

STATE OF NEW YORK

STATE TAX COMMISSION

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In the Matter of the Petitions

of

ATLAS LINEN SUPPLY CO., INC.

DECISION

for Revision of Determinations or for Refunds  
of Sales and Use Taxes under Articles 28 and  
29 of the Tax Law for the Period June 1, 1980  
through August 31, 1984.

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Petitioner, Atlas Linen Supply Co., Inc., 405 West Taylor Street, Syracuse, New York 13202, filed petitions for revision of determinations or for refunds of sales and use taxes under Articles 28 and 29 of the Tax Law for the period June 1, 1980 through August 31, 1984 (File Nos. 61661 and 62775).

A hearing was held before Arthur Johnson, Hearing Officer, at the offices of the State Tax Commission, 333 East Washington Street, Syracuse, New York, on January 29, 1987 at 1:15 P.M., with all briefs to be submitted by June 19, 1987. Petitioner appeared by Scolaro, Shulman, Cohen, Lawler & Burstein, P.C. (Bruce M. Poushter, Richard S. Scolaro, Walter D. Kogut, Esqs., of counsel). The Audit Division appeared by John P. Dugan, Esq. (James Della Porta, Esq., of counsel).

#### ISSUES

I. Whether linens and garments furnished to customers of petitioner's Hospital Division were purchased for resale.

11. Whether the penalty and that portion of interest exceeding the minimum rate should be cancelled.

FINDINGS OF FACT

1. Petitioner, Atlas Linen Supply Co., Inc. ("Atlas"), was engaged in the business of providing a laundry and linen service. The operation consisted of two separate divisions, the Commercial Division and the Hospital Division.

2. On April 19, 1985, as the result of an audit, the Audit Division issued notices of determination and demands for payment of sales and use taxes due against Atlas covering the period June 1, 1980 through August 31, 1984 for taxes due of \$96,711.43, plus penalty of \$20,163.49 and interest of \$28,745.54, for a total of \$145,620.46.

3. On audit, the Audit Division examined purchase invoices in detail for the audit period and found that no sales or use tax was paid on the following purchases:

<u>Category</u>	<u>Amount of Purchases</u>	<u>Tax Due 7%</u>	<u>Tax Due 3%</u>	<u>Tax Due 1½%</u>
Linen Inventory	\$1,203,581.00	\$84,250.67		
Recurring Expenses	163,624.00	8,067.64	\$1,169.61	\$140.78
Fixed Assets	44,039.00	3,082.73		
		<u>\$95,401.04</u>	<u>\$1,169.61</u>	<u>\$140.78</u>

At the hearing, counsel for Atlas conceded to the amount of tax determined due on recurring expenses and fixed assets. In addition, counsel agreed to tax due on linen purchases of \$700,543.00. Said amount represented linens and garments purchased for its Commercial Division. The unresolved portion of the audit is the tax **due** on purchases of linens and garments for the Hospital Division.

4. The Audit Division determined that Atlas was engaged in providing nontaxable laundering services in both the Commercial and Hospital Divisions and **as** such, the linens and garments purchased and furnished to its customers as part of the service were subject to tax. Atlas agreed with the Audit

Division regarding the purchases made for the Commercial Division. However, with respect to the Hospital Division, Atlas took the position that it rented the linens and garments to the hospitals separate and apart from providing a laundry service, and therefore the linens and garments were purchased for resale.

5. Atlas proposed in writing two options to hospitals' when negotiating contracts. The first option was for the hospital to own and provide linens and Atlas would render laundering services for a flat rate per pound. Under the second option, Atlas provided both the linens and the laundry service and charged a specified price for each particular type of linen or garment.

6. The standard contract that Atlas entered into with the hospitals that selected the second option above provided, in part, as follows:

"Whereas, the Company is among other things engaged in the Hospital Linen Rental Service and is desirous of serving the Hospital, and

Whereas, the Hospital is desirous of the Company servicing hospital linens and laundering needs on a rental basis.

\* \* \*

1. The Company agrees to rent and service and the Hospital agrees to accept and use normal requirements for linen items as set forth in the Price Schedule....

\* \* \*

3. The Company agrees to pay for all normal linen and garment replacements.

4. That all linens furnished and supplied, shall at all times, be and remain the property of the Company."

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1 The Audit Division stipulated that the hospitals that had entered into contracts with Atlas during the audit period were organizations exempt from the imposition of sales and use taxes under section 1116(a)(4) of the Tax Law.

7. The responsibilities of Atlas under the contract included assisting the hospital with controlling its linen cost, inventory management and budget controls. The "Proposal for Service" submitted by Atlas to the hospitals provided for special delivery in sanitized trucks and employed pickup procedures to ensure that soiled linens were not commingled with clean linens. Atlas agreed to use wash formulas that were free of allergenics, toxicity and irritants.

8. Annexed to each contract was a list of all linen and garments used by the hospital and the unit charge per item. The unit price was determined based on an estimate of the cost of laundering the item and the cost recovery factor for the item. Factors considered in the cost of laundering included the weight of the particular item and the useful life expectancy of an item.

9. The charge to the hospital was determined based on the quantity of the items used by the hospital and returned to Atlas for laundering times the applicable unit price specified in the contract. The invoice to the hospital did not show separately a charge for the item and a charge for the laundry service.

10. The Audit Division argued alternatively that there were no substantial differences between the operations of Atlas's Commercial Division and the Hospital Division and consequently, if Atlas was renting linens and garments to hospitals then it was also renting to customers of the Commercial Division and such rental charges were subject to sales tax.

11. The Commercial Division of Atlas operated separately from the Hospital Division. The two divisions had separate physical locations, employees, accounting systems and customers. The Commercial Division also owned and furnished linens to its customers; however, customers were charged on a per pound basis for laundering services. The charge per pound considered the cost

for laundering and the cost recovery factor for the linen or garment. The cost recovery factor for linens and garments in the Commercial Division was less than in the Hospital Division.

12. Atlas argued that the capital recovery cost of linens which were furnished to commercial customers represented a very small and insignificant percentage of total operating costs whereas in the Hospital Division, there is a substantial relationship between the per piece charge to the hospital and the cost of the linens and garments.

13. With respect to the penalties asserted by the Audit Division, Atlas took the position that reasonable cause existed for its failure to pay sales or use taxes on the purchases of linens and garments for both the Commercial Division and the Hospital Division. Atlas gave the following reasons to establish reasonable cause:

(1) There was a fire in 1984 at the offices of the corporation and certain records were destroyed. The destruction of records caused by the fire made it difficult to determine if sales taxes were due.

(2) Atlas had four different controllers between 1979 and the present. Due to the high turnover of controllers, Atlas was unable to obtain a clear picture if any sales taxes were due in the course of its business operations.

(3) Atlas relied on various published case law and rulings cited in its brief to support the position that linens were rented to customers by its Hospital Division.

#### CONCLUSIONS OF LAW

A. That sections 1101(b)(1) and 1101(b)(4)(i) of the Tax Law define "purchase at retail" and "retail sale" as a sale or purchase of tangible personal property to or by any person for any purpose, other than for resale.

The term "sale" as defined in section 1101(b)(5) of the Tax Law includes rental or lease.

B. That section 1105(c)(3)(ii) of the Tax Law excludes laundering services from the imposition of sales tax. Tangible personal property purchased for use in performing a service not subject to tax is not purchased for resale (20 NYCRR 526.6[b][7]),

C. That the essence of the transactions between Atlas and the hospitals was to provide laundry services and not rent linens and garments separately from such services, notwithstanding that the form of the contract and the method of billing were structured to create a rental arrangement. The transfer of linens and garments in conjunction with rendering laundry services did not result in a "resale" thereof. Accordingly, petitioner was required to pay tax on the linens and garments purchased for use in its Hospital Division.

D. That section 1145(a)(1)(i) of the Tax Law provides for the imposition of penalty and interest for failure to file a return or pay over any tax when due. Former subparagraph (ii) of said section provides for the remission of penalty and that portion of interest that exceeds the minimum rate if the Tax Commission determines that the failure or delay was due to reasonable cause and not due to willful neglect.

E. That 20 NYCRR 536.1(b) (former 20 NYCRR 536.5[b]) provides:

"Reasonable Cause. In determining whether reasonable cause exists, either as a basis for remitting assessed interest or penalties or as grounds for remitting interest or penalties upon the late filing of a return or payment, the taxpayer's previous compliance record may be taken into account. Reasonable cause for failure to file a return on time must be affirmatively shown by the taxpayer in a written statement. Grounds for reasonable cause, where clearly established, may include the following:

- (1) death or serious illness of the taxpayer, a responsible officer or employee of the taxpayer, or his unavoidable absence from his usual place of business;
- (2) destruction of the taxpayer's place of business or business records by fire or other casualty;

- (3) timely prepared returns misplaced by the taxpayer or a responsible employee of the taxpayer and discovered after the due date;
- (4) inability to obtain and assemble essential information required for the preparation of a complete return despite reasonable efforts;
- (5) pending petition to Tax Commission or formal hearing proceedings involving a question or issue affecting the computation of tax for the year, quarter, month or other period of delinquency; or
- (6) any other cause for delinquency which appears to a person of ordinary prudence and intelligence as a reasonable cause for delay in filing a return and which clearly indicates an absence of gross negligence or willful intent to disobey the taxing statutes. Past performance will be taken into account. Ignorance of the law, however, will not be considered reasonable cause.

F. That petitioner's failure to pay sales or use taxes on purchases of linens and garments made for the Hospital Division was due to reasonable cause and not due to willful neglect. However, such is not the case with respect to the tax admittedly due on such purchases for the Commercial Division. Petitioner was negligent in its failure to pay tax on purchases of \$700,543.00 and the penalty and applicable interest is sustained on that portion of the assessment.

G. That the petitions of Atlas Linen Supply Co., Inc. are granted to the extent that penalty and that portion of interest exceeding the minimum amount prescribed by law is cancelled on taxes due of \$45,379.39 (\$648,277.00 x 7%); the Audit Division is hereby directed to modify the notices of determination

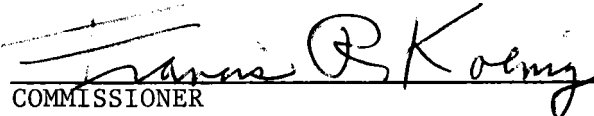
and demands for payment of sales and use taxes due issued April 19, 1985; and that, except as so granted, the petitions are in all other respects denied.

DATED: Albany, New York

STATE TAX COMMISSION

AUG 28 1987

  
PRESIDENT

  
COMMISSIONER

  
COMMISSIONER