

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :

of :

ANDREW COSTABILE :

for Revision of Determinations or Refund of Sales and :
Use Taxes under Articles 28 and 29 of the Tax Law for the :
Periods September 1, 2007 through May 31, 2008 and :
March 1, 2009 through February 29, 2012. :

In the Matter of the Petition :

of :

RALPH COSTABILE :

for Revision of Determinations or Refund of Sales and :
Use Taxes under Articles 28 and 29 of the Tax Law for the :
Periods September 1, 2007 through May 31, 2008 and :
March 1, 2009 through February 29, 2012. :

DETERMINATION
DTA NOS. 826105,
826106, AND 826107

In the Matter of the Petition :

of :

MICHAEL DELPONTE :

for Revision of Determinations or Refund of Sales and :
Use Taxes under Articles 28 and 29 of the Tax Law for the :
Periods September 1, 2007 through May 31, 2008 and :
March 1, 2009 through February 29, 2012. :

Petitioners, Andrew Costabile, Ralph Costabile and Michael Delponte, filed petitions for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the

Tax Law for the periods September 1, 2007 through May 31, 2008 and March 1, 2009 through February 29, 2012.

A consolidated hearing was held before Joseph W. Pinto, Jr., Administrative Law Judge, in Albany, New York, on April 10, 2015 at 10:30 A.M., with all briefs to be submitted by July 24, 2015, which date began the six-month period for the issuance of this determination. Petitioners appeared pro se. The Division of Taxation appeared by Amanda Hiller, Esq. (Stephanie M. Scalzo, Esq., of counsel).

ISSUE

Whether purchases of materials by a corporation installed as part of capital improvements to real property are subject to sales and use tax.

FINDINGS OF FACT

1. During the periods September 1, 2007 through May 31, 2008 and March 1, 2009 through February 29, 2012 (audit period), Andrew Costabile, Ralph Costabile and Michael Delponte (petitioners) were officers and persons responsible for the collection and payment of sales and use taxes on behalf of Tre Potenti, Inc. (Tre Potenti) d/b/a Stone Age, a business that acted as a retailer of cabinets, countertops, tile and other building products used in kitchens and baths. Tre Potenti also acted as a contractor, performing installations of its products for some customers.

2. The Division of Taxation (Division) began an audit of Tre Potenti in April 2012 and made two requests for the books and records of the company pertaining to its sales and use tax liability. The Division did not audit the period June 1, 2008 through February 28, 2009 because the period of limitations on assessment of additional tax for this period had expired.

3. The records produced in response to the Division's request were deemed inadequate because they could not trace a transaction back to the original source or forward to a final total. As a result, the Division utilized an estimated audit methodology, a test period audit, which examined sales records for the period March through May 2009. It used bank deposits as a baseline in its audit because the deposits were in substantial agreement with the books and records that were produced. Further, Tre Potenti reported its sales based on bank deposits.

4. After a review of the sales tax returns filed for the audit period, it was discovered that no return was filed for the quarter ended May 31, 2008. The Division established a taxable ratio of taxable sales to bank deposits for all quarters in the audit period, 18.91%, and applied it to the bank deposits for the quarter ended May 31, 2008 to arrive at taxable sales and then applied the tax rate to calculate the additional tax due for the quarter of \$5,276.67.

5. A review of the sales records for the test quarter indicated that there had been errors in the tax rate used resulting in unpaid tax of \$106.07, or an error rate of 0.0649% for the test period. When applied to total bank deposits for the audit period it resulted in additional tax of \$1,919.85.

6. The review of the test period also indicated that additional tax of \$661.72 was due for disallowed nontaxable sales, which projected an error rate of 0.4047%, which, when applied to total bank deposits for each quarter, resulted in additional tax due for the audit period of \$11,971.68.

7. The review of the test quarter indicated also that tax was owing in the sum of \$332.55 for sales tax that was collected and not reported and remitted. When compared to the tax reported of \$2,272.00, it yielded an error rate of 14.64%. This rate was applied to each quarter's reported tax to yield additional tax due of \$7,196.33.

8. The final area examined by the Division was purchases of materials, which revealed that Tre Potenti paid no sales or use tax on any of these purchases regardless of whether the materials were used in capital improvements or sold at retail. Using the same test period of March to May, 2009, the Division determined from the sales records that 54.66% of the jobs were capital improvements. It applied 54.66% to total material purchases of \$1,564,996.00 and arrived at taxable purchases of \$855,426.59 and additional tax due of \$69,948.23.

9. On or about February 12, 2013, the Division issued to Tre Potenti two statements of proposed audit change for sales and use taxes for the period September 1, 2007 through February 29, 2012. The first statement asserted additional sales tax based on all of the areas discussed above except the tax associated with material purchases. The first statement asserted additional taxes due of \$26,364.53 plus penalty and interest.

The second statement asserted additional tax due on materials purchases only for use in capital improvements in the sum of \$69,948.23 plus interest.

10. When Tre Potenti failed to agree with the audit results, the Division issued notices of determination to each of the petitioners herein as persons responsible for the collection and payment of sales and use tax on behalf of the corporation. With respect to the areas of the audit that found additional sales and use taxes due for collecting and not remitting the tax, charging the incorrect tax rate, not substantiating exempt sales, and failing to file a tax return, the Division issued to each of the petitioners a Notice of Determination, dated March 8, 2013, stating additional tax due of \$26,364.53 plus penalty and interest.

With respect to the part of the audit that determined additional tax due on material purchases, the Division issued to each of the petitioners a Notice of Determination, dated March 8, 2013, stating additional tax due of \$69,948.23 plus interest. Although petitioners protested all

notices issued to them, they disputed only the tax asserted on purchases of materials used in capital improvements, as set forth in their petitions and stated at hearing.

SUMMARY OF THE PARTIES' POSITIONS

11. Petitioners contend that Tre Potenti should not have been held liable for the purchases of materials that were subsequently used in capital improvements. Since Tre Potenti sold materials at retail, it purchased its materials for resale and did not pay sales tax. They argue that when they performed capital improvements for customers and were presented with capital improvement certificates, it diminished their profit because they were forced to discount the jobs to the extent of the sales tax (use tax) owed. Petitioners argue that Tre Potenti was a retailer and all its purchases were for resale and therefore it owed no tax at the time of purchase.

12. Petitioners maintain that the Division has never indicated to them the legal basis for asserting the use tax due herein, despite numerous requests for an explanation.

13. The Division asserts that the concept of a contractor's obligation for paying sales and use tax on purchases of materials used by it in the performance of a capital improvement is well established and believes petitioners have stated no basis for the relief they seek.

CONCLUSIONS OF LAW

A. In general, sales tax is imposed on the receipts from every retail sale of tangible personal property (Tax Law § 1105[a]). The definition of a retail sale excludes the sale of tangible personal property for resale as such (Tax Law § 1101[b][4]).

B. Tax Law § 1101(b)(4) provides that the sale of tangible personal property to a contractor for use or consumption in construction is a retail sale and subject to sales and use tax, regardless of whether tangible personal property is to be resold as such or incorporated into real property as a capital improvement or repair (*Matter of Swet*, Tax Appeals Tribunal, February 22,

1991). A similar provision appears in the regulations at 20 NYCRR 541.1(b) and states, in pertinent part, as follows:

“The principal distinguishing feature of a sale to a contractor, as compared to a sale to other vendors who purchase tangible personal property for resale, is that the sale of tangible personal property to a contractor for use or consumption in construction is a retail sale and subject to sales and use tax, regardless of whether tangible personal property is to be resold as such or incorporated into real property as a capital improvement or repair.”

C. It appears that petitioners herein do not recognize that they can be both retailers and contractors depending on the nature of the transactions in which materials are used (20 NYCRR 541.13[a]), and if they are acting as contractors, they are liable for the tax due on the purchases of the materials (20 NYCRR 541.13[b]).

Although petitioners may have been accustomed to purchasing all materials in contemplation of all their sales being for resale and therefore not subject to tax (Tax Law § 1101[b][4][i][A]), subsequent utilization of any materials incorporated into capital improvements clearly made those purchases taxable as provided for in the statute and regulations.

The fact that petitioners were ignorant of the law and regulations is not an excuse for nonpayment of the tax. (*Matter of McGaughey*, Tax Appeals Tribunal, March 19, 1998.) Had they been aware of their sales and use tax obligations, they could have accounted for their additional expense when costing their capital improvement projects.

D. In these matters, petitioners do not dispute the fact that they acted as contractors and performed capital improvements, receiving properly executed certificates from customers. These certificates allowed petitioners to receive payment for these projects without collecting sales tax from their customers. However, the clear language of the law and regulations provide that where materials are used in the performance of capital improvements, the purchase of the materials is

subject to tax. (Tax Law § 1101[b][4][i][A]; 20 NYCRR 541.13[b]; 20 NYCRR 527.7[b][5]; *Matter of Lombard*, Tax Appeals Tribunal, March 6, 1997.)

Likewise, the Division's Publication 862, provided to petitioners on audit, clearly reiterates all the statutory and regulatory rules discussed above.

E. Petitioners concede their responsibility for the collection and payment of sales and use taxes on behalf of Tre Potenti. Mr. Ralph Costabile held the offices of secretary and treasurer, Mr. Andrew Costabile held the office of vice president and Mr. Michael Delponte held the office of president. All of the petitioners took part in operating the company and it is concluded they are jointly and severally liable for the sales and use taxes determined to be due herein (Tax Law §§ 1131[1]; 1133[a]).

F. Petitioners argued that they have never been given any basis for imposition of use tax in circumstances like those presented herein where tax was not paid on the purchases of materials, although clearly due. The transactions in which Tre Potenti purchased its materials were retail sales subject to sales tax. However, since Tre Potenti purchased all materials tax free, no tax was paid on materials subsequently used in capital improvements. These material purchases were subject to use tax since the materials were consumed by Tre Potenti in its capital improvement projects (20 NYCRR 527.7[b][5]).

Tax Law § 1110(a) explains that “[e]xcept to the extent that property or services have already been or will be subject to the sales tax [under Article 28], there is hereby imposed on every person a use tax for the use within this state . . . (A) of any tangible personal property purchased at retail.” Thus, Tre Potenti was liable for use tax on the materials it purchased for use in its capital improvement projects to the extent they had not already been subject to sales tax (20 NYCRR 531.3; *Matter of Alpha Window Systems, Ltd.*, Tax Appeals Tribunal, May 1, 1997).

_____G. The petitions of Andrew Costabile, Ralph Costabile and Michael Delponte are denied and the Division's six notices of determination, dated March 8, 2013, are sustained.

DATED: Albany, New York
January 14, 2016

Joseph W. Pinto, Jr.
ADMINISTRATIVE LAW JUDGE
