STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition :

of :

**SHARPER IMAGE CORPORATION** : DETERMINATION
DTA NO. 815434

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 December 10, 1989 through August 31, 1992. :

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Petitioner, Sharper Image Corporation, 650 Davis Street, San Francisco, California 94111, filed a 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 December 10, 1989 through August 31, 1992.

A hearing was held before Jean Corigliano, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on October 3, 1997 at 10:15 A.M., with all briefs to be submitted by April 13, 1998, which date began the six-month period for the issuance of this determination. Petitioner appeared by Martin I. Eisenstein, Esq. The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Robert Tompkins, Esq., of counsel).

## *ISSUES*

I. Whether imposition of use tax on the printing costs of petitioner's catalogs violates the First Amendment of the United States Constitution.

II. Whether, by the operation of Tax Law § 1110(a)(A) and § 1101(b)(7), petitioner is liable for the use tax imposed on the cost of catalogs mailed from outside New York State to residents in New York State.

III. Whether imposition of the use tax on petitioner's catalogs is barred by the Commerce Clause of the United States Constitution.

## *FINDINGS OF FACT*

1. The Division of Taxation ("Division") issued to petitioner, Sharper Image Corporation (hereafter, "petitioner" or "Sharper Image"), a Notice of Determination, dated November 30, 1995, assessing use tax of $104,578.88 plus penalty and interest for the period December 1, 1989 through August 31, 1992. Following a conference, the Division issued a Conciliation Order, dated August 9, 1996, sustaining the tax assessment but canceling all penalties.

2. The issuance of the assessment followed a field audit of petitioner's books and records for the audit period. The only contested item arising from that audit is the Division's imposition of use tax on the printing cost of catalogs distributed in New York.

3. Petitioner is a Delaware corporation with its headquarters in San Francisco, California. Sharper Image sells merchandise by mail order and from retail stores located throughout the United States, including three stores in New York City. Sharper Image is a registered vendor, files New York State sales tax returns and collects and remits sales tax and use tax to New York on receipts from sales made in its New York stores and by mail order to residents of New York.

4. The Sharper Image catalog serves as the primary source of advertising for petitioner's retail stores and mail-order business. The catalog is published monthly. Copywriting, photography and design of the catalog are completed in San Francisco. Sharper Image had a contract with a Nebraska printer, known as Foote & Davies during the audit period and now named Quebecor, for the printing, labeling and mailing of the catalogs to persons throughout the world, including persons in New York. All arrangements, instructions and payments to Foote & Davis were made from petitioner's California headquarters, or at the offices of Foote & Davis or

by telephone. No activities related to the design, printing or distribution of the catalogs were performed in New York.

5. Foote & Davis printed the catalogs, addressed them as directed by petitioner, and bundled them according to the regulations of the United States Postal Service (USPS). What is known as a "plant loading system" was used to deliver the catalogs to the custody of the USPS. A Postal Service employee worked on-site at the Foote & Davis plant which is considered a mailing facility of the USPS. Postal Service employees verified weight and sortation levels and inspected the mail prior to its being loaded into USPS trailers located on-site. After the catalogs were loaded, the trailers were sealed, and the catalogs were considered to be mailed at that time. The catalogs were sent by third class mail to the address on the mailing label.

6. On audit, it was determined that the catalogs were advertising materials subject to use tax under sections 1110(a) and 1101(b)(7) of the Tax Law. The audit report contains only one paragraph describing the tax assessed on the catalogs. It states that the cost of producing the catalogs was reviewed in detail with the following conclusions. Two types of catalogs were produced. One was sent to customers' homes, and a shorter version was sent to Sharper Image retail stores throughout the country. Nine percent of the total number of catalogs mailed were sent to an address in New York State. Based upon these findings, the Division computed a total tax due of $104, 578.88, of which $9,700.00 is attributable to catalogs delivered to Sharper Image retail stores in New York. The computation of tax is not in issue.

7. During the course of the audit, the Division determined that the text and pictures displayed in the Sharper Image catalog constituted advertisements for products being sold by petitioner. There is no indication in the audit report that the auditor examined the catalogs with any care after she determined that they contained descriptions of products for sale. The auditor's

supervisor, Donald Dahlgren, stated in testimony that during the course of the audit the catalogs were never considered to be anything other than advertising materials. When asked to provide a definition of advertising material, Mr. Dahlgren referred to the Sharper Image catalog and testified:

> Advertising material. This is advertising material, this is what I mean by advertising material. They are showing a picture of a product, they give a description of the product, they give a price for the product.

8. Whether the catalogs might be considered exempt from tax as periodicals was never raised as an issue on audit. On cross-examination, Mr. Dahlgren was asked to apply the regulations pertaining to the periodical exemption and provide an opinion as to whether the Sharper Image catalog would be considered a periodical under the regulations. He stated that it would not because it did not contain a variety of articles on different topics by different authors. It was his opinion that the product descriptions in the catalog did not constitute "articles" as that term is used in the Division's regulations.

9. The Sharper Image catalogs placed in evidence were between 60 and 75 pages long. Each catalog solicits mail-order sales through the use of glossy color photographs and descriptions of the products for sale. A toll-free telephone number is prominently and frequently displayed in the catalogs, and above that number, it reads "To order, call 24 hours a day."

10. Almost all of the pictures and text in the Sharper Image catalog relate directly to a product for sale. Each product is pictured with accompanying text describing the product. Every product description ends with an item number, a price and an amount for delivery. A tear-out order form and a postage paid mailing envelope is attached to the middle of each catalog.

11. Typically, the product descriptions are detailed and informative and occasionally entertaining. Woodrow Nelson, who is responsible for producing the catalog, explained the philosophy behind the catalog design.

> We have believed since day one that our customers wanted to be informed about the latest and greatest things. They are very interested in anything that's new, whether it's technology, whether it's collectibles, whether it's science, whether it's fitness, what have you. They want to be informed. Philosophically, our creative approach is to make sure that our customers are, number one informed, number two, entertained, and we believe for many, many years that our customers enjoy getting the catalog in their mailbox. (Tr., p. 62.)

12. The following description of a Lava Lite, offered for sale on page 13 of the February 1991 catalogue, exemplifies the philosophy described by Mr. Nelson.

> What a head trip! Lava Lites are now 25 years old. At a recent anniversary bash and be-in, one party goer commented (as quoted in the ***New York Times***), "*I'm reminded of sneaking into people's parents dens to make out. Everybody had one over the TV set, and when the lights went out the Lava Lite glowed."*
>
> To celebrate a passionate quarter century, Lava Lite's maker creates this bodacious new coral version exclusively for Sharper Image customers. Still made in the US, Lava Lite's secret formula of 11 non-toxic fluids undulates with a *"fascinating, intriguing, soothing, endlessly captivating motion."* Or as an official of the American Institute of Architects put it: the lamp's "*kinetic sculptural elements constitute an intriguing relief from hard-edged rectilinearity."*
>
> Made from sturdy aluminum and glass, Lava Lite measures 16½H x 4½" in diameter and weighs 3¾ lbs. Plugs into wall outlet. UL-listed. Comes with a 40W bulb and 90 day warranty. *Styrofoam-free packaging*.
>
> ■ **Lava Lite**
> **# BLV845 Was $49.95.**
> **Now $39.95 (5.50)**[1]

13. Sharper Image employs between two and five writers each month to write the text found in each catalog. Like the Lava Lite advertisement, many of the product descriptions quote from other sources, including periodicals, newspapers and scientific and medical journals and

[1] The amount in parenthesis refers to the delivery charge.

attempt to be informative and entertaining. The text may not always be a description of a product, but it is always related to products for sale. Page 18 of the February 1991 catalog, for example, advertises products related to recycling. Boxed text on that page states:

> Did you know that if you toss out one aluminum can, you waste as much energy as if you'd filled the same can half full of gasoline and poured it into the ground? The average can that is returned for recycling is melted and back on the supermarket shelf in six weeks.

One of the products advertised on the page where this information appears is a device for compacting aluminum cans prior to recycling ("The Crusher"). Similarly, an advertisement in the June 1990 catalog for a device that sanitizes toothbrushes (a Purebrush) describes the product; briefly summarizes university research studies which concluded that toothbrushes are a breeding ground for bacteria; and offers testimonials from dentists regarding the efficacy of the Purebrush.

14. Petitioner's customer mailing list came primarily from a list of customers who had previously purchased from the catalog. In addition, one could ask to be placed on a mailing list by calling the company's toll-free number or registering at a retail store, with or without making a purchase. Sharper Image sometimes advertised its catalog in other magazines, and it sometimes rented customer mailing lists from other publications. The catalog was not available at newsstands. The entire catalog was not distributed in Sharper Image retail stores, but an abridged version of it was available in the stores. Each catalog contained an advertisement listing the Sharper Image retail stores nationwide under the headline: "VISIT OUR STORES."

15. Petitioner's retail catalog sales operations and its retail stores are overseen by a common central management. Mail-order sales were shipped to customers from the same warehouse and distribution centers which service the Sharper Image retail stores.

16. Some products available by mail order were not offered for sale in the retail stores, although most were. Mr. Nelson testified that store personnel would place a telephone order for a customer if asked to do so and would accept returns of merchandise ordered through the catalog. There is no evidence, however, that Sharper Image encouraged these practices.

17. Typically, newspapers and magazines contain some form of advertising. Some of those advertisements are similar to the advertisements found in the Sharper Image catalog. A picture of a product is displayed, text describes the product and information is provided about purchasing the product in-person or by mail order.

***SUMMARY OF THE PARTIES' POSITIONS***

18. Petitioner's first argument is that imposition of the use tax on the cost of printing the Sharper Image catalogs violates the First Amendment to the United States Constitution. The retail sale of periodicals and newspapers is exempt from sales tax (Tax Law § 1115[a][5]). Through its regulations, the Division construes the statute to exclude advertising materials, including catalogs, from the scope of the exemption (20 NYCRR 528.6[c][3][i]). Petitioner asserts that commercial speech, e.g., advertising, is fully protected by the First Amendment and argues that distinguishing between its catalog and other publications on the basis that the catalog is merely advertising material is a form of content-based discrimination which violates the First Amendment.

19. The Division takes the position that the Division of Tax Appeals has no jurisdiction to rule on constitutional challenges to either statutes or regulations and, therefore, cannot consider petitioner's First Amendment claim. Presuming that the Division of Tax Appeals has such authority, the Division asserts that there is no legal precedent which requires that two different

classes of publications, in this case periodicals and advertising catalogs, be afforded the same tax treatment.

20. Petitioner claims that it did not make a taxable use of the Sharper Image catalog in New York. Tax Law § 1110(a) provides that the distribution of promotional materials within New York is a taxable use. Petitioner, however, claims that all of its catalog-related activities occurred outside of New York. Since its power and control of the catalogs ended when the catalogs were deposited with the USPS in Nebraska, petitioner claims that it made no taxable use of the catalogs within New York. It takes the position that the statutory language applies only to vendors located in New York. The Division asserts that petitioner's reading of the statute is erroneous and that petitioner clearly makes a taxable use of the catalogs within New York.

21. Finally, petitioner contends that an assessment of use tax based on catalogs sent to New York residents from outside of New York violates the Commerce Clause of the United States Constitution because there is insufficient nexus between New York and the activity being taxed, i.e., the design, printing and mailing of the catalogs. The Division takes the position that the required nexus exists where there is some definite link between the taxing state and the person it seeks to tax and there is more than the slightest physical presence of the vendor in the taxing State. In this case, the Division argues, there is both a definite connection and the physical presence of Sharper Image in New York.

## *CONCLUSIONS OF LAW*

A. New York imposes a sales tax on receipts from the retail sale of tangible personal property and a broad range of services (Tax Law § 1105). Tax Law § 1115(a)(5) exempts from sales tax all receipts from the sale of newspapers and periodicals. There is no definition of a "periodical" in Article 28 of the Tax Law; however, sales tax regulations issued by the Division

define the word "periodical" as used in section 1115(a)(5) (hereafter the "periodical exemption") as follows:

> In order to constitute a periodical, a publication must conform generally to the following requirements:
>
> (i) it must be published in printed or written form at stated intervals, at least as frequently as four times a year;
> (ii) it must not, either singly or, when successive issues are put together, constitute a book;
> (iii) it must be available for circulation to the public;
> (iv) it must have continuity as to title and general nature of content from issue to issue; and
> (v) *each issue must contain a variety of articles by different authors devoted to literature, the sciences, or the arts, news, some special industry, profession, sport or other field of endeavor*. (20 NYCRR 528.6[c][1]; emphasis added).

Section 528.6(c)(3) of the Division's regulations provides that advertising materials, such as the Sharper Image catalog, are not exempt as periodicals. It states: "Nothing in this section shall be construed to exempt as a periodical the following: . . . advertising material, such as catalogs, flyers, pamphlets and brochures" (20 NYCRR 528.6[c][3][i]).

B. The parties agree that the Sharper Image catalog satisfies the first four requirements of the regulation. In his testimony, Mr. Dahlgren gave his opinion that the Sharper Image catalog does not satisfy the fifth criteria because it does not contain a variety of articles by different authors on a variety of subjects; however, the record establishes that the auditors gave no consideration to the fifth criteria of the periodical exemption because they determined, based on a cursory review, that the Sharper Image catalog is advertising material.

The Division does not address petitioner's claim that the Sharper Image catalog satisfies the fifth requirement of 20 NYCRR 528.6(c)(1). It takes the position that regardless of any other

facts, the Sharper Image catalog is not exempt from sales tax as a periodical because it is advertising material (20 NYCRR 528.6[c][3][i]).

C. When the issue to be decided is whether the taxpayer is entitled to an exclusion or exemption from tax, the taxpayer is required to prove that its interpretation of the statute is the only reasonable interpretation or that the Division's interpretation is unreasonable (***Matter of Blue Spruce Farms v. NYS Tax Commn***., 99 AD2d 867, 472 NYS2d 744, ***affd*** 64 NY2d 682, 485 NYS2d 526; ***Matter of Grace v. State Tax Commn.***, 37 NY2d 193; ***Matter of Old Nut Company v. State Tax Commn.***, 126 AD2d 869, 871, ***lv denied*** 69 NY2d 609). The burden of proving entitlement to a tax exemption rests with the taxpayer (***Matter of Young v. Bragalini***, 3 NY2d 602). These principals of statutory construction also apply to the interpretation of regulations (***see***, ***Cortland-Clinton v. NYS Dept. Of Health,*** 59 AD2d 229, 399 NYS2d 492).

D. Petitioner's First Amendment argument is premised partially on its claim that the Sharper Image catalog satisfies the fifth criteria of section 528.6(c)(1). If Mr. Dahlgren was correct in his opinion that the catalog does not contain a variety of articles by different authors, then the catalog is not a periodical and this inquiry need go no further. Therefore, I begin by addressing whether the catalog satisfies the fifth criteria of the regulation.

Under section 528.6(c)(v), a publication must contain three elements to qualify as a periodical: (1) each issue must contain a variety of articles; (2) the articles must be written by different authors; and (3) the articles must be devoted to literature, the sciences, or the arts, news, some special industry, profession, sport or other field of endeavor.

Arguably, the text and images found in the Sharper Image catalogs, albeit short, are "articles" within the meaning of 20 NYCRR 528.6(c)(1)(v). Since there is no definition of an "article" in the regulation, it is reasonable to resort to the dictionary in an attempt to define the

term as it is commonly understood (***see***, ***Cortland-Clinton v. NYS Dept. Of Health***, 59 AD2d 229, 399 NYS2d 492). Article is defined as "a generally short nonfictional prose composition usu.[ally] forming an independent portion of a publication" (Webster's Third New International Dictionary 123 [1986 ed]). The Sharper Image catalog contains such articles. The lava light text quoted in the findings of fact is exemplary. It is a short nonfictional prose composition, and it forms an independent portion of a publication. It cannot be deemed something other than an "article" merely because it is short, consists mostly of facts about the lava lamp, and describes a product for sale. The articles in the Sharper Image catalog were written by different authors, and they cover a variety of topics. However, the articles in the Sharper Image catalog are not "devoted to literature, the sciences, or the arts, news, some special industry, profession, sport or other field of endeavor." They are devoted to selling a product. For this reason, the Sharper Image catalog does not satisfy the definition of a periodical. Moreover, section 528.6(c)(3) states directly that publications devoted to selling products do not come within the purview of the periodical exemption. It states that the periodical exemption is not to be construed in such a way as to include advertising materials, including catalogs, whether those materials otherwise satisfy the criteria of section 528.6(c)(1) or not. Thus, the Sharper Image catalog is not a periodical as that word is defined in the Division's regulations.

Petitioner argues that the publication in question cannot be identified as advertising material without scrutiny of its contents and suggests that it is impossible to draw a "bright line" between a periodical, as defined in section 528.6(c)(1)(v), and advertising material. This argument is rejected. There is no question that the Sharper Image publication is a catalog. One definition of "catalog" is "a complete enumeration of items (as of books for sale or courses of instruction in a college) arranged systematically in a pamphlet or book often alphabetically and

with descriptive details (as of price or content) accompanying each item" (Webster's Third New International Dictionary 350 [1986 ed]). This is a very good description of the Sharper Image catalog. In addition, categorizing the Sharper Image catalog as advertising material is in accord with the test of common understanding. Based on a glance, any member of the public would identify the Sharper Image publication as a catalog rather than a periodical. A toll-free telephone number is prominently displayed throughout the publication, every article describes a product for sale or is related directly to products for sale, every product description is followed by a price and delivery charge, and there is an order form in each catalog. Unlike newspapers and magazines, all the articles or features relate to a particular product for sale or promote the sale of products by the Sharper Image retail operation. The mere fact that the product descriptions are linked to a more general discourse on issues of public concern does not remove the Sharper Image catalog from the category of advertising material.

E. The Division's regulations draw a line between communication which is devoted to disseminating information of general interest to the public (periodicals) and communication which is devoted to selling a product (advertising). This distinction can be made without offending reason or common sense. In light of the general principle that exemptions from tax should be narrowly construed against the taxpayer (***Matter of Grace v. New York State Tax Commn.***, ***supra***, 37 NY at 195-196, 371 NYS2d at 718), the line drawn by the Division's regulations is a reasonable interpretation of the legislative intent behind Tax Law § 1115(a)(5). Petitioner has not established that the Division's interpretation of the statute is unreasonable, and under the scheme of the regulation, petitioner is barred from claiming the benefit of the periodical exemption.

F. Petitioner does not challenge the reasonableness of the Division's regulatory scheme; rather, it argues that the line drawn by the regulations violates the First Amendment. Before addressing petitioner's First Amendment argument, it is necessary to consider the Division's contention that the jurisdiction of the Division of Tax Appeals does not extend to the facial validity of statutes or regulations. Although petitioner casts its claim in terms of a challenge to the application of the statute, the Division asserts that it is, in actuality, a challenge to the "statutory/regulatory scheme" (Division's brief, p. 36) and that the Division of Tax Appeals has no jurisdiction to hear such a claim.

To the extent that the Division argues that the Division of Tax Appeals has no jurisdiction to invalidate a regulation on constitutional grounds, its argument is rejected. The jurisdiction of the Tribunal, as prescribed in its enabling legislation, does not encompass constitutional challenges to the facial validity of a legislative enactment (***see***, ***Matter of Gasit, Inc.,*** Tax Appeals Tribunal, July 19, 1990; ***Matter of Scotsman Press, Inc.***, Tax Appeals Tribunal, September 14, 1989; ***Matter of Fourth Day Enterprises***, Tax Appeals Tribunal, October 27, 1988). At the administrative level, it is presumed that statutes are constitutional. However, none of the cases cited by the Division extend this presumption to regulations of the Division. The Tax Appeals Tribunal has "the authority to rule on the validity of the regulations of the commissioner of taxation and finance where such regulations are at issue" (Tax Law § 2006[7]). Thus, the Tax Appeals Tribunal has the authority to rule on whether a regulation is a valid interpretation of a statute. There is no decisional law or other authority which precludes the Tribunal from exercising this authority where the issue is whether the Division has interpreted a legislative enactment in a manner that violates the United States Constitution.

Petitioner is not claiming that Tax Law § 1115(a)(5) is constitutionally invalid on its face; rather, it argues that the Division, through its regulations, has interpreted and applied the statute in a manner that offends the United States Constitution. This is a challenge to the Division's application of the statute, and I do not view it as a "de facto challenge to the facial validity of the Tax Law" (Division's brief, p. 34).

G. Next, I will consider petitioner's primary argument, that defining the statutory term "periodical" in such a way as to exclude catalogs from the scope of the exemption violates the First Amendment.[2]

The Supreme Court has held that tax laws which discriminate among different speakers violate the First Amendment only if the discrimination is based on the content of the speech. (***Regan v. Taxation with Representation***, 461 US 540, 547, 76 L Ed 2d 129, 138). In ***Regan,*** the Supreme Court considered provisions of the Internal Revenue Code which discriminated between tax exempt organizations that do not engage in lobbying activities and those that do. The Court began its analysis with the commonplace statement that "tax exemptions and tax deductions are a form of subsidy that is administered through the tax system" (***Regan v. Taxation with Representation***, ***supra***, 461 US at 544, 76 L Ed 2d at 136). It rejected the lower court's suggestion that strict scrutiny of a taxing statute is required when a legislature subsidizes some, but not all speech. Describing tax exemptions as a "matter of grace," the Court concluded that while a legislature may not restrict the exercise of free speech, it is not required to subsidize First Amendment rights through a tax exemption or tax deduction (***Regan v. Taxation with Representation***, ***supra***, 461 US at 549, 76 L Ed 2d at 139).

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[2] Both parties made extensive use of decisions of other state courts in urging their respective positions on this issue and on other issues raised in this proceeding. Inasmuch as those decisions have no precedential value in this forum, they were not considered and will not be discussed in this determination.

The reasoning of ***Regan*** was affirmed in ***Leathers v. Medlock*** (499 US 439, 113 L Ed 2d 494). There, the Court considered an Arkansas sales tax statute which provided an exemption for receipts from the sale of newspapers and magazines. The tax was extended to cable television operators but excluded scrambled satellite broadcast television services to home dish-antennae owners. In 1989, the tax was extended to all television services. The exemption for newspapers and magazines remained in place and did not include television services of any kind. The Supreme Court found that cable television is engaged in "speech" under the First Amendment and is part of the "press" (***Leathers v. Medlock***, ***supra***, 499 US at 445, 113 L Ed 2d at 502). It held that extending the Arkansas sales tax to cable television alone, or to all television services, while exempting the print media does not violate the First Amendment. Summarizing earlier decisions, the Court stated that a tax which discriminates among speakers is constitutionally suspect only under certain circumstances: (1) where the tax singles out the press for special treatment; (2) where a selective tax targets individual members of the press; and (3) where the tax discriminates on the basis of the content of the taxpayer's speech (***Leathers v. Medlock***, ***supra***, 499 US at 445-446, 113 L Ed 2d at 502-503; ***see also, Arkansas Writers' Project v. Ragland***, 481 US 221, 95 L Ed 2d 209; ***Minneapolis Star & Tribune,*** 460 US 575, 75 L Ed 2d 295). Regarding this last standard, the Court stated that its prior cases "establish that differential treatment of speakers, even members of the press, does not implicate the First Amendment unless the tax is directed at, or presents the danger of suppressing, particular ideas" ***Leathers v. Medlock***, ***supra***, 499 US at 445, 113 L Ed 2d at 502.

The Division's regulations raise none of the constitutional concerns identified by the Court in ***Leathers***. New York's sales tax is a tax of general applicability which does not single out the press for taxation. There is no indication that the regulation attempts to interfere with the

First Amendment rights of a targeted group. Excluding all advertising materials from the scope of the periodical exemption hardly resembles a selective tax targeted to a small number of speakers. Finally, the regulation is not content-based. It makes a distinction between periodicals and catalogs based on the form of communication (advertising) and the common understanding of what constitutes advertising—not on the content of the communication.

Rather than drawing a line between different members of the press, as the State of Arkansas did, the Division's regulations draw a line between communication which advances the exchange of ideas, newspapers and periodicals, and material which is designed to sell a product, i.e., commercial speech. Although, as petitioner asserts, speech that does no more than propose a commercial transaction is protected by the First Amendment (***Virginia State Board of Pharmacy v. Virginia Citizens Consumer Council, Inc.***, 425 US 748, 48 L Ed 2d 346), it has never been held that commercial speech is entitled to the same degree of protection that other constitutionally guaranteed expression receives (***Ohralik v. Ohio State Bar Assn.***, 436 US 447, 455-456, 56 L Ed 2d 444, 453). Moreover, the mere fact that an advertisement links a product to matters of current public interest does not elevate the advertisement to pure speech (***Board of Trustees of State University of NY v. Fox***, 492 US 469, 106 L Ed 2d 388).

Petitioner would argue that ***Leathers*** does not provide support for the Division's position because television and print media may be distinguished on an objective basis; whereas, a degree of content-based scrutiny is required to differentiate between a periodical and a catalog.

In my view, petitioner's attempt to equate the Division's regulation with content-based scrutiny of a publication fails. The case primarily relied on by petitioner, ***Arkansas Writers' Project, Inc. v. Ragland*** (***supra***), is distinguishable. At issue was an exemption from the Arkansas sales tax for newspapers and "religious, professional, trade and sports journals and/or

publications printed and published within this state when sold through regular subscriptions" (Ark Stat Ann § 84-1904[j], quoted in ***Arkansas Writers' Project, Inc. v. Ragland***, ***supra***, 481 US at 224, 95 L Ed 2d at 216). The Arkansas Times included articles on a variety of subjects, including sports and religion. It was denied the exemption, however, because its articles were not uniformly devoted to one or another of the topics listed in the statute. The Court found that the Arkansas statute targeted a small group within the press for taxation since it was not evenly applied to all magazines and treated some magazines less favorably than others. Moreover, the statute was especially repugnant to First Amendment values because "[i]n order to determine whether a magazine is subject to sales tax, Arkansas' 'enforcement authorities must necessarily examine *the content of the message that is conveyed* . . . .'" (***Arkansas Writers' Project, Inc. v. Ragland***, ***supra***, 481 US at 230, 95 L Ed 2d at 220, quoting ***FCC v League of Women Voters of California***, 468 US 364, 383, 82 L Ed 2d 278, 294; emphasis added.)

In contrast with the statute in ***Ragland***, the Division's regulation does not require scrutiny of the "content of the message that is conveyed" to determine whether a publication is exempt from sales tax. It was apparent from Mr. Dahlgren's testimony that the auditors did not scrutinize the content of the articles contained in the Sharper Image catalog or believe that such scrutiny was required in order to determine that the publication as a whole was advertising material. The fact that the publication consisted of pictures of products for sale, descriptions of those products and the price of each product was enough to identify the publication as a "catalog" as that term is commonly understood. The auditor did not need to scrutinize (or even read) the product descriptions, or articles, to determine that the Sharper Image catalog is advertising material.

Petitioner's reliance on ***Cincinnati v. Discovery Network*** (507 US 410, 123 L Ed 2d 99) is also misplaced. There, the Supreme Court struck down a city of Cincinnati regulation prohibiting the distribution, via newsrack, of commercial handbills on public property. The Court found that the city did not establish a reasonable fit between its interests in safety and esthetics and its outright ban on commercial handbills. The Court's opinion in ***Discovery Network*** is not controlling here. The Cincinnati regulation contained an outright ban on the distribution of commercial speech by an avenue, newsracks, which was open to noncommercial speech. Moreover, the Court found that the number of newsracks used to distribute commercial handbills was tiny when compared with the number of newspaper racks which continued to exist. Therefore, the regulation did not even contribute to the stated goal of improving the safety and attractiveness of the cityscape. Here, the regulation merely construes a tax exemption so as to exclude commercial speech. As stated in ***Regan***, a legislature is not required to subsidize First Amendment rights through a tax exemption or tax deduction.

Petitioner has not demonstrated that the line drawn by the regulations discriminates on the basis of ideas or that the implementation of the regulation presents a danger of suppressing particular ideas. Therefore, I find that imposition of use tax on the printing costs of the Sharper Image catalogs does not violate the First Amendment of the United States Constitution.

H. I will now turn to petitioner's contention that Sharper Image did not make a taxable use of the catalogs in New York State. Tax Law § 1110(a) imposes "on every person a use tax for the use within this state" of any tangible personal property purchased at retail. Tax Law § 1101(b)(7) defines "use" as

> *[t]he exercise of any right or power over tangible personal property by the purchaser thereof and includes*, but is 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. Without limiting the foregoing, use also shall include *the distribution of only tangible personal property, such as promotional materials*. (Emphasis added.)

Although the Sharper Image catalogs were distributed within New York State, petitioner claims that it made no use of them in New York since all of its activities pertaining to the publication and distribution of the catalogs occurred outside of New York. It further claims that it exercised no power and control over the catalogs within New York because the catalogs were in the exclusive control of the USPS once they were loaded on the USPS trucks in Nebraska. This argument runs contrary to the statutory scheme. "Use," as that word is used in section 1110(a), encompasses the distribution of advertising catalogs. The "use" in question, i.e., the distribution of the catalogs, occurred within New York when those catalogs made their way to Sharper Image customers and retail stores in New York. Thus, the catalogs were used within New York. Even though the postal service carried out the actual delivery of the catalogs, petitioner exercised complete power and control over the distribution. Petitioner provided the names and addresses of the catalog recipients to Foote & Davis and directed their mailing by USPS to residents and retail stores in New York. Thus, petitioner made a taxable use of the catalogs within New York.

The last sentence of section 1101(b)(7) was added by amendment in 1989 (L 1989, ch 61, § 242, eff Sept. 1, 1989). Petitioner claims that the legislative history of the amendment supports its reading of the statute. The legislative history indicates that the expansion of the definition of the term "use" to the distribution of catalogs and promotional material was to restore the competitive position of New York printers with respect to printers in other states and to eliminate the unfair advantage enjoyed by out-of-state printers by overturning the result

in ***Bennett Bros., Inc. v. State Tax Commission*** (62 AD2d 614, 405 NYS2d 803) (Bill Jacket, L 1989, ch 61, pp 52-54).

The petitioner in ***Bennett Brothers*** was a New York corporation engaged in the sale of merchandise by mail order catalog throughout the Eastern half of the United States. The catalogs were produced and mailed from outside of New York to the petitioner's customers, some of whom were in New York. The Division imposed use tax on the costs related to printing and distributing the catalogs (***Bennett Brothers, Inc. v. State Tax Commission***, ***supra,*** 405 NYS2d at 804). The court annulled the determination of the State Tax Commission.

Petitioner agrees that the 1989 amendment expanded the term "use" to include the distribution of promotional materials. It argues, however, that the amendment applies only to New York companies who have their promotional materials printed out-of-state, as the petitioner in ***Bennett Brothers*** did. In support of its position, petitioner quotes the following language from the legislative history:

> the State has been unable to collect use tax on the use within New York of such catalogs and other mailings which have been shipped via common carrier or mailed into New York by an out-of-state printer *on behalf of a New York vendor*. . . . [As a consequence of the ***Bennett Brothers*** decision], New York vendors are encouraged to patronize out-of-state printers to avoid paying sales tax that an in-state printer is required to collect on catalogs sent by it to in-state addresses. . . . [B]y expanding the definition of 'use' to include distribution of tangible personal property, such as promotional materials, thus reversing the result in ***Bennett Brothers***, these provisions eliminate the unfair advantage enjoyed by out-of-state printers." (L 1989, ch 61, §§ 52-53; emphasis in petitioner's brief.)

According to petitioner, this language shows that "the 1989 amendment was enacted to prevent New York-based companies from avoiding the New York sales tax by making purchases in other states." It contends that it is not an in-state company to which the 1989

amendment is applicable. I agree with the Division that this is an unpersuasive reading of the statute, the legislative history and the ***Bennett Brothers*** decision.

First, as the Division states, petitioner is a New York State vendor. During the audit period, it owned and operated three retail stores in New York, collected sales tax, filed sales tax returns and paid tax over to the State (***see***, Tax Law §1101[b][8]). The Sharper Image catalogs were printed out of state and mailed into New York State on behalf of petitioner, a New York State vendor. Thus, the quoted excerpt from the Bill Jacket applies directly to petitioner.

Second, the opinion in ***Bennett Brothers*** was not predicated on the fact that the petitioner was a New York company. The core issue was whether the petitioner exercised a right or power over the catalogs "in directing the distributor to mail them to certain designated firms and individuals for the purpose of generating sales of merchandise within the State" (***Bennett Brothers, Inc. v. State Tax Commission***, ***supra,*** 405 NYS2d at 805). The Court resolved this issue with the following analysis.

> From our examination of the record, we conclude that petitioner lacked real control over the catalogs once they were deposited with the common carrier. While petitioner may have held theoretical ownership and had the ability to recall the materials, such control was unsubstantial and insufficient, in our view, to justify assessment pursuant to the use tax statute. Furthermore, the record demonstrates to us that petitioner did not exercise a right or power over the catalogs within the State of New York.

This is the conclusion that was overturned by the 1989 amendment which clearly provides that the distribution of promotional materials in New York is a "use" of those materials within New York State. The argument made here is the same one made in ***Bennett Brothers***—that the activities relating to the distribution of the catalogs occurred outside New York and that petitioner did not exercise any right or control over the catalogs within the State

of New York. The Legislature amended the definition of a taxable use to reverse the holding of ***Bennett Brothers*** and to provide for the application of the use tax in this situation.

Finally, the plain wording of the statute leaves no room to argue that the distribution of advertising catalogs in New York by a New York vendor is not a taxable use within New York.

I. Petitioner's final argument is that the imposition of use tax on catalogs printed outside of New York and shipped to residents and retail stores in New York, at its direction, violates the Commerce Clause of the United States Constitution. This argument is also rejected.

Article 28 of the Tax Law imposes a tax on the receipts from every retail sale of tangible personal property (Tax Law § 1105[a]). Tax Law § 1110(a) imposes a compensating use tax for use within New York of any tangible personal property purchased at retail. In this instance, the tax was imposed for the "use" of tangible personal property in New York (the catalogs). The printing cost of the catalog was the measure of the consideration paid for the catalogs; however, as the Division notes in its brief, no tax was imposed on receipts for any service purchased by petitioner. No tax was imposed on the printing, design or mailing of the catalogs or on any other activity or service which might be considered to have been performed across state lines. With this understanding in place, I will begin to address petitioner's Commerce Clause arguments.

The Commerce Clause provides that Congress shall have the power "[t]o regulate Commerce with Foreign Nations, and among the several States, and with the Indian Tribes." (United States Constitution, Art I, § 8, cl 3.) The Commerce Clause prevents the states from discriminating against interstate commerce. When a state seeks to tax the sale or use of goods

within its borders, the tax is subject to a four prong test: (1) the activity being taxed must have a substantial nexus with the taxing state; (2) the tax must be fairly apportioned; (3) the tax may not discriminate against interstate commerce; and (4) the tax must be fairly related to benefits provided by the state (***see***, ***Complete Auto Transit, Inc. v. Brady***, 430 US 274, 51 L Ed 2d 326). In this case, the distribution of Sharper Image catalogs constitutes "use" under Tax Law § 1110(a). The four prong test of ***Complete Auto*** must be applied to this use of the catalogs in New York.

A tax is fairly apportioned if it is structured (1) so that an identical tax imposed by another state would not result in multiple taxation and (2) so as to clearly tax only that portion of the revenues from the interstate activity which reasonably reflects the in-state component of the activity being taxed (***see***, ***Goldberg v. Sweet***, 488 US 252, 102 L Ed 2d 607). In this instance, there is no threat of multiple taxation and the tax is imposed only on activity taking place wholly within New York. Thus, the second prong of the four prong test is met.

If Nebraska had a sales and use tax statute identical to New York's, double taxation of the catalogs would not occur. New York's sales tax is a "transaction" tax and a "destination" tax, "that is, the point of delivery or point at which possession is transferred by the vendor to the purchaser or designee controls both the tax incident and the tax rate" (20 NYCRR 525.2[a][2],[3]). New York imposed the tax on the catalogs transferred by the printer to the designees of Sharper Image in New York, nine percent of the total number of catalogs produced. The Division did not attempt to tax catalogs that went to addresses in other states. It did not impose tax on the services of printing, mailing or delivering the catalogs. If Nebraska had a sales and use tax scheme exactly like New York's scheme, the catalogs

shipped to New York would not be subject to sales or use tax in Nebraska. Consistent with this understanding of the tax is the exemption provided at Tax Law § 1115(n)(1):

> Promotional materials mailed, shipped or otherwise distributed from a point within the state, by or on behalf of vendors or other persons to their customers or prospective customers located outside this state for use outside this state shall be exempt from the tax on retail sales imposed under subdivision (a) of section eleven hundred five and the compensating use tax imposed under section eleven hundred ten of this article.

Moreover, New York provides a credit against the use tax for sales taxes paid to other states provided that the other state has a corresponding exemption with respect to tax paid to New York (Tax Law § 1118[7][a]). If Nebraska had a tax scheme identical to New York's, there would be no danger of multiple taxation of catalogs shipped to destinations inside or outside of Nebraska.

As the Division aptly states in its brief, this case "does not concern sales tax on a service or activity crossing state lines." Inasmuch as the use tax was imposed only on the catalogs which were distributed within New York, there is no interstate activity to be considered. Petitioner's contention that the use tax is imposed on interstate activity is based on an apparent misapprehension of New York's sales and use tax scheme. It may be that "the catalogs were published in California, printed in Nebraska [and] mailed in Nebraska" (Petitioner's reply brief, p. 18), but the tax was not imposed on publishing, printing or mailing. It was imposed on petitioner's use of a specific number of the catalogs in New York. The distribution of the catalogs in New York was a use of tangible personal property within New York.

The imposition of the use tax on catalogs distributed in New York is not factually or legally similar to the sales tax imposed on waste hauling in ***Matter of General Electric*** (Tax Appeals Tribunal, March 5, 1992). In ***General Electric*** the Tribunal found that the

petitioner's removal of waste from its facility in New York, the transportation of that waste across state lines to Arkansas and the ultimate disposal of the waste material in Arkansas through the process of incineration was an integrated service subject to New York sales tax as a service of maintaining, servicing or repairing real property (***Matter of Cecos Intl. v. State Tax Commn.*** (126 AD2d 884, 511 NYS2d 174, ***affd*** 71 NY2d 934, 528 NYS2d 811; ***see,*** Tax Law § 1105[c][5]; 20 NYCRR 527.7[b][2]). The Tribunal held that since the incineration of the waste was done wholly in Arkansas, the Division's imposition of the tax upon the entire receipt was not fairly apportioned under Commerce Clause standards. The reason for this conclusion was that Arkansas could tax the entire receipt for the integrated service if Arkansas had the same law as New York which viewed waste removal as an integrated service. The tax assessed against Sharper Image is a tax on the use of tangible personal property within New York. It is not a tax on a service that crosses state lines. Therefore, there is nothing to apportion.

New York's use tax does not discriminate against interstate commerce. The use tax is designed to compensate New York for revenue lost when residents or businesses purchase goods and services outside of New York for use in New York. It is equal to the sales tax applicable to the purchase of tangible personal property purchased in New York. (***See***, ***D.H. Holmes Co., Ltd. v. McNamara***, 48 US 26, 100 L Ed 2d 21).

The use tax is fairly related to benefits provided by New York, including fire and police protection for Sharper Image stores, public roads and mass transit. Inasmuch as petitioner has not raised any issue regarding this prong of ***Complete Auto's*** four prong test, no more discussion than this is needed.

Finally, petitioner has a substantial nexus with New York. Its contacts with New York are not limited to delivery by mail or common carrier. As noted, petitioner is a New York State vendor under Article 28 of the Tax Law, and it owned and operated three retail stores in New York during the audit period. Petitioner acknowledges that its substantial physical presence in New York places it under a duty to collect sales and use tax. However, it claims that it has no obligation to pay the use tax because the activities it performed with respect to the catalogs were performed outside of New York. With respect to the catalogs, petitioner claims that it had no physical presence in New York.

In ***National Geographic Socy. v. California Bd. of Equalization*** (430 US 551, 51 L Ed 2d 631), the Supreme Court upheld a use tax collection obligation with respect to the magazine's mail-order sales from the District of Columbia on the basis of the physical presence of two offices in California which performed activities unrelated to retail sales. In this context, the Court ruled that the test for determining whether requisite nexus exists for requiring an out-of-state seller to collect and pay the use tax is not whether the duty to collect tax relates to the seller's activities within the State, but whether the facts demonstrate a definite link or minimum connection between the taxing state and the person it seeks to tax (***National Geographic Socy. v. California Bd. of Equalization*** , ***supra***, 430 US at 561, 51 L Ed 2d at 640). Obviously, that connection exists between Sharper Image and New York; however, it is petitioner's position that this standard does not apply to the obligation to pay the use tax. It claims that "to sustain a direct tax on an interstate transaction, such as the mailing of promotional material from outside the state to residents of the taxing state . . . there must be a 'substantial nexus' between the *activity* being taxed and the taxing state" (Petitioner's brief,

p. 18; emphasis added). Assuming that this is the correct standard, I believe that petitioner's distribution of its catalogs in New York reflects a substantial nexus with New York.

In a case similar to this, ***D.H. Holmes Co. v. McNamara*** (486 US 24, 100 L Ed 2d 21), the Supreme Court found "'nexus' aplenty" where a Louisiana corporation challenged the State's imposition of a use tax on catalogs printed at the corporation's request outside Louisiana and shipped to prospective customers within the State. Petitioner distinguishes itself from the Louisiana corporation by virtue of the fact that the former had its headquarters in Louisiana, while petitioner is a California corporation and made all arrangements for the publication, printing and mailing of the catalog in California. According to petitioner, the Court found nexus to exist in ***D.H. Holmes*** "because the entire process by which the catalogs and flyers were printed and mailed was centered in and directed from the taxing state" (Petitioner's brief, pp. 19-20). This is simply not the case. The Court did not focus on the locus of those activities. Rather, it found nexus on the basis of the Louisiana corporation's significant economic presence in Louisiana, its many connections with the state and the direct benefits it received from Louisiana in conducting its business. Moreover, the Court applied the standard set forth in ***National Geographic*** to the facts of ***D.H. Holmes***.

Although Sharper Image is not a New York corporation and performed many of the activities associated with the catalogs from California, it has sufficient nexus with New York to allow imposition of the use tax. The Sharper Image has a significant economic and physical presence in New York. The distribution of the Sharper Image catalog was directly aimed at increasing its New York business. The catalog invited New York residents to visit the Sharper Image retail stores in New York. Most of the products advertised for sale in the catalog were also for sale in the stores. Anyone wishing to inspect one of these products could do so by

visiting a New York store. On occasion at least, products purchased through the catalog were returned to the stores. Petitioner's catalog customer list was built, in part, by obtaining the names and addresses of its store customers when they purchased products in New York. The Sharper Image catalog serves as the primary source of advertising for petitioner's retail stores and mail-order business. It is not possible to draw an impenetrable line between petitioner's retail business and its catalog business, as petitioner tries to do. The activity taxed, distribution of the catalogs, occurred in New York. There is nexus aplenty.

J. The petition of Sharper Image Corporation is denied, and the Notice of Determination dated November 30, 1995 is sustained as modified by the Conciliation Order of August 9, 1996.

DATED: Troy, New York
September 24, 1998

/s/ Jean Corigliano
ADMINISTRATIVE LAW JUDGE