

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :
of :
BORSAWALLACE, 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 December 1, 2004 through August 31, 2007. :

In the Matter of the Petition :
of :
FRANK BORSA :
for Revision of a Determination or for Refund of Sales and :
Use Taxes under Articles 28 and 29 of the Tax Law for the :
Periods March 1, 2007 through August 31, 2007. :

DETERMINATION
DTA NOS. 824173,
824174, 824175

In the Matter of the Petition :
of :
JEFFREY M. WALLACE :
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 March 1, 2007 through August 31, 2007. :

Petitioner BorsaWallace, Inc., filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period December 1, 2004 through August 31, 2007. Petitioners Frank Borsa and Jeffrey M. Wallace filed petitions for revision of determinations or for refunds of sales and use taxes under Articles 28 and 29 of the Tax Law for the periods March 1, 2007 through August 31, 2007.

A hearing was held before Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, 1384 Broadway, New York, New York, on December 18, 2012 at 10:00 A.M., with all briefs to be submitted by July 12, 2013, which date began the six-month period for the issuance of this determination. Petitioners appeared by Caplin & Drysdale (Mark D. Allison, Esq., and Zhanna A. Ziering, Esq., of counsel). The Division of Taxation appeared by Amanda Hiller, Esq. (Marvis A. Warren, Esq., of counsel).

ISSUES

I. Whether petitioner BorsaWallace, Inc., has established that its sales are exempt from sales and use tax pursuant to Tax Law § 1105(c)(1) and 20 NYCRR 527.3(b)(5) as the sales of advertising services.

II. Whether petitioner BorsaWallace, Inc., has established that its sales were nontaxable as sales for resale pursuant to Tax Law § 1105(a) and Tax Law § 1101(b)(4).

III. Whether petitioner BorsaWallace, Inc., has established that its sales were nontaxable sales of promotional materials pursuant to Tax Law § 1115(n).

IV. Whether petitioner BorsaWallace, Inc., has established that its sales were nontaxable assignments of reproduction rights pursuant to 20 NYCRR 526.7(f).

FINDINGS OF FACT

1. Petitioner BorsaWallace, Inc. (BorsaWallace), was a New York corporation. It was formed in 1991 and, during the period in issue, had a business address on West 27th Street in New York City. Petitioner Jeffrey M. Wallace, was the president of BorsaWallace, and petitioner Frank Borsa was the secretary/treasurer.

The Audit

2. In or about September 2007, the Division of Taxation (Division) initiated a sales and use tax audit of BorsaWallace for the period December 1, 2004 through August 31, 2007. In the course of the audit, BorsaWallace and the Division signed a test period agreement providing that the sales records would be reviewed using a test period method. The test period selected was the months of June, July and August 2006.

3. On the basis of its review of the sales records for the test period, the Division calculated an error rate and applied it to the gross sales reported on BorsaWallace's sales tax returns for the audit period. The computation resulted in a determination that there was an underpayment of sales tax during the audit period. Accordingly, on April 5, 2010, the Division issued a Notice of Determination to BorsaWallace that assessed sales tax in the amount of \$197,710.70 plus interest of \$74,063.71. The Division also issued a Notice of Determination to petitioner Jeffrey M. Wallace, dated April 5, 2010, that assessed sales tax in the amount of \$51,528.49 plus interest of \$12,942.03 for the period March 1, 2007 through August 31, 2007. Lastly, on the same date the Division issued a Notice of Determination to petitioner Frank Borsa that assessed the same amount of sales and use tax as was assessed against Jeffrey M. Wallace. Each of the notices issued to the individual petitioners explained that they were assessed as an officer or responsible person of BorsaWallace.

BorsaWallace

4. BorsaWallace provided services in the field of graphic design. Specifically, BorsaWallace was retained by public relations companies or other advertising companies such as DeVries Public Relations (DeVries), The Bromley Group, Lane Communications and Sensei Health, to create promotional materials referred to as "kits," as well as other promotional items,

including binders, letterheads, banners, handbooks, hang tags, boxes, and posters. The clients, in turn, used the kits and other promotional items in public relations, marketing or advertising campaigns on behalf of customers. BorsaWallace provided design services to the DeVries Public Relations firm for brands such as Pepperidge Farm, Vicks, Tide, Tupperware, Tropicanna, P & G Beauty and Crest.

5. BorsaWallace, as part of its graphic design business, designed the promotional material and retained a third-party printer to produce a certain number of samples of the kits and other promotional items, including binders, letterheads, banners, handbooks, hang tags, boxes, and posters.

6. The design-related services performed by BorsaWallace were in an effort to promote the brands of DeVries' or other public relations firms' clients.

7. Not all of the work performed by BorsaWallace resulted in the creation of marketing kits or other tangible personal property; at times, BorsaWallace work was limited only to the provision of services for the design of the kits.

BorsaWallace's Clients

8. BorsaWallace's clients mainly, but not exclusively, included public relations, advertising and marketing firms. BorsaWallace also rendered a few design-related services projects directly for end user customers rather than working with public relations firms who in turn contracted with the end user customers.

9. Beginning in 1991 and continuing through the audit period, DeVries was BorsaWallace's main client. DeVries was a public relations agency that created programs in support of marketing, advertising and public relations campaigns.

10. As a public relations agency, DeVries conducted its business in a different manner than an advertising agency. An advertising agency utilizes a large budget to place advertising with the media. Public relations agencies typically operate with a much smaller budget and utilize a staff who are skilled at being able to convince media to report on a brand without the substantial expense of purchasing media. In order to achieve this result, DeVries needed items that set their client's brands apart from other brands without having the substantial expense of paying for media coverage.

11. DeVries was generally retained by consumer products companies and pharmaceutical companies to support their customers' brand communication objectives and to increase their sales.

12. DeVries retained BosaWallace because DeVries did not have creative services in-house, and therefore, could not perform the design services. During the audit period, at least 80 percent of BosaWallace's services were performed for DeVries.

13. BosaWallace was retained by separate groups within a client such as DeVries. For example, the service for Vicks was requested from the health and wellness group within DeVries and the services for Tide were requested from the fabric care group within DeVries.

14. At times, BosaWallace was retained by DeVries to prepare designs for marketing materials in order to assist DeVries itself in pitching for work from prospective customers.

15. BosaWallace did not have contracts or other written agreements concerning its design work with its clients. However, email, correspondence and the course of dealings defined BosaWallace's and its clients' obligations to one another.

The Work Flow

16. During the audit period, BosaWallace's work flow process was as follows:

Step 1: Generally, the brand customer retained a public relations firm, such as DeVries, for public relations services;

Step 2: The public relations firm, in turn, commissioned BorsaWallace and submitted to BorsaWallace a creative brief, and its objectives;

Step 3: BorsaWallace conducted a “design exploratory” and presented several sketches and concepts or written ideas to the public relations firm;

Step 4: The public relations firm chose the preferred idea to best support the promotion of the brand;

Step 5: BorsaWallace created the final digital artwork, which was electronically delivered to an outside source for printing and manufacturing, if the public relations firm requested the creation of marketing kits or other promotional material;

Step 6: BorsaWallace supervised the outside source for printing and manufacturing;

Step 7: Upon completion, the product was delivered to the public relations firm;

Step 8: BorsaWallace sent an invoice to the public relations firm; and

Step 9: The public relations firm sent an invoice to the brand.

Terms of Engagement Between BorsaWallace and the Client

17. BorsaWallace generally did not have engagement letters with its public relations firm clients, including DeVries, because it had a long-standing relationship with most of the public relations firms, and the engagement was generally done through a more informal process.

18. The terms of the specific engagement, such as the quantities of the product or specific requirements including budget limitations, or creative briefs, were generally communicated by the public relations firms to BorsaWallace informally, via emails or communication briefs. This

informal approach to engagements for long-standing relationships is consistent with industry norms.

19. In cases where BorsaWallace was retained by the public relations firm clients, it never had a contract or a service agreement directly with the end user brand customers of the public relations firms. Generally, the public relations firms had engagement letters or service agreements with the brand customers of the public relations firms.

The Design Process

20. BorsaWallace generally consulted about the designs and worked with its public relations firm clients through account teams. It took directions from the public relations firms on the development of the designs. It was rare for BorsaWallace to consult directly with the brand customers of the public relations firms. The public relations firms' clients ultimately approved the final design of the marketing kits or promotional materials and determined the number of kits or materials to be actually printed. At times, the public relations firms would reject BorsaWallace's design ideas and the project would not proceed any further.

21. The names of the public relations firms were never on the marketing kits or other promotional materials. Rather, only the name of the public relations firm customers - the brand - was reflected on the kits.

22. DeVries did not own, have a licence or right to the brand name on the marketing kits or other promotional materials; the names were owned by the brand customers only.

Production and Distribution of Marketing Kits and Other Promotional Materials

23. The printing of tangible personal property, such as marketing kits, was generally outsourced to outside printers selected by BorsaWallace.

24. In projects where BorsaWallace required printing services, it digitally sent its designs to the printers.

25. BorsaWallace was invoiced by the printer and paid the printer directly for the costs of the printing.

26. Upon finishing the work, the printer sent the marketing kits or other promotional materials either directly to the public relations firm or to the firm's redemption facility that handled the distribution of the kits or materials. BorsaWallace directed the printer where to ship the final product.

27. The printer generally shipped the final product via UPS, messenger, truck or freight services.

28. After the public relations firm client, such as DeVries, received the marketing kits or other promotional materials, it generally distributed the materials to the media and other influential persons (referred to as influencers) without charge to promote the brand. DeVries used some kits or other materials to present its recommendations to its clients, the brand.

29. The marketing kits and promotional materials were sent by the public relations firms to the media and influencers on behalf of their end user brand customers. Consequently, BorsaWallace did not generally possess the marketing kits or other promotional materials.

30. BorsaWallace's clients did not return, nor did it seek the return, of the designed tangible personal property to BorsaWallace. However, BorsaWallace maintained ownership of the designs that provided the parameters for the printing and creation of the kits.

31. DeVries did not have a messenger service or in-house mailing service. DeVries generally sent the kits and materials to the media via Federal Express, UPS or messenger service.

32. The brand end user customers ultimately approved the marketing kits or other promotional materials before the public relations firms distributed them to media or influencers.

33. The end user brand customers also had the ability to instruct the public relations firm clients to stop any further distribution of the kits or other materials.

34. DeVries did not charge the media or influencers for the marketing kits or promotional materials.

Budget and Fees

35. BorsaWallace's budget for a particular design was based on a number of factors, such as the time it would take to create the design, how the design would be used, and the size of the brand.

36. The budget for BorsaWallace's fees and the printing of marketing kits or other promotional materials was proposed by the public relations firm and ultimately had to be approved by the end user brand customer of the public relations firm.

37. After the completion of the engagement, BorsaWallace submitted invoices to and was paid by its public relations firm clients.

38. BorsaWallace's fees included charges for its services, expenses and for the printing costs of any marketing kits or other promotional materials created as part of the engagement. Thus, the fee was, in part, based upon BorsaWallace's time to create the design.

39. BorsaWallace bills the cost of printing marketing kits and other promotional materials to the public relations firms with a markup on those costs.

40. The public relations firms invoiced their end user brand customers for the amount of BorsaWallace's fees plus expenses consisting of the cost of the marketing kits and other promotional materials. Some of BorsaWallace's clients marked up the cost of the kits to the

customers and some of the clients did not. DeVries marked up the cost of BorsaWallace's design materials for a period of time and then stopped doing so.

41. When DeVries received an invoice from BorsaWallace, an employee of DeVries placed a code on the invoice that indicated the business that DeVries was working on such as Tide or Crest. The invoice was then sent to the finance team for the preparation of monthly bills, which included agency fees and the out-of-pocket expenses. The agency fees paid for the services performed by DeVries and the out-of-pocket expenses paid for the services of BorsaWallace and anything that BorsaWallace produced. Thus, the cost of printing the kits and the cost of the work performed by BorsaWallace was charged to the public relations firms' clients.

42. In addition, the public relations firms invoiced their brand customers for the firms own fees and costs.

43. The marketing kits and other promotional materials were purchased by the public relations firms and resold to those firms' end user brand customers.

44. The public relations firms' clients of BorsaWallace did not provide resale certificates with its purchases from BorsaWallace.

45. BorsaWallace did not request resale certificates from its clients because, at first, it collected sales tax on all the items, and even after it switched its tax collection practices, it was still collecting sales tax on the production of the marketing kits and other promotional materials.

Requests for Design Revisions and Printing of Additional Kits

46. If a public relations firm client wanted to receive additional marketing kits or other promotional materials, the public relations firm had to make the request to BorsaWallace. BorsaWallace would then again retain its third-party printer to reproduce the material.

47. The public relations firm clients generally did not have a relationship with the printer, and therefore was not able to request additional copies directly from the printer.

48. If the public relations firm or the end user brand customer attempted to order additional marketing kits or promotional materials from the printer directly, the printer would immediately notify BorsaWallace.

49. The public relations firms generally could not seek additional copies of marketing kits or promotional materials from another printer because it was unethical, it was not a common industry practice and neither the public relations firm nor the printer had the design or the template necessary to generate the kits or materials.

50. In selling the marketing kits and other promotional materials to the public relations firms and other clients, BorsaWallace retained the rights to the design. As a result, the public relations firms were unable to alter the design and were required to request that BorsaWallace revise the design work.

51. BorsaWallace's clients did not explicitly request a right to reproduce. However, it was BorsaWallace's understanding that its clients requested a right to reproduce. BorsaWallace confirmed this understanding to its clients by including the "reproduction rights granted" statement on the invoice.

52. If the end user brand customer of the public relations firms wanted to modify the design of a marketing kit, the brand customer would have to contact the public relations firm and it, in turn, would have to contact BorsaWallace for permission to modify the design.

53. BorsaWallace's clients did not have the ability to change the design of the marketing kits or other promotional materials because BorsaWallace owned the designs.

54. BorsaWallace did not put any restrictions on how its clients used the marketing kits or other promotional materials.

55. In circumstances in which additional marketing kits or promotional materials were requested, BorsaWallace invoiced its public relations firm clients for the cost of the printing with a further markup. The public relations firm clients in turn passed this further printing cost that may include a mark up, to their end user brand customers.

Terminology Used in the BorsaWallace Invoice

56. The term “design” included the design exploratory, which was the process that BorsaWallace used to come up with design ideas. Design work was purely a service and the fees for design were determined based on the hours spent and the client’s budget for the project.

57. The term “production” referred to the service of creating a final artwork in a digital format, which included the artwork itself and any specifications for the kits or other materials. The final artwork was created and transmitted digitally, and therefore, did not include the creation of any tangible personal property.

58. The term “programming” referred to the programming or coding for websites. It did not involve creation of any tangible personal property.

59. The term “photo licensing” referred to licensing of a photograph from either a photographer or a stock photo house, which was delivered to BorsaWallace in a digital format.

60. The term “expenses” included all miscellaneous expenses, such as messenger fees, cab fares, digital printouts used to present designs, and art supplies needed to create designs.

61. The term “printout” referred to a printing of digital artwork for presentation to a client. The printout was not sold to the client and was retained by BorsaWallace at the conclusion of the meeting.

62. The term “printing” referred to a production of marketing kits or brochures, or other promotional materials, that was ultimately delivered to BorsaWallace’s clients.

63. The term “print revisions” referred to the fees charged by the printer for printing the revised artwork. A client’s request for change in the design of a kit would be billed on an invoice as a print revision. However, a client’s request for additional kits would be billed on an invoice as a printing fee.

64. The term “DVD” referred to the production of an actual DVD.

65. The term “shipping” referred to the fees incurred for bulk shipping of the items from the printer or any vendor which could have been to the client directly or another location pursuant to the client’s instructions.

66. The term “reproduction rights granted” on an invoice identified instances where BorsaWallace was not selling the design itself to the client, but rather was selling the right to reproduce the design (e.g., marketing kits) in identified quantities. BorsaWallace began including the notation “reproduction rights granted” on the invoices after receiving guidance from the Division as described in Finding of Fact 68.

67. The term “OOS” meant that any marketing kits or other promotional materials were shipped out of state.

BorsaWallace’s Sales Tax Collections Practices During the Audit Period

68. In 2003, BorsaWallace contacted the Division to seek guidance with respect to its sales tax collection practices. The representative from the Division advised BorsaWallace that there was a distinction between instances where BorsaWallace was granting its clients a right to alter the design that was identified as a taxable transaction, and where the clients could not alter

the design, was identified as merely a grant of the reproduction rights and thus a nontaxable transaction.

69. Based on the guidance received during the call with the Department, BorsaWallace established the following tax collection practices during the audit period:

a. Where BorsaWallace provided only services to its clients that did not result in the production of marketing kits or promotional materials, BorsaWallace charged its clients sales tax if the clients were able to make alterations to the digital files created by BorsaWallace.

b. However, if the clients could not make any alterations to the digital files transmitted by BorsaWallace, no sales tax was charged.

c. When the project involved designing and printing marketing kits or promotional materials, BorsaWallace only charged sales tax on the printing of kits or materials, but not the design services if the client could not alter the design.

d. However, if the design involved a creation of a Power Point presentation, that a client could alter, then BorsaWallace charged sales tax on the design work as well as the printing.

Invoices

70. The invoices contained in 23 exhibits include the following characteristics: BorsaWallace provided design services, the design was digitally transmitted to the client, no tangible personal property was included as part of the invoice, and BorsaWallace believes that it incorrectly charged the client sales tax on the services rendered.¹

71. Eleven invoices in the record have the following characteristics: BorsaWallace provided no design services, the design was digitally transmitted to the client, no tangible

¹ This finding refers to the following invoices located in exhibit 1: F-12, F-14, F-15, F-17, F-20, F-22, F-23, F-24, F-31, F-35, F-44, F-58, F-61, F-83, F-84, F-85, F-98, F-99, F-100, F-102, F-122, F-125 and F-128.

personal property was included as part of the invoice, and BorsaWallace either charged the client sales tax only on expenses or did not charge any sales tax.²

72. Forty-two invoices in the record have the following characteristics: all reflect a sale of marketing kits or other promotional materials by BorsaWallace to public relations firm clients that in turn resold, in certain instances, the same kits or materials to their respective end user brand customers and BorsaWallace charged the client sales tax on the printing of the marketing kits or promotional materials, expenses and shipping, but not the design services.³

73. Four invoices in the record reflect sales of promotional materials to end users, rather than for resale to public relations firm clients, on which BorsaWallace charged sales tax for such promotional materials but not the services.⁴

74. Forty-five invoices in the record have the following characteristics: all reflect the right to reproduce copies of marketing kits or other promotional materials designed by BorsaWallace to a public relations firm client, the invoices include a notation "Reproduction rights granted," and, BorsaWallace charged the client sales tax on the printing of the marketing kits or promotional materials, expenses and shipping, but not the design services.⁵

² This finding refers to the following invoices located in exhibit 1: F-6, F-21, F-29, F-34, F-36, F-60, F-64, F-87, F-95, F-97 and F-101.

³ This finding of fact refers to the following invoices located in exhibit 1: F-2; F-3, F-4, F-5, F-8, F-9, F-13, F-19, F-25, F-30, F-32, F-38, F-39, F-41, F-42, F-47, F-49, F-50, F-51, F-52, F-53, F-56, F-59, F-62, F-65, F-72, F-73, F-76, F-80, F-86, F-88, F-89, F-92, F-94, F-109, F-110, F-111, F-112, F-114, F-117, F-123 and F-129.

⁴ This finding of fact refers to the following invoices located in exhibit 1: F-26, F-28, F-69, F-115.

⁵ This finding of fact refers to the following invoices located in exhibit 1: F-2, F-3, F-4, F-5, F-8, F-9, F-13, F-19, F-25, F-26, F-28, F-30, F-32, F-38, F-39, F-41, F-42, F-47, F-49, F-50, F-51, F-52, F-53, F-56, F-59, F-62, F-65, F-69, F-72, F-73, F-76, F-80, F-86, F-87, F-88, F-92, F-94, F-109, F-110, F-111, F-112, F-114, F-115, F-123 and F-129.

75. Petitioners submitted proposed findings of fact pursuant to section 3000.15(d)(6) of the Rules of Practice and Procedure of the Tax Appeals Tribunal. The proposed findings were substantially accepted with the following exceptions:

- a. All or portions of proposed finding of fact 2, 3, 4, 5, 14 and 15 were omitted as irrelevant to the determination.
- b. Proposed findings of fact 17, 18 and 19 were replaced by the corresponding facts which were stipulated to by the parties.
- c. Proposed finding of fact 22 was in the nature of a legal conclusion and included in the summary of the parties' positions.
- d. Proposed findings of fact 20, 21, 25, 29, 31, 43, 50, 60, 73 and 90 were modified to reflect the record.
- e. The substance of proposed findings of fact 61 and 62 were accepted and incorporated into other findings of fact.
- f. Additional findings of fact were made.

SUMMARY OF THE PARTIES' POSITIONS

76. The parties agree that the kits resulting from BorsaWallace's services are tangible personal property.

77. \$76,157.28 of the amount assessed against BorsaWallace has been paid by one of BorsaWallace's clients. The parties agree that BorsaWallace is entitled to a credit because the tax paid by such client was based upon the client's purchases from BorsaWallace.

78. The remaining arguments are set forth in the conclusions of law.

CONCLUSIONS OF LAW

A. In general, Tax Law § 1105(a) imposes sales tax upon the receipts from the sale of tangible personal property. Section 1105(c)(1) of the Tax Law further imposes tax upon the

receipts arising from “[t]he furnishing of information by printed, mimeographed or multigraphed matter or by duplicating written or printed matter in any other manner” However, this section excludes the imposition of tax upon the receipts from the services provided by “advertising or other agents, or other persons acting in a representative capacity.”

B. In their brief, petitioners submit that BorsaWallace provided advertising services that are exempt from the imposition of sales tax. In response, the Division argues that petitioners have not met their burden of proof of establishing that its sales were excluded from tax as sales of advertising services. The Division submits that BorsaWallace was a graphic design firm and not an advertising agency. In this regard, the Division notes that BorsaWallace holds itself out to the public as a graphic design firm and makes sales to public relations firms.

C. The record supports petitioners’ position. As explained by petitioners in their brief, the Tax Law and regulations look to the nature of the services performed and not the way the taxpayer or the taxpayer’s client or customer characterized the service rendered. Thus, Tax Law § 1105(c)(1) provides an exclusion for “the services of advertising or other agents, or other persons acting in a representative capacity.” Similarly, the regulations of the commissioner at 20 NYCRR 527.3(b)(5) state that “[a]dvertising services consist of the consultation and development of advertising campaigns” As commonly understood, the term “advertising” includes the service of design. Webster’s Third International Dictionary of The English Language Unabridged defines “advertising” as “the action of calling something (as a commodity for sale, a service offered or desired) to the attention of the public especially by means of printed or broadcast paid announcements.” Clearly, petitioners’ intention in designing the kits was to call a particular product to the attention of the public. There is no requirement that it be

accomplished by a firm that calls itself an advertising firm or that its goals are accomplished through paid media as opposed to “influencers.”

In this instance, BorsaWallace presented a series of examples of the services it performed in order to promote the products of the customers of DeVries or other public relations firms to the general public. At the hearing, it was explained that DeVries, which was BorsaWallace’s primary client, retained BorsaWallace because DeVries was unable to provide the required creative services for promotion of a product. On the basis of this evidence, it is concluded that BorsaWallace’s activities constituted advertising services within the meaning of Tax Law § 1105(c)(1) and 20 NYCRR 527.3(b)(5). Nevertheless, for the reason set forth in Conclusion of Law D, tax remains due on these disputed transactions.

D. A seller is required to remit all sales tax collected, including those amounts in excess of the correct amount (Tax Law § 1137[b][iii]). Tax Law § 1139(a) permits a seller to obtain a refund of any tax that is “erroneously, illegally or unconstitutionally collected or paid. However, in order to obtain a refund of the tax which was erroneously collected, the vendor must prove that it repaid the tax to the customer (Tax Law § 1139[a]; 20 NYCRR 534.2[c]). Here, petitioners did not refund the tax to their customers. Accordingly, the Division correctly concluded that tax was due (*see Matter of McCluskey’s Steak House v. State Tax Commn.*, 80 AD2d 713 [3d Dept 1981]).

E. Petitioners next argue that to the extent that BorsaWallace provided services that led to the sale of tangible property, the property was sold to BorsaWallace’s public relations firm clients for resale to their end-user customers. According to petitioners, BorsaWallace did not collect resale certificates from its public relations firm clients because it was misadvised by an

employee of the Division that it was required to collect sales tax on the tangible personal property portion of the sale but not on the exempt service portion.⁶

The Division controverts the forgoing position and asserts that petitioners failed to present any evidence that their clients resold the tangible personal property. It is noted that petitioners did not present any of their clients' invoices indicating that they collected sales tax from retail sales to their clients. The Division submits that BorsaWallace's clients used the design to present their recommendations to their brand clients and not for resale. Lastly, the Division notes that DeVries Public Relations, BorsaWallace's largest client, paid sales taxes on its purchases from BorsaWallace during an audit performed by the Division for an overlapping audit period. The Division contends that the payment of the sales tax shows that DeVries purchases from BorsaWallace were not made for resale.

In response to the Division's arguments, petitioners maintain that they presented overwhelming evidence that the marketing kits and other promotional materials were sold for resale. Petitioners also state that the Division is mistaken that the fact that DeVries settled its own tax issues is evidence of BorsaWallace's tax liability. No evidence has been offered as to DeVries' motivations or reasons for settling. Moreover, DeVries made no admission that the transactions with BorsaWallace were not sales for resale.

F. As set forth above, Tax Law § 1105(a) imposes a sales tax on the receipts from "every retail sale" of tangible personal property. Tax Law § 1101(b)(4) defines a retail sale as a sale for any purpose "other than . . . for resale as such." The Tax Law proceeds to create a presumption that all receipts are subject to tax "until the contrary is established" and places the burden of establishing the contrary "upon the person required to collect tax or the customer" (Tax Law §

⁶ BorsaWallace is not relying upon the substance of the conversation with the Division as an excuse for the manner in which sales taxes were collected. Rather, it is offered to show BorsaWallace's state of mind.

1132[c].

G. The presumption of taxability created by Tax Law § 1132[c] is rebuttable (*see Matter of RAC Corp. v. Gallman*, 39 AD2d 57 [1972]). The regulations of the Commissioner provide that the failure to receive a timely exemption certificate does not alter the tax status of the transaction (20 NYCRR 532.4[6]). Rather, when there has been a timely protest of a notice of determination, the vendor retains the right to establish that the transaction is nontaxable (20 NYCRR 532.4[6]). However, the vendor will be unable to rely solely upon the exemption certificate to establish that it was unnecessary to collect tax (*id*). Thus, the specific question in this case is whether petitioners have provided sufficient evidence that the sales to the public relations firms were sales for resale and therefore not subject to tax (*Matter of Intercontinental Audio & Video, Inc.*, Tax Appeals Tribunal, January 4, 1996).

H. The term sale includes “any transaction in which there is a transfer of title or possession, or both, of tangible personal property.” (20 NYCRR 526.7[a][1] [emphasis supplied]). In their brief, petitioners argue that the nature of the transactions with the design firm make it evident that the sales were for resale. That is, it is petitioners’ contention that the public relations firms had no other purpose for the kits other than for resale.

There are two leading court cases in New York wherein similar circumstances were presented, *Matter of Savemart v. State Tax Comm.* (105 AD2d 1001, 482 NYS2d 150 [1984], *lv denied* 65 NY2d 604, 493 NYS2d 1025 [1985]) and *Matter of RAC Corp. v. Gallman*. In *RAC*, the seller failed to obtain an official resale certificate. However, the seller did receive a statement from the purchaser that the items purchased would be held as an investment and then sold when the market price would make a sale advantageous. There was also evidence in the record that the goods were, in fact, resold. Under these circumstances, the Court concluded that a taxable event

had not occurred.⁷ In *Savemart*, the taxpayer argued that the sale of approximately 9,600 television sets was sufficient to rebut the statutory presumption that the sale was taxable because of the inference that a purchaser of such large quantities of televisions must have intended to resell the product. The Court rejected this argument on the basis that the inference was insufficient to rebut the statutory presumption in Tax Law § 1132[c] that all receipts for property are subject to tax unless the contrary is established. The Court further noted that the taxpayers did not receive a resale certificate or any other relevant documentation or “testimony or evidence to indicate what [the purchaser] intended to do or did do with the televisions” (*Savemart* at 482 NYS2d 152).

I. In this matter, petitioners offered the testimony of Ms. Laura Bremer who was employed by DeVries during most of the audit period. At the time she left DeVries, her title was senior vice president. Ms. Bremer explained that BorsaWallace was paid by DeVries. Although there would occasionally be client input from the brand, the design was usually approved by an account team at DeVries. DeVries communicated the approval to BorsaWallace.

When DeVries received an invoice from BorsaWallace, an employee of DeVries placed a code on the invoice that indicated the business that DeVries was working on such as Tide or Crest. The invoice was then sent to the finance team for the preparation of monthly bills, which included agency fees and the out-of-pocket expenses. The fees paid were for the services performed by DeVries, the out-of-pocket expenses paid for the services of BorsaWallace and anything that BorsaWallace produced. Thus, the cost of printing the kits and the cost of the work performed by BorsaWallace was charged to the public relations firms’ clients.

⁷ It is noted that the *RAC Corp.* case predated the enactment of the statutory requirement that the vendor obtain an official exemption certificate (Laws of 1969, ch 473).

J. The testimony of Ms. Bremer was credible and satisfies the evidentiary requirement described by the Court in *Savemart*. Accordingly, it is concluded that the sales listed in footnote 8 were sales for resale and exempt from tax.⁸ The sales made to the remaining firms were not included in footnote 8 because there is no evidence regarding their practices (*Matter of Savemart*).

K. Petitioners next argue that they satisfy the requirements for the exemption for promotional materials in Tax Law §1115(n)(4). This section provides as follows:

Notwithstanding any contrary provisions of paragraph one of this subdivision, promotional materials which are printed materials and promotional materials upon which services described in paragraph two of subdivision (c) of section eleven hundred five have been directly performed shall be exempt from tax under this article where the purchaser of such promotional materials mails or ships such promotional materials, or causes such promotional materials to be *mailed or shipped, to its customers or prospective customers, without charge to such customers or prospective customers*, by means of a common carrier, United States postal service or like delivery service. (Emphasis supplied.)

L. On its face, petitioners' reliance upon this section is misplaced. This section applies when the materials are shipped to a customer or prospective customer without charge. In this instance, BorsaWallace, either directly or indirectly by instructing the printer, shipped the promotional materials to the media or the influencers and charged DeVries. However, the media or the influencers were not BorsaWallace's customers. Rather, BorsaWallace's customers were the public relations firms that paid for the items.

M. The last issue presented is whether the evidence shows that BorsaWallace's sales were excluded from tax as assignments of reproduction rights under Tax Law § 1105(a) and 20 NYCRR 526.7. In general, the right to reproduce an original work of art is not considered a

⁸ Petitioners have identified the following invoices which satisfy this requirement: exhibit 1, F-2, F-3, F-4, F-5, F-8, F-9, F-13, F-19, F-25, F-30, F-32, F-38, F-39, F-41, F-42, F-47, F-49, F-50, F-51, F-52, F-53, F-56, F-59, F-62, F-65, F-72, F-73, F-76, F-80, F-86, F-88, F-89, F-92, F-94, F-109, F-110, F-111, F-112, F-114, F-117, F-123 and F-129.

taxable transaction as a licence to use or a sale when the payment for such a right is in the nature of a royalty to the grantor (20 NYCRR 526.7[f][1]). Possession for a temporary period of time in order to make a reproduction is not deemed a transfer which converts a right to reproduce into a license to use (20 NYCRR 526.7[f][2]). In support of its position that a portion of the transactions are taxable, the Division relies upon two cases. In *Matter of McCall Publishing* (State Tax Commission, May 1, 1981), McCall, in the course of its business as a publisher of magazines, obtained reproduction rights to fine artwork pursuant to a contract or order with the respective artist. The contracts included a price for the purchase of reproduction rights and the type of reproduction rights being granted by the artists. The artwork was delivered into the temporary possession of McCall in order to make separations and engraved metal plates for reproductions. In the process, McCall did not “retouch, correct, change, alter, exhibit or destroy the artwork.” (*Matter of McCall*) McCall conducted itself in a manner that recognized that the title to the artwork remained with the artists. When the artists sought a return of the artwork, it was returned to the artists. There were instances when the artists submitted invoices for payment stating that the artwork was for reproduction only or that the artwork was to be returned after reproduction. In other instances, there was no indication on the invoice of ownership. The former State Tax Commission concluded that sales and use taxes were not due since the transactions involved only the granting of a right to reproduce.

In *Matter of Zagoren Group Inc.* (Tax Appeals Tribunal, May 19, 1994) the taxpayer operated a design and consulting production group that worked to create an image for a company. Following an audit, the company’s sales were divided into three categories: the sale of tangible personal property, the sale of an advertisement placed in a publication for sale and the sale of an advertisement placed in a publication not for sale. The Division concluded that only the first category was subject to tax on the basis that the taxpayer was selling tangible personal property

consisting of items such as brochures that were delivered to the petitioner's clients. At the hearing, the taxpayer claimed that it always retained the right to all of the artwork and that the design or layouts remained the property of the corporation. The taxpayer further submitted that the design elements were separate from the sale of the tangible personal property. On appeal, the Tax Appeals Tribunal affirmed the determination of the Administrative Law Judge, which concluded that "[t]he receipts from the sale of the tangible personal property cannot be broken down into the taxable and nontaxable services involved in the production of the tangible personal property" (*Matter of Zagoren*). The Tribunal explained that the essence of the matter was the production of tangible personal property which was transferred to the client.

In essence, the Division submits that the transactions at issue herein are analogous to those presented in *Matter of Zagoren* and that petitioners cannot break down their receipts from the sale of tangible personal property into taxable and nontaxable services involved in the production of tangible personal property.

N. In response to the Division's position, petitioners submit that BorsaWallace often assigned only a right to reproduction rather than transferring tangible personal property. Petitioners submit that the reproduction rights were noted on the invoices, that the clients did not have the right to alter the design but could only request copies of the marketing kits or promotional materials, and that BorsaWallace charged its clients a markup on the printing costs for each marketing kit or other accessory consistent with a royalty payment. Petitioners raise a number of arguments as to why they believe that many of the designs that BorsaWallace created were assignments of a limited right to reproduce an agreed upon number of designs. The factors that allegedly show that reproduction rights only were granted are: (1) the invoices indicate that the transfer is a transfer of reproduction rights only through the notation "*Reproduction rights granted"; (2) BorsaWallace determined the amount that its clients would be charged on the basis

of the number of reproductions of the marketing kits granted to be printed or produced; (3) BorsaWallace's clients were not required to alter the designs and were required to ask for permission and pay royalties in order to make additional reproductions; and (4) BorsaWallace maintained ownership of the designs it produced.

O. As alluded to in the *McCall* decision, there are different types of reproduction rights. In my opinion, the type of reproduction right presented here is not the type that is excluded from tax by 20 NYCRR 526.7(f)(1) and (2). The forgoing regulation contemplates a situation where, in the course of taking temporary possession of an item in order to make a reproduction, there is a payment in the nature of a royalty. No permanent possessory interest is transferred. It is noteworthy that this was the pattern presented in the two cases cited in the regulation, i.e., *Howitt v. Street and Smith Publications* (276 NY 345) and *Matter of Frissell v. McGoldrick* (300 NY 370). As pointed out by the Division, a very different set of facts is presented here.

BorsaWallace's clients did not request a right to reproduce, and there is no evidence that BorsaWallace and its clients exchanged anything of value for this right. Although petitioners submit that the payments they received were in the form of a royalty, the evidence shows that the fee was at least in part for the time it took to create the design. The most significant factor, however, is that there was a permanent exchange of the kits or other tangible personal property. Upon receipt of the kits, the clients used the tangible personal property in any manner they wished. The permanent transfer of the tangible personal property makes this matter analogous to *Matter of Zagoren* and the transactions at issue taxable.

P. The petitions of BorsaWallace, Inc., Frank Borsa and Jeffrey M. Wallace are granted to the extent of Conclusion of Law J and the Division is directed to adjust the notices of

determination accordingly; except as so granted, the petitions are denied and the notices of determination, dated April 5, 2010, are sustained together with such interest as is lawfully due.

DATED: Albany, New York
January 9, 2014

/s/ Arthur S. Bray
ADMINISTRATIVE LAW JUDGE