STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. C981021B

On October 21, 1998, a Petition for Advisory Opinion was received from Independent Television Network Inc., 747 Third Avenue, New York, New York 10017.

The issue raised by Petitioner, Independent Television Network Inc., is how to allocate its receipts within and without New York State for purposes of the receipts factor of the business allocation percentage under Article 9-A of the Tax Law.

Petitioner submits the following facts as the basis for this Advisory Opinion.

Petitioner, a New York S corporation, was created to offer a new and different way for the country's national advertisers to broadcast their commercial messages on independent television stations that are not affiliated with the wired networks like ABC, CBS and NBC. The broadcasting of the commercial messages on the independently owned television stations not only benefitted the independent stations by offering them a new source of revenue that they never had access to before but also allowed the large, national advertisers an opportunity to tap into hundreds of additional stations that were only available to them through spot advertising.

Petitioner states that television advertising and the broadcasting of television commercials is done at two levels: Local advertising and National advertising. Local advertising is bought by the advertising agencies for their advertiser clients on a market by market basis. This is referred to as "spot television advertising". Spot television advertising is bought without any demographic or audience guarantee. The advertiser's commercial is aired by the television station and the advertiser pays the television station the contracted amount for the broadcast of its commercial. If one million people or ten million people watched the commercial the price is the same. There is no guarantee of delivery to a specified audience number.

National advertising is bought by the agencies for their clients and typically is referred to as national network advertising. National network advertising is always bought by national advertisers with the understanding that the broadcast of their commercials will cover a minimum percentage of the United States, typically 85 percent of the country and guarantee that a predetermined demographic/audience will view their commercials nationally. National advertisers expect to receive 100 percent of the audience guarantee that they contracted for. If the audience that is delivered is less than 100 percent then the network must run additional commercials to make up for the under delivery. There is no additional cost to the advertiser for the additional commercials. The entire cost of running the additional commercials must be born by the network.

A national network consists of a lineup of television stations throughout the United States. Large markets, medium markets and small markets combined are expected to reach 85 percent of the United States television households. Each market and each television station within each market have different audience delivery efficiencies. The cost of buying commercial time on television stations varies from market to market and from station to station within each market. Some markets and television stations are more efficient than others. Every television station has a different cost for a 30 second commercial and every television station has a different percent of audience delivery. The ratio between a television station's cost and its delivery is the efficiency for that television station.

The three major national networks (ABC, CBS and NBC, the "Networks") consist of affiliated stations throughout the United States. Typically a Network will have 250 - 400 affiliated television stations. The Networks use the Nielsen NTI Peoplemeter independent rating service to measure the actual viewing audience for each commercial broadcast. Network commercials are priced to deliver a guaranteed number of viewers at a cost per thousand viewers ("CPM"). If the commercial(s) deliver(s) 100 percent of the guarantee then the Network has earned the CPM. If the commercial delivers less than 100 percent (under delivery) then the Network must air additional commercials (make good) to make up for the under delivery. The additional cost to run these make good commercials is born by the Networks and increases the CPM. The Network profit margins are reduced by the increased CPM.

The ability to estimate the audience delivery by market and price the commercials accordingly is very critical in determining the profitability of the Network. Some markets will deliver 100 percent of what was projected and other markets will under deliver their projected audience. Petitioner states that, therefore, the income that is earned from the lump sum received is earned market by market based upon that market's share of delivering the total audience guarantee.

In addition to the Network affiliated television stations, there are hundreds of independent television stations (the "Independents") in the United States that have no affiliation with one of the Networks. Every market in the United States has both Network affiliated television stations and Independent television stations. Prior to Petitioner, only the three broadcast Networks controlled the viewing options for advertisers of the entire television audience in the United States. Petitioner created a network of the Independent television stations in the United States and offered the advertising community another option for reaching targeted audiences the same as the Networks. Petitioner competes for the same national advertising dollars as the Networks. Petitioner also guarantees a CPM and audience delivery much the same as the Networks. Petitioner uses the same Nielsen NTI Peoplemeter independent rating service to measure the actual viewing audience for each aired commercial on Petitioner.

The following is Petitioner's step by step explanation of how a television network realizes earned income. The process begins with an advertising agency placing an order for a client advertiser. Typically, a national network advertising contract will run for a minimum of one quarter and up to four quarters. For example, an advertising contract runs for two quarters; the part of day is "Adult Early Fringe"; the demographic is adults 18 - 49; and 76 units of 15 second duration are ordered for a total price of $1,353,204. To earn the entire $1,353,204, the contract would have to deliver 100 percent of the guaranteed demographic.

After a contract is completed, a post analysis is computed to determine how the contract performed. It is Petitioner's "report card" back to the advertiser. The actual Nielsen data is compared to the contract guarantee data. In the above example, the contract delivered 87 percent of the guarantee. The contract under delivered its audience. This under delivery has to be "made good" by running additional commercials at no cost to the advertiser in order to recognize the total contracted dollars. The alternative would be to refund, to the advertiser, the unearned dollar amount. equivalent to the undelivered viewers times the contract guaranteed CPM .

Petitioner also states the following:

1. A comparison of Petitioner with the traditional Networks shows that:

- The same advertisers are used.
- An identical method is used for rating the commercials that are aired on their respective national network.
- The commercials are run in the same programs.

2. Rating information is received from Nielsen. This information is entered into Petitioner's data base to generate the ratings for each advertiser contract. This Nielsen report is received for each week for each month for all contracts that were on Petitioner's network each month. This Nielsen data is what generated the "actual" information in the example above.

3. Nielsen also issues the Nielsen Station Index which shows the United States television households by market and the percentage that a market has to the total United States. For example, for September 1996 (estimates as of January 1997), the Nielsen Station Index states that the New York State markets on Petitioner's network represent 9.2 percent of the total United States household estimates. Petitioner's coverage of the United States is typically 80 - 85 percent of the United States television households. Petitioner states that this equates to a New York State percentage of 10.8 - 11.5 percent.

4. Petitioner keeps records showing the dollar amount spent on its network stations each month. The station costs are tracked by contract, by market and by station.

Petitioner states that it earns its income by delivering the guaranteed audience market by market, station by station for each and every market on its network of television stations. Every television station has different efficiencies. The higher priced television stations are generally in the larger markets and accordingly deliver a higher percentage of the overall audience guarantee.

Discussion

Section 208.1-A of the Tax Law provides that the term "New York S corporation" means, with respect to any taxable year, a corporation subject to tax under Article 9-A of the Tax Law for which an election is in effect pursuant to section 660(a) of the Tax Law for the year. The term "New York C corporation" means with respect to any taxable year, a corporation subject to tax under Article 9-A of the Tax Law which is not a New York S corporation.

Section 210.1(g) of the Tax Law provides that a New York S corporation is not subject to the minimum taxable income base or the capital base tax. It is only subject to the tax on the entire net income base at a rate reduced to the differential rate or the fixed dollar minimum tax. The differential rate is the difference between the corporate rate under Article 9-A and the Article 22 equivalent rate.

When computing a taxpayer's entire net income base, section 210.3(a) of the Tax Law provides that the taxpayer's business income is allocated by the business allocation percentage. Section 210.3(a)(2)(B) of the Tax Law and section 4-4.3 of the Franchise Tax on Business Corporations Regulations ("Article 9-A Regulations") provides for the allocation of receipts from compensation for services.

Section 4-4.3(a) and (b) of the Article 9-A Regulations provides as follows:

> (a) The receipts from services performed in New York State are allocable to New York State. All receipts from such services are allocated to New York State, whether the services were performed by employees, agents or subcontractors of the taxpayer, or by any other persons. It is immaterial where such receipts are payable or where they are actually received.
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> (b) Commissions received by a taxpayer are allocated to New York State if the services for which the commissions were paid were performed in New York State. If the services for which the commissions were paid were performed for the

> taxpayer by salesmen attached to or working out of a New York State office of the taxpayer, the services will be deemed to have been performed in New York State....

Section 4-4.3(f)(1) and (2) of the Article 9-A Regulations provides that:

> (1) [w]here a lump sum is received by the taxpayer in payment of services performed within and without New York State, the portion of the sum attributable to services performed within New York State is determined on the basis of the relative values of, or amounts of time spent in performance of, such services within and without New York State, or by some other reasonable method. Full details must be submitted with the taxpayer's report.
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> (2) The broadcasting of radio and television programs and commercial messages by way of radio or television antennae pursuant to a license granted by the Federal Communications Commission is deemed to be a service. When a lump sum is received for such service, that lump sum must be allocated to New York State and another state or states according to the number of listeners or viewers in each state.

In Alan Langer, CPA, Adv Op Comm T & F, May 20, 1992, TSB-A-92(9)C, a taxpayer booked trips and tours. The taxpayer's purchase agents, and administrative personnel were located outside New York State and the "booking agent" or sales agent was located in New York State. The opinion held that the taxpayer's activities through the efforts of the purchasing agents in packaging the tours and arranging pricing with the various vendors; the marketing efforts; the computer operation and the activities of the administrative personnel, all of which were conducted outside New York State, do not generate any income. The generation of income is based on the booking agent's efforts in New York State in selling, to a customer, a trip or tour "packaged" by the purchasing agent. No revenue is generated until a customer buys a ticket or tour package at the booking agent's New York location. It is the booking agent's efforts in making the sale that generates the taxpayer's receipts from services. The opinion concluded that since the booking agents were located in New York State, 100 percent of the receipts from services rendered would be attributable to New York State for purposes of the receipts factor of the business allocation percentage. The efforts of the taxpayer's purchasing agents and its administrative personnel, the marketing efforts and the computer operation all conducted outside of New York State would be reflected in the property and payroll factors.

In this case, Petitioner created a network of independent television stations in the United States that offers the large national advertisers another option for broadcasting their commercial messages on the independent television stations tapping markets that were previously only available to them through spot advertising, and offers the independent stations a new source of revenue that they did not have access to before. Petitioner contracts with an advertiser, or the advertiser's ad agency, that the advertiser's commercial will reach a guaranteed audience market by market, station by station for each and every market on its network of television stations. After Petitioner secures the advertiser's contract, Petitioner purchases air time on the independent television stations to fulfill Petitioner's contract with the advertiser, and gives the stations copies of the commercials to be aired. After the contract is completed, a post analysis is done. Using the Nielsen NTI Peoplemeter independent rating service, the actual Nielsen data is compared to the contract guarantee data. If the contract under delivered its audience, Petitioner must purchase additional air time to make up for the under delivery at no additional cost to the advertiser or the advertiser's ad agency, or an alternative would be for Petitioner to refund, to the advertiser, or the advertiser's ad agency, the unearned dollar amount equivalent to the number of undelivered viewers times the guaranteed CPM.

Petitioner is somewhat similar to the Networks in that it competes for the same national advertising dollars as the Networks, it guarantees a CPM and audience delivery similar to the Networks, and it uses the same Nielsen NTI Peoplemeter independent rating service to measure the actual viewing audience for each aired commercial on its network. However, Petitioner is not the broadcaster of the television programs and commercial messages, the independent television stations are the entities broadcasting the commercial messages at issue. Accordingly, for purposes of computing the receipts factor of the business allocation percentage under Article 9-A of the Tax Law, Petitioner is not a broadcaster of television programs and commercial messages as described in section 4-4.3(f)(2) of the Article 9-A Regulations, and Petitioner may not allocate its advertising contract receipts pursuant to such section.

Petitioner's activities are comparable to the activities in Alan Langer, supra. Petitioner is providing a service for the advertising industry, by contracting with an advertiser, or the advertiser's ad agency, that Petitioner will guarantee that the advertiser's commercial message will be aired on the independent television network and will reach a specified number of viewers at a specified CPM. It is Petitioner's efforts in securing the advertiser's contract that generates Petitioner's receipts subject to allocation. Petitioner's efforts in fulfilling the contract do not generate any income. Petitioner's costs attributable to the delivery of the guaranteed audience that is measured by the Nielsen NTI Peoplemeter independent rating service, including the amount of air time that Petitioner must purchase to deliver the guaranteed audience, affect Petitioner's CPM and profit margin, but are not measurements of Petitioner's activities in earning its receipts by securing the advertising contracts.

Accordingly, Petitioner's receipts from its contracts with an advertiser or the advertiser's ad agency are receipts from services and are allocated within New York State pursuant to section 4-4.3(a) of the Article 9-A Regulations. That is, where Petitioner's activities in securing an advertiser contract are performed in New York State, the receipt attributable to such contract is allocated within New York and is included in the numerator of the receipts factor of the business allocation percentage under Article 9-A of the Tax Law.

If such allocation does not properly reflect the receipts allocable to New York State, Petitioner may request that the Commissioner of Taxation and Finance to permit it to use some other method of allocation. However, such determination is a question of fact not susceptible of determination in an advisory opinion. An Advisory Opinion merely sets forth the applicability of pertinent statutory and regulatory provisions to "a specified set of facts." Tax Law, §171.Twenty-fourth; 20 NYCRR 2376.1(a).

DATED: April 7, 1999

/s/
John W. Bartlett
Deputy Director
Technical Services Bureau

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