STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition of **J. C. PENNEY CO., 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 June 1, 1981 through May 31, 1984.	DECISION DTA NO. 801964

Petitioner, J. C. Penney Co., Inc., P.O. Box 2429, Field Tax Office, Pittsburgh, Pennsylvania 15230, filed an exception to the determination of the Administrative Law Judge issued on June 30, 1988 with respect to its 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 June 1, 1981 through May 31, 1984 (File No. 801964). Petitioner appeared by Ben D. Campbell, Esq. and Wayne Zakrzewski, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Anne W. Murphy, Esq. of counsel).

Petitioner filed a brief on exception. The Division of Taxation filed a letter in lieu of a brief in opposition to the exception. Oral argument was not requested by either party.

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

ISSUE

Whether the Division of Taxation properly determined that petitioner was selling certain catalogs at a "minimal charge" for promotional or advertising purposes, thereby entitling the Division to impose against petitioner a use tax on the costs of production of such catalogs pursuant to 20 NYCRR 526.6 rather than treating the sales of catalogs by petitioner to its customers as retail sales subject to sales tax.

FINDINGS OF FACT

We find the facts of this matter as stated in the Administrative Law Judge's determination and such facts are incorporated herein by this reference. Such facts are restated below.

Petitioner, J. C. Penney Co., Inc., is a Delaware corporation which, until recently, had its principal place of business located at 1201 Avenue of the Americas, New York City. In addition to petitioner's chain of retailstores, it also conducts a mail order business throughout the United States, including New York State. In the course of this mail order business, petitioner furnishes catalogs to prospective customers.

On January 25, 1985 the Division, pursuant to the results of a field audit, issued to petitioner a Notice of Determination and Demand for Payment of Sales and Use Taxes Due assessing tax in the amount of $262,834.98, plus interest, for the period June 1, 1981 through May 31, 1984. Certain post-field audit conferences were held resulting in mutually satisfactory resolutions to all but one of the issues upon which the aforementioned assessment was premised. The remaining issue is that presented in this proceeding, to wit, the assessment of use tax calculated on the costs of petitioner's 1980, 1981 and 1982 seasonal and Christmas catalogs sold to New York residents.

Until the late 1970's, petitioner distributed its catalogs free of charge. Beginning in the late 1970's, petitioner began charging some customers for its seasonal (i.e., Spring/Summer, Fall/Winter, and Christmas) catalogs, with the aim being to defray part of the cost of furnishing its catalogs to prospective customers and also of maximizing the amount of merchandise ordered per catalog.[1]

The majority of the seasonal catalogs distributed to residents of New York were mailed by an out-of-state printer directly to the homes of selected New York addressees without charge to

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[1]Petitioner continued, however, to distribute the bulk of its catalogs without charge to customers who had placed a minimum dollar amount of catalog orders during the previous year.

the recipient. Petitioner collected no New York sales or use tax on such interstate mailings of catalogs in reliance upon the 1978 New York Appellate Division (3rd Dept.) ruling in Bennett Brothers v. State Tax Commn. (62 AD2d 614), and the Division does not contest such treatment. A portion of the catalogs distributed to New York residents without charge were shipped by the out-of-state printer to petitioner's retail stores throughout the State, where they were picked up by prospective customers. Petitioner conceded that it exercised a taxable use over these catalogs and self-assessed the applicable use tax. The treatment of these catalogs is likewise not at issue.

The only catalogs at issue are those seasonal catalogs shipped to petitioner's retail stores and sold to customers. During the period in question on this remaining issue (the years 1980 through 1982), petitioner sold its Spring/Summer and Fall/Winter catalog for $2.00 each, and its Christmas catalogs for $1.00 each, and collected and remitted sales tax on sales of such catalogs to New York residents. These catalogs contained a coupon entitling customers to a reduction equal to the cost of the catalog (excluding sales tax) against merchandise ordered from the catalog.

During the three years in question, petitioner's receipts from sales of seasonal catalogs at the above-noted prices totalled $696,907.00, and petitioner collected and remitted sales tax on such sales in the aggregate amount of $47,377.00. By contrast the Division, utilizing petitioner's cost accounting information and other records, determined petitioner's costs for the above catalogs to be $1,134,388.00 and determined use tax due thereon in the aggregate amount of $77,118.48.[2] At hearing, petitioner provided information as to the selling prices, the costs and the price-to-cost percentages of its catalogs for the years in question. This information may be presented as follows:

[2]Tax in both instances was calculated through use of an effective tax rate of .06798245, being an amalgam of the various rates in effect in the different taxing jurisdictions throughout the State. This effective rate was agreed to between petitioner and the Division and is not in dispute.

SCHEDULE OF CATALOG BOOKS

SALES PRICE AND COST

Catalog Book	Sales Price	Cost	Price/Cost Percentage
Spring/Summer 1980 (A-80)	$2.00	$ 2.663	75.10%
Fall/Winter 1980 (R-80)	2.00	3.228	61.96%
Spring/Summer 1981 (A-81)	2.00	2.834	70.57%
Fall/Winter 1981 (R-81)	2.00	3.527	56.71%
Christmas 1981 (X-81)	1.00	1.677	59.63%
Spring/Summer 1982 (A-82)	2.00	3.101	64.50%
Fall/Winter (A-82)	2.00	3.620	55.25%
Christmas 1982 (X-82)	1.00	1.797	55.65%
TOTALS: Spring/Summer	$6.00	$ 8.598	69.78%
Fall/Winter	$6.00	$10.375	57.81%
Christmas	$2.00	$ 3.474	57.57%

OPINION

The Administrative Law Judge held that: (1) petitioner's purchase of promotional material was not for resale because petitioner's transfer of these materials, for less than their cost, was not a retail sale, (2) no resort to dictionary definitions or other guidance in determining the meaning of "minimal charge" is warranted when, as here, the contested term is defined within the regulation and that (3) 20 NYCRR 526.6(c)(4)(ii) (hereinafter "the regulation") clearly defines a "minimal charge" selling price for advertising or promotional materials as a price less than the seller's costs for such materials. On exception, petitioner asserts that the Administrative Law Judge erred in failing to: (1) find that the Division had acted arbitrarily in levying its assessment upon petitioner, (2) conclude that the regulation is unconstitutionally vague and (3) properly interpret and apply the regulation.

We affirm the determination of the Administrative Law Judge.

The regulation at issue, 20 NYCRR 526.6(c)(4)(ii), provides in relevant part as follows:

> "(ii) Tangible personal property which is purchased for promotional or advertising purposes and sold for a minimal charge which does not reflect its true cost, or which is not ordinarily sold by that person in the operation of his business, is a retail sale to the purchaser thereof, and not a sale to the recipient of the property.

* * *

> "Example 3: A vendor purchases catalogs and distributes them to his potential customers for a minimal charge, which does not reflect the cost to him. He is the retail purchaser of the catalog, and is required to pay the tax thereon. He cannot charge his customer tax on the charge for the catalog."

We first address whether the Division acted arbitrarily in assessing petitioner herein. We conclude that the Division has not acted arbitrarily.

A presumption of regularity shields agency actions (Matter of AT&T Information Systems, Inc. v. Donohue, 68 NY2d 821, 823; revg 113 AD2d 395 on dissenting opn). Nonetheless, an agency's "discretionary power" is not absolute; it is subject to the limitation that it cannot be exercised arbitrarily (Freidus v. Guggenheimer, 57 AD2d 760, 761; citing Matter of Mandel v. Board of Regents, 250 NY 173, 176-77). The decision in Freidus (supra at 761) found a cause of action for mandamus stated in pleadings which asserted that an administrative agency failed to revoke a license issued by it, which failure was "totally at odds with the action" taken against another similarly situated license holder. Petitioner cites Freidus for the proposition that the Division cannot interpret the regulation as the lawful basis for its assessment against petitioner, when to do so would be totally at odds with the treatment accorded other retailers and mail order businesses similarly situated to the petitioner. Petitioner also claims that this interpretation was "established arbitrarily for only one taxpayer, i.e. Penney".

Whatever the applicability of Freidus to the instant case, we note that petitioner has proferred no evidence that the Division has allowed other taxpayers, distributing catalogs in the course of advertising and promotion activities at a charge less than their true cost, to remit sales tax only on the "minimal charge" and not on the greater "true cost" of production. As proof of its allegation, petitioner relies upon a portion of its cross-examination of the auditor wherein the auditor stated that he could not say whether it was the Division's policy to construe the phrase "minimal charge" to automatically include every transfer of a catalog for less than its cost. However, petitioner itself later elicited testimony from the same auditor which revealed that the auditor had neither been involved in nor was aware of another retailer or mail order firm where the issue as to what

constitutes "minimal charge" had ever arisen. We conclude that this testimony does not establish that petitioner was treated differently than other similarly situated taxpayers.

The record contains no other proof that the Division established its interpretation of "minimal cost" to single out Penney in an abuse of discretion. We do note that in all the past cases dealing with the assessment of use tax on advertising and promotional materials, the petitioners had given away the materials free of charge so that 20 NYCRR 526.6(c)(4)(i), not 526.6(c)(4)(ii), was at issue (see, Matter of Heidelberg Eastern, Inc., State Tax Commn., November 22, 1985; Matter of Gaslight Village, Inc., State Tax Commn., June 12, 1981; Matter of Levy Bros. Plattsburgh, Inc., State Tax Commn., November 17, 1980; Matter of Storytown U.S.A. Inc., December 10, 1979; Matter of Waxlife, State Tax Commn., March 8, 1979). Petitioner cannot apply the fact that it is the first New York taxpayer to litigate this application of the phrase "minimal cost" within the regulation as proof that the Division has somehow abused its discretion. Neither does petitioner's attempt to force the Division to, at all times, uniformly assess all taxpayers similarly situated hold weight. We note that, "The Tax Commission is not put to the choice of taxing either all sales or none" (Matter of Seafarer Fiber Glass Yachts, Inc., 475 F Supp 1097 [ED NY 1979]; see also, Matter of Savemart, Inc. v. State Tax Commn., 105 AD2d 1001, 1004 appeal dismissed 64 NY2d 1039).

We next deal with petitioner's claim that the regulation is unconstitutionally vague on its face owing to its lack of an objective standard for determining the phrase "minimal charge." As a threshold matter, we question whether this issue is within our scope of review. We conclude that it is.

The Tribunal's enabling legislation does not extend our scope of review to determine the facial constitutionality of Tax Law statutes (Fourth Day Enterprises, Tax Appeals Tribunal, October 27, 1988); however, we may determine whether Tax Law statutes are constitutional as applied (see, Matter of David Hazan, Inc., Tax Appeals Tribunal, April 21, 1988). From this authority it follows that we may determine whether the Commissioner's regulations are

constitutionally valid, both facially - as in the instant case - and as applied (20 NYCRR 3000.11[e][3]).

We next address the appropriate test to determine whether 20 NYCRR 526.6(c)(4)(ii) is, in fact, unconstitutionally vague. The rule with respect to statutes is that "Due process requires only a reasonable degree of certainty so that individuals of ordinary intelligence are not forced to guess at the meaning of statutory terms" (41 Kew Gardens Road Associates v. Tyburski, 70 NY2d 325, 336; citing Foss v. City of Rochester, 65 NY2d 247, 253). Substantially the same rule has been adopted to determine whether a regulation is unconstitutionally vague, at least where serious civil sanctions were implicated (Quintard Associates, Ltd. v. New York State Liquor Authority, 57 AD2d 462, 394 NYS2d 960, 963; Matter of Montgomery Ward & Co., Inc. v. State Dept. of Motor Vehicles, 90 AD2d 643, 644; Town of Olive v. Martins, 79 AD2d 822, 823, appeal dismissed 54 NY2d 752; Slocum v. Berman, 81 AD2d 1014, 439 NYS2d 967, 969; Tommy & Tina, Inc. v. Dept. of Consumer Affairs of the City of New York, 117 Misc 2d 415, 421). We thus conclude this is the strictest test that could be applied to determine whether the Division's regulations are impermissibly vague.

We now address whether the regulation expresses a "reasonable degree of certainty" as to what is meant by a "minimal cost." We conclude that it does.

Petitioner cannot isolate "minimal charge" by ignoring the accompanying language, "which does not reflect its true cost" (20 NYCRR 526.6[c][4][i]), and then persuasively argue that the regulation is vague. As pointed out by the Administrative Law Judge, the latter phrase, both within the regulation and Example "3" thereunder, specifies what is meant by "minimal cost" so that resorting to dictionary definitions would be inappropriate. Simply put, the regulation defines "minimal charge" with certainty, as less than true cost, when the sentence in which that phrase is found is read as a whole.

We next address whether the Administrative Law Judge correctly interpreted and applied the regulation. We conclude that he did.

Petitioner's first point is that the Administrative Law Judge incorrectly interpreted the regulation when he concluded that "minimal charge" meant any charge less than the cost of the promotional material. As stated above, we conclude that the regulation, read in its entirety, plainly states that minimal charge means any charge less than the cost of the material. Accordingly, the Administrative Law Judge's reading of the regulation appears to us unassailable and petitioner's challenge must be evaluated as a challenge of the regulation itself, rather than of the Administrative Law Judge's interpretation.

Petitioner argues that the limitation put on its retail sale of the catalogs herein, i.e., that the transfer of the catalogs must be at least equal to their cost, results in so over narrow a definition of "resale" that it is inconsistent with the ordinary meaning of the term. To support its position, citing Burger King, Inc. v. State Tax Commn. (51 NY2d 614), petitioner relies on the rule of construction that exclusions from tax, like the resale exclusion, are strictly construed in favor of the taxpayer. Petitioner urges that the construction of "resale" that results from the definition of "retail sale" at issue is contrary to this general rule of construction. We conclude that petitioner's argument fails because it does not analyze the regulation in the context of the sales tax as a "consumer tax" (20 NYCRR 525.2[a][4]).

To resolve this recurring issue of distinguishing a sale for resale from a retail sale, the courts have frequently relied on the nature of the tax as a consumer tax. This analysis has been directly based on the spirit of the sales tax "to impose tax only upon the sale to the ultimate consumer, at which time the price paid for the taxable item would presumably be at its highest" (Burger King, Inc. v. State Tax Commn., supra, at 621). In other instances the courts sought to identify the consumer by determining whether a purchase of materials was for the primary purpose of reselling them or whether a subsequent sale was purely incidental to the purchaser's primary business (Laux Advertising, Inc. v. Tully, 67 AD2d 1066, at 1067 citing Albany Calcium Light Co. v. State Tax Commn., 44 NY2d 986, at 988). When the instant regulation is analyzed in this context, as an effort to define when petitioner is the consumer of the promotional material, we conclude that the

regulation is revealed as an appropriate interpretation of the terms "retail sale" and "sale for sale", pursuant to the Commissioner of Taxation and Finance's authority under Tax Law section 1142[1].

At the heart of the regulation is the principle that petitioner is the consumer of these catalogs when it purchases them primarily for advertising and promotional purposes. The regulation then establishes an objective test to determine when petitioner's purchases are primarily for advertising, i.e., whenever petitioner subsequently transfers a catalog for less than its cost. On the other hand, the regulation provides that the petitioner has purchased a catalog primarily for resale whenever a catalog is sold for more than its cost. This objective test appears to us an appropriate manner of determining the primary purpose of petitioner's purchases of promotional material, in accord with the spirit of the sales tax as a consumer tax.

Petitioner, while acknowledging that the requirement of a minimal charge for a retail sale is reasonable, challenges setting the minimal charge at anything less than cost. In essence, petitioner does not question the Division's authority to draw a line to define minimal, but challenges where the Division drew the line. Petitioner argues that the decision in Matter of Nehi Bottling Co., Inc. v. Gallman (39 AD2d 256, affd 34 NY2d 808) requires a finding that the sale of the instant catalogs for 55% to 75% of their cost was a minimal charge and thus a retail sale. In Nehi, the court held that a soft drink bottler's purchase of bottles was a purchase for resale, because the bottler subsequently transferred title and possession of the bottles to its customers in exchange for a security deposit. The court made this finding even though the security deposit was less than the cost of the bottle; however, the relationship of the security deposit to the cost of the bottle was not the contested issue in Nehi. Instead, the issue was whether the record supported the Tax Commission's finding that the bottler never relinquished ownership of the bottles to its customers (Matter of Nehi Bottling Co., Inc. v. Gallman, supra, at 257). Furthermore, Nehi did not involve a regulation, as here, which specifically defined the minimal charge necessary for a retail sale. For these reasons we conclude that Nehi does not determine the correctness of the instant regulation.

Applying our own analysis, we conclude that defining a retail sale of promotional material at the point where the advertiser recovers 100% of its cost is correct because it makes economic sense. The rule is consistent with the theory of the tax as a tax on the consumer, where the price is presumably the highest (Burger King, Inc. v. State Tax Commn., 51 NY2d 614, at 623). In contrast, had the Division defined "minimal charge" as 50% or 55% of cost, as urged by petitioner, we would have perceived no economic or other theoretical basis for the rule. Accordingly, such a rule would have been vulnerable to attack as an arbitrary rule, unlike the instant regulation.

Petitioner's final point is that the Administrative Law Judge improperly applied the regulation since petitioner was not attempting to avoid the payment of sales tax in selling the catalogs below cost, "the wrong which the regulation is promulgated to prevent". Petitioner asserts that the regulation presumes an intent on the part of the advertiser to avoid tax and that petitioner, in lacking this necessary intent, has been improperly assessed.

First, petitioner has not cited the source of its statement that the regulation "presumes an intent . . . to avoid tax" and neither do we know of any. Furthermore, tax "avoidance" is not synonymous with tax "evasion," our focus being directed to the latter. After all, to the extent that the Tax Law allows parties to structure transactions in such a way that tax is lawfully avoided, no impropriety should be read into what is otherwise prudent business-like conduct (see, Helvering v. Gregory, 69 F2d 809, 810 [2nd Cir 1934]; Stewart v. Commissioner, 714 F2d 977, 987-88 [9th Cir 1983]).

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the petitioner, J. C. Penney, Inc., is denied;

2. The determination of the Administrative Law Judge is affirmed; and

3. The petition of J. C. Penney, Inc. is denied and the notice of determination and demand issued January 25, 1985 (insofar as pertaining to the imposition of use tax based on the cost of catalogs reduced nonetheless to reflect credit for sales tax collected and remitted per Finding of Fact "7" within the Administrative Law Judge's determination) is sustained.

Dated: Troy, New York
April 27, 1989

/s/John P. Dugan
John P. Dugan
President

/s/Francis R. Koenig
Francis R. Koenig
Commissioner