

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

TSB-H-81(19)C
Corporation Tax
March 24, 1981

STATE OF NEW YORK
STATE TAX COMMISSION

ADVISORY OPINION

PETITION NO. C801006B

On October 6, 1980, a Petition for Advisory Opinion was received from Buddy L Corporation, 200 Fifth Avenue, New York, New York 10010.

The issue raised is the nature and proper method of allocation of certain receipts received by Petitioner, under the circumstances described below, for purposes of the Franchise Tax on Business Corporations imposed under Article 9-A of the Tax Law.

Petitioner is in the business of manufacturing and selling toys. It designs its own toys and has the appropriate molds and dies manufactured for it. Petitioner owns patents and trademarks for its toys, in various countries. The toys are manufactured for Petitioner by contractors in the Far East. Petitioner supplies its molds and dies to the contractors, which are responsible for obtaining raw materials and producing the toys. The toys are manufactured only in accordance with the order of Petitioner, which thus controls the quantity, timing and styles manufactured. Petitioner's usual method of operation is to obtain toys from the contractors for an agreed upon price and then to sell the toys directly to customers. However, in the case of large-scale customers having foreign commerce capabilities the customer is permitted to deal directly with the contractor. In such cases the customer, rather than Petitioner, bears the burden of financing the sale and, indeed, Petitioner asserts that this alternate sales method is dictated by financing considerations. In such instances the price charged by the contractor to the customer is dictated by Petitioner, and the sale is made to the customer only at the direction of Petitioner. Title to the product passes directly from the contractor to the customer. However, where the goods prove to be defective it is Petitioner, and not the contractor, which takes the merchandise back and incurs the loss. The excess of the price paid by the customer to the contractor over the price payable by Petitioner to the contractor for the same product is remitted by the contractor to Petitioner. It is the nature of this income which is at issue herein.

Receipts from the transactions described by Petitioner do not clearly and unmistakably lie within the ambit of any of the categories employed under the Franchise Tax on Business Corporations. These transactions constitute a route, albeit a circuitous one, whereby Petitioner effectuates its business purpose of selling its product. However, Petitioner's receipts cannot properly be denominated receipts from sales inasmuch as it is the contractor and not Petitioner which transfers both title and possession from itself to the customer. The receipts in question bear certain of the characteristics of royalty payments. Thus, the contractor is permitted to use Petitioner's patents and copyrights, in addition to its dies and molds, in order to produce and sell a product. However, the receipts also resemble commissions, in that they constitute payments made by a seller to a party which arranged for the sales of such seller. In effect, then, the receipts in question constitute a hybrid, composed of royalties and commissions. Accordingly, such receipts should be appropriately apportioned between the two and each portion treated, for purposes of allocation, pursuant to such apportionment.

DATED: March 24, 1981

s/LOUIS ETLINGER
Deputy Director
Technical Services Bureau

JAMES H. TULLY., COMMISSIONER

LOUIS M. JACOBSON, DEPUTY COMMISSIONER

FRANK J. PUCCIA, DIRECTOR