

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :
of :
AUTOMATIQUE, INC. :
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 September 1, 1985 :
through May 31, 1988. :

In the Matter of the Petition :
of :
ROBERT A. LAUDICINA, :
OFFICER OF AUTOMATIQUE, INC. :
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 September 1, 1985 :
through May 31, 1988. :

DETERMINATION

In the Matter of the Petition :
of :
DONALD A. SILVERSTONE, :
OFFICER OF AUTOMATIQUE, INC. :
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 September 1, 1985 :
through May 31, 1988. :

In the Matter of the Petition :
of :
ARTHUR STEVENS, :
OFFICER OF AUTOMATIQUE, INC. :
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 September 1, 1985 :
through May 31, 1988. :

In the Matter of the Petition

of

WALTER S. WELYTOK,
OFFICER OF AUTOMATIQUE, INC.

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 September 1, 1985
through May 31, 1988.

Petitioners, Automatique, Inc., Robert A. Laudicina, Donald A. Silverstone, Arthur Stevens, and Walter S. Welytok, officers of Automatique, Inc., 3269 Roanoke Road, Kansas City, Missouri 64111, each 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 September 1, 1985 through May 31, 1988 (File Nos. 806584, 806585, 806586, 806587 and 806588, respectively).

A consolidated hearing was commenced before Frank W. Barrie, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on May 11, 1990 at 9:00 A.M. and continued to conclusion at the same location on May 17, 1990 at 10:00 A.M., with all briefs to be submitted by October 12, 1990. Petitioners appeared by Morrison, Hecker, Curtis, Kuder & Parrish, Esqs. (George G. Crawford, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Robert J. Jarvis, Esq., of counsel).

ISSUES

I. Whether recurring purchases by Automatique, Inc. of paper and plastic products which were, in turn, furnished by it to certain exempt organizations, along with bulk foodstuffs, were purchases for resale and thereby not subject to sales and use tax.

II. Whether recurring purchases by Automatique, Inc. of paper and plastic products which were, in turn, furnished by it to individual consumers at cafeterias operated by it for certain exempt organizations, were such critical elements of the final food products sold, so as to be purchases for resale and thereby not subject to sales and use tax.

III. Whether purchases by Automatique, Inc. of materials and equipment, which were installed at cafeterias operated by it for certain exempt organizations, were purchases for resale or, in the alternative, capital improvements, and thereby not subject to sales and use tax.

IV. Whether Automatique may claim a manufacturing exemption for the equipment purchased for use in its commissary for production of bulk foodstuffs.

V. Whether penalties imposed against petitioners should be abated.

FINDINGS OF FACT

The corporate petitioner, Automatique, Inc.¹ (hereinafter "Automatique"), is a Delaware corporation with three branches in the Midwest (Kansas City, St. Louis and Des Moines) and a New York City branch, which has been authorized to do business in New York since August 10, 1972. The New York City operation involves primarily food production, while the Midwest operation involves primarily vending machine services.

The Division of Taxation issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due dated November 18, 1988 against Automatique asserting tax due of \$81,890.79, plus penalty and

interest for the period September 1, 1985 through May 31, 1988. Similar notices, also dated

¹On August 1, 1989, Automatique changed its name to Ambassador Food Services Corporation.

November 18, 1988, were issued against each of the four named officers of Automatique. None of the officers challenged their status as persons required to collect sales tax on behalf of Automatique.

Automatique's records were adequate to warrant an audit method that utilized all records within the audit period. However, in lieu of such an audit of recurring purchases, Automatique agreed to the utilization of a representative test period audit method. Petitioners did not challenge the methodology of such estimated audit.

The field audit report summarized the results of the audit performed as follows:

	<u>Additional Taxable</u>	<u>Additional Tax Due</u>
Sales	\$ 50,846.00	\$ 4,194.79
Purchases/Expenses	692,944.00	57,167.88
Assets	<u>248,826.00</u>	<u>20,528.12</u>
Totals	\$992,616.00	\$81,890.79

The additional tax due for purchases/expenses was determined by a test of such expenses for the month of September 1987. An error percentage was calculated in relationship to gross sales for the test month and was then applied to gross sales for each quarter in the audit period.

According to the audit report:

"Vendor did not report purchases of plastic flatware, napkins, straws, and other supply items which were purchased and used by vendor on a recurring basis as tax exempt items." (Emphasis added.)

The additional tax due for sales was based upon the auditor's disallowance of nontaxable sales claimed of \$50,846.00 for the entire audit period:

"Vendor did not have exempt certificates on file, and the resale and exempt numbers relating to the nontaxable sales were found to be nonexistent in NYS Tax & Finance files."

The additional tax due for assets was based upon a detailed audit of the fixed asset purchases of Automatique during the entire audit period:

"Vendor did not pay any sales tax on the majority of its asset purchases from its suppliers for the audit period."

Subsequent to the issuance of the notices, the assessment was reduced by the Division of Taxation to \$67,588.59, plus penalty and interest. Petitioners are contesting only \$25,976.68 of

the \$67,588.59 asserted as due.² The \$25,976.68 includes the following sales and use taxes asserted as due:

<u>Amount</u>	<u>Description of Tax Asserted as Due</u>
\$ 9,967.75	Tax on recurring purchases of paper and plastic products which petitioners claim were resold to exempt organizations along with the sale of bulk foodstuffs
\$ 6,810.06	Tax on recurring purchases of paper and plastic products which petitioners claim were resold at cafeterias it operated for exempt organizations
\$ 3,286.07	Tax on purchases of items petitioners claim were installed as capital improvements to real property of exempt organizations or, in the alternative, were resold to such exempt organizations
\$ 1,149.14	Tax on purchases of equipment petitioners claim were resold to Brooklyn College
\$ 943.14	Tax on purchases of equipment petitioners claim were resold to Bronx Community College

²It appears that petitioner conceded liability for additional sales and use tax on certain recurring purchases of operating supplies and for repair and maintenance services, although the record does not include a clear explanation by either party concerning the conceded portion of the audit.

\$ 2,560.59	Tax on purchases of equipment petitioners claim were resold to Long Island University
\$ 1,259.94	Tax on purchases of equipment petitioners claim were for use in producing tangible personal property
<u>\$25,976.68</u>	Total

The \$9,967.75, which represents tax assessed on what petitioners claim were resales of paper and plastic products (napkins, stirrers, straws, utensils), as part of the sale of bulk foodstuffs to exempt organizations, is made up of the following:

	Tax Asserted as Due
1. New York City Human Resources Administration	
Crisis Intervention Services	\$6,508.17
Special Services for Children	259.82
Emergency Assistance Units	<u>980.06</u>
Total H.R.A.	\$7,748.05
2. Salvation Army	1,051.97
3. American Red Cross	<u>1,167.57</u>
	<u>\$ 9,967.59</u>

Automatique was the successful bidder on several proposals for bids for food services issued by the Human Resources Administration, Department of Social Services of the City of New York (hereinafter "HRA"). The HRA, as a governmental entity, was exempt from payment of sales and use taxes. Automatique introduced evidence of 10 formal contracts which it entered into with the HRA on the basis of its successful bids in accordance with HRA specifications. The HRA contracts provided for the furnishing of meals and other food and beverage products to facilities operated by the following subunits of the HRA:

Crisis Intervention Services (hereinafter, "CIS")
Economic Assistance Units (hereinafter, "EAU")
Special Services for Children (hereinafter, "SSC")

There were four CIS contracts in effect during the audit period as follows:

Petitioners' Exhibit	Period <u>Covered</u>	
Maximum <u>Amount</u>		
20-1	December 1985 through December 31, 1986	Unstated

20-2	January 29, 1987 through June 30, 1987	\$1,885,717.35
20-3	July 1, 1987 through August 31, 1987	\$1,885,717.35
20-4	September 1, 1987 through June 30, 1988	\$5,331,025.00

These contracts all required Automatique to prepare and deliver meals to family emergency centers at various locations throughout New York City. The meals were prepared and delivered by Automatique personnel in (steam-table type) aluminum foil pans, and approximately 80 people could be fed from one pan. Automatique personnel did not serve the meals and had no contact with the persons to whom the meals were served. Invoices for such meals were submitted to HRA on a weekly basis, and payment was made periodically by the City of New York.

The specifications in the CIS contracts included the following requirements regarding the products to be furnished:

Petitioners' Exhibit 20-1 (Page 52):

"3. The food must be delivered at the beginning of the serving period of each meal. The food for each meal must be delivered to the specifically designated Crisis Intervention Services employee or employees on duty, and a signed receipt must be obtained from such person(s). The identity of the staff person will be revealed upon the award of the contract. Crisis Intervention Services will call to inform the contractor, prior to the delivery of each meal, of the number of clients to be fed. The calls will be made at least two (2) hours prior to the scheduled serving time of each meal....

4. The contractor shall deliver all meals in large covered serving bins. Sandwiches must be wrapped in clear plastic wrappers. Food must be transported in vehicles equipped with refrigeration for the storage of cold foods, and with heaters for the storage of hot foods....

5. The contractor must provide steam tables at the Family Shelter to keep the food hot while it is served at the site. The contractor shall provide soup bowls as applicable, heavy duty sectioned paper plates, plastic flatware, packets of sugar, pepper, salt, margarine, slices of lemon and other necessary items with each meal. The contractor must also provide heavy duty trays for each person served at each meal. The contractor will be responsible for cleaning the serving bins and the heavy duty trays. At the contractor's option, the trays may be inventoried and stored at the site. All meals shall be served by the staff of Family Shelter." (Emphasis added.)

The other three CIS contracts included substantially identical specifications.

There were three EAU contracts in effect during the audit period as follows:

Petitioners' Exhibit Maximum <u>Amount</u>	Period <u>Covered</u>	
21-1	July 1, 1985 through June 30, 1986	Unstated
21-2	April 1, 1986 to June 30, 1987	\$602,321.69
21-3	August 1, 1987 to July 31, 1988	\$537,268.44

The EAU contracts included the following provisions:

Petitioners' Exhibit 21-1 (Page 52):

"Catering service for the provision of assorted sandwiches, whole milk and fruit juices seven (7) days per week as set forth in Exhibits Ia - Ih which are attached and made a part of this agreement for the Human Resources Administration Emergency Assistance Unit locations at 241 Church Street, New York, New York; 92-16 147th Place, Queens, New York; 414 E. 147th Street, Bronx, New York; and 114 Willoughby Street, Brooklyn, New York.... The number of sandwiches, whole milk and fruit juices that are stipulated in Exhibits Ia - Ih are to be delivered no later than 4:00 p.m. each day.

The food must be delivered to a specifically designated staff member of EAU and a signed receipt obtained from said staff person. The identity of the staff person will be revealed upon the award of the agreement. All food provided must meet quality standards set forth in the USDA codes which are attached hereto and made a part of this agreement (Attachment A). One half the number of sandwiches must be made with white bread, and one half with whole wheat bread. All sandwiches must be individually wrapped in clear plastic wrappers and transported in vehicles equipped for this service." (Emphasis added.)

The other two EAU contracts included substantially identical specifications.

The cover sheets for the proposals for bids for two of the three contracts were marked into evidence as part of petitioners' Exhibit "21". These cover sheets both refer to the service to be provided as a "catering service". The cover sheet for the contract covering the period July 1, 1985 through June 30, 1986 noted that the bidder was "(t)o furnish al [sic] labor and materials necessary and required for catering service."

There were three SSC contracts in effect during the audit period as follows:

Petitioners' Exhibit Maximum <u>Amount</u>	Period <u>Covered</u>
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22-1	February 4, 1987 to January 31, 1988	\$251,652.74
22-2	Date of Award through June 30, 1987	Unstated
22-3	March 20, 1987 through June 30, 1988	\$446,692.95

The SSC contracts required the delivery of "preplated frozen" meals to special service units of HRA at various specified locations. These contracts included the following provisions:

Petitioners' Exhibit 22-1 (Pages 80-81):

"4. The food must be delivered at the beginning of the serving period of each meal. At each site, the contractor shall deliver all food and supplies to the point or points and at the times specified by the Field Office Director or his/her designee. The food for each meal must be delivered to the designated employee on duty, and a signed receipt must be obtained for each such delivery. Upon the award of the contract, the contractor shall be informed of the identity of SSC staff members authorized to accept food deliveries. SSC will telephone to inform the contractor, prior to the delivery of meals, of the number of clients to be fed. The call will be made at least two (2) hours prior to the scheduled serving time of each meal as indicated in Exhibit II which is attached hereto and made a part hereof. Upon request, the contractor will provide meals for persons with special dietary requirements.

* * *

6. The contractor shall provide soup bowls as applicable, heavy duty sectioned paper plates, plastic flatware, packets of sugar, pepper, salt, margarine, slices of lemon and all other necessary items to complete each meal. The contractor will be responsible for cleaning the serving bins and the heavy duty trays. At the contractor's opinion [sic], the trays may be inventoried and stored at the location. All meals shall be served by the staff of SSC." (Emphasis added.)

Petitioners' Exhibit 22-2 (Page not numbered):

"4. Upon the award of the contract, the contractor shall be informed by the agency's Director of Institutional Field Service or his/her designee of the identity of the person/persons in charge of the special Diet Program. The agency shall order the meals on a per case basis (a case shall consist of 24 meals.) The designated person/persons will telephone the contractor, one week in advance of the requested delivery date to advise the Contractor of the number of cases of each particular meal needed at each location(s). All meals shall be delivered in a solid frozen state. Contractor shall not substitute for any ordered entree without the prior approval of person/persons in charge of the special diet program, [sic] Said substitution must be requested at least 48 hrs prior to a scheduled delivery.

5. The meals shall be delivered on a bi-weekly basis, Monday through Friday between the hours of 6:00 AM and 2:00 PM in accordance with the provisions of this paragraph and paragraph 4 above. Said Meals shall be delivered and off-loaded onto receiving platforms or at such other agency designated area at

each location. An invoice must accompany each delivery. The invoice must be signed by the designated HRA staff member and one copy left with said person." (Emphasis added.)

Petitioners' Exhibit 22-3: This SSC Contract related to the same locations as Exhibit 22-2 and represented an extension thereof.

A review of the pages from the latter two contracts, submitted into evidence as part of petitioners' Exhibit "22", does not disclose any explicit reference to the provision of paper products by Automatique. These contracts describe the scope of Automatique's performance in terms of it supplying preplated, frozen, and microwavable meals. Nonetheless, Automatique apparently provided all necessary paper goods and eating utensils.

None of Automatique's contracts with HRA involved service or transactional relationships between Automatique personnel and the persons to whom the meals were provided by HRA. All of the contract prices charged by Automatique to the HRA included all necessary paper goods, eating utensils and appropriate condiments.

Automatique also provided meals on a contract basis to the Salvation Army, a tax-exempt organization. Under the Salvation Army contracts, Automatique delivered meals, as prescribed in menus³ included in the contracts, in bulk form, to specified locations for service by Salvation Army personnel. The prices charged to the Salvation Army included paper goods (plates, bowls, cups and napkins) and eating utensils (plastic spoons, knives and forks). Under these contracts, Automatique was paid by the Salvation Army on a per diem basis per client served by the Salvation Army.

Automatique also provided meals to the Red Cross, a tax-exempt organization, for service to its clients at two family centers in New York City, pursuant to a letter agreement dated March 3, 1987. The letter agreement specified that the contract price included spoons and paper products, and also made clear that such meals were provided on a "drop-off" basis. Automatique's activities in performance of this agreement were

³These menus noted that paper goods and utensils were included.

essentially the same as those relating to the Salvation Army and HRA contracts. An Automatique invoice dated September 23, 1987 in the amount of \$689.38 was submitted to the Red Cross for paper plates, cups, cereal bowls, napkins and spoons provided and sold to the Red Cross by Automatique during the test period. No explanation was provided why, apparently in this one instance, a separate invoice was issued for paper and plastic goods.⁴ It appears that the usual practice was for Automatique to bill for such items as part of its overall charge and invoices did not separately show the price of paper and plastic products.

Sales and use tax in the amount of \$6,810.06 was asserted as due on Automatique's recurring purchases of paper and plastic products including plates, plastic utensils, paper cups, napkins and stirrers, which petitioners claim were resold at cafeterias operated by Automatique for tax-exempt entities including Brooklyn College, Bronx Community College, Long Island University⁵, Roosevelt Hospital and Elmhurst Hospital. Hot and cold food was prepared on site at these cafeterias on generally a Monday-through-Friday basis and included, for example, soups, salads, roast beef and stuffed chicken breasts.

Robert Laudicina, the corporate officer in charge of the New York City operation, testified that the cafeterias were staffed "sometimes by our employees and sometimes [particularly the hospitals] by the employees of the institution itself." He also estimated that approximately 30% of the cafeteria sales were part of a meal plan in which "the hospital or college would be invoiced at a later point...." The cost of the paper and plastic goods were

⁴Robert Laudicina testified that on two contracts, including one with the Red Cross, Automatique's charges were based on its total costs. Automatique would get 9 or 10 percent as a management fee. This might explain why the paper products delivered to the Red Cross in this instance were separately invoiced.

⁵Robert Laudicina in a letter dated June 25, 1986 confirming a renewal of Automatique's "current food service agreement for a 5 year period" with Long Island university noted that Automatique "will remain committed to maintain a responsive management team at the University". [Emphasis added.]

factored into the price of the meal and, according to Mr. Laudicina, represented 5% to 7% of the price charged.

Automatique's contract with Brooklyn College provided that cafeteria prices would correspond to "current price schedule and portion sizes that exist at Brooklyn College campus." Changes in pricing by Automatique had to be approved by the college.

During the audit period, Automatique purchased certain materials and equipment for installation on the premises of various tax-exempt organizations with which it had contractual arrangements for the provision of food and beverages. The two principal organizations for which such equipment was purchased and installed were Long Island University and Bronx Community College. The contractual undertaking of Automatique with respect to the installation at Long Island University is reflected in a letter agreement dated June 25, 1986 from it to the Dean of Administration of Long Island University confirming the renewal of Automatique's food service agreement for a five-year period commencing June 30, 1986. This letter contained the following commitment:

"Automatique, Inc will commence renovation and reconstruction of the dormitory cafeteria at the Brooklyn campus according to architectural drawings and specifications previously submitted by Automatique up to an amount not to exceed \$45,000.00."

The contractual undertaking with respect to installations at Bronx Community College is contained in a letter agreement dated March 31, 1986, originated by the Associate Dean of Administration and confirmed by Automatique. In connection with and in consideration of a five-year extension of Automatique's contract with Bronx Community College beyond June 30, 1986, Automatique was required to confirm the following commitment:

"[A]s indicated in your proposal, you will continue your capital improvement program which in the period of your relationship with Bronx Community College has clearly improved the efficiency of the food services operation, as well as enhanced the general ambience of the student cafeteria.

...Likewise, it is understood that as in the original contract, all capital equipment installed will become the property of the Association at the end of the five-year extension period."

Additional sales and use tax in the amount of \$3,286.07 was asserted as due on

purchases of items petitioners claim were installed as capital improvements to real property of exempt organizations or, in the alternative, were resold to such exempt organizations. The parties agreed upon the following listing as the items in dispute and the cost for such items:

<u>Purchase Invoice Number</u>	<u>Item</u>	<u>Amount</u>
<u>Long Island University</u>		
88-192	Ducted Exhaust Hood	\$ 2,800.00
88-21	Air Conditioner	916.00
88-23	Air Conditioner	916.00
86-126	Walk-in Cooler	2,000.00
87-73	Sprinkler System	1,200.00
86-128	Steam Table	388.00
88-75	Walk-in Refrigerator	2,200.00
87-82	Steam Table	775.00
87-79	Steam Cooker	8,610.00
		<u>\$19,805.00</u>
 <u>Bronx Community College</u>		
87-72	Sprinkler System	\$ 2,150.00
87-105	Compressor for Walk-in Cooler	1,200.00
86-110	Solar Shades	3,275.00
87-139	2 Steam Tables	750.00
87-142	2 Steam Tables	790.00
87-156	Sneeze Guard	140.00
88-72	2 Sneeze Guards	280.00
86-88	Salad Bar/Steam Table	2,095.00
		<u>\$10,680.00</u>

H.R.A.

87-114	Electrical Outlets - Counter	\$ 1,425.00
86-76	Refurbish Kitchen	2,100.00
86-113	Overdraw Board for Sink	<u>200.00</u>
		\$ 3,725.00
Brooklyn College 88-109	Lumber & Construction Materials [for the construction of counters]	\$ 266.22
Roosevelt Hospital 86-45	Lumber & Construction Materials [for the construction of counters]	\$ 754.90
College of Old Westbury 87-84	2 Sinks	\$ 950.00
Elmhurst Hospital 87-6	Air Conditioner	\$ 950.00
LaGuardia C. College 86-58	Compressor for Walk-in Cooler	<u>\$ 2,700.00</u>
		\$39,831.12
Sales and Use Taxes Assessed:		\$3,286.07

If the equipment was removed from Long Island University and Bronx Community College, they would no longer have cafeterias to serve their students. However, they could remove the equipment and place it somewhere else if they so chose. Mr. Laudicina testified that it might be possible to remove some of the equipment installed, but that certain items would not be worth much if removed. The walk-in cooler could be used in another location, but removal would be a considerable project.

Mr. Laudicina testified that all the items were installed as part of the consideration for Automatique's contracts with the various exempt organizations and irrevocably became the property of such entities. By way of illustration, he noted that Long Island University retained possession and control of the installed items during a two-year period in which it closed down its cafeteria.

In addition to the items described in Finding of Fact "14", supra, Automatique purchased during the audit period other equipment and furniture for installation in the cafeterias of

Brooklyn College, Bronx Community College and Long Island University. While petitioners concede that these items were not capital improvements, they were provided in consideration of the granting of food service contracts to Automatique. The parties agreed upon the following listing as the items in dispute and the cost for such items:

<u>Equipment Claimed Resold to Bronx Community College</u>		
<u>PURCHASE</u>		
<u>ORDER #</u>	<u>DESCRIPTION</u>	<u>COST</u>
88-128	Fryer	\$ 575.00
86-60	Beverage Air	695.00
86-56	16- Self Standing Screens	1,905.00
86-38	Sneeze Guard	900.00
86-38	Pastry Case	240.00
87-47	2 Work Tables	263.00
88-71	Pizza Oven	1,500.00
88-143	Freezer	450.00
88-142	2 Coffee Makers	378.00
87-138	Fryer	650.00
87-23	Slicer	700.00
87-21	Microwave	200.00
88-177	4 Food Warmers	516.00
86-103	Refrigerator	775.00
86-103	Salad Bar	690.00
86-41	Grill	300.00
86-41	Sandwich Counter	<u>695.00</u>
		\$11,432.00
	Tax Assessed	\$943.14

<u>Equipment Claimed Resold to Brooklyn College</u>		
<u>P.O. #</u>	<u>DESCRIPTION</u>	<u>COST</u>
88-125	Grill, Work Table, Sneeze Guards	\$ 1,575.00
88-115	Refrigerator	1,795.00
88-123	Refrigerator	1,100.00
88-123	2 Glass Cases	220.00
88-123	Bakers Rack	159.00
888-123	3 Work Tables	445.00
88-123	Bug Light	225.00
88-123	Food Warmer	110.00
88-124	2 Sneeze Guards, Time Clock	1,020.00
88-77	Various Cafeteria Equipment	<u>7,280.00</u>
		\$13,929.00
	Tax Assessed	\$ 1,149.14

<u>Equipment Claimed Resold to Long Island University</u>		
<u>P.O. #</u>	<u>DESCRIPTION</u>	<u>COST</u>
86-35	200 Sidex Chairs, 25 Table Tops	\$ 5,640.00
86-65	100 Table Bases	1,665.00
86-98	40 Sidex Chairs	1,008.00
86-99	18 Sidex Chairs	453.60
86-127	2 Cecilware Coffee Makers	658.00
86-129	1 Proofer	1,128.00
86-152	Refrigerator	1,690.00
87-16	Shelf, Steamtable	540.00
87-22	Menu Board	125.00
87-81	Proofer	1,180.00
87-83	Proofer	1,100.00
87-85	Sneeze Guard	270.00
87-86	2 Cash Registers	450.00
87-128	3 Work Tables, Soup Kettle, Cash Register Coffee Maker, 24" Stand	2,915.00
87-129	Microwave	225.00
87-130	Cabinet	295.00
87-131	Proofer	1,290.00
87-132	Hot Dog Roller	300.00
87-133	Mixer, Scale	750.00
87-135	Coffee Maker	400.00
87-136	Proofer	1,290.00
87-140	Proofer	1,290.00
87-141	Steam Table	450.00
87-144	Mixer	675.00
87-145	Refrigerator	500.00
87-146	Work Table Microwave	425.00
87-149	Coffee Maker	650.00
88-10	2 Metro Carts	450.00

88-74	Slicer Guard	175.00
88-76	2 Toasters	900.00
88-130	Food Processor, Pizza Oven	<u>2,150.00</u>
		\$31,037.60
	Tax Assessed	\$ 2,560.59

With respect to the items furnished to Brooklyn College, the consideration for the items furnished is contained in the "Interim Contract" dated July 31, 1987, between Automatique and Brooklyn College (through Brooklyn College Auxiliary Enterprises). This contract included the following provisions:

"PRODUCTION AND PRESENTATION: Automatique will install a full service counter for the presentation of a variety of foodstuffs, including breakfast items, soups, sandwiches, salads, grilled items, and entrees.

* * *

FINANCIAL ARRANGEMENTS: Automatique will guarantee \$2,500 per month in consideration of providing vending services, and commission of 5.5 percent of gross sales for manual food services at the Brooklyn Cafe. Commission monies will become payable to BCAE only after the first \$25,000 has accrued. Whatever commission earned up to \$25,000 will pay for food service equipment and counters needed to produce, maintain, and present foodstuffs at Brooklyn College. BCAE will not be liable for balance of commission if earned amount falls short of the \$25,000."

With respect to the items furnished to Bronx Community College, the contractual basis for Automatique's obligation to provide such items is reflected by Automatique's letter agreement dated March 31, 1986 with the college, as noted in Finding of Fact "14", supra. Similarly, with respect to the items furnished to Long Island University, the contractual basis for Automatique's obligation to provide such items is reflected by Automatique's letter agreement dated June 25, 1986 with the university, as noted in Finding of Fact "14", supra.

Automatique's internal auditor, Richard A. Mitchell testified that the cost of items purchased for and supplied to Brooklyn College was recorded in a special asset account which was amortized (reduced) as commissions were earned by BCAE over the life of the contract, reflecting the terms of the contract whereby BCAE was to pay the purchase price of the equipment by waiver of commissions (up to a maximum of \$25,000). Mr. Mitchell also testified that the items purchased for Bronx Community College and Long Island University

were erroneously recorded and depreciated as Automatique's capital equipment acquisitions rather than expensed. Nonetheless, the depreciation of these items was done in a manner similar to that by which items supplied to Brooklyn College were amortized.

Sales and use tax in the amount of \$1,259.94 was asserted as due on Automatique's purchases of equipment which petitioners claim was for use in producing tangible personal property. These purchases consisted of a work table grill, walk-in cooler and walk-in freezer at a cost of \$15,272.00 which were installed in Automatique's commissary in Long Island City and used entirely in the production of food for delivery and sale in bulk to its institutional purchasers, principally HRA. It was not used to produce food products for delivery and sale to consumers at institutions where Automatique operated cafeteria services.

Petitioners introduced into evidence the following analysis to show that the additional sales and use tax they have conceded of \$44,478.61 represents less than five percent of Automatique's total sales and use tax liability during the nearly three-year audit period:

Sales tax due on sales during audit period	\$647,622.38
Estimated sales tax due on purchases as per audit	<u>307,020.32</u>
Total tax liability for the audit period	954,642.70

Sales tax assessment audit period-sales	2,122.23
Sales tax assessment audit period-purchases	43,130.74
Sales tax assessment audit period-equipment	<u>22,335.62</u>
Total tax assessed on sales & purchases	67,588.59
Less-amounts contested	<u>23,109.98</u>
Conceded additional tax due	\$ 44,478.61
% of error	4.66%

The auditors refused to abate penalty because this was a subsequent audit to one for the period June 1982 through May 1985, and the audit report noted:

"[Automatique's] staff was operating under the premise that all of the fixed asset and recurring expense purchases were exempt. Vendor does not have any accounting staff or tax consultant in its New York City office that it could rely on to clarify what was taxable or nontaxable."

SUMMARY OF THE PARTIES' POSITIONS

Petitioners contend that Automatique was selling prepared food in bulk and necessary paper and plastic products to the HRA, the Red Cross and the Salvation Army and was not operating a food service on their behalf. Consequently, Automatique's recurring purchases of paper and plastic products used to satisfy their contractual obligations with these three entities were purchases for resale. They also assert that the decisions of the Court of Appeals in Burger King v. State Tax Commission (51 NY2d 614, 435 NYS2d 689) and in Celestial Food of Massapequa v. State Tax Commission (63 NY2d 1020, 484 NYS2d 509) are distinguishable because the paper and plastic products used by Automatique at its cafeteria operations were not merely a matter of comfort or convenience, but were critical and integral parts of the meals, especially plates and utensils, since hot and cold meals including soup, salads, roast beef and stuffed chicken breast were served. Further, petitioners argue that at cafeterias operated under a "meal plan", Automatique invoiced and received payment from the institution, not individual customers. Therefore, they argue that Automatique's purchase of paper and plastic products used for "meal plan" cafeterias were purchases for resale to the institution.

Petitioners also assert that Automatique's purchases of equipment and items used to construct and/or operate cafeterias were nontaxable because they were purchases of tangible personal property for resale to exempt organizations for which it operated the cafeterias and, in

the alternative, that certain of these purchases were nontaxable capital improvements.

Petitioners further contend that certain purchases of equipment which Automatique installed in its commissary were nontaxable because the equipment was used for the production of bulk food and "not restaurant food" and therefore comes under the exemption from sales tax for equipment used in the production of tangible personal property. Finally, petitioner argues that penalties should be abated because any tax deficiencies are slight compared to taxes paid.

The Division of Taxation contends that Automatique was not reselling paper and plastic products to tax exempt organizations but rather was providing a catering service to such entities. Automatique was therefore liable for sales tax on its recurring purchases of such products used in its catering service. Similarly, Automatique did not resell equipment used to construct and/or operate its cafeterias. Rather it purchased such equipment for use in its own cafeteria operations. It further asserts that Automatique lacked reasonable cause for its failure to report or remit the additional sales and use tax due.

CONCLUSIONS OF LAW

A. Sales tax is imposed upon the receipts from every retail sale of tangible personal property, subject to specified exemptions (see Tax Law §§ 1105[a]; 1115). A "retail sale" is 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..." (Tax Law § 1101[b][4][i][A]).

B. The above definition of retail sale explicitly excludes purchases of tangible personal property for resale as such. However, "(a)ny resale which is purely incidental to the primary purpose of the business is not a purchase for resale as such" (Custom Management v. New York State Tax Commission, 148 AD2d 919, 539 NYS2d 550).

C. Automatique's purchases of napkins, straws, stirrers, plastic knives, forks, and spoons (which appear to be the paper and plastic products at issue herein) are taxable. The sales tax regulations at 20 NYCRR 528.20(d), in keeping with the decisions of the Court of Appeals in Celestial Food of Massapequa v. State Tax Commission (63 NY2d 1020, 484 NYS2d 509) and

Burger King, Inc. v. State Tax Commission (51 NY2d 614, 435 NYS2d 689), specify with considerable detail the types of paper and plastic items which may be purchased under the resale exclusion:

"(d) Cups, plates and other containers, purchased by restaurants and other eating establishments for resale as containers.

(1) Cups, plates and containers for hot and cold drinks purchased for resale as a container of food or drink of any nature taxed under section 1105(d) of the Tax Law, and actually transferred to the purchaser of such food or drink, are purchased for resale and thus not subject to sales or use taxes.

(i) The following is a list, which is not intended to be all-inclusive, of packaging materials which may be purchased under the resale exclusion of the Tax Law:

- (a) sandwich wrappers;
- (b) cups and lids;
- (c) food sleeves;
- (d) disposable plates; and
- (e) paper bags.

(2) Napkins, straws, stirrers, plastic knives, forks, spoons and other similar items are not purchased for resale as such, nor are they packaging materials or supplies or components thereof. Purchases of these items by restaurants and similar establishments are not purchases for resale nor exempted from tax by paragraph (19) of section 1115(a) of the Tax Law and are subject to tax.

Example 1: A restaurant purchases napkins, straws and stirrers which are made available to its customers. The purchase of these supply items is subject to tax whether purchased for on- or off- premises consumption.

Example 2: A food vending machine operator purchases stirrers and napkins. Since these supplies do not become part of the products sold nor are they used to package the product, they are subject to tax."

D. Automatique's purchases of the paper and plastic items in dispute for its cafeteria operations are clearly subject to the imposition of sales tax. Petitioners argue that a distinction should be made between fast food restaurants and its cafeterias. For example, petitioners contend that an Automatique customer, who ordered a hot stuffed chicken dish, needed and expected plastic utensils in order to consume the meal. Nonetheless, it cannot be concluded that such plastic utensils were "such a critical element of the final product sold to customers" (Burger King v. State Tax Commn., *supra*, 435 NYS2d 689, 693). The Court of Appeals decision in Burger King was rooted in an earlier line of sales tax cases known as the "container cases". According to the Court of Appeals:

"(t)he nub of these cases is that a sale is not one at retail when a supplier sells containers to a wholesaler or manufacturer, who then sells his product packed in these containers either to a retailer or to an ultimate consumer" (*id.*, 435 NYS2d

689, 692).

Furthermore, Automatique's purchases of such plastic utensils for its cafeteria operation were "more akin to items of overhead, enhancing the comfort of restaurant patrons consuming the food products" (Celestial Food of Massapequa v. State Tax Commission, supra, 484 NYS2d 509, 510). The Court of Appeals in Celestial Food noted further that:

"(o)nly when, as in Burger King, such items are necessary to contain the product for delivery can they be considered a critical element of the product sold, and excluded from sales tax." (Id., 484 NYS2d at 510 [emphasis added].)

Further, the fact that Automatique might have invoiced Long Island University for "meal plan" participants rather than charging individual customers at the cash register, at the point of sale, does not alter the result. It is still Automatique that provided the food service to the individual customers. Petitioners' attempt to extend the reasoning of the former State Tax Commission in Matter of Seiler Corp. (State Tax Commn., September 13, 1985) is unpersuasive. In Seiler, the Commission had determined that certain so-called "function sales" were made by Seiler to the college, rather than to the individual group, with Seiler receiving payment on such sales from the college.

E. The issue concerning whether recurring purchases by Automatique, Inc. of paper and plastic products which were, in turn, furnished by it to certain exempt organizations, along with bulk foodstuffs, were purchases for resale is not as easily resolved. Unlike the taxpayer in Custom Management Corp. v. Tax Commission (supra), Automatique was not operating a food service facility. Rather, it was providing bulk foodstuffs along with necessary paper and plastic products. Although the CIS contracts and one of the SSC contracts specify that Automatique shall provide "plastic flatware", the other contracts do not appear to so specify. Further, the EAU contracts refer to Automatique as a "catering service". Consequently, it cannot be concluded that Automatique's purchases of paper and plastic products were being resold as such to these institutional customers (cf. Matter of Fannon & Osmond Photography, Inc., Tax Appeals Tribunal, July 19, 1990). Rather, it is reasonable to conclude that the provision of paper and plastic products were "purely incidental to the primary purpose of [Automatique's]

business" (Custom Management v. Tax Commission, supra).

F. On the other hand, petitioners have sustained their burden of proof to show that Automatique's purchases of the various items, noted with great detail in Findings of Fact "15" and "16", supra, were purchases of tangible personal property for resale as such (cf., Matter of D-M Restaurant Corp., Tax Appeals Tribunal, April 18, 1991 [where the Tribunal reasoned that the party who had right of ownership and control of the items in dispute was determinative]). Based upon the credible testimony of Robert Laudicina, it is concluded that once installed the items at issue became the property of the respective non-profit entities and could not be removed by Automatique. The fact that Automatique used the items in its operations does not alter the result because the institutions had the ultimate right of ownership and control over the items. However, one exception to this conclusion must be made for the equipment purchased by Automatique for installation at Bronx Community College. In this instance, notwithstanding the understanding of Mr. Laudicina, the contract as noted in Finding of Fact "14", supra, explicitly delayed taking of title to the equipment to "the end of the five-year extension period" (cf. UCC 2-401[2]). Consequently, these purchases must be viewed as first being made by Automatique for its own use at Bronx Community College with a later transfer of title to the college. Consequently the purchases in the total amount of \$10,680.00, as detailed in Finding of Fact "15" supra, and in the total amount of \$11,432.00, as detailed in Finding of Fact "16", supra, are subject to sales tax.

G. It is noted that petitioners failed to sustain their burden of proving that the items detailed in Finding of Fact "15", supra, were capital improvements to real property. Such items do not appear to have been "part of or permanently affixed to real property" (cf. Matter of Howard Johnson Co., Tax Appeals Tribunal, July 19, 1990; Matter of Dairy Barn Stores, Tax Appeals Tribunal, October 5, 1989).

H. It is also concluded that petitioners are entitled to claim a manufacturing exemption for the equipment purchased for use in Automatique's commissary for production of bulk foodstuffs. The food products produced in the commissary were sold as tangible personal

property, not as restaurant food (cf. Matter of Howard Johnson Co., supra).

I. Penalty and that portion of the interest which exceeds the minimum amount prescribed by law may be remitted if it is determined that the failure or delay to pay over any tax when due was due to reasonable cause and not due to willful neglect (Tax Law § 1145[a][1][iii], [vi]).

The grounds for reasonable cause are defined in the sales tax regulations to include:

"[a]ny...cause for delinquency which would appear to a person of ordinary prudence and intelligence as a reasonable cause for delay and which clearly indicates an absence of willful neglect..." (20 NYCRR 536.5[c][5]).

The burden of showing that there was reasonable cause and that the penalty was wrongly assessed is on petitioners.

Petitioners place emphasis, as noted in Finding of Fact "20", supra, on the fact that the amount of additional sales tax they conceded was due of \$44,478.61 represented less than 5% of the total sales tax due during the audit period of \$647,622.38 (irrespective of the \$25,976.68 contested herein). However, petitioners have not offered any explanation for their failure to pay over the proper amount of sales and use taxes due. In fact, the record does not disclose with specificity the basis for the tax due of \$44,478.61 conceded by petitioners. As noted in Finding of Fact "20", Automatique's staff treated all of its fixed asset and recurring expense purchases as exempt. In sum, petitioners have failed to sustain their burden of proving that such practice was reasonable (cf. Matter of Market Diners, Inc., Tax Appeals Tribunal, May 4, 1989). The absence of willful neglect and the extensive nature of petitioners' presentation herein do not provide sufficient grounds for abating penalties (20 NYCRR 536.5[a][3]).

J. The petitions of Automatique, Inc. and of Robert A. Laudicina, Donald A. Silverstone, Arthur Stevens and Walter S. Welytok, officers, are granted to the extent indicated in Conclusions of Law "F" and "H", supra, and the Division of Taxation is directed to modify the notices of determination and demands for payment of sales and use taxes due dated November 18, 1988 accordingly. Except as so granted, the petitions are in all other respects denied.

DATED: Troy, New York

ADMINISTRATIVE LAW JUDGE