STATE OF NEW YORK

DIVISION OF TAX APPEALS

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| In the Matter of the Petition | : | |
| of | : | |
| **SUPERMARKET GENERAL CORP., PATHMARK STORES** | : | DETERMINATION DTA NO. 819768 |
| for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Years 1998 through 2001. | : | |

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Petitioner, Supermarket General Corp., Pathmark Stores, 200 Milik Street, Carteret, New Jersey 07008, 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 years 1998 through 2001.

A hearing was held before Gary R. Palmer, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on August 31, 2004 at 10:00 A.M., with all briefs to be submitted by February 15, 2005, which date began the six-month period for the issuance of this determination. Petitioner appeared by Anderson, Gulotta & Hicks, P.C. (Michael A. Gruin, Esq., of counsel). The Division of Taxation appeared by Christopher C. O'Brien, Esq. (Robert A. Maslyn, Esq., of counsel).

## *ISSUE*

Whether the installation of refrigeration piping and condensation drains to serve petitioner's refrigerated cases, coolers and freezers in its New York stores constitute tax exempt capital improvements.

## *FINDINGS OF FACT*

1. Pursuant to section 3000.15(d)(6) of the Rules of Practice and Procedure of the Tax Appeals Tribunal, and section 307(1) of the State Administrative Procedure Act, petitioner has submitted proposed findings of fact. Petitioner's proposed findings of fact have been substantially incorporated into this determination, with the exception of its proposed finding of fact 5, which is rejected because it states conclusions rather than facts.

2. During the years 1998 through 2001, petitioner operated 55 supermarket grocery stores in New York State at locations within the City of New York, Long Island, and the counties of Westchester and Rockland. It also operated such stores within the State of New Jersey. Of the 55 stores located within New York State, petitioner owned 4 of the stores and leased the remaining 51 stores. The four stores owned by petitioner during the years at issue were the Inwood store located at 410 West 207th Street, New York City (store no. 610); the Baldwin, New York store (store no. 623); the Seaford, New York store (store no. 625); and the Ozone Park, New York store (store no. 626).

3. During the years at issue petitioner purchased installation and maintenance services performed at its New York stores from various vendors. These services included the installation of refrigerated meat, fish, dairy and produce cases, as well as walk-in coolers and freezers ("the refrigerated fixtures"). Other services purchased by petitioner for its New York stores included the installation of security systems, plumbing fixtures, shelving, HVAC systems, doors, locks, light poles and paving and repairs to parking lots. The installation of the refrigerated fixtures included the installation of refrigeration piping to connect each fixture with its associated compressor located on the roof or in a separate compressor room within the store, and the installation of drain pipes to carry away condensation from the cases, coolers and freezers.

4. Petitioner paid sales and use taxes to the Division of Taxation ("Division") in relation to all the installation and maintenance work performed at its New York stores during the years at issue.

5. On or about April 16, 2001 petitioner filed a claim for refund, seeking a sales and use tax refund in the sum of $461,190.17 based, in part, on its assertion that the installation services purchased constituted capital improvements to real property as defined in Tax Law § 1101(b)(9)(i).

6. On or about October 2, 2001 petitioner filed a separate claim for refund seeking a refund of sales and use taxes in the sum of $166,606.14, based, in part, on its position that the installation services purchased by petitioner included capital improvements to real property.

7. By letter dated August 28, 2002 the Division granted, in part, petitioner's initial claim for refund in the sum of $122,009.67, while disallowing the balance of that claim in the sum of $339,180.50.

8. By letter dated October 10, 2002 the Division partially granted petitioner's second claim for refund in the sum of $14,904.29, and disallowed the remainder of that claim in the sum of $151,701.85.

9. Petitioner filed a timely request for a conciliation conference with the Bureau of Conciliation and Mediation Services ("BCMS") as to that part of each of its refund requests that was disallowed by the Division. BCMS consolidated the two proceedings and, on September 26, 2003, issued a conciliation order granting to petitioner a further refund of sales and use taxes in the sum of $25,424.25, while disallowing the balance of petitioner's claims, as consolidated, in the sum of $465,458.10.

10. On or about November 21, 2003 petitioner filed a petition for a hearing with the Division of Tax Appeals wherein it protested the BCMS refund denial.

11. In his opening statement at the hearing petitioner's representative limited the issue for resolution to whether the installation of refrigeration piping and condensation drains for the refrigerated fixtures by five named vendors[1] constituted capital improvements to real property. He conceded that no refunds are due for any of the installation services rendered by any of the other vendors whose invoices are included in the record, and that the amount of the claimed sales and use tax refund at issue in this proceeding is reduced to $289,379.55.

12. In accordance with petitioner's policies, all of petitioner's refrigeration piping was connected to the compressor room by concealing the piping from view either by burying the piping in the floor and covering it with cement, or concealing it in the walls behind sheetrock, above ceiling tiles or buried in sealed vertical columns.

13. All of petitioner's refrigerated fixtures require connection to a drainage system for condensation runoff. Each condensation drain pipe is buried in the floor and connected to the plumbing system of the building.

14. When petitioner's leasehold interest in a New York store terminates or one of the stores owned by it is sold, the refrigerated fixtures are removed from the premises, and the refrigeration piping and condensation drainage systems are uniformly left in place with the pipe stub, that had been connected to the fixture, being cut off even with the wall or ceiling or floor and sealed over.

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[1]The five vendors were AAA Refrigeration Service, Inc.; RAC Mechanical, Inc.; Engineering and Refrigeration, Inc.; Construction Maintenance Plus, Inc.; and Twin County HVAC/Refrigeration LLC.

15. Were the refrigeration piping and condensation drainage systems to be removed from the walls, floors or ceilings, not only would these parts of the building structure be damaged by such removal, but the piping and drain lines so removed would have no value and be rendered unusable.

16. The record includes a copy of petitioner's standard lease agreement, the terms of which have been accepted by the parties as representative of all petitioner's supermarket leases during the years at issue. Section 10.2 of the lease agreement provides as follows:

> 10.2 All signs, counters, shelving, refrigerating and air-conditioning equipment, oil burners, trade fixtures, contents, and other store fixtures and equipment, which may at anytime be installed or placed in or upon the Demised Premises, by or at the expense of Tenant (or its subtenants or licensees), are and shall remain the property of Tenant (or its subtenants or licensees), and Tenant shall remove the same at any time on or prior to the Expiration Date of the term of this Lease, except as otherwise provided herein. All other property (including, without limitation, the Improvements) which may at any time be installed in or built on the Demised Premises, by or at the expense of Landlord or Tenant (or its subtenants or licensees), shall be and remain a part of the Demised Premises and the property of Landlord and shall not be removed by Tenant (or its subtenants or licensees).

The term "improvements" is referenced in section 1.1 of the lease agreement as follows:

> Any building now or hereafter built on the portion of the Land shown on Exhibit B attached hereto as the "Building Area" is herein called the "Tenant's Building", any buildings and improvements now or hereafter built on the Land (including without limitation, the Tenant's Building) are herein collectively called the "Improvements", the Land and the Improvements are herein collectively called the "Demised Premises". . . .

## *SUMMARY OF THE PARTIES' POSITIONS*

17. Petitioner maintains that it is entitled to a refund of all sales and use taxes paid during the years at issue to the five named vendors for the installation of refrigeration piping and condensation drains located in its owned and leased New York stores because such piping and

drainage systems substantially added value to the real property, were permanently affixed to the real property so that removal would result in material damage to the premises, and such installations were intended to be permanent. It follows, according to petitioner, that the installations at issue were tax exempt capital improvements to real property.

18. The Division asserts that the installation services at issue did not qualify as capital improvements and that any invoices which identify both taxable and nontaxable installation services, without separately stating the amount of the sale subject to tax, must be treated entirely as taxable sales.

## *CONCLUSIONS OF LAW*

A. Tax Law § 1105(c)(3) imposes sales tax on the receipts from every sale, except for resale, of the service of installing tangible personal property, except for installing property which, when installed, will constitute an addition or capital improvement to real property. The term "capital improvement" is defined in Tax Law § 1101(b)(9)(i) as:

> An addition or alteration to real property which:
>
> (A) Substantially adds to the value of the real property, or appreciably prolongs the useful life of the real property; and
>
> (B) Becomes part of the real property or is permanently affixed to the real property so that removal would cause material damage to the property or article itself; and
>
> (C) Is intended to become a permanent installation.

B. Petitioner asserts that the installations of the piping and drainage systems in question met the three-prong test of section 1101(b)(9)(i) in that not only did they substantially add value to the real property in question, but because the drains and refrigeration lines are never removed upon the abandonment of the store by petitioner and cannot be removed without damaging the

premises and the piping itself, such piping is both permanently affixed to the realty and intended to be permanent. In ***Matter of Merit Oil of New York v. New York State Tax Commn.*** (124 AD2d 326, 508 NYS2d 107), the Court held that despite the fact that the vast majority of the taxpayer's improvements to the gasoline service stations it leased from others were never removed upon the expiration of the lease, and the removal of the improvements, consisting in part of underground gasoline tanks and the piping systems connecting the tanks to the gas pumps, would be a significant undertaking, because 6 of the taxpayer's 29 lease agreements reserved to the taxpayer the right to remove the installed property, as to those 6 leases the improvements were not permanent and not capital improvements exempt from sales tax. In the matter here under review, petitioner's standard form lease imposes on petitioner the duty to remove all store fixtures and equipment, including refrigerating and air-conditioning equipment, which it, as tenant, has installed or placed in or upon the demised premises. As to all other property, which the standard form lease calls "improvements" that may be installed in or built on the demised premises by or at the expense of the landlord or tenant, such property shall remain the property of the landlord and shall not be removed by the tenant.

C. The thrust of petitioner's argument is that the refrigeration piping and drainage systems are improvements permanently affixed to the demised premises and intended to become permanently installed therein. Petitioner avers that the piping and drainage systems are structural systems or building infrastructure that can be reused in those instances where the store is later "re-leased" by the landlord to another supermarket operator. There is no indication in the record as to how often a future tenant of a building abandoned by petitioner was an operator of supermarkets or what use, if any, such new tenants made of the refrigerant piping and drainage

systems installed for petitioner. There is only a vague reference by petitioner's refrigeration engineer in his affidavit that there have been instances when its leased stores were later turned over to Grand Union or A&P for use as grocery stores.

D. In order to meet its burden of proof petitioner must overcome the presumption against a finding of permanency for tenant improvements (***Matter of Gem Stores, Inc.***, Tax Appeals Tribunal, October 14, 1988). Under this presumption, unless a contrary intention is expressed, installations made by the tenant for the purpose of conducting the business of the tenant on the real property it leases are presumed not to be permanent, but made for the sole use and enjoyment of the owner of the business (***Matter of Empire Vision Center, Inc.***, Tax Appeals Tribunal, November 7, 1991; ***Shell Oil Company v. Capparelli***, 684 F Supp 1052). In ***Matter of Flah's of Syracuse, Inc. v. Tully*** (89 AD2d 729, 453 NYS2d 855) the Court, construing lease provisions relating to three of the taxpayer's retail clothing stores, which leases uniformly provided that title to improvements vested in the landlord upon installation, held that such provision expressed an intention that was contrary to the presumption, thereby rendering the presumption of nonpermanency ineffectual. The standard form lease in the instant proceeding includes a similar clause vesting title to "improvements" in the landlord, and reserving title to tenant-installed fixtures and equipment, including refrigerating and air-conditioning equipment, in the tenant. The task at hand distills to whether, under petitioner's standard form lease, the refrigeration piping and condensation drains are fixtures and equipment or improvements. In ***Matter of Empire Vision Center, Inc. (supra)***, the Vestal office lease, by its terms, differentiated between permanent fixtures and nonpermanent fixtures by whether or not the item could be removed "without material injury to the premises." The instant standard form lease is less helpful.

E. Section 1.1 of the standard form lease recognizes two classes of improvements, (1) "any building," and (2) "improvements now or hereafter built on the land." Although the use of the term "improvements" to define the term "Improvements" may not be the best example of clear and precise draftsmanship, the lease does differentiate between "trade fixtures . . . and other store fixtures and equipment" that are "installed or placed in or upon" the demised premises, and "any buildings and improvements now or hereafter built on the land." By looking to the dictionary definition of the verb "install," which is defined in Webster's Ninth New Collegiate Dictionary as "to set up for use or service," and that of the verb "build," which is defined as "uniting materials by gradual means into a composite whole," it is logical to conclude that the installation of refrigeration piping and drains within the floors, walls and ceilings where they are covered over with cement or sheetrock is more consistent with the dictionary definition of "build" than it is with that of "install." I therefore find that the refrigeration piping and condensation drains, under the terms of the standard form lease relied upon by both parties, are "improvements" that are intended to remain a part of the demised premises and to become the property of the landlord upon the expiration of the lease. It then follows that, in accordance with ***Matter of Merit Oil of New York v. New York State Tax Commission (supra)***, the terms of the lease agreement dictate what items of personalty the tenant has the right, or duty, to remove from the demised premises upon the expiration of the lease, and what items are considered to be permanently affixed to the realty. I further find that because the standard form lease expresses a contrary intention to the presumption against a finding of permanency for tenant-installed business improvements, the presumption does not apply.

F. Having found that petitioner has met its burden as to the second and third elements of the Tax Law § 1101(b)(9)(i) definition of capital improvement, it is appropriate to examine the first element of the definition which requires that the addition or alteration to real property either substantially adds to the value of the real property or appreciably prolongs its useful life. Unlike, for example, a new roof, there is nothing to suggest that the refrigeration piping and condensation drains serve to prolong the useful life of the structure. Absent a definitive showing that the leased premises in issue were uniquely suited for supermarket use only and were later leased as such, and further, that the piping and drains were uniformly reusable in subsequent supermarket operations, it is difficult to discern how the improvements in question substantially add to the value of the real property. The record does not support such a finding. If one of the structures in question was to be later leased for use as a furniture store or an auto parts store or a clothing store, the piping and drains would serve no purpose and add no value to the realty. Should the building again be leased for use as a supermarket, then, to the extent that the piping is reusable, and that the new tenant elects to locate its refrigerated coolers and cases within the store close to where petitioner had placed its coolers and cases, then, although some measure of value could be realized from the improvements at issue, on this record a finding that substantial value is added is all too speculative. It is therefore determined that petitioner has not met its burden to establish that the piping and drains it installed in its leased stores are capital improvements.

G. Having determined that petitioner's installation of piping and drains in its leased stores does not fulfill the requirements of the three-prong test of Tax Law § 1101(b)(9)(i) defining a capital improvement, it must be noted that the failure of proof discussed is inapplicable with

respect to the stores that petitioner owns in fee. This is so because petitioner's installation of the piping and drains in the supermarkets that it both owns and operates is consistent with the Court of Appeals holding in ***Tifft v. Horton*** (53 NY 377, 382), that reads:

> [A]s a general rule, all fixtures put upon lands by the owner thereof become a part thereof . . . .

This case was cited to by the Tax Appeals Tribunal in ***Matter of Gem Stores, Inc. (supra)***, where the Tribunal found that surveillance equipment installed by a tenant in a retail store that it leased was "tenant personalty" subject to sales tax.

H. Having determined that the piping and drains in petitioner's owner-operated stores are capital improvements, it remains to be determined whether, relative to its owner-operated stores, petitioner has met its burden to prove that the sales tax paid on invoices stating a single unapportioned charge covering a mixture of taxable and nontaxable services should be allocated between each class of services (***see, Matter of Dynamic Telephone Answering Systems, Inc.,*** 135 AD2d 978, 522 NYS2d 386; ***lv denied,*** 71 NY2d 801, 527 NYS2d 767). There are three invoices relating to services performed by Engineering and Refrigeration, Inc. at the store petitioner owns in Ozone Park, New York (store no. 626). The first such invoice, that dated October 5, 1999, was issued for $1,990.97 in taxable repair services rendered to petitioner. This invoice includes sales tax in the sum of $164.65. The second invoice is dated May 31, 2000, and was issued to petitioner for the payment of $2,022.90 in unbilled sales tax on a previous invoice, dated May 17, 2000, which was issued for refrigeration work that included a task described as "case change out." While this particular job may have included the nontaxable installation of piping and drains, there is no way to determine from the record that all services reflected in the May 17, 2000 invoice were nontaxable. The third invoice dated September 28, 2000 was issued

for a total of $3,010.74, including sales tax of $229.45. This invoice clearly includes taxable repair work. Because the charges for the taxable services are not separately stated, the single unapportioned charge set forth on each invoice is subject to sales tax in its entirety (***Matter of Dynamic Telephone Answering Systems, Inc., supra***).

I. The record also includes six invoices issued to petitioner by AAA Refrigeration Service, Inc. for work performed at petitioner's owner-operated Seaford, New York store. The first two invoices, one dated April 23, 1999, and the second dated August 27, 1999, cover two payment stages of the same job where the work includes the temporary relocation of deli cases and the relocation of temporary systems, which portion of the overall work is not a capital improvement. The third invoice, also dated August 27, 1999, recites tax in the sum of $360.86 on a charge of $4,245.40 for condensation drain piping on various refrigerated cases. Because no repair or other taxable work is listed on the invoice, the Division is directed to refund to petitioner the sum of $360.86 plus interest. The fourth AAA Refrigeration Service invoice, dated November 8, 1999, relates back to the same job and purchase order covered by the first two invoices which included the taxable temporary relocation work. The fifth invoice, also dated November 8, 1999, relates to the payment of $276.68 in sales tax on the final payment for a job that included the installation of piping. This invoice does not indicate the nature of the work included in the original amount invoiced, which may or may not have been subject to tax. The final invoice is dated November 22, 1999, and reflects a $36,850.00 installation of a temperature control system. The sales tax on this installation is $3,132.55. Because the temperature control system is an essential component of each of the refrigerated fixtures and culminates in an addition to petitioner's realty that qualifies as a capital improvement, petitioner

is entitled to the refund of the sales tax it paid on this system in the sum of $3,132.55 plus interest. Except as indicated above relative to the third and sixth AAA Refrigeration Services invoices, petitioner's applications for a refund are denied and the Division's notices of disallowance of petitioner's claims for refund are sustained.

J. The petition of Supermarket General Corp., Pathmark Stores is granted to the extent indicated in Conclusion of Law I, and is, in all other respects, denied.

DATED: Troy, New York
June 9, 2005

/s/ Gary R. Palmer
ADMINISTRATIVE LAW JUDGE