STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
MICHAEL LOZMAN, D.D.S., P.C.	:	DETERMINATION
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 December 1, 1978 through August 31, 1985.	:	

Petitioner, Michael Lozman, D.D.S., P.C., 17 Johnson Road, Box 821, Latham, New York 12110, 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 period December 1, 1978 through August 31, 1985 (File No. 802874).

A hearing was commenced before Arthur S. Bray, Hearing Officer, at the offices of the State Tax Commission, W. A. Harriman State Office Building Campus, Albany, New York on July 20, 1987 at 9:15 A.M. and completed at the same offices on July 24, 1987 at 11:00 A.M., with all briefs and additional documents to be filed by December 14, 1987. Petitioner appeared by Goldberg & Vadney (Nathan M. Goldberg, C.P.A.). The Audit Division appeared by John P. Dugan, Esq. (Mark Volk, Esq., of counsel).

ISSUES

I. Whether it was permissible for the Audit Division to utilize external indices for a portion of the audit period to determine the amount of sales and use taxes due.

II. Whether the expenses incurred for the creation of lab and study models and the development of x-ray film are subject to sales and use taxes.

III. Whether the Audit Division is under a duty to advise taxpayers of their obligations under the Tax Law.

FINDINGS OF FACT

1. During the period in issue, petitioner, Michael Lozman, D.D.S., P.C., was a professional corporation, whose president, Michael Lozman, was an orthodontist. Petitioner was paid for the orthodontic services it rendered.

2. On October 3, 1985 the Audit Division, on the basis of a field audit, issued two notices of determination and demands for payment of sales and use taxes due to petitioner which, in conjunction, assessed a deficiency of sales and use taxes for the period December 1, 1978 through August 31, 1985 in theamount of $15,461.00 plus interest of $4,227.00 for a total amount due of $19,688.00.

3. In the course of the field audit which led to the foregoing assessment, the Audit Division examined petitioner's supply and lab fee invoices for the years 1982 through 1984. As a result of this examination, the Audit Division concluded that sales and use taxes were due in three areas wherein petitioner incurred expenses: study and lab models, x-rays and orthodontic appliances.

4. The Audit Division did not request an opportunity to examine petitioner's invoices for the period December 1, 1978 through November 30, 1981 or for the sales and use tax periods ending February 28, 1985 through August 31, 1985.[1] In order to calculate the sales and use taxes due for these periods, the Audit Division utilized the amounts shown as lab fees on petitioner's U.S. Corporation Income Tax Return multiplied by the ratio of lab fee expenses which the Audit Division found subject to tax during the years 1982 through 1984 to total lab fee expenses during those years.

5. After the hearing, the Audit Division and petitioner agreed that only a portion of the expenses incurred for orthodontic appliances was subject to sales and use taxes. They further agreed that the amount of tax due for the purchase of orthodontic appliances was $1,186.25, and that only the taxability of the expenses incurred for the developing of x-ray film and the creation of lab and study models remains in issue.

6. The purpose of orthodontic treatment is to alleviate a physical incapacity. Orthodontia deals with aberrations of the teeth, jaws and orofacial soft tissues.

7. A study model is a plaster replica of a patient's mouth. It is a diagnostic record from which an orthodontist establishes a treatment plan. The models are also used to fabricate the appliances which will be used by the patient.

8. In order to create a study model, impression material is mixed to a batter-like consistency and inserted into a tray. The tray, containing the impression material, is then placed into the patient's mouth and left until set. When set, the impression is removed from the patient's mouth and sent to a laboratory which uses the impression to create a plaster duplicate of the patient's mouth.

9. An orthodontist places x-ray film into a patient's mouth where it is either held against the teeth or placed alongside the patient's head. The film is then exposed by use of an x-ray machine. The exposed film is then sent to the laboratory for developing.

10. There are various types of x-rays. The standard x-ray shows roots and crowns as well as the development of baby and permanent teeth. Another type of x-ray shows the structure of the entire skull, and a third type presents a panoramic view of all of a patient's teeth on the same film. X-rays are also diagnostic records which provide insight into a patient's disability and treatment program.

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[1]For the quarter ending February 28, 1982, tax was assessed on an estimated amount of purchases made during December 1981 and on actual purchases made in January and February 1982. For the quarter ending February 28, 1985, tax was computed based on actual purchases of $4,711.00 for December 1984 and estimated purchases for January and February 1985.

SUMMARY OF PETITIONER'S POSITION

11. At the hearing, petitioner argued that it was improper to use its tax returns and percentages of the amounts described thereon as lab fees to determine sales and use taxes due, rather than the actual invoices for the sales tax periods in 1978 through 1981 and 1985. Petitioner also argued that it was unfair to assess tax for a six-year period of time rather than the more common three-year period. Petitioner further asserted it was unfair to assess tax without any prior warning that these items would be held subject to tax.

12. Petitioner maintains that once the impression has set it becomes a diagnostic record and that the study model created by the laboratory provides another type of diagnostic record. Similarly, once the x-ray film is exposed it is a diagnostic record. As diagnostic records, it is argued, they are part of medical and dental treatment which is not subject to sales and use taxes. Petitioner further argues that the exposed x-ray film and the laboratory and study models are unique to the particular patient and therefore not subject to tax as medical supplies pursuant to 20 NYCRR 528.4(h). In reliance upon 20 NYCRR 527.4(d), petitioner also maintains that it is not the owner of the x-ray film and, therefore, it is not liable for a tax on the expense incurred for the processing of this film.

CONCLUSIONS OF LAW

A. That section 1138(a) of the Tax Law provides, in part, that if a return required to be filed is incorrect or insufficient, the amount of tax due shall be determined on the basis of such information as may be available. This section further provides that, if necessary, the tax may be estimated on the basis of external indices.

B. That resort to the use of external indices to determine the tax due must be based on an insufficiency of recordkeeping which makes it virtually impossible to determine such liability and conduct a complete audit (Matter of Christ Cella, Inc. v. State Tax Commn., 102 AD2d 352, 353). In this instance the Audit Division did not request an opportunity to examine petitioner's records prior to resorting to external indices for the months of December 1978 through December 1981, or for the months of January 1985 through August 1985. Since the Audit Division did not initially determine that petitioner's records were inadequate, the use of external indices to determine the tax due was improper (see Matter of Adamides v. Chu, 134 AD2d 776). Accordingly, the tax assessed for the months December 1978 through December 1981, and for the periods ending February 28, 1985 through August 31, 1985 is cancelled, with the exception of the tax assessed on $4,711.00 in actual purchases for December 1984.

C. That in view of Conclusion of Law "B", the argument that it was unfair to assess tax for more than a three-year period is rendered moot.

D. That the Audit Division properly concluded that the expenses incurred for the purchase of the laboratory and study models were subject to sales and use taxes. In reaching this conclusion, it is not disputed that receipts from petitioner's services as an orthodontist are not subject to sales and use taxes. Moreover, it is not disputed that the laboratory and study models are diagnostic tools used by Dr. Lozman in his practice as an orthodontist. However, the expenses which are being held subject to tax are not the services of Dr. Lozman as an orthodontist. Rather, it is the expense incurred for the purchase of the laboratory and study models from the laboratory which is subject to tax. When the laboratory produced the model it was not performing orthodontic services. Accordingly, when Dr. Lozman received the laboratory

and study models there was a transfer of tangible personal property and the expenses incurred thereon were subject to sales and use taxes by virtue of Tax Law § 1105(a).

E. That Tax Law § 1115 provides that the receipts from the sale of certain items are exempt from the tax imposed by Tax Law § 1105(a). Subdivision (a)(3) of Tax Law § 1115 provides one such exemption for supplies intended for use in the cure, mitigation, treatment or prevention of illnesses or diseases in human beings or to correct or alleviate physical incapacity. However, the purchase of medical supplies remains subject to sales and use taxes if the purchase is by a person performing medical or similar services for compensation (Tax Law § 1115[a][3]; 20 NYCRR 528.4[h]). In this instance, the laboratory models constitute a medical supply which is used for one or more of the purposes set forth in Tax Law § 1115(a)(3). Since the models are purchased by a person "performing medical or similar services for compensation", the expense incurred for the purchase of the models is not exempt from tax (Tax Law § 1115[a][3]).

F. That it is of no consequence that the examples of supplies set forth in 20 NYCRR 528.4(h) are not supplies customized to a particular patient, whereas the laboratory models involved herein are replicas of a particular patient's mouth. The regulation does not indicate that the list of examples set forth therein was intended to be exhaustive. Moreover, Tax Law § 1115(a)(3) does not distinguish individualized supplies from other supplies.

G. That Tax Law § 1105(c)(2) provides that tax shall be paid on the receipts from every sale, except for resale, of the following services:

> "Producing, fabricating, processing, printing or imprinting tangible personal property, performed for a person who directly or indirectly furnishes the tangible personal property, not purchased by him for resale, upon which services are performed."

The regulation at 20 NYCRR 527.4(d) defines processing in the following manner:

> "Processing. Processing is the performance of any service on tangible personal property for the owner which effects a change in the nature, shape or form of the property.
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> * * *
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> Example 2: The developing of film by a photographic laboratory is a taxable processing service."

H. That similar to the reasoning set forth above, the Audit Division properly concluded on the basis of Tax Law § 1105(c)(2), that the expenses incurred for the processing of the x-ray film are subject to tax. In reaching this conclusion, it is similarly noted that the expenses which are being held subject to tax are not the services of Dr. Lozman as an orthodontist but the expenses incurred for the development of the x-ray film by the laboratory.

In reliance upon 20 NYCRR 527.4(d) petitioner has argued that the patient is the owner of the x-ray film and, therefore, since the owner has not provided the film, the taxable service of processing has not occurred. However, assuming arguendo that petitioner is not the owner of the x-rays, petitioner remains liable for the sales and use taxes imposed on the expenses incurred for

the development of the x-ray films.[2]

Generally, the interpretation of a regulation is governed by the same canons as the interpretation of statutes (Matter of Cortland-Clinton, Inc. v. New York State Dept. of Health, 59 AD2d 228, 231). One such canon is that, when possible, conflicting parts of a statute must be harmonized (McKinney's Cons Laws of NY, Book 1, Statutes § 98). Furthermore, the plain language used "in a...regulation should be construed in its natural and most obvious sense" including, where appropriate, resort to a dictionary (Matter of Cortland-Clinton, Inc. v. New York State Dept. of Health, supra, at 231).

On the basis of the foregoing canons, it is clear that the expense for the development of the x-ray films arose from the taxable service of processing. Section 1105(c)(2) of the Tax Law imposes tax on the receipts arising from processing "for a person who directly or indirectly furnishes the taxable personal property". This section does not require that the person who provides the property have legal title to it. Moreover, the word own has more than one meaning, one of which is to have, hold or possess an object (Webster's Ninth New Collegiate Dictionary [1987 ed]). With this understanding in mind, it is concluded that the use of the word "owner" in 20 NYCRR 527.4(d) refers to any person who furnishes the property for the service in issue and not just the person who has the greatest legal claim to the property.

I. That petitioner's argument that the Audit Division should have alerted petitioner that tax was due on the purchases of lab and study models and development of x-ray film is without merit. The Audit Division is not under any duty to advise petitioner of its obligations under the Tax Law (see___ Matter of Johnson, State Tax Commn., May 29, 1987).

J. That the Audit Division is directed to modify the notices of determination and demand for payment of sales and use taxes due in accordance with Finding of Fact "5".

K. That the petition of Michael Lozman, D.D.S., P.C. is granted to the extent of Conclusion of Law "B" and "J" and the Audit Division is directed to modify the notices of determination and demands for payment of sales and use taxes due dated October 3, 1985 accordingly. Except as so granted, the petition is in all other respects denied.

DATED: Albany, New York
May 5, 1988

/s/
ADMINISTRATIVE LAW JUDGE

[2]As more fully set forth above, the question of who has a legal claim to the negatives is irrelevant. It is noted, however, that there is authority for the proposition that x-ray negatives are the property of the physician. (See generally, 45 NY Jur., Physicians and Surgeons, §120.)