STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
NORTHERN STATES CONTRACTING CO., INC.	:	DECISION DTA No. 806161
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 September 1, 1983 through May 31, 1986	:	

Petitioner Northern States Contracting Co., Inc., 3020 Clinton Street, West Seneca, New York 14224 filed an exception to the determination of the Administrative Law Judge issued on January 31, 1991 with respect to its 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 September 1, 1983 through May 31, 1986. Petitioner appeared by Martin B. Farber, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Arnold M. Glass, Esq., of counsel).

Petitioner did not file a brief on exception. The Division of Taxation filed a letter in lieu of a brief in response.

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

ISSUES

I. Whether the estimated percentage of taxable purchases determined by the Division of Taxation is erroneous.

II. Whether petitioner established reasonable cause and an absence of willful neglect for its failure to timely pay sales and use taxes due.

FINDINGS OF FACT

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

On June 18, 1987, following an audit, the Division of Taxation (hereinafter the "Division") issued to petitioner, Northern States Contracting Co., Inc., a Notice of Determination and Demand for Payment of Sales and Use Taxes Due which assessed $105,667.13 in tax due, plus penalty and interest, for the period September 1, 1983 through May 31, 1986.

Subsequent to the issuance of the notice, petitioner provided certain documentation to the Division resulting in a reduction in the amount assessed by the Division to $60,636.60, plus penalty and interest. Pursuant to a Conciliation Order, dated July 22, 1988, the assessment herein was further reduced to $59,636.09, plus penalty and interest.

The assessment, as adjusted, is comprised of tax found due in three areas:

Area	Tax Due
-Expense Purchases	$55,495.80
-Materials Incorporated into Capital Improvement Projects	3,650.29
-Asset Purchases	490.00[1]
Total	$59,636.09

Petitioner is a general contractor engaged in the performance of capital improvement projects. On audit, petitioner's business was broadly divided into two categories: contracts with organizations exempt from sales tax and contracts with non-exempt organizations.

On audit, the Division reviewed in detail petitioner's expense purchases during the audit period. Petitioner had paid tax on such expenses incurred in connection with its non-exempt jobs. In connection with its contracts with exempt organizations, however, the Division determined that petitioner had improperly failed to pay sales tax on some $778,728.51 in expense purchases resulting in the tax assessed of $55,495.80. In this category the Division included tools, equipment and other supplies used by petitioner in performing its contracts but which the Division determined were not incorporated into the capital improvement. Also included in this

[1]The $490.00 in tax assessed on asset purchases was conceded by petitioner.

category were certain purchases of diesel fuel, explosives, and certain payments made by petitioner for motel rooms.

Also on audit, the Division sought to determine the amount of purchases of materials incorporated into petitioner's capital improvement projects for non-exempt entities.[2] Petitioner's president advised the Division during the course of the audit that, generally, about one-third of the total contract price was allocable to such materials. During the course of the audit, specifically on May 18, 1987, the Division requested all purchase invoices for materials incorporated into petitioner's non-exempt jobs. When petitioner failed to promptly make such invoices available for review, the Division issued the statutory notice herein on June 18, 1987. The notice assessed tax due in the area of materials incorporated into capital improvements by assessing tax on one-third of the total of petitioner's contract billings. The Division thus estimated that one-third of petitioner's non-exempt contracts constituted purchases of materials incorporated into capital improvements and also determined that petitioner had failed to pay sales tax on all such purchases.

As noted previously, the assessment herein was reduced following the issuance of the notice. Virtually all of the reduction results from a reduction in the materials purchases area. After the assessment was issued, petitioner provided the Division with all of its material purchase invoices in connection with its largest non-exempt contract. This contract, with an entity known as SCA Chemical, generated about 90 percent ($1,890,679 out of $2,048,767) of petitioner's receipts from non-exempt capital improvements contracts during the audit period. A review of the SCA Chemical materials invoices resulted in a determination that, with respect to this job, petitioner had failed to pay tax on $7,481.14 in purchases, resulting in tax due of $523.68. Petitioner conceded this $523.68 in tax due.

Also following the issuance of the notice, the Division reviewed materials purchase invoices with respect to petitioner's jobs numbered 695 and 696. The Division determined

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[2]The Division did not assess tax on petitioner's purchases of materials that the Division determined were incorporated into capital improvements projects for exempt organizations (e.g., asphalt, concrete). The Division concluded that petitioner properly determined that such purchases were exempt from tax.

$185.55 in tax due with respect to these jobs. Petitioner conceded this $185.55 in tax due. With respect to petitioner's remaining contracts, which totalled $124,938.49 in receipts, the Division estimated tax due of $2,941.00 on such purchases of materials incorporated into these projects using the estimate method described above. At no time did petitioner make available invoices with respect to these remaining contracts; nor were any such invoices presented at hearing.

During the audit period, petitioner performed two major highway construction contracts for the New York State Department of Transportation. One of these contracts involved construction of a portion of Route 17 in Corning, New York and the other in the construction of a portion of Interstate Route 81 in Binghamton, New York. Petitioner numbered these projects job 1084 and job 1086, respectively. Both of these projects were funded, in significant amount, by the Federal government.

Job 1084 and job 1086 were the subject of competitive bidding. Petitioner, along with other bidders, prepared their bids for these contracts pursuant to a standard bidding form and a set of "Standard Specifications, Construction and Materials", a 53-page document published by the New York State Department of Transportation and dated January 2, 1981. These Standard Specifications made two references to sales taxes. Section 102-20 of the specifications advised the contractor, in summary fashion, of the exemption set forth in Tax Law § 1115(a)(15). Section 109-05(B)(2)(a)(4) of the specifications advised the contractor that with respect to "force account charges,"[3] the contractor would be paid the "actual and reasonable cost" of "[s]ales taxes, if any, required to be paid on materials incorporated into the work under the order on contract".[4]

The contracts for job 1084 and job 1086 both provided for fuel and asphalt price adjustments on the contract price for the project, if the price of fuel or asphalt increased or decreased during the course of the contract. The fuel price adjustment was determined by

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[3]A "force account" is an account by which the contractor is compensated for extra costs incurred during the course of a project.

[4]The January 2, 1981 specifications were used by petitioner in making its bids for the contracts in question. These specifications were updated in 1985, and in that update Section 109-05(B)(2)(a)(4) was changed to read: "Sales taxes, if any, required to be paid on material not permanently incorporated into the work under the order on contract" (emphasis supplied).

reference to the "average posted price" which was defined in the contract as "The combined average FOB refinery or terminal price per gallon published for No. 2 fuel oil and unleaded gasoline in the cities of New York, Philadelphia, Detroit and Boston and determined by the Department on a monthly basis."

The Division assessed $19,878.33 in tax due on petitioner's purchases of diesel fuel consumed in petitioner's performance of jobs 1084 and 1086.

Petitioner presented no invoices to show that sales tax had been paid with respect to its purchases of diesel fuel.

Petitioner did not pay sales tax on any of its expense purchases made in connection with job 1084 and job 1086. Petitioner was under the impression that all such purchases were exempt from sales tax and submitted its bid in connection with such jobs accordingly. Petitioner reached this conclusion by review of the specifications.

Among the purchases made by petitioner in connection with jobs 1084 and 1086 were purchases of lumber, nails and paint. Certain of the lumber and nails so purchased were used in the foundation of bridges constructed during these jobs. This lumber was used as a form below ground into which concrete was poured. This lumber was not removed. Certain other lumber used for forming concrete on job 1084 in the Corning, New York area was destroyed in the process of building the road through wetlands. Such paint purchased by petitioner was used to mark certain elevations during the course of construction. This was not paint used in the final striping of the roadway.

Petitioner also made purchases of warning flashers and batteries in connection with jobs 1084 and 1086. The flashers were battery-powered lights used for traffic control on these projects. The batteries and flashers were, for the most part, consumed in the course of performing these jobs.

Petitioner also made purchases of explosives in connection with job 1086. The explosives were used to level a 40 to 60 foot wall of earth and rock. This was done to improve the safety of the highway.

As noted previously, included in the expense purchases component of the assessment was tax on petitioner's payment for certain motel rooms. While petitioner was working on job 1084, certain of its employees wanted to travel to the job site to work on this job. These employees incurred motel expenses. After the motel owner contacted petitioner seeking payment for certain unpaid bills, petitioner advised the motel owner that it was not responsible for its employees' lodging expenses. Petitioner did agree to be billed by the motel for the expenses of its employees and to pay such bills by deducting these expenses from the pay of the appropriate employees. Petitioner paid a total of $5,575.00 to the motel pursuant to this arrangement. The motel invoices did not charge sales tax.

Petitioner has been in business since 1978. Petitioner's president, Joseph Barillari, has been in the construction business for about 30 years.

OPINION

In his determination below, the Administrative Law Judge determined that with respect to the estimate methodology employed by the Division to determine tax due in the area of materials incorporated into capital improvements, the method was reasonable. Furthermore, the Administrative Law Judge concluded that in the absence of invoices, and given the presumption of taxability of all receipts for property or services under Tax Law § 1132(c), the Division's determination that all of the estimated materials purchases were subject to tax was proper. It was also determined that the Division's assessment in the area of petitioner's expense purchases was proper since such purchases upon which tax was assessed did not become "integral component parts" of the roads and bridges constructed under jobs 1084 and 1086 and, therefore, were not exempt from sales tax.

The Administrative Law Judge rejected petitioner's argument that the assessed purchases made in connection with the New York State contracts should be exempt under Tax Law § 1116(a) as purchases made by the State. The Administrative Law Judge reasoned that petitioner clearly made the purchases in its own behalf for use in performing the contracts in question and, thus, such purchases were taxable. Since he determined that the tax herein was

imposed upon petitioner's purchases and not as purchases made by either the Federal or State government, the Administrative Law Judge rejected petitioner's constitutional objection to the assessment. Moreover, the Administrative Law Judge rejected petitioner's contention that certain expense purchases made in connection with the State contracts were exempt from taxation since eight of the purchases in question represented payments to subcontractors on the State projects which would be exempt from taxation pursuant to Tax Law § 1115(a)(17). The Administrative Law Judge stated that petitioner presented no evidence at the hearing to show that the eight payments were to subcontractors.

With respect to the assessment of tax on payments made by petitioner for motel rooms, the Administrative Law Judge determined that petitioner was not the customer of the motel and, therefore, he cancelled the assessment relating to the motel room rentals. Lastly, the Administrative Law Judge sustained the assessment of penalties and penalty interest for failure to timely pay tax due.

Petitioner takes exception to two specific conclusions made by the Administrative Law Judge. First, petitioner contends that the percentage of estimated capital improvement material purchases subject to tax was unreasonable. Rather, petitioner asserts that a factor should have been applied to the receipts from capital improvement projects, based upon the error rate determined by a review of invoices for projects for which a detailed review of invoices was made. Secondly, petitioner argues that the imposition of penalty and penalty interest is not supported by the record. Petitioner does not take exception to any other aspect of the determination.

In response, the Division argues that the 1/3% figure was an agreed upon method of determining the cost of materials and the tax was assigned on that basis. The Division, citing Matter of Continental Arms Corp. v. State Tax Commn. (72 NY2d 976, 534 NYS2d 362), contends that the estimate was made pursuant to Tax Law § 1138(a), which is applicable in cases where records are not provided. Moreover, the Division argues that the burden is upon petitioner to demonstrate that its failure to timely pay tax was due to reasonable cause, not willful neglect,

and that petitioner has failed to establish reasonable cause in this case. Therefore, the Division requests that the determination be affirmed in full.

We affirm the determination of the Administrative Law Judge for the reasons set forth below.

Where, as here, the records of the taxpayer are insufficient or inadequate to permit an exact computation of the sales and use tax due, the Division is authorized to estimate the tax liability on the basis of external indices (Tax Law § 1138[a][1]; see, Matter of Ristorante Puglia, Ltd. v. Chu, 102 AD2d 348, 478 NYS2d 91, 93; Matter of Surface Line Operators Fraternal Org. v. Tully, 85 AD2d 858, 446 NYS2d 451, 452). The methodology selected must be reasonably calculated to reflect the taxes due (Matter of Ristorante Puglia, Ltd. v. Chu, supra; Matter of W. T. Grant Co. v. Joseph, 2 NY2d 196, 159 NYS2d 150, 157, cert denied 355 US 869), but exactness in the outcome of the audit method is not required (Matter of Markowitz v. State Tax Commn., 54 AD2d 1023, 388 NYS2d 176, 177, affd 44 NY2d 684, 405 NYS2d 454; Matter of Lefkowitz, Tax Appeals Tribunal, May 30, 1990).

The notice of determination and demand for payment of sales and use taxes due that was issued to petitioner was reduced significantly when petitioner, after the issuance of the notice, provided detailed invoices that demonstrated that, with respect to ninety percent of its receipts from its capital improvement projects with non-exempt entities during the audit period, it had failed to pay tax on purchases representing .00396 of the receipts from such projects. However, petitioner failed to document the tax paid on its material purchases for the remaining ten percent of its projects. Petitioner argues that the .00396 is a fairer estimate to use in this case where it has already established that with respect to ninety percent of its projects, it failed to pay tax on only .00396 of its material purchases. We disagree.

In his determination below, the Administrative Law Judge concluded that the auditor for the Division reasonably utilized a .3333 estimated figure to determine taxable sales based upon petitioner's president's indication that about one-third of a contract price was allocable to materials incorporated into the projects. Petitioner did not provide any detailed records of its

material purchases to the auditor at the time of the audit. Although petitioner did come forward with detailed invoices after the assessment was issued, we can only determine whether the auditor utilized a reasonable audit methodology based upon what was presented to the auditor during the time of the actual audit (see, Matter of Continental Arms Corp. v. State Tax Commn., supra; see, Tax Law § 1138[a][1]).

In this case, the assessment was adjusted by the Division after petitioner provided invoices for ninety percent of its material purchases. With respect to the material purchases for the remaining ten percent of the projects, we conclude that the .3333 figure used by the auditor to estimate taxable purchases was reasonable. Petitioner has not challenged this .3333 figure as being incorrect, but, instead, petitioner has provided its own figure which it purports to be a fairer estimate. We find that petitioner's evidence, at best, indicates imprecision in the audit results, but this is not sufficient to establish by clear and convincing evidence that the amount assessed is erroneous (Matter of Meskouris Bros. v. Chu, 139 AD2d 813, 526 NYS2d 679, citing Matter of Surface Line Operators Fraternal Org. v. Tully, supra; Matter of Pizza Works, Tax Appeals Tribunal, March 21, 1991; see also, Matter of Carmine Rest. v. State Tax Commn., 99 AD2d 581, 471 NYS2d 402, 404). Since petitioner's failure to maintain records prevents exactness, exactness in determining the sales tax liability is not required (Matter of Meyer v. State Tax Commn., 61 AD2d 223, 402 NYS2d 74, 78, lv denied 44 NY2d 645, 406 NYS2d 1025; Matter of Pizza Works, supra).

The next issue before us is whether petitioner has established reasonable cause and an absence of willful neglect for its failure to timely pay its sales tax.

Tax Law § 1145(a)(1)(i) authorizes the imposition of a penalty plus interest at the rate specified therein for failure to file a return or to pay or pay over any tax in a timely manner. However, these charges are to be cancelled if "reasonable cause" is affirmatively shown by the taxpayer (Tax Law § 1145[a][1][iii], former 20 NYCRR 536.1[b]; see, 20 NYCRR 536.5[b]). The regulation in former 20 NYCRR 536.1(b)(6) provides, in pertinent part, that reasonable cause, where clearly established, includes:

> "Any other cause for delinquency which appears to a person of ordinary prudence and intelligence as a reasonable cause for delay in filing a return and which clearly indicates an absence of gross negligence or willful intent to disobey the taxing statutes."

In order to abate the penalty, the taxpayer must show that the failure to comply with the law was due to reasonable cause and not due to willful neglect.

Petitioner argues that the imposition of penalty is not supported by the record. Petitioner notes that the Administrative Law Judge found as a fact below that "[p]etitioner was under the impression that all such purchases [for the New York State projects] were exempt from sales tax and submitted its bid in connection with such jobs accordingly" (petitioner's brief, p. 5). Further, petitioner contends that the booklet entitled "Standard Specifications, Construction and Materials," provided by the State, was confusing and did not clearly state the sales tax liabilities for the transactions in question.

In determining whether reasonable cause and good faith exist, the most important factor to be considered is the extent of the taxpayer's efforts to ascertain the proper tax liability (see, 20 NYCRR 536.5[d][2]). In this case, petitioner states that it relied on the "Standard Specifications, Construction and Materials." We hold that reliance on this booklet was not reasonable. This publication was issued by the New York State Department of Transportation. This is not a tax instruction manual. Petitioner could have easily contacted the Department of Taxation and Finance or any tax expert in order to clear up any confusion it faced in its interpretation of its tax liabilities from this manual, but it did not. Furthermore, it has been held that ignorance of the law will not be considered a basis for reasonable cause (Matter of Auerbach v. State Tax Commn., 142 AD2d 390, 536 NYS2d 557; Matter of LT & B Realty Corp. v. New York State Tax Commn., 141 AD2d 185, 535 NYS2d 121; 20 NYCRR 536.5[c][5]). Therefore, we conclude that petitioner's reliance on the Standard Specifications booklet does not establish reasonable cause and the lack of willful neglect for its failure to pay its tax owed in a timely manner. Therefore, we sustain the penalty and penalty interest imposed in this case.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Northern States Contracting Co., Inc. is denied;

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

3. The petition of Northern States Contracting Co., Inc. is granted to the extent indicated in conclusion of law "N" of the Administrative Law Judge's determination, but in all other respects is denied; and

4. The Division of Taxation is directed to adjust the Notice of Determination and Demand for Payment of Sales and Use Taxes Due, dated June 18, 1987, as modified by the conciliation order dated July 22, 1988, in accordance with paragraph "3" above, but such notice is otherwise sustained.

DATED: Troy, New York
February 6, 1992

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

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

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