STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
HOFFINGER INDUSTRIES, INC. A/K/A LOMART INDUSTRIES, INC., AND MARTIN HOFFINGER, P. ADELBERG AND D. NELSON, AS OFFICERS	:	DECISION
for Revision of Determinations or for Refunds of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period March 1, 1981 through February 29, 1984.	:	

Petitioners, Hoffinger Industries, Inc., a/k/a Lomart Industries, Inc., and Martin Hoffinger, P. Adelberg and D. Nelson, as officers, 980 Alabama Avenue, Brooklyn, New York 11207, filed an exception to the determination of the Administrative Law Judge issued on January 6, 1989 with respect to their petition for revision of determinations or for refunds of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 1981 through February 29, 1984 (File Nos. 801922, 802021, 802022 and 802023). Petitioners appeared by Martin Hoffinger. The Division of Taxation appeared by William F. Collins, Esq. (Lawrence A. Newman, Esq., of counsel).

Petitioners filed a letter in support of their exception. The Division of Taxation filed a letter in response to the petitioners' exception and letter.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUE

Whether the Division of Taxation, upon audit, properly determined a use tax liability on certain expense items and other purchases against petitioner Hoffinger Industries, Inc. a/k/a Lomart Industries, Inc., and against petitioners Martin Hoffinger, P. Adelberg and D. Nelson, as persons responsible under Tax Law sections 1131(1) and 1133(a).

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge and such facts are stated below.

We further find an additional fact as stated below.

During the period March 1, 1981 through February 29, 1984 (as well as during periods both before and after such time span) petitioner HoffingerIndustries, Inc., a/k/a Lomart Industries, Inc. ("Lomart") conducted operations in the tool and dye business and also in the manufacture and sale of a full line of above-ground swimming pools and related products. Lomart operates manufacturing facilities in Brooklyn, New York, and in Arkansas and California.

In or about February of 1985, the Division commenced a field audit of Lomart's business operations. The auditors visited Lomart's business premises at 960 Alabama Avenue, Brooklyn, New York and, after reviewing Lomart's books and records, determined there were insufficient documents to conduct a detailed audit of its expense purchases. More specifically, the auditors did not have available a complete set of purchase invoices such that verification of the payment of tax (or proper non-payment) on such purchases could be made. Accordingly, the auditors decided to utilize a test period, specifically the month of January 1983, to analyze Lomart's purchases and determine a percentage of error in the payment of tax on such purchases.[1]

The test period analysis resulted in a disallowance percentage (error rate in payment of tax on purchases) of .05565 percent. This error rate was applied to expense purchases for the entire audit period, in the categories hereinafter specified, to arrive at the calculation and assessment of additional tax liability.

On March 19, 1985 and March 20, 1985, respectively, the Division issued to petitioner Lomart separate notices of determination and demands for payment of sales and use taxes due,

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[1]Resort to the use of a test period is not challenged by petitioners, it being admitted that not all invoices were available for audit.

assessing tax due in the aggregate amount of $33,772.12 for the period March 1, 1981 through February 29, 1984, plus penalty (Tax Law § 1145 [former (a)(1)]) and interest. These notices of determination and demands were based upon the aforementioned field audit work performed by the Division. Consents extending the period of limitations had been executed allowing assessment for the period spanning March 1, 1981 through November 30, 1981 to occur at any time on or before March 20, 1985.

In addition to the aforementioned notices of determination and demands, additional identical notices of determination and demands were issued to the individual petitioners, Martin Hoffinger, P. Adelberg and D. Nelson, assessing tax liability identical to that assessed against the corporate petitioner both as to amount and as to period. Petitioners P. Adelberg and D. Nelson did not appear either in person or by an authorized representative at hearing.

The Division of Taxation's assessment of use tax represents tax computed on amounts of purchases and expenses as reflected in Lomart's various expense accounts including data processing expenses, operating

supplies, office supplies, automobile and truck expenses (including spare part expenses), machinery purchases, heating services (heating oil), expendable tools, and repair and maintenance expenses. The Division also asserted additional tax due on a portion of the electricity used in Lomart's facility.

As the result of conferences occurring prior to the hearing, at which times additional substantiation was provided by Lomart, the Division revised its assessment. This revision resulted in a tax due of $21,687.92, and reflected reductions in the amount of tax originally assessed upon fixed asset acquisitions, specifically for machinery, automobile and truck acquisitions. Just prior to commencement of the hearing, the Division further reduced the assessment to the amount of $19,934.92. This second reduction was based upon acceptance of documentation provided by Lomart with respect to the category of automobile and truck expenses, including spare parts. Thus, as of the time of hearing, the amount assessed

($19,934.92) reflected tax calculated on some fifteen categories of expenses for which substantiation (of payment of tax or of non-taxability) had not been furnished by Lomart.

Subsequent to the hearing, Lomart submitted additional substantiation (documents) relative to some of the fifteen categories of expense in dispute. After review thereof, the Division further reduced its assessment to $12,736.02, plus penalty and interest. This reduction arrives at the amount now in contest ($12,736.02) and consists of the following items:

ASSESSMENT AS RECOMPUTED POST HEARING

EXPENSE	AMOUNT	TAX	
a) Data Processing - Leased		$32,195.00	
b) Data Processing - Rented		24,000.00	
c) Outside Services - Heating		20,767.00	
d) Repairs & Maintenance		1,000.00	
		$77,962.00	$ 6,431.86
e) Expendable Tools		$ 4,136.00	
f) Operating Supplies		10,363.00	
		$14,499.00	$ 579.96
g) Electricity		$76,933.00	$ 3,077.00
h) Fixed Assets - Machinery		$28,910.71	$ 1,156.43
i) Fixed Assets - Autos/Trucks		18,070.00	1,490.77
Total Tax			$12,736.02

Items "a", "b", "c", "d", "e" and "g" reflect the same dollar amounts of expense as were disallowed per the original audit. Items "f", "h" and "i" reflect adjustments (decreases) in the amounts originally disallowed, based on documentary substantiation submitted by Lomart post hearing[2]. The balance of items originally disallowed as unsubstantiated were allowed in full based upon the substantiation supplied post hearing.

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[2]The original and reduced amounts are as follows:

Item	Original	As Reduced
"f"	$53,629.00	$10,363.00
"h"	68,070.00	28,910.71
"i"	53,589.00	18,070.00

With respect to the remaining expense items held subject to tax, the following presentation was made:

(a) and (b) Data processing - leased and rented ($56,195.00): Lomart owned certain data processing hardware and in connection therewith leased certain software programs for use in its business. Lomart made lease payments totalling $56,195.00 which were subjected to tax upon audit by the Division. Lomart provided no explanation as to what the software products were utilized for, but asserted that such lease payments were, upon information and belief, not subject to tax. It was asserted, although unproven, that such programs may have represented custom (as opposed to standard) software packages.

(c) Outside Services - heating ($20,767.00): Lomart asserted that tax was paid on the purchase of all heating oil and that invoices or confirmation from Lomart's heating oil supplier could be supplied subsequent to hearing. The only additional substantiation documents furnished were five invoices from Lomart's oil supplier reflecting purchases of $5,342.46 and indicating tax paid thereon in the amount of $440.76. It appears no credit was allowed upon audit review of these five invoices.

(d) Repairs and Maintenance ($1,000.00): Lomart offered no specific evidence or argument, stating simply that this was a "negligible amount".

(e) Expendable Tools ($4,136.00): Lomart maintains this item represents an extrapolation based upon one purchase invoice in the amount of $62.05 from Diamond Hardware. Lomart maintains that sales tax was charged on all such purchases. Specific proof thereof, including a copy of the noted $62.05 invoice, was not submitted.

(f) Operating Supplies ($10,363.00): Lomart asserts that tax was paid upon the acquisition of all of such supply items, but that it had been unable to secure invoices to substantiate all of such payments. Lomart noted that such purchases were made, in the main, from local supply houses, and asserted tax was always charged by such supply houses. Credit was given, upon audit review, to the extent of all documentary substantiation furnished.

(g) Electricity ($76,933.00): Lomart paid tax at the rate of 4¼% (New York City rate) on electricity consumed, apparently treating all electricity as having been used in manufacturing. Upon audit, the Division imposed additional tax at the rate of 4 percent on a portion of Lomart's electricity purchases, deeming such portion of total electricity to have been consumed in nonmanufacturing uses. More specifically, of Lomart's total purchases of electricity ($271,971.00), the Division subjected approximately 28.3 percent ($76,933.00) to tax at the additional 4 percent rate. By contrast, Lomart asserts that 38,000 out of 40,000 square feet of space in its facilities was used in manufacturing, with only 2,000 square feet used for administration, and thus maintains only 2½ percent of total electricity charges should be subjected to tax at the additional 4 percent rate. Thus Lomart asserts that only about 10 percent of the amount subjected to additional tax by the Division ($76,933.00 x .10 percent = $7,693.30) should be subject to tax at the additional 4 percent rate.

(h) and (i) Fixed Assets - Machinery, Autos and Trucks ($46,981.71): Lomart presented items of substantiation subsequent to hearing for which the Division made adjustment to the extent verifiable. The balance of such expenses remaining at issue herein are sought by Lomart on the basis of general assertions of nontaxability including intracompany transfers and/or erroneous accounting entries.

The Division asserts that the two petitioning officers other than Martin Hoffinger should be held in default for nonappearance. However, the Division conceded, at the same time, that those reductions to the corporate assessment made both prior to and after hearing, as well as any further reductions to such corporate assessment occurring as the result of these proceedings, would inure to the benefit of such two named officers as well as to petitioner Martin Hoffinger.

We find as an additional fact that the Field Audit Report submitted as a jurisdictional document for the Division (Exhibit C), without objection by the petitioner, stated, "Vendor protested the audit findings. It is noted that on two prior audits, he was assessed on same categories of expenses and fixed assets."

OPINION

The Administrative Law Judge found that Lomart's books and records were incomplete and inadequate in that the auditors did not have available a complete set of purchase invoices such that verification of the payment of tax (or proper nonpayment) on such purchases could be made. The Division used a test period auditing technique which was not challenged by the petitioners, it being admitted that not all invoices were available for audit.

The Administrative Law Judge, subsequent to the hearing held herein, accepted documents with regard to some of the items in question which allowed the Division to further reduce the assessments. Additionally, the Administrative Law Judge reduced the assessment by $440.76 on the basis of submitted invoices which showed tax in that amount paid on "outside services-heating". Except as to these items, the Administrative Law Judge upheld the determination of the Division.

On exception petitioners, although not challenging the Division's right to the use of a test period analyzation of purchases in determining a percentage of error in the payment of tax on such purchases, claim that the final audit result was not reasonable and that certain modifications are necessary to make the audit reasonable.

We affirm the determination of the Administrative Law Judge. We will individually address the points raised by petitioners.

First, petitioners assert that the leased data processing programs at issue were not taxable because they were custom programs. In the record before us, however, petitioner Martin Hoffinger states in testifying as to the data processing, "I am not qualified to tell you what the systems are exactly on the computers, why we would pay them that heavy a leasing fee if it was a standard program. I really don't know. Factually, I do not know. I am just giving an opinion on it based on the opinions that were given to me. It was not a taxable item. I have to rest it there because I really don't know much more about it than that." (Transcript p. 32.)

The applicable rule is that the petitioner has the burden to prove, by clear and convincing evidence, that the method of audit used or the amount of tax assessed was erroneous (Surface

Line Operators Fraternal Organization v. Tully, 85 AD2d 858, 859, 446 NYS2d 45l). Tax Law section 1132(c) places on petitioner the burden of providing records or other evidence sufficient to show that tax was paid on all taxable items. Petitioners did not sustain this burden and we therefore conclude that the assessment as recomputed post hearing must stand.

Second, petitioners assert in their exception to the assessment for outside services, expendable tools, operating supplies, fixed assets machinery and fixed assets auto/truck, that since the audit was on a test period basis and they furnished some invoices that this should have the same effect as having furnished all invoices. Petitioners argue that since the test audit charges were by extrapolation the same logic requires that the invoice documentary substantiation be accorded the same ratio of applicability. Petitioners' argument is without merit and fails to appreciate the source of the Division's authority to utilize test periods.

The Division's right to resort to test periods and external indices to estimate taxes is founded on the taxpayer's failure to maintain records adequate to determine that tax has been charged on all taxable items (Matter of Licata v. Chu, 64 NY2d 874, 487 NYS2d 552) Thus, estimates by the Division of a taxpayer's liability are acceptable only on the principle that "where the taxpayer's own failure to maintain proper records prevents exactness in determination of sales tax liability, exactness is not required." (Matter of Meyer v. State Tax Commn., 61 AD2d 223, 228, 402 NYS2d 74, lv. denied 44 NY2d 645, 406 NYS2d l025).

Petitioners' position would reverse this principle by allowing a vendor who fails to keep adequate and complete books and records to estimate his tax liability. We find no authority for such a benefit in the Tax Law or the cases thereunder (Matter of Raemart Drugs, Inc., Tax Appeals Tribunal, July 8, 1988).

Lastly, petitioners state in their exception to the assessment for electricity that the Administrative Law Judge "recognizes the validity of our positions yet has made no allowance". The Division justified its determination that 28.3% of Lomart's electricity was used in non-manufacturing uses by asserting at hearing that at least 21% of Lomart's electricity was used in intense overhead lighting alone. Petitioners assert that the Division's calculation is

disproportionate to the actual office space used compared to factory space. Petitioner Martin Hoffinger states, in testifying as to the electricity usage, "Our office space is roughly 4 percent of the entire manufacturing facility, and this was like forty percent of our electric bill was (sic) which was totally disproportionate." (Tr. p. 37.)

Petitioners' claim to determine the taxability of electricity based on the relationship office space bears to manufacturing space lacks authority under the law. Tax Law section 1115(c) exempts electricity from the sales and compensating use tax when it is used directly and exclusively in the production for sale of tangible personal property, by manufacturing. "Directly" is defined by regulation (20 NYCRR 528.22[c][1]) to mean that the electricity 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.

"Exclusively" is defined by regulation (20 NYCRR 528.22[c][3][i]) to mean that the electricity be used in total (100%) in the production process. Further, usage in activities collateral to the actual production process, according to the regulations, is not deemed to be used directly in production. Under Reg. Sec. 528.22(c)(3)--example 4: "A manufacturing plant purchases electricity to power its production machinery and also to light its buildings. Only the electricity used to power the production machinery is used directly in production."

Since petitioners' assertion as to the amount of office space versus manufacturing space does not establish the amount of electricity used directly and exclusively in production, petitioners have failed in their burden of proof and we must sustain the Administrative Law Judge.

Accordingly it is ORDERED, ADJUDGED, and DECREED that:

1. The exception of Hoffinger Industries, Inc. a/k/a Lomart Industries Inc., Martin Hoffinger, P. Adelberg and D. Nelson, Officers, is in all respects denied;

2. The determination of the Administrative Law Judge is affirmed;

3. The petitions of Hoffinger Industries, Inc. a/k/a Lomart Industries, Inc., Martin Hoffinger, P. Adelberg and D. Nelson, Officers, are granted to the extent indicated in conclusions of law "C", "D" and "E" of the Administrative Law Judge's determination, but are in all other respects denied; and

4. The Division of Taxation is directed to modify the notices of determination and demands issued on March 19, l985 and March 20, 1985 against each of the four named petitioners accordingly, but such notices are otherwise sustained.

DATED: Troy, New York
July 20, 1989

/s/ John P. Dugan
John P. Dugan
President

/s/ Francis R. Koenig
Francis R. Koenig
Commissioner

/s/ Maria T. Jones
Maria T. Jones
Commissioner