STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
PUBLISHERS CLEARING HOUSE	:	DECISION DTA No. 811500
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, 1982 through November 30, 1985.	:	

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on October 26, 1995 with respect to the petition of Publishers Clearing House, 382 Channel Drive, Port Washington, New York 11050. Petitioner appeared by Hutton & Solomon, Esqs. (Stephen L. Solomon, Esq., of counsel) and KPMG Peat Markwick, LLP (Robert D. Wallingford, Esq., of counsel). The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Michael B. Infantino, Esq., of counsel).

The Division of Taxation filed a brief in support of its exception. Petitioner filed a brief in opposition. The Division of Taxation filed a brief in reply. Oral argument, at the Division of Taxation's request, was heard on January 23, 1997 in Troy, New York.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision. Commissioner Jenkins took no part in the consideration of this decision.

ISSUES

I. Whether petitioner is entitled to a refund, pursuant to Tax Law § 1119(a)(4), for sales or use taxes paid with respect to certain printed and/or imprinted promotional materials mailed from New York State to recipients outside New York State.

II. Whether the printing and/or imprinting services purchased by petitioner and performed upon its promotional materials which were then mailed from New York State to points outside the State were exempt from the imposition of sales tax pursuant to Tax Law § 1115(d).

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for finding of fact "10" which has been deleted as irrelevant to the outcome of this decision. The remaining facts are set forth below.

Pursuant to a field audit of petitioner, Publishers Clearing House ("PCH"), the Division of Taxation ("Division"), on May 12, 1987, issued two notices of determination and demands for payment of sales and use taxes due to PCH as follows:

Notice No.	Period	Tax	Interest	Total
S870512159C	3/1/82 - 2/28/85	$853,345.24	$328,595.95	$1,181,941.19
S870512160C	3/1/85 - 11/30/85	174,283.22	26,349.96	200,633.18

Previously, PCH executed five consents (see, Division's Exhibit "B") extending the period of limitation for assessment of sales and use taxes, the last of which agreed that for the period March 1, 1982 through February 28, 1984, the amount of sales and use taxes due could be determined at any time on or before June 20, 1987.

PCH is in the business of selling magazine subscriptions through direct mail advertising and other related marketing techniques. During the period at issue, PCH mailed millions of promotional packages, consisting of offerings for discounted magazine subscriptions, to persons located both within and without the State of New York. Since its sales are nontaxable, the audit was of PCH's purchases only.

Although the records provided by PCH were sufficient and adequate for the performance of a detailed audit, on June 3, 1986 an officer of PCH executed an audit method election form agreeing to a test period audit of its "personalized paper", i.e., a computer form containing certain artwork, contest entry rules, a standard form letter, other promotional information and the name, address and contest prize numbers associated with the ultimate recipient. The

computerized forms have perforated strips to fit into the sides of a printer. Tax was not assessed on the purchase of any other paper by PCH which was put into the outer envelope. It was conceded that PCH had correctly reported the taxable portion of these paper purchases on its sales tax returns for the audit period.

At the hearing, PCH's controller, Ted Kasnicki, testified that while each envelope actually contained three personalized pieces, these pieces actually start out as a single pre-printed form imprinted in various places with the recipient's name and/or address and contest numbers. The form is then "chopped" (sliced apart into separate personalized pieces) and the pieces are inserted into the package with other nonpersonalized material. One of the pieces is inserted into the envelope so that the recipient's name and address is visible through a translucent window.

Mr. Kasnicki testified, in detail, as to the procedures employed by PCH in purchasing the paper and the printing services. He stated that upon receipt of the personalized computer forms from the printer/imprinter who printed the name, address and contest prize numbers on the form, the mailer performed all of the activities required for mailing out the entire package. These activities included, among other things, collating, folding and stuffing into envelopes. Mr. Kasnicki testified that the personalized and nonpersonalized promotional materials were "timed" so as to arrive at the mailer at approximately the same time. At no time did PCH ever take delivery of any of the printed (personalized or nonpersonalized) promotional materials.

Mr. Kasnicki testified that, during the audit period, approximately 50% of the time PCH bought the paper for the printing of the computerized form letter with blanks left in the appropriate places for the insertion of the personalized information; the other 50% of the time, PCH purchased the computer form letters already printed.

Marsha Eisner, Sales Tax Auditor II, was the team leader throughout the audit. The original auditor was John Mandia, who was assigned the case in March 1985; Stephen Spector became the auditor in September 1985. Ms. Eisner appeared at the hearing on behalf of the Division and testified concerning the conduct of the audit.

With respect to the invoices for the purchase of the computerized forms, Ms. Eisner stated that the auditors had intended to analyze them in order to determine their taxable status. However, the invoices did not include information as to the location from which the forms were mailed (whether mailed from New York State or from outside the State). In the alternative, the auditors examined PCH's advertising campaign records which contained information as to the personalization services and place of mailing. Because PCH did not want to assemble all of its records relating to its previous advertising campaigns, it requested that a test period audit be performed (see, above).

PCH selected the advertising campaigns to be utilized in this test period audit. Three such mailings during 1985 and 1986 were selected (numbers 85-10, 85-60 and 86-30). These mailings revealed the cost of the forms as well as the cost of the personalization services (the additional printing of the recipient's name, address and prize numbers). The personalization service invoices did indicate from where the forms were mailed.

From an examination of the three advertising campaigns, a weighted average was determined (a ratio of forms mailed from New York as compared to total mailings). This weighted average was computed to be 45.66%, i.e., 45.66% were found to have been mailed from New York.

Computer form letter purchases for the audit period were found to be $20,977,916.00. This amount, when multiplied by the weighted average (45.66%), resulted in purchases of computer form letters mailed from New York of $9,578,518.00. Since the in-state bulk mailers were located in Suffolk County, the rate applicable to that county (7.25% or 7.5%) was utilized and tax due was determined to be $699,752.00. Credit for tax paid ($44,493.00) was given and total additional tax due on the purchase of these forms was, therefore, $655,259.00.

Ms. Eisner testified that, during the audit period, PCH had been incorrectly reporting tax due on the purchase of the computer forms based upon a New York State distribution allocation ratio, the numerator of which was mailings from New York delivered into New York and the denominator of which was all mailings. Mr. Kasnicki testified that this New York distribution

allocation ratio was also applied to determine the taxable amount of personalization services (printing, imprinting) as well.

PCH's purchases of personalization printing services were analyzed in detail. After the paper was purchased, it was delivered to a printer (located both inside and outside of New York). In many cases, the same printer printed both the computer form and the general promotional pieces. The general or nonpersonalized pieces were sent from the printer to the mailer; the computer form or personalized form was then sent by the printer, at PCH's direction, to an imager (or personalizer) who imprinted it with the name, address and contest prize numbers associated with the ultimate recipient. Some of the imagers were located in New York, while others were not. Some of the personalized forms were then sent to the bulk mailers located in New York; some were sent to bulk mailers in other states. The bulk mailer collated the forms (both personalized and nonpersonalized), folded them, stuffed them into the other envelopes and mailed them out.

PCH had reported no personalized printing services subject to tax for the periods March 1 through May 31, 1982, December 1, 1982 through May 31, 1983 and March 1 through November 30, 1985. For the remaining portions of the audit period, PCH reported taxable purchases of these services based upon the New York distribution allocation ratio (see, above).

Initially, the Division assessed tax on all personalized printing services performed in and out of New York on forms which were later shipped back to New York for mailing. Later (but prior to the issuance of the notices of determination), the audit findings were revised so that tax was assessed only on services performed in New York on computer forms which were mailed from New York. Total tax due on personalized printing services was, therefore, determined to be $372,369.46. This amount, when added to tax assessed on the purchase of forms ($655,259.00), resulted in a total assessment of sales and use taxes in the amount of $1,027,628.46 which represents the total set forth on the notices of determination issued to PCH (see, above). Tax and interest was paid by PCH which now seeks a refund thereof.

Ms. Eisner testified, on direct examination, that penalty was not assessed because "these issues had not been addressed on the prior audit." On cross examination, she stated that it had, in fact, been addressed, but had been assessed "as though they were regular promotional materials." She further stated, however, that the issue of whether the personalized forms qualified for exemption or refund pursuant to Tax Law § 1119(a)(4) had not been previously addressed.

The audit report stated:

> "Recommend simple interest be imposed on the disagreed portion as vendor reported in accordance with the findings of the prior three audits & the issue involves interpretation of law."

Ms. Eisner testified (see, tr., pp. 38, 53, 60-62, 69-78) that the primary basis for this assessment against PCH was her interpretation of a note contained in the May 1977 supplement to the Division's Form ST-152, Collection and Reporting Instructions for Printers and Mailers. This form, initially published in May 1969 (see, Petitioner's Exhibit "9"), was amended in May 1971 and again in May 1977 (see, Petitioner's Exhibit "3").[1]

Ms. Eisner stated that the "alternative method" set forth in the May 1971 version of the ST-152 provided for a method of determining sales and use taxes where a taxpayer's mailing records are not adequate to show the destinations of all the printed matter mailed to persons in New York. The note in the May 1977 supplement to the ST-152, according to the testimony of Ms. Eisner, prohibits the use of this alternative method for personalized printed matter and renders them fully taxable.

As a result of its audit of PCH, the Division, on June 6, 1986, issued two statements of proposed audit adjustment. The first, in the amount of $271,054.99, set forth additional tax due which was agreed to by PCH on June 11, 1986.

Ms. Eisner testified that the agreed-upon areas of the audit related to assessments on purchases of fixtures and equipment for the entire audit period as well as purchases of outer

---

[1]Petitioner's Exhibit "6," an instruction memorandum entitled "Collection and Reporting Instructions for Printers and Mailers," was issued on July 18, 1966 and was, apparently, the predecessor to Form ST-152, which was initially published in May 1969.

envelopes and list rentals for the transitional period (the period subsequent to the prior audit but before the issues of the prior audit were resolved). As to the list rentals, the transitional period was March 1, 1982 through November 30, 1982. For purchases of outside envelopes, the transitional period was March 1, 1982 through May 31, 1983. Payment of $360,890.68 (representing tax of $271,054.99 and interest of $89,835.69) was received from PCH on October 15, 1985. Ms. Eisner stated that the notices of determination issued to PCH on May 12, 1987 (see, above) include no assessments which relate to PCH's purchases of outside envelopes.

On August 7, 1987, PCH filed a petition with the former Tax Appeals Bureau of the former State Tax Commission. The petition sought a revision of the two notices of determination dated May 12, 1987 in the amounts of $853,345.24 and $174,283.22, plus interest. In addition to the specific grounds relating to the assessments on promotional materials, PCH alleged in paragraph 4(E) as follows:

> "In addition to the foregoing, other and further grounds exist, including constitutional issues, pursuant to which PCH seeks relief herein. PCH reserves the right to supplement and amplify its contentions in this regard."

PCH thereafter filed a petition with the Division of Tax Appeals on December 28, 1992 which incorporated, by reference, the contents of the petition previously filed with the Tax Appeals Bureau. This petition specifically protested assessment numbers S870512159C and S870512160C.

The Division filed a Demand for Bill of Particulars on March 19, 1993 which sought specification of the contents of paragraph "E" of the petition, stating:

> "Paragraph 'E' of the Petition states:
>
> > In addition to the foregoing, other and further grounds exist, including constitutional issues, pursuant to which PCH seeks relief herein. PCH reserves the right to supplement and amplify its contentions in this regard.
>
> "1(a). With respect to paragraph 'E', specify in detail the legal theories or claims contemplated under the terms 'other and further grounds' which Petitioner intends to argue upon the trial of this matter.

"1(b). Specify the facts which you will argue at trial in support of the legal claims or theories articulated in your response to '1(a)', supra."

In a Bill of Particulars dated October 19, 1994, PCH stated as follows:

"1. PCH intends to seek a refund of all sales and/or use taxes paid by it, plus interest thereon, attributable to the purchase of promotional envelopes that were mailed from New York and delivered to recipients outside of New York.

"2. Petitioners [sic] will present, at trial, evidence showing that such promotional envelopes qualify for exemption as described in Department publication ST-152 ('Collection and Reporting Instructions for Printers and Mailers')."

At the hearing, the Division objected to the raising of the issue concerning the taxability of the outer envelopes on the basis that, since the tax had been paid and no refund claim had been filed with respect to tax paid on the purchase of the envelopes, the Division of Tax Appeals was without jurisdiction to substantively decide this issue.

In its brief submitted to the Administrative Law Judge (p. 27, n. 18), PCH stated as follows:

"PCH understands that it remains bound by the amount of the refund claimed in its Petition, which did not include the tax, or interest thereon, paid on the envelopes, and further understands that it may recover on this claim only to the extent that PCH does not obtain complete relief on its claim with respect to the 'personalization' issue."

PCH also stated in its brief submitted to the Administrative Law Judge (at p. 28) that it has learned that this issue will be addressed by the Appellate Division, Third Department in Matter of Garden Way Incorporated (Tax Appeals Tribunal, February 24, 1994) and, as such, PCH desires to keep its claim open should that decision be rendered prior to a determination in the present matter.

In a letter to the Division from Robert D. Wallingford, Esq., one of PCH's representatives, dated April 8, 1993, it was stated, in pertinent part, as follows:

"The sole issue of law raised by the above petition is whether a single promotional piece included among many promotional materials mailed as a single package from New York State to recipients outside New York State is subject to New York State sales or use tax."

OPINION

As stated by the Administrative Law Judge, the assessments at issue herein are for sales and use taxes on both the property (i.e., the computer forms) and the services (i.e., the printing or imprinting of the names, addresses and contest prize numbers) which, together, created the personalized computer forms that, along with various other nonpersonalized promotion materials, were mailed from New York State to out-of-state recipients.

The Administrative Law Judge determined, based upon the Tax Appeals Tribunal (hereinafter the "Tribunal") decision in Matter of Garden Way (supra), that although Tax Law § 1119(a)(4) during the period at issue herein did not specifically provide for an exemption from sales tax for promotional materials, such materials could still qualify for exemption if shipped outside the State for use outside the State if the materials were not used in New York. However, in distinguishing the facts in Garden Way, the Administrative Law Judge noted that the Division has drawn a distinction in this case between personalized and nonpersonalized promotional materials for purposes of qualifying for the exemption under Tax Law § 1119(a) and § 1115(d).

The crux of this matter involves the personalization services performed by the printers/imprinters. The Division asserts in its exception that the printers/imprinters engaged in a taxable use of the forms. Moreover, the Division argues that petitioner gave up possession as well as dominion and control of the personalized promotional materials when its designees, the in-state mailers, handed them over to the possession of the United States Postal Service in New York State. Therefore, the Division asserts that pursuant to Matter of Bennett Bros. v. State Tax Commn. (62 AD2d 614, 405 NYS2d 803), the forms were not used outside New York by petitioner.

During the period at issue, Tax Law § 1119(a)(4) provided an exemption from sales or use tax owed under section 1105(a) or section 1110 as follows:

> "on the sale or use within this state of tangible personal property, not purchased for resale, if the use of such property in this state is

> restricted to fabricating such property (including incorporating it into or assembling it with other tangible personal property), processing, printing or imprinting such property and such property is then shipped to a point outside this state for use outside this state."

20 NYCRR 534.3(e) provides, in pertinent part, as follows:

> "Property, the use of which is restricted to fabricating, processing, printing, or imprinting. (1) A purchaser who has paid the tax on the tangible personal property may claim a refund or credit for such tax provided:
>
> "(i) the use of the tangible personal property in New York is restricted to fabricating such property (including the incorporation of it into or assembling it with other tangible personal property), processing, printing, or imprinting such property;
>
> "(ii) such property is then shipped to a point outside New York State for use outside the State; and
>
> "(iii) such property is so used within three years from the date that tax was payable to the Department of Taxation and Finance, and application for the credit or refund is filed within three years after the date the tax was payable to the Department of Taxation and Finance.
>
> "(2) The fabricator, assembler, processor, printer, or imprinter may be either the purchaser or a user distinct from the purchaser."

Use is defined in the statute as follows:

> "[t]he exercise of any right or power over tangible personal property by the purchaser thereof and includes, but it not limited to, the receiving, storage or any keeping or retention for any length of time, withdrawal from storage, any installation, any affixation to real or personal property, or any consumption of such property" (Tax Law former § 1101[b][7]).

In his determination, the Administrative Law Judge found that while the personalized computer forms may, in effect, have required additional printing and handling activities associated with the personalization performed to them, there was no taxable "use" of this particular form in New York. The Administrative Law Judge determined that the personalized forms, similar to the nonpersonalized forms, were also a promotional material, and there is no evidence that it was ever used as such in New York at any time prior to its having been mailed outside the State. In quoting the Court in Matter of Crown Publs. v. Tully (96 AD2d 990, 466 NYS2d 822, 823-824, revd on other grounds on dissenting opn below 63 NY2d 660, 479 NYS2d 523), the Administrative Law Judge relied on the Court's statement that the exemption

set forth in Tax Law § 1119(a)(4) "specifically allows a limited use in New York provided such use is limited to incorporating the property into or assembling it with other property." The Administrative Law Judge found that all of the ancillary activities by the printers/imprinters and mailers were performed in furtherance of bringing together each of the individual promotional materials to form the complete package which was mailed out of State. Thus, the Administrative Law Judge concluded that the additional activities performed in the personalization of the computer forms did not constitute a taxable use.

We affirm the determination of the Administrative Law Judge.

In analyzing whether any taxable use of the promotional materials occurred in New York State, the Division argues that several activities by the printers/imprinters constituted a taxable use. Such activities include the printer's segregation of the forms and sending them to a personalization printer which received possession of these forms within New York State and stored these forms for an indeterminate length of time, performed the personalization and then forwarded the forms to the mailer. Furthermore, the Division states that the in-state mailers collated the personalized and cut computer form with the nonpersonalized promotional materials and stuffed the materials into an outer envelope for mailing. The Division, relying on Garden Way, states that stuffing is a taxable use of the tangible personal property within New York State. We disagree.

Tax Law § 1119(4) allows a refund or credit for sales or use tax paid on property, including printed materials, if its use in New York State is restricted to fabricating, processing, printing or imprinting such property prior to its shipment outside New York State for use outside the State. 20 NYCRR 531.2(d) defines fabrication, in pertinent part, as follows:

> "the alteration or modification of a manufactured product without a change in the identity of the product. Fabrication includes cutting, perforating, and similar operations."

In this case, we find that the activities performed by the printers/imprinters are essential to the fabricating, processing, printing or imprinting of the computer forms. In fact, the Division agrees that the nonpersonalized forms are not used within the State. Therefore, the distinction to be drawn between the personalized and nonpersonalized forms is the extra step taken by sending the blank computer forms to a personalization printer prior to the forwarding of the personalized materials to the in-state mailer as opposed to the nonpersonalized material being sent directly to the in-state mailer. However, as pointed out by petitioner, in order for the blank computer forms to be personalized, certain incidental uses of the forms occur such as segregation and receipt and storage by the personalized printer. A finding that these incidental uses constitute a taxable use of the tangible personal property within this State would negate the effect on the exemption provided in the statute.

With respect to the alleged uses of the materials in the State by the mailers who collate and stuff the envelopes for shipment out of the state, these activities are also not taxable uses of the property. The Division claims that stuffing is indeed a use based upon our decision in Garden Way. However, in Garden Way, the tangible personal property at issue was the envelope used to mail the promotional materials. In determining whether the use of the envelope was restricted to fabricating, such that the purchases of the envelopes would be exempt from tax pursuant to Tax Law § 1119(a)(4), we held that:

> "[the] [p]etitioner's act of inserting promotional materials into the envelopes did not change the envelopes in any way. Moreover, this use does not fall within the meaning of the terms 'incorporating'[2] or 'assembling,'[3] as it does not effectuate formation of two elements into an 'indistinguishable whole' or a 'new product,' respectively" (Matter of Garden Way, supra).

---

[2] "Incorporate," which is not defined in the statute or the regulations, means "to unite or work into something already existent so as to form an indistinguishable whole" and "to blend and combine thoroughly" (Merriam Webster's Collegiate Dictionary 589 [10th ed 1993]; Matter of Automatique, Inc. v. Bouchard, 97 AD2d 183, 470 NYS2d 791 [where word in a statute is not defined in the statute or regulations, it is appropriate to use the word's ordinary, everyday meaning.]).

[3] The regulations at 20 NYCRR 531.2(c) define "assembling" as "the coupling or the uniting of parts or materials as a manufacturing process which results in a new product" (emphasis added).

In this case, the focus of our inquiry is on the computer forms and not the envelopes. The functions performed by the in-state mailers are properly characterized as assembling as described above. The in-state mailers' performance of collating the materials and stuffing them into the envelopes results in the "new product" which is individually unique to each of its recipients outside of the State. Accordingly, there is no taxable use of the tangible personal property within New York State.

The Division also asserts that an essential element to entitlement to the exemption is that the property must be shipped to a point outside the State for use outside the State by the purchaser which, in this case, is petitioner. We do not find that Tax Law § 1119(a)(4) anticipated that the purchaser must use the property outside the State, but rather, that the intended recipients of the mailings must use the property outside the State (see, 20 NYCRR 534.3[e][2] [example 3]). Therefore, we reject the Divison's argument that, since petitioner did not use the materials outside of the State, petitioner failed to qualify for the exemption.

Additionally, the Division argues, in support of its position, that the exemption from sales and use taxes for promotional material mailed from within New York State to points outside New York was specifically legislated by Chapter 61 of the Laws of 1989. Therefore, the Division argues that since the exemption was specifically provided for beginning on September 1, 1989, it follows that there was no such exemption prior to that time. Moreover, the Division relies on our statement in Garden Way wherein we stated, in pertinent part, that:

> "we note that as of September 1, 1989 the Tax Law was amended to deal specifically with the application of the sales and use tax to promotional materials.[4] Under the amendments, petitioner's use of 'promotional envelopes' to mail promotional packets to out-of-state addresses is exempt from use tax (see, L 1989, ch 61). We agree with the observation of the Administrative Law Judge that the fact that such legislation was necessary to provide for this exemption supports the Division's interpretation that section 1119(a)(4) did not provide for such an exemption for the period March 1, 1984 through August 31, 1989" (Matter of Garden Way, supra).

---

[4] Tax Law §§ 1115(n)(1) and 1101(b)(12) (added by L 1989, ch 61, effective September 1, 1989) provide an exemption from sales and use tax on promotional materials, including outside envelopes, mailed, shipped or distributed from a point within New York State, by or on behalf of vendors or other persons to their customers or prospective customers outside the State for use outside the State.

In reviewing the legislative history contained in the bill jacket for Chapter 61 of the Laws of 1989, it states that Tax Law § 1101(b)(12) was added in order to define "promotional materials" and Tax Law § 1115(n) was added to provide that promotional materials sent from New York State for use outside the State were exempt from sales and use tax (Memorandum in Support, p. 46). The Division focuses on the statement in support section of the Memorandum in Support which states as follows:

> "New York printers suffer additional disadvantages arising from the fact that sales tax applies to the mailing envelopes and labels used in connection with promotional materials, as well as any personalized materials, regardless of where these materials are ultimately destined" (Memorandum in Support, p. 53).

We are unpersuaded by the phrase "as well as any personalized materials" as proof that the amendment provides for an exemption for personalized materials that did not exist in the prior law. It is clear that the additions to the sales and use tax article of the Tax Law were made to define "promotional materials" and to provide an exemption for such materials when mailed from New York State for use outside of the State. Nowhere in the legislative history does it state that the amendments were made in order to exempt personalized materials from sales and use tax. Rather, the amendments were focused on defining the phrase "promotional materials" to include, among other things, the envelope in which the materials were being sent. Thus, we do not find that the legislative history supports the Division's position that the personalized materials herein were subject to tax.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

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

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

3. The petition of Publishers Clearing House is granted; and

4. The refund claim for $ 1,027,628.46 plus interest due and owing is granted.

DATED: Troy, New York
July 22, 1997

/s/Donald C. DeWitt
Donald C. DeWitt
President

/s/Joseph W. Pinto, Jr.
Joseph W. Pinto, Jr.
Commissioner