

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petition :
of :
CHANRY COMMUNICATIONS, LTD. :
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 October 1, 1982 :
through February 28, 1985. :

DECISION
DTA No. 806108 and 806109

In the Matter of the Petition :
of :
STANLEY HENRY, AS OFFICER :
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 October 1, 1982 :
through February 28, 1985. :

Petitioners Chanry Communications, Ltd., 425 Smith Street, Farmingdale, New York 11735 and Stanley Henry, as officer, 318 Southdown Road, Lloyd Harbor, New York 11743 filed an exception to the determination of the Administrative Law Judge issued on April 12, 1990 with respect to their petitions for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period October 1, 1982 through February 28, 1985 (File Nos. 806108 and 806109). Petitioners appeared by Rivkin, Radler, Bayh, Hart & Kremer (Robert L. Folks, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Carroll R. Jenkins, Esq., of counsel).

Petitioners and the Division filed briefs on exception. Oral argument, at the request of petitioners, was heard on September 26, 1990.

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

ISSUE

Whether petitioner Chanry Communications, Ltd. is entitled to an exemption from sales and use taxes with respect to machinery, equipment and electricity used in the production of shopping papers.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge and make additional findings of fact. The Administrative Law Judge's findings of fact and the additional findings of fact are set forth below.

Petitioners, Chanry Communications, Ltd. and Stanley Henry, and the Division of Taxation entered into a stipulation of facts which was adopted as Findings of Fact numbered "1" through "5", "8", "10" through "16", "18", "19", "21" and "23" through "27" in the Administrative Law Judge's determination. The stipulation was supplemented by Findings of Fact numbered "6", "7", "9", "17", "20" and "22" in the Administrative Law Judge's determination.

On July 10, 1987, the Division of Taxation issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due to petitioner Chanry Communications, Ltd. ("Chanry") spanning the period October 1, 1982 through February 28, 1985 and assessing a sales and use tax liability in the aggregate amount of \$246,719.59, plus penalties (Tax Law § 1145[a][1]) and interest. On the same date, the Division of Taxation issued an additional notice of determination and demand for payment of sales and use taxes due spanning the same period and assessing the same amounts as above, against petitioner Stanley Henry as a person required to collect and remit taxes on behalf of Chanry. These two notices were based upon the results of a field audit of the business operations of Chanry as described hereinafter.

At the time of the filing of the petition in this case, on September 30, 1988, Chanry was a corporation residing at 425 Smith Street, Farmingdale, New York 11735. At all relevant times, Chanry was doing business in the State of New York.

Chanry owns, publishes and distributes 17 separate free-circulation pennysaver newspapers or shopping papers ("shopping papers") throughout the Long Island region. The shopping papers are circulated in specifically designated geographic areas.

The shopping papers constitute tangible personal property.

Chanry is in the business of soliciting and receiving advertisements from various advertisers. The advertisers require that these advertisements be placed in the shopping papers and that the shopping papers be distributed within specific geographic areas designated by the advertisers. The advertisers also choose, inter alia, the type of advertisement that is placed in the publication, its style and location in the format of the shopping paper, and its length and publication date(s).

The advertising order between the advertiser and Chanry indicates that a purchaser of advertising is not guaranteed a particular position within the shopping paper; that the art and make-up prepared by Chanry remain the property of petitioner; that only upon purchasing the art and make-up does the advertisement become the property of the advertiser; and that Chanry's liability for an error will not exceed the cost of the space occupied by the advertisement.

The rebate agreement between the advertiser and Chanry indicates that any rebate paid by Chanry can be reinvested in additional advertising; that the rebate will be paid only if all prior advertisements have been paid in full; and that the advertiser shall pay for the advertisements at prevailing rates at the time the advertisement appears.

The advertising rates which Chanry charges are dependent upon the geographic area in which the particular publication is to be distributed.

Chanry did not charge the advertisers sales tax on their purchases of advertisements.

Chanry prints and publishes the shopping papers and then distributes them to the public, free of any charge to them, in the specific geographic area designated by the advertiser. The distribution of these shopping papers is not subject to sales or use tax.

The purchasers of advertising in Chanry's publications understand that the publications are to be distributed by Chanry, free of charge, to the ultimate readers. Chanry has an implied contract to distribute the publication to the reading public.

Despite the advertisers' ability to designate the geographic areas in which they choose to advertise, Chanry retains complete editorial control regarding news and feature content.

As between Chanry and its advertisers, it is expressly understood that Chanry, using its own machinery, equipment and supplies, will produce, print and publish the shopping papers as well as distribute them. In exchange for the advertising and delivery of the published shopping paper to the public, the advertisers pay Chanry a fee.

Advertising revenues of the shopping papers support the operations and are in lieu of other charges that would otherwise be necessary to support the operations.

Notwithstanding Chanry's description as a shopping paper, its publications include news and feature stories, reader polls, editorials, photographs and reader correspondence.

Between 1982 and 1985, Chanry purchased approximately \$1 million in machinery and equipment for use directly and predominantly in the production of the pennysavers or shopping papers.

Chanry's machinery and equipment is used less than 5% of operating time in producing items other than shopping papers.

The purchase by Chanry of paper, ink and printing supplies is not subject to sales tax.

On or about September 11, 1984, the Division of Taxation commenced an audit of petitioners' books and records for the period at issue. The audit followed generally accepted procedures and tests consistent with the nature of the business operation and in accordance with the Tax Law.

The auditor analyzed in detail the fixed asset account and discovered that no tax had been paid by petitioners on purchases of machinery and equipment in the amount of \$2,029,813.22. Use tax due on these purchases was assessed in the amount of \$150,593.54. The auditor next reviewed an account entitled "intangible assets" which consisted of items such as "newspaper morgues" (dead issue files) and libraries of customer insertions. As petitioners had not paid any tax on these purchases of \$325,100.00, the auditor assessed use tax of \$26,820.75. The auditor also assessed use tax in the amount of \$25,040.23 on lease payments for machinery and equipment in the amount of \$314,267.51. Chanry's asset account revealed sales of assets in the amount of \$152,618.00 on which no tax was paid. Therefore, the auditor assessed sales tax in the amount of \$12,490.74. Finally, in reviewing recurring expenses, the auditor determined that petitioners had not paid sales tax on purchases of the bags used to deliver the shopping papers and on the electricity used to operate the publishing plant. The amount of purchases was \$396,127.00 and use tax of \$31,774.33 was assessed by the auditor. In summary, the total amount of sales and use tax assessed is as follows:

	<u>Amount Subject to Tax</u>	<u>Tax</u>
<u>Use Tax</u>		
Fixed Assets	\$2,029,813.22	\$150,593.54
Other Assets	325,100.00	26,820.75
Leases	314,267.51	25,040.23
Expenses	<u>396,127.00</u>	<u>31,774.33</u>
	\$3,065,307.70	\$234,228.85
<u>Sales Tax</u>		
Sale of Assets	<u>152,618.00</u>	<u>12,490.74</u>
TOTAL:	<u>\$3,217,945.70</u>	\$246,719.59

The Division of Taxation determined that Chanry was not registered pursuant to Tax Law §§ 1132 and 1134 until 1986, and therefore could not issue exemption certificates to its suppliers of machinery and equipment.

The auditor assessed penalty due to the substantial underreporting of tax (\$24,672.00 per quarter) and the failure of Chanry to register as a sales tax vendor with the Department of Taxation and Finance.

As a result of the audit, the Division of Taxation determined that petitioners owed additional use tax on purchases of machinery, equipment, supplies and materials as well as additional sales tax on unsubstantiated exempt sales.

The Division of Taxation disallowed a manufacturing exemption claimed by petitioners under Tax Law § 1115(a)(12) on the purchase of certain machinery and equipment used in the production of shopping papers.

Although the determinations of the Division of Taxation are wholly in dispute, the amount of the tax is not in dispute.

We find the following additional facts:

The machinery and equipment at issue here were used directly and predominantly in the production of tangible personal property and did not consist of parts with a useful life of one year or less.

It was stipulated by the parties that Stanley Henry was an officer and/or employee of Chanry throughout the audit period.

OPINION

The Administrative Law Judge held that petitioner Chanry was not entitled to the exemptions provided by Tax Law § 1115(a)(12) and (c) for the machinery, equipment and electricity used by it in the production of shopping papers. The Administrative Law Judge found that the shopping papers were not "sold" within the meaning of Tax Law § 1101(b)(5) because there was no transfer of tangible personal property for consideration as required. Additionally, the Administrative Law Judge held that even if title or possession of the shopping papers passed to the advertisers resulting in a transfer of tangible personal property, Chanry would not be entitled to the exemptions because the papers were being manufactured primarily for Chanry's own use in its advertising service business. Chanry's claim that its shopping papers were entitled to the same exemptions as newspapers was also rejected by the Administrative Law Judge.

On exception, petitioners argue that the shopping papers were sold to the advertisers and that these transactions were sales under the Tax Law which would exempt from tax the cost of the machinery, equipment and electricity used to produce the papers. Petitioners assert that title or possession of the shopping papers was transferred to the advertisers when Chanry distributed the shopping papers to the public as the advertisers' designees. Alternatively, petitioners argue that the shopping papers were "newspapers" within the meaning of the Tax Law and, therefore, petitioners should receive the same production exemptions from sales and use taxes as the producer of a newspaper would receive.

The Division of Taxation (hereinafter the "Division") asserts that the determination of the Administrative Law Judge should be upheld. The Division argues that Chanry was not engaged in the sale of tangible personal property because the shopping papers did not have a purchaser. The advertisers were not the purchasers of the shopping papers because the receipts paid by the advertisers to Chanry were not subject to tax, and because the advertisers did not take title or possession of the shopping papers either directly or through the "public" as their designees. The Division asserts that Chanry was not manufacturing tangible personal property for sale but rather was selling an advertising service. In addition, the Division asserts that Chanry did not establish that it qualified for the exemptions under Tax Law § 1115(a)(12) and (c) by showing that the machinery, equipment and electricity were actually used predominately in production, or did not consist of parts having a useful life of one year or less.

We uphold the determination of the Administrative Law Judge for the reasons set forth below.

Tax Law § 1115(a)(12) exempts from the imposition of sales tax machinery or equipment used or consumed directly and predominantly in the production of tangible personal property for sale. Tax Law § 1115(c) exempts from tax the electricity used directly and exclusively for the same purpose. The term "sale" is defined by Tax Law § 1101(b)(5) and 20 NYCRR 526.7(a)(1) as any transaction in which there is a transfer of title or possession, or both, of tangible personal property for a consideration.

Petitioners allege that Chanry qualifies for these exemptions from tax because it has shown that Chanry's transactions with its customers (the advertisers) were sales as defined by Tax Law § 1101(b)(5). Petitioners allege that the shopping papers were tangible personal property which Chanry was producing for sale to the advertisers appearing in that issue of the paper. The consideration consisted of the fees paid by the advertisers to Chanry. The required transfer of title or possession occurred when the shopping papers were distributed by Chanry to the public as the designees of the advertisers.

Initially, we note that the burden of proving entitlement to a tax exemption rests with the taxpayer and statutes creating tax exemptions are strictly and narrowly construed (Matter of Grace v. New York State Tax Commn., 37 NY2d 193, 371 NYS2d 715, 718, lv denied 37 NY2d 708, 375 NYS2d 1027; Matter of Young v. Bragalini, 3 NY2d 602, 170 NYS2d 805, 807). "[E]xemptions from taxation will be construed against a taxpayer unless it would defeat the settled purpose of the statute" (Matter of G & B Publishing Co. v. Department of Taxation & Fin., 57 AD2d 18, 392 NYS2d 938, 940, lv denied 42 NY2d 807, 398 NYS2d 1029, citing Matter of Grace v. New York State Tax Commn., supra.)

We do not agree that Chanry was producing the shopping papers for sale within the meaning of Tax Law §§ 1115(a)(12) and (c) and 1101(b)(5). In our view, Chanry was in the business of supplying an advertising service and the shopping papers were created, not as tangible personal property for sale, but as material for Chanry's own use in providing this advertising service. Machinery, equipment and electricity are not used in the production of tangible personal property "for sale" within the meaning of the applicable exemptions when the facts indicate that the product is being produced primarily for use in services provided by the producer and not as a separate product (see, Matter of Midland Asphalt Corp. v. Chu, 136 AD2d 851, 523 NYS2d 697, 699, lv denied 72 NY2d 806, 532 NYS2d 847; Matter of Southern Tier Iron Works v. Tully, 66 AD2d 921, 410 NYS2d 711, 713, lv denied 46 NY2d 713, 416 NYS2d 1027; Matter of Howard Johnson Co., Tax Appeals Tribunal, July 19, 1990; Matter of Spancrete Northeast, Tax Appeals Tribunal, March 8, 1990).

The facts clearly support the conclusion that the advertiser was not buying the shopping papers but rather Chanry's services in preparing the advertisement and arranging for the printing and distribution of this advertisement through the medium of the shopping paper. The transaction between Chanry and the advertiser consisted of a fee for the design and preparation by Chanry of an advertisement of a particular style and size, which would be printed and distributed by petitioners. The advertiser's only interest in the paper was that it contain an advertisement of the size and content agreed to and that the paper be distributed in the agreed geographic area.

Since Chanry's activities consisted of advertising services of which the shopping papers were a part, even if, as petitioners argue, title or possession of the papers passed to the advertisers upon distribution to the public, Chanry does not qualify for the the subject exemptions. It is the substance of Chanry's operation that controls for purposes of the production exemptions (see, Matter of Midland Asphalt Corp. v. Chu, *supra*; Matter of Southern Tier Iron Works v. Tully, *supra*; Matter of Spancrete Northeast, *supra*; Matter of Willets Point Contr. Corp., Tax Appeals Tribunal, September 14, 1989).

We do not agree with petitioners' assertion that Matter of B & B Enterprises (State Tax Commn., February 6, 1985) supports their argument that the transaction between Chanry and its advertisers was a sale of tangible personal property. In B & B Enterprises, the petitioner was the publisher of certain theater program magazines known as "stagebills" for specific theater customers (Carnegie Hall and Lincoln Center). The magazines contained articles, program notes for the particular program and advertising. Under an agreement with the two theaters, the petitioner solicited the advertising and was permitted to retain all fees received from the advertisers as consideration under the contract to furnish a specified number of stagebills to each theater. The theaters in turn distributed the stagebills free of charge to individuals attending the performances. The State Tax Commission found that the publisher's costs in producing the programs were not subject to use tax because the program magazines were tangible personal property being sold by the publisher to the theaters. Although the transaction

between the theaters and the publisher of the program magazines may be properly characterized as a sale, this does not convert the transactions between the publisher and the advertisers in the programs into a sale of the same tangible personal property. It is clear that the theaters' interest in the transaction was the receipt of the program magazines themselves. The theaters had no interest in the advertising provided by the publisher which appeared in the magazines except to the extent that the existence of the advertising made it possible under the contract for the theaters to receive programs for their performances without additional consideration. On the other hand, like the advertisers in the matter before us, the main interest of the advertisers in the program magazines was in receiving the advertising services being supplied by the publisher.

Petitioners also argue that amendments made to the Tax Law in 1977 which exempted from the sales and use tax certain activities related to the production of shopping papers (L 1977, ch 884), supports their position that the transaction between Chanry and its advertisers was a sale of the shopping papers. The amendments in 1977, among other things, expanded the list of exemptions from sales and use tax in Tax Law § 1115 as follows:

"Receipts from the retail sale of a shopping paper to the publisher of such publication shall be exempt from the tax imposed by subdivision (a) of section eleven hundred five and receipts from the sale of printing services performed in publishing such paper shall be exempt from the tax imposed by paragraph two of subdivision (c) of such section" (Tax Law § 1115[i][A]).

The activities which are exempted from sales and use tax by Tax Law § 1115(i)(A) are the publisher's purchase of the shopping paper (the printed matter) from another entity and purchases by a publisher of printing services performed in publishing the paper. If, as petitioners argue, the transaction between Chanry and the advertiser was a sale of the shopping papers, it would have been unnecessary for the Legislature to create a specific exemption for the publisher's purchase of the shopping papers from another entity. Such a transaction would have already been excluded from tax as a purchase for resale pursuant to Tax Law §§ 1101(b)(4) or 1105(c). In construing statutory provisions it is necessary for all parts of a statute to be harmonized with each other as well as with the general intent of the whole statute (McKinney's Cons Laws of NY, Book 1, Statutes § 98; Matter of Honeoye Central School Dist.

v. Berle, 72 AD2d 25, 423 NYS2d 336, 343, affd 51 NY2d 970, 435 NYS2d 721; Matter of Anderson v. Board of Educ. of City of Yonkers, 46 AD2d 360, 362 NYS2d 536, 540, affd 38 NY2d 897, 382 NYS2d 750). If the Legislature had intended to provide the publishers of shopping papers with the production exemptions it could clearly have done so. We do not find any support for petitioners' assertion that in Chapter 884 "the Legislature specifically identified the transaction between the advertiser and the publisher as a 'sale'" (Petitioners' Brief to the Tribunal, p. 17).

Petitioners argue alternatively that they should be treated in the same way as a publisher of a newspaper would be treated because shopping papers are "newspapers" within the meaning of the Tax Law. Pursuant to Tax Law § 1115(a)(5) receipts from the sale of newspapers are not subject to tax. Since newspapers are tangible personal property produced for sale, the machinery, equipment and utilities used to produce the newspapers would be exempt from tax under Tax Law § 1115(a)(12) and (c). The publisher of a newspaper would, therefore, be entitled to an exemption pursuant to Tax Law § 1115(a)(12) and (c) for the cost of machinery, equipment or utilities used to produce newspapers for sale. It would also not have to pay tax if it purchased the newspaper or the printing services from another entity, as these would be exempt purchases for resale. The entity from which the newspaper publisher purchases could be entitled to the production exemptions as it would be producing tangible personal property (the newspapers) for sale. The Division in its regulations has indicated that a publication which otherwise meets the definition of a newspaper may be entitled to classification as a newspaper even if it is distributed free of charge (20 NYCRR 528.6[b][2], Example 2). Petitioners argue that their shopping paper conforms to the definition of a newspaper contained in the Division's regulations at 20 NYCRR 528.6(b)(1), and therefore it should receive the same production exemptions as the publisher of a newspaper would receive.

The Administrative Law Judge found that Matter of G & B Publishing Co. v. Department of Taxation & Fin. (supra, 392 NYS2d 938) was dispositive of petitioners' argument. In G & B

Publishing, the petitioner asserted that the shopping paper it published was a "newspaper" and claimed an exemption from use taxes on its purchases of printing services and related supplies. The Court found that the petitioner (the publisher of the shopping paper) was not entitled to the exemptions because the shopping paper was not tangible personal property for sale and was not a newspaper within the meaning of Tax Law § 1115(a)(5). G & B Publishing was decided prior to the legislative changes in 1977 which required a publication to meet certain requirements, including a limitation on the amount of advertising and the inclusion of items of news, in order to be classified as a shopping paper and which provided publishers of shopping papers with sales and use tax exemptions for the purchase of the papers and printing services (L 1977, ch 844).

We agree with petitioners that the shopping paper in G & B Publishing can be distinguished from those produced by Chanry in that Chanry's shopping papers conform to the requirements of Tax Law § 1115(i)(B) enacted in 1977. However, the decision in G & B Publishing is still applicable to the matter before us. While the Court in G & B Publishing focused on whether the shopping papers could be defined as newspapers, the underlying issue was whether the publisher of the shopping papers was engaged in the production of tangible personal property for sale.

Although petitioners claim that the Division has unconstitutionally applied the tax statutes by not permitting Chanry to obtain the same exemptions which are given to newspapers, Chanry's argument is really an attack on the constitutionality of the statutory scheme itself which provides different treatment for publications defined as "newspapers" and publications separately and specifically defined as "shopping papers." The jurisdiction of this Tribunal is limited to determining whether the Division has unconstitutionally applied or interpreted a particular statute, and does not encompass challenges to the constitutionality of the statute itself which is presumed to be constitutional (Matter of Geneva Pennysaver, Tax Appeals Tribunal, September 11, 1989; Matter of Fourth Day Enterprises, Tax Appeals

Tribunal, October 27, 1988). We find that the Division has correctly applied the applicable statutes to petitioners and has not acted unconstitutionally here.

If Chanry had purchased the shopping papers from another entity rather than producing the papers itself, it would not have had to pay tax to the entity from which it purchased, and the entity from which it purchased could have been entitled to the production exemptions for its machinery and utilities because it would have been engaged in the production of tangible personal property for sale. The fact that Chanry could have structured itself so as to take advantage of the Tax Law § 1115(i)(A) exemptions does not result in Chanry's entitlement to the production exemptions here. It is the form chosen by the taxpayer which is controlling and the fact that a taxpayer could have chosen a different form which would have had different tax consequences does not convert a taxable transaction into a nontaxable one (see, Matter of Greco Bros. Amusement Co. v. Chu, 113 AD2d 622, 497 NYS2d 206, 208; Matter of Ormsby Haulers v. Tully, 72 AD2d 845, 421 NYS2d 701, 702; Sverdlow v. Bates, 283 App Div 487, 129 NYS2d 88, 91; Matter of Tops, Inc., Tax Appeals Tribunal, November 22, 1989). If the Legislature had wanted to give the publishers of shopping papers the production exemptions, it could have done so in the 1977 amendments.

The Division has additionally argued that Chanry is not entitled to the exemption provided by Tax Law § 1115(a)(12) because petitioners have not shown that the machinery and equipment was actually used predominantly in the production of shopping papers, or that the machinery and equipment did not have a useful life of more than one year. We do not agree with the Division on this point. The petition in this matter states: "11. Secondly, it is conceded that the machinery which was purchased is used directly and predominantly in the production of pennysavers or shopping papers." A footnote in the petition indicates that this fact and certain others were stipulated to by the auditor in discussions with petitioners' representative. The Division's answer specifically responds to each numbered paragraph of the petition prior to paragraph number 11, but does not respond to paragraph 11 or to the footnote concerning the auditor. Since the Division did not deny it, the allegation by petitioners that the machinery was

used directly and predominantly in the production of the shopping papers must be taken as admitted. In addition, a review of the audit papers indicates that at the audit level, the issue was always considered by the Division to be whether Chanry was producing the shopping papers "for sale" not whether the machinery and equipment otherwise qualified for the exemption. Although we are disturbed by petitioners' failure to even address this issue since it was raised by the Division in briefs to the Administrative Law Judge and this Tribunal, we conclude that petitioners are not disqualified from entitlement to the exemption under Tax Law § 1115(a)(12) for failure to show that the machinery and equipment met the requirements of the statute regarding use and the length of useful life.

In their reply to the answer of the Audit Division, petitioners deny the affirmative allegation made by the Audit Division that Stanley Henry was a person required to collect tax within the meaning of Tax Law § 1131(1) and personally liable for the taxes due from the corporation pursuant to Tax Law § 1133(a). However, no separate petition was submitted on behalf of petitioner Henry in which petitioner's status as a responsible officer was contested. In addition, petitioners presented no facts to the Administrative Law Judge in support of this position, nor was this issue argued in briefs to the Administrative Law Judge or the Tribunal. Therefore, as petitioner Henry has the burden of proving that he was not a person required to collect tax on behalf of the corporation or was otherwise not a responsible officer, we hold that he has failed to do so and find that petitioner Henry was a person required to collect tax within the meaning of Tax Law § 1131(1) and is personally liable for the taxes due from the corporation.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of petitioners Chanry Communications, Ltd. and Stanley Henry, as officer is denied;
2. The determination of the Administrative Law Judge is affirmed;

3. The petitions of Chanry Communications, Ltd. and Stanley Henry, as officer, are denied; and

4. The notices of determination issued on July 10, 1987 are sustained.

DATED: Troy, New York
March 7, 1991

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

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

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