STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
US TELECOM, INC.	:	DECISION DTA NO. 820160
for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Periods March 1, 1997 through February 28, 2002.	:	

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on December 1, 2005 with respect to the petition of US Telecom, Inc., 6500 Sprint Parkway, HL 5ATTX, Overland Park, Kansas 66251. Petitioner appeared by Audra Mitchell, Esq. The Division of Taxation appeared by Mark F. Volk, Esq. (James Della Porta, Esq., of counsel).

The Division of Taxation filed a brief in support of its exception and petitioner filed a brief in opposition. The Division of Taxation filed a reply brief. Oral argument, at the request of the Division of Taxation, was heard on June 7, 2006 in Troy, New York.

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

ISSUE

Whether petitioner's purchases of plastic telephone calling cards were properly excluded from sales tax as purchases for resale pursuant to Tax Law § 1101(b)(4)(i)(A) as sales "for resale as such."

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

Petitioner, US Telecom, Inc., is a division of the Sprint Telecommunications Company, located in Overland Park, Kansas. Petitioner is a corporation engaged in the business of providing telephone service in New York State, which service is subject to tax under Tax Law Articles 28 and 29.

Petitioner's business activity includes selling prepaid telephone calling service. Petitioner uses plastic telephone calling cards to provide information concerning its prepaid telephone calling service to its customers, such as the transfer of the authorization code verifying payment for the telephone service and instructions, including codes for accessing the service.

Petitioner was the subject of a sales tax field audit covering the period March 1, 1997 through February 28, 2002. Upon audit, the Division of Taxation (the "Division") determined no additional tax was due on petitioner's sales during the period in question. However, review of petitioner's asset acquisitions revealed additional taxable asset purchases in the amount of $374,276.71, with tax due thereon in the amount of $18,903.42. In addition, the Division's auditor also reviewed petitioner's expense purchase records for the test month of October 2000. As extrapolated over the audit period, this review resulted in additional taxable expense

purchases of $2,066,210.90, with tax due thereon in the amount of $170,462.40. The additional tax due on expense purchases related to petitioner's purchases of the plastic prepaid telephone calling cards, including the printing, bundling, storage and packaging of such cards.

As a result of its audit, the Division issued to petitioner a Notice of Determination on November 28, 2003 assessing additional tax due in the amount of $189,365.82, plus interest, for the period March 1, 1997 through February 28, 2002.[1]

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge rejected two of petitioner's three arguments and accepted the third. First, he concluded that petitioner's purchases of plastic telephone cards did not qualify as sales for resale under subparagraph (B) of Tax Law § 1101(b)(4)(i) because that provision applies only to property used in performing services subject to tax under enumerated paragraphs of subdivision (c) of section 1105 of the Tax Law. Since the service provided by petitioner is subject to tax under subdivision (b) rather than subdivision (c) of section 1105, this exception did not apply. The Administrative Law Judge also held that the cards purchased by petitioner did not qualify for exemption under Tax Law § 1115(a)(19) as containers or packaging material "for use and consumption by a vendor in packaging or packing tangible personal property for sale."

Finally, the Administrative Law Judge concluded in reliance on the opinion of the Court of Appeals in ***Burger King v. New York State Tax Commn.*** (*infra*), that petitioner's purchases of

[1] Petitioner raised no arguments against, and apparently does not dispute, the calculation method or the $18,903.42 tax liability determined with respect to asset acquisitions. In addition, petitioner does not dispute the use of a test month and extrapolation audit method with regard to expense purchases (its purchases of the plastic telephone calling cards), nor does petitioner dispute the resulting dollar amount of the tax calculated as due using such audit method ($170,462.40). Rather, petitioner challenges only the propriety of imposing tax on its purchases of the plastic telephone calling cards in question.

plastic telephone calling cards were purchases of tangible personal property "for resale as such" within the meaning of Tax Law § 1101(b)(4)(i)(A) and, therefore, not retail sales subject to tax.

Petitioner has not taken exception to the determination with respect to the two issues resolved in favor of the Division.

ARGUMENTS ON EXCEPTION

In support of its exception, the Division of Taxation argues that reliance on ***Burger King*** is inappropriate because the rule of that case was narrowed in the subsequent Court of Appeals case of ***Celestial Food v. New York State Tax Commn.*** (*infra*), and its application limited to items that are "necessary to contain the product for delivery." Since in the Division's view "[t]he plastic cards are not physical containers," they do not meet the test articulated in those cases. An additional reason advanced by the Division for distinguishing ***Burger King*** is that the objects in question, the cards, are "inseparately connected with petitioner's phone service" unlike the food wrappers in ***Burger King*** (Division's brief in support, p. 7, Reply brief, p. 12).

The Division also asserts that if all tangible personal property transferred to a customer qualified as a purchase "for resale as such" under section 1101(b)(4)(i)(A), the exception set out in section 1101(b)(4)(i)(B) and the exemption found in section 1115(a)(19) would be redundant (***see***, Division's brief in support, pp. 10, 18).

The Division also argues based on the reasoning in our decision in ***Matter of Helmsley Enters.*** (Tax Appeals Tribunal, June 20, 1991, ***confirmed Matter of Helmsley Enters. v. Tax Appeals Tribunal***, 187 AD2d 64, 592 NYS2d 851, ***lv denied*** 81 NY2d 710, 600 NYS2d 197), that the exception of property used in performing certain types of services from the definition of retail sale in subparagraph (B) of section 1101(b)(4)(i) implies that property used in performing

any other services cannot be excepted from the definition under subparagraph (A) (***see***, Division's brief in support, pp. 8-10, Reply brief, pp. 16-18).

Petitioner argues that the prepaid calling cards in question contain the prepaid calling service since the cards transfer all the information needed by customers to access and utilize the prepaid telephone service whenever and wherever that service is needed (***see***, Petitioner's brief in opposition, p. 5). Petitioner states that the Administrative Law Judge correctly concluded that the cards constitute a critical element of the prepaid calling service because, as he found, "but for the plastic cards the prepaid telephone calling service would not be, practically speaking, either marketable to the public, accessible to the purchasing consumer, or portable" (Determination, conclusion of law "I").

OPINION

The sales tax statute at issue here is a complicated mosaic of paragraphs, some defining terms, some imposing tax and others providing exemptions. The whole is bound together through the use of the defined terms in the taxing and exemption provisions and through the use of elaborate cross references. The outcome of this case depends on competing interpretations of the relationships among these provisions. In that light, it seems appropriate to begin with a brief description of the statutory scheme.

The sales tax is imposed in subdivision (a) of Tax Law § 1105 on the general category described as "every retail sale of tangible personal property." The term "retail sale" is defined in section 1101(b)(4). In subdivisions (b) through (f) of section 1105, the sales tax is imposed on various types of services and so-called "hybrid" transactions which involve both transfers of property and the rendering of services. One of the services listed in subdivision (b) is "a prepaid

telephone calling service." Subdivision (d) imposes tax on, *inter alia,* restaurant meals. Subdivision (e) imposes tax generally on "rent for every occupancy of a room or rooms in a hotel." In almost all cases, the language imposing the tax contains an exception for sales for resale.

The central issue in this case is whether petitioner's purchases of plastic cards fall within the definition of "retail sale" in Tax Law § 1101(b)(4)(i) which reads in pertinent part as follows:

> 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, or (B) for use by that person in performing the services subject to tax under paragraphs (1), (2), (3), (5), (7) and (8) of subdivision (c) of section eleven hundred five where the property so sold becomes a physical component part of the property upon which the services are performed or where the property so sold is later actually transferred to the purchaser of the service in conjunction with the performance of the service subject to tax.

Much of the Division's argument would lead to the conclusion that the words "as such" in section 1101(b)(4)(i)(A) mean "as tangible personal property" and that this means tangible personal property within the meaning of section 1105(a)--not property that is disposed of by the purchaser in connection with a service or hybrid transaction governed by subdivisions (b) through (f) of section 1105. Consistently, subparagraph (B) of section 1101(b)(4)(i) would be the sole provision by which property involved in such services can qualify for exclusion from the definition of retail sale and that provision is limited to certain services described in section 1105(c). There is much to recommend this reading of the statute, including simplicity, predictability and consistency with the carefully drawn architecture of the statutory provisions. The difficulty with the argument, however, is not that it lacks persuasive force but that it proves too much. If accepted, it would require a rejection of the holding of the Court of Appeals in

Matter of Burger King v. New York State Tax Commn. (51 NY2d 614, 435 NYS2d 689). In that case, the court held that tangible personal property can qualify as purchased "for resale as such" where it is disposed of as part of a service transaction governed by section 1105(d), a restaurant meal, and not as tangible personal property governed by section 1105(a). The Division has offered no convincing argument that would distinguish from that holding property disposed of as part of a service transaction governed by one of the other subdivisions from (b) to (f) of section 1105. Since we are bound by the court's decision, the resolution of this issue in the present case depends on whether the rule of the ***Burger King*** case is met in the circumstances before us which involve a disposition of property, plastic telephone cards, in connection with a service governed by section 1105(b), a prepaid telephone service.

In ***Burger King***, the court held that purchases of wrappers of hamburgers, cups for beverages, and "sleeves" for french fries qualified as purchases "for resale as such" where those items were to be transferred to retail purchasers of food. The opinion of the Court of Appeals states in part as follows:

> As to this problem, decisional guidance is to be found in the so-called "container cases" *(Matter of American Molasses Co. v. McGoldrick* [281 N.Y. 269, 273]; *Matter of Colgate-Palmolive-Peet Co. v. Joseph* [308 N.Y. 333, 338]; *Matter of Dairylea Co-op. v. State Tax Comm.* [41 A.D.2d 312, 316, mot. for lv. to app. den. 33 N.Y.2d 513]). The 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. The courts reasoned that the containers, although bought to be resold as "an incident to the sale of the contents" *(Matter of American Molasses Co. v. McGoldrick* [*supra,* p. 274]), were nonetheless sales for resale as such. The cartons, although *"not inseparable"* from the contents, were, in this context, being resold *"as containers"* (see *Matter of Colgate-Palmolive-Peet Co. v. Joseph* [*supra*, p. 339] [emphasis in original]).

> All the more is this so in the case of Burger King, whose packaging, as we have seen, is such a critical element of the final product sold to customers. So regarded, the packaging material is as much a part of the final price as is the food or drink item itself. It would be exalting form over substance, therefore, to hold that a resale of these paper products does not take place merely because Burger King does not list a separate price.
>
> Now, though the relative delicacy of the paper goods employed in Burger King's "fast food" operation is qualitatively much different from the grosser and coarser containers (pails, wooden barrels, metal drums, wooden crates, burlap sacks and three-gallon ice cream containers) with which the courts treated in the cited cases, and though the containers in these cases were largely confined to conventional delivery functions rather than the far more intimate product association afforded to Burger Kings' wrappings, in the present case, as in the cited ones, the containers and their contents at no time become "inseparably connected" *(Matter of American Molasses Co. v. McGoldrick* [281 N.Y. 269, 273-274]). It follows that Burger King purchases its packaging from its suppliers for "resale as such" to its customers and thus is entitled to the exclusion of section 1101 (subd. [b], par. [4], cl. [I], subcl. [A]), of the Tax Law (***Matter of Burger King v. New York State Tax Commn.***, ***supra***, 435 NYS2d, at 692-693).

The court noted that the taxpayer conceded liability as to outer bags, straws and coffee stirrers. This distinction was addressed by the court in the subsequent case of ***Celestial Food of Massapequa Corp. v. New York State Tax Commn.*** (63 NY2d 1020, 484 NYS2d 509) in which a taxpayer sought to extend the rule of ***Burger King*** to napkins, straws, stirrers, plastic utensils and other similar items. The court rejected the taxpayer's position and clarified the scope of the ***Burger King*** rule in the following statement:

> Unlike the packaging in *Burger King,* the items respondent here seeks to exclude from sales tax are not a critical element of the product sold and thus are not purchased "for resale as such." Whereas a cup of coffee cannot be purchased without a container, the same cannot be said of napkins, stirrers and utensils, which are more akin to items of overhead, enhancing the comfort of restaurant patrons consuming the food products. The Appellate Division's reasoning in this case, that because "the fast food customer expects to be provided with a stirrer for coffee, a straw for soft drinks, plastic utensils for food, and napkins for cleanliness" such items are purchased "for resale as such" (98 A.D.2d 157, 159, 47 N.Y.S. 2d 903), has potentially limitless application. Although the cost of such items may well be taken into account by the restaurateur when setting the price of

> food, so are other amenities a restaurant patron expects, such as service, utilities and fixtures, which do not become a part of the product being sold merely because their cost is a factor in determining the price a customer pays. Only 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 (***Celestial Food of Massapequa Corp. v. New York State Tax Commn.***, ***supra***, 484 NYS2d, at 510).

Accordingly, we are left to consider whether the plastic telephone cards in the present case were "a critical element of the product sold" because they were "necessary to contain the product for delivery."

The Division asserts that the plastic cards were mere "tokens" rather than containers because they do not contain the cell towers and other equipment by means of which the taxable telephone service is provided (Division's reply brief, p. 8). While we agree that the container must contain some element of the taxable property or service, it is clearly not necessary that all such elements be so contained. In ***Burger King,*** it was sufficient that the food wrappers contained one element of a taxable restaurant meal, namely food. They did not need to contain the chairs, tables, light fixtures and kitchen equipment.

The Division also argues that the telephone cards fail to meet the requirements of the cases because they are "inseparately connected" to the product sold. This argument appears to misconstrue the origin and meaning of that phrase. It was drawn from the ***American Molasses Co.*** case on which the court relied in ***Burger King***. In that case, the court distinguished containers for molasses and sugar from chemicals and dye stuffs applied to fur skins in a dyeing business involved in an earlier case, stating as follows:

> [T]he container and contents are not inseparately connected. The container has not been consumed by the refiner or packer in performing services for another as was the case in *Matter of Mendoza Fur Dyeing Works, Inc. v. Taylor* [272 N.Y. 275]. The container remains "tangible personal property" after it has been filled

> by the refiner or packer and resold as an incident of the sale of the contents; it may be resold as tangible personal property by the purchaser of the contents who has no use for an empty container after the contents have been removed (***Matter of American Molasses Co. v. McGoldrick***, 281 NY, at 273).

In the present case, as we understand the facts, the plastic cards are not consumed in the process of providing prepaid telephone service. Accordingly, we do not think they were "inseparately connected" in the sense intended by the court in ***American Molasses*** and ***Burger King***.

The Division argues that because ***Burger King*** and ***Celestial Food*** involved tangible contents, food and drink, the rule of these cases should be limited to tangible objects. Since this does not appear to be a principled distinction, we hesitate to adopt it as the governing standard. Each of the plastic cards in this case is inscribed with information that provides access to the services provided by petitioner. In common parlance, these cards "contain" the information that they carry. Once the useful contents are exhausted, the plastic card, like a molasses barrel, remains the same but is worthless unless it is refilled.

Despite the appeal of the foregoing argument, we are mindful of the decisional history of the controlling cases. ***Burger King*** was decided in 1980 by the Court of Appeals with two judges dissenting. When the court had an opportunity to revisit this issue four years later in ***Celestial Food***, a unanimous court, in the statement quoted above, essentially limited the rule of ***Burger King*** to the facts of that case because of its concern that a more liberal approach would have "potentially limitless application." We think that the court would be equally fearful of an expansion of the rule to property that "contains" merely incorporeal information. Based on that understanding of the court's opinion in ***Celestial Food***, we decline petitioner's invitation to extend the rule of ***Burger King*** to its prepaid telephone cards.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the Division of Taxation is granted;

2. The determination of the Administrative Law Judge is reversed;

3. The petition of US Telecom, Inc. is denied; and

4. The Notice of Determination dated November 28, 2003 is sustained.

DATED: Troy, New York
December 7, 2006

/s/Charles H. Nesbitt
Charles H. Nesbitt
President

/s/Carroll R. Jenkins
Carroll R. Jenkins
Commissioner

/s/Robert J. McDermott
Robert J. McDermott
Commissioner