STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :

of :

LENON SOKOLOWSKI MODELS :

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 March 1, 1984 :
through February 28, 1987.
:

In the Matter of the Petition :

of :

LENON KAPLAN, :
PARTNER OF LENON SOKOLOWSKI MODELS
:

DETERMINATION
DTA NOS. 807478,
807479 AND
807481

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 March 1, 1984
through February 28, 1987. :

:
In the Matter of the Petition
:
of
:
WALLY SOKOLOWSKI,
PARTNER OF LENON SOKOLOWSKI MODELS :

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 March 1, 1984 :
through February 28, 1987.

Petitioners, Lenon Sokolowski Models, Lenon Kaplan and Wally Sokolowski, 236 West 26th Street, New York, New York 10001, 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, 1984 through February 28, 1987.

A hearing was held before Arthur S. Bray, Administrative Law Judge, at the offices of the

Division of Tax Appeals, Two World Trade Center, New York, New York, on January 9, 1991 at 9:15 A.M., with all briefs to be submitted by May 4, 1991. Petitioners filed their brief on March 25, 1991. The Division of Taxation did not file a brief. Petitioners appeared by DeGraff, Foy, Holt-Harris & Mealey, Esqs. (James H. Tully, Jr., Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (James Della Porta, Esq., of counsel).

ISSUES

I. Whether petitioner Lenon Sokolowski Models has established that certain of its sales of architectural models are exempt from tax as sales for resale, sales to tax-exempt organizations or out-of-state sales.

II. Whether petitioner Lenon Sokolowski Models' sales of architectural models are exempt from tax on the basis that they are used "in research and development in the experimental or laboratory sense" within the meaning of Tax Law § 1115(a)(10).

III. Whether photography expenses incurred by petitioner Lenon Sokolowski Models were purchases for resale and, therefore, not subject to sales or use taxes.

FINDINGS OF FACT

Petitioner Lenon Sokolowski Models (the "partnership") is a firm which builds models for architects, developers, museums and photographers. Petitioners Lenon Kaplan and Wally Sokolowski are partners in the partnership. Architects used the models built by the partnership as a planning device to examine the buildings' shapes and colors. It is petitioners' understanding that when the architect was finished with the model, it was sent to the architect's client.

The partnership was not registered as a sales tax vendor during the period in issue.

In or about November 1985, the Division of Taxation ("Division") commenced a sales tax field audit of the partnership. At the outset of the audit, the Division sent the partnership a letter which requested that it make available all sales tax records including journals, ledgers, sales and purchase invoices, cash register tapes and exemption certificates. In response, the

partnership provided the Division with a list of its sales during the audit period. The Division used this list to prepare a worksheet which categorized each sale as a sale for resale, out-of-state sale or a sale to an exempt organization. Those sales which the Division did not consider exempt were placed in a column for disallowed nontaxable sales.

When it conducted its analysis, the Division asked the partnership for documents to substantiate the partnership's claim that certain sales were nontaxable. In those instances where the partnership could show that the delivery was made out of state or that the sale was made to a tax-exempt organization, the sale was considered nontaxable. The Division disallowed most of the claimed sales for resale because the partnership did not present the Division with any resale certificates.

As a result of the foregoing audit, the partnership agreed that tax of $22,447.84 was due on sales of $272,095.00. Sales in the amount of $383,391.00 were determined to be nontaxable because either the items were delivered out of state or the sales were made to tax-exempt organizations. The remaining sales of $376,153.00 were sales to architects for which no resale or other exemption document was provided. The last item resulted in tax due in the amount of $31,032.61.

On the basis of the foregoing audit, the Division issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due, dated July 20, 1988, to the partnership which assessed sales and use tax for the period March 1, 1984 through February 28, 1987 in the amount of $31,032.61, plus interest of $7,958.81, for a total amount due of $38,991.42. The Division also issued separate notices of determination and demands for payment of sales and use taxes due, dated July 20, 1988, to Wally Sokolowski and Lenon Kaplan, as partners of Lenon Sokolowski Models, which assessed the same amount of tax and interest which had been assessed against the partnership.

After the assessments were issued, petitioners attended a conciliation conference at the Bureau of Conciliation and Mediation Services. It was agreed at this conference that petitioners were entitled to be given credit for the tax paid to the suppliers for materials that became a

component part of the models. In order to calculate the amount of the credit, the Division conducted an analysis of petitioners' purchases during 1985 and projected the results to the three-year audit period. The categories of expenses for which petitioners were given credit were tools and machinery, plastics, graphics, lumber and miscellaneous. In performing this analysis, the Division added back the amount of New York City tax imposed on tools and machinery. Further, the Division did not give any credit for utilities or for photographic expenses. The Division's calculations resulted in a net credit of $4,034.84. Thus, the amount currently in dispute is $26,997.77.[1]

The partnership is one of approximately 15 firms in the metropolitan area of New York City which create architectural models. It is petitioners' understanding that in the early 1970's and early 1980's the model-making firms did not consider their product subject to sales tax. This understanding was confirmed when it was learned that, in a letter dated July 14, 1975, the Tax Compliance Division of the Department of Taxation and Finance cancelled a bill for delinquent taxes which had been sent to another architectural model maker in New York City.

On or about February 14, 1986, the Technical Services Bureau of the Taxpayer Services Division issued an Advisory Opinion to one of the architectural model makers in New York which concluded that the charge by the model maker to its customers was subject to tax. When the Advisory Opinion was issued, the New York model makers became very concerned because of the potential tax liability. In order to present their position to the Department of Taxation and Finance, they formed an association known as the Architectural Modelmaking Association of New York, Inc. (the "Association") and retained the law firm of Breed, Abbott & Morgan. Thereafter, Breed, Abbott & Morgan prepared a memorandum which argued that sales tax should not be imposed retroactively on the sale of architectural models produced by model makers who relied on prior practices of the Division and had no way to recoup any sales taxes

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[1]This figure was misstated in the transcript, as $26,998.23, and the Conciliation Order, as $26,998.38. The correct amount, $26,997.77, is the amount assessed $31,032.61, less the credit of $4,034.84.

they were required to pay. The memorandum also

requested that the Department provide guidelines which recognized distinctions in various types of transactions. In its memorandum, Breed, Abbott & Morgan explained that the business of model makers can be broken down into one of four categories as follows:

> "a. Models created for architects for their internal use to transform a two dimensional drawing into a three dimensional model. A design tool for architects use only.
>
> b. Creation of models for architects which are also used as design tools, and are used by the architects to present to developers/owners with the view toward the developers/owners accepting the designs. During the course of the development or creation of such the architects and developers/owners make many changes in the designs before the designs for the projects, and thus the models, are agreed upon.
>
> c. The creation for architects on orders by the architects of models which are used as design tools as in (b) above and then as marketing tools by developers/owners for
>
> (i) attracting investors
>
> (ii) as a vehicle for fund raising, such as models created for hospitals, schools, etc.
>
> d. The creation of models as an end product. For example, models for a museum or a gallery. Often the purchaser of such models are tax exempt organizations, but developers/owners sometimes purchase them to place in the lobbies of their buildings."

In response to the memorandum, the Director of the Taxpayer Services Division mailed a letter, dated March 6, 1987, to Breed, Abbott & Morgan which requested that members of the Association retroactively file returns for a three-year period beginning March 1, 1987. Further, the letter requested that those firms not under audit perform a self audit. In preparing the past due returns, the Division counselled:

> "In filing for the retroactive period we will ask that a reasonable effort be made to compute the taxable sales as follows:
>
> While consideration will be given to (1) sales for resale, (2) models delivered out of state for use out of state, and (3) sales to exempt organizations or entities, you should maintain whatever documentation you have to support such exempt sales.
>
> While we will accept reasonable attempts to reconstruct the taxes, we reserve the right to make adjustments where we identify an obvious discrepancy. In other

words, the self audit is subject to review."

To the extent relevant herein, the letter concluded with the statement that all penalties would be waived and only minimum interest would be imposed.

In an effort to comply with the instructions of the Director of the Taxpayer Services Division, the partnership approached its New York clients and asked them to execute one of two form letters. One of the form letters was on the letterhead of the partnership and stated as follows:

"Dear;

We are writing this letter asking you to confirm the fact that the model which we constructed for your

Client: ____________________________
Model: ____________________________
Cost: ____________________________
Date: ____________________________

was transfered [sic] to them.

If this was the case please initial below and return this letter in the inclosed [sic] envelope.

_________________________________ _________________________
Signature Date

Sincerely;
Lenon Kaplan

Wally Sokolowski"

The other form was on the letterhead of the Association and provided as follows:

"______________ ______________
Modelmaking Firm Purchaser's Firm

______________ ______________
Address Address

______________ ______________
City, State, Zip City, State, Zip

______________ ______________
Attention Signature Attention Signature

______________ ______________
Phone Number Date Phone Number Date

Date of Sale:
Project Name and/or number:
Cost of Model:
Tax Liability:

A. Was this sale ultimately for a tax exempt organization? (I.E. Government, School, Hospital, Religious Organization, etc.)

____
Exempt Organization

____
Address

____
City, State, Zip

____
Tax Exempt I.D. Number (or enclose ST-119.1)

B. Was this sale delivered out of state for use out of state?

____
Out of State recipient

____
Address

____
City, State, Zip

C. Was the cost of this transaction passed on to your client, making the transaction a sale for resale? (PLEASE NOTE: This applies only to sales between 3/1/84 and 3/1/87. After 3/1/87 the purchaser must provide form ST-120 Resale Certificate to hold sale as non-taxable.)

____
Client's Firm

____
Address

____
City, State, Zip"

An analysis of the 50 documents submitted at the hearing reveals the following:

(a) Eight documents were submitted on the form created by the Association which stated that the sale was "delivered out of state for use out of state". The total value of the sales in this category was $94,000.00. Two of the documents in this category with combined sales in the amount of $24,000.00 represented sales made to Maloof Architectural Models. The Division's workpapers show that the Division did not consider the sales to Maloof Architectural Models taxable.

(b) Two documents were submitted on the form provided by the Association which stated that the sale was "ultimately for a tax exempt organization". The value of the sales in this category was $16,700.00. In one instance, the purchaser was listed as a Jane Yu and the tax-exempt organization involved was the Avery Fisher School of Music and Media. In the other

instance, the purchaser was Maloof Architectural Models and the tax-exempt organization was listed as a public school. There is no evidence that the partnership was given a tax-exempt certificate in conjunction with either sale.

(c) The partnership submitted 11 documents bearing the letterhead of the Association which responded affirmatively to the question, "Was the cost of this transaction passed on to your client, making the transaction a sale for resale?" An additional 28 documents were submitted on the letterhead of the partnership which stated that the model constructed for the partnership's customer was transferred to the client of the customer. The value of the sales represented by these documents was $199,433.00. One of the documents described a transaction in the amount of $900.00 dated December 15, 1986. The purchaser was listed as Copeland Novak Israel and Simmons, P.C. and the purchaser's client was listed as A.M.P. Center of Sidney, Australia. A statement on the form advised that delivery was made to Australia. A second document described a transaction dated January 20, 1986 in the amount of $1,500.00. The purchaser was also listed as Copeland Novak Israel and Simmons, P.C. and the purchaser's client was listed as Orange Mall in Connecticut. A statement on the form indicated that delivery was made to Connecticut. The Division's workpapers show that the Division did not consider these particular sales to Copeland Novak Israel and Simmons, P.C. as taxable.

(d) The exhibit contained one form on the letterhead of the Association which did not select a reason for exemption. The sale, in the amount of $450.00, was made to Emery Roth, P.C. on August 13, 1985.

None of the customers who signed the documents which the partnership offered at the hearing gave the partnership a resale certificate, sales tax registration number or an exemption certificate claiming an exemption from sales and use taxes on the basis of research and development.

At the hearing, Mr. Kaplan did not recall the partnership making out-of-state deliveries to those customers who executed any of the documents which petitioners offered at the hearing.

The photography expense incurred by petitioners was for photographs, photostats, silk

screens and various photographic processes which were used to build "skins" on the building models. The photography became an integral component part of the model.

SUMMARY OF PETITIONERS' POSITION

It is petitioners' position that their documentation establishes that the sales in issue were sales to architects for models which were then sold to developers as part of the architectural services. Thus, petitioners submit that the sales in issue were not taxable because they were sales for resale.

Petitioners submit that it would be inappropriate to require resale certificates in this matter because the architects were not registered vendors and therefore they could not provide resale certificates. Secondly, prior to the issuance of the Advisory Opinion (Finding of Fact "9"), the models were not considered taxable by the model makers.

It is petitioners' contention that the documents provided at the hearing comply with the provisions of the letter from the Director of the Taxpayer Services Division. Consequently, an adjustment to the audit is warranted.

Petitioners also argue that the models are exempt from tax because they are used by architects as part of their research and design. Petitioners submit that the use of the models is similar to the test aircraft discussed in example 4 of 20 NYCRR 528.11(c)(3).

Lastly, petitioners argue that the partnership's purchases of photographic equipment should be considered exempt from tax.

CONCLUSIONS OF LAW

A. Tax Law § 1105(a) imposes a sales tax on, among other things, "the receipts from every retail sale of tangible personal property". The term "retail sales" is defined by Tax Law § 1101(b)(4), in pertinent part, as "[a] sale of tangible personal property to any person for any purpose, other than for resale as such." Tax Law § 1132(c) places the burden of showing that a receipt is not subject to tax on the person required to collect the tax or on the customer. Thus, the burden of proof is on petitioners to establish that their sales were not subject to tax. Since one document does not set forth any basis to be considered exempt from tax (see Finding of

Fact "12[d]"), no adjustment for that sale is warranted.

B. In order to establish that a transaction is exempt as a sale for resale, petitioners must establish that the models were "purchased for one and only one purpose: resale" (Matter of Savemart, Inc. v. State Tax Commn., 105 AD2d 1001, 482 NYS2d 150, appeal dismissed 64 NY2d 1039, 489 NYS2d 1029, lv denied 65 NY2d 604, 493 NYS2d 1025). In the instant case, the testimony offered on petitioners' behalf shows that the architects used the models before their transfer to the architects' customers. Thus, the fact that the models were ultimately transferred to the architects' customers does not establish that they were purchased for "resale as such" (Tax Law § 1101[b][4]) and petitioners' claim that the transactions with the architects were exempt sales for resale is rejected. In view of the foregoing, petitioners' argument that they should not be penalized because they did not have resale certificates is academic.

C. As noted, petitioners claimed that two transactions were exempt from sales and use taxes because they were made to tax-exempt organizations. In general, Tax Law § 1116 lists certain organizations whose purchases and sales are exempt from sales and use taxes. Sales to exempt organizations are discussed at 20 NYCRR 529.7(h). Paragraph 2 of this section provides as follows:

> "In order to exercise its right to exemption the organization must be the direct purchaser, occupant or patron of record. It must also be the direct payer of record and must furnish its vendors with a properly completed exempt organization certification. Direct purchaser, occupant or patron as used in this paragraph includes any agent or employee authorized by the organization to act on its behalf in making such purchases, provided the organization and its agent or employee are both identified on any bill or invoice. Direct payer of record means that direct payment is made by the organization or from its funds."

In this instance, petitioners' claim that certain transactions are exempt from tax because the sales were made to tax-exempt organizations must fail for at least two reasons. First, petitioners did not present any evidence to show that the claimed exempt organizations furnished a completed exempt organization certificate. Second, according to petitioners' documents, the exempt organization was not the purchaser of record.

D. The documents submitted by petitioners which claim out-of-state sales are insufficient to establish that those transactions which remain in issue are exempt from tax. The regulations

of the Commissioner of Taxation explain that, with certain exceptions not applicable herein:

> "a sale is taxable at the place where the tangible personal property or service is delivered or the point at which possession is transferred by the vendor to the purchaser or his designee" (20 NYCRR 526.7[e][1]).

In order to qualify for an exemption on the basis of out-of-state sales, the taxpayer must show that actual physical delivery or control of the products took place outside of New York State (Matter of Continental Arms Corp. v. State Tax Commn., 130 AD2d 929, 516 NYS2d 338, revd on other grounds 72 NY2d 976, 534 NYS2d 362). The record shows that, in each instance where an exemption was claimed for an out-of-state sale, the purchaser was located in New York. Further, on those sales which remain in issue, there is no evidence that the partnership delivered any of the models out of state. Therefore, the Division properly considered the transactions as subject to New York State tax.

E. Petitioners' alternative argument that the models are exempt from tax pursuant to 20 NYCRR 528.11 because they are used in research and development is without merit. Tax Law § 1115(a)(10) exempts "[t]angible personal property purchased for use or consumption directly and predominantly in research and development in the experimental or laboratory sense." The meaning of the term "research and development", as set forth in Tax Law § 1115(a)(10), is defined in the Commissioner's Regulations as follows:

> "(b) Research and development. (1) Research and development in the experimental or laboratory sense means research which has as its ultimate goal:
>
> (i) basic research in a scientific or technical field of endeavor;
> (ii) advancing the technology in a scientific or technical field of endeavor;
> (iii) the development of new products;
> (iv) the improvement of existing products;
> (v) the development of new uses for existing products." (20 NYCRR 528.11[b].)

The work of an architect does not constitute research and development as defined above. Clearly, the examination of the shape or color of a building does not involve the "experimental or laboratory sense" to which this exemption is directed. Furthermore, contrary to petitioners' argument, the nature of architectural models is entirely different from that of test aircraft. There is no evidence that an architectural model may be used to test the function and reliability of a

building the way a test airplane may be used to test the function and reliability of the aircraft.

F. Petitioners' argument with respect to its photographic expenses is meritorious. The Division's regulations provide for a resale exclusion as follows:

> "(c) Resale exclusion. (1) Where a person, in the course of his business operations, purchases tangible personal property or services which he intends to sell, either in the form in which purchased, or as a component part of other property or services, the property or services which he has purchased will be considered as purchased for resale and therefore not subject to tax until he has transferred the property to his customer." (20 NYCRR 526.6[c][1].)

G. In this matter, the uncontradicted testimony establishes that the photography was incorporated into and became a component part of the models. Therefore, petitioners are entitled to an adjustment for their photographic expenses.

H. The petitions of Lenon Sokolowski Models, Lenon Kaplan and Wally Sokolowski, as partners of Lenon Sokolowski Models, are granted only to the extent of Conclusion of Law "G" and the Division is directed to modify the notices of determination and demands for payment of sales and use taxes due dated July 20, 1988 accordingly; except as so granted, the petitions are in all other respects denied and the notices, as adjusted at the conciliation conference, are sustained together with such interest as may be lawfully due.

DATED: Troy, New York

ADMINISTRATIVE LAW JUDGE