

STATE OF NEW YORK
DIVISION OF TAX APPEALS

In the Matter of the Petition :

of :

**CMP MEDIA INC., AS SUCCESSOR TO
CMP PUBLICATIONS, INC.** :

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, 1985
through August 31, 1992. :

In the Matter of the Petition :

of :

DANIEL H. LEEDS :

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, 1985
through August 31, 1992. :

DETERMINATION
DTA NOS.814659,
814660,814661,
AND 814662

In the Matter of the Petition :

of :

GERARD G. LEEDS :

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, 1985
through August 31, 1992. :

In the Matter of the Petition :

of :

MICHAEL S. LEEDS :

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, 1985
through August 31, 1992. :

Petitioners, CMP Media Inc., as successor by merger to CMP Publications, Inc., 600 Community Drive, Manhasset, New York 11030-3847; Daniel H. Leeds, as officer of CMP Publications, Inc., 8 Rue Edouard Nortier, Neuilly-Sur-Seine, France 92200; Gerard G. Leeds, as officer of CMP Publications, Inc., 17 Hilltop Drive, Great Neck, New York 11021; and Michael S. Leeds, as officer of CMP Publications, Inc., 131 Yukon Drive, Woodbury, New York 11797-3100, filed petitions for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period September 1, 1985 through August 31, 1992.

A consolidated hearing was held before Frank W. Barrie, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on February 26, 1997 at 9:15 A.M., with all briefs to be submitted by July 7, 1997, which date began the six-month period for the issuance of this determination. Petitioners appeared by Dow, Lohnes & Albertson (J. Michael Hines, Esq., and J. Clark Armitage, Esq., of counsel). The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Brian J. McCann, Esq., of counsel).

ISSUE

Whether the corporate petitioner's purchases of certain materials and equipment for use in the production of various publications were exempt from sales tax under Tax Law § 1115(a)(12), which provides an exemption from tax for machinery or equipment used or consumed directly and predominantly in the production of tangible personal property for sale.

FINDINGS OF FACT

1. Petitioners and the Division of Taxation ("Division") entered into four separate and distinct stipulations of facts. Relevant portions of these stipulations have been incorporated into the following findings of fact.

2. Petitioner CMP Media Inc. ("CMP") is the successor by merger, effective June 1, 1996, to CMP Publications, Inc. CMP, a Delaware corporation, is in all material respects identical to CMP Publications, Inc. CMP is engaged in the business of producing and

distributing a number of separate publications which include articles, information, and advertisements of interest to persons occupying positions of substantial authority within primarily the computer industry.

Description of the Publications

3. The publications published during the audit period include the following 21 newspapers and magazines:

Name of Publication

Description of Publication

- | | |
|------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1. Business Travel News | Delivers news and information to travel managers, travel agents, and travel industry decision makers; focuses on the corporate travel market and business travelers. |
| 2. CommunicationsWeek | Delivers news and information on products and technology of interest to enterprise network managers, who are responsible for the strategic development, purchase, and implementation of networking technologies. |
| 3. CommunicationWeek International | Covers three key trends driving the industry and changing the way the global network buyer builds information networks: mobility (freeing the individual within the corporation), on-line (opening up access to information wherever it resides), and high-capacity (instant, real-time communication in any form-- voice, data, or video). |
| 4. Computer Reseller News | Delivers industry news, analysis, and product information of interest to value-added resellers, systems and network integrators, value added dealers, and computer and software dealers and distributors. |
| 5. Computer Retail Week | Delivers news, products, and competitive information of interest to retailers of technology products, including store-level managers, sales professionals, and headquarter executive buyers who influence stocking decisions and |

make customer recommendations. The retailers include those selling technology products, including computer superstores, consumer electronic retailers, office product superstores, mass merchants, and new technology retailers.

6. Electronic Buyers' News

Delivers news and analysis of interest to professionals who specify, authorize, or supervise the product sourcing or supplier partnering process at electronic OEMs (i.e., original equipment manufacturers).

7. Electronic Engineering Times

Delivers news, analysis, perspective, and predictions of interest to engineers and technical managers in the electronics industry. Four times each year, EET provides special issues on a single important topic in the industry.

8. Electronic World News

Delivers information, analysis, and trends to the purchasing and corporate managers in the international electronics business community.

9. Health Week

Delivers news and information to health industry professionals (doctors, nurses), hospital administrators, and others in the field.

10. High Performance Systems

Delivers business and technology news to technical and system managers. This publication was previously known as VLSI Systems Design.

11. High Tech Marketing News

Delivers news and information on industry trends, agencies, and corporations for marketing and communications executives in the electronics industry.

12. Information Week

Delivers news and information on trends, products, and practices of interest to persons who manage technology in business.

13. Long Island Monthly

Delivers news and information on

topics of interest to Long Islanders covering events, points of interest, and special "spotlight" issues.

14. Macintosh News

Delivers news and information on entertainment, education, and personal productivity products for Macintosh computer users. Features new products, reviews, how-to essays, advice, and ratings.

15. Managed Health Care News

Delivers news and information on the managed care industry, benefits management, managed care organizations, providers of care, legislation and policy, quality and outcomes, information systems, and pharmaceuticals.

16. Network Computing

Delivers news and information regarding trends, technical and strategic information on computing solutions for networks, network software, and network hardware of interest to purchasers of computer and software products to be used in network environments.

17. Open Systems Today

Delivers news and analysis about leading-edge products and practices for people who manage systems technology in business. This publication was previously known as Unix Today.

18. Systems & Network Integration

Delivers news and analysis relating to the systems development and network integration industry and managers in that field. This publication was previously known as Computer Systems News.

19. Tour & Travel News

Delivers news and information of interest to purchasers and suppliers within the leisure travel industry, including travelers, travel agents, travel industry executives and managers. Focuses on trends and developments in the travel industry.

20. VARBusiness

Delivers information on products, technology trends, opening new customer markets, profit strategies for new products and technologies

of interest to value-added resellers, integrators, consultants, and developers who purchase a wide range of computer products

21. Windows Magazine

Delivers news, reviews, features, and how-to's, helping readers to assess their needs and fully utilize Windows-related systems.

4. Sample copies of the above-noted publications were introduced into the record except for the following four: Health Week, High Performance Systems, Long Island Monthly, and Macintosh News. The parties stipulated that Electronic Engineering Times is representative of all of the publications in all respects material to this proceeding.

5. Each publication employs its own full-time editorial staff, typically including an editor-in-chief, one or more copy editors, section editors, bureau chiefs, and reporters. The editorial staff at Electronic Engineering Times included the following full-time staff members: one editor-in-chief, four production editors or supervisors, seven senior writers or editors, five graphic artists, three section editors, two technical editors, nine managing editors, two secretaries, three executive directors, two copy editors, four editors, one research editor and one editorial assistant.

6. The publications' staffs investigate and report on trends and events in the particular industry to which each publication relates and may prepare one or more in-depth feature articles for any issue. Regular outside contributors who are not employees also provide articles and columns, and articles may be solicited from prominent figures in the industry on topics of interest to the publication's readers. The publications' staffs also regularly survey the interests of readers to plan content for upcoming issues.

7. All of the publications are published in printed form at stated intervals at least quarterly; do not, either singly or when combined with successive issues, constitute a book; are available for circulation to the public; have continuity as to title and general nature of content from issue to issue; and each issue of the publications contains a variety of articles by different authors devoted to the sciences, news, a special industry, profession, or other field of endeavor.

The parties have specifically stipulated that the publications qualify as "periodicals" within the meaning of 20 NYCRR 528.6(c)(1).

8. Nearly all¹ of the publications are controlled circulation publications, and all are accepted by and distributed as second class mail through the United States Postal Service. A controlled circulation publication is one which selects as its recipients individuals who possess defined characteristics which allow advertisers to reach those individuals most likely to be interested in purchasing the advertised products. Circulation is limited to a predetermined number of persons believed to possess buying authority in the market served by the publication.

9. The parties have also specifically stipulated that the publications are tangible personal property within the meaning of Tax Law § 1101(b)(6) and for purposes of Tax Law § 1115(a)(12); (c).

CMP's Subscription Information

10. CMP's subscriber information for each of the publications is audited twice each year by BPA International ("BPA"), a nationally recognized auditor of periodical subscription lists specializing in controlled circulation publications.

11. A person may become a subscriber to a publication in only two ways: (i) the person may be accepted by CMP as a qualified recipient if the person establishes to CMP that he or she works in a position of substantial responsibility within the industry to which the particular publication relates and is one of the limited number of persons with buying authority in the market served by the publication; or (ii) the person may purchase a subscription from CMP at a stated cash price.

12. CMP requires each applicant seeking to become a qualified recipient for any of the publications to submit a subscription application form. This form requires an applicant to provide information regarding the primary product or service in use at the applicant's business location, the dollar amount of annual purchases of components, equipment, and services for

¹Long Island Monthly and Windows Magazine are not controlled circulation publications, but instead require solely cash subscriptions.

which the applicant has buying authority, the type of purchasing activities in which the applicant is engaged (such as locating or recommending products or services, evaluating products or services, selecting products or services, etc.), the specific products or services with respect to which the applicant has such authority, and whether the applicant purchases any products from distributors. CMP uses such information in its business as described below.

13. A review of the representative subscription application form for Electronic Engineering Times shows that the applicant must respond to the following nine specific requests for information:

1. Principal job responsibility;
2. Principal job function with a range of ten choices to select from such as (i) general and corporate management and (ii) advertising, media or public relations as two of the ten choices;
3. Type of design applicant is involved in such as (i) analog, (ii) digital, (iii) software, (iv) system, (v) test and evaluation, and (vi) other.
4. Size of the applicant's organization by number of employees at the applicant's location and in the entire company;
5. Listing of computer-related items that the applicant currently has or plans to install with the following specific items noted: (i) multimedia ready computer, (ii) internet, (iii) WWW access, (iv) compuserve, (v) prodigy, (vi) America On Line, (vii) EETnet, (viii) commercial BBS, (ix) CD-ROM, and (x) other;
6. Listing of operating system environments and programming languages that the applicant uses with the following specific items noted: (i) DOS, (ii) Macintosh, (iii) Windows, (iv) Unix-Unix-like, (v) VMS, (vi) OS/2, (vii) ADA, (viii) Assembler, (ix) Basic, (x) C, (xi) C++, (xii) Fortran, (xiii) Pascal, and (xiv) other;
7. Listing of 11 other computer-related and engineering publications with a request that the applicant note which are received "personally addressed to you by mail";
8. A request that the applicant select one of 33 choices to describe the "primary end product (or service)" at the applicant's business location. The choices are grouped by the following seven subheadings: (i) computers, systems and peripherals, (ii) communication systems, (iii) controls, test, medical equipment, (iv) avionics, government and military electronics, (v) automotive, consumer electronics, and appliances, (vi) components, and (vii) other;
9. A request that the applicant select from a list of 93 items the products or services that the applicant may "specify, recommend, approve, purchase or influence the purchase of.

This subscription application form for Electronic Engineering Times specifically provides that:

"All questions must be answered for subscriptions to be processed. The Publisher will only accept those applications from individuals in the United States and Canada which meet the qualification criteria for the publication."

14. CMP's staff reviews each completed subscription application form for each of the publications and approves an applicant as eligible to become a qualified recipient only if the applicant has offered a completed subscription application form reflecting that he or she is one of the limited number of persons with purchasing authority as to products or services in the industry to which the publication relates. Persons whose applications are approved are then either accepted as qualified recipients or placed on a waiting list if CMP determines that the publication does not need additional qualified recipients at that time, as discussed below.

15. For each of the publications, once CMP accepts an applicant as a qualified recipient, that person is entitled to receive the publication for one year. Thereafter, the qualified recipient must reapply each year in order to continue receiving the publication. Reapplications are made on the same subscription application forms used for first-time applications.

16. BPA conducts an audit twice each year to verify whether CMP's subscription information accurately identifies the number and job characteristics of qualified recipients and whether the qualified recipients are in fact eligible to subscribe under CMP's standards established for the relevant publication. BPA's review is thorough and extensive. During the audit period, CMP paid BPA no less than \$565,098.08 to conduct its independent audit. For each of the years under audit, each of the publications received the highest "timeliness" rating from BPA. This rating indicates that CMP's subscription information was found to be accurate by BPA upon audit and that qualified recipients must reapply (and so provide current information) each year to continue receiving the publication. For each publication throughout the audit period, CMP satisfied the strictest reapplication procedures measured by BPA.

17. With respect to Electronic Engineering Times, BPA defines a qualified recipient as follows:

"Qualified recipients . . . perform the functions of design & development engineering (management & engineering), general or corporate management, basic research management, manufacturing & production management."

18. Potential recipients who do not satisfy the qualification criteria under CMP's described standards (or who do not wish to submit the detailed information necessary to become qualified recipients) may pay for a subscription.

19. A review of the publisher's statement for Electronic Engineering Times for the six-month period ending June 1992 prepared by BPA, the circulation auditor, shows that the "qualified non-paid circulation" for this publication was 127,067, which represented 100% of the publication's "qualified" circulation. Included in the record are similar publisher's statements for 15 other publications. A review of these other statements shows that the publication (included among the 15) with the largest qualified nonpaid circulation was InformationWeek with 181,103 subscribers, and the publication with the smallest qualified nonpaid circulation was Computer Retail Week with 22,512 subscribers. The publisher's statement for Windows Magazine shows the highest circulation of 212,506, but these are all "qualified paid" subscribers. Of the 16 publications for which publisher's statements were provided, only Windows Magazine had "qualified paid" subscribers. The subscribers for the other 15 publications were 100% "qualified non-paid" subscribers. However, they all also have a small number of "non-qualified paid" circulation. For example, the publisher's statement for Electronic Engineering Times for the period ending June 1992 shows nonqualified paid circulation of 1,077. Cash subscriptions to Electronic Engineering Times were approximately \$159 per year.

20. The following table sets forth representative annual subscription prices for 16 of the 21 publications listed in Finding of Fact "3" and total revenues generated from cash sales which show that only approximately 1% of issues circulated, or approximately 500,000, were sold for cash:

Publication	Issues to Qualified Nonpaid Recipients in 1992	Cash Sales Annual Subscription Price	Price per Issue	Issues sold for cash in 1992	Total Cash Revenues in 1992
1. Business Travel News	1,513,372	\$ 95.00	\$3.28	13,050	\$ 42,804.00
2. CommunicationsWeek	7,804,472	143.00	2.80	51,510	144,228.00
3. CommunicationsWeek Int'l	592,473	145.00	6.90	33,369	230,246.10
4. Computer Reseller News	3,667,300	199.00	3.75	59,731	223,991.25
5. Computer Retail Week	472,752	159.95	10.00	0	0
6. Electronic Buyers' News	3,063,350	125.00	2.50	19,200	48,000.00
7. Electronic Engineering Times	6,607,484	159.00	3.06	56,004	171,372.24
8. Electronic World News	1,023,099	75.00	3.57	3,066	10,945.62
9. Health Week ²	1,945,944	75.00	3.13	169,200	529,596.00
10. Information Week	9,236,253	120.00	2.35	54,519	128,119.65
11. Managed Health Care News	361,356	50.00	4.17	20,520	85,568.40
12. Network Computing	2,102,592	60.00	4.29	1,246	5,345.34
13. Open Systems Today	2,450,214	59.00	2.27	15,756	35,766.12
14. Systems & Network Integration	2,701,560	199.00	6.63	0	0
15. Tour & Travel News	2,565,696	95.00	1.94	12,201	23,669.94
16. VARBusiness	<u>1,020,680</u>	89.00	4.94	<u>4,230</u>	<u>20,896.20</u>
Total	47,128,597			513,602	\$1,700,548.86

21. CMP does not limit the number of cash subscribers, but does limit the controlled circulation of each publication to a predetermined number of qualified recipients. The

circulation limit approximates the number of persons with substantial buying authority in the market served by the publication. Waiting lists are sometimes maintained by CMP for a publication. As persons leaving the industry or losing buying authority are removed from the subscription list, eligible new applicants are added, from a waiting list, referral or other source of new applications.

22. CMP markets advertising space in each of the publications by stating that persons purchasing advertising will reach a valuable, prequalified, subscriber audience. Because an applicant is accepted as a qualified recipient for any of the publications only if he or she is in fact authorized to make purchases of products or services in the industry to which the particular publication relates, CMP assures prospective advertising customers that advertisements in the publications will reach persons with a likely interest in purchasing the advertised product and with the authority or influence to make or recommend such purchases. During the audit period, CMP incurred the following expenses to develop its base of subscribers, which expenses are primarily for the rental of and related costs of using other mailing lists to contact potential subscribers.

<u>Year</u>	<u>Development Expenses</u>
1985	\$ 213,036.00
1986	287,921.00
1987	374,743.00
1988	664,815.00
1989	1,853,103.00
1990	4,881,733.00
1991	5,209,347.00
1992	6,885,532.00
Total	\$20,370,230.00

23. CMP sells advertising space in the publications at rates that are higher than the average rates charged by comparable periodicals and newspapers without annual prequalification of subscribers. CMP was able to charge higher rates by virtue of providing a targeted audience.

24. CMP also uses the information provided in the subscription application forms to compile mailing lists for rental. Because applicants are accepted as qualified recipients for any of the publications only if they represent that they are in fact authorized to make purchases of

products or services in the industry to which the particular publication relates, CMP is able to provide the significant business information relating to the applicant and the applicant's employer included in any list rental. In addition, CMP has the ability to manipulate the data in its names list to screen for specific business criteria selected by a list renter. Each list is customized to the specific need of the renter.

25. CMP rents mailing lists at rates that are higher than the average rates charged by other mailing list rental companies. CMP was able to charge higher rates by virtue of providing a targeted audience.

26. The parties agree that the December 1995 relationships among the rental prices of the CMP mailing lists, a representative sample of mailing lists, and U.S. consumer magazines subscriber lists fairly represent those relationships during the audit period. In December 1995, the CMP mailing lists were available for a one-time use for a price ranging from \$90.00 per 1,000 names to \$225.00 per 1,000 names with a weighted average price to purchase the complete lists of \$145.00 per 1,000 names. At that same time, a representative sample of a variety of mailing lists was available for a one-time use for a price ranging from \$75.00 per 1,000 to \$175.00 per 1,000 with a weighted average price to purchase the complete lists of \$85.00 per 1,000 names. Similarly, the subscriber lists for U.S. consumer magazines at that time were available for a one-time use for a price ranging from \$60.00 per 1,000 to \$150.00 per 1,000 with a weighted average price to purchase the complete lists of \$78.00 per 1,000 names.

27. During the audit period, CMP derived the following revenues from rental of its mailing lists, which increased significantly year by year. The following table also shows that CMP's mailing list retail revenue was approximately double its revenue from the cash sales of publications, and that both of these revenue sources were a small fraction of CMP's billion dollar advertising revenue.

Year	Mailing List Retail Revenues Revenue	Cash Sales of Publications	Advertising Revenue	Total Operations
1986	\$ 1,560,000.00	\$ 710,900.00	\$ 88,637,084.00	\$ 90,907,984.00
1987	1,761,000.00	918,985.00	114,837,268.00	117,517,253.00

1988	2,165,000.00	1,092,508.00	136,449,341.00	139,706,849.00
1989	2,420,000.00	1,270,838.00	158,820,450.00	162,511,288.00
1990	2,997,000.00	1,420,160.00	177,189,027.00	181,606,187.00
1991	3,316,000.00	1,447,478.00	180,336,021.00	185,099,499.00
1992	4,332,000.00	1,700,549.00	211,510,498.00	217,543,047.00
Total	\$ 18,551,000.00	\$8,561,418.00	\$1,067,779,689.00	\$1,094,892,107.00
Total%	1.7%	0.8%	97.5%	100%

28. The parties stipulated that during the years 1986 through 1992, U.S. business magazines, consumer magazines, and daily newspapers received the majority of their revenue from advertising revenue as compared to circulation revenue as follows:

	<u>Business Magazines</u>	<u>Consumer Magazines</u>	<u>Daily Newspapers</u>
Advertising Revenue	\$31,945,000,000.00	\$44,039,000,000.00	\$213,236,000,000.00
Circulation Revenue	10,335,000,000.00	40,011,000,000.00	59,523,000,000.00
Advertising Revenue as % of Total Revenue	76%	52%	78%
Circulation Revenue as % of Total Revenue	24%	48%	22%

CMP's Production of the Publications

29. The parties have stipulated that petitioner is engaged in the "production" of the publications "by manufacturing, processing, generating or assembling", within the meaning of Tax Law § 1115(a)(12); (c).

30. The manufacture of an issue of any one of petitioner's publications entailed (i) creating text and graphics, (ii) typesetting the text and graphics for columnar presentation, (iii) formatting the typeset text and graphics, along with advertisements supplied by advertisers, within a page and among pages of a single copy, (iv) sending the fully-formatted publication to the printer and (v) printing the requisite number of copies of the issue.

31. Early in the audit period, many of the production steps for the publications were accomplished through use of a mainframe-based central processing unit, known as the "Atex" system, together with local terminals connected to the system. Beginning in the late 1980s, many of the functions previously performed by the Atex system gradually came to be performed by publication-specific, desktop networks of personal computers, allowing principally for the integration of text and graphics during the editorial process, rather than after the typesetting of text.

32. The first step in producing the publications was for the editorial and writing staff of each publication to meet and order the content of an issue, including text, graphics, and advertisements. In many instances, the staff would simply reserve space for articles, drawings, charts, photographs, advertisements, etc., that later would be delivered by the writers, artists, and advertisers.

33. Writers typically created text and graphics through the use of desktop computers, sometimes referred to as work stations, but occasionally provided text and graphics to CMP as typewritten manuscripts. Copy created on desktop computers was delivered via modem and telephone line to the Atex system using "ComputerEase" software. Where text was delivered as a typewritten manuscript, CMP staff used optical scanning equipment to convert the typewritten text to electronic data that was transferred first to a desktop computer and then by modem to the

Atex system. Manuscripts that were in poor condition were retyped directly on an Atex terminal, which was essentially a keyboard with monitor using the Atex system's local server.

34. The Atex system supported approximately 200 local terminals, permitting a staff of 200 to use the system concurrently for the same purposes that desktop computers were used. Once delivered to the Atex system, written articles went through a substantial editorial process, including fact checking, text revision, and selection of title, subtitle, heading, and subheading. The Atex system also placed the text in "galley" columns, a double column format. Graphic components were separately edited in the Atex system, through use of desktop personal computers as described below, for color, captions, labeling, and size.

35. After the basic substance of the articles was completed, the next step was assignment of typesetting, which consisted of assignment of typeface, print size, line endings, and column width and depth, followed by appropriate hyphenation of the product. After completion of assignment of typesetting, articles were proofed once more for content. Assignment of typesetting was performed directly on the Atex system or on connected devices.

36. The Atex system was cabled to a custom-engineered device provided by Compatible Systems Engineering, Inc. Known as the CSE Network, this device automatically prioritized output from the Atex system, assuring the publication which was closest to its publication deadline would be sent first by cable to a typesetting unit. Pages of each publication not compatible with the CSE Network were sent by cable directly from the Atex system to separate typesetting units, by-passing the CSE Network. The CSE Network would also be by-passed when its prioritizing function was not required. At the direction of CMP staff, either the CSE Network or the Atex system itself sent an output-ready data file to "Linotype" or other typesetting equipment for the actual printing of the typeset pages, which were referred to as "reproduction" or "repro" copy. Linotype equipment was located both in CMP's Manhasset facility and at a remote printer location to facilitate meeting deadlines.

37. Initially, repro copy was black and white copy, with graphics and text output separately. The repro copy was organized manually into the desired order of appearance in the

publication in a process called "paste-up". The entire pasted-up output was then proofed to ensure fit within the space allotted for an issue. Once the desired fit was established, the entire pasted-up output was photographed to produce lithographic film negatives. Portions of these film negatives would sometimes be cut out and replaced with lithographic film negatives of artwork and pictures, which were simply taped to the larger negative. As described below, the images on these lithographic film negatives were transferred directly to the printing plates at CMP's remote printing locations through a photographic process. The printing plates then were used in the actual printing of an issue of a publication. Where last minute textual changes had to be made, CMP used specialized communications equipment located at its Manhasset facility to transmit output-ready copy to typesetting equipment located at the printing plant.

38. Later in the audit period, film-based typesetters allowed CMP to by-pass the repro stage and directly generate the lithographic film negatives. Initially, these film negatives were "pasted-up" in much the same way that paper repro copy had been pasted-up, with artwork and pictures added as necessary. Beginning in the late 1980s, however, CMP purchased workstation equipment that allowed the function of "paste-up" to be performed on personal computers connected to the Atex system. Most of this equipment was Macintosh-based personal computers. These workstations retrieved content from the Atex system, formatted the content into pages, then pasted the content back into Atex or directly to film-based typesetting equipment. The Macintosh-based system also allowed for enhanced graphics and for integration of the enhanced graphics with text retrieved from Atex, without manual paste-up. Editors would add charts, graphs and photographs to the text received from Atex, integrate the information, then communicate the integrated product to typesetting equipment for output of camera-ready repro copy.

39. For each page in any issue of a publication, CMP produced four lithographic film negatives, one for black and one for each of the three primary colors, yellow, red, and blue. The four negatives were not identical. For example, the black negative might be the only negative to contain text. The yellow, red, and blue negatives would more often form the basis for artwork,

graphics and pictures. By superimposing the four negatives, one could discern the complete content of the page. A post-audit period development involved CMP's use of "color separation" scanning, which is a process in which photographs are electronically scanned and divided into the primary printing colors, allowing for the pictures on these photographs, broken down into their primary colors, to be integrated with text and graphics prior to CMP's output of lithographic film negatives.

40. Once all information had passed finally through the Atex system, typesetting had been completed, and the lithographic film negatives had been created, the negatives were transported principally to CMP's New Jersey printing plant. The negatives would then be set on photoreceptive printing plates and exposed to light, transferring the image to the printing plate. "Lithographic" refers to the method of printing from a smooth-surfaced plate which is chemically treated so that, when exposed to light, the printing plate is receptive to ink only where the transferred image is present, while the rest of the plate is ink-repellant, allowing for the printing of the image. For each page of any issue, a separate printing plate was produced from each of the four negatives, black, yellow, red, and blue. During printing, separate printing units applied the appropriate colored ink to each of the four printing plates. The printing plates then transferred the inked image onto a moving rubber mat, which in turn transferred the four images to a single paper page, superimposing the images to produce a complete image in full color. Following printing, the publications were collated, bound, distributed, and mailed.

CMP's Purchases of Machinery and Equipment

41. During the audit period, CMP purchased machinery and equipment for use in the manufacture of the publications ("manufacturing expenditures"). The manufacturing expenditures are listed on schedules created and subsequently revised by the Division's auditors, which are attached as exhibits "C" and "D" to the first stipulation executed by the parties. Exhibit "C" itemizes, for the entire audit period, assets that CMP capitalized for financial accounting purposes. Exhibit "D" itemizes purchases that were not capitalized, but is limited to purchases that occurred in a limited period in 1986, which the parties have agreed will serve as

a test period with respect to expense items purchased throughout the audit period.

42. With minor exceptions discussed below, CMP used all of the items described in Exhibits "C" and "D" exclusively in the production of the publications. Findings of Fact "44" to "52", relating to assets, and Findings of Fact "54" to "57", relating to expenses, describe, by categories relating to steps in the production process, the purchases listed in Exhibits "C" and "D", respectively. Each finding of fact also lists, by auditor's reference number, the particular purchases within each category and describes how each category is related to CMP's production of the publications, as described above. In addition, certain items not included in Schedules "C" and "D" are included in the following categories because the tax which the parties agree has been paid on those items is the subject of an equitable recoupment claim by petitioner. These items are listed by so-called "former" reference numbers.

43. The parties have stipulated that Findings of Fact "44" to "52", below, describe categories of assets that are used exclusively in the production of the publications.

44. Atex system- Purchases from Atex, Inc. were for hardware, software and maintenance for the Atex system itself. As discussed above, the Atex mainframe computer was used exclusively as the central unit for the process of producing text and graphics in final form for the printing of any issue of a publication. Some of the equipment included keyboards and monitors providing local access to the Atex mainframe computer. These purchases relate to the following reference numbers: 326, 323, 320, 324, 206, 210, 220, 53, 75, 57, 82, 98, 105, 391, 389, 393, 394, 396, 397, 398, 400, 1010, 1071, 1053, and 1073. Many of the functions performed by the Atex system were later performed on a desktop publishing network. These purchases relate to the following reference numbers: 2044, 2024, 2029, 2020, 2014, 3067, 3069, 3074, 3077, 3081, and 3079.

45. Editorial workstations- Editorial workstations are computer systems used by editors exclusively to create and edit text and graphics. These workstations were used to edit text as it made its way through the Atex system. They typically included a hard drive, memory boards, floppy disk drives, a monitor, a keyboard, a modem, a printer, and software for editing and data

transmission over the modem. These purchases relate to the following reference numbers: 341, 337, 340, 332, 333, 334, 309, 327, 328, 325, 322, 313, 314, 186, 191, 202, 204, 209, 218, 61, 62, 69, 72, 74, 81, 88, 90, 390, 399, 1052, 1056, 1059, 1066, 1106, 2033, 2039, 2031, 2040, 2041, 2019, 2021, 2010, 2013, 3070, 3071, 3072, 3073, 3088, 3089, 3080, 3082, 3083, 3087, 3090, 3084, and 3085. Disk operating system (DOS) and other software sometimes was purchased separately for exclusive use in editorial workstations. These purchases relate to the following reference numbers: 54, 55, 64, 93, 1047, 1048, 1055, and 2038 and former reference number 105. Later in the audit period, CMP purchased "Bestinfo" software and hardware, exclusively for use in allowing editors to perform editorial functions without the help of the Atex mainframe, returning the edited information to the Atex system, specifically to the attached typesetting equipment, after completion. These purchases relate to the following reference numbers: 207, 208, 211, 58, and 63.

46. Modems and related equipment- CMP used modems, which are devices that allow computers to transmit information via a telephone line, for any of several purposes. Modems allowed personnel at CMP's Manhasset, New York location to receive text and graphics from other CMP offices and from other persons. Modems also were used to receive information from news services and other outside sources. Modems allowed editorial work stations to communicate with the Atex system, allowed the Atex system to communicate with CMP's Macintosh-based graphics system and allowed the Atex system to communicate with typesetting equipment and, ultimately with CMP's printing plant. Each editorial workstation included a modem designed to serve its particular communications needs so that most of the modems purchased during the audit period are included in the reference numbers listed under the editorial workstation description above or in the "graphics equipment" description below. Modems were, however, sometimes purchased separately. These separate purchases of modems relate to the following reference numbers: 329, 100, 1063, and 1064. CMP also purchased software to allow its computer systems to communicate with one another via modem. These purchases relate to the following reference numbers: 321, 310, 190, 189, 214, 216, 86, and 94.

Finally, CMP purchased cables over which information was communicated within CMP's computer network. These purchases relate to the following reference numbers: 66, 2042, and 2017.

47. Optical scanning equipment- CMP purchased optical scanning equipment which was used exclusively to scan typewritten manuscripts onto CMP's computer network. These purchases relate to the following reference numbers: 198, 1008, 1062, and 2011.

48. Graphics equipment- CMP purchased Macintosh computers which were used exclusively to create and incorporate graphics that were more advanced than previously could be produced directly on the Atex system. These purchases relate to reference numbers 1050, 1057, 1044, 1045, 1046, 1060, 1061, 1067, 1096, 1094, 1095, 1091, 1092, 2034, 2035, 2036, 2037, 2043, 2030, 2032, 2018, 3068, 3076, and former reference number 1097. CMP also purchased related equipment to perform specialized art and other graphic functions. These purchases relate to reference numbers 185, 215, 219, 1054, 1043, 1058, and 2027.

49. Typesetting equipment- Typesetting equipment was used exclusively to set the type for the eventual final printing of any issue of a publication and to produce black and white paper repro or, later in the audit period, lithographic film negatives. Many of the purchases in this category during the audit period entailed equipment for different typesetting fonts. These purchases relate to the following reference numbers: 83, 197, 200, 201, 212, 213, 222, 223, 217, 221, 224, 59, 60, 67, 68, 71, 99, 77, 79, 85, 92, 101, 102, 103, 401, 1009, 1007, 1070, 1068, 1069, 1041, 2022, 2023, 2025, 2026, 2028, and 2012.

50. Photography equipment- CMP used photographic equipment exclusively to photograph camera-ready black and white print repro copy and to produce negatives of all final materials. The equipment included photography equipment and dark room equipment. These purchases relate to the following reference numbers: 312, 317, 318, 319, 187, 70, 84, and 1042.

51. Printers- CMP used the printers at issue herein exclusively at several stages in the production of the publications. Writers and editors used printers to print text and graphics for review at various stages in the editing process. Editors used printers to print and review text

that the Atex system had formatted. After the advent of CMP's desktop computer-based editorial network, printers also were dedicated to desktop computers for printing charts, graphs, and artwork that had been produced or refined in the desktop system, along with integrated text and graphics. The review process allowed editors to refine the content of the publications. During the audit period, CMP purchased dot matrix, black and white ink jet, black and white laser and advanced color printers. These purchases relate to the following reference numbers: 338, 335, 327-330, 184, 56, 80, 89, 1051, 1065, and 1093.

52. Labor- CMP occasionally purchased the services of outside vendors to install Atex equipment which was used exclusively in the production of the publications. These purchases relate to the following reference numbers: 331, 315, 188, 192, 65, 73, 76, 78, 83, 87, 91, 388, and 395. The installation typically entailed connecting new or replacement equipment to the Atex system. The outside vendor performing the service typically charged separately for the equipment itself. CMP also incurred labor charges for Atex computer hardware maintenance services. These purchases relate to the following reference numbers: 95, 96, and 97.

53. The parties have stipulated that Findings of Fact "54" to "57", below, describe categories of expenses that were used exclusively in the production of the publications.

54. Computer equipment- CMP purchased items of computer equipment which were not part of any larger purchase of hardware or software and, thus, were classified as expenses rather than assets. These items, which include a modem from CS Graphics (reference nos. 396, 514), a computer hard drive for an editorial workstation from Custom Computer (reference numbers 206, 212, 215, 216, and 218) and software for graphics design from Custom Computer (reference number 454), were used exclusively for purposes of production.

55. Editing expenses- CMP purchased equipment for use by its editorial staff exclusively in revising text and graphics and in maintaining equipment. These expenditures include markers, cement dispensers, cleaning spray for typesetting equipment, toner cartridges for printers, cleaning supplies for computer equipment, clear acetate, prepared acetate, blades, clear tape, white tape, blue cover stock, dividers, centrolines, video transfer tape, etc., all of

which were used in manual paste-up of black and white repro copy or for inserting images into lithographic film negatives. These expenditures included items purchased from CS Graphics and relate to the following reference numbers: 391, 416, 444, 476, 484, 525, 543, 378,382, 399, 430, 456, 477, 516, 535, 548, 554, 379, 384, 401, 432, 459, 478, 517, 536, 549, 497, 507, 530, 385, 402, 434, 460, 479, 518, 537, 550, 544, 495, 531, 582, 387, 411, 438, 467, 481, 521, 539, 552, 388, 412, 439, 468, 482, 522, 540, 553, 453, 555, 380, 1110, 1111, 1114, and 1115. They also included items purchased from Custom Computer which relate to the following reference numbers: 532, 440, 451, 469, 492, 504, 389, 454, 396, 514, and 523, as well as items purchased from Ken-Mar Camera which relate to the following reference numbers: 417, 361, 362, and 406.

56. Photographic supplies and development- CMP purchased photographic supplies and development services exclusively in connection with the preparation of graphics, the production of "repro" copy, and the development of lithographic film negatives. Items in this category include:

(a) color separation services necessary for development of graphics and lithographic film negatives. In color separation, a color photograph (or a color slide) containing an image to be used in a publication was sent to an outside firm. There the photograph or slide was mounted on a rotating drum on a sophisticated electronic scanner and electronically scanned. The scanner divided the electronic information into four electronic data streams, one for black and one for each of the three primary colors, yellow, red, and blue. The four electronic data streams were then used by the outside firm to produce for delivery to CMP four lithographic negatives called "color separations". Also delivered to CMP were four matching color transparent positives, superimposed into an overlay to form the composite color image as it would ultimately appear in the publication, allowing both the outside firm and petitioner to verify the quality of the color separations. Color proofs (a fused overlay) were also sometimes delivered to CMP. The lithographic negatives of the image were then integrated by CMP into the lithographic negative of the appropriate page of the publication in the process described in

Finding of Fact "38". The color photograph or color slide provided by CMP was returned unaltered. If the color photograph or color slide had been provided to CMP by a CMP advertiser or its advertising agency, it typically would be returned. Subsequent to the audit period, CMP acquired its own color separation scanning equipment as noted in Finding of Fact "39", decreasing its use of outside color separation firms. The outside color separation firms included Accent on Color (reference numbers 1184, 1051, and 1058), Alvin J. Bart & Assoc. (former reference number 1207), American Laser Graphics (reference numbers 1088, 1066, 1067, 1084, 1069, and 1073), Jack Ward Color Separations (reference number 1153) and Rolland Graphics (reference number 1085);

(b) film, negatives, chemicals, lithographic tape, etc, purchased from Arkin Medo (reference numbers 565, 570, 571, 572, 573, 574, 577, 578, 584, 585, 586, 587, 589, 590, and 336) and Ken-Mar Camera (reference numbers 417, 361, 362, 406, 116, 118, 1101, 1105, 1154, 1102, 1123, 1106, 1107, 1099, 1103, 1104, 1124, and 1137);

(c) photographic proofing materials, such as copy board glass, copy proofs, copy image packs, chemicals, etc., purchased from Arkin Medo (reference numbers 1117, 1119, 1120, 1121, 1122, 1125, 1126, 1127, and 1128);

(d) film development, color conversion and slide conversion services. Film development included conventional chemical processing of the photographic film negatives of pictures taken by CMP staff photographers and the printing of the photographs (reference numbers 506, 498, 1173, 1108, 1162, 1052, 1147, and 1140). Color conversion and slide conversion was necessary as a preliminary step to the color separation described above when the photograph or slide image desired was too big, too stiff, or for any other reason could not be mounted on a drum for electronic color separation scanning. The outside color conversion or slide conversion firm would make a photograph of the photograph or slide provided by CMP and deliver to CMP both the original unaltered photograph or slide and the new photograph (a positive or a negative) suitable for scanning. These items relate to reference numbers 1163, 1164, 1165, 1053, and 1156. If the original photograph or slide had been provided to CMP by a CMP

advertiser or its advertising agency, it typically would be returned.

(e) graphic reproductions purchased from EPD Color Services (reference numbers 558, 342, 343, 246, 559, 560, 344, 561, 247, 248, 1129, 1130, 1159, 1131, 1168, 1169, 1160, 1161, 1151, 1132, 1152, 1133, 1170, 1171, 1148, 1134, 1143, 1155, 1135, 1135=6, 1172, 1144, 1138, 1145, 1139, 1146, 1166, 1157, 1158, 1194, 1167, 1142, 1141, 1149, and 1150) and Orange Front Paint (reference numbers 1050, 1100, 1112, 1113 and former reference number 1109); and

(f) services for enlargement and reduction of advertisement proofs provided by advertisers. Advertisers at times would provide to CMP a press proof of an advertisement that had already been used in another publication. A press proof is not a photographic print, but rather an image on paper which has been produced from a lithographic plate in the same way that a final magazine page is produced by a printing press using a lithographic plate as described in paragraph "37". A press proof is used primarily to test the printing plate prior to a production run of the press using that plate. When the press proof provided by the CMP advertiser or its advertising agency was too small or too large for the desired space in the CMP publication, the proof would be sent to an outside firm. The outside firm would then take a picture of the proof with a special lithographic camera with color filters to make enlarged or reduced, color-separated images. Since the press proof provided to the outside firm by CMP was itself a product of previous electronic color separation scanning, scanning was unnecessary. The lithographic camera with color filters was sufficient to separate the color dot patterns in the press proof into four separate color patterns (black, yellow, red and blue) and to transfer each color pattern to a separate lithographic negative, called a "color separation" for delivery to CMP. Also delivered to CMP were four matching color transparent positives, superimposed into an overlay as described above. Composite proofs (fused overlays) were also sometimes provided to CMP. The lithographic negatives of the advertisement image would then be integrated into the lithographic negative of the appropriate page of the publication. The original press proof was returned to CMP unaltered. The press proof typically would be returned to

CMP's advertiser or its advertising agency. On occasion, an advertiser or its advertising agency would provide to CMP four color-separated lithographic negatives instead of the press proof. CMP's outside firm would then use a lithographic camera to produce four enlarged or reduced lithographic negatives for delivery to CMP and integration by CMP as described above. The four unaltered original lithographic negatives would be returned to CMP, which typically returned them to the advertiser or its advertising agency. The outside proof enlargement and reduction firms were Publishers Prep (reference numbers 90, 72, 84, 87, 59, 55, 69, 79, 73, 80, 63, 74, 56, 91, 88, 57, 60, 77, 75, 110, 81, 124, 115, 78, 116, 65, 76, 82, 70, 81, 58, 83, 125, and 89), Regional Typography (reference numbers 1054, 1055, 1049, 1186, 1077, 1056, 1057, 1068, 1070, 1071, 1185, 1072, 1078, 1086, 1079, 1089, 1080, 1087, 1061, 1081, 1074, 1059, 1062, 1082, 1063, 1090, 1075, 1060, 1064, 1065, 1083, 1076, and 1091) and Richman Litho Plating (reference numbers 54, 85, 86, 128, 66, 71, 92, 133, 64, 97, 93, 135, 67, and 68).

57. Computer repair services- CMP purchased services for repairing a Macintosh desktop computer and related equipment. Certain purchases from Custom Computer include such services (reference numbers 206, 212, 215, 126, 218, and 280). These expenses were incurred exclusively in the production of the publications. The local tax portion of the assessed tax on these items is agreed to be due as reflected in Finding of Fact "64", below.

58. The parties have specifically stipulated that all of the items listed, above, i.e., the manufacturing expenditures, constitute machinery or equipment used exclusively in the production, by manufacturing, processing, generating, or assembling, of the publications and that none of the manufacturing expenditures includes expenditures for "parts with a useful life of one year or less" or "tools or supplies used in connection with such machinery or equipment", all within the meaning of Tax Law § 1115(a)(12). The parties agree that the manufacturing expenditures satisfied each requirement for exemption under section 1115(a)(12), and were in all respects eligible for and not disqualified from exemption under section 1115(a)(12), except that the parties do not agree as to whether the publications produced for qualified recipients were "for sale" within the meaning of such section and do not agree as to whether the

manufacturing expenditures were used "directly" in the production of the publications within the meaning of such section.

59. Petitioner purchased electricity for use or consumption exclusively in the production, by manufacturing, processing, generating or assembling, of the the publications, within the meaning of Tax Law § 1115(c). Such electricity expenditures do not include any expenditures for electricity used or consumed in heating, cooling, or lighting of buildings or for other nonexempt purposes. All of CMP's electricity expenditures satisfied each requirement for exemption under section 1115(c), except that the parties do not agree as to whether the publications produced for qualified recipients were "for sale" within the meaning of such section and do not agree as to whether the electricity expenditures were used "directly" in the production of the publications within the meaning of such section.

History of the Audit

60. CMP timely filed New York State sales and use tax returns for the tax years in issue.

It paid sales and use tax in the following amounts:

<u>Period Ended</u>	<u>Tax Paid</u>
11/30/85 ³	\$ 4,570.19
11/30/86	28,861.20
11/30/87	51,944.98
11/30/88	73,208.79
11/30/89	45,960.55
11/30/90	58,893.38
11/30/91	64,787.43
8/31/92 ⁴	71,826.65
Totals	\$400,053.17

61. CMP paid sales and use tax of \$12,613.04 on its electricity expenditures and timely requested a refund of such amount.

62. The Division issued two notices of determination, one dated March 21, 1994 and the second dated June 13, 1994, against CMP. Corresponding notices of determination were issued

³The period ended 11/30/85 represents a three-month period beginning 9/1/85.

⁴The period ended 8/31/92 represent a nine-month period beginning 12/1/91.

against the individual petitioners. Pursuant to the two notices, the Division (i) disallowed the statutory exemptions claimed by CMP under Tax Law § 1115(a)(12) with respect to the manufacturing expenditures and § 1115(c) with respect to the electricity expenditures, and (ii) disallowed the claim for refund of sales and use taxes paid on a portion of CMP's electricity expenditures. Based on the disallowance of the two statutory exemptions claimed, the Division assessed additional sales and use taxes due in the following amounts:

<u>Tax Period Ended</u>	<u>Manufacturing Exemption Assessment for Assets</u>	<u>Manufacturing Exemption Assessment for Expenses</u>	<u>Electricity Exemption Assessment</u>	<u>Total Assessment</u>
08/31/86	\$ 4,399.93	\$ 55,398.00	\$ 20,265.51	\$ 80,063.44
08/31/87	14,720.93	67,645.86	9,682.91	92,049.70
08/31/88	44,153.35	82,846.28	29,901.38	156,901.01
08/31/89	16,472.09	90,039.17	20,947.17	127,458.43
08/31/90	26,676.99	89,528.13	22,633.89	138,839.01
08/31/91	14,978.99	81,071.98	32,370.43	128,421.40
08/31/92	<u>15,236.29</u>	<u>88,275.22</u>	<u>51,429.42</u>	<u>154,940.93</u>
Totals	\$136,638.57	\$554,804.64	\$187,230.71	\$878,673.92

63. As a result of adjustments agreed upon by the parties based upon additional work done by the Division and CMP and reflected in the exhibits "C" and "D" to the parties' first stipulation, the assessments noted in Finding of Fact "62" have been decreased as follows:

<u>Tax Period Ended</u>	<u>Manufacturing Exemption Assessment for Assets</u>	<u>Manufacturing Exemption Assessment for Expenses</u>	<u>Electricity Exemption Assessment</u>	<u>Total Assessment</u>
08/31/86	\$ 4,204.99	\$ 40,946.84	\$ 20,265.51	\$ 80,063.44
08/31/87	9,503.37	49,999.72	9,682.91	92,049.70
08/31/88	44,120.99	61,234.96	29,901.38	156,901.01
08/31/89	15,702.53	66,551.50	20,947.17	127,458.43
08/31/90	26,642.75	66,173.79	22,633.89	138,839.01
08/31/91	14,209.01	59,923.52	32,370.43	128,421.40
08/31/92	<u>15,236.29</u>	<u>65,247.71</u>	<u>51,429.42</u>	<u>154,940.93</u>
Totals	\$129,619.93	\$410,078.04	\$187,230.71	\$726,928.68

64. The parties agree that certain of the assets listed on Exhibit "C" to the first stipulation and certain of the expenses listed on Exhibit "D" to the first stipulation were not used to produce the publications and were not otherwise exempt from the sales and use tax. In addition,

as noted above, certain of CMP's manufacturing expenditures were for repair services, which are agreed to be subject to the four-percent local tax. The parties also agree that certain photographic development expenditures (reference numbers 506, 498, 1173, 1108, 1162, 1052, 1147, and 1140) were not exempt. Based on these agreements, the parties further agree that sales and use tax is due in the amount of \$7,065.96. As a result, the remaining contested portion of the assessment is \$719,862.72.

65. Petitioners have not contested the individual petitioners' status of officers responsible for sales and use tax which may be determined to be due and owing by the corporate petitioner.

66. The parties agree that CMP's refund claim for \$12,613.04 with respect to electricity expenditures is properly presented in this proceeding.

67. The parties also agree that CMP paid sales and use tax with respect to the asset and expense portions of the manufacturing expenditures, respectively, of \$851.31 and \$16,089.33, totalling \$16,940.64 (former reference numbers 105, 1097, 1109, and 1207). The parties agree that, with respect to this amount paid, in the event it is determined that these expenditures were not taxable, CMP is entitled to equitable recoupment against any part of the original assessment that is ultimately upheld.

68. The parties have specifically stipulated that at the audit and conference levels, CMP's representatives argued for the legal conclusion that CMP's operations resulted in a sale of the publications to the advertisers. Such conclusion was consistent with that reached in the neighboring states of New Jersey and Massachusetts by a court and an administrative board, respectively, construing sales tax statutes almost identical to New York's sales tax law (Fairlawn Shopper, Inc. and Shopper Distributors, Inc. v. Director, Division of Taxation, 98 NJ 64, 484 A2d 659; The Memorial Press v. Commissioner of Revenue, Massachusetts Appellate Tax Board, Docket No. 157114, June 27, 1994). In addition, a Texas court decided similarly in construing a sales tax statute similar to New York's sales tax law (Bullock v. Cordovan Corp., 697 SW3d 432). However, the Division, as well as the conferee, rejected petitioners' argument based upon Matter of Chanry Communications, Ltd., Tax Appeals Tribunal, March 7, 1991,

confirmed sub nom Henry v. Wetzler, 183 AD2d 57, 588 NYS2d 924, affd 82 NY2d 859, 609 NYS2d 160, cert denied ___ US ___, 128 L Ed 2d 863). The issue whether the providing of information to CMP by a qualified recipient in order to receive the publication is "consideration" such that there is a "sale" of the publication to the qualified recipient was not considered or addressed at the audit or conference level by either CMP's representatives or the Division's representatives. However, this argument was asserted by petitioners in their respective petitions dated January 12, 1996.

69. Petitioners have proposed findings of fact, based upon the four separately executed stipulations, which are accepted as findings of fact and incorporated into this determination. Petitioners have also proposed two conclusions of law (i) that the publications were "for sale", and (ii) that the production equipment and production electricity were used directly in the production of the publications. They will be addressed in the Conclusions of Law below.

SUMMARY OF THE PARTIES' POSITIONS

70. The Division maintains that the production exemption under Tax Law § 1115(a)(12) must be narrowly construed since it provides an exemption from tax. According to the Division, CMP is not using the items in dispute to produce tangible person property for sale but rather to provide an advertising service to its clients. The Division relies on the decision of the Tax Appeals Tribunal in Matter of Chanry Communications (supra):

"[P]etitioner here, just as the taxpayer in Chanry, is providing an advertising service, and therefore, its purchases do not qualify for the production exemption" (Division's brief, p. 16).

The Division also argues that the scope of the definition of "sale" within the meaning of the sales tax law is illustrated by the resale exclusion because "[a] purchase of property qualifies for the resale exclusion only if the purchaser sells the property" (Division's brief, p. 17). Citing the decision of the Tax Appeals Tribunal in Matter of J.C. Penney & Co., Inc. (April 27, 1989), the Division contends that:

"Even if there exists a "sale" of the item, the resale exclusion is inapplicable if the primary purpose in purchasing an item was to render a service or to provide promotional material" (Division's brief, p. 18).

Further, according to the Division, CMP's transfer of its publications to qualified recipients is not a sale for consideration within the meaning of Tax Law § 1115(a)(12); (c). The application forms for subscriptions have an indeterminate value and cannot be valued in money:

"If indeed petitioner was receiving valuable information from a barter or exchange with a potential subscriber, the value of the bartered information would be includable in gross income" (Division's brief, p. 24).

The Division contends that the common law concept of consideration sufficient to form a contract is not determinative of whether a "sale" under the Tax Law has occurred. Rather, the Division maintains that the better view is that for a sale to occur for tax purposes:

"[T]here must be consideration that is paid in money or be measurable in monetary money" (Division's brief, p. 26).

The Division rejects the argument that the arrangement between CMP and its qualified recipients constituted either a barter or exchange transaction because the forms completed by the qualified recipients are not tangible personal property for sales tax purposes:

"Rather the potential subscribers are providing intangible information to petitioner" (Division's brief, p. 28).

Further, the Division emphasizes that the avoidance of tax pyramiding underlies the production exemption, and if the assessments are sustained there will be no double taxing of CMP since the periodicals printed by CMP are exempt from sales tax.

Turning to whether the production equipment and production electricity were used directly in the production of the publications, the Division maintains that they were not used during the production phase of the publication process and were not actively involved in the printing of the periodicals:

"The equipment is used in steps toward the actual production of the periodicals, but is not used 'directly' in production" (Division's brief, p. 33).

Relying on Matter of Empire Vision Centers, Inc. (Tax Appeals Tribunal, November 7, 1991), the Division maintains that "there is an important gap which establishes that CMP's equipment is not used directly in the production process" (Division's brief, p. 34). None of the equipment controls the printing process, and the disputed equipment is not even located in the same state as the actual production equipment. According to the Division, necessary to

production is not the same as directly used in production. The disputed equipment and the electricity consumed to operate the equipment are used "in steps preliminary to the production of CMP's publications" (Division's brief, p.35).

71. Petitioners contend that the publications were "for sale" because all of the publications were distributed for "consideration", either cash or other valuable, legally cognizable consideration. According to petitioners, the Division's position that cash consideration is required is contrary to the regulatory definition of "consideration" as well as the decisions of the Tax Appeals Tribunal in Matter of Hygrade Casket Corp. (December 16, 1993) and of the former State Tax Commission in Matter of B & B Enterprises (August 7, 1985). The regulations at 20 NYCRR 526.7(b) broadly define "consideration", and "any valuable consideration will suffice" (Petitioners' brief, p. 13). Petitioners argue that the completed subscription application forms and the information provided on them satisfy the regulatory definition of consideration that includes exchange or barter as well as the granting of a license. Petitioners reject the Division's suggestion that the value of the bartered information, i.e., subscription application forms, was includable in CMP's gross income:

"[T]he right to use the information provided to CMP by qualified recipients gives rise to gross income recognizable for tax purposes as CMP uses that information to generate revenue from sales of advertising and list rental services" (Petitioners' reply brief, p. 3).

Further, petitioners maintain that the statutory definition of "sale" is very broadly stated and supports its argument that the distribution of publications to qualified recipients constituted a sale of such publications. According to petitioners, the Division's resale analogy is not in fact analogous:

"[E]ach of the cited cases held that the resale exemption did not apply because the services and tangible personal property were provided to the same customer and because the services were the true object of the transaction" (Petitioners' reply brief, p. 13 [emphasis in original]).

Petitioners also reject the Division's analogy to cases holding that property purchased for promotion purposes is not purchased for resale:

"These cases are not analogous as CMP is providing the publications in exchange for the information, not so that the qualified recipients will purchase

something else from CMP at a later date. . . . CMP clearly is not giving away the publications to promote its sale of another item, but rather insists on receiving acceptable information or cash from the subscribers before the publication is provided" (Petitioners' reply brief, p. 14).

Petitioners reject the Division's reliance on Matter of Chanry Communications, Ltd. (supra). In Chanry, the manufacturing exemption with respect to machinery and equipment used by the taxpayer to produce "pennysaver" magazines was disallowed "because the pennysavers were distributed not by subscription, but to the general public in a geographic area, without charge to the actual readers" (Petitioners' brief, p. 25). Unlike the matter at hand, in Chanry there was no consideration from the recipient of the pennysaver.

Petitioners also contend that sales tax exemption provisions do not apply only to prevent double taxation:

"They may too provide an exemption for expenditures incurred to produce tangible personal property even where sales of that tangible personal property are themselves exempt. . . . [T]axing petitioner's purchases in these circumstances is still fundamentally unfair and unequal since other publishers of periodicals and newspapers are exempt on both production inputs and sales of the tangible personal property output" (Petitioners' reply brief, pp. 23-24).

Petitioners maintain that the production equipment and production electricity were used directly in the production of the publications. First, the Division has stipulated that the production equipment and production electricity were used exclusively in the production of the publications. They were also used directly in the production of the publications because they had "an active causal relationship in the production of the publications" like the machinery and equipment used by the taxpayer in Matter of T.V. Data, Inc. (Tax Appeals Tribunal, March 2, 1989). Production equipment used in the publishing industry to produce camera-ready copy is exempt under the production exemption. Petitioners reject the Division's reliance on Empire Vision Centers (supra), noting that the Tribunal did not even address the issue of "directly" used in that matter "having concluded that the Wang was not used in production at all" (Petitioners' reply brief, p. 31). In the matter at hand, CMP's production of the lithographic film negatives is an essential and active part of its production of the publications:

"[T]he cessation of the production of either the lithographic negatives or the printed publications would make it impossible to serve either its subscribers or its

advertisers" (Petitioners' reply brief, p. 30).

CONCLUSIONS OF LAW

A. Tax Law § 1115(a)(12) provides, in pertinent part, that receipts from the sale of "[m]achinery or equipment for use or consumption directly and predominantly in the production of tangible personal property . . . for sale, by manufacturing, processing, generating, assembling . . . , but not including parts with a useful life of one year or less or tools or supplies used in connection with such machinery, equipment or apparatus" are exempt from sales and use tax.

B. As noted in Finding of Fact "68", petitioners did not raise their argument, that the providing of information to CMP by a qualified recipient in order to receive a publication is "consideration" such that there is a "sale" of the publication to the qualified recipient, at the audit or conference level. However, petitioners timely raised this issue in their respective petitions, and the parties have addressed this issue in an extremely thorough fashion in their stipulations and briefs as well as at the hearing in this matter. The fact that this issue was not addressed prior to the formal hearing stage is irrelevant for purposes of this determination.

C. Although the Division is correct that an exemption from tax must be narrowly construed, the language of the exemption must nevertheless be given a practical construction (see, Matter of Qualex, Inc./Carhart Photo, Inc., Tax Appeals Tribunal, February 23, 1995). At the heart of the dispute between the parties is how to interpret the term "sale" since in order to obtain the manufacturing exemption, CMP must have produced its publications "for sale".

D. Petitioners are correct that the term "sale" has been given a very broad definition in the Tax Law, the Division's regulations, decisions of the Tax Appeals Tribunal and the State Tax Commission, and under the common law.

E. Tax Law § 1101(b)(5) defines "sale, selling or purchase" as follows:

"Any transfer of title or possession or both, exchange or barter, rental, lease or license to use or consume (including, with respect to computer software, merely the right to reproduce), conditional or otherwise, in any manner or by any means whatsoever for a consideration, or any agreement therefor, including the rendering of any service, taxable under this article, for a consideration or any agreement therefor."

There is no dispute that a "transfer of title or possession" occurred when CMP distributed publications to its qualified recipients. The dispute between the parties concerns whether the transfer of publications to qualified recipients was "for a consideration".

F. The term "sale, selling or purchase" has been given an expansive definition in the tax regulations which mirrors the broad statutory definition. In addition, the term "consideration", which is not specifically defined in the Tax Law, has also been given an expansive definition in the tax regulations. These terms are defined in the tax regulations at 20 NYCRR 526.7, in relevant part, as follows:

"(a) Definition. (1) The words 'sale', 'selling' or 'purchase' mean any transaction in which there is a transfer of title or possession or both of tangible personal property for a consideration.

(2) Among the transactions included in the words 'sale,' selling,' or 'purchase' are exchanges, barter, rentals, leases or licenses to use or consume tangible personal property.

* * *

(b) Consideration. The term 'consideration' includes monetary consideration, exchange, barter, the rendering of any service, or any agreement therefor."

G. The Tax Appeals Tribunal in Matter of Hygrade Casket Corporation (December 16, 1993) cited with approval, in analyzing whether certain items had been "sold" by a subsidiary corporation to its parent corporation, the following common law definition of "consideration":

"'Consideration' has been more generally defined in the common law as 'some right, interest, profit or benefit accruing to one party, or some forbearance, detriment, loss, or responsibility, given, suffered, or undertaken by the other' (citation omitted)" (emphasis in the original).

Applying this expansive interpretation of the term "consideration", the Tribunal in Hygrade Casket Corporation determined that certain accounting entries between a parent corporation and its subsidiary, which reduced an account payable between the parent corporation as buyer and the subsidiary corporation as seller, constituted "consideration" so that a sale subject to sales tax had occurred.

H. The decisions of the former State Tax Commission are not binding on the Tax Appeals Tribunal (see, Nathel v. Commr, 232 AD2d 826, 649 NYS2d 196; Matter of Racial

Corp., Tax Appeals Tribunal, May 13, 1993). Nonetheless, it is observed that the former State Tax Commission in Matter of B & B Enterprises, Inc. (February 6, 1985) also took an expansive view of what constituted a sale by viewing the term "consideration" in a broad fashion. In B & B Enterprises, the Commission decided that the taxpayer which transferred possession of "Stagebills" to Carnegie Hall and Lincoln Center in exchange for the right to solicit, sell, and retain all revenue from advertising appearing in the "Stagebills" had sold the "Stagebills" to the performing arts facilities. The Commission noted that the right of the taxpayer to sell advertising in the "Stagebills" constituted "consideration" under the definition of consideration in the sales tax regulations noted above.

I. Applying the broad definition of "consideration" noted above, it is concluded that the providing of information by the qualified recipients to CMP constituted "consideration" so that the distribution of publications to the qualified recipients may be viewed as a "sale" of tangible personal property. By completing the subscription application forms and providing the detailed business information, as detailed in the findings of fact, the qualified recipients have provided value to CMP. The record established that as a result of obtaining the qualified recipients' information, as noted in Findings of Fact "23" and "25", CMP was able to charge higher than average advertising rates and higher than average mailing list rental rates, respectively.

J. In addition, petitioners' responses to the various other arguments made by the Division as summarized in paragraph "71" are persuasive. Petitioners are not maintaining inconsistent positions by treating the provision of information by the qualified recipients as consideration and at the same time not including in CMP's gross income the value of such information. Petitioners' position that CMP has recognizable income for tax purposes as CMP uses the information to generate revenue from sales of advertising and list rental services is persuasive (cf., Burnet v. Logan, 283 US 404). Further, the fact that CMP sells advertising services does not change the fact that it also sells the publications to its subscribers including the qualified recipients. The Division's reliance on Chanry Communications (supra) is misplaced because the pennysavers at issue in Chanry Communications could not be viewed as having been sold to the

persons who received them. Rather, they were freely distributed on a geographic basis. In addition, petitioners are correct that the Division's resale analogy is not in fact analogous for the reason noted in paragraph "71". Petitioners' response to the Division's pyramiding of tax justification for the manufacturing exemption is also persuasive. The manufacturing exemption may be applicable in situations where the avoidance of the pyramiding of tax or double taxation is not an issue.

K. In sum, the Division's position that in order for a sale to occur for tax purposes there must be consideration that is paid in money is rejected in light of the broad definition of consideration noted above. The Division's narrow interpretation of the meaning of a "sale" for purposes of the manufacturing exemption, which would require an examination of the taxpayer's motivation and intent, is not the practical, albeit expansive, construction of the term which is properly applied.

L. Turning to whether the equipment, materials, and certain services, as detailed in the findings of fact, were used directly in the production of the publications, it is initially noted that the parties have stipulated that such equipment, materials, and services were, in fact, used in the production of the publications. Therefore, the only remaining issue is whether they were used directly in such production.

M. The tax regulations set forth criteria in determining whether machinery or equipment is used "directly" in production. 20 NYCRR 528.13(c)(1) provides that:

"Directly means the machinery or equipment must during the production phase of a process:

- (I) act upon or effect a change in material to form the product to be sold, or
- (ii) have an active causal relationship in the production of the product to be sold, or
- (iii) be used in the handling, storage, or conveyance of materials or the product to be sold, or
- (iv) be used to place the product to be sold in the package in which it will enter the stream of commerce."

N. 20 NYCRR 528.13(c)(3) also provides that machinery used to produce other

machinery or equipment or parts for self use in production is considered to be used directly in production. Examples specified in this regulation include (1) machinery used to construct molds, which form the products being manufactured for sale, and (2) a lathe in a machine shop to make new machinery which is used to product tangible personal property.

O. What is meant by the regulatory language of having "an active causal relationship in the production of the product to be sold" is at the center of the parties' dispute. In Matter of Deco Builders (Tax Appeals Tribunal, May 9, 1991), the Tribunal analyzed this regulatory language. In reversing the Administrative Law Judge, the Tribunal decided that the taxpayer's purchase of certain custom-made wooden staves later assembled on site into a penstock was exempt from sales tax as the purchase of machinery or equipment used directly in the production of tangible personal property. The Administrative Law Judge had determined that although the penstock was machinery and equipment, it was used to produce electricity which was used in the production process, and therefore its relationship to production was secondary and did not have the "active causal relationship" to the product to be sold. To the contrary, the Tribunal held that the penstock was directly used in production:

"The determination as to whether a particular piece of machinery qualifies for the exemption depends upon the peculiarities of a taxpayer's operation and must be individually assessed on its own fact pattern [citation omitted].

". . . [T]he penstock was a required element in the process of producing electricity at the Newton Falls paper mill. The electricity produced was used to run the machinery in the mill that made the paper. The Division argues that these facts show that the penstock's relationship to production was secondary to production and insufficiently 'active' because it did not actually operate on the paper or on materials used to form the paper. We find this to be a strained interpretation of the language of the regulation. Clearly, electricity was an essential and active part of production at the mill, (in fact, there would have been no production process without electricity) (see, Matter of T.V. Data, Tax Appeals Tribunal, March 2, 1989, [where a computer that produced commands that drove typesetting equipment, while not actually connected to the typesetting equipment, was found to be an integral and essential part of the production process and therefore, met the test for exemption in 20 NYCRR 528.13(c)(1)]."

P. Based on the Tax Appeals Tribunal decision in Matter of Deco Builders (*supra*), the question to be resolved is whether the items at issue were "an essential and active part" in the production of petitioners' publications.

Q. As noted in Finding of Fact "30", CMP's production process consists of five stages: (i) creating text and graphics, (ii) typesetting the text and graphics for columnar presentation, (iii) formatting the typeset text and graphics, along with advertisements supplied by advertisers, within a page and among pages of a single copy, (iv) sending the fully-formatted publication to the printer, and (v) printing the requisite number of copies.

This production process is very similar to the production process at issue in Matter of T.V. Data, Inc. (Tax Appeals Tribunal, March 2, 1989). In T.V. Data, Inc., the tangible personal property produced was primarily camera-ready copy, similar to the repro copy that CMP produced during the early part of the audit period. A computer file was created for each customer's specifications, and the computer manipulated the data to produce the television listings. Another computer relayed commands to typesetting equipment which produced television listings on photographic paper which could be pasted up by the customer/newspaper.

R. The "System C" computer that was the core of the computer network used by T.V. Data to create and edit content is like CMP's Atex computer. T.V. Data also used video terminals and keyboards to input information into the network. These items served the same function as CMP's terminals, editorial workstations, and graphics workstations. Further, T.V. Data, like CMP, purchased and used substantial typesetting equipment. The Tax Appeals Tribunal in T.V. Data, Inc. decided that the System C computer was:

"[A] direct, necessary and integral part of the production of camera ready copy. Without the processes provided by the System C computer, the overall production process of the camera-ready copy would be incomplete."

The Tribunal also decided that the terminals were used "directly" because:

"[W]ithout the video terminals and keyboards, the production process could never be completed . . . as they are responsible for entering information into the computer network."

S. The items at issue which are involved in the production of lithographic film negatives, which are then set on printing plates and exposed to light, transferring their images to the printing plates and allowing for the actual printing of the publications, are directly used in the production of the publications (see, Matter of Qualex, Inc./Carhart Photo, Inc., supra). The

Macintosh personal computers, which allowed the function of "paste-up" to be performed on personal computers, and the film-based typesetters (which were used by CMP later in the audit period), as noted in Finding of Fact "38", enabled CMP to bypass the repro stage in producing the lithographic film negatives. Like the taxpayer in Qualex, CMP's production of film negatives was essential to its production of the publications, and the purchase of these technologically-advanced items were clearly entitled to the manufacturing exemption.

T. The decision of the Tax Appeals Tribunal in Matter of Empire Vision Center, Inc. (November 7, 1991) does not require a different result. In Empire Vision Center, the Tribunal noted:

"While the point of demarcation between what is administration and what is production is gossamer in nature, we conclude that the computer's function, while necessary for production to eventually occur, is not one which is engaged in the production process within the statute's meaning [citation omitted]".

Here, the parties stipulated that all of the items at issue were engaged in the production process. Furthermore, the negatives produced by CMP were not instructions for the company's workers, like the output from Empire Vision's computer, but provided the actual form that would become the printed pages of the publications.

U. The petitions of CMP Media Inc., as successor to CMP Publications, Inc., Daniel H. Leeds, Gerard G. Leeds, and Michael S. Leeds are granted, the refund claim noted in Finding of Fact "61" is granted, and the two notices of determination dated March 21, 1994 and June 13, 1994, respectively, against CMP Media Inc., as well as the corresponding notices issued to the individual petitioners, are to be modified to conform to this determination.

DATED: Troy, New York
December 31, 1997

/s/ Frank W. Barrie
ADMINISTRATIVE LAW JUDGE