STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
HUDSON SHERATON CORPORATION D/B/A SHERATON CENTRE HOTEL	:	DECISION
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, 1979 through February 28, 1982.	:	

Petitioner, Hudson Sheraton Corporation d/b/a Sheraton Centre Hotel, 811 Seventh Avenue, New York, New York 10019, and the Division of Taxation each filed an exception to the determination of the Administrative Law Judge issued on September 3, 1987 with respect to petitioner's 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, 1979 through February 28, 1982 (File No. 800736). Petitioner appeared by William D. Maroney, Esq., The Division of Taxation appeared by William F. Collins, Esq. (Patricia L. Brumbaugh, Esq., of counsel),

Each of the parties filed a brief on exception. Oral argument was heard at request of both parties on April 14, 1988.

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

ISSUES

I. Whether separately-stated advertising commissions billed to petitioner by Needham & Grohmann, Inc. are excluded from the imposition of sales taxes by virtue of the fact that a principal-agent relationship existed between petitioner and Needham & Grohamann, Inc.

II. Whether all of the other charges billed to petitioner by Needham & Grohmann, Inc., in addition to the separately-stated commissions, are receipts subject to the sales and use taxes.

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, except to the extent such facts are modified and supplemented as indicated below.

In April of 1982, an audit of the Hudson Sheraton Corporation d/b/a Sheraton Centre Hotel (hereinafter "petitioner") was commenced by the Division of Taxation. On June 10, 1983, a representative of petitioner, John D. Gillis, Manager, State Taxes, executed Form AU-377.12, Audit Method Election, whereby he agreed on behalf of petitioner that, despite being advised that records available for audit were adequate and sufficient to warrant an audit method utilizing all records within the period, a representative test period audit method would be used for purposes of auditing recurring expense purchases.

Finding of fact "3" of the Administrative Law Judge's determination is modified to read as follows:

> Based upon a test period audit of petitioner's expense purchases, fixed assets, food and beverages and advertising purchases, total tax liability in the amount of $154,474.14 was determined by the Division of Taxation. Only the Division's determination of petitioner's tax liability on advertising purchases remains in issue in the amount of $72,995.49. This entire amount involves transactions between petitioner and Needham & Grohmann, Inc. (hereinafter *"N & G"*). A Notice of

> Determination and Demand for Payment of Sales and Use Taxes Due was issued on June 20, 1983 assessing this amount of tax, plus interest.

For purposes of the audit of petitioner's advertising purchases, invoices relative to purchases of advertising artwork and of brochures, signs and other tangible personal property for the year 1981 were analyzed. Total purchases for 1981 were found to be in the amount of $297,208.54. A taxable percentage of .84 percent was determined. The auditor then applied this percentage to the total advertising purchases for the audit period of $907,888.00. The appropriate sales tax rate was then applied, resulting in tax due in the amount of $72,995.49. We find as an additional fact that the audit report states that "[t]hese items were assessed on the basis that there is no principal-agency relationship since the advertising agency did not clearly disclose to the supplier, the name of the client for whom the agency is acting as agent."

We modify finding of fact "6" of the Administrative Law Judge's determination, at the request of the petitioner, to read as follows:

> Petitioner contests the Division's method of computing the tax because petitioner asserts that this method imposed tax on advertising services and because it imposed tax on purchases which were already subject to sales tax and on which sales tax had been paid.

With respect to petitioner's contention that it established a principal-agent relationship with N & G, it was the Division's position at hearing that such relationship did not qualify as a principal-agent relationship because it did not satisfy Department requirements as outlined in memoranda of the Technical Services Bureau of the Department of Taxation and Finance's Taxpayer Services Division (TSB-M-78[3]S and TSB-M-83[16]S),

On March 24, 1978, the Technical Services Bureau of the Department of Taxation and Finance's Taxpayer Services Division issued guidelines (TSB-M-78[3]S) relative to principal-agent relationships which provided, in pertinent part, as follows:

> "Recent inquiries as to whether an advertising agency may act as an agent for a disclosed principal and if it can, what elements would constitute a principal-agency relationship, resulted in the following guidelines.
>
> Generally speaking, an agent is one who represents another, called the principal, in dealings with third persons. It has been concluded through departmental correspondence that an advertising agency can act as agent on behalf of its client in dealings with third persons.
>
> To establish that a particular requisition was made by an advertising agency acting as agent for his client, the following conditions must be met:
>
> 1. The advertising agency must clearly disclose to the supplier the name of the client for whom the agency is acting as agent, and
>
> 2. The advertising agency must obtain, prior to the acquisition, and retain written evidence of agent status with the client, and
>
> 3. The price billed to the client, exclusive of any agency fee, must be the same as the amount paid to the supplier. The advertising agency may make no use of the property for its own account, such as charging the item to the account of more than one client.
>
> * * *
>
> If an advertising agency has established a principal-agency relationship, meeting all of the criteria listed above, all sales of tangible personal property such as catalogs, mailing devices or promotional handouts, tapes or films by that advertising agency to its clients are subject to appropriate New York State and Local Tax on the total charge, <u>excluding any separately stated agency commissions</u>" (emphasis added).

The relationship between petitioner and N & G meets conditions 1 and 3 above.

On June 10, 1983, the Technical Services Bureau issued additional guidelines (TSB-M-83[16]S) to clarify the conditions set forth in TSB-M-78(3)S. As to condition 2, TSB-M-83(16)S stated as follows:

> "Condition 2 above will be met only where there exists a properly executed written agency agreement which clearly sets forth that the advertising agency is appointed to act as agent for and on behalf of the client with respect to making purchases."

No written agency agreement was ever executed between petitioner and N & G.

For approximately 22 years, N & G had been performing services for petitioner's parent corporation, The Sheraton Corporation, and certain affiliates thereof. When petitioner purchased what was formerly the Americana Hotel in New York City in 1978, renovated the hotel and changed the name to the Sheraton Centre, N & G immediately became involved in the advertising campaign relative thereto.

When N & G, in the course of the performance of its services, was required to engage the services of outside suppliers such as photographers or typesetters, such services or supplies were purchased from said suppliers by *N* & G through the use of a purchase order or art purchase order form on which the name of the client, i.e., the petitioner, was included and on which form, under “Terms and Conditions", the following clause was contained:

> "This order is placed by us in our capacity as advertising agency -- not as principal -- for the advertiser whose name appears on the face of this order, its subsidiaries, affiliated and controlled companies."

N & G paid sales tax to these suppliers and when N & G billed petitioner, petitioner was billed at the same amount as paid by N & G to the supplier. A separately-stated fee of N & G was also included on the bill, said fee having been calculated at approximately 15 percent of the total bill.

We find as an additional fact that N & G did not have the capability to perform any of the production work for petitioner's advertising in-house, with the exception that N & G employees did assemble mechanicals from the photographs, typeset type and other materials prepared by outside suppliers. *N &* G did not itself transfer any tangible personal property to petitioner.

OPINION

The Administrative Law Judge determined that petitioner proved it had a principal-agent relationship with N & G and as a result that N & G's separately stated commissions were excluded from the tax imposed by section 1105(c)(1) of the Tax Law as a fee for advertising services.

The Division of Taxation has taken exception to this conclusion of law. The Division of Taxation did not take exception to the facts as found by the Administrative Law Judge.

The Administrative Law Judge also determined that with respect to all of the charges by *N & G*, other than the separately stated commissions, petitioner failed to prove that such charges were solely for placement of advertisements with the media without the transfer of tangible personal property. The Administrative Law Judge concluded that all of these charges were then subject to tax.

The petitioner has taken exception to this conclusion of law.

The Division has challenged the Administrative Law Judge's conclusions on these grounds:

1. The Administrative. Law Judge erroneously concluded that proof sufficient to establish a principal-agent relationship as between the parties is sufficient to prove such a relationship as regards the Division of Taxation.

2. The Administrative Law Judge failed to recognize the statutory basis for Technical Services Bureau Memoranda and the Administrative Law Judge failed to apply the second condition of TSB-M-78(3)S that "To establish that a particular requisition was made by an advertising agency acting as agent for his client . . . The advertising agent must obtain, prior to the acquisition, and retain written evidence of agent status with the client."

3. The Administrative Law Judge erroneously concluded that petitioner proved that the separately stated commissions were solely for advertising services as defined at 20 NYCRR 527.3(b)(5).

We affirm the determination of the Administrative Law Judge on this issue.

First, we find that petitioner satisfied the second condition of TSB-M-78(3)S by proving that its agent, N & G, obtained, prior to acquisition, and retained written evidence of *N & G*'s agency status. Therefore, we need not address whether the Division is authorized to require such proof of the principal-agent relationship in a Technical Services Bureau memorandum.

The record indicates that petitioner introduced a number.of documents with respect to the relationship of petitioner and N & G. The most relevant of these are as follows:

1. A letter dated September 13, 1978 from N & G to petitioner acknowledging that petitioner was a vitally important account for N & G and discussing possible conflicts of interest with other clients of N *& G.* (Exhibit 1)

2. A letter dated November 15, 1978 from petitioner to N & G reviewing the advertising thus far developed by N & G and discussing media placement strategy. (Exhibit 2)

3. A memorandum dated October 25, 1978 between officers of petitioner acknowledging that N & G had been selected as the advertising agent of petitioner. (Exhibit 10)

4. A conference report dated January 4, 1979 prepared by *N & G* reporting on a conference between N & G and petitioner discussing the advertising campaign of petitioner. This report details petitioner's approval of certain materials and directions to N & G to commission certain artwork. The report indicates petitioner's representatives were present at the meeting and received copies of the report. (Exhibit 3)

5. Petitioner introduced copies of the purchase order and art purchase order used by N & G to make all purchases of services and materials from suppliers. These forms reveal the client's name and state, "This order is placed by us in our capacity as advertising agency not as principal -- for the advertiser whose name appears on the face of this order..." (Exhibit 8)

6. The petitioner introduced copies of these forms actually used by N *& G* to make purchases on behalf of N & G during the audit period. (Exhibits 6 & 7)

The Division challenges the sufficiency of these documents on the grounds that they are not a manifestation from petitioner to N & G that N & G is authorized to act as petitioner's purchasing agent, as contrasted to its advertising agent. The conference report of January 4, 1979 and the purchase orders are discounted as not having been obtained from petitioner.

Through these challenges the Division is seeking to impose requirements that are not expressed in the language of the second condition of TSB-M-78(3)S -- namely that the documents clearly state N *& G 's* authority as purchasing agent and that such written statement be made by petitioner. Although the Division has not directly argued on exception that the written agency contract condition of TSB-M-83(16)S must be satisfied, it does seek on exception to impose similar requirements. The Division argues that these are not merely technical requirements but are necessary to satisfy the Division's need for auditable evidence to

exist at the time an advertising organization acquires property or services so that the incidence of tax, whether on the agent or on the principal, may be determined. While we acknowledge the Division's need for auditable evidence, we also note that it might have more readily satisfied this need had it audited the agent rather than the principal.

Nonetheless, we find that documents offered by petitioner, considered as a whole, satisfy the letter and spirit of the second condition of TSB-M-78(3)S and the Division's need for auditable evidence of the nature of N & G's purchases as purchases on behalf of petitioner. As a whole, through these documents, petitioner has proved that N & G obtained written evidence that N & G was the advertising agent of petitioner and that, in the course of providing advertising services, N & G was authorized to make acquisitions on behalf of petitioner. Further, the purchase orders indicate that N & G was in fact exercising such authority on each purchase it made from-third party suppliers. Finally, we find that petitioner proved that N & G obtained this written evidence prior to any acquisition during this audit period and retained such evidence. Thus, the second condition of TSB-M-78(3)S was satisfied by N & G. Since the Division has never disputed that the other two conditions were satisfied, we conclude that petitioner proved that N & G was entitled to be treated by the Division as the purchasing agent of petitioner. With respect to all purchases made by N & G as purchasing agent. the transfers occurred between the petitioner and the third party suppliers. The Division has not disputed the Administrative Law Judge's finding that tax was paid on all purchases from third party suppliers,

Our finding that petitioner satisfied the second condition of TSB-M-78(3)S dispenses with the entire basis upon which the instant assessment was issued. Upon audit it was determined that petitioner did not establish that N & G was authorized, as agent, to make purchases on

behalf of petitioner. As a result, the auditor concluded that all charges by *N &* G to petitioner were taxable receipts for the transfer of tangible personal property by N & G to petitioner. The auditor did not perform an audit in the alternative based on the assumption that a principal-agent relationship was established authorizing N & G to purchase services and materials in the place of petitioner and which:

1. identified those purchases made by N *& G* as purchasing agent pursuant to such principal-agent relationship;

2. identified services that N & G performed to the property of petitioner which would be taxable under section 1105(c)(2) of the Tax Law;

3. identified advertising services provided by N & G excluded from tax under section 1105(c)(1); and

4. identified tangible personal property acquired by N & G not as purchasing agent which was subsequently transferred by N & G to petitioner in a retail sale subject to tax under section 1105(a) of the Tax Law.

The Division on exception correctly notes the possibility of this range of transactions between an advertising agent and its client. Because of these possibilities, the Division states that "[i]n order to ascertain the taxable status of transactions between an advertising organization and its client, it is therefore necessary to analyze the underlying business practices and evaluate the facts of each transaction. 'This is exactly the type of weighing process in which the courts regularly defer to the knowledge and expertise of respondent.'" ([Citation omitted] Division of Taxation brief p. 17.) Unfortunately, in the instant case, an analysis of the underlying transactions and a weighing process is exactly what the Division did not do on audit. Instead,

tax was assessed on the entire billed amount by *N &* G on the basis that no principal-agent relationship existed.

As a result of this single track audit based on an assumption we find erroneous, it is not possible to now construct the audit that should have been done.

Based on the record that is before us, we make the following conclusions with respect to the tax liability of petitioner.

Petitioner did not purchase any tangible personal property from N *&* G as vendor. All such purchases were made from third party suppliers through N *& G* as agent.

N & G did not perform any services on the tangible personal property of petitioner taxable under section 1105(c)(2) of the Tax Law, except for the production of mechanicals. The record indicates one charge by N *&* G to petitioner for the production of a mechanical in the amount of $2,200.

All of the services provided by N *&* G to petitioner were either advertising services or purchasing services, both of which are excluded from the tax imposed by section 1105(c)(1) as "the services of advertising or other agents."

Therefore, the Division of Taxation is directed to determine tax due on advertising purchases for the audit period by recomputing the percentage of petitioner's taxable purchases of advertising material utilizing the amount of $2,200 as the amount of taxable purchases. In all other respects the assessment is cancelled.

Based on the above disposition of the case, petitioner's exception that all of the charges by N *&* G to petitioner were advertising services excluded from the tax imposed by section 1105(c)(1) as advertising services or personal or individual information services is moot.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

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

2. The exception of the "petitioner, Hudson Sheraton Corporation, is granted except to the extent that the Division is directed to recompute the percentage of taxable purchases based on the finding of $2,200 as the amount of taxable purchases;

3. The determination of the Administrative Law Judge is affirmed in part and reversed to the extent indicated in paragraph "2" above; and

4. The petition of Hudson Sheraton Corporation d/b/a Sheraton Centre Hotel is granted except to the extent indicated in paragraph "2" above and the Division of Taxation is directed to modify the Notice of Determination and Demand issued on June 20, 1983 accordingly.

Dated: Albany, New York
SEP 29, 1988

John P. Dugan
President

Francis R. Koenig
Commissioner