

New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB-A-92 (1) C
Corporation Tax
January 31, 1992

STATE OF NEW YORK

COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. C911023A

On October 23, 1991, a Petition for Advisory Opinion was received from KPMG Peat Marwick, 3100 Two Union Square/601 Union Street, Seattle, Washington 98101.

The issue raised by Petitioner, KPMG Peat Marwick, is whether, for purposes of computing the business allocation percentage under Article 9-A of the Tax Law, the payments made by a taxpayer to sales corporations are treated as payments to independent contractors and excluded from both the numerator and denominator of the payroll factor.

The taxpayer is a corporation which designs and distributes wearing apparel. The taxpayer is not incorporated in New York, but for a number of years the taxpayer has had nexus with New York and has filed Article 9-A franchise tax reports.

The taxpayer markets its products to customers in New York using three independent corporate sales representatives (sales corporations) which employ individuals (salespersons) who live and work in New York as well as surrounding states.

Each sales corporation has qualified to do business in New York. Each salesperson and each employee of the sales corporations is paid by his/her sales corporation according to the salary agreement made between such salesperson/employee and the respective sales corporation.

The taxpayer paid for a certain percentage of tenant improvements made to two-sales offices maintained by the independent sales corporations in New York City. These improvements constituted showroom space maintained by the sales corporations but used from time to time by the taxpayer for apparel shows in New York. Based upon these tenant improvement payments, the taxpayer has been filing and paying all appropriate New York State and New York City taxes.

The taxpayer and each of the sales corporations enter into a "Regional Sales Representation Agreement" for the services of the sales corporation. According to the agreement, the sales corporation may negotiate returns and allowances, markdowns, and retail advertising subject to taxpayer approval, but the sales corporation may not accept or modify orders for goods and must forward such orders to the taxpayer. Each agreement is for a definite duration, usually for a period one year. The agreement may be extended only by mutual agreement of both parties. Either party may terminate their agreement for any reason by providing the other party with written notice.

The agreements specifically disclose that the sales corporation will have the status of independent contractor with respect to the taxpayer, and that the sales corporation will be responsible for payment of employment taxes, liability insurance, required licenses, and other items necessary to discharge the duties under the agreement.

The agreements provide that the taxpayer has no right of control over the manner or method in which the sales corporation fulfills its responsibilities under the agreement and that the sales corporation is free to perform its services for the taxpayer in any manner it chooses so long as it holds itself out consistent with the quality of the taxpayer's image. The taxpayer has no control over the hiring or firing of the sales corporation's agents or employees. The salespersons, as employees of the sales corporations, discharge the service obligations under the agreements.

A salaried executive employee of the taxpayer who is a less than five percent shareholder is moving to New York to provide better service to east coast customers and to be in closer contact with the taxpayer's east coast market. The salaried executive will hire an assistant and will share office space with the sales corporations. Rent on the office space will be paid proportionally; the taxpayer will pay the rent on the portion used by the executive and the assistant, while the sales corporations will pay rent for their portion of the office space used.

Section 4-5.2 of the Business Corporation Franchise Tax Regulations provides the definition of employee:

(a) Employees whose wages, salaries and personal service compensation are included in the computation of the payroll factor of the business allocation percentage include every individual, except a general executive officer, where the relationship existing between the taxpayer and the individual is that of employer and employee.

(b) Generally, the relationship of employer and employee exists when the taxpayer has the right to control and direct the individual not only as to the result to be accomplished by him but also as to the means by which such result is to be accomplished. If the relationship of employer and employee exists, the designation or description of the relationship, and the measure, method or designation of the compensation are immaterial

This provision of the Business Corporation Franchise Tax Regulations merely restates the common law rule for determining whether one individual is an employee (or "servant") of another. Although there does not appear to be any judicial authority for the proper application of this rule within the context of Article 9-A of the Tax Law, there is authority developed with respect to such rule under former Article 23 of the Tax Law-Unincorporated Business Income Tax, and is applicable herein. A leading case in this area is Matter of Liberman v Gallman, 41 NY 2d 774, which upheld a State Tax Commission decision holding a particular salesman not to be an employee. The court

there stated that it "is the degree of control and direction exercised by the employer that determines whether the taxpayer is an employee." Id., at 778. Further, speaking with specific regard to the issue of salesmen as employees, the court said that "In the absence of supervision and control of the sales routine, salesmen do not become employees." Id., at 779. The court found such control and direction lacking with regard to the manner in which Liberman's customers were approached and persuaded to make purchases, although Liberman did take direction in a number of other significant areas. For example, Liberman was directed to visit particular areas or customers; was required to report frequently on his sales activities; was occasionally required to concentrate on specific duties, to attend to specific accounts, to emphasize the sale of certain shoe styles and to attend sales meetings and conventions; and was prohibited from taking time off without permission. Nonetheless, the court held that the lack of control over Liberman's sales routine, coupled with the fact that Liberman was responsible for office and clerical expenses and that there was no withholding of income tax from his commissions, was sufficient to support the State Tax Commission's finding to the effect that Liberman was not an employee. In accord is Raynor v Tully, 60 AD 2d 731, which upheld a similar State Tax Commission decision, in large part based upon a determination to the effect that the purported employer "did not exercise any real supervision over the Petitioner's sales methods and was more interested in the results obtained than the means used." Id., at 732.

In El Greco Leather Products Co., Inc., Adv Op St Tax Comm, June 1, 1983, TSB-A-83(2)C, it was held that the salesmen at issue were not employees of the petitioner for purposes of the payroll factor. Therein, the petitioner did not demonstrate the type of control and direction over its salesmen's sales activities which would warrant a finding that the salesmen constitute its employees. The petitioner did state that it "has the right to direct the activities of its salesmen." However, the instances of the exercise of such right adduced by Petitioner did not relate to the area of sales routines and the like, but to matters of the same type as those mentioned in Liberman, supra. The petitioner presented neither contractual provisions indicating the requisite right of control, nor demonstrated a course of conduct which would give rise to an inference of the existence of such right.

Herein, based on the facts as presented, the employees of the sales corporations are not employees of the taxpayer within the definition of an employee contained in Section 4-5.2 of the Business Corporation Franchise Tax Regulations and thus the taxpayer would exclude the payments to the sales corporations from the computation of both the numerator and denominator of the payroll factor when computing its business allocation percentage.

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It should be noted that the determination of who is an employee for purposes of section 4-5.2 of the Business Corporation Franchise Tax Regulations is a factual matter and, as in E1 Greco Leather Products, supra., the actual relationship between the taxpayer and each sales corporation should be analyzed regardless of language of contractual agreements.

DATED: January 31, 1992

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NOTE: The opinions expressed in Advisory Opinions are limited to the facts set forth therein.