STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
JOHN GALLIN & SON, INC.	:	DETERMINATION DTA NO. 817990
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 August 1, 1996 through September 9, 1999.	:	

Petitioner, John Gallin & Son, Inc., 102 Madison Avenue, New York, New York 10016, 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 August 1, 1996 through September 9, 1999.

A hearing was held before Timothy J. Alston, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on March 27, 2001 at 10:30 A.M. and continued to conclusion at the same location on March 29, 2001 at 10:00 A.M., with all briefs to be submitted by August 9, 2001, which date began the six-month period for the issuance of this determination. Petitioner appeared by Gerard W. Cunningham, Esq. The Division of Taxation appeared by Barbara G. Billet, Esq. (James Della Porta, Esq., of counsel).

ISSUE

Whether the installation of floor covering and the rental of scaffolding parts in connection with office renovation and reconstruction contracts entered into by petitioner constituted capital improvements to real property, thereby requiring a refund of sales tax paid by petitioner in respect of such services and for such rental.

FINDINGS OF FACT

1. Petitioner, John Gallin & Son, Inc., is a 116-year-old, family-owned general contractor engaged in the business of renovating and reconstructing existing interior office space in New York City. With annual revenues of $40 to $50 million, petitioner employs an office staff of 20 to 25, 4 project managers, 12 superintendents, and 30 to 50 field laborers and carpenters.

2. Petitioner filed an application for credit or refund of state and local sales and use taxes dated August 23, 1999 seeking a refund of $75,000.00 in sales tax paid for the period "August 1996 through present." The refund application indicates that petitioner sought a refund of tax paid on "services and materials rendered in connection with the completion of capital improvement construction projects." The application claimed that tax was improperly paid on "such items as initial finished floor coverings as described in Section 1101(b)(9)(iii) [of the Tax Law] for tax exempt capital improvements, as well as scaffolding services provided on capital improvement projects."

3. Together with its refund claim, petitioner submitted invoices from subcontractors and capital improvement certificates related to some 35 jobs. Although petitioner claimed a refund of $75,000.00, the invoices submitted with the refund claim totaled $65,380.67 in sales tax paid by petitioner to its subcontractors.

4. By letter dated February 29, 2000, the Division of Taxation ("Division") requested additional documentation from petitioner in respect of its refund claim. Specifically, the Division requested that petitioner provide a supporting schedule summarizing the computation of the refund claim. The Division also requested that the petitioner provide a copy of all original invoices, estimates and contracts for all "qualifying" installations of carpeting and other floor covering. The Division further advised petitioner of its position that the installation of floor

covering does not qualify as a capital improvement unless such installation is the initial installation in new construction, a new addition to an existing structure or a total reconstruction of an existing building.

5. Petitioner did not provide any additional information and the Division issued a letter dated June 23, 2000 informing petitioner that its refund claim was denied in full.

6. Petitioner subsequently filed a petition with the Division of Tax Appeals in protest of the Division of Taxation's refund claim denial. The petition claimed a refund of sales tax paid to subcontractors in the amount of $75,000.00.

7. At hearing petitioner submitted documentation with respect to some 35 jobs[1] and claimed a refund of $69,515.46 in sales tax paid to subcontractors in connection with such jobs. With one exception (***see***, Finding of Fact "19") such documentation consisted of the contract (or a portion thereof) between petitioner and its customer, a capital improvement certificate related to the job in question, purchase orders from petitioner to its flooring subcontractor, invoices from the subcontractor to petitioner, and copies of checks issued to the subcontractor in payment of the invoices.

8. The work performed by petitioner on the 35 jobs at issue consisted of the renovation and reconstruction of office space in large, multi-story buildings in New York City. In all cases, petitioner performed its work on an existing office building; none of the jobs involved the construction of a new building or an addition to an existing building. Typically, petitioner contracts with a new tenant to reconstruct the leased space to meet the tenant's specific needs. In all of the jobs in question petitioner provided such reconstruction services after a previous tenant had vacated the premises.

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[1] 27 of these 35 jobs were among the jobs included in petitioner's original application for refund.

9. Most of the jobs in question involved the renovation and reconstruction of an entire floor of a building. Some of the jobs involved the reconstruction of two or three floors, while a few required work on less than an entire floor.

10. The first step in the reconstruction process is the demolition or gutting of the space where the reconstruction work is to be performed. Generally, this involves the removal of the previous tenant's leasehold improvements. Often the demolition work has been completed when petitioner gets involved; frequently such work has been performed under the landlord's direction. On some of the jobs at issue petitioner was responsible for the demolition. In any event, the premises are always vacant when petitioner does its work. The gutting involves the removal of everything "between the slabs." That is, all interior walls and doors are removed; all floor covering is removed; the ceiling is removed; all plumbing and HVAC is removed. When the demolition process is completed, the space has been stripped down to the concrete slab on the floor, the exterior walls of the building, and the trusses and beams which are attached to the concrete slab above. The gutting does not involve the removal of any of the structural components of the building.

11. Petitioner begins its renovation and reconstruction work after the gutting has been completed. Such work is performed pursuant to detailed plans and specifications prepared by architects and engineers. Petitioner generally subcontracts about 95 percent of the work on any given contract. Such work includes the installation of drywall, ceilings, doors, marble and wood flooring, carpeting, vinyl tile, architectural woodwork, lighting and electrical fixtures, plumbing, kitchen equipment, and painting and wall covering.

12. On three of the jobs at issue, in addition to the sort of work described above, petitioner constructed and installed a stairway between two floors of a building by cutting a hole in the

concrete slab floor. Additionally, on Job 8566, petitioner installed additional structural steel to support high density file cabinets.

13. As noted above, petitioner produced Certificates of Capital Improvement (Form ST-124) for 34 of the jobs at issue. These certificates were signed by petitioner's customer, who is, in nearly all cases, the tenant. Of the 34 certificates produced by petitioner, 21 indicated that the customer was a tenant of the real property, 2 indicated that the customer was the owner of the real property, and 13 of the certificates were incomplete to the extent that the customers failed to indicate in the space provided whether they were the owner or tenant of the real property. Petitioner did not introduce any of its customers' leases.

14. The documentation submitted indicates that the contracts for the 35 jobs in question totaled approximately $17.5 million. Twenty-two of the contracts exceeded $100,000 in amount, including six in excess of $1 million.

15. For 33 of the jobs at issue petitioner seeks a refund of sales tax paid to subcontractors for furnishing and installing carpeting, vinyl composite tile and vinyl base. Such carpeting, tile and base were installed pursuant to contracts generally described in Findings of Fact "8" through "12."

16. With the exception of Job 7877 (***see***, Finding of Fact "19"), petitioner established that it paid sales tax to its subcontractor in the amount claimed for the furnishing and installation of carpeting, vinyl composite tile and vinyl base.

17. As noted previously, petitioner's refund claim also sought a refund of tax paid for "scaffolding services." The documentation submitted by petitioner reveals invoices for the rental of scaffolding parts in connection with two contracts (Jobs 8071 and 8301). The scaffolding parts were assembled by either an employee or a subcontractor and used in the

performance of these two contracts. In both jobs, the scaffolding enabled workers to perform work on or near the ceiling. The scaffolding was on wheels and was easily moved. Petitioner did not purchase any services in connection with the rental of the scaffolding parts. Petitioner paid $43.40 and $14.03 in sales tax on Jobs 8071 and 8301, respectively, for the rental of scaffolding parts.

18. Petitioner's charges to its customers included the payment of sales tax to its flooring subcontractors. Petitioner thus ultimately passed the cost of sales tax paid to its subcontractors on to its customers as part of the total charge.

19. With respect to one of the contracts at issue, Job 7877, petitioner did not submit any invoices from the flooring subcontractor or any other documentation showing that sales tax was charged to petitioner. Petitioner claimed a refund of $3,418.00 on this job. Petitioner also did not submit a capital improvement certificate for this job.

CONCLUSIONS OF LAW

A. The service of installing tangible personal property is not subject to sales tax if such property, when installed, constitutes a capital improvement to real property, property, or land (***see***, Tax Law § 1105[c][3][iii]). Petitioner asserts that the furnishing and installation of carpeting, vinyl composite tile and vinyl base by its subcontractors in connection with the jobs described herein qualified for capital improvement treatment. In order to come within the exception from taxation for capital improvements provided by Tax Law § 1105(c)(3)(iii), petitioner must show that the installation of floor covering herein fell within the definition of that term as contained in Tax Law § 1101(b)(9) which provides, in relevant part, as follows:

> Capital improvement. (i) An addition or alteration to real property which:
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> (A) Substantially adds to the value of the real property, or appreciably prolongs the useful life of the real property; and

> (B) Becomes part of the real property or is permanently affixed to the real property so that removal would cause material damage to the property or article itself; and
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> (C) Is intended to become a permanent installation.
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> (iii) Notwithstanding the provisions of subparagraph (i) of this paragraph:
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> (A) Floor covering, such as carpet, carpet padding, linoleum and vinyl roll flooring, carpet tile, linoleum tile and vinyl tile, installed as the initial finished floor covering in new construction or a new addition to or total reconstruction of existing construction shall constitute an addition or capital improvement to real property, property or land; and
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> (B) Floor covering, such as carpet, carpet padding, linoleum and vinyl roll flooring, carpet tile, linoleum tile and vinyl tile, installed other than as described in clause (A) of this subparagraph shall not constitute an addition or capital improvement to real property, property or land.

B. Subparagraph (iii) of Tax Law § 1101(b)(9) defines the circumstances under which the installation of floor covering shall constitute a capital improvement. The introductory clause, "notwithstanding the provisions of subparagraph (i) of this paragraph," establishes that this subparagraph supercedes the general definition of capital improvement in subparagraph (i). Furthermore, clause (B) unequivocally provides that unless floor covering is installed as described in clause (A) it shall not constitute a capital improvement. Subparagraph (iii) therefore exclusively defines when the installation of floor covering shall be treated as a capital improvement.

The question presented in the instant matter is thus whether the floor covering herein was installed as "the initial finished floor covering in *new construction* or *a new addition to* or *a total reconstruction of existing construction*" (Tax Law § 1101[b][9][iii]; emphasis added). If the floor covering was installed in such a manner, the installation qualifies as a capital improvement.

C. The Division's regulations, promulgated under Tax Law § 1101(b)(9)(iii), provide the following definitions to determine whether the installation of floor covering qualifies as a capital improvement:

> (i) *New construction of a building or structure* means the original construction of a building or structure that did not exist before such construction.
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> (ii) *New construction of an addition to an existing building or structure* means the original construction of a new room, wing or other discrete, substantial unit of a building or structure which enlarges the exterior of the existing building or structure.
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> (iii) *Total reconstruction of an existing building or structure* means the complete rehabilitation or replacement of most of the major structural elements of an existing building or structure, such as the roof, ceiling trusses, floor joists, walls, support columns, support beams, girders and the foundation. (20 NYCRR 541.14[b][2] [emphasis in original].)

D. The installations of floor covering at issue were not made under any of the circumstances defined in the regulation. Accordingly, such installations were not capital improvements and were properly subject to tax.

None of the installations involved new construction or new additions to existing construction as those terms are defined in the regulation. Additionally, none of the subject floor covering installations involved the "total reconstruction of an existing building or structure" as defined in the regulation. While many of the projects at issue were extensive, such projects did not involve "the complete rehabilitation or replacement of most of the major structural elements" of the buildings as required under the regulation. Indeed, with a few exceptions, the projects did not involve any structural work. In those four jobs in the record where petitioner did perform structural work, i.e., the installation of stairs between floors and additional steel to support high density file cabinets, such work did not involve the "complete rehabilitation or replacement of most of the structural elements of the building" as required under the regulation.

E. Petitioner contends that the Division's interpretation of Tax Law § 1101(b)(9)(iii) as stated in 20 NYCRR 541.14(b) is "overly restrictive, an unauthorized imposition of tax, illogical and invalid."

The Division of Tax Appeals has authority to rule on the validity of regulations promulgated by the Division of Taxation (***see***, Tax Law § 2006[7]). If reasonable, the regulations of a State agency have the force and effect of law (***se***e, ***Molina v. Games Management Services***, 58 NY2d 523, 462 NYS2d 615). In general, the Division's regulations must be upheld unless shown to be irrational and inconsistent with the statute (***Matter of Slattery Assocs. v. Tully***, 79 AD2d 761, 434 NYS2d 788, ***affd*** 54 NY2d 711, 442 NYS2d 978) or erroneous (***Matter of Koner v. Procaccino***, 39 NY2d 258, 383 NYS2d 295).

F. The regulation in question is a reasonable interpretation of Tax Law § 1101(b)(9)(iii). The regulation's interpretation of the statutory term "new construction" as the new construction of a building or structure is not only logical, but is also compelled by its juxtaposition in the statute to the contrasting statutory term "existing construction." "Existing construction" clearly refers to an existing building or structure. "New construction" must therefore refer to a new building or structure. Additionally, the regulation's interpretation of the statutory term "new addition to existing construction" comports with the plain meaning of those words. Finally, the regulation's interpretation of the statutory term "total reconstruction of existing construction" is also reasonable. This definition is in accord with the common understanding of the word "total."

The regulation in question is also consistent with the language of subparagraph (iii) of Tax Law § 1101(b)(9) as contrasted with the general definition of capital improvement in subparagraph (i). Significantly, the Legislature used the terms "new construction," "new addition" and "total reconstruction" in this provision, rather than the broader three-part test in

subparagraph (i). Such terms define the circumstances under which the installation of floor covering shall constitute a capital improvement more narrowly than the general definition in subparagraph (i). By its use of these terms, the Legislature limited the kind of construction work in which floor covering will qualify as a capital improvement. The definition of "new construction," "new addition" and "total reconstruction" in the regulation comports with this statutory language.

The regulation is also consistent with the legislative intent to provide "consistency and certainty" for floor covering retailers at the time of sale (***see***, Memorandum of Division of Budget, Governor's Bill Jacket, L 1989, ch 61). The narrow and more precise definition of capital improvement for floor covering in subparagraph (iii), as contrasted with the general definition in subparagraph (i), serves to effectuate that intent.

Petitioner argues that the regulation in question improperly violates the "three prong" test in Tax Law § 1101(b)(9)(i) and that "there is no evidence that the Legislature ever intended to redefine capital improvement or authorize the Department to do so." This argument is without merit. As discussed, Tax Law § 1101(b)(9)(iii) defines capital improvement for floor covering, and section 541.14(b) of the regulations is a reasonable interpretation of that statute. Indeed, if as petitioner argues, the regulation defined the terms in subparagraph (iii) in accordance with the general "three prong" test, then Tax Law § 1101(b)(9)(iii) would be rendered meaningless.

G. Petitioner contends that, Tax Law § 1101(b)(9)(iii) notwithstanding, the question of whether the installation of floor covering should be considered a capital improvement is properly determined by application of the general definition contained in Tax Law § 1101(b)(9)(i) and the related "end result" test (***see***, 20 NYCRR 527.7[b][4]). Petitioner notes that the kind of work described herein has long been considered capital improvement work, and also asserts that "the

Legislature created no new definitions whereby a capital improvement project could nonetheless be viewed as taxable for the sake of floor covering installations."

Petitioner's contention is rejected. The Legislature did, in fact, create a definition of capital improvement specific to floor covering installations by its enactment of subparagraph (iii) of Tax Law § 1101(b)(9). Contrary to petitioner's assertion, the enactment of subparagraph (iii) was not a clarifying amendment, but a substantive change in the statutory definition of capital improvement. As noted previously, the introductory clause of this subparagraph, "notwithstanding the provisions of subparagraph (i) of this paragraph," indicates that it supercedes the general capital improvement definition of subparagraph (i). Additionally, clause (B) of this subparagraph underscores the exclusivity of subparagraph (iii) in determining whether floor covering qualifies as a capital improvement. Accordingly, neither the general definition of subparagraph (i) nor the end result test (which applies the general definition to the overall project) apply. Pursuant to Tax Law §1101(b)(9), then, a portion of a project may receive capital improvement treatment under subparagraph (i), while the floor covering portion of the same project may not qualify under subparagraph (iii). Indeed, while portions of many of the jobs at issue may have properly received capital improvement treatment under subparagraph (i)[2], the floor covering portion of such jobs did not qualify for such treatment under subparagraph (iii).

Petitioner's position not only ignores the clear language of subparagraph (iii), but would also render this entire provision a nullity. Why would the Legislature have enacted a special rule defining capital improvements for floor covering in subparagraph (iii) of Tax Law § 1101(a)(9),

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[2] Because it is not necessary to a resolution of this matter, this determination does not address whether the jobs at issue were capital improvements under subparagraph (i) of Tax Law § 1101(b)(9).

if such capital improvements are properly determined, as petitioner argues, under subparagraph (i)? The Legislature could not have intended such a result.

H. Petitioner asserts that its rental of scaffolding is exempt from tax as a temporary facility at a construction site pursuant to 20 NYCRR 541.8, which provides, in relevant part, as follows:

> (a) General. Subcontracts to provide temporary facilities at construction sites, which are a necessary prerequisite to the construction of a capital improvement to real property, are considered a part of the capital improvement to real property. Charges for installation of materials and the labor to provide temporary heat, temporary electric service, temporary protective pedestrian walkways, and temporary plumbing by a subcontractor are therefore not subject to tax provided the subcontractor receives a copy of the properly completed certificate of capital improvement issued by the customer to the contractor.
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> * * *
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> (b) The subcontractor is liable, however, for the tax on the purchase of the materials used to provide the temporary facilities at construction sites described in subdivision (a) of this section.

I. Petitioner's rental of scaffolding parts was a retail sale of tangible personal property properly subject to tax (***see***, Tax Law 1105[a]). Capital improvement treatment is available with respect to the sale of certain services (***see***, Tax Law §1105[c][3][iii]; [5]). Petitioner, however, did not purchase any services in connection with its scaffolding rental. As the invoices show, petitioner simply rented equipment. Such a rental is subject to tax even if the end result of the project is a capital improvement (***see***, 20 NYCRR 541.9, 541.10). Petitioner's reliance on section 541.8 of the regulations is misplaced. That regulation contemplates the *installation* of temporary facilities at a construction site. Specifically, the regulation provides that "charges for installation of materials and the labor to provide temporary [facilities]" are not subject to tax. The regulation thus provides an exemption for the service of providing temporary facilities.

Petitioner cited ***Matter of F.W. Woolworth Co.*** (Tax Appeals Tribunal, December 1, 1994) in support of its position that the scaffolding should receive capital improvement treatment. That case involved the rigging and erecting of scaffolding; that is, the provision of services, and not merely the sale or rental of tangible personal property, as is the case herein. ***F. W. Woolworth*** is thus inapposite to the instant matter. Additionally, the advisory opinions cited by petitioner also involved the provision of services and are therefore not pertinent herein.

J. At hearing the parties raised the issue of whether petitioner's receipt of capital improvement certificates from its customers had any relevance to the subject refund claim. It has none. The receipt of a capital improvement certificate under the terms set forth in the Division's regulations relieves a vendor of liability for failure to collect tax (***see***, Tax Law § 1132[c][1]; 20 NYCRR 532.4[b][2]). In this case, the issue is whether petitioner, as a customer, properly paid tax to a vendor. Capital improvement certificates do not alter the liability of customers (***see***, ***Saf-Tee Plumbing Corp. v. Tully***, 77 AD2d 1, 432 NYS2d 409). Accordingly, irrespective of whether petitioner received the certificates in good faith, they are of no relevance to this matter.

K. The petition of John Gallin & Son, Inc. is denied and the Division of Taxation's denial of petitioner's refund claim is sustained.

DATED: Troy, New York
January 31, 2002

/s/ Timothy J. Alston
ADMINISTRATIVE LAW JUDGE