STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
LIQUID CARBONIC INDUSTRIES CORPORATION F/K/A LIQUID CARBONIC SPECIALTY GAS CORPORATION	:	DECISION DTA No. 815427
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 December 1, 1990 through February 28, 1993.	:	

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on August 20, 1998 with respect to the petition of Liquid Carbonic Industries Corporation f/k/a Liquid Carbonic Specialty Gas Corporation, c/o Praxair, Inc., 39 Old Ridgebury Road, L-2, Danbury, Connecticut 06810-5113. Petitioner appeared by Audrey H. McCarthy, Esq., Associate Tax Counsel for petitioner and Lynn A. Kopnick, Esq., Corporate Tax Counsel for petitioner. The Division of Taxation appeared by Terrence M. Boyle, Esq. (James Della Porta, Esq. and Robert Tompkins, Esq., of counsel).

The Division of Taxation filed a brief in support of its exception. Petitioner filed a brief in opposition and the Division of Taxation filed a reply brief. Oral argument, at the Division of Taxation's request, was heard on June 10, 1999 in Troy, New York.

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

ISSUE

Whether petitioner's "loss of use" charges on unreturned or damaged gas cylinders are subject to sales tax pursuant to Tax Law § 1105(a).

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for findings of fact "4," "5," "7" and "11" which have been modified. We have also deleted finding of fact "12" as extraneous. The Administrative Law Judge's findings of fact and the modified findings of fact are set forth below.

Petitioner, Liquid Carbonic Industries Corporation (petitioner or "Liquid Carbonic"), formerly known as Liquid Carbonic Specialty Gas Corp. ("Specialty Gas"), has been authorized to do business in New York State since 1987. Prior to January 1, 1993, Liquid Carbonic was known as Specialty Gas. After January 1, 1993, Specialty Gas consolidated with other related companies, Liquid Carbonic Carbon Dioxide, Liquid Carbonic Industrial Medical and Liquid Carbonic Freezing Systems, to form Liquid Carbonic.

Petitioner's principal business activity is the production and sale of industrial, medical and specialty gases, including, but not limited to, oxygen, nitrogen and carbon dioxide. Its customers include physicians, hospitals, universities, hotels and users in the chemical industries.

Petitioner's gas products are sold in both bulk and packaged form. Bulk delivery is made with the gas shipped via petitioner's truck to a customer's storage vessel, usually located on-site at a customer's facility. Packaged form delivery refers to gas delivered to customers in pressurized stainless steel gas cylinders ("cylinders"). Petitioner's customers may supply their own cylinders for filling, or they may rent or lease petitioner's cylinders. Cylinders are equipped

with safety valves and require other control equipment in order for the customer to utilize the gas contained within. Cylinder size varies depending upon the contents and the intended use.

We modify finding of fact "4" of the Administrative Law Judge's determination to read as follows:

> Petitioner's rental charge for its cylinders depends upon the size and type of cylinder involved. Some cylinders are subject to demurrage (daily rate), while others are subject to a monthly rate. Petitioner collects sales tax from its customers on the cylinder rental charges.[1]

We modify finding of fact "5" of the Administrative Law Judge's determination to read as follows:

> At times, petitioner's customers lose, misplace or damage leased cylinders. When that occurs, petitioner charges a "loss of use" fee to the customer. The loss of use fee is based upon the type and size of cylinder involved. No sales tax is collected on the loss of use fee.[2]

The detailed loss of use charge appearing on each of petitioner's invoices includes the type, size and number of cylinders lost, as well as the unit price and amount due. The following statement appears in the lower right-hand corner of each invoice "[b]ailment contract as to cylinders is shown on the reverse side of delivery receipt."

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[1]We modified finding of fact "4" of the Administrative Law Judge's determination by deleting the penultimate sentence which referred to a time period after the audit period herein.

[2]We modified finding of fact "5" of the Administrative Law Judge's determination by deleting the example set forth therein..

We modify finding of fact "7" of the Administrative Law Judge's determination to read as follows:

> The "BAILMENT CONTRACT AS TO CYLINDERS" states, in pertinent part, as follows:
> :
> Liquid Carbonic [Specialty Gas] (seller) and the buyer agree to the following terms and conditions:
>
> * * *
>
> 2. Buyer shall, at the election of seller, either notify seller when a cylinder is empty and ready for pick-up, or return all cylinders promptly as emptied, freight prepaid by the buyer to the location from which the cylinders originated.
>
> 3. *Buyer is responsible for seller's cylinders, including valves and cylinder caps, while in the buyer's possession, and must return all seller's cylinders in the same condition as received (reasonable wear and tear excepted); failure to do so constitutes a breach of this contract. Buyer shall be liable for the loss, unaccountability, or destruction of, or for the repair or replacement of all damaged cylinders, valves and caps which are either damaged or not returned.*
>
> 4. Buyer agrees not to refill or permit any other person to use seller's cylinders, except as provided for in seller's distributor agreement.
>
> 5. Buyer agrees to pay seller for the use of the cylinders in accordance with seller's current schedule which may be revised from time to time.
>
> 6. Failure to pay either for product or for use of cylinders results in automatic cancellation of this bailment contract, and buyer shall promptly return all seller's cylinders, freight prepaid, to the location from which the cylinders originated. (Emphasis added.)[3]

[3]We modified finding of fact "7" of the Administrative Law Judge's determination by removing extraneous material.

On or about January 18, 1994, the Division of Taxation ("Division") commenced a sales tax field audit of the corporation's books and records for the period December 1, 1990 through November 30, 1993. Petitioner fully cooperated with the auditor, making its books and microfiche records available to him. The Division and petitioner agreed to a test of sales for the months of October 1992, for sales prior to January 1, 1993, and April 1993, for sales after January 1, 1993. The result of the test for the month of October 1992 revealed an additional tax due of $168.49, $91.16 of which is for tax due on loss of use charges and the remaining $77.33 is additional tax due on sales, which the auditor projected over nontaxable sales for the period December 1, 1990 to December 31, 1992. Additional tax of $344.05 was found to be due for the month of April 1993 and the result was projected over nontaxable sales for the period January 1, 1993 to November 30, 1993. According to the auditor's notes, expenses were not tested because they were determined to be immaterial. In addition, since petitioner did not have any facilities in New York State, capital assets were not reviewed.

The audit work papers indicate that the audit findings were discussed with members of petitioner's tax department and that petitioner did not agree with a tax being due on the loss of use charge. As a result, the auditor issued two statements of proposed audit adjustment, one for the agreed audit issue and the other for the disagreed audit issue. The Statement of Proposed Audit Adjustment issued for additional tax due on disagreed sales for the period December 1, 1990 through February 28, 1993 reflected a tax liability of $2,476.70, plus interest of $707.43,

for a total amount due of $3,184.13. The auditor determined the tax liability by multiplying an error rate of .0001746698[4] by $14,179,222.00, the base amount of sales for the audit period.

On May 8, 1995, the Division issued to petitioner a Notice of Determination of sales and use taxes due (L-010333301-5) for the period December 1, 1990 through February 28, 1993 for tax due in the amount of $2,476.70, plus interest due of $718.80, for a total amount due of $3,195.50.

We modify finding of fact "11" of the Administrative Law Judge's determination to read as follows:

> As noted above, petitioner was acquired by Praxair, Inc. in January 1996. Because of the merger and the resulting reorganization and relocation of its business, petitioner was unable to locate some of the documents contemporaneous with the audit period. The following documents, among others, were offered in evidence by petitioner to illustrate petitioner's practice with respect to loss of use charges: the Bailment Contract as to Cylinders, ***supra***; the Master Agreement for Cylinder Gases Between the Metropolitan Chicago Healthcare Council and Liquid Carbonic for the period January 1, 1996 through December 31, 2001 ("master agreement"); a Liquid Carbonic loss of use letter dated March 18, 1996, addressed to Atlantic City Medical Center ("loss of use letter") and the accompanying loss of use invoice; and a Praxair Distribution Inc. agreement dated June 1, 1997 between Praxair and John Carroll University ("Praxair agreement"). The master agreement, the Bailment Contract as to Cylinders and the Praxair agreement were also separately offered in evidence as Division exhibits. Documentary excerpts relevant to cylinders and loss of use fees follow.
>
> According to page 2 of the master agreement, Liquid Carbonic reserves the right to conduct an annual cylinder audit. If cylinders are found to be lost, then the customer is to be billed for "loss of use" for those cylinders. The loss of use rates effective

[4]The error rate was computed by dividing additional tax due on sales for the test month by total sales tested (91.16 ÷ 521,899.00).

January 1, 1996 were set forth. Page 5 of the master agreement contains a paragraph under the heading "Containers." According to the provisions of the container paragraph, the customer ("buyer") agrees, among other things, "to pay for the loss, unaccountability, or destruction of or for the repair or replacement of all damaged containers, valves and caps which are either damaged or not returned with the containers"; from "time to time" to allow Liquid Carbonic to inspect and count its containers on the buyer's premises; and upon the termination of the agreement, to immediately return all containers to Liquid Carbonic's plant within 30 days and pay for all missing or damaged containers, valves and caps.

The loss of use letter refers to an invoice for missing medical compressed gas cylinders and states in pertinent part:

> Monthly demurrage must be paid in full until cylinder loss is acknowledged by payment of Loss-Of-Use. Consequently any delay in payment of this invoice would mean that [the customer] agrees to continue paying demurrage on the missing cylinders.
>
> Cylinders bearing Liquid Carbonic neckrings [sic], trade marks or other ownership markings are not for sale. This invoice is for Loss-Of-Use and Liquid Carbonic in no way relinquishes any rights, title or interest to the cylinders. If an unaccounted cylinder is subsequently located please return it promptly to Liquid Carbonic. Loss-Of-Use credit would then be issued, less demurrage, from the time that payment was posted to your account until the time a missing cylinder is returned to Liquid Carbonic.

Paragraph 5 of the Praxair agreement sets forth the following terms concerning cylinders:

> (a) The Products will be delivered by Seller in cylinders. All cylinders will remain the property of Seller at all times.
>
> (b) Purchaser will not permit the refilling of any of the Seller's cylinders or containers by any third party with any substance, whether gas, liquid or solid.

(c) Purchaser will return all cylinders to Seller in a noncontaminated condition with valves tightly closed and sufficient residual pressure to prevent contamination. Purchaser will pay Seller for any loss of or damage to cylinders beyond normal wear and tear and for any cleanup of cylinders returned in a contaminated condition.

(d) Purchaser will pay rent or facility fee as outlined in Schedule 'A,' Seller may increase the amount of such charge to its then current standard rates at any time on 30 days' prior written notice. Rent shall be paid for each rented cylinder until it is returned or, if it is missing, until Purchaser pays for such cylinder in full at Seller's then current published price.

(e) Purchaser shall, from time to time, at the request of Seller, submit an accounting of cylinders delivered to Purchaser which have not been returned and shall permit Seller to enter its premises to verify such accounting. Purchaser shall pay Seller for any cylinders, which in Seller's opinion are damaged beyond repair or lost or stolen, at Seller's then current published prices.

(f) All cylinders delivered to Purchaser hereunder which have not been previously returned or paid for in full shall be returned to Seller within 30 days of the expiration or cancellation of this Agreement. Purchaser shall pay Seller, at Seller's then current published prices, for any cylinder(s) which are not so returned.

(g) Seller may enter Purchaser's premises and remove any of its cylinders which have not been returned to Seller within 30 days after the expiration or cancellation of this Agreement or at any time for non-payment of rent or for Purchaser's breach of this Agreement. Seller will not be liable for any damages resulting from such removal.[5]

[5]We have modified finding of fact "11" of the Administrative Law Judge's determination to more completely set forth the record.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The issue in this matter, the Administrative Law Judge stated, is whether the customer's payment of the loss of use charge for unreturned or damaged beyond repair cylinders constitutes a sale subject to tax under Tax Law § 1101(b)(5). The Administrative Law Judge found from the record that petitioner's rental of the cylinders created a bailment for mutual benefit. "The general rule of liability in a bailment for the mutual benefit of both parties is that the bailee is only responsible for a loss occasioned by its negligence, *absent an express agreement to the contrary*" (***Davis v. Lampert Agency***, 30 AD2d 299, 291 NYS2d 745, 746 [emphasis added]). However, a bailee may by contract assume greater responsibility for the bailed property "even to the extent of making himself an insurer, and it is his contract which must measure the extent of his liability" (***Allemania Fire Ins. Co. of Pittsburgh v. Keller Diamond Corp.,*** 101 NYS2d 9, 12, ***revd on other grounds*** 278 App Div 899, 104 NYS2d 875; ***see also***, ***Rapid Safety Fire Extinguisher Co. v. Hay-Budden Mfg. Co.,*** 37 Misc 556, 75 NYS 1008, ***affd*** 79 NYS 1145).

The record includes exhibits offered by the Division and petitioner (Exhibits "G" and "4," respectively) entitled "Bailment Contract As To Cylinders,"[6] as well as more current Liquid Carbonic and Praxair cylinder agreements. The Administrative Law Judge noted that, while the language in each of these contracts differs slightly, each contains provisions governing the customer's responsibilities with respect to petitioner's cylinders. The Administrative Law Judge found that under the terms of the various agreements, the customer is liable for damage or destruction of the cylinders, for whatever reason, and therefore is the insurer of petitioner's

[6]The Administrative Law Judge refers to this exhibit as the "Specialty Gas bailment contract," apparently referring to the fact that it relates to the Liquid Carbonic Specialty Gas Corporation.

cylinders (***see***, ***Rapid Safety Fire Extinguisher Co. v. Hay-Budden Mfg. Co., supra***). The Division's regulation gives examples of transactions which do not constitute a sale subject to tax (***see***, 20 NYCRR 526.7[a][5]). While petitioner's situation with respect to the imposition of the loss of use charge is not identical to the examples under 20 NYCRR 526.7(a)(5), the Administrative Law Judge found it sufficiently analogous to place the loss of use charge outside the scope of a sale subject to tax.

The Division argued that the loss of use charge is a substitute for demurrage which is subject to sales tax. The Administrative Law Judge rejected this argument and found that as bailor, petitioner is entitled to recover damages from its customers for conversion of the bailed property. The cylinder loss of use charge represents those damages. If the bailed property is returned to the bailor, the return must be considered in mitigation of damages (***see,*** 9 NY Jur 2d, Bailments and Chattel Leases, § 157). The Administrative Law Judge viewed the fact that petitioner credits some or all of the loss of use payment against its customer's demurrage charges as commendable. However, the Administrative Law Judge found that petitioner would be entitled to damages to the extent of any expenses it incurred to recover a cylinder, and in repairing that cylinder if it was recovered in a damaged condition. Moreover, petitioner's business decision to net the credited payment against the demurrage due on the returned cylinder does not change the character of the loss of use charge.

Based on the foregoing, the Administrative Law Judge found that petitioner's loss of use charges are not sales within the meaning of Tax Law § 1101(b)(5) and are not subject to sales tax.

ARGUMENTS ON EXCEPTION

The Division takes exception to that portion of the Administrative Law Judge's determination that sets forth the parties' positions. Specifically, the Division claims the statements of petitioner's arguments contained in paragraphs 13(c) and 15 of the determination are not supported by the record. However, the Division has not taken exception to any of the numbered findings of fact of the Administrative Law Judge.

The Division notes that the master agreement, the loss of use letter and the Praxair agreement in evidence are all dated after the audit period and "cannot be accepted as representative of any possible terms that may have applied to the transaction in the periods in issue" (Division's brief in support of exception, p. 6).

The Division contends, as it did below, that there is a transfer of possession of the cylinders to petitioner's customers such that the loss of use charges constitute receipts from a retail sale of tangible personal property subject to tax. The Division asserts that the customer may still have possession of a misplaced cylinder or one which is damaged beyond repair, but the customer has no further obligation to remit any monies for its possession of the cylinder. In essence, the customer has purchased the cylinder.

The Division also argues that petitioner has failed to prove that the loss of use receipts are not subject to sales tax. Since the loss of use charge is a form of demurrage, the Division urges, and demurrage charges are subject to sales tax, the receipts in question are subject to sales tax. Therefore, the Division states, since the lost or damaged cylinders remain in the customer's actual and exclusive possession, a taxable sale has occurred.

Petitioner counters that there is no sale of its cylinders upon the payment of the loss of use charge by its customers. It argues that customers who purchase gases enter into an agreement

which includes a bailment provision that enumerates the customer's responsibility for cylinders, valves and caps which are either damaged or not returned. Petitioner maintains that, pursuant to the bailment contract, its customers agree and consent to be liable for loss for whatever reason and consequently have become insurers of the cylinders. Petitioner asserts that the separately stated loss of use charges represent contract damages or indemnification for its lost property which are not subject to sales tax.

Petitioner states that the following happens once a cylinder is determined to be missing:

a. The customer is given the opportunity to locate the cylinder. Rent or demurrage charges continue to be billed until the customer acknowledges that the cylinder is lost. Upon acknowledgment, the loss of use charge is billed to the customer and the rental or demurrage charge is discontinued.

b. The loss of use charge may be separately billed or added to a customer's regular billing. At that time, the customer also receives a letter reiterating petitioner's loss of use policy, i.e., that the cylinders are not for sale, that the lost or misplaced cylinders remain petitioner's property, and that the payment of the loss of use charge in no way relinquishes any of petitioner's rights, title or interest to the cylinder.

c. If the customer subsequently finds the lost cylinder, the customer is required to return it to petitioner. Upon its return, the customer is credited for the loss of use charge, minus any rental or demurrage charge plus sales tax that would have been billed from the time the customer acknowledged its loss to the time it was returned.

Petitioner maintains that even though it makes every effort to recover its cylinders, it is unlikely to be able to do so because usually the cylinders are lost by customers in the course of business either through theft or other loss.

Petitioner also argues that the Division's contention that petitioner's customers retain possession of damaged beyond repair cylinders is in error. Petitioner points out that it makes the determination as to whether or not a particular cylinder is damaged beyond repair. Once petitioner makes such a determination, it retains the damaged cylinder and bills the customer the loss of use charge. Petitioner contends that it discards the damaged cylinder and removes it from its inventory. The damaged cylinder is never returned to the customer.

Petitioner also maintains that the loss of use charge and demurrage are separate charges and that the loss of use charge is not a substitute for demurrage. Petitioner contends that the evidence establishes that the loss of use charge is most similar to contract damages or compensation for indemnification for lost property and, therefore, is not a "sale" within the meaning of Tax Law § 1101(b)(5).

OPINION

We affirm the determination of the Administrative Law Judge.

The Division's arguments attack petitioner's evidence by stating that the master agreement, the Praxair agreement and the loss of use letter were all written after the audit period and, therefore, cannot be treated as probative here. Ordinarily, we would agree with the Division, but in this matter the Division's arguments are rejected.

First, most of petitioner's exhibits objected to by the Division were also offered in evidence by the Division as part of its case in chief. In fact, other than the audit report, all of the

Division's probative exhibits duplicate petitioner's exhibits. Specifically, the master agreement, the Praxair agreement and the Bailment Contract as to Cylinders were all separately offered as the Division's own exhibits. That being the case, the Division is deemed to have adopted petitioner's evidence and cannot now be heard to attack the quality of its own evidence. Further, while the Division argues against certain statements contained in the Administrative Law Judge's ***Summary of the Parties Positions*** as not being supported by the record, it has not taken exception to any of the Administrative Law Judge's numbered findings of fact, particularly finding of fact "11."

The exhibits offered by the Division establish that petitioner's customers have a continuing duty to return its cylinders, that the cylinders remain the property of petitioner, and that cylinders that are not returned or are damaged shall be paid for by the customer via the loss of use charge (***see***, Exhibit "F," ¶ 5[a], [e] and [f] and Exhibit "E," p. 5). By the terms of these agreements, it is clear that the Administrative Law Judge correctly found they reflect a bailment for mutual benefit, and that the loss of use payments are in the nature of an insurance payment and an incident of the customer's duties under the bailment contracts. The Administrative Law Judge correctly and fully considered each of the issues presented, and we can find no basis to modify her determination in any respect.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the Division of Taxation is denied;

2. The determination of the Administrative Law Judge is affirmed;

3. The petition of Liquid Carbonic Industries Corporation f/k/a Liquid Carbonic Specialty Gas Corporation is granted; and

4. The Notice of Determination (L-010333301-5) dated May 8, 1995 is hereby canceled.

DATED: Troy, New York
December 9, 1999

/s/Donald C. DeWitt
Donald C. DeWitt
President

/s/Carroll R. Jenkins
Carroll R. Jenkins
Commissioner

/s/Joseph W. Pinto, Jr.
Joseph W. Pinto, Jr.
Commissioner