

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition :

of :

SUPERMARKET GENERAL CORP. : DECISION
PATHMARK STORES : DTA NO. 819768

for Revision of a Determination or for Refund of Sales
and Use Taxes under Articles 28 and 29 of the Tax Law :
for the Years 1998 through 2001.

Petitioner Supermarket General Corp, Pathmark Stores, 200 Milik Street, Carteret, New Jersey 07008 and the Division of Taxation each filed an exception to the determination of the Administrative Law Judge issued on June 9, 2005. Petitioner appeared by Stevens & Lee (Michael A. Gruin, Esq., of counsel). The Division of Taxation appeared by Mark F. Volk, Esq. (Robert A. Maslyn, Esq., of counsel).

Petitioner filed a brief in support of its exception. The Division of Taxation filed a letter brief in support of its exception and in opposition to petitioner's exception. Petitioner filed a brief in opposition to the Division of Taxation's exception and a reply brief. The Division of Taxation filed a letter brief in reply. Oral argument, at the request of both parties, was heard on May 15, 2006 in New York, New York.

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

ISSUE

Whether the installation of refrigeration piping and condensation drains to serve petitioner's refrigerated cases, coolers and freezers in its New York stores constitutes tax exempt capital improvements.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for finding of fact "12" which has been modified and finding of fact "13" which has been deleted as unsupported by the record herein. The Administrative Law Judge's findings of fact and the modified finding of fact are set forth below.

During the years 1998 through 2001, petitioner operated 55 supermarket grocery stores in New York State at locations within the City of New York, Long Island, and the counties of Westchester and Rockland. It also operated such stores within the State of New Jersey. Of the 55 stores located within New York State, petitioner owned 4 of the stores and leased the remaining 51 stores. The four stores owned by petitioner during the years at issue were the Inwood store located at 410 West 207th Street, New York City (store no. 610); the Baldwin, New York store (store no. 623); the Seaford, New York store (store no. 625); and the Ozone Park, New York store (store no. 626).

During the years at issue petitioner purchased installation and maintenance services performed at its New York stores from various vendors. These services included the installation of refrigerated meat, fish, dairy and produce cases, as well as walk-in coolers and freezers ("the refrigerated fixtures"). Other services purchased by petitioner for its New York stores included the installation of security systems, plumbing fixtures, shelving, HVAC systems, doors, locks,

light poles and paving and repairs to parking lots. The installation of the refrigerated fixtures included the installation of refrigeration piping to connect each fixture with its associated compressor located on the roof or in a separate compressor room within the store, and the installation of drain pipes to carry away condensation from the cases, coolers and freezers.

Petitioner paid sales and use taxes to the Division of Taxation (“Division”) in relation to all the installation and maintenance work performed at its New York stores during the years at issue.

On or about April 16, 2001 petitioner filed a claim for refund, seeking a sales and use tax refund in the sum of \$461,190.17 based, in part, on its assertion that the installation services purchased constituted capital improvements to real property as defined in Tax Law § 1101(b)(9)(i).

On or about October 2, 2001 petitioner filed a separate claim for refund seeking a refund of sales and use taxes in the sum of \$166,606.14, based, in part, on its position that the installation services purchased by petitioner included capital improvements to real property.

By letter dated August 28, 2002 the Division granted, in part, petitioner’s initial claim for refund in the sum of \$122,009.67, while disallowing the balance of that claim in the sum of \$339,180.50.

By letter dated October 10, 2002 the Division partially granted petitioner’s second claim for refund in the sum of \$14,904.29, and disallowed the remainder of that claim in the sum of \$151,701.85.

Petitioner filed a timely request for a conciliation conference with the Bureau of Conciliation and Mediation Services (“BCMS”) as to that part of each of its refund requests that

was disallowed by the Division. BCMS consolidated the two proceedings and, on September 26, 2003, issued a conciliation order granting to petitioner a further refund of sales and use taxes in the sum of \$25,424.25, while disallowing the balance of petitioner's claims, as consolidated, in the sum of \$465,458.10.

On or about November 21, 2003 petitioner filed a petition for a hearing with the Division of Tax Appeals wherein it protested the BCMS refund denial.

In his opening statement at the hearing petitioner's representative limited the issue for resolution to whether the installation of refrigeration piping and condensation drains for the refrigerated fixtures by five named vendors¹ constituted capital improvements to real property. He conceded that no refunds are due for any of the installation services rendered by any of the other vendors whose invoices are included in the record, and that the amount of the claimed sales and use tax refund at issue in this proceeding is reduced to \$289,379.55.

We modify finding of fact "12" of the Administrative Law Judge's determination to read as follows:

¹The five vendors were AAA Refrigeration Service, Inc.; RAC Mechanical, Inc.; Engineering and Refrigeration, Inc.; Construction Maintenance Plus, Inc.; and Twin County HVAC/Refrigeration LLC.

In accordance with petitioner's policies, all of petitioner's refrigeration piping was connected to the compressor room by concealing the piping from view.²

When petitioner's leasehold interest in a New York store terminates or one of the stores owned by it is sold, the refrigerated fixtures are removed from the premises, and the refrigeration piping and condensation drainage systems are uniformly left in place with the pipe stub, that had been connected to the fixture, being cut off even with the wall or ceiling or floor and sealed over.

Were the refrigeration piping and condensation drainage systems to be removed from the walls, floors or ceilings, not only would these parts of the building structure be damaged by such removal, but the piping and drain lines so removed would have no value and be rendered unusable.

The record includes a copy of petitioner's standard lease agreement, the terms of which have been accepted by the parties as representative of all petitioner's supermarket leases during the years at issue. Section 10.2 of the lease agreement provides as follows:

10.2 All signs, counters, shelving, refrigerating and air-conditioning equipment, oil burners, trade fixtures, contents, and other store fixtures and equipment, which may at anytime be installed or placed in or upon the Demised Premises, by or at the expense of Tenant (or its subtenants or licensees), are and shall remain the property of Tenant (or its subtenants or licensees), and Tenant shall remove the same at any time on or prior to the Expiration Date of the term of this Lease, except as otherwise provided herein. All other property (including, without limitation, the Improvements) which may at any time be installed in or built on the Demised Premises, by or at the expense of

²We modified finding of fact "12" to more accurately reflect the record.

Landlord or Tenant (or its subtenants or licensees), shall be and remain a part of the Demised Premises and the property of Landlord and shall not be removed by Tenant (or its subtenants or licensees).

The term “improvements” is referenced in section 1.1 of the lease agreement as follows:

Any building now or hereafter built on the portion of the Land shown on Exhibit B attached hereto as the “Building Area” is herein called the “Tenant’s Building”, any buildings and improvements now or hereafter built on the Land (including without limitation, the Tenant’s Building) are herein collectively called the “Improvements”, the Land and the Improvements are herein collectively called the “Demised Premises”. . . .

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

In his determination, the Administrative Law Judge noted that the Tax Law imposes sales tax on the receipts from every sale on the service of installing tangible personal property unless such property when installed qualifies as a capital improvement. The Administrative Law Judge set forth the three-prong test which is required to be met in order to qualify as a capital improvement within the meaning and intent of the statute.

The issue in this case involves whether the installations of the piping and drainage systems qualified as capital improvements to the building. In reviewing a standard form lease agreement executed by petitioner, the Administrative Law Judge concluded that the piping and drains were improvements that were intended to remain a part of the premises and were permanently affixed to the property. The Administrative Law Judge further reasoned that given the improvements were permanently affixed and became the property of the landlord upon expiration of the lease, then it followed that such improvements were intended to be permanent. Therefore, the Administrative Law Judge determined that both the second and third prong of the capital improvement test were met.

At this point in his determination, the Administrative Law Judge shifted gears and moved back to addressing whether the first prong of the test was met. The first prong requires that the improvement substantially adds to the value of the property. The Administrative Law Judge addressed this factor by focusing on whether petitioner demonstrated that the leased premises were uniquely suited for supermarket use only and that such premises were, in fact, leased as such after the expiration of the leases with petitioner and whether the piping and drains were uniformly reusable in subsequent supermarket operations. The Administrative Law Judge found that petitioner did not meet its burden with respect to this factor. The Administrative Law Judge stated that if, for instance, the leased premises were to be later used as a furniture store, the piping and drains would serve no purpose to that particular lessee and as such, the piping and drains did not add value to the realty.

Yet, in juxtaposition to the leased property, the Administrative Law Judge determined that the previous rationale would not apply to the stores that petitioner owned in fee. The Administrative Law Judge explained that petitioner's installation of piping and drains in its own buildings clearly becomes a part of its own real property and does qualify as a capital improvement.³

The next argument addressed by the Administrative Law Judge was whether the sales tax paid on the piping and drains, as capital improvements, was separately stated as such on the invoices for the overall charge. In relying on *Matter of Dynamic Tel. Answering Sys. v. State Tax Commn.* (135 AD2d 978, 522 NYS2d 386, *lv denied* 71 NY2d 801, 527 NYS2d 767), the

³As set forth in the findings of fact, petitioner owned the real property for only four of the 55 stores discussed in this proceeding; the remainder were operating under lease agreements.

Administrative Law Judge stated that petitioner had the burden to show that the sales tax paid on invoices stating a single unapportioned charge covering a mixture of taxable and nontaxable services should be allocated between each class of service. The Administrative Law Judge reviewed nine invoices that related to the capital improvements installed at petitioner's own operated stores. Services performed by Engineering and Refrigeration, Inc. at petitioner's Ozone Park store were represented by three invoices. The Administrative Law Judge found that the charges for the taxable services were not separately stated and were subject to sales tax in their entirety. The next six invoices were issued to petitioner from AAA Refrigeration Service, Inc. for work performed at the Seaford store. Of these half dozen invoices, the Administrative Law Judge determined that the Division must refund the sales tax charged on the third and sixth invoices as these invoices clearly represented nontaxable services.

ARGUMENTS ON EXCEPTION

Both parties filed exceptions in this case. Petitioner argues that it established that it paid \$2.6 million on the improvements at issue herein. Therefore, petitioner reasons that there is no question that its installation substantially added value to the property. Thus, since the Administrative Law Judge concluded that prongs two and three of the test to determine whether an installation is a capital improvement have been satisfied, then all three prongs were certainly met and petitioner argues that it is entitled to a refund on the sales tax paid on the installation of the piping and drains at issue. Moreover, petitioner asserts that at no time during these proceedings was it ever an issue that the cost of the installation did not substantially add to the value of the real property. Petitioner states that there has never been a case decided where prongs two and three have been met and that prong one has not been established. Petitioner states that “the determination of the ALJ is wrong because it is unprecedented” (Petitioner’s reply brief and brief in opposition to the Division’s exception, p. 7).

With respect to the issue of the invoices reflecting a combination of taxable and non-taxable items, petitioner urges this Tribunal to remand this issue to the Administrative Law Judge for a hearing.

In its exception, the Division asserts that the Administrative Law Judge incorrectly determined that the refrigeration piping and drainage systems were permanently affixed to the real property. The Division points out that under the terms of the lease agreement, petitioner was required to remove all fixtures and equipment, including refrigeration equipment at the conclusion of the lease term. Thus, the Division states that such installations were not intended to be permanent and it follows that such installations do not qualify as capital improvements.

The Division also emphasizes that the only installations at issue involved the refrigeration piping and the drains. Thus, the Division argues that the Administrative Law Judge erred in addressing whether the installation of a temperature control system was an essential component of the refrigerated fixtures. Therefore, the Division states that the Administrative Law Judge incorrectly granted a refund on the sales tax paid with respect to the installation of such system.

In reply, petitioner argues that its position from the outset had focused on the installations relevant to the refrigeration systems and that issue necessarily included a review by the Administrative Law Judge of the sales tax paid on the installation of the temperature control system.

OPINION

Tax Law § 1105(c)(3) imposes sales tax on the receipts from every sale, except for resale, of the service of installing tangible personal property, except for installing property which, when installed, will constitute an addition or capital improvement to real property. The term “capital improvement” is defined in Tax Law § 1101(b)(9)(i) as:

An addition or alteration to real property which:

(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

(C) Is intended to become a permanent installation.

We will address the prongs of the test in the order in which they are set forth above.

The first prong requires that the installation of the piping and drains adds value to the real property. We agree with the Administrative Law Judge that petitioner has failed to prove its

installations substantially added to the value of the real property which it leased. Petitioner's mere argument that the items cost \$2.6 million for installation is irrelevant to the issue of whether such installation substantially adds value to the real property and such argument falls short in meeting petitioner's burden of proof required on this issue.

The second prong of the capital improvement test is whether the installation of the piping and drains was permanently affixed to the real property so that removal would cause material damage to the property or the article itself. We disagree with the Administrative Law Judge with respect to this factor.

As pointed out by the Division, exhibits "4"- "6"⁴ in the record clearly show that certain piping is not affixed and could be dismantled without causing material damage to the property. This situation is distinguishable from the facts in *Matter of Manufacturers & Traders Trust Co.* (Tax Appeals Tribunal, September 23, 2004) wherein the petitioner established that the installation of automatic teller machines (ATMs) required significant modifications to be made at the site of installation, either a hole had to be made through an outer wall of the bank building or a vestibule room had to be constructed in the interior of a building. The facts of this case are also distinguishable from the facts in *Matter of Emery Air Freight Corp.* (Tax Appeals Tribunal, October 17, 1991, *confirmed Matter of Emery Air Freight Corp. v. New York State Tax Appeals Tribunal*, 188 AD2d 772, 591 NYS2d 264) where the petitioner introduced voluminous testimony by two witnesses and photographs that established that certain components of the material handling system at issue were permanently affixed to the real property so that removal caused material damage to both the building and the handling system themselves. Specifically,

⁴These enumerated three exhibits contain the same 37 photos. One copy of the photos is in color.

the petitioner showed that some components were welded and bolted to specially-located building framing members. Other components were welded and bolted to heavier-than-normal roof framing members. Numerous components were located in special pits, embedded in the floor, or recessed into floor slab.

The case before us does not contain the level of proof that was introduced in either of the two cases outlined above and in looking at the photographs submitted into evidence in this case, it appears that some of the piping could be easily removed. As noted by the Division, the pictures show piping that is exposed and suspended from ceilings. Also depicted is piping passing through temporary walls of plywood or concealed behind a drop ceiling. We agree with the Division that removal of the pipes would not cause material damage to the property.

The last prong of the test that is required to be met in order to qualify as a capital improvement is that the installation must have been intended to be permanent. To determine whether, at the time of the installation, the intention was for such installation to be permanent, we focus our attention on the standard form lease agreement.

In our review of the lease agreement, we find that the Administrative Law Judge incorrectly held that the installations fell within the meaning of “improvements” under the lease. The lease agreement entered into as of March 26, 1999 contains a paragraph that describes the demised premises as follows:

1.1 Landlord hereby leases to Tenant and Tenant hereby hires from Landlord certain premises located at Castle Center, Eastchester Road and Waters Place, Bronx, New York, as more particularly described in Exhibit A attached hereto and made a part hereof (the “Land”), together with the improvements now or hereafter constructed thereon, together with any and all easements, appurtenances, rights and privileges now or hereafter belonging thereto. Any building now or hereafter built on the portion of the Land shown on Exhibit B attached hereto as the “Building Area” is herein called the “Tenant’s Building”,

any buildings and improvements now or hereafter built on the Land (including without limitation, the Tenant's Building) are herein collectively called the "Improvements", the Land and the Improvements are herein collectively called the "Demised Premises", and the portion of the Demised Premises other than the Tenant's Building and the portion of the Land thereunder is herein called the "Common Area". The Demised Premises shall at all times be as shown on Exhibit B attached hereto, except that Tenant may make changes thereto if the subject changes do not have an Adverse Effect and Tenant shall have given notice thereof to Landlord . . . (Exhibit "G").⁵

The Administrative Law Judge noted that although this section was inartfully drafted, he determined that the refrigeration piping and condensation drains, under the terms of this lease are "improvements" that are intended to remain a part of the demised premises and to become the property of the landlord upon the expiration of the lease. We are unable to read this distinction into this section defining "Demised Premises." Under Article 10 of the agreement, it discusses alterations to the property. Section 10.2 specifically states:

All signs, counters, shelving, refrigerating and air-conditioning equipment, oil burners, trade fixtures, contents, and other store fixtures and equipment, which may at anytime be installed or placed in or upon the Demised Premises, by or at the expense of Tenant (or its subtenants or licensees), are and shall remain the property of Tenant (or its subtenants or licensees), and Tenant shall remove the same at any time on or prior to the Expiration Date of the term of this Lease, except as otherwise provided herein. All other property (including, without limitation, the Improvements) which may at any time be installed in or built on the Demised Premises, by or at the expense of Landlord or Tenant (or its

⁵It is noted that this section of the lease defining "Demised Premises" refers to attached exhibits which further describe the property leased. This standard form lease agreement entered into evidence does not include any of the 17 attached exhibits referenced in the table of contents to the lease agreement.

subtenants or licensees), shall be and remain a part of the Demised Premises and the property of Landlord and shall not be removed by Tenant . . . (Exhibit “G,” pp. 16-17).

It appears to us that this section that addresses the alterations to the property considered refrigerating and air-conditioning equipment as something different than the improvements described in the section defining Demised Premises. Further, we interpret this section as requiring that the refrigeration piping and drainage systems be removed rather than an installation that would remain and become a part of the Demised Premises. As we concluded above in our discussion of the requirements to meet the second prong of the test, it is apparent that the piping shown in the photographs submitted into evidence could be easily removed without damaging the property. Therefore, in light of our interpretation of this lease, we cannot conclude that petitioner intended the installations at issue to be permanent.⁶

Thus, the installation of the refrigeration piping and condensation drains do not qualify as capital improvements and, thus, petitioner’s claim for refund with respect to these installations is denied.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Supermarket General Corp., Pathmark Stores is denied;
2. The exception of the Division of Taxation is granted;

⁶Since our conclusion finds that the installations at issue did not qualify as capital improvements, we do not reach the question of whether a refund on the installation of the temperature control systems was properly before this Tribunal for review.

3. The determination of the Administrative Law Judge is reversed;
4. The petition of Supermarket General Corp., Pathmark Stores is denied; and
5. The claim for refund, as modified by the conciliation order dated September 26, 2003, is denied.

DATED: Troy, New York
November 9, 2006

/s/Charles H. Nesbitt

Charles H. Nesbitt
President

/s/Carroll R. Jenkins

Carroll R. Jenkins
Commissioner

/s/Robert J. McDermott

Robert J. McDermott
Commissioner