STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :

of :

UPSTATE FARMS COOPERATIVES, INC.
F/K/A UPSTATE MILK COOPERATIVES, INC. :

: DETERMINATION

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, 1993 through August 31, 1995. : DTA NO. 816340

Petitioner, Upstate Farms Cooperatives, Inc. f/k/a Upstate Milk Cooperatives, Inc., 7115 West Main Street, LeRoy, New York 14482-9352, 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, 1993 through August 31, 1995.

A hearing was held before Frank W. Barrie, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on January 12, 1999 at 9:15 A.M., with all briefs to be submitted by July 30, 1999, which date began the six-month period for the issuance of this determination. Petitioner appeared by Christopher M. Potash, Esq. The Division of Taxation appeared by Terrence M. Boyle, Esq. (at the hearing by Brian J. McCann, Esq., of counsel, and on the brief by James Della Porta, Esq., of counsel).

ISSUES

I. Whether purchases of milk cases by petitioner, a milk processor and distributor, for use in its delivery of milk to its customers were exempt from sales tax under Tax Law § 1115(a)(19), which provides an exemption from tax for cartons, containers and wrapping and

packing materials for use and consumption by a vendor in packing tangible personal property for sale and actually transferred by the vendor to the purchaser.

II. Whether, in the alternative, petitioner's purchases of milk cases were purchases for resale and not subject to sales tax because the cases were resold by petitioner to its customers.

III. Whether the Division of Taxation should be estopped from imposing sales tax on petitioner's purchases of milk cases because (i) in a prior audit of petitioner's predecessor, such purchases were not subject to tax, and (ii) similar purchases by other milk processors and distributors have never been subject to tax.

FINDINGS OF FACT

1. Petitioner, which is owned by approximately 430 small dairy farmers in the western part of New York State, processes and distributes milk and dairy products to various retailers, including the Wegman's supermarket chain, and to institutional customers, such as hospitals and nursing homes. Petitioner operates three milk bottling plants located in Buffalo, Rochester and Jamestown, respectively. During the two-year period at issue,[1] petitioner had gross sales of approximately $50,000,000.00, none of which were subject to sales tax. However, on audit, the Division of Taxation ("Division") determined that certain *purchases* made by petitioner were subject to sales tax.

2. The Division issued two statements of proposed audit adjustment against petitioner. One dated January 21, 1997 asserted sales and use taxes due of $27,463.19 plus interest on petitioner's purchases of certain fixed assets and recurring expenses for the three-year period June 1, 1993 through May 31, 1996, which has not been contested by petitioner. The second

[1] Although the period audited consisted of the three-year period, June 1, 1993 through May 31, 1996, petitioner has contested tax determined due by the Division of Taxation during only the two-year period at issue, September 1, 1993 through August 31, 1995.

dated February 6, 1997 asserted sales and use taxes due of $59,077.39 plus penalty and interest on petitioner's purchases of milk cases[2] and dollies totaling $738,467.63 for the two-year period September 1, 1993 through August 31, 1995.

3. The Division issued a Notice of Determination, dated March 24, 1997, against petitioner asserting sales and use taxes due in the total amount of $59,077.39, which corresponds to the amount asserted due in the second statement of audit adjustment noted in Finding of Fact "2", plus interest. The notice did *not* assert any penalties against petitioner.[3] Tax asserted due was detailed by sales tax quarters as follows:

Tax Period Ended	Tax Asserted Due
November 30, 1993	$14,198.04
February 28, 1994	8,712.46
May 31, 1994	3,920.88
August 31, 1994	3,436.33
November 30, 1994	1,634.56
February 28, 1995	12,712.32
May 31, 1995	9,641.39
August 31, 1995	4,821.41
Total	$59,077.39

4. Of the total sales and use taxes asserted due by the Notice of Determination dated March 24, 1997 of $59,077.39, the parties stipulated that $56,311.81 relates to petitioner's

[2] The milk cases at issue also have been referred to as milk *crates* in the record. In their stipulation of facts dated December 30, 1998 by petitioner's representative and December 31, 1998 by the Division's representative, the items at issue have been referred to as milk *cases* by the parties and are similarly described by the regulation of the Department of Agriculture and Markets cited in the stipulation. Consequently, this terminology has been used in this determination.

[3] Nonetheless, petitioner argued in its brief that penalties should not be imposed.

purchases of milk cases, and $2,765.58 relates to petitioner's purchases of dollies used to deliver milk. Petitioner contested only $56,311.81 of the total tax asserted due by the Notice of Determination of $59,077.39, thereby conceding that sales and use tax of $2,765.58 is due on its purchases of dollies.[4]

5. At its three milk bottling plants, petitioner processes and then packages milk in cartons and jugs.[5] These cartons and jugs are then packed in milk cases for delivery to petitioner's customers. The milk cases, with the cartons and jugs packed in them, are left with petitioner's customers upon delivery. They are not unpacked and immediately removed by petitioner's personnel.

6. The Division's auditor prepared a schedule which details petitioner's purchases of the milk cases at issue in this proceeding as follows:

Vendor	Invoice Date[6]	Invoice Amount	Tax Alleged Due
Langer Manufacturing Co.	09/24/93	$170,811.92	$13,664.95

[4] A listing of petitioner's invoices prepared by the Division's auditor shows that he determined sales and use taxes due of $2,785.58 on the following purchases of dollies:

Invoice Date	Vendor	Invoice Amount	Tax Due
October 11, 1993	Cannon Equipment	$ 6,663.59	$ 553.09
March 14, 1994	Cannon Equipment	13,243.41	1,059.47
December 9, 1994	Various	14,662.78	1,173.02
Totals		$34,569.78	$2,785.58

There is no explanation in the record for the $20.00 difference between the total of $2,785.58 shown in this footnote and the $2,765.58 conceded due by petitioner on its purchases of dollies.

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[5] Petitioner also packages juice products in cartons and jugs which are also packed into milk cases for delivery to its customers.

[6] The invoices are listed in the same order as in a worksheet prepared by the auditor which was introduced into evidence. Although grouped by year, they were not always listed in chronological order.

Langer Manufacturing Co.	12/29/93	108,905.81	8,712.46
Langer Manufacturing Co.	09/15/94	20,432.04	1,634.56
Langer Manufacturing Co.	07/21/94	35,724.72	2,857.98
Langer Manufacturing Co.	07/12/94	7,229.40	578.35
Langer Manufacturing Co.	05/27/94	13,988.40	1,119.07
Erie Crate & Mfg. Co.	05/06/94	10,220.90	817.67
Erie Crate & Mfg. Co.	03/30/94	11,558.40	924.67
Langer Manufacturing Co.	12/21/94	55,579.72	4,446.38
Langer Manufacturing Co.	12/12/94	88,661.48	7,092.92
Langer Manufacturing Co.	04/05/95	120,517.39	9,641.39
Langer Manufacturing Co.	06/30/95	60,267.67	4,821.41
Totals		$703,897.85	$56,311.81

7. Petitioner also introduced into evidence photocopies of four sample sales invoices. These invoices each account for cases delivered to the customer as well as cases returned by the customer to petitioner at a unit price of $2.00 per case. The cases had been purchased by petitioner for approximately $4.50 each for wire metal milk cases and $2.00 each for plastic milk cases. For example, an invoice dated May 7, 1994[7] to a customer, Top Lube, Inc., for shipments to a Buffalo store named Win Mart shows a billing of $88.00 for 44 cases delivered to the customer and a credit of $94.00 for 47 cases returned by the customer to petitioner.

8. The charge of $2.00 per case represented a deposit which petitioner was required to charge its customers pursuant to a regulation of the Department of Agriculture and Markets

[7]This invoice is dated within the audit period. Two of the four other invoices are dated outside the audit period.

promulgated at 1 NYCRR 42.4. Such charges were not included in the gross sales reported by petitioner in the sales tax returns filed for the period at issue.

9. In its general ledger, petitioner has accounts which keep track of milk cases delivered to its customers as well as cases returned by them. Petitioner introduced into evidence an analysis entitled "Consolidated Case Deposits," based upon its general ledger, which shows that as of the end of June 1993, petitioner had deposits on milk cases with a negative balance of $296,496.32. On a monthly basis, running from July 1993 until June 1996, this balance varied based upon the number of cases returned by and delivered to customers. In the course of this three-year period, the balance ranged from a negative $338,455.99, as of October 1993, to a negative $217,068.29 as of August 1995. As of June 1996, this analysis showed a balance of a negative $228,339.00.[8]

10. For income tax purposes, petitioner depreciated the cost of the milk cases, which were carried on petitioner's balance sheet as an asset.

11. Petitioner did not have the right under any written agreement or any document, such as an invoice or delivery ticket, to require its customers to return the milk cases in which milk was delivered to them. If a customer did not return the milk cases to petitioner, petitioner had no right to force their return if the customer chose to use the milk cases in some other fashion. For example, petitioner's customers sometimes used the milk cases at the end of a supermarket aisle to build up a display of a certain grocery product, such as a breakfast cereal. Petitioner has never brought a legal action to repossess the cases. Edward Luongo, petitioner's director of finance, in his credible testimony, noted that on occasion when petitioner's supply of milk cases was running low, customers have been asked "to return cases to us" (tr., p. 44). In light of the fact

[8] Petitioner's analysis of milk case deposits also has a column labeled "adjustments" which was not explained in the record. Also unexplained is why the varying balance amounts are dollar and cents amounts not evenly divisible by $2.00 in light of the $2.00 deposit per milk case.

that a new wire metal milk case costs approximately $4.50, it is more economical for petitioner to seek the return of a milk case in exchange for the $2.00 deposit to be credited to the customer. Nevertheless, based upon Mr. Luongo's credible testimony, a finding of fact may be made that petitioner did not have the right to *compel* a customer to return milk cases if the incentive of obtaining credit for the $2.00 deposits was insufficient. In practice, Mr. Luongo testified that the return rate was "relatively high" (tr., p. 58).

12. The Division introduced into evidence a determination dated April 5, 1982 of the Department of Agriculture and Markets concerning whether the minimum case deposit to be collected by milk dealers on milk cases delivered in New York City, Long Island and Westchester County should be increased from 50¢ to $2.00 per case. This determination included a finding which set forth the regulatory purpose for requiring a deposit on milk cases as follows:

> The rules and regulations for a deposit on milk cases [were] instituted to improve accountability of cases and thereby reduce the cost to the industry of replacing them. The loss of cases had become a serious problem to milk dealers resulting in increased costs for marketing milk and ultimately higher prices to consumers. A milk case deposit regulation was first adopted by the Department in November 1974 applicable to transactions in the New York Metropolitan Area and was extended to the entire state in April 1976. . . . The minimum deposit was increased to $2.00 per case in [all areas of New York State other than New York City, Long Island, and Westchester County] on August 29, 1981.

13. The regulations of the Department of Agriculture and Markets at 1 NYCRR 42.3[9] also require petitioner to put its name on its milk cases. Mr. Luongo, petitioner's director of finance, explained the purpose for this requirement as follows:

> One is that particular case was delivered to a store. Let's take Wegman's . . . . They may have dairy cases that have been delivered from other processors in there too, so it's a way of kind of keeping those things sorted somewhat. And the other thing it does, quite frankly, is we believe that milk cases sometimes end up in the hands of individuals. Possibly, you know, a college student grabs those things. That's what we think. Although, I've often questioned how many could possibly go that way. But it's an indication that those things shouldn't be taken. They're not for your personal use. So I think those are the two practical purposes. One is to keep them organized at the store level for the customer, and one is to hopefully prevent theft (tr. p. 93).

14. The parties entered into a stipulation of facts, dated December 30, 1998 by petitioner's representative and December 31, 1998 by the Division's representative, relevant portions of which have been incorporated into these findings of fact.

SUMMARY OF THE PARTIES' POSITIONS

15. According to petitioner, its purchases of milk cases were not subject to sales tax because they were purchases for resale like the soda bottles and carrying cases at issue in ***Nehi Bottling Co. v. Gallman*** (39 AD2d 256, 333 NYS2d 824). Petitioner maintains that this matter "falls squarely" within the decision of the Appellate Division, Third Department in ***Nehi Bottling Co. v. Gallman (supra)***. Petitioner also cites to the exemption from the imposition of sales tax provided by Tax Law § 1115(a)(19) for containers used by a vendor in packing tangible personal

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[9] This regulatory provision provides as follows:

"[E]ach milk case used for the sale or delivery of milk and milk products to wholesale customers in the State of New York shall have the name or other business identification of the person who is the owner clearly printed, embossed, inscribed or otherwise permanently marked on each such milk case."

In its brief, the Division pointed out that an earlier version of this regulation also stated that ownership of or title to a milk case remained with the milk dealer whose name appears on the milk case (Division's brief, p. 33). However, this provision was deleted prior to the period at issue.

property for sale, which are actually transferred by the vendor to the purchaser. Petitioner points to an Example 1 in the tax regulations at 20 NYCRR 528.20(b), which provides that a soda bottle, returnable for deposit, nonetheless is actually transferred to the purchaser and therefore may be purchased without payment of tax under the exemption provided by Tax Law § 1115(a)(19).

16. The Division counters that ***Nehi Bottling v. Gallman (supra)*** did not establish a general proposition that the exchange of property for a deposit constitutes a sale for the purposes of sales tax. Rather, this decision is distinguishable because petitioner's purchases of milk cases were not purchases for resale to its customers for numerous reasons. According to the Division: (i) the milk cases were not actually transferred to the purchasers of petitioner's products; (ii) pursuant to the regulations of the Department of Agriculture and Markets, the milk cases remained the property of petitioner at all times; (iii) the milk cases were used by petitioner for transporting its product and were also used by petitioner even when they were in the possession of its customers and therefore were not purchased by it solely for resale to its customers; (iv) the milk cases were not sold by petitioners to its customers because the $2.00 deposit charged was not greater than its own purchase price per milk case and the deposits merely represented a security to encourage the return of petitioner's property; (v) petitioner accounted for its purchases of milk cases as a depreciable asset on its balance sheet for income tax purposes; (vi) petitioner did not report its receipt of deposits on the milk cases as income; (vii) ownership of the milk cases always remained with petitioner because its name was permanently marked on the milk cases; and (viii) petitioner did not actually charge a deposit on every case sent to a customer location because it collected deposits only when the aggregate number of cases at a customer location had increased at the end of a billing cycle.

The Division further maintains that the exemption from the imposition of sales tax provided by Tax Law § 1115(a)(19) for containers used by a vendor in packing tangible personal property is not applicable because petitioner did not actually transfer the milk cases to its customer within the meaning of the regulatory definition of "actually transferred." According to the Division, the milk cases were not "physically transferred to the purchaser, for whatever disposition the purchaser wishes" (20 NYCRR 528.20[b][4]). The Division also points to Example 2 in the tax regulations at 20 NYCRR 528.20(b), which provides that a keg containing beer is not actually transferred to a customer because it is required to be returned to the vendor after its contents are used.

The Division also argues that "the Division's failure on a prior audit to assess tax does not estop the Division from assessing tax for a later period" (Division's brief, p. 40).

17. In its reply brief, petitioner reiterates its reliance on the decision in **Nehi Bottling v. Gallman** ***(supra)***. In particular, petitioner emphasizes that based upon the testimony of its chief financial officer, it has established that it had no continued ownership interest or title to the milk cases once they were delivered to its customers. Citing to its review of the hearing transcript in ***Nehi Bottling***, petitioner points out that the taxpayer in ***Nehi Bottling*** similarly established that it retained no interest in the soda bottles and cases by the testimony of a company officer. Consequently, petitioner rejects the Division's contention that it is "significant that petitioner did not offer in evidence a statement from a customer that it understood it was buying petitioner's milk crates" (Division's brief, p. 29).

CONCLUSIONS OF LAW

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

tangible personal property are presumptively subject to tax pursuant to Tax Law § 1132(c) "until the contrary is established."

B. Tax Law § 1115(a) enumerates a lengthy list of various items of tangible personal property which are exempt from the imposition of sales tax on the receipts from the sale of such items. Included in this listing, at Tax Law § 1115(a)(19), is the following:

> Cartons, containers, and wrapping and packaging materials and supplies, and components thereof for use and consumption by a vendor in packaging or packing tangible personal property for sale, and actually transferred by the vendor to the purchaser.

C. Exemptions from tax are strictly construed. "An exemption from taxation 'must clearly appear, and the party claiming it must be able to point to some provision of law plainly giving the exemption'" (***Matter of Grace v. State Tax Commn.***, 37 NY2d 193,196, 371 NYS2d 715, 718, ***lv denied*** 37 NY2d 708, 375 NYS2d 1027 quoting ***People ex rel. Savings Bank of New London v. Coleman***, 135 NY 231, 234). In addition, the statutory language providing the exemption must be construed in a practical fashion (***see, Matter of Qualex, Inc.***, Tax Appeals Tribunal, February 23, 1995).

D. Initially, it is concluded that the milk cases at issue are properly viewed as "containers," i.e., "receptacle[s] . . . for the shipment of goods" (Websters's Ninth New Collegiate Dictionary 282 [1983]). The milk cases receive and contain the cartons and jugs of milk produced by petitioner, which are then shipped to its customers. Second, the milk cases are used by petitioner to pack cartons and jugs of milk, i.e., "tangible personal property," which is expansively defined at Tax Law § 1101(b)(6) as "corporeal personal property of any nature." Therefore, the crux of this matter, in determining whether the exemption at issue is applicable to

the milk cases, is the requirement that the milk cases are "actually transferred" by petitioner to its customers.

E. The tax regulations at 20 NYCRR 528.20(b)(4) define "actually transferred" as follows:

> "Actually transferred" means that the packaging material is physically transferred to the purchaser, for whatever disposition the purchaser wishes.
>
> Example 1: A returnable soda bottle may be returned for a refund of deposits [sic] or disposed of otherwise. Such a bottle is actually transferred to the purchaser and may be purchased without payment of tax.
>
> Example 2: A keg of beer is required to be returned to the vendor after its contents is used. This keg is not actually transferred to the purchaser of the beer, and may not be purchased by the vendor without payment of tax.

F. The parties, as noted in the Summary of the Parties' Positions above, have focused most of their legal arguments on whether the milk cases were *sold* by petitioners to its customers. These arguments are not directly relevant to the issue of whether the milk cases were *actually transferred*[10] by petitioner to its customers. There is no issue that the milk cases were physically transferred by petitioner to its customers, the first requirement of the regulatory definition. The issue to be resolved, under the regulatory definition, is whether petitioner's customers could dispose of the milk cases in whatever fashion they chose.

G. The record establishes that the customers had a financial incentive to return the milk cases to petitioner. By doing so, they would obtain credit for the $2.00 deposit per milk case. Although the $2.00 deposit only equaled the approximate cost of a new plastic milk case and was only 44.44% of the approximate cost of a new wire metal milk case, nonetheless petitioner's customers had a financial incentive to return the milk cases in order to recoup the deposits. As

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[10] If "actually transferred" as used in the exemption at issue promulgated in 1974 was deemed to mean "sold," there would be no need to legislate the exemption at issue since it would merely duplicate the resale exclusion included in the 1965 definition of "retail sale."

noted in Finding of Fact "12", the Department of Agriculture and Markets set the minimum deposit as $2.00 per milk case with the very purpose of encouraging the return of the milk cases to milk dealers like petitioner. Further, with petitioner's name permanently marked on the milk cases, petitioner's customers had less incentive to retain the cases for their own use. Nonetheless, as noted in Finding of Fact "11", petitioner could not *compel* its customers to return milk cases, if the incentive of obtaining credit for the deposits was insufficient, because petitioner did not have the right under any written agreement or any other documents, such as an invoice or delivery ticket, to require its customers to return the milk cases. Rather, petitioner's customers, in the first instance, had to decide to return the milk cases. Therefore, it is concluded that the milk cases were "actually transferred" by petitioner to its customers.

H. As noted in the Summary of the Parties' Positions, the Division has relied on Example 2 in the tax regulations at 20 NYCRR 528.20(b), which provides that a keg containing beer is not actually transferred to a customer because it is required to be returned to the vendor after its contents are used, while petitioner has relied on Example 1 in the same tax regulation, which provides that a soda bottle, returnable for deposit, nonetheless is actually transferred to the purchaser. These two examples may be reconciled on the basis that the beer kegs, as noted in the example in the regulation, are *required* to be returned while the soda bottles, like the milk cases at issue, *may* be returned for a refund of deposits.

I. In sum, petitioner's purchases of milk cases are properly treated as exempt from sales tax under Tax Law § 1115(a)(19) because they were "actually transferred" to its customers.

J. In light of the above analysis, it is not necessary to determine whether petitioner *sold* the milk cases to its customers. Further, the issues designated "II" and "III" at the beginning of this determination are rendered moot.

K. The petition of Upstate Farms Cooperatives, Inc. f/k/a Upstate Milk Cooperatives, Inc. is granted, and the Notice of Determination dated March 24, 1997 is modified to so conform.

DATED: Troy, New York
October 7, 1999

/s/ Frank W. Barrie
ADMINISTRATIVE LAW JUDGE