

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :
of :
DISCOVERY TOYS, INC. : DETERMINATION
DTA NO.
820441
for Revision of a Determination or for Refund of Sales :
Use Taxes under Articles 28 and 29 of the Tax Law for :
the Period March 1, 2001 through November 30, 2003. :

Petitioner, Discovery Toys, Inc., 6400 Brisa Street, Livermore, California 94550, 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 March 1, 2001 through November 30, 2003.

On November 9, 2005 and November 16, 2005, respectively, petitioner by its representative, Robert A. Putzier, Enrolled Agent, and the Division of Taxation by Mark F. Volk, Esq. (Jennifer A. Murphy, Esq., of counsel), waived a hearing and agreed to submit the matter for determination based on documents and briefs to be submitted by March 24, 2006, which commenced the six-month period for the issuance of this determination. After review of the evidence and arguments presented, Arthur S. Bray, Administrative Law Judge, renders the following determination.

ISSUES

I. Whether petitioner erroneously failed to include the value of the noncash consideration in determining the amount of sales tax due on its sales of tangible personal property pursuant to its "Hostess Rewards Program."

II. Whether the penalty imposed against petitioner should be waived.

FINDINGS OF FACT

1. Petitioner is a distributor of educational toys, books and software for children. It is headquartered in Livermore, California.

2. Petitioner makes sales using a direct sales approach through in-home demonstrations conducted by “educational consultants” (“ECs”). The ECs operate as independent contractors and not employees of petitioner. The ECs earn a commission on the basis of the total amount of sales that they generate.

3. The in-home demonstrations are organized by a host or hostess and are known as “parties.” The host or hostess is responsible for organizing the party, generating sales and collecting payments for all of the orders. When the host or hostess has collected the payments, they are given to the EC who forwards the payments to petitioner.

4. In accordance with its “Hostess Rewards Program,” petitioner rewards a host or hostess for services in three ways. If a guest at the party books a party of his or her own, the host or hostess will receive a 50 percent discount on any item. Second, for every new party booked by a guest, the host or hostess will receive a \$15.00 gift certificate that can be used at future parties with total sales of more than \$100.00. Third, the host or hostess will receive free products based on the total amount of sales generated at the party.

5. Petitioner’s sales tax returns are prepared by a third party that is located in Los Angeles. When the returns are prepared, each taxable sale is multiplied by the tax rate and the results are summarized by jurisdiction.

6. Petitioner's operations were reviewed during a previous audit which examined the period June 1, 1997 through May 31, 2000. The prior audit resulted in an assessment of tax in the amount of \$51,118.01.

7. The current audit covers the period March 1, 2001 through November 30, 2003. The gap between the prior audit's ending date and the beginning date of this audit was the result of the reassignment of this case from the district office that covers the Los Angeles area to the Rochester district office.

8. The Division mailed a letter, dated October 22, 2003, which scheduled a field audit of petitioner's sales tax records for the period March 1, 2001 through November 30, 2003. Among other things the letter explained that "[a]ll books and records pertaining to the sales and use tax liability, for the audit period, must be available on the appointment date." The Division attached a Records Requested List to this letter which set forth a detailed list of all of the records required to be available for the audit on the appointment date.

9. As was the case in the prior audit, if a guest at a party booked a demonstration of his or her own with the EC, the host or hostess could purchase any one item in the catalogue for one-half of the regular selling price. The Division found that petitioner collected sales tax on the invoice amount of the goods, that is, the cash received. However, the Division took the position that the amount of sales tax collected was inadequate because petitioner should have been collecting sales tax on the noncash consideration provided by the host or hostesses in exchange for the merchandise under petitioner's "Hostess Rewards Program." The Division reasoned that petitioner was offering goods to its hosts and hostesses in exchange for cash and the service of recruiting guests to schedule sales promotional parties of their own. The same issue arose during

the prior audit and resulted in a portion of the previous assessment. The remaining areas that resulted in tax being assessed on the prior audit were corrected.

10. On the present audit, the Division found that petitioner's records listed sales by tax jurisdiction. The goods sold were enumerated chronologically by the date of the invoice within the jurisdiction. Petitioner collected sales tax on the invoice amount of the goods. Utilizing petitioner's records, the invoice amount of the goods that were sold, that is, \$181,387.91, was doubled to calculate the audited taxable sales. The Division concluded that it was appropriate to double the invoice amount since petitioner's catalogue stated that the product could be purchased for one-half of the cash that was normally charged when a guest booked a party. Following this reasoning, additional taxable sales were deemed to be \$181,387.91. On the basis of the foregoing, the Division issued a Notice of Determination, dated May 24, 2004, which assessed tax in the amount of \$14,512.92 plus interest in the amount of \$3,632.09 and penalty in the amount of \$3,747.10 for a balance due of \$21,892.11.

SUMMARY OF THE PARTIES' POSITIONS

11. Petitioner argues that the 50 percent discount offered to those who host Discovery Toys product sales parties qualifies as a discount within the meaning of 20 NYCRR 526.5. The discount is used at the discretion of the host or hostess. Petitioner submits that true consideration is not discretionary. According to petitioner, true consideration is the result of an agreement and a certain result for the performance of services. Petitioner further argues that the value of the discount is not defined or certain. Petitioner posits that true consideration needs a certain value because a reasonable person would not agree to provide services without a definite amount of compensation. Lastly, petitioner maintains that neither it nor the host or hostess perceives the discount as consideration or compensation. Petitioner does not account for the discount as a

selling expense and the host or hostess does not purchase the most expensive product available. According to petitioner, if the discount were perceived as compensation, the result would be that hosts and hostesses would always purchase the most expensive items to receive the most consideration. Petitioner submits that it views the discount as a way to gain additional sales and stimulate interest in its products.

12. The Division maintains that petitioner did not reduce the price of the goods it sold to the host or hostess. It merely accepted consideration by the provision of services and the value of these services must be included as part of the sale price. The Division also argues that there is no basis to remit penalties.

CONCLUSIONS OF LAW

A. Tax Law § 1105(a) imposes sales tax on, among other things, the receipts of every retail sale of tangible personal property. The terms “[s]ale, selling or purchase” are defined by Tax Law § 1101(b)(5) as:

[a]ny transfer of title or possession or both, exchange or barter, rental, lease or license to use or consume . . . 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. . . .

B. 20 NYCRR 526.7(d) provides the following definition of barter: “[t]he transfer of tangible property or services to a person in consideration for tangible personal property or services received is a ‘sale’ under the Tax Law.” Tax Law § 1101(b)(3) defines “receipt” as:

[t]he amount of the sale price of any property and the charge for any service taxable under this article, . . . valued in money, whether received in money or otherwise, including any amount for which credit

is allowed by the vendor to the purchaser, without any deduction for expenses or early payment discounts and also including any charges by the vendor to the purchaser for shipping or delivery . . . regardless of whether such charges are separately stated in the written contract, if any, or on the bill rendered to such purchaser and regardless of whether such shipping or delivery is provided by such vendor or a third party, but excluding any credit for tangible personal property accepted in part payment and intended for resale. For special rules governing computation of receipts, see section eleven hundred eleven.

C. The regulations of the Commissioner at 20 NYCRR 526.5(d)(2) provide that “[d]iscounts which represent a reduction in price, such as a trade discount, volume discount or cash and carry discount are deductible in computing receipts.” As set forth above, petitioner relies upon this regulation to establish that it collected the correct amount of tax.

Petitioner’s reliance upon 20 NYCRR 526.5(d)(2) is misplaced. Here, rather than receiving a true discount, the host or hostess paid for the item partially by cash and partially by providing the service of hosting a party. Thus, the transaction between petitioner and the host included an element of barter within the definition of a sale, and the Division properly included the value of the barter in determining the amount of the sale (Tax Law § 1101[b][5]; *see, Matter of House of Lloyd, Inc.*, Tax Appeals Tribunal, November 13, 1998).

D. Petitioner also argues that the amount of the discount should not be regarded as consideration because the amount of the consideration is indefinite. Petitioner is correct that a legally enforceable contract requires reasonable certainty in its material terms (*see, Cobble Hill v. Henry & Warren*, 74 NY2d 475, 482, 548 NYS2d 920, *rearg denied* 75 NYS2d 863, 552 NY2d 925, *cert denied* 498 US 816, 112 L Ed 2d 33). However, it is unnecessary to resolve whether the terms of the agreement between petitioner and the host or hostess constitutes a legally enforceable contract because that is not the issue presented. The issue presented is governed by the sales tax law and not contract law. As set forth above, a sale is defined as a

transfer of title or possession or both (Tax Law § 1101[b][5]). Unquestionably, that occurred inasmuch as the hosts or hostesses were acquiring items from petitioner. The only issue is the amount of the receipt. As stated directly above, since the discount was conditioned upon the host or hostess providing a service, it is clear that the provision of a service was an essential element of the transaction and the value of that service was part of the receipt (*see*, 20 NYCRR 526.5[a]).

E. Since petitioner underwent a prior audit where an adjustment was made on the same point as was in issue in this matter, it has not established that the failure to pay was due to reasonable cause and the absence of willful neglect (*see*, 20 NYCRR 536.1[c][example 3]; *Matter of S.H.B. Supermarkets, Inc. v. Chu*, 135 AD2d 1048, 522 NYS2d 985).

F. The petition of Discovery Toys, Inc. is denied, and the Notice of Determination issued May 24, 2004 is sustained.

DATED: Troy, New York
September 14, 2006

/s/ Arthur S. Bray
ADMINISTRATIVE LAW JUDGE