STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
TRI-COUNTY POOL CORP.	:	DECISION
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	:	
	:	
In the Matter of the Petition	:	
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 Donald Faraci,[1] 475 Front Street, Hempstead, New York 11550 filed an exception to the determination of the Administrative Law Judge issued on September 27, 1990 with reference to his and Tri-County Pool Corp.'s 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 Nos. 805451 and 805445). Donald Faraci appeared pro se and on behalf of petitioner Tri-County Pool Corp. The Division of Taxation appeared by William F. Collins, Esq. (Angelo A. Scopellito, Esq., of counsel, with Gary Palmer, Esq., on the brief). Petitioners filed a brief on exception. The Division of Taxation filed a letter in response to petitioners' exception and brief. Oral argument which was requested by petitioners was denied.

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

ISSUES

I. Whether the audit methodology utilized to determine the amount of use tax due was erroneous.

II. Whether the purchases herein are subject to use tax.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

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.

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[1]An exception was filed by Donald Faraci, Officer of Tri-County Pool Corp. The Administrative Law Judge granted the petition of Anthony Phelps, Officer of Tri-County Pool Corp. Therefore, this opinion addresses only the petition of Donald Faraci and Tri-County Pool Corp.

THE AUDIT

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.

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.

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.[2] 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.

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

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[3] 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

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[2]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").

[3]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.

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.

Review of the Federal income tax returns indicated that there were no major additions to the fixed asset accounts. Recurring expenses were minimal and considered tax paid.

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 demand 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.

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.

OPINION

In his determination below, the Administrative Law Judge sustained the audit results, as modified at conference. The Administrative Law Judge reasoned that because petitioners' books and records were deemed inadequate, the Division of Taxation (hereinafter the "Division") appropriately calculated taxes based on the available records which were petitioners' Federal income tax returns and 37 contracts for pools submitted by petitioner Tri-County Pool Corp. (hereinafter "Tri-County").

Moreover, the Administrative Law Judge determined that petitioner Donald Faraci was required to collect tax on behalf of Tri-County, whereas, he determined that petitioner Anthony Phelps was not required to collect taxes on behalf of Tri-County.

On exception, petitioners Donald Faraci and Tri-County contend that the use tax assessment is inappropriate and they request an abatement of tax. They argue that their books and records were reasonably complete for the auditor's stated test period. They argue that the auditor arbitrarily changed the test period without notifying them. Therefore, petitioners contend that since the records which they submitted to the auditor were for the original test period only, such records were inadequate for the newly extended time framework introduced by the auditor.

Furthermore, petitioners argue that use tax does not apply because no tangible personal property was used personally by the taxpayer. Lastly, they argue that because the tangible personal property in question consists of pool kits which are purchased solely to be installed on a specific customer's property, such purchase of tangible personal property is for a capital improvement and, thus, not taxable. Petitioner Donald Faraci does not take an exception to the conclusion that he was required to collect tax on behalf of Tri-County.

In response, the Division argues that the audit methodology was reasonable. Secondly, the Division argues that the pool kits did not undergo a manufacturing process that caused the pool kits to lose their identity before or at the time that they were affixed to real property in New York and, thus, the purchase of the pool kits are properly taxable as a retail sale. Therefore, the Division requests that we affirm the determination of the Administrative Law Judge.

We uphold the determination of the Administrative Law Judge for the reasons stated below.

We begin our analysis by noting that petitioners have the burden to prove, by clear and convincing evidence, that the method of audit used or the amount of tax assessed was erroneous (Matter of Meskouris Bros. v. Chu, 139 AD2d 813, 526 NYS2d 679; Matter of Surface Line Operators Fraternal Org. v. Tully, 85 AD2d 858, 446 NYS2d 451). Petitioners argue that they supplied reasonably adequate records for the original test period which the auditor indicated that he was to use in determining taxable sales, however, petitioners allege that the auditor changed the length of the test period. Because the auditor allegedly changed the length of the test period without informing petitioners, petitioners contend that they necessarily did not have an opportunity to supply the added books and records for such period of time. We disagree.

We note that to determine the adequacy of a taxpayer's records, the Division must first request (Matter of Christ Cella, Inc. v. State Tax Commn., 102 AD2d 352, 477 NYS2d 858, 859), and thoroughly examine (Matter of King Crab Rest. v. Chu, 134 AD2d 51, 522 NYS2d 978, 979-80) the taxpayer's books and records for the entire period of the proposed assessment (Matter of Adamides v. Chu, 134 AD2d 776, 521 NYS2d 826, 828, lv denied 71 NY2d 806, 530 NYS2d 109). The purpose of the examination is to determine, through verification drawn independently from within these records (Matter of Giordano v. State Tax Commn., State of New York, 145 AD2d 726, 535 NYS2d 255, 256-57; Matter of Urban Liqs. v. State Tax Commn., 90 AD2d 576, 456 NYS2d 138, 139; Matter of Meyer v. State Tax Commn., 61 AD2d 223, 402 NYS2d 74, 76, lv denied 44 NY2d 645, 406 NYS2d 1025; see also, Matter of Hennekens v. State Tax Commn. of State of New York, 114 AD2d 599, 494 NYS2d 208, 209), that they are, in fact, so insufficient that it is "virtually impossible [for the Division of Taxation] to verify taxable sales receipts and conduct a complete audit" (Matter of Chartair, Inc. v. State Tax Commn., 65 AD2d 44, 411 NYS2d 41, 43), "from which the exact amount of tax can be determined" (Matter of Mohawk Airlines v. Tully, 75 AD2d 249, 429 NYS2d 759, 760).

Where the Division follows this procedure, thereby demonstrating that the records are incomplete or inaccurate, the Division may resort to external indices to estimate tax (Matter of Urban Liqs. v. State Tax Commn., supra). The estimate methodology utilized must be reasonably calculated to reflect taxes due, but exactness is not required from such a method (Matter of W. T. Grant Co. v. Joseph, 2 NY2d 196, 159 NYS2d 150, 157, cert denied 355 US 869, 2 L Ed2d 75; Matter of Markowitz v. State Tax Commn., 54 AD2d 1023, 388 NYS2d 176, 177, affd 44 NY2d 684, 405 NYS2d 454). The burden then rests upon the taxpayer to demonstrate that the method of audit or the amount of tax assessed was erroneous (Matter of Meskouris Bros. v. Chu, supra, 526 NYS2d 679, 681; Matter of Surface Line Operators Fraternal Org. v. Tully, supra, 446 NYS2d 451, 453).

From the record below, it is clear that the auditor requested books and records from petitioners for the entire audit period, but petitioners provided only the 37 pool contracts and the

two Federal income tax returns. According to Exhibit Z, the auditor requested all books and records for the period from June 1, 1983 to the date of the audit. Further, petitioners have not submitted any evidence to support their contention that the auditor only requested books and records for a limited time period. Therefore, the auditor was justified in using the books and records provided by petitioners to estimate taxes for the entire audit period.

We agree with the Administrative Law Judge below that petitioners did not have adequate books and records. The only records submitted by petitioners were two Federal income tax returns and 37 pool contracts. Therefore, we conclude that the Division was authorized to resort to external indices to estimate tax. As stated above, the burden then rests with petitioners to prove that the method of audit was incorrect. Petitioners did not submit any evidence that shows that the audit methodology was erroneous. Accordingly, petitioners have failed to sustain their burden of proof, and we sustain the audit results.

Next, we address petitioners' argument that use tax does not apply herein because no tangible personal property was used personally by petitioners. Except to the extent that property has already been or will be subject to the sales tax, section 1110(A) of the Tax Law imposes on every person a use tax for the use within this State of any tangible personal property purchased at retail.

Section 1101(b)(4)(i) of the Tax Law defines a retail sale as:

> "[a] sale of tangible personal property to any person for any purpose . . . Notwithstanding the preceding provisions of this subparagraph, a sale of any tangible personal property to a contractor, subcontractor or repairman for use or consumption in erecting structures of buildings, or building on, or otherwise adding to, altering, improving, maintaining, servicing or repairing real property, property or land . . . is deemed to be a retail sale . . . "

Section 541.2(e) of the regulations states that "[c]ontractor means a construction contractor, subcontractor or repairman" (20 NYCRR 541.2[e]). Section 541.2(d) of the regulations defines a "construction contractor" as:

> " . . . any person who engages in erecting, constructing, adding to. altering. improving, repairing, servicing, maintaining, demolishing or excavating any building or other structure, property, development, or other improvement on or to real property, property or land" (20 NYCRR 541.2[d]).

Clearly, petitioner Tri-County Pool Corp. was a contractor which was in the business of installing swimming pools. As such, the corporation's purchases of the pool kits were retail purchases. Thus, the issue before us is whether petitioners used the pool kits within New York State (see, Tax Law § 1110[A]), not whether petitioners purchased the pool kits for their own personal use as petitioners argue in their exception.

The Tax Law defines "use" as:

> "The exercise of any right or power over tangible personal property by the purchaser thereof and includes, but is not limited to, the receiving, storage or any keeping or retention for any length of time, withdrawal from storage, any installation, any affixation to real or personal property, or any consumption of such property" (Tax Law § 1101[b][7], emphasis added).

Since petitioners were purchasing the pool kits solely to be installed into the in-ground swimming pools, the pool kits were used by petitioners within the meaning of Tax Law § 1101(b)(7). Thus, the purchase of the pool kits was subject to use tax.

Lastly, petitioners argue that since the installation of in-ground swimming pools is a capital improvement, the purchase of the pool kits was exempt from tax as part of the capital improvement. We disagree.

The Tax Law exempts from tax certain retail sales:

> "Tangible personal property sold by a contractor, subcontractor or repairman to a person . . . for whom he is adding to, or improving real property, property or land by a capital improvement . . . if such tangible personal property is to become an integral component part of such structure, building or real property" (Tax Law § 1115[a][17]).

The pool kits for the vinyl pools that were purchased by petitioners include a vinyl liner, walls, assembly hardware, plumbing, filtration equipment and start-up chemicals. These pool kits did become an integral component part of the swimming pools installed by petitioners. Therefore, when petitioners sell the pools to their customers, petitioners are not required to charge sales tax on the pool kits. The exemption provided by Tax Law § 1115(a)(17) applies on the sale from petitioners to its customers. The exemption does not apply on the purchase of the pool kits by petitioners as petitioners contend in their exception. Instead, as noted above,

purchases of the pool kits by petitioners, as contractors, were taxable as retail sales under section 1101(b)(4)(i) of the Tax Law.

Moreover, petitioners refer us to Morton Bldgs. v. Chu (126 AD2d 828, 510 NYS2d 320, affd 70 NY2d 725, 519 NYS2d 643) to support their contention that the use tax does not apply to the situation herein.

In Morton Bldgs., the petitioner was an Illinois corporation. Its business involved the manufacture, sale and erection of pre-engineered timberframe, metal sheathed buildings for agricultural and commercial use. The petitioner bought raw materials in bulk outside of New York and stored the raw materials outside of New York. Petitioner manufactured the raw materials into building components outside of New York, and then shipped the building components into New York and erected the buildings on land prepared by its customers (Morton Bldgs. v. Chu, supra).

The court held that the petitioner did not "use" the raw materials within the State, because when petitioner manufactured the raw materials into building components, the raw materials lost their identity, i.e., the raw materials were "used" outside of New York, and only the building components were shipped into New York. Therefore, use tax was not imposed (Morton Bldgs. v. Chu, supra, 510 NYS2d 320, 321-322).

The facts in Morton Bldgs. are easily distinguishable from the facts presented in petitioners' situation. First of all, although petitioners contend in their brief on exception that they purchased their pool kits in New Jersey, there is absolutely nothing in the record to indicate that this was the case. Secondly, the pool kits purchased by petitioners did not undergo any type of manufacturing process outside of New York. Petitioners used the pool kits in New York when they installed the swimming pools as set forth above. Thus, petitioners' use of the pool kits is taxable pursuant to Tax Law § 1110(A) as stated above.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of petitioners Tri-County Pool Corp. and Donald Faraci Officer of Tri-County Pool Corp. is denied;

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

3. The petitions of Tri-County Pool Corp. and Donald Faraci Officer of Tri-County Pool Corp. are denied; and

4. The notices of determination and demand for payment of sales and use taxes due, issued September 19, 1986 to Tri-County Pool Corp. and Donald Faraci, as reduced by the Bureau of Conciliation and Mediation Services conference (Administrative Law Judge's Finding of Fact "4"), are sustained.

DATED: Troy, New York
May 23, 1991

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

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

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