STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
LINEN SYSTEMS FOR HOSPITALS, INC.	:	DECISION
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, 1977 through February 29, 1980.	:	

Petitioner, Linen Systems for Hospitals, Inc., c/o Carol A. Hyde, 90 State Street, Albany, New York 12207, filed an exception to the determination of the Administrative Law Judge issued on August 19, 1988 with respect to its 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, 1977 through February 29, 1980 (File No. 800201). Petitioner appeared by DeGraff, Foy, Conway, Holt-Harris & Mealey, Esqs. (Carol A. Hyde, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Lawrence A. Newman, Esq., of counsel).

Petitioner filed a brief on exception. The Division of Taxation filed a letter in response to the petitioner's exception and brief. Oral argument, at the request of the petitioner, was heard on December 15, 1988.

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

ISSUE

Whether the Division of Taxation properly determined that, for the period at issue herein, petitioner was in the laundering business thereby subjecting its purchases of linens to New York State and local sales and use taxes.

FINDINGS OF FACT

We find the facts as stated in the determination of the Administrative Law Judge except that we modify finding of fact "14" as stated below.

Pursuant to a field audit of Linen Systems for Hospitals, Inc. (hereinafter "petitioner") which commenced in June 1980, a Notice of Determination and Demand for Payment of Sales and Use Taxes Due was issued to petitioner on November 20, 1981 in the amount of $133,022.16 plus interest for a total amount due of $164,539.90 for the period September 1, 1977 through February 29, 1980.

On December 17, 1980, petitioner, by its Controller, Robert A. Evans, executed a consent extending the period of limitation for assessment of sales and use taxes agreeing that said taxes for the period September 1, 1977 through February 29, 1980 could be assessed at any time on or before March 20, 1981. On March 6, 1981, a subsequent consent was executed whereby petitioner agreed that sales and use taxes for the period September 1, 1977 through November 30, 1978 could be assessed at any time on or before March 20, 1982.

Due to the fact that petitioner's linen supply and laundering services were performed almost exclusively for exempt organizations, no audit of petitioner's sales was performed. Petitioner's controller agreed to a test period analysis for recurring expense purchases. The month of October 1979 was selected and approximately 600 invoices were examined. An error percentage was calculated for each of petitioner's plants in New York State. Additional tax was determined in the amount of $6,478.84 ($5,615.74 for the Batavia plant and $863.10 for the Ballston Spa plant).

All invoices relative to fixed asset acquisitions were examined by the auditor and, as a result therefrom, additional tax was determined to be due in the amount of $12,943.08.

At the time of the commencement of the audit, petitioner agreed to a one-month test period analysis of its new linen purchases. Subsequently, petitioner's representative requested that a complete audit of said purchases be performed. Petitioner's representative prepared summary worksheets (with invoices attached) for each month in 1979 and, because the auditor found no errors, petitioner's worksheets were accepted for the entire audit period. The auditor calculated additional tax due on linen purchases made by each of petitioner's plants in the State

($60,371.24 from Batavia and $16,509.99 from Ballston Spa). Petitioner's purchases from its parent company, Angelica Corporation, and its subsidiary, Kansas City White Company, were examined separately and it was determined that no tax had been paid on these purchases. Additional tax due was, therefore, found to be $3,544.60. In 1979, petitioner began importing linens from India. Additional tax of $9,833.46 was determined on these purchases. The auditor further determined that additional tax of $472.98 was due on purchases from Baltic Linen on which a 4 percent sales tax was charged, but, because these purchases were delivered to the Batavia plant (a 6 percent area), sales tax at the rate of 6 percent was due and owing.

Use tax resulting from intercompany transfers from petitioner's plants in Scranton, Pennsylvania and Jersey City, New Jersey was found to be due in the amount of $13,625.84 ($10,484.72 on transfers to Batavia and $3,141.12 on transfers to Ballston Spa). Because petitioner uses the linens in jurisdictions other than those in which its plants were located, the auditor calculated an effective rate of tax using sales for the week ending August 11, 1979. The effective rate was determined to be .0676 for the Batavia plant and .0493 for the Ballston Spa plant. Therefore, an additional rate of .0076 was assessed against linen purchases by the Batavia plant and .0093 was assessed against Ballston Spa purchases. The auditor decided that all of petitioner's purchases were subject to sales and use taxes based upon his determination that petitioner was in the laundering/cleaning business.

At the hearing held herein, petitioner's representative conceded that additional tax due resulting from recurring expense purchases ($6,478.84) and from fixed asset acquisitions ($12,943.08) was due and owing. Therefore, the amount of additional tax remaining at issue is $113,600.24 ($133,022.16 original assessment - $19,421.92 recurring expenses and fixed asset acquisitions), said amount representing additional tax found to be due on petitioner's linen purchases.

During the period at issue, petitioner was engaged in the business of providing linen supply and laundering services to hospitals and health-related facilities exclusively. It supplied over 250 different types of patient, operating room, obstetric, nursery and kitchen linens and

uniforms. Its linen service system included providing linens, sanitized laundering, sanitized pick-up and delivery service, preparation of monthly pathology reports, light table inspection of all operating room linens, thermal patching, preparation of operating room packs and linen utilization management services. Petitioner supplied the linen to its customers and performed its services on this linen only. It did not launder linen which was owned by its customers. Petitioner's delivery and pick-up service was designed to insure that cleaned linens and soiled linens were never transported together in the same delivery truck for fear of cross-contamination. Each delivery truck was cleaned and fogged with a sanitizing agent before being loaded with clean linens. The delivery truck dropped the clean linens off at hospitals along its route and, only when the truck was empty, did it return to each hospital to pick up soiled linens.

When laundering soiled linens, petitioner added bacteriostats to the wash to inhibit the growth of pathogens. During the period at issue, petitioner operated four plants, two of which were located within the State. Once a month, a pathologist from a hospital served by each plant visited the plant and took cultures on various pieces of linen. This pathologist prepared and signed a monthly pathology report, a copy of which was then sent to each hospital served by the plant. The pathology reports were designed to give the hospitals assurance that they were receiving sanitary products.

As part of its service, petitioner performed a "light table inspection" on each piece of operating room linen after it was laundered. A light table is a table with a plasticized top and a light beneath which allows light to shine through linen, thereby disclosing pinholes and tears. This process inhibited the passage of bacteria through such openings. After patching, the linen was rewashed, dried, ironed and reinspected on the light table. Approximately 50 percent of the operating room linen was rejected after light table inspection and was returned for patching, recleaning and ironing. Prior to petitioner's performing the light table inspection of operating room linen, the hospitals performed this inspection themselves. Such inspections, repair and relaundering of operating room linen were expensive processes.

During the period at issue, petitioner began packaging some of its linen in "O.R. Packs". An O.R. Pack is a package of operating room linens needed for a particular type of operation. Various kinds of O.R. Packs were assembled by petitioner. Petitioner was the first linen supply company to prepackage linens at its plant in O.R. Packs. Previously, customers assembled their own packs.

As part of its service, petitioner also provided extensive linen utilization management services to customers. Such services involved preparation of a monthly linen utilization report for each hospital and review of such report with hospital personnel. The utilization report detailed the hospital's cost per patient day for surgical, nursery and kitchen linens as well as its cost per patient day. This usage information was reported for each department in the hospital to enable the hospital to compare the usage of its departments. Each report also gave the hospital linen usage statistics for similarly sized hospitals, thereby allowing that hospital to compare its linen costs per patient day with that of other hospitals. Petitioner's employees visited each hospital monthly or quarterly (depending upon size) to review the monthly utilization reports with hospital personnel. Virtually every management employee of petitioner was involved in providing utilization management services for some part of his time.

The purpose of petitioner's utilization management services was to assist its customers in controlling their linen costs per patient day. Petitioner would make recommendations for linen usage, but each hospital established its own policy with respect to linen usage. Additionally, the purpose of such services was to lower each hospital's usage and cost, which petitioner's management personnel believed would cause such hospital to continue as a customer.

Petitioner entered into a written contract with each of its customers. Each contract guaranteed prices for one year. Prices were changed once a year, effective January 1. During the period at issue, petitioner's New York customers increased from about 50 to 100.

Each piece of linen was supplied at a fixed price. For example, sheets were furnished for $.30 each. Thus, if petitioner delivered 10 sheets, it charged $3.00.

Petitioner computed the price which it charged for furnishing each type of linen by taking into account all of its costs. Its linen cost was a significant component of the price. The costs of its ancillary special services (see___ Findings of Fact "5" through "9") were also included in the price and comprised a substantial part thereof.

Petitioner used the accrual method of accounting and a fiscal year ending January 31. On its annual income statements, the cost of linen purchases was amortized. Fifty-nine percent of the cost of "installation linen" (i.e., linen purchased to initially supply a new hospital customer) was amortized over a three-year period. The remaining 41 percent was neither expensed nor amortized and never appeared as an expense on the company's financial statements. "Replacement linen" (i.e., linen purchased to replace installation linen) was amortized for financial accounting purposes over a twelve-month period from the time it was placed in service.

The amortized cost of linen, as a percentage of revenue, was 17.9 percent in fiscal year ending January 31, 1978, 20 percent in fiscal year ending January 31, 1979, and 20.05 percent in fiscal year ending January 31, 1980. Other nonlaundering expenses (such as the cost of soil, sort and counting; light table inspections; O.R. Packs, thermal patching and mending; an allocable portion of indirect payroll, power and light, and maintenance; delivery costs; and other overhead expenses) equalled approximately 45.7 percent of total rental revenue in fiscal year 1978, 40.4 percent in fiscal year 1979, and 28.72 percent in fiscal year 1980.

Finding of fact "14" is modified as follows[1]:

> During the period at issue, when petitioner purchased linens and other supplies from its vendors, it paid sales or use tax when the vendor's invoice included the tax and did not pay tax when the vendor's invoice did not include the tax. Tax was not paid on approximately 65 percent of purchases.

---

[1]The Administrative Law Judge's finding of fact "14" read as follows:

"During the period at issue, when petitioner purchased linens and other supplies from its vendors, it paid sales or use tax when the vendor's invoice included the tax and did not pay tax when the vendor's invoice did not include the tax. Tax was not paid on approximately 65 percent of purchases. No resale certificates were furnished by petitioner to its vendors."

Our review of the record indicated that it did not support the finding that resale certificates were not provided by petitioner to its vendors.

All but one of petitioner's New York customers were exempt organizations. Petitioner did not collect sales tax from its New York customers.

On March 6, 1981, petitioner, by its then representative, requested from the Counsel of the Department of Taxation and Finance an interpretation of an Opinion of Counsel issued July 12, 1965 regarding the applicability of the sales and use tax to the receipts of linen supply companies. On July 13, 1981, then Deputy Commissioner and Counsel, Ralph J. Vecchio, issued an Opinion of Counsel which initially cited the pertinent portions of the July 12, 1965 Opinion of Counsel Best as follows:

> '"This letter will serve as a reply to your request for a ruling as to whether the receipts of a linen supply company are within the statutory exemption made for "receipts from laundering", although the linens so furnished are owned by the company rather than the customer.
>
> 'Persons engaged in the business of furnishing coats, trousers, caps, aprons, dresses, towels, linens, napkins, diapers, tablecloths and articles of a similar nature to barber shops, beauty parlors, restaurants, industrial plants, offices and
>
> households and other establishments under an agreement which provides for having such articles returned periodically for laundering or dry cleaning and replacing them with clean articles should not collect a tax on the receipts from such service since they are rendering a laundering or dry cleaning service. The service of laundering or dry cleaning is exempt from the sales tax under section 1105(c)(3) of the Tax Law. However, this rule only applies to those agreements where the value of the article of personal property furnished has no substantial relationship to the charge for the service rendered so that the major portion of the charge made is for laundering or dry cleaning service.
>
> 'However, the persons so engaged in supplying uniforms, linens and items of a similar nature are required to pay a sales tax on all their purchases of uniforms, linens and other tangible personal property used in rendering such service.
>
> 'It should be noted, however, that the rental of formal dresswear, uniforms and other items of tangible personal property is subject to the sales tax. There what is involved is not a laundering or dry cleaning service but, rather, a rental or license to use. In the case of such transactions, the company which rents the item to the customer must collect the tax from the customer.'"

The Opinion of Counsel Vecchio then stated, in pertinent part, as follows:

> "A review of the July 12, 1965 Opinion of Counsel indicates that receipts from supplying of linen and other similar items pursuant to agreements providing for the periodic return and laundering or dry cleaning of and replacement of such linens with clean articles are and have, since the inception of the State-administered sales tax, been excluded from the imposition of the sales tax on maintaining, servicing or repairing tangible personal property (as laundering or dry cleaning within the meaning of section 1105(c)(3) of the Tax Law). The last paragraph of the Opinion of Counsel

> as noted above was presumably meant to contrast and distinguish laundering and dry cleaning services from the rental or license to use formal dresswear, etc., where the value of the article of personal property furnished to the customer presumably was a substantial portion of the charge made for the rental or license to use so that the portion of the charge made for laundering or dry cleaning service was presumably minor.
>
> The guidelines laid down by Counsel Best in 1965 are still the guidelines of this Department. They were derived in substance from Article 126 of the Regulations of the City of New York with respect to the sales and use taxes imposed and administered by such City prior to the State administration of the sales and use taxes as the State tax was in turn derived, in general, from the City tax.
>
> * * *
>
> The activities of Linen Systems seem clearly to be the rendering of certain specialized laundering and dry cleaning services in which the cost of the linens which customers are furnished is a minor part of the service rendered (19.76% of revenue receipt). In view of the continuous and long-standing period during which the State sales and compensating use tax has been administered on the foregoing basis, as well as the sales tax administered by the City of New York, we are not disposed to change the administration of this area of the sales and use taxes."

On March 17, 1981, a petition for advisory opinion was received from Linen Systems for Hospitals, Inc. seeking an advisory opinion regarding the identical issue presented herein. The Technical Services Bureau of the Department of Taxation and Finance issued the advisory opinion on August 14, 1981 which held, in pertinent part, as follows:

> "An Opinion of Counsel dated July 13, 1981 and issued in response to an inquiry from Petitioner has confirmed that the interpretation of law made in the July 12, 1965 Opinion of Counsel is a correct interpretation and remains the policy of this Department.
>
> Accordingly, Petitioner is advised that it is subject to sales tax on its purchases of linens, inasmuch as the furnishing of linens by Petitioner to its customers is deemed to be an exempt laundering or drycleaning service."

Along with its memorandum of law, petitioner submitted proposed findings of fact. In accordance with section 307(1) of the State Administrative Procedure Act, petitioner's proposed findings of fact have been generally accepted with the following exceptions: portions of proposed findings of fact "1", "2", "3", "4", "26", "27", "28" and "29" have been accepted while portions thereof which refer to rentals of linen are rejected as being conclusory in nature and not fully supported by the record; proposed findings of fact "6", "16", "23" and "24" are rejected as not being supported by credible evidence; a portion of proposed finding of fact "33" has been

accepted while a portion thereof referring to the cause of petitioner's failure to pay tax on some of its purchases is rejected as not being supported by credible evidence; and proposed findings of fact "25", "38", "39" and "40" are rejected in their entirety as being conclusory in nature and not fully supported by the record.

OPINION

The Administrative Law Judge determined that the petitioner was in the "laundering" business and did not rent linens to its customers. Accordingly, the petitioner's services were held not taxable by virtue of Tax Law section 1105(c)(3)(ii) which excludes laundering services from the sales tax. The Administrative Law Judge concluded that petitioner was required to pay use tax on its purchases of linens and certain other items used in its business. This determination was based on 20 NYCRR 526.6(c)(7) which provides that tangible personal property is not purchased for resale if it is purchased for use in performing a service not subject to tax.

Petitioner asserts that it is not engaged in the laundering business, that laundering is only a minor part of its business, that its primary business is the rental of linens and the providing of other special linen services to hospitals. Petitioner argues that the meaning of laundering, as used in the Tax Law, is the laundering of articles owned by the customer. Further, petitioner asserts that the conclusion of the Administrative Law Judge that petitioner is engaged in the business of laundering is inconsistent with the facts, in particular, that the cost of linen and nonlaundering service provided by petitioner to its customers exceeded 63 percent of the petitioner's rental revenue in 1978, 60 percent in 1979 and 48 percent in 1980.

The petitioner also argues that the facts found by the Administrative Law Judge that the amortizable cost of linens equalled 17.0 percent of total revenues in fiscal year 1978, 20 percent in 1979, and 20.05 percent in 1980 requires the conclusion, under the 1965 Opinion of Counsel, that the "major" and "substantial" part of the petitioner's customer charge is for tangible personal property and, thus, petitioner is not in the laundering business.

The Division, on exception, relies wholly on the determination of the Administrative Law Judge.

We affirm the determination of the Administrative Law Judge. We are guided by the recent Appellate Division decision in Matter of Atlas Linen Supply Co., Inc. v. State Tax Commn. (App. Div., 3d Dept, April 20, 1989, Harvey, J.) which involved similar facts. In Atlas, the former State Tax Commission determined that the vendor's purchases of linens and garments were for use in providing laundering services for hospitals and were not purchases "for resale" (Tax Law § 1101[b][4][i][A]) and were thus subject to tax (see Tax Law § 1105[a]). Only Atlas' dealings with hospitals were at issue and it did not launder any linens owned by the hospitals.

Atlas contended that it purchased the linens for resale or rental and thus should not have been subject to sales tax on its purchases.

In affirming the decision of the Commission, the court noted that Tax Law section 1105(a) imposes a tax upon every retail sale of tangible personal property unless otherwise excluded, excepted or exempted and that laundering services are excluded from sales tax (Tax Law § 1105[c][3][ii]). The court went on to point out that certain purchases which are made for resale or rental are not subject to sales tax (Tax Law § 1101[b][4]; § 1105[a]) but, that ". . . tangible personal property purchased for use in performing a service not subject to tax is not purchased for resale (20 NYCRR 526.6[c][7]) and is therefore not exempt from tax" (Matter of Atlas Linen v. State Tax Commn., supra, at 2). The court concluded that the Commission's determination that Atlas was providing a laundering service was supported by the record and that while the contracts between Atlas and the hospitals contained some aspects of a rental arrangement, ". . . none of the contracts for price item laundering actually split the stated price into its component parts of laundering service and rental charge. In fact, no separate charge for linen rental is indicated anywhere in the contracts" (Matter of Atlas Linen v. State Tax Commn., supra, at 2, cites omitted). The court concluded that the provision of linens by Atlas to its customers was purely incidental to its primary or essential business of laundering. "These

operations were inseparably connected to each other and therefore cannot be considered separate transactions for tax purposes" (Matter of Atlas Linen v. State Tax Commn., supra, at 3 [citing Matter of Burger King v. State Tax Commn., 51 NY2d 614, 623; Matter of Penfold v. State Tax Commn., 114 AD2d 696, 697]).

We can find no meaningful distinction between the facts presented in Atlas and those before us here. In both cases the vendor charged for the service on a per piece basis, which price recovered the costs of laundering, the linen itself, and a linen management service (Matter of Atlas Linen Supply Co., Inc., State Tax Commn., August 28, 1987). In addition, the petitioner in Atlas also argued that the cost of the linens furnished bore a substantial relationship to the per piece charge (Matter of Atlas Linen Supply Co., Inc., State Tax Commn., supra). The only difference we see between the facts of the two is that here petitioner has established the exact relationship between the cost of the linen and the charge for the overall service, i.e., the cost of the linens was 17 to 20.05 percent of total revenues, for the years at issue. We conclude, however, that this fact is not sufficient to overcome the application and result of the Appellate Division's decision in Atlas.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Linen Systems for Hospitals, Inc. is denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petition of Linen Systems for Hospitals, Inc. is denied; and

4. The Notice of Determination issued on November 20, 1981 is sustained in full.

DATED: Troy, New York
August 24, 1989

/s/John P. Dugan
John P. Dugan
President

/s/Francis R. Koenig
Francis R. Koenig
Commissioner

/s/Maria T. Jones
Maria T. Jones
Commissioner