

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petition :
of :
MOTION MARKETING ASSOCIATES, INC. : DECISION
T/A ON TARGET AND : DTA No. 805977
SHELDON DANUFF AND IRVING SIEGAL, OFFICERS :
for Revision of Determinations or for Refund of Sales and :
Use Taxes under Articles 28 and 29 of the Tax Law for the :
Period June 1, 1983 through November 30, 1986 :

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on April 25, 1991 with respect to the petition of Motion Marketing Associates, Inc. t/a On Target and Sheldon Danuff and Irving Siegal, officers, P.O. Box 1400, Westbury, New York 11590 with respect to their petition for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period June 1, 1983 through November 30, 1986. Petitioners appeared by Isaac Sternheim & Co. (Isaac Sternheim, C.P.A.). The Division of Taxation appeared by William F. Collins, Esq. (Robert J. Jarvis, Esq., of counsel).

Neither party filed a brief on exception. Oral argument, requested by the Division, was denied.

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

ISSUE

Whether the intercompany allocation of labor and overhead is subject to sales and use tax.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for findings of fact "2," "3," and "7" which have been modified. The Administrative Law Judge's findings of fact and the modified findings of fact are set forth below.

On May 12, 1986, the Division of Taxation ("Division") commenced an audit of petitioner Motion Marketing Associates, Inc. t/a On Target ("On Target"). On this date, an auditor met with On Target's controller and discussed the impending audit.

We modify the Administrative Law Judge's finding of fact "2" to read as follows:

The auditor learned that On Target was a company which mailed coupons to residences in designated target areas. The coupons offered discounts or other inducements to patronize a party's business. On occasion, the inducements included merchandise such as plastic bags, American flags, shoe stretchers and plungers. When such merchandise was ordered, the order was placed with, and the merchant was billed by, Motion Marketing. Motion Marketing and On Target are the same corporation -- On Target represents the coupon program, and Motion Marketing represents the merchandising program.¹

We modify the Administrative Law Judge's finding of fact "3" to read as follows:

On Target's activity consisted of placing coupons, and perhaps a flyer, into an envelope and then mailing the item. On Target provided the paper on which the coupons were printed, although the actual printing of the coupons was done by a sister corporation known as Getting To Know You ("GTKY").²

In its brochure, On Target described its activities as follows:

"The complete Direct Mail Advertising company with on-premises facilities for art, typography, composition, printing, collating, inserting and computerized list management."

¹The Administrative Law Judge's finding of fact "2" read as follows:

"The auditor learned that On Target was a company which produced and mailed coupons. The coupons offered discounts or other inducements to patronize a party's business. On occasion, the inducements included merchandise such as plastic bags, American flags, shoe stretchers and plungers."

This fact was modified to more accurately reflect the record.

²The Administrative Law Judge's finding of fact "3" read as follows:

"On Target's activity consisted of placing coupons, and perhaps a flyer, into an envelope and then mailing the item. The actual printing of the coupons was done by a sister corporation known as Getting to Know You ('GTKY')."

This fact was modified to more accurately reflect the record.

The order form used by On Target was entitled "On Target Advertising Order". It described On Target's customer as the advertiser.

On the first day the auditor visited On Target's premises, she left a letter which scheduled an audit appointment. The letter requested an opportunity to review On Target's books and records including ledgers, invoices, tax returns and other documents pertaining to On Target's sales tax liability.

When the auditor first visited On Target's premises, she found that On Target was located in a large rectangular building which contained printing equipment as well as desks, telephones and clerical staff. On Target shared the premises with GTKY.

We modify the Administrative Law Judge's finding of fact "7" to read as follows:

On June 20, 1986, the auditor went to On Target's premises and transcribed certain preliminary information. The auditor found that it was On Target's practice to collect sales tax on its sales. Generally, On Target charged a rate of \$64.00 per 1,000 coupons mailed. Rather than collecting sales tax on its gross sales, it was On Target's practice to collect tax at a rate of \$3.00 per 1,000 coupons sold, regardless of both the tax rate of the jurisdiction where On Target's customer was located and the actual charge for the coupons. The auditor also found that On Target remitted those taxes which it collected.³

After making an inquiry to Division personnel in Albany, New York, the auditor informed On Target that the Division's position was that On Target was engaged in advertising and that all of its expenses would be held taxable. Thereafter, the auditor requested On Target's expense records and transcribed the amounts listed for the month of November 1985. Through this

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This fact was modified to more accurately reflect the record.

process, the auditor sought to determine if the amounts in the expense records were reported in the general ledger.

The auditor found an entry called production costs which was entered once a year in January. When asked what this amount represented, On Target responded that: "Production costs are entered once a year in January for the prior year. Production costs are the payroll costs to produce the printed coupons, to mail them, to do the artwork, delivery, warehousing, et cetera." On Target also explained that: "All employees are on GTKY, Getting to Know You, payroll. GTKY is an affiliate corporation that shares the premises and has the same corporate offices as Motion Marketing Associates has."

Upon receiving the foregoing explanation, the auditor requested that On Target furnish its purchase records. This request was refused because On Target felt that it was selling tangible personal property and therefore its tax liability should not be premised upon its purchase records.

In order to calculate the amount of tax due, the auditor determined that tax was due on the amounts recorded in the general ledger for printing, mailing, production costs and office stationery for the period June 1983 through November 1986. This resulted in tax due of \$233,417.00. The auditor also concluded that tax was due in the amount of \$3,596.57 on the purchase of certain equipment. Petitioner had not paid sales tax on the machinery on the basis of its position that it was producing tangible personal property for sale. Therefore, On Target regarded its purchase of machinery as exempt from tax. Lastly, the Division imposed omnibus penalties for the periods beginning June 1, 1985 because the amount of tax found due was more than 25% of the amount of tax which had been remitted.

On the basis of the foregoing audit, the Division issued two notices of determination and demands for payment of sales and use taxes due, dated June 20, 1987, to Motion Marketing Associates, Inc. t/a On Target. One notice assessed tax for the period June 1, 1983 through November 30, 1986 in the amount of \$237,013.35, plus penalty of \$56,783.69 and interest of \$66,127.19, for a total amount due of \$359,924.23. The Division also issued a notice to On

Target which assessed a penalty in the amount of \$10,651.86 for the period June 1, 1985 through November 30, 1986. On the same date, the Division issued notices of determination and demands for payment of sales and use taxes due to Sheldon Danuff and Irving Siegal, as officers of On Target. The notices assessed the same amount of tax, penalty and interest which had been assessed against On Target.

After the foregoing assessments were issued, On Target filed a petition. On January 5, 1988, the matter was scheduled for a conciliation conference before the Bureau of Conciliation and Mediation Services. On the basis of the Chartair decision,⁴ the conferee directed the auditor to return to On Target's place of business to examine in detail the printing and mailing accounts for November 1985. After a review of these accounts, the auditor determined that printing was 99.85% taxable and that mailing was 88.62% taxable. Thereafter, the conferee directed that these percentages be applied to the month of November 1985 and that the tax liability be limited to the amount found due for that month alone. The conciliation conferee's decision effected the following reduction:

	<u>Original Amount</u>	<u>Revised Amount</u>
Printing	\$163,082.00	\$ 6,954.00
Mailing	12,076.00	109.00
Production	55,783.00	55,783.00
Office Supply	<u>2,475.00</u>	<u>2,475.00</u>
	<u>\$233,416.00</u>	<u>\$65,321.00</u>

When the auditor calculated the taxable percentage in the mailing account, she inadvertently failed to give On Target credit for two items, in the respective amounts of \$210.68 and \$75.78, upon which tax was paid.

The auditor strenuously disagreed with the adjustments made at the conciliation conference. In furtherance thereof, the auditor filed an internal form seeking a review of the

⁴See, Matter of Chartair, Inc. v. State Tax Commn. (65 AD2d 44, 411 NYS2d 41).

conferee's decision. Although the record is not completely clear, it appears, on review, that the conferee's decision was upheld.

On Target does not sell space on a coupon. Rather, it charges customers based on its sales of groups of a thousand coupons. On Target's customers pay one price, per thousand coupons, which covers all expenses including postage. On Target does not pay tax on the production equipment, paper or any related matter on the basis of its position that it is making purchases for resale.

One of the items which was found taxable during the examination of the printing account was an expense of \$24,794.82 from Tri-Boro Carton Company, Inc. in Brooklyn, New York. The expense was for the purchase of boxes which On Target bought to distribute the books of GTKY and its franchisees. The containers would be shipped to On Target's plant in Westbury, New York where they would be combined with books. Thereafter, the books would be shipped to individuals who were the targets of GTKY's advertising or in bulk to franchisee's of GTKY which were in California and along the eastern seacoast.

The only equipment which On Target has is a machine which places coupons in envelopes. All employees of Motion Marketing are on the payroll of GTKY. Therefore, in order to allocate expenses, an annual journal entry was made to allocate the cost of the premises, labor and equipment. Through this journal entry, all of the profit was allocated to GTKY because this was the corporation that had the lines of credit and the franchises.

OPINION

The Administrative Law Judge determined: that the Division had failed to establish grounds to challenge the conferee's decision; that petitioner On Target was performing an advertising service and that, therefore, On Target's purchases of materials were purchases at retail subject to sales tax; that On Target's purchases of cartons, mailing labels, and other packaging materials are subject to sales tax; that the intercompany allocation of labor and overhead is not subject to sales tax; and that On Target is subject to penalty because it has failed

to demonstrate that its failure to comply with the Tax Law was due to reasonable cause and not willful neglect.

On exception, the Division asserts that the intercompany allocation of labor and overhead by On Target to a sister corporation, GTKY, constitutes a taxable transaction.

We reverse the determination of the Administrative Law Judge on the issue of the taxability of the intercompany allocation of labor and overhead.

A corporation is a distinct legal entity, independent of its shareholders (see, Matter of 107 Delaware Assocs. v. New York State Tax Commn., 99 AD2d 29, 472 NYS2d 467, revd on dissenting opn below 64 NY2d 935, 488 NYS2d 634; Matter of Mt. Sinai Hosp., 250 NY 103; Berkey v. Third Ave. Ry. Co., 244 NY 84; Matter of Tops, Inc., Tax Appeals Tribunal, November 22, 1989). There has been no allegation that On Target has abused the corporate form. Therefore, we consider On Target and GTKY to be two independent corporations, notwithstanding the informal interaction and commingling of funds which occurred between the two corporations on a regular basis (see, Tr., pp. 26, 34, 48-50, 73-76, 78-79; Exhibits "G" and "I").

Approximately 95 percent of On Target's operation consisted of contracting to distribute coupons for merchants (Tr., p. 58). These coupons were mailed to residences in a target area (Tr., p. 59). The other relevant corporation, GTKY, performed all design, artwork, and printing of the coupons distributed by On Target (Tr., pp. 59-60). In addition, GTKY conducted its own operation of compiling phone books which listed area advertisers (Tr., pp. 72-73; On Target's post-hearing memorandum). All employees were hired and paid by GTKY (Tr., pp. 26, 73, 81-82). Salespersons completed deals for all three operations -- On Target's coupon advertising, Motion Marketing's merchandising, and GTKY's listing of area merchants in a phone book it published (Tr., pp. 73, 76-78, 82-84).

Both On Target and GTKY were in the same building and controlled by the same principals (Tr., pp. 20, 26, 74, 80-81). Bills received by On Target and GTKY were paid by one

of the companies based on convenience, not strictly according to which company was, in fact, responsible for the bill (Tr., pp. 74-75; Exhibits "G" and "H"). At On Target's fiscal year-end, all funds over and above a minimum profit were transferred from On Target to GTKY through a journal entry labeled "production costs" (Tr., pp. 73-76, 78-79). When questioned by the auditor as to what was represented by this journal entry, On Target responded:

"production costs are entered once a year in January for the prior year. Production costs are the payroll costs to produce the printed coupons, to mail them, to do the artwork, delivery, warehousing, et cetera" (Tr., p. 26).

Tax Law § 1105(c) imposes tax on the receipts from the services of:

"(2) Producing, fabricating, processing, printing or imprinting tangible personal property, performed for a person who directly or indirectly furnishes the tangible personal property, not purchased by him for resale, upon which services are performed."

In addition, the Division's regulations provide:

"(e) Printing and imprinting. (1) The services of printing and imprinting tangible personal property furnished by or on behalf of a customer of the printer are taxable under section 1105(c)(2) of the Tax Law; the service of printing or imprinting tangible personal property which is sold by the person performing the service in conjunction with the sale is taxable as part of the sale under section 1105(a) of the Tax Law" (20 NYCRR 527.4[e][1]).

We determine that On Target has not established that the transfer of funds for production costs did not include consideration for printing services provided by GTKY to On Target, taxable under Tax Law § 1105(c)(2). The page of the auditor's workpapers entitled "Detail of Printing Account, November 1985, Motion Marketing" contains information which shows that both Motion Marketing t/a On Target and GTKY had made orders for paper (Exhibit "G" -- audit workpaper labeled C3A; Exhibit "I" -- audit workpaper labeled both C3A and CM5). Additionally, On Target's advertising order form states, in part, that:

"ON TARGET will prepare and print Advertiser's offer on ON TARGET Certificate blanks, and include these at the rate of 1000 per month in each Target Number package designated below" (Ex. "L," emphasis added).

Based on this evidence, we determine that On Target supplied the paper on which its coupons were printed. Therefore, some of the transactions between On Target and GTKY were taxable printing services.

This conclusion distinguishes this case from Matter of John Hancock Mut. Life Ins. Co. (Tax Appeals Tribunal, April 30, 1992) where there was no basis to find, and the Division had not contended, that any of the funds transferred between the two corporations were for the rendition of taxable services. Rather, in John Hancock, the Division had argued that a component of an otherwise nontaxable service was a taxable receipt for the rental of property.

Based on our decision above, we must next determine what portion of the total "production costs" amount is taxable. Tax Law § 1132(c) states that:

"it shall be presumed that all receipts for property or services of any type mentioned in subdivisions (a), (b), (c) and (d) of section eleven hundred five . . . are subject to tax until the contrary is established, and the burden of proving that any receipt, amusement charge or rent is not taxable hereunder shall be upon the person required to collect tax or the customer."

On Target has not presented any evidence that might allow for the "production costs" amount to be broken down into individual taxable and nontaxable components. Therefore, the entire amount is taxable (see, Matter of LaCascade, Inc. v. State Tax Commn., 91 AD2d 784, 458 NYS2d 80).

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the Division of Taxation is granted;
2. The determination of the Administrative Law Judge is reversed with respect to conclusion of law "E," and is otherwise affirmed;
3. The petition of Motion Marketing Associates, Inc. t/a On Target and Sheldon Danuff and Irving Siegal, officers, is granted to the extent of conclusions of law "B" and "G" of the Administrative Law Judge's determination, but is otherwise denied; and

4. The Division of Taxation is directed to modify the notices of determination and demand for payment of sales and use taxes due dated June 20, 1987 in accordance with paragraph "3" above, but such notices are otherwise sustained.

DATED: Troy, New York
July 23, 1992

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

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

/s/Maria T. Jones
Maria T. Jones
Commissioner