

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petitions	:	
of	:	
MARSHALL FARMS USA, INC.	:	DETERMINATION
for Revision of Determinations or for Refunds	:	
of Sales and Use Taxes under Articles 28 and 29	:	
of the Tax Law for the Periods June 1, 1976	:	
through February 28, 1981 and March 1, 1981	:	
through February 28, 1986.	:	

Petitioner, Marshall Farms USA, Inc., Box 91, R.D. 1, North Rose, New York 14516, filed petitions for revision of determinations or for refunds of sales and use taxes under Articles 28 and 29 of the Tax Law for the periods June 1, 1976 through February 28, 1981 and March 1, 1981 through February 28, 1986 (File Nos. 800173 and 803958).

A hearing was held before Timothy J. Alston, Hearing Officer, at the offices of the State Tax Commission, 259 Monroe Avenue, Rochester, New York, on June 1, 1987 at 1:15 P.M., with all briefs to be submitted by September 18, 1987. Petitioner appeared by Harris, Maloney, Horwitz, Evans & Fox, Esqs. (Donald R. Fox, Esq., of counsel). The Audit Division appeared by John P. Dugan, Esq. (James Della Porta, Esq., of counsel).

ISSUES

I. Whether food, drugs, medicine and other items of tangible personal property purchased by petitioner for use or consumption in the raising of beagle dogs constituted purchases for resale under Tax Law § 1101(b)(4).

II. Whether such food, drugs, medicines and other items of tangible personal property purchased by petitioner qualify for the exemptions from sales and use taxes provided under Tax Law §§ 1105-B and 1210(a)(1).

FINDINGS OF FACT

1. Petitioner, Marshall Farms USA, Inc., was engaged in the business of breeding and

raising beagle dogs and ferrets for sale. The dogs were sold generally for research purposes with the principal customers being pharmaceutical companies, universities and government facilities located throughout the United States, Canada, Japan and Europe.

2. On June 20, 1981, as the result of a field audit, the Audit Division issued notices of determination and demands for payment of sales and use taxes due against Marshall Research Animals, Inc.¹ covering the period June 1, 1976 through February 28, 1981 for taxes due of \$91,446.64, plus interest of \$15,755.94, for a total of \$107,202.58.

3. On June 27, 1986, as the result of a second audit for the period March 1, 1981 through February 28, 1986, the Audit Division issued notices of determination and demands for payment of sales and use taxes due against petitioner for taxes due of \$122,535.81, plus interest of \$37,699.39, for a total of \$160,235.20.

4. The audit conducted for the period June 1, 1976 through February 28, 1981 disclosed additional taxes due as follows:

<u>Category</u>	<u>Tax Due</u>
(a) food and drug purchases	\$73,358.11
(b) recurring expense items	15,691.99
(c) fixed assets	2,629.07
(d) shipping materials	<u>(232.53)</u>
Total	\$91,446.64

5. In May 1984, the Audit Division commenced a second audit of petitioner's books and records. After the conclusion of the previous audit, the Audit Division changed its position with respect to the taxability of food and drugs consumed by ferrets. The ferrets were considered "fur-bearing" animals for purposes of the farming exemption under Tax Law § 1115(a)(6), and therefore, purchases of tangible personal property related to the breeding and raising of ferrets were exempt from sales and use taxes. On audit, the Audit Division determined that 71.5 percent of food and drug purchases was consumed by dogs. Based on an allocation of purchases, the additional tax due on food and drugs was \$88,488.95 and \$15,053.31, respectively. The audit

¹Petitioner was formerly known as Marshall Research Animals, Inc.

also revealed additional tax due on expense purchases of \$21,700.36 and on fixed asset acquisitions of \$661.55, and a credit due of \$3,368.36 for tax paid on exempt use of electricity.

6. The Audit Division conceded that the amount of tax assessed for the period June 1, 1976 through February 28, 1981 should be adjusted to \$65,384.42² by deleting the tax due on that portion of the purchases relating to the raising of ferrets (\$91,446.64 x 28.5%). The remaining issue on both audits involves the tax imposed on purchases of food, drugs, medicines and other items of tangible personal property used in connection with the raising of beagle dogs.

7. On June 30, 1986, the Audit Division received full payment of the notices issued June 27, 1986. On the same date, petitioner paid the notices issued June 20, 1981, as revised to \$65,384.42, plus interest accrued to June 30, 1986.

8. The dogs are housed at petitioner's facility in North Rose, New York, in specially built pens. The pens are in insulated, ventilated buildings specifically constructed to create individualized housing facilities for the dogs. The building area is surrounded by a protective fence in order to prevent any exposure to outside animals, thereby eliminating the possibility that the dog colony will come in contact with common parasites and diseases from other animals outside of the colony. The dog colony is a "closed colony" in that all animals are bred at petitioner's facility with no other animals having been brought into the colony since 1967. The colony population ranges from 8,000 to 10,000 dogs.

9. The breeding process utilizes a computerized genetic analysis and matching system to determine the suitability of selective matings. Each dog is appraised both as to its physical traits and its personality to determine if it is a suitable specimen. Blood values are analyzed to assure that the dog has no abnormality that would be passed on to the next generation. Past genetic reproduction is established and considered, as are traits of siblings and their offspring, prior generations, etc. Each dog is contrasted statistically to the computerized norm of the colony as a whole as to each material genetic trait in order to properly appraise the dog's genetic status.

²Petitioner's exhibit "2" allocates the revised deficiency into the proper categories.

10. The feed for the dogs consists of a dry ration formulated by Agway and mixed with a meat product. The dry ration is formulated with ingredients that contain the nutritional needs of the dogs. There are at least 40-plus nutrients that are essential to the growth and development of the dogs. These include amino acids, vitamins and minerals. Food is the vehicle whereby the dog is supplied, through the process of ingestion, digestion and assimilation, the specific nutrients that cells need for life. It is the cells that grow, divide and produce the products to convert fatty acids, amino acid residues and/or glucose or carbohydrates into energy. Deficiency or excess of the essential nutrients can cause abnormalities in the dogs and would make them unacceptable for sale. The average age of a dog when sold is six months.

11. The essential nutrients retain their physical identity and are detectable in the dogs following ingestion of the food. This would be accomplished by taking tissue biopsies or blood samples. However, not all the nutrients in the food are metabolized by the dog.

12. Petitioner submitted proposed findings of fact numbered 1 through 20. Proposed findings 2 through 7, 9, 10, 15, 16, 18 and 19 are accepted in whole and are incorporated herein; proposed findings 1, 8, 11 through 14, 17 and 20 are rejected as conclusory in nature.

CONCLUSIONS OF LAW

A. Tax Law § 1101(b)(4) defines retail sale as:

"(i) A sale of tangible personal property to any person for any purpose, other than (A) for resale as such or as a physical component part of tangible personal property...."

20 NYCRR 526.6 provides the following with respect to Tax Law § 1101(b)(4):

"(c) Resale exclusion. (1) Where a person, in the course of his business operations, purchases tangible personal property or services which he intends to sell...as a component part of other property or services, the property...which he has purchased will be considered as purchased for resale...."

* * *

(5) The purchase by a vendor of an item of tangible personal property which is sold by him as a physical component part of tangible personal property to a customer is a purchase for resale and therefore is not subject to tax."

Additionally, Tax Law § 1101(b)(6) and 20 NYCRR 526.8(4) define tangible property to include animals.

B. The dog food became a physical component part of the dogs within the meaning of the aforesaid statutes and regulations. "[T]he ordinary meaning of 'component' is broad enough to include detectable materials in a finished whole." (Finch, Pruyn & Co., v. Tully, 69 AD2d 192, 196.) As shown in Findings of Fact "10 and "11", detectable elements of the dog food were present in the dogs when sold. Although not all elements of the dog food remained in the dogs, it was enough that some elements did remain, for "the degree of consumption was not made a statutory factor" in determining the applicability of the resale exclusion (Finch, Pruyn & Co. v. Tully, supra, at 196). The same conclusion cannot be reached with respect to drugs, medicines and other items of tangible personal property as petitioner failed to establish that any detectable amounts of such items were present in the dogs when sold.

C. The Audit Division's argument that the dog food purchases did not fall within the resale exclusion because no single helping of dog food remained part of the dogs when sold fails, for the facts establish that some detectable portion of the nutrients which comprise the dog food was present in the dogs when sold by petitioner (Findings of Fact "10" and "11"). The dog food therefore became a physical component part of the dogs in light of Finch, Pruyn, supra. Nor does the fact that the dogs received many feedings prior to sale by petitioner compel a different result. The dogs are fed a certain amount of food prior to sale; a portion of that food becomes a component of the dogs and is present in the dogs when sold. The dog food was therefore purchased for resale within the meaning of Tax Law § 1105 and Finch, Pruyn.

D. The Audit Division also asserted that the existence of a sales tax exemption for farming supplies (Tax Law § 1115[a][6]) precludes the application of the resale exclusion to the dog food purchases at issue herein. The Audit Division's argument is unpersuasive. The existence of the farming exemption, which would exempt the purchase of certain animal food under certain circumstances, does not preclude the application of the resale exclusion to the purchase of certain other animal food under certain other circumstances (such as those presented herein). Tax Law §§ 1101(b)(4) and 1101(b)(6) and the regulations promulgated thereunder contain no language to restrict purchases of animal food from the application of the resale exclusion, unlike, for

example, the language of Tax Law §§ 1105(B) or 1210(a)(1) which do contain what may be interpreted as restrictive language (see Conclusions of Law "F" and "G", infra).

E. Additionally, in making its arguments, the Audit Division emphasized that the biological processes of ingestion, digestion and assimilation are different from physical combinations of inanimate matter, as were at issue in *Finch*, Pruyn. The Audit Division failed to point to any language in the relevant statutes or regulations to justify drawing a distinction for purposes of the resale exclusion between biological processes and physical processes.

F. Tax Law § 1210(a)(1) provides an exemption from local sales and use taxes for all sales of "tangible personal property for use or consumption directly or predominantly in the production of tangible personal property... for sale, by manufacturing, processing, generating, assembling, refining, mining...." Effective March 1, 1981, Tax Law § 1105-B provided an exemption from State sales and use taxes for supplies used or consumed directly and predominantly in the production of tangible personal property for sale by "manufacturing, processing, generating, assembling, refining, mining or extracting...." For the period September 1, 1980 through February 28, 1981, said section of the Tax Law provided for a reduced tax rate of two percent on such supplies.

G. The pertinent regulation defines manufacturing and processing as follows:

"(b) Manufacturing. Manufacturing is the production of tangible personal property that has a different identity from its ingredients. Manufacturing includes the production of standardized items as well as the production of items to a customer's specifications.

* * *

(e) Processing. Processing is the performance of any service on tangible personal property which effects a change in the nature, shape or form of the property." (20 NYCRR 531.2)

The breeding and raising of dogs involves the production of tangible personal property for sale; however, such operation does not constitute manufacturing, processing or any of the other activities enumerated in Tax Law §§ 1210(a)(1) and 1105-B. Accordingly, the exemptions provided under said sections of the Tax Law are not applicable to the purchases of drugs,

medicines and other items held subject to tax on audit.

H. The Audit Division was not bound by its interpretation of the Tax Law in Matter of Blue Spruce Farms, Inc. (supra). The fact that the Department chose not to assess the local tax on food and supplies in that case does not bar it from assessing the tax against petitioner (Savemart, Inc. v. State Tax Commission, 105 AD2d 1001).

I. The petitions of Marshall Farms USA, Inc. are granted to the extent indicated in Conclusion of Law "B"; the Audit Division is hereby directed to modify the notices of determination and demands for payment of sales and use taxes due issued June 20, 1981 and June 27, 1986 and refund the sums of \$50,069.38 plus applicable interest for the period June 1, 1976 through February 28, 1981 and \$88,488.95 plus interest covering the period March 1, 1981 through February 28, 1986; and, except as so granted, the petitions are in all other respects denied.

DATED: Albany, New York
March 17, 1988

ADMINISTRATIVE LAW JUDGE