

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
MGK CONSTRUCTORS	:	
for Revision of Determinations or for Refund	:	
of Sales and Use Taxes under Articles 28 and 29	:	
of the Tax Law for the Periods June 1, 1986	:	
through August 31, 1986 and June 1, 1987	:	
through November 30, 1987.	:	

DETERMINATION

In the Matter of the Petitions	:	
of	:	
MGK CONSTRUCTORS	:	
for Revision of Determinations or for Refund	:	
of Sales and Use Taxes under Articles 28 and 29	:	
of the Tax Law for the Period March 1, 1983	:	
through February 28, 1988.	:	

Petitioner MGK Constructors, 1 Lafayette Place, Greenwich, Connecticut 06830, filed a petition for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the periods June 1, 1986 through August 31, 1986 and June 1, 1987 through November 30, 1987 (File No. 807262).

Petitioner MGK Constructors, 1 Lafayette Place, Greenwich, Connecticut 06830, 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 period March 1, 1983 through February 28, 1988 (File Nos. 807881 and 807882).

A hearing was held before Nigel G. Wright, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on May 9, 1990 at 1:15 P.M., with all briefs submitted by June 26, 1990. Petitioner appeared by Charles Slepian, Esq., and Herman Soloway, C.P.A. The Division of Taxation appeared by William F.

Collins, Esq. (Carroll R. Jenkins, Esq., of counsel).

ISSUES

I. Whether the assertion of a penalty for late filing of tax returns and late payment of tax under Tax Law § 1145(a) is valid when the assertion is made by a "notice and demand for payment" and not by a notice of determination under Tax Law § 1138(a)(1).

II. Whether the delay of petitioner in filing and paying its sales and use tax returns "was due to reasonable cause and not due to willful neglect" within the meaning of Tax Law § 1145(a)(1)(iii) so that the penalty imposed and interest (in an amount which exceeds the interest calculated under Tax Law § 1142) may be remitted.

III. Whether the New York City sales tax on protective and related services imposed by Administrative Code of the City of New York § 11-2040(a)(2) (imposed prior to September 1, 1986 by Administrative Code § BB46-2.0[a][2]) is due on the sale of guard services to a construction contractor, petitioner herein, who then billed such services to its customer, the City of New York.

FINDINGS OF FACT

(a) Petitioner, MGK Constructors, file a petition (File No. 807262) on August 21, 1989 protesting three notices and demands for payment of sales and use taxes due (D8612089980 for the quarter ending August 31, 1986; D8712124534 for the quarter ending August 31, 1987; and S8804121289 for the quarter ending November 30, 1987) each dated April 11, 1988.

(b) A request for a conference was made on January 13, 1989 but was found untimely by a conciliation conferee on June 9, 1989. The Division of Taxation has withdrawn that objection and any further objection that the petition was untimely.

(c) These notices were paid in full but petitioner challenges the penalties shown thereon totaling \$17,758.32.

(a) Petitioner filed a petition (File No. 807881) on February 12, 1990 protesting two notices of determination (S881230000L and S881230003L) issued December 30, 1988 and eleven notices and demands for payment issued at various times (three of the notices and

demands for payment are the three notices which are the subject of the petition in case number 807262 (see Finding of Fact "1[a]" above).

(b) One notice of determination (S881230000L) is for the quarter ending May 31, 1983, the two quarters ending May 31, 1984, the quarter ending November 30, 1984, the two quarters ending August 31, 1985, the quarter ending February 28, 1986 and the quarter ending August 31, 1986. The other notice of determination (S881230003L) is for the quarter ending August 31, 1985 and is for omnibus penalty under Tax Law § 1145(a)(1)(vi) only.

(c) A timely request for a conciliation conference with respect to the notices of determination was made on January 17, 1989 and the requests were denied on December 8, 1989.

(d) The notices of determination showed that the amount of tax had been paid but the amount of penalty and interest had not been paid.

(e) The eleven notices and demands for payment which are contested by this petition are as follows:

<u>Notice Number</u>	<u>Period Ending</u>	<u>Date Issued</u>
D8601090585	August 31, 1985	January 13, 1988
D8604031747	November 30, 1985	April 11, 1988
D8605232112	February 28, 1986	January 13, 1988

D8609143053	May 31, 1986	September 21, 1987
*D8612089980	August 31, 1986	April 11, 1988
D8703019119	November 30, 1986	September 26, 1988
D8706171465	February 28, 1987	September 26, 1988
D8709258657	May 31, 1987	September 26, 1988
*D8712124534	August 31, 1987	April 11, 1988
*S8804121289	November 30, 1987	April 11, 1988
S8810312142	February 28, 1988	October 31, 1988

*These determinations are included also in petition 807262.

(f) All notices and demands for payment with one exception, show that the amount of tax due had been paid, but that the amount of penalty and interest had not been paid. The exception is the last notice, S8810312142, which shows tax due of \$8,598.21, penalty of \$1,075.30 and interest of \$488.57 but on which only \$2,977.88 was paid.

(a) A petition (File No. 807882) was filed on February 12, 1990 protesting two notices of determination and demands for payment of sales and use taxes due each issued on December 30, 1988. One notice of determination (S881230001L) was for the period March 1, 1983 through November 30, 1986 (omitting, however, the quarter ending August 31, 1983) and was in the amount of \$50,497.37, plus penalty of \$13,994.27 and interest of \$24,547.31, for a total amount due of \$89,038.95. The other notice of determination (S881230002L) was for the period December 1, 1986 through February 28, 1988 and was in the amount of \$17,971.67, plus penalty of \$4,466.74 and interest of \$3,031.14, for a total amount due of \$25,469.55.

(b) A conciliation conference was timely requested on January 17, 1989, but the request was denied on December 8, 1989.

(c) The notices show that all amounts due have been fully paid.

Petitioner had executed consents which extended the time within which the tax due may be determined. These consents were as follows:

(a) A consent executed on December 20, 1986 that the amount of taxes due for the period September 1, 1983 through February 28, 1984 may be determined on or before June 20, 1987.

(b) A consent executed on June 18, 1987 that the amount of taxes due for the period September 1, 1983 through May 31, 1984 may be determined on or before September 20, 1987.

(c) A consent executed on August 21, 1987 that the amount of taxes due for the period September 1, 1983 through August 31, 1984 may be determined on or before December 20, 1987.

(d) A consent executed on December 18, 1987 that the amount of taxes due for the period September 1, 1983 through February 28, 1985 may be determined on or before June 20, 1988.

(e) A consent executed on May 20, 1988 that the amount of taxes due for the period September 1, 1983 through August 31, 1985 may be determined on or before December 20, 1988.

(f) A consent executed on November 17, 1988 that the amount of taxes due for the period September 1, 1983 through February 28, 1986 may be determined on or before June 20, 1989.

(a) Petitioner, MGK Constructors, of Greenwich, Connecticut is a joint venture composed of MacLean Grove & Company, Inc., Grow Tunneling Corp., Kiewitt Construction Co. and Morrison Knudsen Company, Inc. Its managing partner is MacLean Grove & Company, Inc. also of Greenwich, Connecticut.

(b) Petitioner pays sales and use taxes to New York under a direct pay permit under Tax Law § 1132(c) and so does not pay tax on its purchases from its vendors.

(c) Petitioner is a very well-capitalized business and has never had a cash-flow problem. At least one of its members is a "big board" member.

Petitioner failed to timely file returns and pay sales and use taxes for several periods. These are the periods for which the notices of determination and the notices and demands for payment described in Findings of Fact "1" and "2" have been issued. Petitioner has, however, now filed such returns and paid the taxes due thereon.

Abatement of Penalties

(a) The books and the tax returns of petitioner were prepared by Mr. Lou Johnston, described at times as the comptroller of petitioner. Lou Johnston was employed by MacLean

Grove and Company, Inc. around 1974. His father had been a very respected senior vice-president of MacLean Grove. Lou Johnston started as a clerical employee but rapidly entered computer work and came to be in charge of all clerical functions, including preparing tax returns. His work had involved three construction contracts prior to the one here involved.

(b) Mr. Johnston was supervised by Mr. Nadel (who was also president of MacLean Grove) and by Mr. Simoni, described as the "principals" of the joint venture. This supervision was informal only and no written reports were required.

Petitioner had arranged for periodic audits of its financial affairs. An audit was made by Blau, Soloway, Goldstein and Company, CPA's. The audits were done quarterly at first and annually in later years. That firm had noticed slight irregularities in the bookkeeping of petitioner but had dealt only with Mr. Johnston and had not reported any problem to anyone else employed by petitioner.

Petitioner knew nothing of any delay or failure to file or pay its sales or use taxes prior to the day when its employee, Mr. Johnston, disappeared.

The auditor of the Division of Taxation first tried to contact petitioner by writing to Mr. Johnston on September 17, 1986. He persisted in this with no result until December 7, 1987 when he went unannounced to petitioner's offices. Mr. Johnston said he was busy and he would telephone him. The auditor left and did not get back until May 2, 1988. By this time, the auditor found that Mr. Johnston had left the company and he dealt with a Mr. Plotkin, an office manager.

(a) Petitioner discovered after the disappearance of Lou Johnston that many of its suppliers had not been paid. Some had failed to complain because of the very good reputation of petitioner. It also found sales taxes unfiled and unpaid.

(b) Petitioner's officers found that Mr. Johnston had a "substance abuse" problem and they believe that he is under treatment.

Protective Services

Petitioner was the successful bidder with the City of New York Department of

Environmental Protection, Bureau of Water Supply, for the building of a part of a tunnel under the East River.

With respect to sales taxes, the contract provides as follows:

"Article XXXVII...

The Bureau of Water Supply of the Department of Environmental Protection is an exempt organization under the New York State Tax Law and is exempt from the payment of Sales Taxes for materials and supplies incorporated in this project as an integral part thereof. The Contractor should not include in his prices such Sales or Compensating Use Taxes of the State of New York and its cities and counties."

The contract, known as contract 521B, provided for security guard services in the quantity of 14,400 man-days.

The guard services started on March 1, 1983 and continued until February 28, 1988.

The guards were supplied to petitioner by a firm, Sheldon Martin Associates, which was on a list of "local business enterprises" furnished by the City of New York.

New York City engineers and inspectors were on duty at the job site at all times. A New York City employee directed where the security guards would be posted. The City would not authorize the guarding of employees' cars or of petitioner's property.

Petitioner received from the City the cost it paid for the services plus a percentage allowance for administrative costs and profit.

CONCLUSIONS OF LAW

A. The assertion of a penalty under Tax Law § 1145(a) without a notice of determination is not valid. Unpaid penalties and interest under Tax Law § 1145(a) "may be determined...in the same manner as the tax..." (Tax Law § 1145[a][7]). Under Tax Law § 1138, a tax "shall be determined by the commissioner of taxation and finance" and a "[n]otice of such determination shall be given..." where a return is not filed or, if a return is filed, it is incorrect or insufficient. In this case, a notice of determination was not given for many of the periods in issue. For such periods, there is no claim by the Division of Taxation that the returns were filed or that any filed returns were adequate. A notice of determination was therefore necessary for the assertion of the penalty here in issue. The notices and demands for payment issued in this case were

insufficient to assert a tax due.

These notices and demands for payment may be reviewed by the Division of Tax Appeals. The amounts in issue, there being no valid notice of determination with respect thereto, are reviewable under Tax Law § 2006(4), which provides that a right to a hearing is provided "unless a right to a hearing is specifically provided for, modified or denied" by another provision of the Tax Law. No other provision of the Tax Law would so provide a hearing with regard to the propriety of the use of a notice and demand for payment. In this case, in fact, the Division of Taxation has admitted that the notices and demands for payment may be reviewed by the Division of Tax Appeals.

B. The penalty and a portion of the interest (the interest in excess of that computed under Tax Law § 1142) may be remitted if the failure to pay was, in the language of Tax Law § 1145(a)(1)(iii), "due to reasonable cause and not due to willful neglect". That language has been interpreted in regulations to cover even such inadvertent errors as the misplacing of tax returns due to be filed. It is interpreted in such regulations more generally to refer to "any other cause for delinquency which appears to a person of ordinary prudence and intelligence as a reasonable cause...and which clearly indicates an absence of gross negligence or willful intent to disobey the taxing statutes." (See, 20 NYCRR former 536.1[b][3], [6], effective December 27, 1982; 20 NYCRR former 536.5[b][3], [6], effective September 3, 1985.) In this case it is clear that there was no gross negligence or willful neglect on the part of this petitioner. Here, an employee who had some experience in his duties became involved in drug abuse and deliberately falsified accounts. This could not under these circumstances have been anticipated by petitioner. There is certainly no evidence in this case that this obviously successful and competitive company was managed in any way in a manner which was deficient by ordinary business standards.

C. The purchases of protective services here in question are not subject to tax. The guard services purchased by petitioner are, of course, unquestionably protective services within the meaning of Administrative Code of the City of New York § 11-2040(a)(2) (and prior to

September 1, 1986 of Administrative Code § BB46-2.0[a][2]). The receipts from the sale of such services to petitioner by its supplier are therefore subject to tax and, since petitioner did not pay the tax to its supplier (because of a valid direct pay permit), petitioner would itself be liable for the tax (Administrative Code § 11-2044; Tax Law § 1133[b]). However, that tax is imposed only on the receipts from "every sale, except for resale...." In this case, it is clear that the sale to petitioner was for resale to a customer. The rendering of services, such as guard services, do come within the meaning of "sale" (20 NYCRR 526.7[a][4]). The guard services in question were furnished at the customer's specific direction and were billed to the customer under a "cost-plus" provision of the contract. The purchase in question is thus not subject to tax.

D. The argument of the Division of Taxation that the sale to petitioner is not a sale for resale because of the regulations of the Commissioner of Taxation and Finance concerning contractors must be rejected. That regulation provides that "contractors' purchases of construction supplies...as well as purchases of taxable services...are subject to the tax" (20 NYCRR 541.3[d][2][iv]). That regulation is promulgated, as it states, under Tax Law §§ 1115 and 1116 which would be relevant only to sales by petitioner to the City and not to sales by others to petitioner as are in issue in this case. More important, however, the application of this regulation would deprive petitioner of the resale exemption in the Tax Law. That exemption would still be available to petitioner, the Division of Taxation argues, if its contract with the purchaser, the City of New York in this case, was an "agency" contract as specified in the regulations (20 NYCRR 541.3[d][4]). That, however, ignores the fact that the application of that provision is confined to only certain types of exempt organizations (those described in Tax Law § 1116[a][3], [4], [5] and [6]) and the City of New York is not included in those types. In any event, the requirement by the Division of Taxation of specific provisions in a contract of sale which are not required by the statute itself for exemption from tax has been held invalid by the courts (Matter of Perlstein Builders, Inc. v. New York State Tax Commission, 87 AD2d 906).

E. The petitions of MGK Constructors are granted and the notices of determination and demands for payment of sales and use taxes due issued December 30, 1988 and the notices and demands for payment of sales and use taxes due (see Findings of Fact "1" and "2") are cancelled. The Division of Taxation is ordered to refund the amount of penalty and any interest in excess of that computed under Tax Law §1142 actually paid by petitioner, in accordance with conclusions of Law "A" and "B".

DATED: Troy, New York
1/17/91

ADMINISTRATIVE LAW JUDGE