STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
LIQUID CARBONIC INDUSTRIES CORPORATION F/K/A LIQUID CARBONIC SPECIALTY GAS CORPORATION	:	DETERMINATION 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.	:	

Petitioner, Liquid Carbonic Industries Corporation f/k/a Liquid Carbonic Specialty Corporation, c/o Praxair, Inc.,[1] 39 Old Ridgebury Road, L-2, Danbury, Connecticut 06810-5113, 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 December 1, 1990 through February 28, 1993.

On September 1, 1997 and September 12, 1997, respectively, petitioner, appearing by Lynn D. Kopnick, Esq., corporate tax counsel and Audrey H. McCarthy, Esq., associate tax counsel, and the Division of Taxation appearing by Steven U. Teitelbaum, Esq. (Marvis A. Warren, Esq., of counsel), waived a hearing and agreed to submit the matter for determination based on documents and briefs to be submitted by February 24, 1998, which date commenced the six-month period for the issuance of this determination. After review of the evidence and

[1]Petitioner in this matter is Liquid Carbonic Industries Corporation, formerly Liquid Carbonic Specialty Gas Corp., a wholly-owned second-tier subsidiary of Praxair, Inc. In January 1996, Praxair, Inc. acquired Liquid Carbonic Industries Corporation.

arguments presented, Winifred M. Maloney, Administrative Law Judge, renders the following determination.

ISSUE

Whether the Division of Taxation's determination that petitioner's "loss of use" charges are subject to sales tax pursuant to Tax Law § 1105(a) was proper.

FINDINGS OF FACT

1. 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.

2. 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.

3. 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.

4. 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. For example, in September 1993, petitioner, in its contract with First Environment, agreed to a rental charge of $.23 per day per cylinder with 15 free days.[2] Petitioner collects sales tax from its customers on the cylinder rental charges.

5. 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. For example, according to the invoices for October 1992 petitioner's rates for the loss of use of cylinders included the following: type 31 Medial D and E size cylinder at $105.00 per cylinder; type 01 High pressure cylinder at $250.00 per cylinder; and type 60 Carbon Dioxide cylinder at $250.00 per cylinder. No sales tax is collected on the loss of use fee.

6. 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."

7. A single-sided copy of an undated Specialty Gas document containing separate titled sections is part of the record.[3] The section entitled "BAILMENT CONTRACT AS TO CYLINDERS" sets forth, in pertinent part, the following:

> Liquid Carbonic [Specialty Gas] (seller) and the buyer agree to the following terms and conditions:

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[2]The record is silent as to the type and size of cylinder which petitioner was renting to First Environment.

[3]It is unclear whether this document originally was the reverse side of petitioner's purchase agreement or was the reverse side of the delivery receipt.

* * *

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.

* * *

8. Buyer agrees to indemnify and save seller harmless against all loss or damage to persons or property involving the cylinders or contents thereof, furnished by the seller, from the time of acceptance of delivery until return thereof to the seller. (Emphasis added.)

8. 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.

9. 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.

10. 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.

11. 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

[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).

to locate some of the documents contemporaneous with the audit period. The following documents, among others, were submitted to illustrate petitioner's practice with respect to loss of use charges: 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"). Documentary excerpts relevant to cylinders and loss of use fees follow.

According to page 2 of the master agreement, Liquid Carbonic reserved the right to conduct an annual cylinder audit. If cylinders were found to be lost, then the hospital was to be billed for "loss of use" for those cylinders. The loss of use rates effective January 1, 1996 were set forth. Page 5 of the master agreement contains various paragraphs including one entitled "Containers". According to the provisions of the container paragraph, the buyer agreed, 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 references 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 Atlantic City Medical Center, Mainland Division, 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.

12. Under the terms of the master agreement, demurrage rates varied from $.105 per day per cylinder for type 30 or 31 cylinders with a 40-day free loan to $.235 per day per cylinder for type 80, 81 or 85 cylinders with a 40-day free loan. According to the master agreement, the replacement cost was $81.00 per cylinder for cylinder types 30, 31 and 80 and $223.00 for cylinder types 32, 33, 81 and 85.

SUMMARY OF THE PARTIES' POSITIONS

13. Petitioner contends that the Division erroneously characterized the loss of use charge as a sale subject to sales tax. Petitioner asserts 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 in package form usually 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 argues that the purpose of the loss of use charge is not to penalize its customers; rather, it is to discourage customers from losing cylinders. It maintains that there are three circumstances in which cylinders may be found to be missing and a loss of use charge incurred. The first, and most common, occurs when a customer fails to return a cylinder for refill. The second occurs when petitioner conducts a periodic audit or inventory count of cylinders. The

third circumstance occurs at the termination audit which takes place when a customer's business needs change or its supplier changes. Petitioner contends 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. "Depending on the length of time a cylinder has been missing, the demurrage or rental charges could exceed the loss of use charge." (Petitioner's brief, p. 8.)

14. The Division contends that in the instant case there is a transfer of possession such that the loss of use charges constitute receipts from a retail sale of tangible personal property subject to tax. It argues that after the loss of use charge is paid, the customer is not required to make any further payments of any kind. 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. The customer has actual and exclusive possession of the cylinder. In essence, the customer has purchased the cylinder.

The Division also contends that petitioner in its loss of use letter raises a new policy which should not be afforded any weight because (1) the letter was written outside the audit period and after the Notice of Determination was issued; and (2) the letter raises the issue of parol evidence. Alternatively, the Division argues that, even if the parol evidence rule is inapplicable and the loss of use letter was written during the audit period, petitioner's policy fails to prove that the loss of use receipts are not subject to sales tax. It asserts that if the cylinder is returned and demurrage has actually accrued, the loss of use payment will be netted against demurrage. The Division argues that the loss of use charge appears to be a substitute for the demurrage which is subject to sales tax. Since the loss of use charge is a form of demurrage and demurrage charges are subject to sales tax, the receipts in question are subject to sales tax. Additionally, the Division asserts that the customer has only a conditional obligation to return the cylinder to petitioner, i.e., "only *if* the customer subsequently finds the lost cylinder" (Division's brief, p. 8; emphasis in original). It argues that petitioner does not have any expectation that a cylinder, which remains lost or stolen, or is damaged beyond repair, will be returned to petitioner. The Division also asserts that there is no evidence in the record that petitioner takes any affirmative steps to find lost, stolen or damaged beyond repair cylinders. Therefore, since the cylinder remains in the customer's actual and exclusive possession, a taxable sale has occurred.

15. In its reply brief, petitioner argues that the Division has failed to fully comprehend either petitioner's cylinder business, or its loss of use policy. Petitioner contends that when a customer pays a loss of use charge for a missing cylinder, the customer is acknowledging that it

no longer has physical possession of the cylinder. 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. However, it argues that it expects its customers to make every reasonable effort to locate the lost cylinders. It contends that, many times, competitors find and return cylinders to petitioner, and that it also returns lost cylinders to its competitors.

Petitioner also argues that the Division's contention that petitioner's customers retain possession of damaged beyond repair cylinders is not true. Petitioner asserts 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. It asserts that the damaged cylinder is never returned to the customer.

Petitioner 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. It also contends that its loss of use policy has been in effect since it began doing business. Moreover, petitioner asserts that its loss of use policy is standard within the industrial gas industry. Petitioner contends that the evidence clearly 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).

CONCLUSIONS OF LAW

A. Tax Law § 1105(a) imposes a sales tax upon "[t]he receipts of every retail sale of tangible personal property, except as otherwise provided by this article."

Tax Law § 1101(b)(5) defines a sale as

> [a]ny transfer of title or possession or both, exchange or barter, rental, lease or license to use or consume . . . conditional or otherwise, in any manner or by any means whatsoever for a consideration, or any agreement thereof, including the rendering of any service, taxable under this article, for a consideration or any agreement thereof.

B. 20 NYCRR 526.7(a) defines sale in pertinent part, as:

> (1) . . . any transaction in which there is a transfer of title or possession, or both, of tangible personal property for a consideration.
>
> (2) . . . exchanges, barters, rentals, leases or licenses to use or consume tangible personal property.
>
> * * *
>
> (5) The term *sale* does not apply to the transfer of tangible personal property to a carrier, repairman, warehouseman or insurer by the owner of the property after payment for damages thereto or loss thereof.
>
> *Example* 1: A carrier, while transporting tangible personal property for a customer, damages the property. The carrier then makes a cash payment to the customer for the amount the customer paid for the property, and retains the damaged property. The retention of the property by the carrier is not a sale.
>
> *Example* 2: A motor vehicle is damaged in an accident, and the insurer considers it a total loss. The insurer pays the owner cash, and takes the vehicle. The taking of the vehicle by the insurer is not a sale. The purchase of another vehicle by the owner of the damaged vehicle, with the proceeds of the insurance is a retail sale.

C. The crux of the issue in this matter is whether the customer's payment of the loss of use charge for lost or damaged beyond repair cylinders constitutes a sale subject to tax under Tax Law § 1101(b)(5). There is no dispute that the title to the cylinders remains with petitioner. However, the Division contends that after the loss of use charge is paid, the customer is not required to make any further payments of any kind, even if the customer still has possession of a misplaced or damaged beyond repair cylinder. It argues that at that point the customer has actual and exclusive possession of the cylinder and, in essence, has purchased it. Petitioner argues that

a sale has not taken place; rather the loss of use charge represents the customer's obligation as bailee under the cylinder agreement.

D. It is clear 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. Lambert Agency, Inc.,*** 30 AD2d 299, 291 NYS2d 745, 746). 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. v. Keller Diamond Corp.,*** 101 NYS2d 9, 12, ***revd on other grounds*** 278 App Div 899, 104 NYS2d 875; ***Rapid Safety Fire Extinguisher Co. v. Hay-Budden Mfg. Co.,*** 37 Misc 556, 75 NYS 1008, ***affd*** 77 App Div 643, 79 NYS 1145). The record includes an undated Specialty Gas bailment contract, as well as more current Liquid Carbonic and Praxair cylinder agreements. While the language in each of these contracts differs somewhat, each contains provisions pertaining to the customer's responsibilities with respect to petitioner's cylinders. Under the terms of these various agreements, the customer is liable for damage or destruction of the cylinders, for whatever reason, and therefore is the insurer of petitioner's cylinders (***see***, ***Rapid Safety Fire Extinguisher Co. v. Hay-Budden Mfg. Co., supra***). As noted above, 20 NYCRR 526.7(a)(5) gives examples of transactions which do not constitute a sale subject to tax. 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), I do find it to be sufficiently analogous to place the loss of use charge within the scope of the regulation.

As noted previously, the Division also argues that the loss of use charge is a substitute for demurrage which is subject to sales tax. This argument is based upon petitioner's policy of

crediting a customer's account with the loss of use payment when a cylinder is returned, assessing demurrage to the date of return and netting the credited payment against the demurrage. The Division's argument is without merit. 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 fact that petitioner credits some or all of the amount of the loss of use payment against its customer's demurrage charges is commendable. 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. The demurrage it collects on any returned cylinders is subject to sales tax.

Based on the foregoing, I find that petitioner's loss of use charges are not sales within the meaning of Tax Law § 1101(b)(5).

E. The petition of Liquid Carbonic Industries Corporation f/k/a Liquid Carbonic Specialty Gas Corporation is granted and the Notice of Determination (L-010333301-5) dated May 8, 1995 is hereby canceled.

DATED: Troy, New York
August 20, 1998

/s/ Winifred M. Maloney
ADMINISTRATIVE LAW JUDGE