1,063,000.00 resulting in a percentage of 50.997%. This percentage was applied to the allowed capital improvement sales of $307,230.00, which resulted in purchases of $156,678.00 subject to use tax and use tax due of $12,925.94.

(f) Review of the Federal income tax returns indicated that there were no major

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[1]The specific contracts and the reasons certain items were deemed repairs are set forth in the auditor's worksheets (See Exhibit "U", Field Audit Report, worksheets, pages 6 and 7; petitioners' Exhibit "2").

[2]The returns showed no beginning or ending inventory. It is noted that the return for the fiscal year ending February 28, 1985 does not contain a completed Schedule A showing the breakdown of cost of goods sold for said year.

additions to the fixed asset accounts. Recurring expenses were minimal and considered tax paid.

(g) Total tax due on unsubstantiated exempt sales and materials incorporated into capital improvements was found to be $124,379.97.

On September 19, 1986, the Division of Taxation issued similar notices of determination and demands for payment of sales and use taxes due to Tri-County and to Donald Faraci and Anthony Phelps, as officers, for the period June 1, 1983 through May 31, 1985 for tax due of $124,379.97, total

penalty due of $30,130.35 and total interest due of $40,598.70 for a total amount due of $195,109.02.

At a Bureau of Conciliation and Mediation Services conference, the 96.032% capital improvement percentage was applied to all sales, resulting in capital improvement sales of $1,592,390.00 and repair sales of $65,798.00. The materials cost percentage of 50.997% was applied to capital improvement sales resulting in materials costs of $812,072.00 for materials utilized in capital improvements. Petitioner submitted purchase invoices from its main supplier, Heldor, showing purchases of $292,876.68 as having been tax paid for the period June 1983 through December 1984. Credit was allowed for the said Heldor purchases, reducing the untaxed materials costs for capital improvement sales from $812,072.00 to $519,195.00. Accordingly, tax was reduced from $124,379.97 to $48,261.81. This is based on $42,833.45 in additional tax on materials costs and $5,428.36 on repair sales.

The tax assessed against petitioner Anthony Phelps was further reduced to $37,882.15 by eliminating certain later sales tax quarters, as said petitioner had resigned from Tri-County prior to the end of the audit period.

Penalty and interest were sustained by the conferee.

On or about March 10, 1988, petitioner Donald Faraci executed a consent to the assessment as reduced to $48,261.81 at conference. This appears to have been inadvertent, however, as on the same date said petitioner executed a petition protesting the assessment. On

May 18, 1988, petitioner submitted a letter to the Division of Taxation's Law Bureau stating:

> "The purpose of this letter is to revoke my consent in reference to CMS #72209 [the conference case]. I would like the petition to stay."

The Involvement of Donald Faraci and Anthony Phelps

Tri-County was formed by petitioner Donald Faraci, who was its president and sole shareholder. Mr. Faraci was a signatory on the corporation's checking account. He also signed tax returns on behalf of the corporation. Mr. Faraci controlled the financial affairs of the corporation.

Petitioner Anthony Phelps, who had no tax or accounting training, started with Tri-County in September 1981. Donald Faraci appointed him as vice-president primarily for purposes of dealing with customers and also so that he could sign checks in Mr. Faraci's absence. Mr. Phelps was not a director or shareholder of Tri-County. Mr. Phelps was an authorized signatory on the corporation's checking account, but would generally consult with Mr. Faraci before signing checks. Mr. Phelps signed sales tax and withholding tax returns in the absence of Mr. Faraci, when Tri-County's accountant or bookkeeper would present them to him for his signature. Petitioner Anthony Phelps was not responsible for maintaining Tri-County's books and records. He could not hire or fire employees without consultation with Mr. Faraci, and had no authority to determine which creditors were to be paid first. Mr. Phelps was essentially a salesman. He was paid a salary of approximately $400.00 per week and received no share of the profits of the business or other compensation. Mr. Phelps resigned in August 1984 and subsequently entered the automotive business.

Business Operations Of Tri-County

During the period at issue, Tri-County was engaged in the business of selling and installing in-ground swimming pools, both the vinyl lined and Gunite concrete varieties. Tri-County would purchase a "pool kit" for the particular pool to be installed and would then excavate the land and install the pool. The pool kit, in the case of a vinyl pool, would include the vinyl liner, walls, assembly hardware, plumbing and filtration equipment and start-up chemicals. It is not clear from the record if the Gunite concrete pools were wholly or partly in

kit form.[3]

Both Mr. Faraci and Mr. Phelps testified that Tri-County was unable to purchase pool kits without paying sales tax. At the Bureau of Conciliation and Mediation Services conference, petitioners produced evidence that $292,876.68 in purchases from Heldor, petitioner's main supplier, had been tax paid (Finding of Fact "4"). No other documentation or evidence has been offered with respect to sales tax paid on the purchase of materials.

Both Mr. Faraci and Mr. Phelps testified that Tri-County was not engaged in the pool repair business. They claimed that Tri-County made repairs only for pools under warranty and referred customers to two other companies for repairs on out-of-warranty pools. As noted in Finding of Fact "2(c)", review of the 37 contracts submitted by Tri-County's accountant to the auditor showed that 3.968% of the sales were repair sales. Petitioners did not explain what the 3.968% represented, if not repairs.

Tri-County's tax returns had been prepared by a public accountant. Donald Faraci claimed that this accountant had retained most of Tri-County's records and both Mr. Faraci and the new accountant retained by him for the purpose of the audit claimed that they had been unable to locate the former accountant.

Proposed Findings of Fact

Petitioner Anthony Phelps has submitted 19 proposed findings of fact. Pursuant to State Administrative Procedure Act § 307.1 and 20 NYCRR 3000.11(d)(5), said proposed findings are hereby ruled upon as follows:

(a) Proposed findings 1, 2, 3, 5, 6, 7, 8, 10, 11, 12, 13, 14, 18 and 19 are accepted in full.

(b) Proposed findings 15 and 16 are rejected because the essential facts stated therein are unsupported by the evidence.

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[3]In Mr. Phelps's testimony, however, he states that with respect to kits "sometimes they would also deliver concrete and everything else" (Transcript, page 108).

(c) Proposed finding 4 is rejected to the extent that it provides that Tri-County did no repair work not covered by an original warranty, but is otherwise accepted.

(d) Proposed finding 9 is rejected to the extent not incorporated into Finding of Fact "7". It is noted that petitioner Anthony Phelps conceded that he sometimes wrote checks (Transcript, page 97).

(e) Proposed finding 17 is rejected to the extent that it indicates the only area of dispute was the $12,695.00 in tax due on repair sales, as said finding is controverted by the auditor's worksheets which show that sales of $1,350,958.00 were treated as being other than capital improvement sales. The auditor's DO-220.5 (Tax Field Audit Record) indicates that copies of the workpapers were sent to the accountant on September 10, 1986.

The proposed findings of fact have been incorporated into the Findings of Fact herein to the extent that they have been accepted and also to the extent they are deemed material to the case.

SUMMARY OF THE PARTIES' POSITIONS

(a) Petitioners contend, with respect to the audit, that:

(i) The auditor incorrectly assumed that 3.968% of Tri-County's business represented taxable repairs. Petitioners allege that Tri-County performed no repairs.

(ii) The auditor erred in assuming that Tri-County was able to purchase "pool kits" without paying tax. Petitioners allege that taxes were paid on all purchases of pool kits.

(iii) In any event, liability for unpaid taxes should be limited to $12,925.94, the amount of "use tax" originally determined by the auditor.

(b) Petitioners Donald Faraci and Anthony Phelps also contend that they were not persons required to collect tax and thus were not personally liable for taxes due from Tri-County.[4]

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[4]While petitioner Anthony Phelps's reply brief states in footnote 1 that "at no time has Donald Faraci contended that he was not a 'responsible officer'", it is noted that the petition of Donald Faraci (Exhibit "L") states that he "was not the officer responsible for paying sales tax".

The Division of Taxation contends, essentially, that:

(a) Tri-County has not sustained its burden of proof to show that the sales at issue were not taxable;

(b) That both Mr. Phelps and Mr. Faraci were persons required to collect tax on behalf of Tri-County and thus were personally liable for the taxes due.

CONCLUSIONS OF LAW

A. That during the period in issue, Tax Law § 1138(a) (former [1]) provided, in pertinent part, as follows:

> "If a return required by this article is not filed, or if a return when filed is incorrect or insufficient, the amount of tax due shall be determined by the tax commission from such information as may be available. If necessary, the tax may be estimated on the
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> basis of external indices, such as stock on hand, purchases, rental paid, number of rooms, location, scale of rents or charges, comparable rents or charges, type of accommodations and service, number of employees or other factors."

B. That where a taxpayer's records are incomplete or insufficient, the Division of Taxation may select a method reasonably calculated to reflect sales and use taxes due. The burden then rests upon the taxpayer to demonstrate by clear and convincing evidence that the method of audit or amount of tax assessed was erroneous (Surface Line Operators Fraternal Organization, Inc. v. Tully, 85 AD2d 858).

C. That under Tax Law § 1132(c), the burden of showing that a receipt is not subject to tax is on the person required to collect tax, or the customer.

D. That the audit results, as modified at conference, are sustained. Petitioners' books and records were clearly inadequate. Accordingly, it was appropriate for the Division of Taxation to calculate taxes based on the available records, i.e., the Federal income tax returns and the 37 contracts submitted by Tri-County. Petitioners' criticism of the audit method is unjustified:

(1) Petitioners' own records show that 3.968% of the total amount of sales on the 37 contracts were for repairs (Finding of Fact "2[c]"). Petitioners offered no evidence at the hearing to show that the specific items (which were set forth in the workpapers) did not constitute taxable repairs.

(2) When the disallowed capital improvement sales were allowed at conference, Tri-County still had the burden of proof to show that the purchases of materials used in the capital improvements were tax paid. The purchases were based on Tri-County's own Federal income tax returns. Tri-County was given credit for the $292,876.68 in purchases from Heldor, but submitted nothing with respect to the balance of the purchases. Thus, the Division of Taxation is not limited to the $12,925.24 in use tax included in the original assessment.

E. That Tax Law § 1133(a) provides, in pertinent part, as follows:

> "Except as otherwise provided in section eleven hundred thirty-seven, every person required to collect any tax imposed by this article shall be personally liable for the tax imposed, collected or required to be collected under this article."

F. That during the period in issue, Tax Law § 1131 (former [1]) provided as follows:

> "'Persons required to collect tax' or 'person required to collect any tax imposed by this article' shall include: every vendor of tangible personal property or services; every recipient of amusement charges; and every operator of a hotel. Said terms shall also include any officer or employee of a corporation or of a dissolved corporation who as such officer or employee is under a duty to act for such corporation in complying with any requirement of this article and any member of a partnership."

G. That petitioner Donald Faraci was a person required to collect tax on behalf of Tri-County. He was president and sole shareholder of the corporation, was a signatory on the corporation's checking account, signed tax returns and controlled virtually every aspect of the corporation's existence.

H. That petitioner Anthony Phelps was not a person required to collect tax on behalf of Tri-County. While he was also an officer of the corporation, he was not a director or shareholder and did not have control over the financial affairs of the corporation.

I. That the petition of Tri-County Pool Corp. is denied and the Notice of Determination and Demand for Payment of Sales and Use Taxes Due issued against it on September 19, 1986, as reduced after the Bureau of Conciliation and Mediation Services conference (Finding of Fact "4"), is sustained.

That the petition of Donald Faraci is denied and the Notice of Determination and Demand for Payment of Sales and Use Taxes Due issued against him on September 19, 1986, as reduced

after the Bureau of Conciliation and Mediation Services conference (Finding of Fact "4"), is sustained.

That the petition of Anthony Phelps is granted and the Notice of Determination and Demand for Payment of Sales and Use Taxes Due issued against him on September 19, 1986, is cancelled.

DATED: Troy, New York

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ADMINISTRATIVE LAW JUDGE