

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petitions	:	
of	:	
GARDEN WAY INCORPORATED	:	DECISION
for Revision of Determinations or for Refund of Sales and	:	DTA Nos. 809048
Use Taxes under Articles 28 and 29 of the Tax Law for the	:	and 809714
Period March 1, 1984 through August 31, 1989.	:	

Petitioner Garden Way Incorporated, 102nd Street and 9th Avenue, Troy, New York 12180, filed an exception to the determination of the Administrative Law Judge issued on May 20, 1993. Petitioner appeared by Halfpenny, Hahn, Roche & Marchese, Esqs. (Thomas E. Roche, Esq. and Louis R. Marchese, Esq., of counsel) and Herzog, Engstrom & Koplovitz, P.C. (Sholom B. Koplovitz, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Mary R. Hurteau, Esq., of counsel).

Both petitioner and the Division of Taxation filed briefs. The six-month period to issue this decision began on September 7, 1993, the date by which petitioner could submit a reply brief.

The Tax Appeals Tribunal renders the following decision per curiam.

ISSUE

Whether petitioner's purchases of promotional envelopes qualify for an exemption from sales tax pursuant to sections 1119(a)(2) or 1119(a)(4) of the Tax Law.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

The instant matter involves two audits of petitioner, Garden Way Incorporated. The first audit resulted in the issuance of a Notice of Determination and Demand for Payment of Sales

and Use Taxes Due dated December 20, 1989 which assessed \$136,892.46 in additional tax due, plus interest, for the period March 1, 1984 through February 28, 1987. The second audit resulted in the issuance of a similar statutory notice dated April 8, 1991 which assessed additional tax due of \$161,660.96, plus interest, for the period March 1, 1987 through August 31, 1989.

The assessments herein result from the Division of Taxation's ("Division") determination on audit that petitioner improperly failed to pay sales or use taxes on its purchase of certain envelopes (more fully described hereinafter).

STIPULATED FACTS¹

Petitioner is engaged, in the State of New York, in the business of manufacturing and selling outdoor power equipment. Petitioner's base of operations is in Troy, New York. A substantial portion of petitioner's products are marketed by way of direct mail solicitations to customers and potential customers in New York and throughout the United States.

Petitioner is a registered vendor for purposes of Articles 28 and 29 of the Tax Law.

Petitioner markets its products through regular, periodic promotional campaigns wherein envelopes and their promotional contents (hereinafter the envelopes and promotional contents are referred to as "promotional packets") are sent from petitioner's place of business in New York to customers and potential customers within and without the State.

The items at issue in this case are the envelopes which are a part of the promotional packets. The envelopes at issue have advertising copy and promotional depictions printed thereon, and are referred to hereinafter as the "promotional envelopes."

Precision Marketing Associates, a division of Garden Way Incorporated, designs the promotional envelopes, the advertising copy, graphic depictions and the promotional inserts that go into the promotional envelopes. Design and copy for the promotional envelopes are then

¹At hearing, the parties submitted into evidence a Stipulation of Facts, dated July 31, 1992. Said stipulation is reproduced here in its entirety as Findings of Fact "3" through "25" with minor editing for clarification and consolidation.

sent to West Shore Envelope Company ("West Shore") to do the printing and folding of the promotional envelopes. During the printing process, West Shore also prints the bulk rate permit indicia required by the U.S. Postal Service contract on each envelope that will be mailed at bulk rate.

West Shore purchases the paper and other required materials, does the printing and folding and returns the printed promotional envelopes to petitioner in Troy.

Introduced into the record herein (as Exhibit "F") were copies of postal regulations and contracts between petitioner and the U.S. Postal Service which accurately reflected the agreements that existed between petitioner and the U.S. Postal Service during the audit periods.

Promotional packets to be mailed by bulk rate to addressees in Canada are shipped via common carrier from petitioner's place of business to a bulk rate facility located in Canada. The procedures for sorting and delivery of bulk rate Canadian mail are essentially the same as those for U.S. mail. The U.S. Postal Service does not, however, have any involvement with the processing or delivery of petitioner's bulk rate mailings to Canadian addressees.

At petitioner's Troy location, advertising and promotional materials are inserted into the promotional envelopes and the promotional envelopes are addressed. [Generally, addresses are printed on the promotional materials which are inserted into the envelopes. These addresses are visible through a window in the promotional envelope.] The promotional packets are sorted by petitioner according to their destination pursuant to petitioner's contract with the U.S. Postal Service.

At petitioner's Troy location, the addressed promotional packets are then placed into bags provided by the U.S. Postal Service. Each bag has a destination tag affixed to the bag by petitioner's employees. An employee of the U.S. Postal Service inspects random samples of the bags to verify their contents. A truck or conveyance owned or contracted for by the U.S. Postal Service comes to petitioner's place of business, the bags are loaded onto the trucks, and the truck is then sealed. Bags containing promotional packets which are to be mailed by bulk rate are delivered to the U.S. Postal Service's Bulk Rate Facility in Springfield, Massachusetts. The

trucks containing petitioner's bulk rate mail bags will, if fully loaded, travel directly to Springfield or, if not fully loaded, may stop at the Albany Postal Service facility and pick up additional bulk rate mail bags destined for Springfield. Bags containing promotional packets that are to be sent by first-class mail are delivered to the U.S. Postal Service Facility in Troy, New York.

The unopened bulk rate bags are distributed from the Bulk Rate Facility in Springfield, Massachusetts to various local post office facilities across the country. The bags are opened at their local destination where the promotional packets are delivered to their respective addressees.

Set forth below are 10 categories representing the 10 different types of items that are at issue in this case. The parties agree that each of the promotional envelopes can be classified as fitting into one of the 10 different categories. The parties also agree that the samples introduced at the hearing illustrate the general type of item represented in each of the 10 separate categories.

CATEGORIES OF PROMOTIONAL ENVELOPES AT ISSUE²

9 x 12 Envelopes

1. Full color photographic depictions with advertising copy.
2. Black and white photographic depictions with advertising copy.
3. Advertising copy only.

6 x 9 Envelopes

4. Full color photographic depictions with advertising copy.
5. Black and white photographic depictions with advertising copy.
6. Advertising copy only.

#9 and #10 Envelopes

7. Advertising copy only.
8. Black and white photographic depictions with advertising copy.

²This list is a reproduction of Stipulation Exhibit "1" which was expressly made part of the stipulation.

9. Full color photograph depictions with advertising copy.

10. No advertising copy.

Petitioner organized and numbered invoices from West Shore reflecting the full purchase price paid by petitioner for each shipment of promotional envelopes. The invoices have been labeled with consecutive reference numbers and then classified as being in one of the 10 categories referred to.

Submitted into evidence and attached to the stipulation of facts was a document prepared by petitioner which represents the agreed upon classification of each West Shore invoice. The promotional envelopes that correspond to each invoice are therefore classified in this document (referred to herein as Stipulation Exhibit "2") as being in one of the 10 different categories.

Stipulation Exhibit "2" also sets forth the amount of tax due (not including interest) if the full purchase price reflected on each invoice was subject to taxation as contended by the Division. The parties agree that the tax due as calculated by the Division and set forth in Stipulation Exhibit "2" is the correct calculation of tax due if the full purchase price reflected on each invoice is subject to taxation.

The parties agree that the full purchase price of the promotional envelopes classified under category No. 10 (no advertising copy) is subject to taxation. The total amount of tax attributable to this category for both audit periods is \$6,576.05.

The parties also agree that the promotional envelopes in the remaining categories (categories 1-9) have promotional and/or advertising material printed thereon. The tax asserted on the full cost of these promotional envelopes, when mailed to addressees outside New York, is the only tax in dispute in this proceeding.

The parties agree that the full purchase price of all envelopes mailed to New York addressees, whether containing promotional material or not, are taxable and the tax due on such items is not in dispute. The amount of tax attributable to this category for both audit periods is \$12,828.20.

Also attached to the stipulation of facts is a table that accurately summarizes the invoice-by-invoice breakdown that is contained in Stipulation Exhibit "2". The parties agree that this table, referred to herein as Stipulation Exhibit "3", accurately sets forth the total tax due on each category of envelope, if as the Division contends, the full purchase price is subject to taxation.

Stipulation Exhibit "3" also summarizes the tax due by category of promotional envelope for the earlier audit period as calculated by use of statistical projections rather than by examining individual invoices. The parties agree that Stipulation Exhibit "3" sets forth the total tax due by category for the first audit period if, as the Division contends, the full purchase price of each promotional envelope is subject to taxation.

Due to the utilization of samples and projections during the first audit period and the fact that some West Shore invoices from the second audit period have been lost or destroyed in the course of business, the parties have agreed to use statistical projections for purposes of classifying invoices that were not included, for the second audit period, in Stipulation Exhibit "2". Stipulation Exhibit "3" also summarizes the projected tax due by category of promotional envelopes for second audit period invoices that have been lost or destroyed. Specifically, Stipulation Exhibit "3" indicates the following total tax due by category of promotional envelope:

<u>Category</u>	<u>Total Tax Due</u>
<u>9 x 12</u>	
1	\$ 50,743.84
2	38,153.72
3	21,176.72
<u>6 x 9</u>	
4	\$ 16,239.12
5	11,638.78
6	3,433.39
<u>#9 & #10</u>	
7	\$ 48,076.13
8	40,056.06
9	49,796.95
10	<u>6,512.93</u>
Total	\$285,827.64

Also submitted with the stipulation of facts is a table, identified herein as Stipulation Exhibit "4", showing the tax due on promotional envelopes that were processed through the U.S. Postal Service Bulk Rate Facility in Springfield, Massachusetts, the tax due on promotional envelopes that were sent via first class mail through Troy, New York, as described, supra, and the tax due on promotional envelopes that were sent via bulk rate to Canadian addresses. The parties agree that Stipulation Exhibit "4" reflects the amount of tax due if, as the Division contends, the full purchase price of these promotional envelopes is subject to taxation.

The parties agree that the promotional materials that are inserted into the promotional envelopes are not subject to taxation when the resulting promotional packets are sent to out-of-state recipients. The parties agree that the full purchase price of the entire promotional packet is subject to taxation when the packet is sent to New York addresses.

ADDITIONAL FACTS

Approximately 90% of the cost of the promotional envelopes remaining at issue herein (that is, categories 1-9) is attributable to the advertising printed thereon. This 90% figure does not include development costs associated with the promotional envelopes. Such costs are significant, as petitioner continuously tests its promotional envelopes in order to gauge their effectiveness in promoting sales. Based on such testing, petitioner determines which promotional envelopes "work" and which do not. Envelopes that do not work are improved or are discontinued. The promotional envelopes at issue are thus part of petitioner's sophisticated direct marketing strategy, which features several different packages of promotional materials and promotional envelopes to generate sales. Approximately 60% of petitioner's sales during the period at issue were sold via direct marketing directly to customers. Also during this period, about 25% of petitioner's sales were made through dealers. Of this 25%, about one-half were generated by petitioner's direct mail efforts.

OPINION

In the determination below, the Administrative Law Judge sustained the assessment issued to petitioner, finding that petitioner failed to establish that its purchases of promotional envelopes were exempt from sales tax under either paragraph (2) or (4) of Tax Law § 1119(a). The Administrative Law Judge first concluded that petitioner's insertion of promotional materials into the envelopes and placement of the envelopes into United States (U.S.) Postal Service bags for mailing constituted a "use" of the envelopes as defined in Tax Law § 1101(b)(7). It was then held that this use of the envelopes in New York was not exempt under Tax Law § 1119(a)(4) because it was not restricted to "fabricating . . . processing, printing or imprinting" the property prior to its shipment outside New York. The Administrative Law Judge then concluded that because petitioner did not qualify under section 1119(a)(4), petitioner also failed, a fortiori, to meet the narrower exception under Tax Law § 1119(a)(2).

The Administrative Law Judge also rejected petitioner's reliance on a 1979 Technical Services Bureau memorandum titled "Taxability of Promotional Materials Sent into New York State" (TSB-M-79[9]S), which states that promotional materials sent by vendors mailed or shipped to customers outside New York State are exempt, finding first that Tax Law § 1119(a) did not provide for an exemption for promotional materials and secondly, these envelopes were not only promotional materials, but were also used to convey promotional materials.

On exception, petitioner argues that its submission of "overwhelming and uncontradicted" evidence that the primary function of its envelopes is promotional in nature entitles it to an exemption, despite the fact that an explicit "promotional materials exemption" did not exist under the Tax Law during the years at issue (citing TSB-M-79[9]S; Petitioner's brief, pp. 4-6, 10). Petitioner also contends that "[t]he [Division] cannot assert any rational basis for a legislative intent that promotional inserts should be treated any differently than promotional envelopes," noting the subsequent statutory definition of "promotional materials" to include envelopes (Petitioner's brief, p. 12; Tax Law § 1101[b][12]). In its reply brief, petitioner objects to the Division's contention that petitioner be required to prove its entitlement to an exemption

by clear and convincing evidence, stating that because this dispute hinges solely on statutory interpretation, the function of judicial review is simply to determine the legislative intent behind the statute (citing Matter of Rosen v. Public Empl. Relations Bd., 72 NY2d 42, 530 NYS2d 534, 537; Petitioner's reply brief, p. 2).

In response, the Division contends that because petitioner's placement of promotional contents inside the envelopes, labeling of the envelopes, placement of the envelopes in mailbags of the U.S. Postal Service and loading of the mail bags onto U.S. Postal Service trucks each constituted a "use" of the envelopes within New York, the envelopes were subject to sales or use tax (citing Tax Law §§ 1105[a], 1110, 1101[b][7]). The Division also contends that petitioner's placement of other promotional materials into the envelopes did not constitute "fabricating," therefore, petitioner was not entitled to the exemption under Tax Law § 1119(a)(4). Finally, the Division agrees with the conclusion of the Administrative Law Judge that because petitioner does not meet the requirements under section 1119(a)(4), it also must fail to meet the narrower exemption under section 1119(a)(2).

We affirm the determination of the Administrative Law Judge.

During the period at issue, Tax Law § 1101(b)(7) defined "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, or any installation, any affixation to real or personal property, or any consumption of such property" (emphasis added).

In addition to receiving and storing the promotional envelopes in New York, petitioner inserted promotional materials into the envelopes. We agree with the Administrative Law Judge that his activity clearly constitutes a "use" as this word is defined under section 1101(b)(7). In light of this conclusion, we must now determine whether this use entitles petitioner to an exemption³ under Tax Law 1119(a). As an exemption statute, Tax Law § 1119

³As noted by the Administrative Law Judge, Tax Law § 1119, which provides for a credit or refund of sales or use taxes under circumstances, is not, strictly speaking, an exemption statute. However, if petitioner can establish its entitlement to such a credit or refund, this would effectively offset any sales tax liability on petitioner's purchases of promotional envelopes. In effect, this constitutes an exemption. Moreover, the courts have treated Tax Law § 1119 as an exemption statute (see, Matter of Crown Publishers v. Tully, 96 AD2d 990, 466 NYS2d 822; revd on

is to be strictly construed, with ambiguities construed against the exemption (Matter of Allied New York Servs. v. Tully, 83 AD2d 727, 442 NYS2d 624).

We will first address whether petitioner qualifies for an exemption under Tax Law § 1119(a)(2). This provision allows for an exemption from sales or use tax owed under sections 1105(a) or 1110, respectively:

"on the sale or use of tangible personal property purchased in bulk, or any portion thereof, which is stored and not used by the purchaser or user within this state if that property is subsequently reshipped by such purchaser or user to a point outside this state for use outside this state" (Tax Law § 1119[a][2], emphasis added).

This exemption from sales tax has been held to apply only when the subject property has not "been put to any use" in New York other than storage (Matter of Crown Publishers v. Tully, 96 AD2d 990, 466 NYS2d 822, 823, emphasis added, revd on other grounds on dissenting opn below 63 NY2d 660, 479 NYS2d 523).

In this case, petitioner has not shown that the act of inserting promotional materials into the envelopes does not fall within the broad definition of "use" under section 1101(b)(7), or that this activity constitutes "storage and not use." However, petitioner contends that because the "primary function"⁴ of the envelopes was promotional, they fall within the definition of "promotional materials," exempting them from sales tax. In support of this argument, petitioner cites a Technical Services Bureau memorandum entitled "Taxability of Promotional Materials Sent Into New York State" (TSB-M-79[9]S).

Technical Services Bureau memoranda are statements issued by the Division which are informational in nature, designed to disseminate the Division's current interpretation of the Tax Law in response to similar requests from a broad class of taxpayers; however, these statements

other grounds on dissenting opn below 63 NY2d 660, 479 NYS2d 523). We will hereinafter refer to this "credit or refund" as an exemption.

⁴Petitioner's theory that only the "primary function" of goods is relevant in determining whether goods were used in New York appears to be founded in a 1983 advisory opinion which discussed whether envelopes having promotional advertising printed on the front and back sides were subject to sales or use tax (TSB-A-83[1]S). The opinion stated that because the envelopes' "primary function [wa]s to serve as vehicles for delivery" of the promotional material contained therein, their promotional aspect was merely incidental (TSB-A-83[1]S; emphasis added). However, because advisory opinions bind the Division only with respect to the applicants for such opinions, this pronouncement did not establish a "primary use" doctrine (see, Tax Law § 171.24).

are not promulgated pursuant to specific statutory authorization or direction and, thus, are not legally binding (see, Developing and Communicating Interpretations of the Tax Laws: A Report to the Governor and the Legislature Reviewing Department of Taxation and Finance Policies and Practices at 20, 29 [Mar. 1990]; Matter of Grand Union Co. v. Tully, 94 AD2d 509, 466 NYS2d 492; see also, Proposed Regulations Communicating Tax Policy and Interpretations, § 2375.6[c].⁵ In short, TSB-M-79(9)S did not and could not grant an exemption. That can only be done by statute. What the memorandum could and did do was to advance an interpretation of section 1119(a), based on case law, that certain activities in connection with promotional materials, e.g., mailing or shipping to customers outside of New York State, did not constitute a taxable use under section 1119(a). As the Administrative Law Judge pointed out:

"[p]etitioner's contention must be rejected. During the period at issue, Tax Law § 1119(a) did not provide for an exemption for promotional materials. This provision allowed an exemption from use tax where, after allowing for certain limited (nontaxable) uses, tangible personal property was shipped outside New York for use outside New York. Promotional materials are one kind of tangible personal property which may have been exempt under Tax Law § 1119(a) since such materials are generally not put to use as promotional materials until received by prospective customers. The fact that certain tangible personal property may be classified as promotional materials does not, however, qualify such property for exemption. The key to taxation or exemption is use or non-use in New York. Where tangible personal property is used in New York it is generally subject to use tax. The fact that this same tangible personal property may also be used outside New York does not result in an exemption. Accordingly, where, as here, promotional envelopes are used in New York to convey other promotional materials, the fact that these envelopes are also used as promotional materials outside New York does not render such materials exempt" (Determination, conclusion of law "I").

We will now address whether petitioner falls within the requirements of section 1119(a)(4). This provision allows for an exemption from sales or use tax owed under section

⁵This provision states in part:

"Technical Services Bureau memoranda are advisory in nature and fall within the exclusions from the rule making procedure imposed by the State Administrative Procedure Act. That is, these statements in themselves have no legal effect but are merely explanatory Accordingly, Technical Services Bureau memoranda do not have legal force or effect, do not set precedent and are not binding" (emphasis added).

1105(a) or 1110:

"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)" (Tax Law § 1119[a][4], emphasis added).

Petitioner contends that its use of the envelopes constitutes "fabricating" under this provision.

"Fabrication" is defined under the regulations as:

"the alteration or modification of a manufactured product without a change in the identity of the product. Fabrication includes cutting, perforating, and similar operations" (20 NYCRR 531.2[d], emphasis added).

The words "alteration" and "modification" both mean to change or become different (Merriam Webster's Collegiate Dictionary 34, 784 [10th ed 1993]). Petitioner'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"⁶ or "assembling,"⁷ as it does not effectuate formation of two elements into an "indistinguishable whole" or a "new product," respectively. The fact that an envelope was made ready and was used to accomplish one of its functions -- the carrying of promotional material to prospective customers -- does not rise to the level of fabricating, incorporating or assembling as used in section 1119(a)(4). Thus, we conclude that petitioner's purchases of "promotional envelopes" also fail to qualify for the exemption from sales tax under section 1119(a)(4).

Finally, 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.⁸ Under the

⁶"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]).

⁷The 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).

⁸Tax 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.

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, the years covered in this case.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Garden Way Incorporated is denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petitions of Garden Way Incorporated are denied; and
4. The Notice of Determination dated December 20, 1989 is sustained.

DATED: Troy, New York
February 24, 1994

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

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