

STATE OF NEW YORK  
TAX APPEALS TRIBUNAL

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In the Matter of the Petition	:	
of	:	
<b>JENKINS COVINGTON, N.Y., INC.</b>	:	DECISION
<b>AND ANDREW JENKINS, OFFICER</b>	:	DTA NOS. 800310
	:	AND 800311
for Revision of a Determination or Refund of Sales	:	
and Use Tax under Articles 28 & 29 of the Tax	:	
Law for the Period September 1, 1976 through	:	
August 31, 1980.	:	

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Petitioners, Jenkins Covington, N.Y., Inc. and Andrew Jenkins, 510 East 74th Street, New York, New York 10021, filed an exception to the determination of the Administrative Law Judge issued on September 24, 1987 with respect to their petition for revision of a determination or for refund of sales and use tax under Article 28 and 29 of the Tax Law for the period September 1, 1976 through August 31, 1980 (File Nos. 800310 and 800311). The petitioners appeared by Barash, Goodfriend & Friedman, P.C. (Harvey Sanders, CPA). The Division of Taxation appeared by William F. Collins, Esq. (Anne W. Murphy, Esq. of counsel).

Neither party filed a brief on exception. Oral argument was heard, at petitioner's request, on March 8, 1988. After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

***ISSUES***

I. Whether petitioners are liable for additional sales tax for services performed on tangible personal property which property was alleged to have been delivered to a point outside of New York State thereby qualifying for exemption from sales and use tax.

II. Whether petitioner, Andrew Jenkins, was a person required to collect and pay sales and use taxes imposed, collected or required to be collected by petitioner, Jenkins Covington, N.Y., Inc.

### ***FINDINGS OF FACT***

We find the facts as stated in the Administrative Law Judge's determination and such facts are incorporated herein by this reference. These facts may be summarized as follows.

During the period September 1, 1976 through August 31, 1980 (the "audit period") Jenkins Covington, N.Y., Inc. ("the corporation") was engaged in the production of television commercials. In general, the customers of the corporation were advertising agencies which contract with the corporation for the production of commercials on behalf of the advertising agencies' clients. The corporation shot and developed substantial footage of original negative film. The original negative footage was then sent to an editing house, also engaged by the corporation, for the purpose of editing and processing said footage. The editing house selected various "takes" which were used to assemble a product known as a "duplicate negative" or "optical negative". The "duplicate" or "optical" negatives were used to prepare additional prints which were in turn sent to television stations for airing. The corporation contends that original negatives were shipped out of state to a storage vault for safekeeping. Often, the shipping was done by the editing house per instructions from the corporation.

On July 27, 1982, the Division of Taxation issued to the corporation a Notice of Determination and Demand for Payment of Sales and Use Taxes Due for the period September 1, 1976 through August 31, 1979 in the amount of \$772,533.12 plus interest of \$300,783.54 for a total amount due of \$1,073,316.66. On the same date, the Division of

Taxation issued to the corporation a second Notice of Determination and Demand for Payment of Sales and Use Taxes Due for the period September 1, 1979 through August 31, 1980 in the amount of \$151,839.54 plus interest of \$38,818.05 for a total amount due of \$190,657.59. Also on July 27, 1982, the Division of Taxation issued to Andrew Jenkins, as officer of Jenkins Covington, N.Y., Inc. two notices of determination and demand for payment of sales and use taxes due in the same amounts and for the same periods as those encompassed by the assessments against the corporation.

The above-noted assessments, issued as a result of a field audit, consisted of tax due in three different areas of examination:

- (a) \$129.92 due on the purchase of fixed assets;(b) \$15,389.00 due on recurring expenses; and
- (c) \$908,853.74 due on unsubstantiated exempt sales, consisting of the services performed on tangible personal property, i.e., original negatives which are delivered outside of New York State.

Petitioners did not contest the tax assessed with respect to items “(a)” and “(b)” above, nor is the audit methodology employed at issue. Petitioners do contest the tax assessed on what the Division of Taxation determined to be unsubstantiated exempt sales, item “(c)”.

Numerous times during the course of the audit, the Division of Taxation requested that the corporation produce substantiating documentation of the out-of-state sales, including such documents as shipping invoices, warehouse receipts and contracts as proper proof of delivery to an out-of-state warehouse. The corporation did not produce such documentation during the course of the audit.

Exempt sales were tested by the Division of Taxation for the quarter ended May 31, 1979. The corporation was unable to produce proof of exempt sales which was satisfactory to the Division of Taxation, and therefore total gross sales per the Federal income tax returns were considered taxable for the entire audit period. The Federal figures were chosen after it was determined that sales per the ST-100's could not be reconciled with the general ledger and that the Federal figures reflected on the U.S. corporation income tax returns were higher than the general ledger figures. Proper credit was given for those sales on which sales tax was charged and paid.

The month of August 1979 was selected by the Division of Taxation as a test period for use tax. Those items not considered for resale were assessed, resulting in additional use tax of \$10,537.80, an amount to which petitioners agreed at the time of the test. One item in the amount of \$1,400.00 was contested by the corporation and resulted in a percentage of error of 1.87 percent, which, when applied to the entire audit period, yielded additional use tax due of \$4,851.20. However, since no amounts were ultimately consented to by the corporation, the total additional use tax due of \$15,518.92 was assessed. Petitioners' representative did not contest the use tax assessment at the hearing.

With regard to the exempt sales, it was decided by petitioners' representative and the Division of Taxation to select several accounts from the test quarter and to verify the delivery of the specific items to warehouses in New Jersey by a visit to same.

According to notes taken on August 22, 1984 by one of the auditors working on the case, Mr. Miguel Cruz, an employee at the Fort Lee Film Storage and Service Company was unable to tell the Division of Taxation what in fact was delivered in boxes from editing houses

or the corporation. At another warehouse, that of MGS Services, Inc., the manager, Mr. Bob Ryan, told the Division of Taxation representatives that his understanding was that the boxes received from the editors and the corporation contained “inactive” material such as “trim-outs”, original picture negatives, voice tracks, narrative tracks, optical material and other negatives. Mr. Ryan informed auditor Cruz that it was his understanding that the final product was not delivered to the warehouse but to the advertising agency.

Subsequent to the hearing, petitioners’ representative submitted contracts, some with supporting documentation of delivery attached, including delivery receipts, warehouse receipts, receiving notices and vault packing slips, for the alleged exempt sales which took place during the test period ending May 31, 1979. Upon close scrutiny of the contracts and documentation substantiating out-of-state delivery of original negatives and duplicate negatives/optical negatives or fine grain master positives (“production materials”) the Administrative Law Judge concluded that on approximately half the transactions at issue delivery was effected outside the State of New York.

As a result, total exempt sales for the test quarter ended May 31, 1979 were \$587,624.07. When added to the amount already allowed by the Division of Taxation, \$14,151.44, total exempt sales for the quarter were \$601,775.51, or 51.292 percent of total sales for the quarter. The Division of Taxation had disallowed 99.05 percent.

Petitioners failed to file sales tax returns for the periods ended May 31, 1977, February 28, 1978 and May 31, 1978.

### ***OPINION***

We affirm the determination of the Administrative Law Judge.

The parties do not dispute that proof of delivery of the production materials out of state exempts the transaction from sales tax. The issue is the application of this principle to the books, records and other documentation offered by petitioners.

The Administrative Law Judge performed an extensive review of the numerous documents relating to 82 accounts submitted by petitioners after hearing. The Administrative Law Judge found that with respect to 41 of these accounts the petitioners documented the out-of-state receipt of the production materials or established that all activity with regard to the contract took place outside the State. Based on this finding, the Administrative Law Judge reduced the percentage of sales disallowed by the Division from 99.05 percent to 49.81 percent.

On exception petitioners argue that the Administrative Law Judge erred in not accepting the documentation they submitted with respect to the other 41 accounts as proving delivery outside the State.

Our review of the record indicates no reason to, in any way, modify the Administrative Law Judge's determination since the documentation submitted with respect to the other 41 accounts failed to prove delivery outside the State.

Petitioners failure to produce documentation concerning the transactions at issue during the audit is unfortunate since that was the appropriate time for adequate consideration by both parties of the documents and the nature of the transactions they represent. The formal nature of the hearing before the Administrative Law Judge operates against such discussion and analysis. While such documents can be reviewed post-hearing by the Administrative Law Judge, again the bilateral review and consideration that can occur during audit is absent.

Petitioners assertion at oral argument, that in prior years contracts indicating out-of-state delivery were sufficient for audit purposes, is not persuasive. Such practice does not preclude, as here, the examination of the actual transaction to determine if it reflects the provisions of the contract, i.e., out-of-state delivery.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of petitioners is in all respects denied;
2. The determination of the Administrative Law Judge is affirmed; and
3. The petitions of the petitioners are granted to the extent indicated in conclusions of law "E", "F" and "I" of such determination and the four notices of determination and demand are to be modified accordingly; and except as so granted the petitions are in all other respects denied.

DATED: Albany, New York  
August 25, 1988

/s/ John P. Dugan  
President

/s/ Francis R. Koenig  
Commissioner