STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
MICHAEL J. SCHNEIDER	:	ORDER DTA NO. 823640
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 June 1, 2005 through February 28, 2006.	:	

Petitioner, Michael J. Schneider, 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 June 1, 2005 through February 28, 2006. On June 14, 2012, Administrative Law Judge Thomas C. Sacca issued a determination that granted the petition in part and denied the petition to the extent that petitioner stipulated to owing sales tax of $10,234.84.[1]

On August 13, 2012, petitioner, appearing by Herzog Law Firm (Keith J. Roland, Esq., of counsel), timely filed an application for costs pursuant to Tax Law § 3030. The Division of Taxation, appearing by Mark F. Volk, Esq. (Osborne K. Jack, Esq., of counsel), timely responded to petitioner's application by filing a memorandum in opposition thereto, together with affidavits and exhibits. The due date for the Division of Taxation's response was September 12, 2012, and it is this date which began the 90-day period for issuance of this order. Based upon petitioner's application for costs, the Division's affirmation in opposition, the affidavits and exhibits provided

[1] The determination issued was also issued with respect to a second petition, ***Matter of VGR Systems Corp.*** (Division of Tax Appeals, June 14, 2012), which is not at issue herein.

by the parties, and all pleadings and proceedings had herein, Thomas C. Sacca, Administrative Law Judge, renders the following order.

ISSUE

Whether petitioner is entitled to an award of costs pursuant to Tax Law § 3030.

FINDINGS OF FACT

1. VGR Systems Corporation (VGR) is a corporation headquartered in Cleveland, Ohio, that manufactures, installs and services video viewing booths for adult book stores. VGR sells video equipment to customers (store owners) who operate the video machines it manufacturers at their own business premises. In addition, VGR installs video machines in store owners' premises and shares the resulting revenues with the owners. Only the sales from the latter aspect of VGR's business are at issue herein.

2. The Division of Taxation (Division) commenced a sales tax audit of VGR on March 17, 2006 for the period March 1, 2003 through February 28, 2006. At the outset of the audit, a list of requested books and records was provided to VGR by the auditor. In response to the Division's request for records, VGR provided copies of its sales tax returns and New York State corporation tax reports for the years 2003 and 2004. In reviewing the records provided, the auditor discovered a discrepancy between income reported on the corporation tax reports and the amount of sales reported on the sales tax returns. The discrepancy related to VGR's allocation of sales of tangible personal property to customers in the state as listed on its corporation tax reports when compared to sales of the same that VGR reported on its sales tax returns for the same period.

In response to the auditor's inquiries as to the basis of the discrepancy, VGR's then-representative, Mr. Donahoe, wrote to the auditor on May 31, 2007 and provided copies of an agreement between VGR and one of its New York State customers and a statement of VGR's

operations in the State. The letter stated that a copy of a service agreement was enclosed, and further stated that: "[t]he general terms and conditions of this agreement are consistent with the other NY locations. Fees and the length of the contract are the primary variables."

On June 12, 2007, the auditor requested that VGR provide "a listing of service contracts in New York State, all information containing the amount of revenue generated by each service contract in New York State, and the [*sic*] a depreciation schedule listing the equipment held in New York State by VGR Systems Corporation." The auditor added that "[u]pon review of the single service contract that you mailed to me it is necessary to obtain and review all of the service contracts for the audit period." No additional service contracts were provided to the auditor. During the consolidated hearing, the parties stipulated that the Division had properly requested VGR's books and records and that the audit was conducted based on the records provided.

3. At conclusion of the audit, the Division issued a Notice of Determination (Assessment No. L-030703077) dated October 3, 2008 to VGR assessing sales and use taxes in the amount of $64,442.77, plus interest, for the period March 1, 2003 through February 28, 2006. On December 1, 2008, the Division issued a Notice of Determination (Assessment No. L-031111890) to petitioner assessing sales and use taxes due for the period June 1, 2005 through February 28, 2006 in the amount of $21,987.55, plus interest. The notice advised petitioner that he was being assessed as an officer or person responsible for the payment of taxes determined to be due from VGR pursuant to Tax Law §§ 1138(a), 1131(1) and 1133. Petitioner states that he "was, during the audit period (March 1, 2003 - February 28, 2006) a responsible officer of VGR" (petitioner's application at 2).

4. VGR and petitioner each filed petitions with the Division of Tax Appeals and a consolidated hearing was held on October 25, 2011. At or before the hearing, VGR and petitioner stipulated to owing sales tax of $10,234.84. The sole issue to be determined at the hearing was whether, pursuant to Tax Law § 1101(b)(5), certain transactions between VGR and New York store owners were subject to sales tax as a transfer of possession, rental, lease or license to use for a consideration.

The Division contended that the transactions were subject to sales tax as taxable rentals or leases of tangible personal property. In support of its position, the Division relied on certain provisions contained in a service agreement between VGR and one of its customers. In particular, the Division's conclusion relied on certain provisions therein that required the store owner to pay VGR a percentage of the gross revenue derived from the machines; obtain all governmental permits, insurance, electricity and security for the machines; clean the area around the machines; and provide all tapes, videos and disks used in the machines.

Countering the Division's position, VGR asserted that the transactions were nontaxable and pointed out that it had retained control of the machines and, therefore, VGR was merely renting space from the store owners. In support of this position, VGR cited provisions in the agreement that required VGR to: incur certain expenses related to installation, service and maintenance of the machines; continue to own the machines; repair or replace defective machines; determine the number of machines in the store; provide trained technicians to service the machines; change the tapes, videos and disks on a regular basis; and collect, account for and pay to the store owner the appropriate amount of revenue earned by the machines.

5. On June 14, 2012, a determination was issued denying the petitions as so stipulated by VGR and petitioner (***see*** Finding of Fact 4) and granting the petitions in all other respects. Therein, it was noted that, while the Division was correct in its conclusion that certain provisions in the service agreement were "consistent with the conclusion that the transactions between VGR and the store owners constitute a rental or lease of tangible personal property," ultimately, the most important factor was "whether VGR relinquished exclusive possession of the [machines]" and it was determined that VGR had not done so. Therefore, the transactions at issue were determined to be nontaxable. Accordingly, the Division was directed to recompute the assessments issued to VGR and petitioner in accordance therewith.

Because VGR had retained the exclusive right to access the revenue derived from the machines in the transactions at issue, it was determined that VGR had retained "actual, exclusive possession" of the machines, and therefore, the transactions were not taxable sales of tangible personal property within the meaning and intent of Tax Law § 1101(b)(5) and § 1105(a). In reaching this conclusion, the determination relied on case law and also examined an advisory opinion, ***Matter of Joseph Granatelli*** (TSB-A-83[16]S, March 28, 1983), issued by the Division almost 20 years earlier to a taxpayer who was not one of the parties to the consolidated hearing.

6. On August 13, 2012, petitioner filed an application for costs pursuant to Tax Law § 3030. Therein, petitioner identifies two categories of costs incurred by petitioner and VGR: travel expenses totaling $2,000.00 and legal expenses totaling $21,037.46. Attached to the application are, inter alia, an August 9, 2012 affidavit by petitioner in support of the application and an August 13, 2012 affidavit by petitioner's representative, Keith J. Roland, Esq. Petitioner

states that at the time the assessments were issued to VGR and petitioner, "my personal net worth was less than $2 Million" (affidavit of petitioner ¶ 5).

7. With respect to the travel expenses, petitioner's application states that "[t]he out-of-pocket travel expenses of VGR's expert witness, who was required to travel twice from Denver to Albany, New York, for both the conciliation conference and the administrative hearing, set forth in Schedule A, total $2,000" (petitioner's application at 7). Schedule A, attached to petitioner's application, contains an itemized list of travel expenses as follows:

Expense Description	Expense Amount
Air fare	$700.00
Car rental	$350.00
Hotel	$650.00
Dining	$250.00
Parking	$50.00
Total	**$2,000.00**

Petitioner did not provide any receipts to substantiate the expenses.

8. In his brief, petitioner describes the legal expenses incurred by himself and VGR as follows:

> The total number of hours billed by taxpayers' attorney, directly and soley attributable to defense of the taxpayer [*sic*] position in these proceedings, totaled 53.75 hours. Of these, 10.5 hours were billed at $375/hr., and 43.25 were billed at $385/hour, which were the attorney's standard rates applicable to representation in matters of this nature. The taxpayers respectfully request reimbursement for those hours at the maximum rate permitted by the statute and Department precedent, up to a maximum of $385 per hour. Reimbursement is also requested for reasonable disbursements of $448.71 (***id.*** at 7-8).

In support of these fees and disbursements, petitioner provided copies of nine itemized invoices for Mr. Roland's services, reflecting the date of each service, the amount of time spent, the fee

charged, and a description of the services provided and/or the expense incurred. The invoices are printed on letterheads bearing the name and address of Mr. Roland's law firm. Additionally, in the heading portion, each invoice bears VGR's name and its address; either "Attention: Scott Moore, President" or "Attention: Scott Moore, General Manager"; and lists file number "32932" as well as an invoice number and a date. Petitioner's name is not mentioned in any of the nine invoices.

SUMMARY OF THE PARTIES' POSITIONS

9. Petitioner argues that the Division's position in issuing the protested assessments was not substantially justified insofar as the Division failed to follow its own published guidance. In support of this position, petitioner cites to an Advisory Opinion that he asserts was issued "to an operator of video games, which operated in the exact same manner as VGR . . . " in which the Division concluded that the transactions there at issue were not subject to sales tax (application of petitioner at 5, ***citing Matter of Joseph Granatelli***, TSB-A-83[16]S, March 28, 1983). Petitioner believes that "VGR had the same business relationship with its store owners, and no basis existed for assessing tax on VGR's receipts" (***id.***). Petitioner also contends that the Division's basis for issuing the assessments in these matters conflicted with "a long line of cases hold[ing] that to be taxable as a sale or rental, there must be a transaction 'involving passage of title or of actual exclusive possession' of the property" (application of petitioner at 6 [internal citation omitted]).

Petitioner believes that he and VGR substantially prevailed regarding both the amount in controversy and the most significant issue or set of issues presented. In support of this contention, petitioner states that "a total of $64,000 in principle [*sic*] (plus interest) was initially

at stake, of which $53,000 (plus interest) related to the only issue in controversy" (***id.*** at 5) and that since VGR and petitioner prevailed on this sole issue, petitioner concludes that they substantially prevailed in both of these respects (i.e., as to the amount in controversy and the issue presented).

As to his eligibility for an award of costs, petitioner asserts that when the Division issued the assessment to him, his net worth was not in excess of $2 million. Petitioner further states that his "litigation efforts [were coordinated with VGR] during the administrative process through the use of one attorney and one expert witness" and, moreover, that he "would not have incurred any legal costs if he were not personally responsible for the assessment against VGR" (***id.*** at 7).

10. The Division, citing Tax Law § 3030, counters that the application should be denied on grounds that: (a) its position was substantially justified; (b) petitioner failed to establish that VGR's net worth was within the statutory limits; (c) petitioner provided insufficient detail to determine whether the litigation and administrative expenses claimed in his application were reasonable; and (d) such expenses are unauthorized and unreasonable.

In particular, the Division notes that petitioner's reliance on the Advisory Opinion is misplaced insofar as advisory opinions are not precedential and, moreover, even if it were precedential, the Advisory Opinion cited by petitioner is factually dissimilar to the facts surrounding the assessments issued to petitioner and VGR. The Division also argues that its position was substantially justified because the Division reasonably concluded, based on information it was provided during the audit, that VGR failed to report and remit sales tax due from certain sales of tangible personal property that were made in New York. As to the legal and travel expenses claimed by petitioner, the Division notes that the proof submitted by petitioner in

support of the claimed expenses fail "to show that he, individually, has incurred any fees or expenses" and the Division further notes that petitioner "failed to submit a retainer agreement upon which the billing would be based or to submit any documentation concerning his understanding of the fees to be charged" (Division's brief at 6).

CONCLUSIONS OF LAW

A. Tax Law § 3030 is "the exclusive means for a prevailing party to be awarded administrative and litigation costs incurred in connection with any administrative or court proceeding" brought in protest of the Division's determination of any tax due by a taxpayer (Tax Law § 3030[b][4]). Accordingly, a discretionary award of attorney's fees may be granted by the Division of Tax Appeals to the prevailing party upon a showing by such party that the requirements of this section have been satisfied (***see Matter of Grillo***, Tax Appeals Tribunal, August 23, 2012; ***see also*** Tax Law § 3030[c][5][C]).

B. Section 3030 "was enacted to provide taxpayers with additional rights and equitable relief under the Taxpayer Bill of Rights Act of 1997" (***City of New York v. State of New York***, 94 NY2d 577, 598 [2000], ***citing*** Governor's Program Bill Mem, Bill Jacket, L 1997, ch 577). "The Legislature modeled Tax Law § 3030 after Internal Revenue Code § 7430" (***Matter of Grillo***). Accordingly, "it is appropriate to use both New York and Federal jurisprudence as guidance in applying this statute" (***Matter of 33 Virginia Place***, Tax Appeals Tribunal, March 31, 2011).

C. In pertinent part, Tax Law § 3030(a) provides as follows:

> In any administrative or court proceeding which is brought by or against the commissioner in connection with the determination . . . of any tax, the prevailing party may be awarded a judgment or settlement for:

> (1) reasonable administrative costs incurred in connection with such administrative proceeding within the department, and
>
> (2) reasonable litigation costs incurred in connection with such court proceeding.

The term "reasonable administrative costs" includes reasonable fees paid in connection with the administrative proceeding after the issuance of the notice giving rise to the taxpayer's right to a hearing before the Division of Tax Appeals (***see*** Tax Law § 3030[c][2][B]). Similarly, the term "reasonable litigation costs" includes

> reasonable fees paid or incurred for the services of attorneys in connection with the court proceeding, except that such fees shall not be in excess of seventy-five dollars per hour unless the court determines that an increase in the cost of living or a special factor . . . justifies a higher rate (Tax Law § 3030[c][1][B][iii]).

D. In this matter, the determination as to whether petitioner is the "prevailing party" first requires a showing that his "net worth did not exceed two million dollars at the time the civil action was filed . . . " (Tax Law § 3030[c][5][ii][II]). Petitioner has satisfied this requirement through his provision of an affidavit in which he affirms this fact (***see*** Finding of Fact 6; ***see also Matter of Grillo***).

Next, it is incumbent on petitioner to prove that he has substantially prevailed with respect to either "the amount in controversy" or "the most significant issue or set of issues presented" (Tax Law § 3030[c][5][A][i]) and it is petitioner who carries this burden (***see Rustam v. Commissioner***, 89 TCM 829 [2005]; ***Minahan v. Commissioner***, 88 TC 492 [1987]). Contrarily, a party will not be treated as the prevailing party if the Division establishes that its position was substantially justified and the burden of proving the same rests with the Division (***see*** Tax Law § 3030[c][5][B][i], [ii]). If, however, the Division failed to follow its own "applicable published guidance in the administrative proceeding," it is presumed that the Division's position was not substantially justified, though this presumption may be rebutted (Tax

Law § 3030[c][5][B][iii]). In this context, "applicable published guidance" means "regulations, declaratory rulings, information releases, notices, announcements, and technical services bureau memoranda" as well as advisory opinions "*issued to the taxpayer*" (Tax Law § 3030[c][5][B][iv] [emphasis added]).

E. Petitioner seeks to establish that he substantially prevailed as to both the amount in controversy and the issue presented and, further, that the Division failed to follow its own published guidance and established case law. The Division counters by arguing that its position was substantially justified and disputes petitioner's position that it failed to follow its own guidance.

Petitioner's argument as to the Division's departure from its own published guidance is without merit. For purposes of Tax Law § 3030, neither case law nor an advisory opinion issued to a taxpayer other than the petitioner seeking an award of costs fall within the statute's definition of "applicable published guidance" as set forth above (***see also*** Tax Law § 171[24] [noting that advisory opinions "shall not be binding upon [the Division] except with respect to the person to whom such opinion is rendered . . . "]). Therefore, there is no evidence that the Division failed to follow its own published guidance. Accordingly, it must be determined whether the Division's position was substantially justified.

F. The Division's position is substantially justified if it is "one that is 'justified to a degree that could satisfy a reasonable person' or that has a 'reasonable basis both in law and fact'" (***Rasbury v. Internal Revenue Service***, 24 F3d 159, 168 [11th Cir 1994], quoting ***Pierce v. Underwood***, 487 US 552, 565 [1988]). That is, a finding of substantial justification requires only a showing by the Division that it acted reasonably in light of "all the facts and circumstances surrounding the proceeding and the fact that the [Division] loses the case should not be

determinative" (***Phillips v. Commissioner***, 851 F2d 1492, 1499 [1988], quoting ***Baker v. Commissioner***, 83 TC 822, 828 [1984]).

Here, it is determined that the Division acted reasonably in light of the facts and circumstances surrounding the audit and the consolidated hearing. Upon identifying discrepancies between VGR's sales tax records and its corporation tax records, the auditor requested additional documentation in order to understand the discrepancy. However, the requested information was never provided. Further, the parties stipulated that the Division had properly requested VGR's books and records and that the audit was conducted based on the records provided. Based on the records provided by VGR, the Division determined that VGR was liable for additional sales tax and, derivatively, as a responsible person for the sales tax due from VGR, petitioner was as well. In the determination it was noted that the Division correctly concluded that certain provisions in the service agreement were "consistent with the conclusion that the transactions between VGR and the store owners constitute a rental or lease of tangible personal property." Further, petitioner concedes that he was a responsible person during the audit period (***see*** Finding of Fact 3). Although the transactions at issue were ultimately found to be nontaxable sales based on case law that identified one factor that trumps those that were reasonably relied upon by the Division, this is not dispositive in determining whether the Division was substantially justified in its position. Instead, the fact that certain provisions in the agreements were consistent with the Division's conclusion is sufficient to demonstrate that its position was substantially justified.

G. Based on the foregoing, it is unnecessary to determine whether the proof offered by petitioner in support of the claimed legal expenses – invoices for legal services that fail to indicate what, if any, expenses were actually incurred by petitioner, rather than by VGR – is

enough to satisfy the requirements of Tax Law § 3030 because the outcome of such inquiry is insufficient to overcome the determination that the Division's position was substantially justified. It is similarly unnecessary to address the Division's argument that petitioner failed to establish that VGR's net worth was within the statutory limits as the result of such inquiry has no bearing on the outcome herein.[2]

H. Petitioner's application for costs and fees is denied.

DATED: Albany, New York
December 6, 2012

/s/ Thomas C. Sacca
ADMINISTRATIVE LAW JUDGE

[2] It is noted that even if a different result had been reached in this matter, VGR's net worth would nonetheless be irrelevant as Tax Law § 3030(c)(5)(A)(ii)(II) defines "prevailing party" with reference only to the party seeking an award of costs. Accordingly, the net worth of related parties and other non-parties to the application, i.e., VGR, would be inconsequential for this purpose.