

A hearing was held in this matter on August 3, 2004, at which time evidence was submitted and testimony taken. Petitioner was represented by Stuart A. Wilkins, Esq.³ and Respondent, the Commissioner of Finance, was represented by Frances J. Henn, Esq., Assistant Corporation Counsel. The parties submitted written arguments in support of their positions, with the final brief received on February 2, 2005. Petitioner was granted until March 25, 2005 to file a reply brief, but chose not to do so.

ISSUES

I. Whether Petitioner was a utility services provider within the meaning of the UT provisions of the Code.

II. When may Respondent apply a change in audit policy to retroactively include Monthly Charges computed against long-distance telephone calls in UT gross operating income.

STATEMENT OF FACTS

1. Petitioner, ABTS, is a New Jersey corporation located in Berlin, New Jersey. During the Tax Years, Petitioner was engaged in the business of providing telephone systems and services. ABTS Investment Corp. ("Investment Corp.") is a related corporation.

³ On February 16, 1994, pursuant to a Tribunal Power of Attorney, Petitioner appointed Stuart A. Wilkins, Esq., as its representative in this matter. On February 28, 1996, pursuant to another Tribunal Power of Attorney, Petitioner appointed Steve J. Lalor and John Wilson, of Arthur Andersen LLP as its representatives. From time to time other individuals from Arthur Andersen were appointed. During this period, correspondence indicates that Mr. Wilkins was also named by Petitioner as "Special Counsel." Mr. Wilkins presently represents Petitioner pursuant to a Tribunal Power of Attorney dated August 31, 1999.

2. Petitioner did not file City UT returns for the Tax Years.

3. In June 1990, Respondent initiated a field audit of Petitioner's books and records, for a period through April 30, 1990.⁴ Field audit review did not take place until August of 1991. The audit period was subsequently extended to include the period ending November 30, 1991.

4. Following the field audit, on August 7, 1992 Respondent issued a Notice of Determination ("Notice"), asserting a UT deficiency for the Tax Years in the base tax due amount of \$91,439.89, with interest and penalties computed thereon, for a total due of \$155,550.00.

5. Petitioner filed the Petition for Hearing protesting the Notice on August 21, 1992.

6. In 1986, Petitioner and Park Centre Associates ("Park Centre"), a New York limited partnership, entered into a Telephone Service Agreement ("Agreement"), pursuant to which Petitioner agreed to provide a telephone system ("System") and telephone service to the Omni Park Central Hotel located at 7th Avenue and 56th Street in the City ("Hotel").⁵ The parties agreed that Petitioner would be

⁴ The initial appointment letter of June 15, 1990 requested review of returns with respect to UT, General Corporation Tax and Commercial Rent Tax. The subsequent deficiency asserted was for UT only. The auditor testified that the Department first sought to audit the Hotel Omni, the entity engaged in the relevant business relationship with Petitioner. T. 95-6. According to the auditor, the individual initially assigned the case concluded that the hotel was not the appropriate audit subject.

⁵ Dominic Dalia, Petitioner's President, stated in his Declaration submitted in the 1992 Park Centre bankruptcy proceedings, that Investment Corp. was the "owner of the telephone equipment and provider of telephone services" to Hotel. Documents reviewed on audit and at hearing indicate that Investment Corp. prepared the bills to Hotel for certain telephone charges, and that ABTS was the

the sole provider of telephone services to Hotel.⁶

7. The System was comprised of a "private branch exchange" ("PBX") system which recorded the individual guest telephone calls and interfaced with a call accounting system, which in turn interfaced with a central billing system known as the "property management system." Petitioner was responsible for the PBX and call accounting systems, and Hotel was responsible for the property management system.

8. Petitioner agreed to act as the facility manager for the System which included the installation, use, and maintenance of certain telephone equipment that Petitioner leased from an unrelated third party. Petitioner held an option to purchase the telephone equipment from that third party and the right to assign that option to Park Centre.

9. The Agreement provided that Park Centre would pay Petitioner "Monthly Charges," and Petitioner would pay Park Centre a "Concession Fee."

10. The Monthly Charges were amounts in addition to the costs of calls charged by unrelated carriers. Hotel billed these charges to guests for use of the System. These amounts were variously referred to as "billing rates," "service charges" or "surcharges." The Monthly Charges were calculated on a per call basis by Hotel,

"billing agent."

⁶ The Agreement specifically excluded coin operated (pay) telephones and systems which had already been installed by lessees of Hotel .

at a rate not less than the amounts recited in the Agreement.⁷ The parties further agreed that any increases in the Monthly Charges would be at the sole discretion of Hotel.

11. ABTS maintained the records of telephone call charges and bills for each guest room on the System and prepared a daily printout. The records included the Monthly Charges, carrier charges, and the charges for Hotel's administrative use.

12. Hotel acted as ABTS' agent,⁸ billing and collecting the Monthly Charges and other telephone carrier fees from its guests pursuant to the ABTS printouts.

13. ABTS prepared invoices which reflected: (a) guests' telephone charges (Monthly Charges);⁹ (b) administrative charges to Hotel and its employees; (c) advertising costs; (d) collect call amounts; (e) voice call amounts; and (f) phone rental amounts. These amounts were reduced by: (a) the Concession Fee; (b) the amount of any allowance for disputed calls; and (c) System maintenance and repair expenses. ABTS prepared a printout of the Monthly Charges and the monthly invoices, and presented them to Hotel for payment.

14. The Concession Fee was an annual fee of \$475,000, which

⁷ Pursuant to Exhibit D to the Agreement, the rates for Guest Room charges were to be at least \$.90 for each overseas access charge and collect and credit card call, and a \$.90 surcharge on all calls except administrative calls. Guest calls were to be billed at operator-assisted and/or local carrier rates. The hotel was permitted a 25% discount on all administrative calls.

⁸ In his Declaration, *fn. 5, supra*, Mr. Dalia stated that the Monthly charges are "the property of ABTS" and the Hotel is ABTS' "collection agent."

⁹ The monthly invoices characterized this amount variously as "current guest charges," "current guest equipment charges" and/or "current guest usage charges."

Petitioner agreed to pay Hotel for rights granted under the Agreement. The Agreement provided for several payment options, including that the Hotel could deduct this Fee "against the Monthly Charges." It appears from the invoices submitted that this was the manner in which the parties accounted for the Concession Fee.

15. Petitioner agreed to pay all amounts due local and long distance carriers.

16. The parties agreed that Hotel should include the reimbursement of "any and all taxes or other charges . . . based upon such calls . . ." in the Monthly Charges payment.

17. Ameritech Credit Corporation ("Ameritech") held a security interest in certain equipment used in the System.

18. Petitioner maintained a "lockbox" account at The Northern Trust Company established to ensure payment to Ameritech. Hotel deposited the Monthly Charges into the lockbox account and Ameritech deducted the amount due on its promissory note from that account, remitting the balance to ABTS. ABTS paid the following expenses from the balance: (a) debt service on the telephone equipment; (b) local and long distance charges; (c) System maintenance; (d) reimbursable (from Hotel) directory advertising; and (e) other related operation and maintenance costs.

19. Based upon Petitioner's books and records, the auditor added the Monthly Charges, administrative charges, and charges for collect and other calls, initially reduced that amount by any disputed calls, and then subtracted costs, to arrive at "total revenue."

20. ABTS provided the auditor with copies of telephone invoices from unrelated carriers (e.g., New York Telephone/NYNEX, AT&T and MCI Communications). The invoices listed separate charges for local and long distance calls made from the Hotel (including itemized, directory assistance, and network calls) which were accounted for on audit as "total telephone cost." The auditor increased the total telephone cost by 3% in order to give credit for a federal surcharge, arriving at "applicable cost."

21. The auditor subtracted "applicable cost" from "total telephone revenue" to arrive at "taxable revenue." The appropriate UT rate was applied to this revenue to arrive at the deficiency.

POSITION OF THE PARTIES

Petitioner argues that it is not subject to UT as a utility service provider. Rather, Petitioner asserts that Hotel is the taxable entity. Alternatively, Petitioner argues that should it be determined that it is a utility service provider, Petitioner is not liable for UT on surcharges computed against long-distance telephone calls under the decision of the Appellate Division of the New York State Supreme Court in *Matter of Hilton Hotels Corp. v. Commissioner of Finance of the City of New York*, 219 A.D.2d 470 (1st Dept. 1995).

Respondent argues that Petitioner is a utility service provider and, therefore, that receipts from its provision of telephone service are subject to the UT. Respondent further argues that the Appellate Division's decision in *Hilton, supra*, does not apply to receipts from Petitioner's provision of utility services as its policy not to tax surcharges attributable to long-distance calls was not in effect during the Tax Years. Respondent

further argues that should the date of publication of the policy change be the determinative factor under *Hilton, supra*, only those surcharges attributable to long-distance calls made before the date of the

Commissioner's decision in that matter, April 17, 1991, should be eliminated from Petitioner's gross operating income.

CONCLUSIONS OF LAW

Code §11-1102(a) imposes an excise tax on the gross operating income from the provision of utility services by a vendor of such services. For the Tax Years, a taxpayer was a vendor of utility services if it was a corporation "not subject to the supervision of the department of public service who . . . furnishes or sells . . . telephone . . . service." Former Code §11-1101.7.¹⁰

The gross operating income of a telecommunications entity is comprised of receipts from the sale of telephone services, without any deduction for costs or other expenses. Code §11-1101.5. It includes amounts charged in addition to the carrier costs of telephone calls, often referred to as "surcharges," which are collected by the utility service providers (usually hotels). See, e.g., *Hilton, supra*. The Code does not specifically identify telephone surcharge income as utility tax gross operating income. However, since City enabling legislation requires conformity with

¹⁰ Subsection 7 of §11-1101, as amended in 1998, eliminated the language "telephone and/or telegraphy" (with respect to sales) and "telephone or telegraph service" (with respect to furnishing services), and expanded the category "vendor of utility services" to include "telecommunications services". L. 1998, ch. 536, §5. Subsection 9 was added, defining "telecommunications services" to include "telephony" and "telephone . . . service." L. 1998, ch. 536, §6.

the State Utility Tax provisions,¹¹ and the State provisions specifically include surcharge income in gross operating income,¹² such amounts are included in the UT income base.

Petitioner is liable for UT as a vendor of utility services. Pursuant to the Agreement, Petitioner operated and maintained the System, providing telephone service to Hotel's guests and administrative offices. The invoices from ABTS to Hotel support the terms of the Agreement and establish that Petitioner received gross operating income for the provision of such services in the form of Monthly Charges which were computed on each call and were in addition to third party carrier charges. Code §11-1102 requires that Petitioner pay UT on this gross operating income, as, on the facts, Hotel was not the service provider.

The Monthly Charges represented income to Petitioner from the provision of telephone services, whereas the Concession Fee is Hotel's remuneration from Petitioner to allow ABTS to operate the System on Hotel's property. The Monthly Charges were deposited into the lockbox account. After adjustment for payments to Ameritech, Petitioner received the balance of the Monthly Charges. The fact that the Concession Fee was accounted for as an adjustment to the Monthly Charges in no way alters the fact that Petitioner was the entity which received income for providing utility services. Nor does the fact that Hotel collected the surcharge from its guests make Hotel the service provider. Petitioner's President acknowledged that Hotel was simply operating as ABTS' agent to collect the charges for services provided by ABTS.

¹¹ See, General City Law §20-b, and Tax Law §186-a.

¹² See, 20 NYCRR §46.3(d) (former 20 NYCRR §502.3) which includes in Tax Law Article 9 gross operating income "the excess above the charge of the telephone company."

There is a presumption in the statute that the provision of UT services is wholly local, notwithstanding the telephone call itself is extra-City. See, Code §11-1102(c). Therefore, a surcharge imposed by a City service provider on a long distance telephone call is a local receipt. Nevertheless, Respondent did not always impose the UT against surcharge income attributable to long distance telephone calls. In 1943, the Hotel Association of the City of New York obtained a formal ruling from the Bureau of Excise Taxes which stated:

Receipts from out-of-City telephone messages will be excluded from 'gross operating income' by which the [Utility] tax is measured.

See, *Hilton, supra at 472*. Subsequently, in a 1949 letter, the Special Deputy Comptroller stated that gross operating income does not include income from long distance telephone calls. *Id.* Relying on these pronouncements, for at least forty years UT taxpayers generally, and hotels in particular, interpreted these rulings to mean that the surcharge income attributable to long-distance phone calls was excluded from UT gross operating income. *Id. at 471, 476*.

In 1985, the Department reviewed its policy regarding the taxation of surcharge income attributable to long-distance calls and determined that vendors were underreporting their gross operating income by excluding such surcharge income from the UT base. Accordingly, Respondent initiated a series of audits of hotels, including an audit of The Waldorf Astoria Hotel.¹³ A UT deficiency was asserted against that hotel, computed on surcharge income from long distance telephone calls which that hotel received between June

¹³ At the administrative level, the case was brought in the name of the Hotel Waldorf-Astoria Corp. d/b/a The Waldorf Astoria Hotel. When the case reached the Appellate Division, the taxpayer was Hilton Hotels Corp.

1, 1983 and December 31, 1985. That hotel protested the deficiency and the matter was heard before the Commissioner of Finance. See, *Hilton, supra*. In 1991, the Commissioner sustained the audit position that surcharges attributable to long distance calls were subject to the UT, notwithstanding the prior advisory interpretations. The Waldorf Astoria then filed a motion for summary decision with the Tax Appeals Tribunal¹⁴ and, in 1994, summary decision was granted to the Commissioner of Finance.

The Waldorf Astoria appealed the Tribunal's decision. The Appellate Division held that hotel telephone surcharge receipts attributable to long-distance calls were City receipts and could be included gross operating income for purposes of the UT. The Court noted:

inasmuch as the surcharge was not inseparable from the long-distance telephone call, the geographical limitation on the City's Utility Tax did not bar imposition of such tax. *Hilton, supra at 476*.

However, the Court held that the decision could not be applied retroactively. Relying on the three-part test articulated in *Chevron Oil Co. v. Huson*, 404 U.S. 97, 106-107 (1971), and adopted by the State Tax Appeals Tribunal in *Matter of NewChannels Corp.*, DTA Nos. 808420 & 808458, 93-2 NYTC T-894 (New York State Tax Appeals Tribunal, September 23, 1993), the Court found that: (1) the City Tribunal's decision dealt with an issue of first impression and the taxpayer could not have anticipated the change in policy which

¹⁴ See, fn. 1 *supra*. See, also, Ch. 808, Laws 1992, §142, which provided: "Any appeal to the . . . tribunal . . . commenced prior to the effective date of this act and still pending before the . . . tribunal on such date shall continue to be governed by the provisions of sections 168 through 172 of the charter . . . as such sections were in effect immediately prior to such effective date."

would have made the charges subject to UT; (2) the Commissioner of Finance failed to establish that retroactive application would further the new policy or that prospective application would be detrimental; and (3) the equities "balance[d] in favor of petitioner (and other hotels). . ." *Hilton, supra at 477-478.*

Therefore, with respect to whether the specific Monthly Charges (computed on long-distance calls) should be included in Petitioner's Tax Years gross operating income, the issue is at what point in time could Petitioner have reasonably "foreseen the change in policy so as to consider the tax in setting its surcharge prices" on long distance telephone calls. *Hilton, supra at 477.*

The earliest date would be when the Commissioner published the decision in *Hilton*. The decision was dated April 17, 1991, and it was published in the *Finance Quarterly Bulletin ("FQB") Summer 1991 edition*, which covered the second quarter of 1991. Therefore, publication occurred at some point after June 30, 1991, the end of the second quarter. However, by admission of the Commissioner in her introductory remarks for *FQB Summer 1991*, this volume was published late due to City budget constraints. Respondent did not introduce evidence which would establish the *FQB Summer 1991* publication date (although it is noted that similar comments do not appear in the next published *FQB* for Fall 1991). Accordingly, it is found that the earliest time at which Petitioner could have anticipated the policy change would have been late 1991, after the audit period that ended on September 30, 1991. Therefore, Petitioner is not liable to include long distance telephone call surcharge income in gross operating income for the Tax Years.

ACCORDINGLY, IT IS CONCLUDED THAT Petitioner is liable for UT on the gross operating income it received during the Tax Years from

the provision of the telephone services to Hotel to the extent that those services are attributable to local telephone calls. The Deficiency asserted by Respondent shall be adjusted to eliminate any taxable revenue attributable to long-distance calls made before 1992

since the new audit policy cannot be applied retroactively under *Hilton, supra*.

Dated: July 21, 2005
New York, New York

ANNE W. MURPHY
Administrative Law Judge