STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
TRI-STATE INDUSTRIAL LAUNDRIES, 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 March 1, 1984 through November 30, 1986.	:	

Petitioner, Tri-State Industrial Laundries, Inc., 1634 Lincoln Avenue, P.O. Box 4145, Utica, New York 13504, 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 March 1, 1984 through November 30, 1986 (File No. 805797).

On May 31, 1989 and June 2, 1989, respectively, petitioner by its representative, Nathan M. Hayes, Esq., and the Division of Taxation by William F. Collins, Esq. (Carroll R. Jenkins, Esq., of counsel) executed a consent to have the controversy determined on submission without hearing, with all documents and briefs to be submitted by August 1, 1989. After due consideration of the record, Jean Corigliano, Administrative Law Judge, renders the following determination.

ISSUE

Whether charges imposed by petitioner on its customers for articles provided as a part of petitioner's laundering services and never returned are subject to sales tax.

FINDINGS OF FACT

Petitioner, Tri-State Industrial Laundries, Inc., and the Division of Taxation entered into a stipulation of facts which has been adopted as Findings of Fact "1" through "7". The stipulation is supplemented by Findings of Fact "8" through "13".

Petitioner is in the business of industrial garment laundering. Prior to and during the period in question, it purchased industrial garments from a supplier (paying the appropriate sales and use tax thereon) and then supplied its customers with those garments in order for it to be able to provide the service of laundering the same and delivering fresh ones on a weekly basis. With each of its customers, petitioner agreed, typically for a term of three years, to provide the weekly garment service in return for a fee. Petitioner did not intend to rent or sell the garments to itscustomers, rather it transferred possession of the same to its customers in order to perform the service on a weekly basis of picking up soiled ones, laundering them, and delivering clean ones.

Upon the collection of soiled garments each week, and again at the expiration of the entire service agreement term, petitioner would count and inspect the garments returned. A

charge or penalty was levied for any garment not returned or returned in a damaged condition. The same charge was levied, regardless of whether the garment was returned in a damaged condition or not returned at all. It is the charges for unreturned garments that the New York State Department of Taxation and Finance has declared to be subject to sales and use tax on the basis that a "sale" of a garment had taken place. The Department concedes that no sales tax is due on charges levied for garments returned in a damaged condition. Petitioner's position is that no sales occurred as a result of the imposition of charges for either garments returned in a damaged condition or not returned at all.

Garments returned to petitioner in a damaged condition, for which petitioner levied a charge, were retained by petitioner, not the customer. At the expiration of any service agreement term not renewed, garments were returned to petitioner and retained by it.

The amount a customer paid for any unreturned or damaged garment included a fair approximation of the replacement cost of the garment plus the underlying service agreement amount for that garment and that total far exceeded the value of the garment.

Petitioner contends that its purpose in imposing a charge for unreturned or damaged garments was to discourage mistreatment of the garments, to induce their safe return, and to cover the administrative costs of accounting for them. It also contends that said charges were not intended, viewed or utilized as a payment for the garments.

It is petitioner's understanding that its customers, upon the imposition of charges for unreturned or damaged garments, virtually always pursue indemnification therefor or return thereof from their respective employees responsible for the non-returned or damaged garments, as the customers viewed their employees' actions giving rise to the imposition of the charges as constituting an unauthorized appropriation, conversion or damage, as the case may be, to personal property under contract with petitioner. More specifically, after receiving a first billing for such charges, it was petitioner's experience that its customers virtually always located and returned to petitioner some if not all of the theretofore "lost" or unreturned garments, so as to significantly reduce the amount of the assessment.

On October 9, 1987, as the result of a field audit, the Division of Taxation issued to petitioner a Notice of Determination and Demand for Payment of Sales and Use Taxes Due for the period March 1, 1984 through November 30, 1986, assessing tax due of $16,048.56 plus interest.

Petitioner executed two consent documents having the effect of extending the period of limitation for assessment of sales and use taxes under articles 28 and 29 of the Tax Law for the period March 1, 1984 through August 31, 1984 to December 20, 1987.

All of the assessed tax represents the amount of sales tax determined by the Division of Taxation to be due on charges for garments not returned to petitioner by its customers.

A "Rental Service Agreement" used by petitioner contains the following provisions:

"SUPPLY OF GARMENTS

A. Tri-State agrees to furnish and the Customer agrees to take Tri-State Uniform Rental Service for the employees of the Customer; the employees to be serviced, the quantity of garments to be issued, the number of clean uniforms to be furnished each week, the rates and other particulars to be as below indicated.

* * *

OBLIGATIONS OF CUSTOMER

* * *

B. Customer agrees to notify Supplier of any desired changes in service and to return all garments from cancelled services to the Supplier or to pay at the listed rates (plus applicable sales taxes) for any garments, lost, stolen, destroyed or customer altered.

* * *

TITLE TO GARMENTS

A. Title to all merchandise shall remain at all times in Tri-State; and all merchandise shall be promptly returned to Tri-State at termination of its use. Merchandise that is destroyed, lost or not returned to Tri-State within two weeks, shall be charged for at the listed rates (plus applicable sales taxes)."

A second form used by petitioner entitled "Non-Personal Service Agreement" contains the following provision:

"Rental merchandise that is destroyed, stolen, lost, or not returned to the supplier for any reason shall be charged to the customer at the rate shown and in the replacement charge column (repl. chg/u) or at the prevailing replacement charge if the supplier has made adjustments to its general replacement charges since the date of first delivery." (Emphasis added.)

Petitioner did not collect sales tax from its customers on charges imposed for merchandise not returned to petitioner.

CONCLUSIONS OF LAW

A. In weighing the claims of the parties, it is useful to keep in mind that the essence of the transaction between petitioner and its customers was the provision of laundry services and not the rental of garments separately from such services. The rendering of such services is excluded from the operation of the Tax Law (Tax Law § 1105[c][3][ii]), and the provision of garments under such an arrangement is deemed to be incidental to the rendering of laundering services (see, Matter of Atlas Linen Supply Co., State Tax Commission, August 28, 1987). Taken as a whole, the record establishes that petitioner imposed a single charge for laundering services and that those services included the transfer of possession of garments owned by petitioner to its customers.

B. The transaction giving rise to the controversy here is petitioner's imposition of a separate charge whenever a customer failed to return, by an agreed upon time, the garments supplied by petitioner. The position of the Division of Taxation ("Division") is that petitioner provided garments to its customers as part of its laundering services, but where a garment was not returned, the transaction was converted to a sale and the customer was then required to pay for the article. In essence, the Division argues that the agreements between petitioner and its customers created conditional sales which fall within the definition of a sale found in the Tax Law. A sale is defined by Tax Law § 1101(b)(5) 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 therefor, including the rendering of any service, taxable under [article 28], for a consideration or any agreement therefor."

Petitioner argues that the terms of the agreements do not evidence an intention to enter into sales transactions, conditional or otherwise, and that any monies paid by its customers for unreturned merchandise were in the nature of contract damages, compensating petitioner for its loss of property. Petitioner contends that its customers were insurers of the garments placed in their possession and that payments for damage to or loss of property under such an arrangement are not subject to sales tax. Petitioner points to 20 NYCRR 526.7[a][5] as authority for its position. The regulation states: "[t]he 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." The cited regulation provides the following examples of such a transaction:

"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."

Petitioner argues that its transactions with its customers are indistinguishable from the examples in the regulations, since, by the terms of the agreements, its customers were made insurers of the garments placed in their possession.

It is apparent that petitioner's imposition of a fee if customers failed to return merchandise placed in their possession is not identical to the situations in either of the examples found in the regulation. However, it is sufficiently analagous to place the transactions within the scope of the regulation.

C. Implicit in petitioner's argument that its customers were insurers of the garments provided to them is the claim that the underlying agreement created a bailment for mutual benefit. If personal property is delivered by one person to another under an agreement that the same property is to be returned to the person delivering it in the same or altered form, the contract is one of bailment (Mays v. New York, N.H. & H.R. Co., 197 Misc 1062, 97 NYS2d 909, 911). Here, petitioner entered into agreements with its customers for the rendering of laundering services, a service excluded from taxation under Tax Law § 1105(c)(3)(ii). In accordance with certain provisions within the agreements, petitioner provided its customers with merchandise which was to be returned to petitioner at a specified time. It is evident that these provisions created a bailment. Ordinarily, the bailee is not held to be the insurer of the bailed property and is only obligated to exercise ordinary care and diligence in the preservation of the bailor's property, hence the bailee is only responsible for a loss occasioned by its own negligence (Davis v. Lambert Agency, Inc., 30 AD2d 299, 291 NYS2d 745, 746; First Nat. City Bank v. Frederics-Helton Travel Serv., 29 Misc2d 104, 209 NYS2d 704, 709). However, the parties to a bailment contract may alter the legal duties of both the bailor and bailee by mutual agreement (see, Lash v. Knapp, 143 NYS2d 516, 519). In Zaidens v. Salter (142 Misc 439), the court held that where a defendant accepted goods at his risk, "reasonable wear and tear only excepted, if they are lost, stolen or destroyed while in defendant's possession and through no fault or negligence on his part, he is liable therefor to plaintiff. In such circumstances, the defendant assumes more than the obligation arising out of an ordinary bailment." (Zaidens v. Salter, supra at 441.)

By agreeing to pay for any garments not returned "for any reason", petitioner's customers agreed to be insurers of petitioner's garments. That is, they enlarged their responsibility for the subject of the bailment beyond that which would be expected of an ordinary bailee and agreed to bear liability for the garments even if they were lost, stolen or destroyed through no fault of their own. The "Rental Service Agreement", although less explicit, evidences the same intent. Accordingly, any amount paid by petitioner's customers for unreturned garments was in the nature of a contract damage.

The record does not support a conclusion that petitioner and its customers intended to enter into conditional sales agreements. "A conditional sale ... contemplates that the purchaser can by complying with the terms of the contract acquire title to the goods involved and it is contemplated that he will" (Lash v. Knapp, supra at 518). Under the terms of the agreements entered into by petitioner and its customers, it was not anticipated that the customers would ever acquire title to the garments by not returning them and paying an agreed upon fee. In fact, such an arrangement would not be reasonable, since the amount the customer paid for an unreturned garment exceeded its replacement cost. The Division of Taxation notes that the "Rental Service Agreement" states garments were to be paid for at the listed rate "plus applicable sales tax". It argues that this statement demonstrates petitioner's recognition that a sale took place upon payment of a charge for the unreturned garments. In view of the other factors discussed above, I am not persuaded that this language evidences an intent on the part of petitioner and its customers to enter into a sales transaction. Based on the foregoing, it is concluded that the transactions under consideration were not sales within the meaning of Tax Law § 1101(b)(5).

D. The petition of Tri-State Industrial Laundries, Inc., is granted, and the Notice of Determination and Demand for Payment of Sales and Use Taxes Due issued on October 9, 1987 shall be canceled.

DATED: Troy, New York
November 2, 1989

/s/ Jean Corigliano
ADMINISTRATIVE LAW JUDGE