STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
SANTA FE CONSTRUCTION, INC.	:	DETERMINATION DTA NO. 819437
for Revision of a Determination or for Refund of Sales and Use Tax under Articles 28 and 29 of the Tax Law for the Period March 1, 1996 through November 30, 2001.	:	

Petitioner, Santa Fe Construction, Inc., 250 Park Avenue South, New York, New York 10003, 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 March 1, 1996 through November 30, 2001.

A hearing was held before Joseph W. Pinto, Jr., Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on December 9, 2003 at 10:30 A.M., with all briefs due by April 7, 2004, which date began the six-month period for the issuance of this determination. Petitioner appeared by M. Alexa Blair, Controller. The Division of Taxation appeared by Mark F. Volk, Esq. (James Della Porta, Esq., of counsel).

ISSUE

Whether the Division of Taxation properly assessed petitioner additional sales and use taxes on purchases of scaffolding and security services.

FINDINGS OF FACT

1. During the period March 1, 1996 through November 30, 2001 (the "audit period"), petitioner was engaged in the construction industry in New York City as a "public works"

general contractor, managing various subcontractors and suppliers in completing building projects.

2. On or about February 19, 2002, the Division of Taxation ("Division") began a sales and use tax audit of petitioner. All records requested by the Division were made available for inspection with the exception of a few fixed asset invoices. Petitioner's sales were reviewed using a test period, which had been agreed to by petitioner in a test period election. After reviewing the test period materials, the Division accepted taxable sales as reported. This was premised on the Division's acceptance of petitioner's monthly billings, which represented that 94.81% of all jobs were performed for exempt entities; 4.53% of all jobs were capital improvements; and 0.66% were real property rentals.

3. Petitioner's asset records were deemed to be adequate also. However, the Division examined the asset records in detail and discovered $81,832.36 in additional taxable assets on which no tax was paid, resulting in additional sales tax due of $6,751.17. Although petitioner originally challenged this additional tax, it has not pursued the issue and it is deemed abandoned.

4. The Division analyzed petitioner's material purchases and expense accounts by means of an agreed upon test period audit using the periods March 1, 1998 through May 31, 1998 and March 1, 2000 through May 31, 2000. The audit determined the following error ratios:

a) office supplies, 6.7009%;

b) office repair and maintenance, .1134%;

c) job cost/other expenses, .3041% (agreed);

d) job cost/other expenses, .2818% (disagreed).

After these error ratios were applied to the total for each category for the entire audit period, the resulting use tax was as follows:

a) office supplies, $9,831,89;

b) office repair and maintenance, $101.17;

c) job cost/other expenses, $30,128.28 (agreed);

d) job cost/other expenses, $27,918.98 (disagreed).

The disagreed portion of the job cost/other expenses represented unpaid tax on invoices from R & R Security. The auditor examined the invoices from R & R Security during the six-month test period and found that they did not separately state sales tax and used this information to calculate the error ratio and resulting tax. In the same examination, the auditor found other invoices from Saratoga Security which separately stated sales tax which was paid by petitioner.

5. The Division also reviewed the subcontractor expense account and noted purchases from Spring Scaffolding, Inc. on which no tax had been paid, even though some of the invoices separately stated sales tax and noted "rentals 100 percent taxable." The auditor confirmed this by tracing payments of the invoiced amounts to the general ledger, where it was found the amounts posted were net of tax. The Spring Scaffolding account was examined in detail for the entire audit period, revealing purchases of $470,486.18, which yielded additional tax due of $38,815.11.

6. The total amount of additional tax determined to be due on materials purchases and expenses was $106,795.43. When added to the additional tax due on fixed asset purchases of $6,751.17, the total additional tax due amounted to $113,546.60. Of this amount, petitioner disagreed with $66,734.09, representing the tax found due on the R & R Security account and the Spring Scaffolding account.

7. The Division of Taxation issued to petitioner two statements of proposed audit change for sales and use tax, dated January 31, 2003, for the periods March 1, 1996 through February

28, 2001, and March 1, 2001 through November 30, 2001, which set forth additional tax due of $37,969.38 and $8,843.13, respectively. These statements represented the agreed tax due as determined on audit. In addition to tax, both statements set forth interest on the tax due.

8. The Division of Taxation issued petitioner a Notice of Determination, dated March 10, 2003, for the period March 1, 1996 through November 30, 2001, which set forth additional tax due of $66,734.09 plus interest. The tax determined to be due on audit was derived from the sources referenced above.

9. The subcontract between petitioner and Spring Scaffolding, dated January 18, 1998, for sidewalk sheds and bridges, specified a contract price of $80,000.00, but failed to state whether the price included sales tax. Taxes were addressed in Article 21 of the subcontract, which stated as follows:

> 21.1 Subcontractor shall pay all local, state, and federal taxes, assessments and charges resulting from the Work. In the Event any law, rule or regulation require [sic] General Contractor to pay or collect, either directly or indirectly, the amount of any tax assessment or charge resulting from subcontractor's Work, Subcontractor shall pay these amounts to General Contractor and shall indemnify and hold harmless General Contractor from all such payments or liability.

The subcontract was drafted by petitioner and this article appeared on its form.

SUMMARY OF THE PARTIES' POSITIONS

10. Petitioner argues that sales and use tax was included in the purchase price stated in its subcontracts with R & R Security and Spring Scaffolding and that the subcontractors assumed responsibility for the taxes. Petitioner contends that it was its custom to place the responsibility for collecting and remitting tax on its vendors and that it did not maintain a tax account or have the "operational mechanism" to pay the tax.

11. Petitioner maintains that it engaged in "public work" covered by exemption certificates issued by municipal or state agencies which it believes conferred tax exempt status upon it. In addition, petitioner claims that $53,047.50 was never paid out on the Spring Scaffolding contract and that amount should have been "backed out" of the original contract price. Finally, petitioner argues that its employees made posting errors to its general ledger accounts which should be taken into account for purposes of determining any additional taxes due pursuant to the audit performed.

12. The Division of Taxation maintains that it cannot assume sales tax was paid unless it is separately charged on an invoice and that in this matter either it was not stated or, when stated, it was not paid. The Division asserts that petitioner cannot avoid its liability for the sales or use tax by providing that the vendor pay the tax in its contracts. Finally, the Division argues that petitioner's claim that its jobs were tax exempt because it was acting as an agent of municipal or state agencies was unfounded since it submitted no evidence of such a relationship.

CONCLUSIONS OF LAW

A. Although petitioner has not contested directly the sales and use taxes imposed on either the security services or the scaffolding, it will be briefly discussed for clarification before addressing its arguments in chief.

B. Tax Law § 1132(c)(1) provides in pertinent part as follows:

> For purpose of the proper administration of this article and to prevent evasion of the tax hereby imposed, it shall be presumed that all receipts for property or services . . . are subject to tax until the contrary is established, and the burden of proving that any receipt . . . is not taxable hereunder shall be upon the person required to collect the tax *or the customer*. (Tax Law § 1132[c][1]; emphasis added.)

The property and services purchased by petitioner were both taxable. Tangible personal property, like scaffolding, sold to a contractor for use in erecting a structure or building is taxable if it does

not become an integral component part of the structure or building. (Tax Law § 1115[a][16]; 20 NYCRR 541.3[d][2][iv][c].) Petitioner's rental of scaffolding parts was a retail sale of tangible personal property properly subject to tax (***see***, Tax Law §1105[a]). A capital improvement exemption was available with respect to the sale of installation services (***see***, Tax Law §1105[c][3][iii]; [5]), but petitioner's purchases did not qualify. The invoices and subcontract clearly intended a rental of the scaffolding and several of the invoices in evidence noted that "rentals are 100% taxable" and separately stated sales tax due on the entire receipt.

Security services purchased to complete its construction contracts were also subject to tax. (***Matter of MGK Constructors*** Tax Appeals Tribunal, March 5, 1992.)

The remaining question presented is whether petitioner has stated a valid reason for not paying the sales and use taxes on its purchases of scaffolding and security services.

C. Petitioner's argument that it should be exempt from taxation because it engaged in "public works" under exemption certificates from the City of New York or its agencies is without basis. First, petitioner's argument is actually one of agency. It believes that because it was acting as a contractor on jobs for the state, city or a municipal agency, all its purchases should be exempt because it is acting in the place of one of those entities. Generally, the City of New York would not be subject to tax as a purchaser. (Tax Law § 1116[a][1]; 20 NYCRR 529.2[b].) A contractor acting as agent would likewise not be subject to sales and use taxes. (20 NYCRR 541.2[c]; 20 NYCRR 529.2[b].)

Statutes which provide for exemptions from tax must be strictly construed, and the taxpayer must clearly demonstrate that it is entitled to the exemption. (***Matter of Lever v. New York State Tax Commn.***, 144 AD2d 751, 535 NYS2d 158.) Since petitioner has introduced no evidence of an agency relationship with the City of New York or any municipal agencies, it has

not demonstrated a right to the exemption from tax. Nowhere in any of the contracts it submitted was an agency relationship created. Petitioner's vague reference to its work for the City or its agencies does not establish an agency relationship which would qualify it for an exemption from sales and use taxes.

D. Petitioner argues that the nature of its industry and customary business practices militates against its payment of sales and use taxes. Noting that its contracts state lump sum prices inclusive of all applicable taxes and that provisions in its contracts place the responsibility for taxes on its subcontractors, petitioner argues that it did not have the "operational capability" to pay taxes and relied on the language in its contracts to insulate it from liability. Unfortunately, there are many problems with this reasoning.

First, petitioner drafted the contracts under which it now seeks protection. The sample contract it submitted between Nicholas J. Bouras, Inc.and itself, dated August 25, 1998, stated in item 8 that the price stated included "all taxes applicable to the Goods." The sample contract with S & C Products Corp., dated July 23, 1999, and the contract with Spring Scaffolding, dated January 18, 1998, indicated in section 21.1 that the subcontractor would pay all taxes resulting from the work and hold petitioner harmless for any taxes found due. However, petitioner's efforts to assure that taxes were paid stopped there. It did not require that tax be separately stated on invoices or progress payments, which would have allowed an auditor to verify that tax had been paid. In sum, petitioner chose to structure its transactions such that it delegated its responsibility for payment of the tax to its subcontractors.

While indemnification clauses in contracts may serve to protect petitioner from a breach of contract by its subcontractor, it will not shield it from its liability for sales tax under the Tax Law. (***Matter of Edens*****,** Tax Appeals Tribunal, April 25, 1996.) Further, even though petitioner

would like to believe that it can dispose of its tax obligations by drafting its contracts to place the responsibility for taxes on its subcontractors, this ignores the obligation placed on it by Tax Law §1133(b), which provides that where a customer fails to pay sales tax to its vendor, then it shall pay the tax directly to the Commissioner of Taxation and Finance. Therefore, petitioner's admission in its brief that it was unfamiliar with the Tax Law and had no account for the collection and disbursement of sales and use taxes does not relieve it of its liability for the tax. Further, petitioner was careful in its contractual phraseology to assert that "in the event any law, rule or regulation require general contractor to pay or collect, either directly or indirectly, the amount of any tax assessment," indicating that it was aware of the possibility that it might be liable for tax, but chose to deal with that contingency with an indemnification clause rather than a mechanism for providing an assurance that the tax would be paid. Further, its objection to the tax asserted on the R & R Security account is belied by its payment of invoices from another security service, Saratoga Security, which supplied invoices that separately stated sales tax, paid by petitioner.

Petitioners chose its form of business operation and must bear the tax consequences (***See, Matter of Sverdlow v Bates,*** 283 App Div 487, 129 NYS2d 88; ***Matter of 107 Delaware Associates***, 99 AD2d 29, 472 NYS2d 467, ***revd on other grounds*** 64 NY2d 935, 488 NYS2d 634.) It foresaw the potential for tax liability and chose to provide for that potential by incorporating an indemnification clause in its contracts, making no effort to ensure that the proper sales and use tax was paid.[1]

[1]It is noted that some invoices from Spring Scaffolding which were submitted in evidence revealed a separately stated sales tax due. However, when the auditor traced the payment for the invoice to the general ledger she discovered that the payment was net of the stated tax. This is in direct conflict with petitioner's assertion in its brief that it was never presented with an invoice indicating that tax was not included in the "lump sum" contract price.

E. Petitioner has the burden of proof in this matter. (20 NYCRR 3000.15[d][5]; ***Allied New York Services, Inc. v. Tully***, 83 AD2d 727, 442 NYS2d 624.) In two arguments raised post-hearing, petitioner has not met its burden. First, with respect to the Spring Scaffolding account, petitioner contends that the stated contract price was never paid in full and that the assessment was therefore overstated by the amount of the contract remaining unpaid, $53,047.50. The problems with this issue arising after the hearing are numerous. First, the auditor examined the Spring account in detail for the entire audit period and did so while working closely with petitioner's controller, Ms. Blair. No evidence of this modification to the contract price was provided to the auditor in 2002 or to this forum at hearing or after. The mere assertion in a brief that the contract price was not paid does not suffice to meet petitioner's burden of proof. Any offset would have to have been demonstrated with more substantive and probative documentary or testimonial evidence. An unsworn assertion of a fact by a representative commands little weight (***Matter of Café Europa***, Tax Appeals Tribunal, July 13, 1989), especially when brought to light years after a detailed audit was performed on the Spring account and without any chance for cross-examination or verification.

The second argument raised by petitioner where it failed to meet its burden of proof was with regard to its argument that there was an overstatement of taxes due related to the job cost account. Petitioner contends that its staff misposted subcontractor amounts to the account entitled "job cost - other." There are two glaring problems with this argument. First, petitioner offers no evidence of such mispostings whatsoever. Second, the reasoning is flawed. With its post-hearing submission, petitioner included a schedule of subcontractor costs which it believes should have been backed out before the error rate was applied. However, as the Division of Taxation pointed out in its brief, petitioner's argument does not take into account the fact that

decreasing the amount of total job costs for the test periods would presumably increase the error rate, thus increasing the amount of tax due.

F. The petition of Santa Fe Construction, Inc. is denied and the Notice of Determination, dated March 10, 2003, is sustained.

DATED: Troy, New York
September 16, 2004

/s/ Joseph W. Pinto, Jr.
ADMINISTRATIVE LAW JUDGE