STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition :

of :

**SODEXHO USA, INC.** :

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, 1998 through :
February 29, 2000.
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In the Matter of the Petition :

of :

**SODEXHO OPERATIONS, LLC** :

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, 1999 through :
November 30, 2002.

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In the Matter of the Petition :

of :

**SODEXHO MANAGEMENT, INC.** :

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, 1999 through :
November 30, 2002.

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DETERMINATION
DTA NOS. 820020,
820021, 820022,
820023 AND 820024

Petitioner Sodexho USA, Inc., 10 Earhart Drive, Buffalo, New York 14421-7078, 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, 1998 through February 29, 2000.

Petitioner Sodexho Operations, LLC, 10 Earhart Drive, Williamsville, New York 14221-7078, 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, 1999 through November 30, 2002.

Petitioner Sodexho Management, Inc., 10 Earhart Drive, Williamsville, New York 14221-7078, filed petitions for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period September 1, 1999 through November 30, 2002.

A hearing was commenced before Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on May 24, 2005 at 10:30 A.M., continued at the same offices on May 25, 2005 at 9:15 A.M. and completed on May 26, 2005 at 9:15 A.M., with all briefs submitted by October 6, 2005, which date began the six-month period for the issuance of this determination. Petitioners appeared by McDermott, Will & Emery LLC (Arthur R. Rosen, Esq. and Karen S. Dean, Esq., of counsel). The Division of Taxation appeared by Christopher C. O'Brien, Esq. (Lori P. Antolick, Esq., of counsel).

## *ISSUES*

I. Whether petitioners' purchases of nonfood items were exempt from sales and use taxes because they were procured as agents of tax exempt entities or because they were purchased for resale to their tax exempt client.

II. Whether the Division of Taxation is estopped from assessing sales and use taxes.

## *FINDINGS OF FACT*

1. Petitioner Sodexho Operations LLC ("Sodexho Operations") is organized as a Delaware limited liability company with its principal office in Gaithersburg, Maryland.

Petitioner Sodexho USA, Inc. ("Sodexho USA") was merged with petitioner Sodexho Operations in 2000. Before that time, Sodexho USA was organized as a Massachusetts corporation with its principal office in Gaithersburg, Maryland. Petitioner Sodexho Management, Inc. ("Sodexho Management") is organized as a New York corporation with its principal office in Gaithersburg, Maryland. Petitioners are the successors to various entities that had contractual relationships with tax exempt clients during the relevant audit periods.[1]

2. The Division of Taxation ("Division") issued Notice of Determination L-021426296-8 dated August 29, 2002 to petitioner Sodexho USA seeking additional tax due of $5,116.00 and interest of $1,572.92 for a balance due of $6,688.92 for the audit period March 1, 1998 through February 29, 2000.

3. The Division issued Notice of Determination L-022947802-6, dated August 28, 2003, to petitioner Sodexho Operations seeking additional tax of $31,125.02 and interest of $4,667.04 for the period December 1, 1999 through November 30, 2002. The Division also issued Notice of Determination L-022947801-7 dated August 29, 2003 to petitioner Sodexho Operations seeking additional tax of $102,298.25 and interest of $13,981.71, less credits or payments of $112,400.35, for a balance due of $3,879.61 for the audit period December 1, 1999 through November 30, 2002.

4. The Division issued Notice of Determination L-023578537-7 dated March 12, 2004 to petitioner Sodexho Management seeking additional tax of $357,014.54 and interest of $73,671.15 for a balance due of $430,685.69 for the period September 1, 1999 through

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[1] Sodexho Operations is the successor in interest to Sodexho USA, Inc., Sodexho Services, Inc. and The Seiler Corporation. Petitioner Sodexho Management is the successor by name change only to Sodexho Marriott Management, Inc., Marriott Management Services Corp., and Saga Corporation. In addition, Sodexho Management is the sole member of Sodexho America, LLC.

November 30, 2002. The Division also issued Notice of Determination L-023578538-6 dated March 15, 2004 to petitioner Sodexho Management seeking additional tax due of $1,151,183.57 and interest of $240,367.73, less credits or payments of $825,304.78, for a balance due of $566,246.52 for the period September 1, 1999 through November 30, 2002.

5. Sodexho USA is protesting the entire Notice of Determination issued to it.

6. Sodexho Operations is protesting $13,722.00 of the total amount of tax sought in the notices of determination issued to it. Sodexho Operations filed a timely claim for refund relating to overpayments of tax on expense purchases, which was disallowed by the Division. Sodexho Operations is protesting $3,279.00 of the disallowed refund that relates to the tax exempt clients.

7. Sodexho Management is protesting $343,468.00 of the total amount of tax sought in the Sodexho Management notices of determination. Sodexho Management filed a timely claim for refund relating to overpayments of tax on expense purchases, which was disallowed by the Division. Sodexho Management is protesting $108,134.00 of the disallowed refund that relates to the tax exempt clients.

8. During their respective audit periods, petitioners, or their predecessors, were engaged in the business of providing food and facilities management services to nonprofit hospitals, healthcare facilities and educational institutions, as well as to certain for-profit clients. Petitioners' predecessors offered their clients the same types of services that are provided by petitioners. Petitioners, and their predecessors, each conducted business in New York State.

9. Petitioners provided two types of services: full-service contracts and management contracts.

10. In a full-service contract, petitioners assume responsibility for operating all of the client's food or facility functions. Specifically, petitioners provide all of the employees to manage and perform the food or facilities operations located at the tax exempt clients' facilities.

11. In a management contract, petitioners provide a layer of management employees to facilitate the tax exempt clients' food or facilities operations that are performed by the tax exempt client's employees.

12. Management contracts can be viewed as having two components: (1) the management of the hourly employees employed by the clients who physically perform the food and facility functions; and (2) the management of the procurement of food and nonfood items for use in the clients' food or facilities operations.

13. Petitioners entered into management agreements to provide management services to certain tax exempt clients. The tax exempt clients were exempt organizations for purposes of sales and use taxes pursuant to Tax Law § 1116. The tax exempt clients would not be liable for sales and use tax had the tax exempt clients directly purchased the nonfood items that are the subject of the notices of determination relating to the agency issue and the resale issue.

***Petitioners' Food Management Services: The Lenox Hill Arrangement***[2]

14. During the period in issue, the Lenox Hill arrangement was governed by the terms and conditions of the contract dated January 1, 1997 and the contract dated July 31, 2000.

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[2] Petitioners and the Division have stipulated that the terms and language contained in the agreements between Sodexho Management and Lenox Hill (the "Lenox Hill arrangement") are representative of the terms and language contained in all of the contracts governing the arrangements between petitioners and the tax exempt clients to whom petitioners provided food management services. The Division and petitioners have also stipulated that the determination of the Division of Tax Appeals concerning the agency issue and the resale issue based on the contractual terms and the evidence presented with respect to the Lenox Hill arrangement will control the resolution of the contested portions of the notices of determination of each petitioner that relate to food management services provided to petitioners tax exempt clients.

15. The Lenox Hill nutrition services department is responsible for the preparation, service, and sale of food, beverages, merchandise, and other items at Lenox Hill Hospital that relate to patient food and nutrition service, retail cafeteria operations and vending machine services.

16. The Lenox Hill arrangement was based on a management contract pursuant to which Sodexho was hired to provide management employees to supervise Lenox Hill's nutrition services department. The contracts expressly appointed petitioners as an agent of Lenox Hill with respect to the management of the nutrition services department. Under the contracts, Sodexho was required to "manage and operate" the following patient services for Lenox Hill: purchasing and production services, patient food and tray services and clinical dietetic services. Sodexho was also required to "manage and operate" the cafeteria services and special functions and catering services for Lenox Hill. Petitioners are contesting only the portion of the assessments that relate to purchases of nonfood items for use by Lenox Hill in its patient food service and retail cafeteria operations.[3]

17. Pursuant to the management contract arrangement with Lenox Hill, petitioner provided management and professional employees to manage the nutritional services operations including: the director of food and nutrition services, the clinical nutrition manager, an assistant director of operations, an assistant director for patient services, two cafeteria managers, a patient services manager, the clinical nutritionist and an administrative assistant.

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[3] Under the terms of the contracts, Sodexho provided the vending services and was responsible for managing and stocking the machines. The contested portions of the assessments do not relate to items sold in the vending machines.

18. After a recommendation was made by Sodexho, Lenox Hill made the final decision over which Sodexho management employees were placed on-site in the nutrition services department, including which general manager should be the department head of the nutrition services management. If Lenox Hill became unhappy with Sodexho employees, Lenox Hill had the right to request that the situation be addressed or that the employee be removed from Lenox Hill. The control that Lenox Hill exercised over Sodexho's on-site management employees was comparable to the control that Lenox Hill exercised over its own employees. All Sodexho employees placed on-site at Lenox Hill were required to attend Lenox Hill's hospital orientation and other Lenox Hill training programs.

19. Sodexho's on-site general manager, Tom Dooley, was the Director of Nutrition Services. Mr. Dooley functioned, and was recognized by Lenox Hill, as a department head within Lenox Hill. The other Sodexho employees on-site at Lenox Hill were management employees who reported to Mr. Dooley. Those Sodexho employees were responsible for supervising various aspects of Lenox Hill's food service operations, including managing the Lenox Hill employees who performed the patient food service operations and retail service cafeteria operations, and managing the clinical dieticians.

20. Lenox Hill employed all of the nonmanagement, hourly employees who actually performed all of the day-to-day operations of Lenox Hill's patient food service and cafeteria operations of Lenox Hill's nutrition services department. These Lenox Hill hourly employees were unionized workers.

21. Under the terms of the union contract, petitioners were not permitted to perform any functions performed by a union employee except in an emergency or training situation. Sodexho

employees did not physically perform the day-to-day operations of the nutrition services department.

22. Lenox Hill furnished and maintained the premises where the patient food service and cafeteria operations of the nutrition services department were performed, including office space and kitchen facilities. Lenox Hill also owned, provided, and maintained all of the equipment, including all of the kitchen equipment, used by its nutrition services employees in the performance of the patient food service and cafeteria operations.

23. Lenox Hill's policies governed all aspects of the operations of the nutrition services department and Sodexho employees were required to manage the department in accordance with those policies. Sodexho was required to manage the nutrition services department in a manner that complied with the regulations imposed by the Joint Commission on Accreditation of Healthcare Organizations to which Lenox Hill was required to adhere.

24. Lenox Hill decided all aspects of the performance of the nutrition services operations, including choosing the menu items that were to be served to the patients and to patrons of the cafeteria, determining the quantity and quality of food to be served, setting the prices of the meals and other items served, and deciding on the hours of cafeteria operation and the times when patient meals were to be served. Before Lenox Hill made its decisions on the foregoing items, Sodexho recommended the recipes and production methods.

25. Lenox Hill's policies governed all aspects of Sodexho's management of the Lenox Hill nutrition services department employees, including Lenox Hill's human resources policies governing the hiring and discipline of nutrition department employees. Sodexho's role in the hiring of Lenox Hill's nutrition services employees consisted of interviewing the candidates

screened by Lenox Hill's human resources department and making recommendations as to whom should be hired. Lenox Hill made the ultimate hiring and other human resource decisions concerning the nutrition services hourly employees and any nutrition services department management employees employed by Lenox Hill.

26. Lenox Hill set and administered the overall budget for the nutrition services department. Sodexho's role was to "maintain" the budget.

27. Sodexho was required to ensure that a minimum of 80 percent of the food and nonfood items used by Lenox Hill in the performance of the food service operations were acquired from vendors affiliated with Premier, a group purchasing organization ("GPO") in which Lenox Hill participated through Greater New York Hospital. The Premier GPO arrangement provided the basis of the Purchasing Guidelines that were followed by the nutrition services department. Said guidelines provided that only Premier/Sodexho-approved suppliers were permitted to be utilized.

28. The quantity of food and nonfood supplies, including the items at issue, needed for use in the operations of the nutrition services department was determined based upon the volume of meals served, which was determined by the number of patients. However, authorized usage guidelines were established by the district manager who was a Sodexho employee.

29. A Lenox Hill employee, typically its purchasing agent, placed orders for the food or nonfood items and supplies by phone. To the extent at issue here, the items purchased included plastic utensils, paper supplies and cleaning agents used in conducting food service operations. The vendors were provided with Lenox Hill's exemption certificate.

30. Once the food and nonfood items were ordered, the vendors delivered the items to Lenox Hill's loading dock. The items were received and checked in by Lenox Hill employees and then placed into storage facilities at the hospital owned by Lenox Hill by a storeroom clerk employed by Lenox Hill. Lenox Hill owned all of the inventories of smallwares,[4] food beverages and other supplies used in the patient food service and cafeteria operations.

31. When it was time for the items to be used in the performance of the food service operations, Lenox Hill employees retrieved them from storage. The items were then used by the Lenox Hill union employees to prepare and cook the food for delivery to the patients or to the cafeteria.

32. Meals prepared for delivery to the patients were sent to the tray line where the trays for each patient were assembled with the meal, napkins and utensils. When the trays were completed, they were placed on a cart and taken upstairs to the patient floors where the meal trays were delivered to the patients. When the patients were through with the meal, the trays were picked up, placed back on the cart and returned to the kitchen where the trays were cleaned and set up for the next patient service. Throughout the process, all of the tasks were performed by Lenox Hill employees.

33. Meals intended for sale in the cafeteria were placed in serving vessels and then placed on the cart and taken on the elevator to the cafeteria. The meals were unloaded by the cafeteria workers and placed in the display stations. The meal items were served to the cafeteria patrons, who paid for the meals at the cafeteria registers operated by Lenox Hill employees. After the patrons were done with their meals, the used trays were picked up, placed back on the cart and

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[4] Smallwares include items such as dishware, glassware, flatware, utensils, pots and pans.

returned to the kitchen where the trays were cleaned and set up for the next cafeteria delivery. Throughout this process, all tasks were performed by Lenox Hill employees.

34. Sodexho's role with respect to the purchases was the management of the purchasing activities and the management and coordination of the billings from the vendors. The vendor invoices for the purchased items were generally sent to Sodexho at the Lenox Hill facilities. The vendor invoices were all addressed to Sodexho and Lenox Hill. They were not addressed to Sodexho as an agent for Lenox Hill. Sodexho's on-site employees sent the vendor invoices to Sodexho's control center in Buffalo, New York. Upon receipt of the invoices, the Buffalo control center remitted payment for the purchased items to the vendors.

35. Under the terms of the contracts, Lenox Hill paid Sodexho a flat management fee to compensate Sodexho for the management of Lenox Hill's patient services operations and cafeteria operations.

36. The contracts required Sodexho to collect and deposit gross revenues from Lenox Hill patient food service and cafeteria services and then invoice Lenox Hill for "Operating expenses in excess of net cash receipts." Any excess net cash receipts from the cafeteria operations were credited to the operations costs of the patient food service. "Operating expenses" specifically included the cost of supplies, and the taxes thereon, used in the patient services and cafeteria operations. As a result of this arrangement, Sodexho was reimbursed dollar-for-dollar for the amounts that it had advanced for Lenox Hill's purchases.

37. Sodexho provided weekly "pre-bills" to Lenox Hill. For each aspect of the food service operations, that is, patient food service, cafeteria and vending, the pre-bill contained line-item breakdowns of the estimated fees and expenses for the next week including the

management fee, estimated expenses and, for the cafeteria, the estimated credit for cash receipts collected. At the end of each month, Sodexho's accounting office reconciled the actual expenses incurred with the actual cash credits from the cafeteria services, plus amounts received from Lenox Hill in the payment of the pre-bills. In addition, Sodexho provided a monthly operating statement to Lenox Hill, which detailed the back-up information to the invoices sent to Lenox Hill showing the cash sales for the month, the outlays for purchases of food and supplies, and labor costs.

***Petitioners' Facilities Management Services: The Burke Arrangement***[5]

38. The Burke arrangement during the audit period was governed by the terms and conditions of the contract dated January 1, 1999, the amendment to the 1999 Burke contract dated June 25, 1999, the amendment to the Burke contract dated February 22, 2000, the amendment to the 1999 Burke contract dated January 3, 2001 and the amendment to the 1999 Burke contract dated December 7, 2001.

39. The Burke arrangement was a management contract pursuant to which petitioners provided management employees to supervise the housekeeping and laundry services of Burke's

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[5] The Division and petitioners have stipulated that the terms and language contained in the arrangements between petitioner Sodexho Management and Burke Rehabilitation Hospital (the "Burke Arrangement") are representative of the terms and language contained in all of the contracts governing the arrangements between petitioners and the tax exempt clients to whom petitioners provided facilities management services. The Division and petitioners have also stipulated that the determination of the Division of Tax Appeals concerning the agency issue and the resale issue based on the contractual terms and evidence presented with respect to the Burke arrangement will control the resolution of the contested portions of the notices of determination of each petitioner that relate to the facilities management services provided to petitioners' tax exempt clients. The terms "facilities management" and "environmental services" have been used interchangeably to describe the general housekeeping operations performed at the tax exempt clients' facilities. The term "facilities management" includes both environmental services, such as housekeeping, and engineering services, such as changing light bulbs or taking care of structural issues. At Burke, Sodexho's operations were limited to the management of Burke's environmental services operations, that is, the daily cleaning of the facility.

environmental services department. The contracts expressly appointed petitioners as Burke's agent with respect to the management of purchasing activities.

40. Under the contracts, Sodexho was required to "manage and operate" the housekeeping and laundry services at the Burke facilities, which were part of Burke's environmental services department. The environmental services department was responsible for housekeeping tasks such as cleaning and disinfecting the hospital premises, including stripping, waxing and burnishing corridors, cleaning patient rooms and sanitizing equipment. The department was not responsible for general maintenance tasks such as changing light bulbs or checking pipes or fans.

41. Pursuant to the management contract with Burke, Sodexho provided management and professional employees to manage the environmental services operations, including the general manager and the operations manager.

42. Burke had control over which Sodexho management employees were placed on-site in the environmental services department, including which general manager should be the department head of the environmental services department. Burke made the final decision after the general manager, an employee of Sodexho, screened for the best possible candidate. If Burke became unhappy with a Sodexho employee, Burke had the right to request that the situation be addressed or that the employee be removed from Burke.

43. Sodexho's general manager, David Schleissmann, supervised the management and function of Burke's environmental services department. Mr. Schleissmann functioned, and was recognized by Burke, as a department head within Burke. The only other Sodexho employee on-site at Burke was the operations director, who reported to Mr. Schleissmann and who was

responsible for supervising the performance of the day-to-day housekeeping and laundry operations by Burke employees.

44. All of the hourly employees who performed the housekeeping services were employed by Burke. The actual performance of the environmental services operations was done by Burke's hourly employees. Sodexho employees did not physically perform the day-to-day operations of the environmental services department.

45. Burke provided and maintained the premises at which the housekeeping and laundry services were performed by Burke employees. Burke also owned and provided all of the equipment used in the performance of the housekeeping and laundry services.

46. Burke's policies governed all aspects of the operations of the environmental services department and Sodexho employees were required to manage the department in accordance with those policies. Sodexho was also required to manage the environmental services department in a manner that complied with the regulations imposed by the Joint Commission on Accreditation of Healthcare organizations to which Burke was required to adhere.

47. Burke dictated the areas of service for the environmental services department, that is, which of its facilities were to be cleaned, and the cleaning specifications for each area of service, including the types of tasks that the environmental services employees were to perform and how frequently these tasks were to be performed.

48. Burke's policies governed all aspects of Sodexho's management of the Burke environmental services department employees, including Burke's human resources policies governing the hiring and discipline of Burke's environmental services employees.

49. Sodexho's role in the hiring of Burke's environmental services employees consisted of interviewing the candidates screened by Burke's human resources department and making recommendations concerning which candidate should be hired. Upon a reasonable request by Sodexho's on-site managers, Burke, as the employer of the nonmanagement environmental services employees, hired, discharged, or disciplined its employees. Burke made all of the ultimate hiring and other human resource decisions concerning the environmental services employees employed by Burke.

50. Burke set the overall budget for the environmental services department. Sodexho's role was to "administer" the budget.

51. The quantity of supplies, such as toiletry items, toilet tissue, cleaning products and germicides needed for use in the operations of the environmental services was determined based on the weekly inventory by a Burke supervisor of the stock on hand. On the basis of its management expertise, Sodexho told Burke the number of items to purchase, when to purchase the items and how the items were to be delivered. In furtherance of their duties, petitioners created a schedule which explained where the supplies should be sent within the hospital.

52. Orders were placed by a Burke supervisor with the vendors by phone. When Sodexho first took over, Burke was using Burke's vendors. Thereafter, Burke switched to Sodexho's vendors in order to save money. When Sodexho became involved with Burke, the vendors were provided with Burke's exemption certificate.

53. The vendors delivered the items directly to Burke's receiving area. The labels on the packages bore Burke's address, generally under the names of Sodexho and Burke. Once delivered, the items were received by Burke's receiving department and placed by Burke's

receiving department employees into the storage facilities at the hospital owned by Burke. Burke owned all of the inventories and supplies used in the environmental services operations.

54. Sodexho's role with respect to the purchases was the management of the purchasing activities and the management and coordination of the billings from the vendors. The vendor invoices for the purchased items were generally sent to Sodexho at the Burke facilities. The invoices were all addressed to Sodexho and Burke. They were not addressed to Sodexho as an agent for Burke. All vendor invoices were sent by Sodexho's on-site employees to Sodexho's control center in Buffalo, New York. Upon receipt of the invoices, the Buffalo control center remitted payment for the purchased items to the vendors.

55. When it came time for the items to be used in Burke's environmental services operations, the items were requisitioned by one of the Burke supervisor employees and then distributed to the Burke hourly employees who actually used the items to perform the Burke environmental services operations.

56. Under the terms of the contracts, Burke paid Sodexho a flat management fee to compensate Sodexho for the management of Burke's housekeeping and laundry operations.

57. Pursuant to the contracts, Sodexho invoiced Burke for all operating expenses in connection with the housekeeping and laundry services. Operating expenses specifically included items purchased on behalf of the housekeeping and laundry services. As a result, Sodexho was reimbursed dollar-for-dollar for the amounts that it advanced for Burke's purchases.

58. Sodexho provided weekly pre-bills to Burke with a breakdown of estimated fees and expenses for the next week, including the management fee and the estimated expenses. At the

end of each month, Sodexho's accounting office reconciled the actual expenses incurred with the amounts from Burke in payment of the pre-bills.

59. The terms of the contract specifically provided that, in the event sales and use taxes were assessed against items used in the environmental services operations, Burke was required to reimburse Sodexho for the assessment and any interest and penalties thereon.

***Petitioners' Letter and The Division's Response***

60. On or about November 11, 1993, petitioner's predecessor, Marriott Management Services Corp., ("MMS") wrote a letter to the Department of Taxation and Finance's Technical Services Bureau requesting advice on the correct tax treatment of MMS's purchases of food and nonfood supplies and repairs performed on the food service equipment belonging to an exempt organization. On or about April 30, 1993, the Division advised MMS that the purchases of food and nonfood items as well as the repairs to the food service equipment were all purchases for resale since MMS issued a bill to the tax exempt organization after making purchases of the tangible personal property or repair service. In examining the correct tax treatment of MMS's purchases, the Division specifically focused upon three factors: all inventory was owned by the exempt organization and it was its expense to maintain and replace the inventory; all food service equipment was owned by the exempt organization, and MMS provided only management employees. The Division further pointed out that in order to qualify for the exemption, the purchaser and seller must both be registered New York State sales tax vendors and, unless the hospital is a Federal or New York State owned and operated institution, it must provide MMS with a properly completed Exempt Organization Certification.

61. On the basis of this letter, petitioners did not accrue tax on items that met the criteria of the letter.

62. In accordance with New York State Administrative Procedure Act § 307(1), petitioners' proposed findings of fact have been generally accepted and incorporated herein. It is noted that proposed finding of fact "6" was modified to include petitioners' estoppel argument. Proposed findings of fact "23," "28," "29," "30," "33," "35," "55," "57," and "59 " were modified because portions thereof were argumentative. Proposed findings of fact "20, " "26," "31," and "56" were modified to conform to the record. A portion of proposed finding of fact "36" was rejected as unnecessary for the determination. Additional findings of fact were also made.

***PROCEDURAL MATTERS***

63. Petitioners are contesting the notices of determination and denials of the refund claims only with respect to purchases of nonfood items made pursuant to food management contracts and facilities management contracts with certain tax exempt clients.

64. Prior to the hearing held on this matter on May 24, 2005 to May 26, 2005, the parties resolved certain portions of the contested assessments. The parties also stipulated that the notices of determination issued to Sodexho Operations and Sodexho Management would be revised in accordance with the stipulated resolution of the issue.

65. The only issues to be resolved in this matter are whether petitioners purchased the nonfood items as agents on behalf of their tax exempt clients, whether petitioners purchased nonfood items for resale to tax exempt clients or whether the Division is estopped from assessing sales and use tax on petitioners' purchases of nonfood items.

## ***CONCLUSIONS OF LAW***

A. In general, all retail sales of tangible personal property are subject to sales tax pursuant to Tax Law § 1105. Petitioners contend, however, that certain purchases were exempt from tax because they were made as agents on behalf of tax exempt organizations. At the hearing and in their brief, petitioners have drawn a distinction between two distinct business arrangements. In one type of arrangement, Sodexho offered what has been referred to as full-service. That is, Sodexho provided the employees who performed the work. For example, in order to provide food service, Sodexho employees performed the tasks of cooking, cutting and cleaning. In this situation, petitioners agree that sales tax is due on their purchases of nonfood supplies since they are consuming the supplies when they are performing the service.

In this case, however, Sodexho provided only management personnel, and the actual operations were conducted by employees of the tax-exempt institution. Petitioners submit that in this situation where the purchases were on behalf of the institutions and used by the institutions' employees, their purchases were exempt from tax because the items were purchased as an agent for the tax-exempt institutions. In response, the Division submits that petitioners have not established that they were acting as agents for their tax exempt clients when they made the purchases in issue and, as a result, their purchases were properly found to be taxable.

B. The question presented here is under what circumstances petitioners, who are unquestionably not exempt from sales tax, may stand in the shoes of their tax exempt clients and make purchases without liability for sales tax. This issue has been raised in New York on previous occasions. In ***Matter of the Seiler Corporation*** (State Tax Commn., September 13, 1985), a case involving one of petitioners' predecessors, the State Tax Commission determined that Seiler's recurring purchases were taxable. Seiler was not able to utilize its clients' hospitals' exemption from sales and use tax when providing administrative and financial services to the hospitals' food service departments because Seiler was the purchaser of record, Seiler used the items in providing food service operations and there was a lack of proof of the extent of the hospital's control over Seiler's activities in operating the food service departments.

In ***Matter of Custom Mgt. Corp. v. State Tax Commn.*** (148 AD2d 919, 539 NYS2d 550), the taxpayer set up and managed food service facilities at educational and health care institutions which were exempt from tax. In general, the client provided the dining area and petitioner ran the entire food service operation including ordering, preparing and cleaning up the food. In order to perform this task, the taxpayer provided trained food service managers who hired the individuals who worked in the dining halls. The taxpayer's invoices separately stated the costs of food, supplies, repairs, labor, payroll, other expenses and the taxpayer's fee. The taxpayer asserted that its purchases of plastic spoons and cups, paper supplies, napkins and cleaning products were exempt from sales tax because it was an agent for the tax-exempt clients. The Court rejected this argument and stated:

> We conclude from the record that petitioner's control over the details of its food management service supports the determination that it was not merely an agent for the tax-exempt entities. Indeed, it was specifically hired so that its institutional clients would be relieved of the responsibility for running the service. Evidence that petitioner purchases the food and supplies, usually determines which vendors to use, performs the bookkeeping functions and generally places all of the employees on its payroll supports respondent's determination. In sum, petitioner did not meet its burden of showing that it was acting solely on behalf of and subject to the control of its institutional clients. (***Matter of Custom Mgt. Corp. v. State Tax Commn.***, ***supra,*** at 920.)

C. A review of the factors examined in ***Custom Management*** supports the Division's position. Here, as in ***Custom Management***, the record establishes that petitioners were hired in order to relieve the management of the responsibility for running the environmental and food service operations. The exempt institutions looked to Sodexho to perform tasks that they did not know how to perform. Namely, Sodexho was expected to manage the environmental and food service operations in an appropriate and cost effective manner. Petitioners' witnesses acknowledged that they were selected because of their expertise in managing the forgoing areas and, in return for these services, Sodexho received a management fee. Under the circumstances, petitioners' argument that their purchases were solely as an agent does not comport with the facts presented (***see, Matter of Custom Mgt. Corp. v. State Tax Commn.***, ***supra,*** 539 NYS2d at 551).

Second, as was the case with the taxpayer in ***Custom Management***, petitioners were the purchasers of record. The invoices were sent to petitioners at the location of the respective institution.[6] All of the vendor invoices were sent to Sodexho's office in Buffalo, New York, and the Buffalo office, in turn, paid the vendors.

Third, as part of its management function, Sodexho exercised significant influence over which vendors to use. Although individuals in the respective hospitals' purchasing departments contacted the vendors, the record shows that Sodexho managed all purchasing activity and coordinated the billing process with the respective vendors. The Lenox Hill purchasing guidelines show that items were to be purchased according to purchasing agreements where it was to Sodexho's overall advantage to do so and only Premier/Sodexho-approved suppliers were

[6] In ***Matter of Seiler Corp.*** (State Tax Commn., Sept. 13, 1985) it was observed that while the invoices included the name of both the hospital and the petitioner, such information would, of necessity, be included for purposes of delivery.

to be utilized with respect to nutritional product supplies. Similarly, after it was retained, Burke began using Sodexho-approved vendors in order to save money.

Sodexho performed bookkeeping functions for its clients through its furnishing of a pre-bill procedure which outlined estimated cash, credit for cash from the cafeteria, the management fee and estimated expenses. The pre-bill permitted Sodexho's clients to estimate a portion of their anticipated expenses and revenues.

The last factor which the Court focused upon was that the taxpayer placed all of the employees on its payroll. Petitioners are correct that the ***Custom Management*** case is different in that the taxpayers in this matter did not place the employees on their payroll. However, the point is not whether Sodexho placed the hourly employees on its own payroll. It is whether Sodexho acted solely as an agent or whether it exercised independent discretion. On this point, it is clear that Sodexho had significant input regarding the hiring of a particular employee. For example, the record shows that the Lenox Hill human resources department did the initial screening of the job applicants. If the persons passed the initial screening, they were sent to Sodexho for an interview. If Sodexho approved of the person, it would recommend that Lenox Hill hire the individual. Sodexho also had input regarding the individuals who were hired by Burke. Furthermore, in each institution, Sodexho management supervised the employees of the client.

D. On the basis of the forgoing it is concluded that petitioners have not established that they were merely agents of the tax-exempt institutions and that it was permissible for petitioners to rely upon the tax-exempt status of their clients to exempt their purchases from taxation. Under the circumstances, the factors cited by petitioners regarding the agency provisions in the contracts between them and their clients and the purported disclosures of the principal-agency relationship are irrelevant. Moreover, petitioners' claim that the tax-exempt institutions were the purchasers of the nonfood items does not comport with the record.

E. In the alternative, petitioners argue that the purchases of the nonfood items are excluded from tax as purchases for resale. It is submitted that the subsequent sales of the nonfood items to petitioner's exempt clients are exempt from tax as sales to tax exempt clients.

F. The forgoing argument is also without merit. The Court of Appeals has held that an item is purchased for resale, for purposes of Tax Law § 1101, when the purchaser acquires the item for the purpose of resale (***see, Matter of Albany Calcium Light Co. v. State Tax Commn.***, 44 NY2d 986, 408 NYS2d 333; ***Matter of Micheli Contr. Corp. v. New York State Tax Commn.***, 109 AD2d 957, 486 NYS2d 448). Any resale which is purely incidental to the primary purpose of the business is not a purchase for resale as such (***see, Matter of Custom Mgt. Corp. v. New York State Tax Commn.***, 148 AD2d 919, 539 NYS2d 550; ***Matter of Laux Advertising v. Tully***, 67 AD2d 1066, 414 NYS2d 53).

Petitioners did not purchase the items in order to resell them. Rather, they purchased the items in order to provide a service. At Lenox Hill, for example, petitioners agreed to "manage and operate" a variety of nutritional services. Furthermore, the regulations of the Commissioner of Taxation provide, in part:

> Napkins, straws, stirrers, plastic knives, forks, spoons and other similar items are not purchased for resale as such nor are they packaging materials or components thereof. Purchases of these items by restaurants *and similar establishments* are not purchases for resale nor exempted from tax by paragraph (19) of section 1115(a) of the Tax Law and are subject to tax. (20 NYCRR 528.20[d][2]; emphasis added.)

Here, since the recurring purchases were used in its service of managing a food service, the items were clearly not purchased for resale.

Similarly the items delivered to Burke were not purchases for resale as such. Rather, they were acquired as a part of a service. Sodexho was hired by Burke for its management expertise and to establish control over the supplies. As a result, Sodexho told Burke the number of items to purchase, when to purchase the various items and how the items were to be delivered. Moreover, in performing its duties under the contract, Sodexho created a schedule which explained where the supplies should be sent within the hospital.

G. Petitioners argue that the Division should be estopped from assessing tax because they relied upon a letter issued by the Division on April 30, 1993. In general, unless there are exceptional facts which require its application to avoid a manifest injustice, the doctrine of estoppel does not apply to governmental acts (***Matter of Consolidated Rail Corp***., Tax Appeals Tribunal, August 24, 1991, ***confirmed*** 231 AD2d 140, 660 NYS2d 459, ***appeal dismissed*** 91 NY2d 848, 667 NYS2d 683). This rule is considered especially strong when a taxing authority is involved, because public policy supports the enforcement of the Tax Law (***Matter of Glover Bottled Gas Corp.***, Tax Appeals Tribunal, September 27, 1990).

The Tax Appeals Tribunal has utilized a three-part test in order to determine whether to invoke an estoppel. The test asks if there was a right to rely on the representation, whether there was such reliance and whether the reliance was to the detriment of the party who relied upon the representation (***see, Matter of Consolidated Rail Corp., supra***).

H. The record shows that on or about November 11, 1992, MMS, a predecessor of petitioners, wrote a letter to the Division asking for the correct tax treatment of its purchases of food, nonfood supplies and repair services performed on food service equipment belonging to an exempt hospital.  MMS had entered into a contract with a tax exempt hospital to provide meals and cafeteria facilities. The Division responded that MMS's purchases of food, nonfood supplies and repair services to the equipment owned by the hospital were purchases for resale since MMS would bill the hospital for the purchases of the tangible personal property and repair services.

I.  The Division argues that the facts do not support invoking the remedy of estoppel. According to the Division, the facts in the present case do not mirror the facts set forth in the letter inasmuch as petitioners were not hired to provide patient meals or cafeteria facilities and they did not  perform repair work.  In contrast, petitioners maintain that the material facts are nearly identical to those cases where an estoppel has been granted.

An examination of the record shows that the material facts in the matter at hand and the facts underlying the 1993 opinion letter are substantially identical.  In each case, the taxpayer was contacted by exempt organizations to provide management services for the operation of food services.  In each instance, petitioners used their expertise to purchase food and nonfood supplies.  Ultimately, in both cases, all of the inventory was owned by the tax exempt organization.  In the earlier matter and the current matter, all of the food service equipment was owned by the exempt organization.  Lastly, petitioners provided only management employees in both the earlier matter and the current matter.  The fact that petitioners' predecessor arranged for repairs on the food service equipment or that Sodexho was not hired to provide patient meals is irrelevant.  In sum, the material facts underlying the previous letter and the current matter are largely the same.

J. The record supports petitioners' position that all of the elements of an estoppel are present. Petitioners had a right to rely on the letter they received from the Division. It is reasonable to expect a taxpayer to accept written guidance from the Division regarding the taxability of a particular transaction and to rely upon the same (***see, e.g.***, ***Matter of Bolkema Fuel Co.***, Tax Appeals Tribunal, March 4, 1993). Petitioners have also established that they relied upon the letter. Internal memoranda of MMS show that MMS made administrative decisions based upon whether the three criteria set forth in the letter of April 30, 1993 were satisfied. Lastly, it is clear that the reliance was to the detriment of the taxpayer. Since petitioners were advised that the activity that they outlined was not subject to tax, they did not have the option of either accruing the tax or changing their business practice to avoid the imposition of the tax (***Matter of Consolidated Rail Corporation, supra***). Accordingly, the Division is estopped from assessing tax or denying a refund to the extent that the tax assessed or refund claimed is based upon the purchase of nonfood items during the period in issue.

K. The petitions of Sodexho USA, Inc., Sodexho Operations, LLC and Sodexho Management, Inc. are granted to the extent of Conclusion of Law "J" and the Division is directed to modify the notices of determination and denial of the claims for refund accordingly.

DATED: Troy, New York
March 30, 2006

/s/ Arthur S. Bray
ADMINISTRATIVE LAW JUDGE