

STATE OF NEW YORK
DIVISION OF TAX APPEALS

In the Matter of the Petition :
of :
JENKINS COVINGTON, N.Y., INC. : DETERMINATION
AND ANDREW JENKINS, OFFICER :
for Revision of a Determination or for Refund :
of Sales and Use Taxes under Articles 28 and 29 :
of the Tax Law for the Period September 1, 1976 :
through August 31, 1980. :

Petitioners, Jenkins Covington, N.Y., Inc. and Andrew Jenkins, 510 East 74th Street, New York, New York 10021, 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 September 1, 1976 through August 31, 1980 (File Nos. 40061 and 40062).

A hearing was held before Joseph W. Pinto, Jr., Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on July 17, 1986 at 9:15 A.M., with all briefs to be submitted by April 10, 1987. Petitioners appeared by Barash, Goodfriend & Friedman, P.C. (Harvey Sanders, CPA). The Audit Division appeared by John P. Dugan, Esq. (Anne W. Murphy, Esq., of counsel).

ISSUES

I. Whether petitioners are liable for additional sales tax for services performed on tangible personal property which property was alleged to have been delivered to a point outside of New York State thereby qualifying for exemption from sales and use tax. II. Whether petitioner Andrew Jenkins was a person required to collect and pay sales and use taxes imposed, collected or required to be collected by petitioner Jenkins Covington, N.Y., Inc.

FINDINGS OF FACT

1. On July 27, 1982, the Audit Division issued to petitioner Jenkins Covington, N.Y., Inc. (the "corporation") a Notice of Determination and Demand for Payment of Sales and Use Taxes

Due for the period September 1, 1976 through August 31, 1979 in the amount of \$772,533.12 plus interest of \$300,783.54 for a total amount due of \$1,073,316.66. On the same date the Audit Division issued to the corporation a second Notice of Determination and Demand for Payment of Sales and Use Taxes Due for the period September 1, 1979 through August 31, 1980 in the amount of \$151,839.54 plus interest of \$38,818.05 for a total amount due of \$190,657.59. Also on July 27, 1982, the Audit Division issued to Andrew Jenkins, as officer of Jenkins Covington, N.Y., Inc. two notices of determination and demands for payment of sales and use taxes due in the same amounts and for the same periods as those encompassed by the assessments against the corporation.

2. The corporation by its secretary, Stacey Mokotoff, and its representative, Marvin Goodfriend, executed a series of consents extending the period of limitation for assessment of sales and use taxes for the period September 1, 1976 through August 31, 1979 to September 20, 1982.

3. During the period September 1, 1976 through August 31, 1980 (the "audit period") the corporation was engaged in the production of television commercials. In general, the customers of the corporation are advertising agencies which contract with the corporation for the production of commercials on behalf of the advertising agencies' clients. The corporation shoots and develops substantial footage of original negative film. The original negative footage is then sent to an editing house, also engaged by the corporation, for the purpose of editing and processing said footage. The editing house selects various "takes" which are used to assemble a product known as a "duplicate negative" or "optical negative". The "duplicate" or "optical" negatives are used to prepare additional prints which are in turn sent to television stations for airing. The corporation contends that original negatives are shipped out of state to a storage vault for safekeeping. Often, the shipping is done by the editing house per instructions from the corporation.

4. The above-noted assessments, issued as a result of a field audit, consist of tax due in three different areas of examination:

- (a) \$129.92 due on the purchase of fixed assets;
- (b) \$15,389.00 due on recurring expenses; and
- (c) \$908,853.74 due on unsubstantiated exempt sales, consisting of the services performed on tangible personal property, i.e., original negatives which are delivered outside of New York State.

Petitioners did not contest the tax assessed with respect to items "(a)" and "(b)" above, nor is the audit methodology employed at issue. Petitioners do contest the tax assessed on what the Audit Division determined to be unsubstantiated exempt sales, item "(c)".

5. Numerous times during the course of the audit the Audit Division requested that the corporation produce substantiating documentation of the out-of-state sales, including such documents as shipping invoices, warehouse receipts and contracts as proper proof of delivery to an out-of-state warehouse.

6. Exempt sales were tested by the Audit Division for the quarter ended May 31, 1979. The corporation was unable to produce proof of exempt sales which was satisfactory to the Audit Division, and therefore total gross sales per the Federal income tax returns were considered taxable for the entire audit period. The Federal figures were chosen after it was determined that sales per the ST-100's could not be reconciled with the general ledger and that the Federal figures reflected on the U.S. corporation income tax returns were higher than the general ledger figures. Proper credit was given for those sales on which sales tax was charged and paid.

7. The month of August 1979 was selected by the Audit Division as a test period for use tax. Those items not considered for resale were assessed, resulting in additional use tax of \$10,537.80, an amount to which petitioners agreed at the time of the test. One item in the amount of \$1,400.00 was contested by the corporation and resulted in a percentage of error of 1.87 percent, which, when applied to the entire audit period, yielded additional use tax due of \$4,851.20. However, since no amounts were ultimately consented to by the corporation, the total additional use tax due of \$15,518.92 was assessed. Petitioners' representative did not contest the use tax assessment at the hearing.

8. With regard to the exempt sales, it was decided by petitioners' representative and the Audit Division to select several accounts from the test quarter and to verify the delivery of the specific items to warehouses in New Jersey by a visit to same.

9. According to notes taken on August 22, 1984 by one of the auditors working on the case, Mr. Miguel Cruz, an employee at the Fort Lee Film Storage and Service Company was unable to tell the Audit Division what in fact was delivered in boxes from editing houses or the corporation. At another warehouse, that of MGS Services, Inc., the manager, Mr. Bob Ryan, told Audit Division representatives that his understanding was that the boxes received from the editors and the corporation contained "inactive" material such as "trim-outs", original picture negatives, voice tracks, narative tracks, optical material and other negatives. Mr. Ryan informed auditor Cruz that it was his understanding that the final product was not delivered to the warehouse but to the advertising agency.

10. Subsequent to hearing, petitioners' representative submitted contracts, some with supporting documentation of delivery attached, including delivery receipts, warehouse receipts, receiving notices and vault packing slips, for the alleged exempt sales which took place during the test period ending May 31, 1979. Petitioners submitted documentation for those client accounts listed on pages 8 through 18 of the field audit report and which provided the basis of the Audit Division's assessment. Upon close scrutiny of the contracts and documentation substantiating out-of-state delivery of original negatives and duplicate negatives/optical negatives or fine grain master positives ("production materials") the following sales were shown to have effected delivery outside the State of New York:

<u>Agency</u>	<u>Client</u>	<u>Amount Which Should Have Been Allowed as Exempt</u>
1) Ingalls Associates	Hartford National Bank	\$ 7,215.00
2) Young & Rubicam, Inc.	Gulf Oil Corp.	10,153.00
3) D'Arcy-MacManus & Masius	Anheuser-Busch, Inc.	15,493.20
4) D'Arcy-MacManus & Masius	Anheuser-Busch, Inc.	26,684.80
5) McCaffrey & McCall, Inc.	Vydec, Inc.	8,663.33

6)	Scali, McCabe, Sloves, Inc.	Singer	5,600.00
7)	Scali, McCabe, Sloves, Inc.	Dane Johnson	35,030.00
8)	Foote, Cone & Belding Advertising, Inc.	Frito-Lay	87.70
9)	Leo Burnett USA	Wilson Sporting Goods	5,542.63
10)	Young & Rubicam, Inc.	Gulf Oil Corp.	285.00
11)	Leo Burnett	Wilson Sporting Goods	10,028.60
12)	Scali, McCabe, Sloves, Inc.	Singer	4,035.00
13)	Scali, McCabe, Sloves, Inc.	Sperry Rand	38,320.00
14)	D'Arcy-MacManus & Masius	Anheuser-Busch, Inc.	3,893.30
15)	D'Arcy-MacManus & Masius	Anheuser-Busch, Inc.	6,671.20
16)	Scali, McCabe, Sloves, Inc.	Sperry Rand	3,200.00
17)	Scali, McCabe, Sloves, Inc.	Sperry Rand	38,320.00
18)	Young & Rubicam, Inc.	General Foods	32,708.00
19)	Young & Rubicam, Inc.	General Foods	16,354.00
20)	D'Arcy-MacManus & Masius	Anheuser-Busch, Inc.	7,325.39
21)	N W Ayer	John Deere Company	10,320.00
22)	N W Ayer	A T & T Long Lines	5,475.00
23)	Campbell-Ewald Company	Goodyear Tire & Rubber Co.	29,780.00
24)	N W Ayer	Car-X	20,777.50
25)	D'Arcy-MacManus & Masius	Anheuser-Busch, Inc.	7,325.39
26)	D'Arcy-MacManus & Masius	Anheuser-Busch, Inc.	12,192.00
27)	D'Arcy-MacManus & Masius	Anheuser-Busch, Inc.	295.28
28)	DKG, Inc.	Corning Glass Works	2,500.00
29)	DKG, Inc.	Corning Glass Works	27,782.50
30)	Ingalls Associates, Inc.	Hartford National Bank	10,947.50
31)	Ingalls Associates, Inc.	Hartford National Bank	10,947.50
32)	Foote, Cone & Belding Advertising, Inc.	Clairol, Inc.	13,405.00
33)	Campbell-Ewald	Goodyear Tire & Rubber Co.	14,890.00
34)	Campbell-Ewald	Goodyear Tire & Rubber Co.	10,375.00
35)	Campbell-Ewald	Goodyear Tire & Rubber Co.	5,187.00
36)	Campbell-Ewald	Goodyear Tire & Rubber Co.	5,187.50
37)	Young & Rubicam, Inc.	Stayfree	35,617.50
38)	N W Ayer	John Deere Company	10,320.00
39)	N W Ayer	Car-X	22,777.50
40)	Campbell-Ewald	Goodyear Tire & Rubber Co.	38,103.00
41)	Young & Rubicam, Inc.	Stayfree	17,808.75

11. Total exempt sales for the test quarter ended May 31, 1979 were \$587,624.07. When added to the amount already allowed by the Audit Division, \$14,151.44, total exempt sales for the quarter were \$601,775.51, or 51.292 percent of total sales for the quarter. The Audit Division had disallowed 99.05 percent.

12. Petitioners failed to file sales tax returns for the periods ended May 31, 1977, February 28, 1978 and May 31, 1978.

CONCLUSIONS OF LAW

A. That Tax Law § 1105(c) imposes a sales tax on:

"The receipts from every sale, except for resale, of the following

services:

* * *

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

(3) Installing tangible personal property, or maintaining, servicing, repairing tangible personal property not held for sale in the regular course of business...."

B. That Tax Law § 1115(d) states, in pertinent part, as follows:

"Services otherwise taxable under paragraphs (1), (2), or (3) of subdivision (c) of section eleven hundred five shall be exempt from tax under this article if the tangible property upon which the services were performed is delivered to the purchaser outside this state for use outside this state."

C. That exemptions from taxation are to be narrowly and strictly construed against the taxpayer seeking such exemption. (Matter of Grace v. New York State Tax Commission, 37 NY2d 193.)

D. That the contracts provided by Jenkins Covington, N.Y., Inc. substantiating the sales for the test quarter ended May 31, 1979 provided that the original negative and duplicate negative or fine grain master positives were to be sent to storage vaults located outside the State of New York. In those accounts listed in Finding of Fact "10" either the production elements were documented as received by warehouses outside of the State of New York or all activity with regard to the contract took place outside the State of New York.

E. That the evidence submitted by petitioners verified that 51.292 percent of the sales of tangible personal property examined for the test quarter ended May 31, 1979 were exempt by reason of the fact that the films they produced were properly delivered outside of New York State. (Cf. Matter of Film Factory, Inc., State Tax Commission, January 28, 1986; Matter of Muyskens Madison, Inc., State Tax Commission, March 12, 1981.)

F. That the Audit Division is directed to modify its determination consistent with Conclusion of Law "E" above with the exception of the three periods for which petitioners did

not file any sales tax returns; for those three periods, all exempt sales are disallowed.

G. That section 1133(a) of the Tax Law provides "every person required to collect any tax imposed by this article shall be personally liable for the tax imposed, collected, or required to be collected under this article."

H. That petitioner Andrew Jenkins was a person required to collect tax within the meaning and intent of section 1131(1) of the Tax Law and, therefore, is personally liable for the sales and use taxes due from Jenkins Covington, N.Y., Inc. in accordance with section 1133(a) of the Tax Law. (Matter of A-1 Fence Company, Inc., State Tax Commission, July 3, 1981.)

I. That the petitions of Jenkins Covington, N.Y., Inc. and Andrew Jenkins, as officer, are granted to the extent set forth in Conclusion of Law "F"; the four notices of determination and demands for payment of sales and use taxes due dated July 27, 1982 are to be modified accordingly; and, except as so granted, the petitions are in all other respects denied.

DATED: Albany, New York
November 21, 1991

ADMINISTRATIVE LAW JUDGE