

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition :

of :

ANDREW COSTABILE :

for Revision of Determinations or Refund of Sales and :
Use Taxes under Articles 28 and 29 of the Tax Law for the :
Periods September 1, 2007 through May 31, 2008 and :
March 1, 2009 through February 29, 2012.

In the Matter of the Petition :

of :

RALPH COSTABILE :

for Revision of Determinations or Refund of Sales and :
Use Taxes under Articles 28 and 29 of the Tax Law for the :
Periods September 1, 2007 through May 31, 2008 and :
March 1, 2009 through February 29, 2012.

DECISION
DTA NOS. 826105,
826106, AND 826107

In the Matter of the Petition :

of :

MICHAEL DELPONTE :

for Revision of Determinations or Refund of Sales and :
Use Taxes under Articles 28 and 29 of the Tax Law for the :
Periods September 1, 2007 through May 31, 2008 and :
March 1, 2009 through February 29, 2012.

Petitioners, Andrew Costabile, Ralph Costabile and Michael Delponte, filed an exception to the determination of the Administrative Law Judge issued on January 14, 2016.¹ Petitioner Andrew Costabile appeared pro se. The Division of Taxation appeared by Amanda Hiller, Esq. (Stephanie Scalzo, Esq., of counsel).

Petitioner Andrew Costabile filed a letter brief in support of the exception. The Division of Taxation filed a letter brief in opposition. Petitioner Andrew Costabile filed a letter brief in reply. Oral argument was heard in New York, New York on October 20, 2016, which date began the six-month period for issuance of this decision.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUE

Whether purchases of materials by a corporation installed as part of capital improvements to real property are subject to sales and use tax.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge, except we have modified finding of fact 1 to more accurately reflect the record. The modified finding of fact and findings of fact as determined by the Administrative Law Judge are set forth below.

1. During the periods September 1, 2007 through May 31, 2008 and March 1, 2009 through February 29, 2012 (audit period), Andrew Costabile, Ralph Costabile and Michael

¹ We note the Division's argument opposing the exercise of jurisdiction on exception over petitioners Ralph Costabile and Michael Delponte, neither of whom signed the exception filed herein. However, the petitions here at issue were consolidated during the course of the proceeding below and therefore we deem the exception taken from the consolidated determination of the Administrative Law Judge to include all three petitioners. This Tribunal is charged with providing a review of a determination of an Administrative Law Judge if *any* party to the proceeding takes an exception within 30 days of a notice of notice of determination (*see* Tax Law § 2006 [7]).

Delponte (petitioners) were officers of Tre Potenti, Inc. (Tre Potenti) d/b/a Stone Age, a business that acted as a retailer of cabinets, countertops, tile and other building products used in kitchens and baths. Tre Potenti also acted as a contractor, performing installations of its products for some customers. Petitioners conceded that they were persons responsible to collect and pay sales and use tax on behalf of Tre Potenti.

2. The Division of Taxation (Division) began an audit of Tre Potenti in April 2012 and made two requests for the books and records of the company pertaining to its sales and use tax liability. The Division did not audit the period June 1, 2008 through February 28, 2009 because the period of limitations on assessment of additional tax for this period had expired.

3. The records produced in response to the Division's request were deemed inadequate because they could not trace a transaction back to the original source or forward to a final total. As a result, the Division utilized an estimated audit methodology, a test period audit, which examined sales records for the period March through May 2009. It used bank deposits as a baseline in its audit because the deposits were in substantial agreement with the books and records that were produced. Further, Tre Potenti reported its sales based on bank deposits.

4. After a review of the sales tax returns filed for the audit period, it was discovered that no return was filed for the quarter ended May 31, 2008. The Division established a taxable ratio of taxable sales to bank deposits for all quarters in the audit period, 18.91%, and applied it to the bank deposits for the quarter ended May 31, 2008 to arrive at taxable sales and then applied the tax rate to calculate the additional tax due for the quarter of \$5,276.67.

5. A review of the sales records for the test quarter indicated that there had been errors in the tax rate used resulting in unpaid tax of \$106.07, or an error rate of 0.0649% for the test

period. When applied to total bank deposits for the audit period, it resulted in additional tax of \$1,919.85.

6. The review of the test period also indicated that additional tax of \$661.72 was due for disallowed nontaxable sales, which projected an error rate of 0.4047%, which, when applied to total bank deposits for each quarter, resulted in additional tax due for the audit period of \$11,971.68.

7. The review of the test quarter indicated also that tax was owing in the sum of \$332.55 for sales tax that was collected and not reported and remitted. When compared to the tax reported of \$2,272.00, it yielded an error rate of 14.64%. This rate was applied to each quarter's reported tax to yield additional tax due of \$7,196.33.

8. The final area examined by the Division was purchases of materials, which revealed that Tre Potenti paid no sales or use tax on any of these purchases regardless of whether the materials were used in capital improvements or sold at retail. Using the same test period of March to May, 2009, the Division determined from the sales records that 54.66% of the jobs were capital improvements. It applied 54.66% to total material purchases of \$1,564,996.00 and arrived at taxable purchases of \$855,426.59 and additional tax due of \$69,948.23.

9. On or about February 12, 2013, the Division issued to Tre Potenti two statements of proposed audit change for sales and use taxes for the period September 1, 2007 through February 29, 2012. The first statement asserted additional sales tax based on all of the areas discussed above except the tax associated with material purchases. The first statement asserted additional taxes due of \$26,364.53 plus penalty and interest.

The second statement asserted additional tax due on materials purchases only for use in capital improvements in the sum of \$69,948.23 plus interest.

10. When Tre Potenti failed to agree with the audit results, the Division issued notices of determination to each of the petitioners herein as persons responsible for the collection and payment of sales and use tax on behalf of the corporation. With respect to the areas of the audit that found additional sales and use taxes due for collecting and not remitting the tax, charging the incorrect tax rate, not substantiating exempt sales, and failing to file a tax return, the Division issued to each of the petitioners a notice of determination, dated March 8, 2013, stating additional tax due of \$26,364.53 plus penalty and interest.²

With respect to the part of the audit that determined additional tax due on materials purchases, the Division issued to each of the petitioners a notice of determination, dated March 8, 2013, stating additional tax due of \$69,948.23 plus interest. Although petitioners protested all notices issued to them, they disputed only the tax asserted on purchases of materials used in capital improvements, as set forth in their petitions and stated at the hearing.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge first set forth the statutory provisions that impose sales tax on retail sales with the exclusion of sales for resale. The Administrative Law Judge then set forth the statutory and regulatory provisions that specifically provide for the imposition of use tax on sales of tangible personal property to contractors for use or consumption in construction, regardless of whether the tangible personal property is to be resold or incorporated into real property as a capital improvement. The Administrative Law Judge concluded that although petitioners were accustomed to purchasing their materials tax free, they in fact acted as both

² On February 18, 2016, following the issuance of the Administrative Law Judge's determination, petitioners Andrew Costabile and Ralph Costabile entered into stipulations for discontinuance of their respective protests of the notices of determination, asserting \$26,364.53 plus penalties and interest (assessment numbers L-039117472 and L-039117473). Thus, these proposed assessments are no longer at issue in this matter.

retailers and contractors and should have applied use tax to the subsequent utilization of materials for consumption in capital improvements to real property.

The Administrative Law Judge also concluded that petitioners conceded their liability as persons responsible for the collection and payment of sales and use tax, citing petitioners' status as corporate officers and participation in Tre Potenti as the basis for his conclusion. As such, they are jointly and severally liable for any underreporting of sales and use tax during the audit period. Because Tre Potenti was liable for sales and use tax on materials used in the installation of capital improvements to the extent such materials were not already subjected to sales and use tax, each of the petitioners were in turn liable for any additional sales and use tax due on such materials. The Administrative Law Judge denied petitioners' protests and sustained the notices of determination.

SUMMARY OF ARGUMENTS ON EXCEPTION

Petitioners continue their argument presented below and contend that Tre Potenti should not have been held liable for the tax due on purchases of materials that were subsequently used in capital improvements. They claim that because Tre Potenti sold materials at retail, it purchased its materials for resale and should not pay sales tax. They argue that when they were presented with capital improvement certificates, their profit was diminished because they were forced to discount the jobs to the extent of the sales and use tax owed on the purchase of materials.

Petitioners contend that Tre Potenti was at all times a retailer and its purchases were for resale and therefore it owed no tax at the time of purchase of the materials at issue here. Petitioners further maintain that they are entitled to relief because the Division has thus far failed to explain the correct application of sales and use tax to retailers who also engage in installation of capital improvements.

The Division asserts that a contractor's obligation for paying sales and use tax on purchases of materials used in the installation of a capital improvement or repair is well established under the Tax Law, regulations, and case law. The Division urges this Tribunal to reject petitioners' argument that taxpayer guidance on application of sales and use tax to retailer/contractors was so vague as to require cancellation of the notices here at issue.

OPINION

As noted by the Administrative Law Judge, sales tax is imposed on receipts from every retail sale of tangible personal property under Article 28 of the Tax Law (Tax Law § 1105 [a]). Tangible personal property for resale is excluded from the definition of a retail sale (Tax Law § 1101 [b] [4]).

However, the Tax Law clearly sets out specific treatment of sales of tangible personal property to contractors for use or consumption in construction (*id.*; Tax Law § 1105 [c] [5]). The statute provides that the sale of tangible personal property to a contractor for use or consumption in construction is a retail sale and subject to sales and use tax, regardless of whether tangible personal property is to be resold as such or incorporated into real property as a capital improvement or repair (*id.*; *see also Matter of Swet*, Tax Appeals Tribunal, February 22, 1991). The regulation at 20 NYCRR 541.1 (b) confirms that such sales are subject to sales and use tax:

“The principal distinguishing feature of a sale to a contractor, as compared to a sale to other vendors who purchase tangible personal property for resale, is that the sale of tangible personal property to a contractor for use or consumption in construction is a retail sale and subject to sales and use tax, regardless of whether tangible personal property is to be resold as such or incorporated into real property as a capital improvement or repair.”

We agree with the Administrative Law Judge that Tre Potenti was acting as both a retailer of tangible personal property in the form of kitchen and bath construction materials while also

acting as a contractor for installation of capital improvements for some of its customers. Ultimately, Tre Potenti and petitioners as responsible persons were liable for sales or compensating use tax on the materials they purchased depending on the nature of the transactions in which those materials were used. If they were acting as contractors in a transaction, they are liable for the tax due on the purchases of the materials used or consumed in those capital improvement projects (*see* 20 NYCRR 541.13 [a] - [b]: “Retailers when installing tangible personal property which constitute a capital improvement are liable for the use tax based upon their cost for the property . . .”). This is because tangible personal property or services purchased at retail not already subject to sales tax (or that otherwise qualify for an exemption under Tax Law § 1115) are subject to a use tax under Tax Law § 1110 (a). Thus, as Tre Potenti did not pay sales tax on its purchases of materials for resale, it was liable for use tax on the materials it purchased for use in its capital improvement projects to the extent they had not already been subject to sales tax (20 NYCRR 531.3; *Matter of Alpha Window Systems, Ltd.*, Tax Appeals Tribunal, May 1, 1997).

It appears that petitioners are arguing that they purchase all materials as retailers because at the time of the purchase they do not know if the materials will be resold as merchandise or whether petitioners will act as the contractor in installing the materials. Petitioners’ argument that they should not be held liable for the tax in question due to their self-identification as retailers only and their particular understanding of taxpayer guidance on the issue is unavailing. After their purchase, any materials used in installing capital improvements made petitioners contractors regarding those materials and those purchases taxable as provided for in the statute and regulations (Tax Law § 1101 [b] [4] [i] [A]; 20 NYCRR 527.7 [b] [5]; *see also* Publication 862, “Sales and Use Tax Classifications of Capital Improvements and Repairs to Real

Property”³). Petitioners’ misinterpretation of the law, regulations or taxpayer guidance is not an excuse for nonpayment of the tax (*Matter of McGaughey*, Tax Appeals Tribunal, March 19, 1998, *affd sub nom. Matter of McGaughey v Urbach*, 268 AD2d 802 [2000]). Although petitioners here complain that presentation of capital improvement certificates lowered their profit margins, they could have accounted for that expense when providing estimates on their capital improvement projects. The clear language of the law and regulations provide that where materials are used in the performance of capital improvements, the purchase of the materials is subject to tax (Tax Law § 1101 [b] [4] [i] [A]; 20 NYCRR 541.13 [b]; 20 NYCRR 527.7 [b] [5]; *Matter of Lombard*, Tax Appeals Tribunal, March 6, 1997).

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Andrew Costabile, Ralph Costabile, and Michael Delponte is denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petitions of Andrew Costabile, Ralph Costabile, and Michael Delponte are denied;

and

4. The notices of determination L-039117477, L-03911747 5, L-039117474 and L-039117476, dated March 8, 2016, are sustained.

³ We note that the second paragraph of the introductory section of Publication 862 (4/01) clearly sets forth the obligations of contractors with regard to collection of sales tax on materials used in capital improvements: “If a contractor does a capital improvement for a customer and the customer provides the contractor with a properly completed Form ST-124, *Certificate of Capital Improvement*, no sales tax is required to be collected from the customer. On the other hand, when a contractor performs a job that constitutes a repair, maintenance, or installation service to real property, sales tax must be collected from the customer, unless the contractor receives a properly completed Form ST-119.1, *Exempt Organization Certification*, or other applicable exemption document.”

DATED: Albany, New York
April 14, 2017

/s/ Roberta Moseley Nero
Roberta Moseley Nero
President

/s/ James H. Tully, Jr.
James H. Tully, Jr.
Commissioner

/s/ Dierdre K. Scozzafava
Dierdre K. Scozzafava
Commissioner