STATE OF NEW YORK

TAX APPEALS TRIBUNAL

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| In the Matter of the Petition | : | |
| of | : | |
| **THE UNIMAX CORPORATION** | : | DECISION |
| for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Years 1975 through 1979. | : | |

Petitioner, The Unimax Corporation, 54 East 64th Street, New York, New York 10021, and the Division of Taxation each filed an exception to the determination of the Administrative Law Judge issued on September 29, 1988 with respect to a petition for redetermination of a deficiency or for refund of corporation franchise tax under Article 9-A of the Tax Law for the years 1975 through 1979 (File Nos. 800076 and 800303)

Petitioner appeared by Paul, Weiss, Rifkind, Wharton & Garrison (Richard J. Bronstein, Esq., of counsel) and Peat, Marwick, Mitchell & Co. (John N. Bush, CPA). The Division of Taxation appeared by William F. Collins, Esq. (Anne W. Murphy, Esq., of counsel).

Both parties filed briefs on exception. Oral argument was heard on May 24, 1989.

After reviewing the entire record in this matter the Tax Appeals Tribunal renders the following decision.

## *ISSUES*

I. Whether, in computing interest expense indirectly attributable to subsidiary capital, loans and advances made to a parent corporation by a subsidiary may be netted against (1) petitioner's cost of stock for its subsidiaries and (2) loans and advances made by the parent to its subsidiaries to reduce said loans and advances from the parent to an amount less than zero.

II. Whether advances to and investments in insolvent subsidiaries should constitute part of "subsidiary capital".

III. Whether the cost of Richmond Hill Laboratories, Inc. was $1.00 rather than $100,000.00.

IV. Whether the Division substantially overstated the cost of Barry's Jewelers, Inc. and whether an advance from petitioner to Barry's Jewelers, Inc. of $356,201.00 was properly included for purposes of determining subsidiary capital.

## *FINDINGS OF FACTS*

We find the facts as stated by the Administrative Law Judge except we modify findings of fact "4", "7" and "14" as indicated below. Such facts relevant[1] to this exception and the modified facts are stated below.

Petitioner, The Unimax Corporation, is a Delaware corporation with headquarters in New York City.

Prior to March 11, 1969, petitioner was known as Riker Corporation ("Riker"). On March 11, 1969, Riker and Maxson Electronics Corporation merged, with Riker as the survivor. Riker's name was changed to Riker-Maxson Corporation. Riker-Maxson Corporation's name was subsequently changed to The Unimax Group, Inc. and eventually to The Unimax Corporation.

Petitioner is a holding corporation with numerous subsidiaries. The subsidiaries had been owned by either Riker Corporation or Maxson Electronics Corporation prior to the 1969 merger, or were acquired by petitioner after the merger. The subsidiaries are engaged primarily in the manufacture and sale of electrical components, in the graphic arts business, in the manufacture and sale of metal products and in the retail jewelry business.

We modify finding of fact "4" to read as follows:

[1]Findings of fact "15" through "21" are not relevant to the exception and are not repeated herein.

> Petitioner filed New York State corporation franchise tax reports for each of the years at issue, on which it deducted the full amount of interest it paid to third parties in computing its entire net income. The reports for 1975, 1976 and 1977 indicated no allocated net income and tax was computed as the minimum tax plus tax on allocated subsidiary capital. For 1978, petitioner reported a loss and computed tax as the minimum tax plus tax on allocated subsidiary capital. For 1979, petitioner computed franchise tax due on allocated net income plus allocated subsidiary capital. For each of the years the reports indicated no "add-back" of interest deductions attributable to subsidiary capital.[2]

On January 8, 1979, pursuant to a desk audit, the Division issued the following notices of deficiency to petitioner:

| YEAR | TAX DUE | INTEREST | TOTAL |
|---|---|---|---|
| 1975 | $141,045.63 | $34,082.80 | $175,128.43 |
| 1976 | 80,085.00 | 12,544.82 | 92,629.82 |

On July 29, 1982, pursuant to a field audit, the Division issued the following notices of deficiency to petitioner:

| YEAR | TAX DUE | INTEREST | TOTAL |
|---|---|---|---|
| 1977 | $122,399.69 | $55,497.24 | $177,896.93 |
| 1978 | 152,271.99 | 56,098.52 | 208,370.51 |
| 1979 | 128,029.45 | 36,284.83 | 164,314.28 |

The deficiencies were based, as is pertinent to this proceeding, on adjustments with respect to petitioner's subsidiary capital. Interest expense deemed to be indirectly attributable to subsidiary capital was added back to entire net income. The Division then essentially disallowed loans and advances made to petitioner by a subsidiary to the extent that they would reduce loans and advances from petitioner to such subsidiary to an amount less than zero for purposes of the formula for determining the portion of interest indirectly attributable to subsidiary capital[3].

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[2]The original finding of fact "4" did not include the last sentence of the modified finding, i.e., that petitioner's franchise tax reports for the year 1975, 1976, 1977, 1978 and 1979 indicated no add-back of interest attributable to subsidiary capital.

[3]The auditor had found that advances to petitioner from its subsidiaries exceeded advances to subsidiaries in all years at issue except 1977:

It also substituted fair market value of subsidiary capital for book value shown on petitioner's Federal corporation tax returns. Other adjustments were made based on disallowance or partial disallowance of net operating loss deductions, however, petitioner has withdrawn its opposition to such adjustments.

The notices of deficiency were timely protested by petitioner and, after several conferences, the deficiencies were revised to the following amounts:

| YEAR | ADDITIONAL TAX DUE |
|---|---|
| 1975 | $100,966.00 |
| 1976 | 54,553.00 |
| 1977 | 91,177.00 |
| 1978 | 152,436.00 |
| 1979 | 123,456.00 |

The adjustments at issue are based on the Division's use of a formula designed to determine the portion of petitioner's interest expense which was indirectly attributable to subsidiary capital and thus not deductible for the purposes of computing "entire net income" pursuant to Tax Law § 208.9(b)(6). The formula utilized by the Division may be expressed as follows:

$$\frac{\text{Investment in subsidiaries}}{\text{Total Assets}} \times \begin{array}{c}\text{Gross}\\\text{Interest}\\\text{Expense}\end{array} = \begin{array}{l}\text{Interest indirectly}\\\text{Attributable to}\\\text{Subsidiary Capital}\end{array}$$

For purposes of the formula, "Investment in Subsidiaries" is comprised of the cost of stock, plus paid-in capital and loans and advances.

Petitioner does not contest the use of the above formula to determine the portion of its interest expense which is indirectly attributable to investments in subsidiaries. It does, however,

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| Year | Net Advances from Subsidiaries |
|---|---|
| 1974 | $1,313,588.00 |
| 1975 | 4,421,090.00 |
| 1976 | 3,921,896.00 |
| 1977 | (300,491.00) |
| 1978 | 721,961.00 |
| 1979 | 3,690,509.00 |

object to the Division's treatment of loans and advances made to petitioner by certain subsidiaries as equal to zero, claiming rather that such loans and advances should be netted against the investments made by petitioner in its other subsidiaries. It also maintains that the Division failed to treat petitioner's investments in worthless subsidiaries as zero.

We modify finding of fact "7" to read as follows:

> Petitioner claims that if it should prevail on these issues, the numerator of the disallowance fraction would be reduced to zero and no interest expense would be indirectly attributable to subsidiary capital. Petitioner asserts that, "On a net basis, if you look in the advance on each subsidiary, Unimax did not advance to subs on a net basis. It borrowed money from its subs. Therefore, in each year, if you are looking at advances it made to its subsidiaries, it really didn't have any investment in the subsidiary. Each year the amount of advance on a net back to Unimax was approximately equal to or exceeded the amount of the net investment that was recorded on the books of Unimax as equity investment in the subsidiary." (Tr. June 5, 1986, p. 10.) In the event that petitioner should not so prevail, it claims in the alternative that the Division erred in its treatment of certain specific items and that the following are correct:
>
> a) The cost of Richmond Hill Laboratories, Inc. was $1.00 and not $100,000.00.
>
> (b) The cost of Barry's Jewelers, Inc. was substantially overstated and an advance in 1976 was "double-counted"[4].

***OFFSET OF LOANS AND ADVANCES***

There is no provision in the Tax Law or the regulations which specifically prohibits the use of loans and advances to a parent corporation from a subsidiary so as to reduce loans and advances from the parent to an amount less than zero when calculating investment in subsidiaries. The prohibition represents long-standing policy of the Division which was formalized in Corporation Tax Audit Guidelines dated June 1, 1983. Section 314.2 A 2 of the written guidelines, dealing with investment in subsidiaries, provides, in pertinent part, as follows:

> "In determining the amount of loans and advances, loans and advances to the parent by one of its subsidiaries may be offset

[4]This finding of fact is modified to amplify the petitioner's position on the netting issue by inclusion of the cited statement of petitioner's representative at hearing. It also is modified to delete references to the Dressler, Master Eagle Loan and Utilities and Industries Corporation matters not at issue on this exception.

> against loans and advances to such subsidiary. At no time may loans and advances from a subsidiary reduce loans and advances from the parent to an amount lower than zero (0). Loans and advances to the parent may not be offset against capital stock or against loans and advances to any other subsidiary."

***INVESTMENTS IN INSOLVENT SUBSIDIARIES***

The consolidated income statements and balance sheets attached to petitioner's Federal income tax returns show that three of petitioner's subsidiaries, Longview Precision, Inc., Riker Information Systems, Inc. and Stemes Liquidating Corp., appear to have been relatively inactive, i.e., no sales or no employee compensation paid, for 1975 and 1977 through 1979, and that the liabilities of said subsidiaries were substantially in excess of their assets for all of the years at issue[5]. Longview Precision, Inc. and Riker Information Systems, Inc. were not completely dormant, however, as each had items of income, i.e., rent, interest or other income, and/or deductions for said years. Stemes Liquidating Corp. does appear to have been dormant, at least for 1975, 1977 and 1979[6]. The income statements and balance sheets also show that another subsidiary, Richmond Hill Laboratories, Inc., appears to have been relatively inactive (no sales or employee compensation) in 1978 and 1979 and that its liabilities substantially exceeded its assets for said years. It did, however, have negative net sales in 1978, "other income" in 1979 and substantial deductions in both years.

The balance sheets for each of the above subsidiaries reported loans from stockholders or affiliates and also showed capital stock and, where appropriate, paid-in or capital surplus.

The auditor did not treat advances to and investments in the aforementioned subsidiaries, referred to by petitioner as "insolvent" or "worthless" subsidiaries, any differently than advances to and investments in petitioner's other subsidiaries. Accordingly, advances to and investments in said subsidiaries were included in the numerator of the disallowance fraction.

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[5]Exhibits 2(a)-(d). It is noted that the 1976 income statement is not in the record.

[6]Income statements for 1976 and 1978 for this subsidiary are not in the record. However, the balance sheets for said years indicate no changes and thus appear to be consistent with inactivity.

***RICHMOND HILL LABORATORIES, INC.***

Petitioner acquired all of the issued and outstanding stock of Richmond Hill Laboratories, Inc. from Richmond Hill Laboratories, Ltd. of Scarborough, Ontario, on August 31, 1977 in consideration of $1.00. The $1.00 was applied against an indebtedness of $1,445,129.99 owed by Richmond Hill Laboratories, Ltd. to petitioner.

The Division treated the cost of petitioner's subsidiary, Richmond Hill Laboratories, Inc., as $100,000.00 in the years 1977, 1978 and 1979, based on a statement made to the auditor by Warren Kaplan, a former officer of petitioner. Mr. Kaplan told the auditor that petitioner contributed furniture and fixtures worth approximately $100,000.00 to Richmond Hill Laboratories, Inc.

The balance sheet of petitioner for the year ending December 31, 1977 shows that Richmond Hill Laboratories, Inc. had buildings and other fixed depreciable assets of $358,431.00. It also shows that said subsidiary had a negative net worth of $616,526.00.

***BARRY'S JEWELERS, INC.***

We modify finding of fact "14" as follows:[7]

> Petitioner acquired slightly more than 80 percent of the stock of Barry's Jewelers, Inc. ("BJI") from David Blum and Gerson I. Fox pursuant to a stock purchase agreement dated November 18, 1976. The balance of the shares was acquired from BJI's minority stockholders in exchange for petitioner's stock. The transaction was effectuated as follows:
>
> (a) Barry's Purchasing Corp. ("BPC"), a wholly-owned subsidiary of petitioner, was named as "Buyer" under the stock purchase agreement. BJI and Messrs. Fox and Blum were named as "Sellers". Petitioner was also a party to the agreement.
>
> (b) Under section 1.3.1 of the agreement, Buyer was to pay Seller the following:
>
> (i) $100,000.00 cash, at closing;

[7]The modifications to this finding of fact are twofold: 1) reference to the payment sections of the stock purchase agreement are inserted; 2) paragraph (e) is added which states the substance of section 1.3.8 of the Stock Purchase Agreement which requires the petitioner to contribute to the capital of BPC the amounts needed for BPC to make payments under section 1.3.1 and 1.3.2 of the agreement.

(ii) promissory notes in the principal amount of $400,000.00, guaranteed by petitioner, at closing;

(iii) 20,000 shares of petitioner's common stock, at closing;

(c) Under section 1.3.2 of the agreement, Buyer was to pay Seller $500,000.00 in cash upon approval of the transaction by petitioner's shareholders;

(d) Under sections 1.3.3, 1.3.4 and 1.3.5 of the agreement Buyer was to pay Seller:

(i) on April 30, 1977, cash and stock of petitioner equal to 70 percent of BJI's pre-tax profit for the period commencing on the closing date and ending on December 31, 1976;

(ii) on April 30, 1978, 1979 and 1980, payments equal to 70 percent of BJI's pre-tax profit for the prior fiscal year (ending December 31) in cash and petitioner's common stock;

(iii) on April 30, 1981 and 1982, payments equal to 45 percent of BJI's pre-tax profit for the prior fiscal year (ending December 31) in cash and petitioner's common stock.

(e) Section 1.3.8 of the Stock Purchase Agreement provides that petitioner was required to contribute to the capital of Barry's Purchasing Corp the amounts required for Buyer to make the payments, prior to their due dates, under sections 1.3.1 and 1.3.2 of the agreement.

(f) Petitioner, BJI and Barry's Merger Corp. ("BMC"), another wholly-owned subsidiary of petitioner, but not a party to the stock purchase agreement, were to enter into a merger agreement. BJI and BPC were to enter into a second merger agreement. The terms of the merger agreements are not in the record and the mechanics of the merger process are not entirely clear[8]. In any event, after the merger, BJI became a wholly-owned subsidiary of petitioner and was primarily responsible for the payments specified above. Petitioner was guarantor of said obligations.

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[8]The process is ostensibly stated in paragraph 3(a)(ii) of the affidavit of Tom Scheinman, petitioner's president and chief executive officer (petitioner's Exhibit 9). It is noted, however, that Mr. Scheinman's statement that BMC was a wholly-owned subsidiary of BPC is inconsistent with section 1.10.1 of the stock purchase agreement (Exhibit 7) which states that BMC was a wholly-owned subsidiary of petitioner.

> (g) Petitioner paid the $100,000.00 initial cash payment and the $400,000.00 promissory note specified in Finding of Fact "14(b)". The $500,000.00 was at first recorded in the investment in subsidiaries account. This entry was later changed by recording an advance to BJI in the amount of $352,201.00 and reducing its investment account in the stock of BJI by the same amount. (This was done because the transaction had not closed by the end of 1976.) The Division included both the $500,000.00 and the $352,201.00 in the numerator of the disallowance fraction.

***OPINION***

The Administrative Law Judge determined that a) petitioner's position that loans and advances between petitioner and its subsidiaries should be netted against petitioner's full investment in such subsidiaries is correct, b) petitioner sustained its burden of proof to show that Richmond Hill Laboratories, Inc. should be valued at $1.00, c) petitioner sustained its burden of proof to the extent that it showed that the cost of Barry's Jewelers, Inc. was inflated by $353,201.00 due to double counting, d) the Division was correct in determining that petitioner's advances to its insolvent subsidiaries should be treated as part of subsidiary capital.

On exception the Division asserts (1) that the franchise tax regulations of the Division provide ample basis for prohibiting netting of loans and advances from a subsidiary to a parent so as to reduce loans and advances from the parent to an amount less than zero when calculating investment in subsidiaries, (2) petitioner did not sustain its burden of proof to show that the valuation for the Richmond Hill Laboratories, Inc. is less than $100,000.00.

On exception the petitioner asserts that the Division incorrectly determined the calculation of the cost of Barry's Jewelers, Inc. (BJI) and that its advances and capital investments in certain insolvent and worthless subsidiaries should be treated as worthless.

We describe first the statutory provisions relative to the issues at hand and the relevant arguments of the parties.

Tax Law section 209(1) imposes a corporate franchise tax on every corporation doing business in New York, and provides in pertinent part:

> "1. For the privilege of exercising its corporate franchise, or of doing business, or of employing capital, or of owning or leasing property in this state . . . every domestic or foreign corporation . . . shall annually pay a franchise tax, upon the basis of its entire net income . . ."

Entire net income is generally the same amount reported as Federal taxable income modified by additions and/or subtractions prescribed by statute. To compute Federal taxable income a taxpayer is allowed a deduction for interest expense on indebtedness in each report (Internal Revenue Code, § 163[a]).

Tax Law section 208 subdivision 9 sets forth the definition for and the method of computing entire net income for State franchise tax purposes. Paragraph (a), subparagraph (1) provides that entire net income shall not include ". . . income, gains and losses from subsidiary capital . . . ." Paragraph (b) sets forth those exclusions, deductions and credits which are not permitted in the determination of entire net income and provides, in pertinent part:

> "(b) Entire net income shall be determined without the exclusion, deduction or credit of:
>
> * * *
>
> "(6) in the <u>discretion</u> of the tax commission, any amount of interest <u>directly or indirectly</u> and any other amount directly or indirectly attributable as a carrying charge or otherwise to subsidiary capital or to income, gains or losses from subsidiary capital." (Emphasis added.)

Tax Law section 208(4) defines subsidiary capital, in relevant part, as follows:

> "4. The term 'subsidiary capital' <u>means investments in the stock of subsidiaries and any indebtedness from subsidiaries</u> . . . on which interest is not claimed and deducted by the subsidiary for purposes of taxation under articles nine-a . . . of this chapter . . . ." (Emphasis added.)

The purpose of the exclusion under section 208(9)(b)(6) is to prevent a parent corporation from obtaining a double tax benefit by taking a deduction for interest payments on loans incurred for <u>directly or indirectly</u> financing investments in subsidiaries while at the same time the parent's income derived from such investments is tax free (<u>F. W. Woolworth Co. v. State Tax Commn.</u>, 126 AD2d 876, 510 NYS2d 926, affd 71 NY2d 907, 528 NYS2d 537 (case 2); see, Letter from Mortimer M. Kassell to Hon. Averell Harriman, Bill Jacket, L 1955, ch 715).

In determining if interest expense is directly attributable to subsidiary capital the purpose for which the indebtedness is incurred or continued is the deciding factor, i.e., each asset to which interest expense is directly attributed, the amount of the interest, the nature, the date and the amount of the liability incurred to acquire the asset are identified.

If it is not possible to isolate the assets to which interest expense is directly attributed, the long standing policy of the Division is that each asset held by a corporation shares a portion of the cost of its borrowings (Matter of Worldwide Volkswagen, State Tax Commn., April 30, 1974). Thus, a proportional part of a corporation's interest expense on borrowings is attributed to subsidiary capital and results in an adjustment to determine entire net income.

Both parties agree that the formula used by the Division to calculate interest expense of the parent which is indirectly attributable to subsidiary capital is proper. The formula is stated as follows:

$$\frac{\text{Investment in subsidiaries}}{\text{Total Assets}} \quad \text{x} \quad \begin{array}{c}\text{Gross}\\ \text{Interest}\\ \text{Expense}\end{array} \quad = \quad \begin{array}{l}\text{Interest indirectly}\\ \text{attributable to}\\ \text{subsidiary capital}\end{array}$$

The basic difference between the parties in this case is how each calculates the numerator. The Division's first rule in calculating this numerator is that the parent's investment in each subsidiary must be separately determined. The sum of those investments is then totalled and put in the numerator of the fraction.

The Division's second rule is to calculate the numerator for each subsidiary as the total of two distinct components; the investment in the stock of the subsidiary and loans and advances between the parent and the subsidiary. These components reflect the language of Tax Law section 208(4), defining subsidiary capital as the investment in the stock of the subsidiary and any indebtedness from the subsidiary.

Within this calculation, the Division allows loans and advances to the parent by one of its subsidiaries to be offset against loans and advances from the parent to such subsidiary. However, as a result of the first rule, calculating the numerator for each subsidiary separately, the Division does not permit loans and advances to the parent to be offset against loans and advances to any other subsidiary. As a result of the second rule, the Division does not permit loans and advances to the parent to be offset against the investment in the stock of a subsidiary.

The overall result is that a parent will have an investment in its subsidiaries first, to the extent of the investment in the stock of each subsidiary to the parent and paid-in capital, and, second, to the extent of the net of loans and advances from the parent to each of its subsidiaries.

Petitioner argues that such result is wrong, that it produces a distorted picture of its investment in its subsidiaries which in turn results in an improper attribution of interest to its investments in subsidiary capital and has no basis in statute or regulation. Instead, petitioner calculates the investment in the subsidiaries as a group. Petitioner asserts that since it did not advance monies to its subsidiaries on a net basis, but rather was a net debtor to its subsidiaries, that it did not have any investment in its subsidiaries for purposes of calculating how much of its interest expense is indirectly attributable to its investments in its subsidiaries. Petitioner bases its position on the economic result of the transactions.

We now deal with the issue of netting.

The so-called disallowance fraction represents the exercise of the discretionary authority given the Division by section 208(9)(b)(6). It is contained only in audit guidelines, which as petitioner correctly points out do not have the force and effect of law. Accordingly, our inquiry is whether the exercise of the discretion accorded the Division, through the use and application of the fraction, is a proper interpretation of the statutory language.

We reverse the determination of the Administrative Law Judge on this issue and determine that the Division's method of determining the interest expense indirectly attributable to subsidiary capital is a proper exercise of the discretionary authority vested in it by the Legislature in section

208(9)(b)(6). The Division's authority to indirectly attribute interest expense to subsidiary capital, like its authority to exercise discretion in other areas, is not unlimited (Coleco Industries, Inc. v. State Tax Commn., 92 AD2d 1008, 461 NYS2d 462). The statute must be interpreted in a manner designed to promote its underlying purpose. We conclude the Division's interpretation meets this standard.

The Division's formula utilizes the disallowance fraction to measure the cost of petitioner's investment in its subsidiaries relative to its total assets. It is grounded on the principle that each asset held by a corporation shares a portion of the cost of its borrowings (Matter of Worldwide Volkswagen, State Tax Commn., April 30, 1974). The formula was sustained by the court in F. W. Woolworth Co. v. State Tax Commn., supra.

The Division calculates the numerator of the fraction by determining the petitioner's cost of the purchase of subsidiary capital, i.e., the cost of stock in each of its subsidiaries, and the cost of carrying its subsidiary capital, i.e., indebtedness from each of its subsidiaries. The Division does not permit loans and advances to the petitioner to be offset against the cost of stock of the subsidiary. This is consistent with the definition of subsidiary capital in section 208(4) and properly treats the components as two separate and discrete parts which together comprise the cost of petitioner's investment in its subsidiaries. In short, "investments in the stock of subsidiaries" . . . are not . . . "any indebtedness from subsidiaries." The former phrase clearly indicates an investment to obtain an ownership interest and the latter petitioner's cost of carrying its subsidiary capital.

With regard to loans and advances the Division's approach recognizes petitioner may finance investment in subsidiaries through borrowings from third parties as well as through loans and advances to the parent from each subsidiary. It provides for an allocation between these funding sources by allowing the petitioner to offset loans and advances between it and each subsidiary. To the extent of the offset, petitioner's investment in each subsidiary is reduced. The zero limitation on this offset is consistent with the definition of subsidiary capital, i.e., "indebtedness from subsidiaries", since an amount less than zero would not represent indebtedness from the subsidiary. The formula thus attributes a part of the petitioner's financing needs as being met by loans and advances between it and its subsidiaries and in part by third party borrowings.

Petitioner's approach contains no such balance. Petitioner's assertion is that because it is a "net debtor" with respect to its subsidiaries it does not have any investment in them and they are not assets for purposes of indirect attribution of interest expense to subsidiary capital. Stated in the alternative, petitioner asserts that because it borrowed more from its subsidiaries than it advanced to them, none of the borrowings from third parties should be treated as if invested in the subsidiaries.

We cannot agree. Petitioner's approach of netting loans and advances against its entire investment in its subsidiaries totally fails to take into account the individual elements of subsidiary capital in section 208(4) by completely disregarding petitioner's continuing investment in the stock of its subsidiaries and the fact that such subsidiaries are indeed assets each of which indirectly shares a portion of the cost of its borrowings. Petitioner provides no statutory support for the validity of its position nor has it demonstrated how money owed by petitioner to its subsidiaries reduces or otherwise alters petitioner's investment in the stock of its subsidiaries.

Given (1) the underlying purpose of section 208(9)(b)(6), i.e., to prevent a taxpayer from obtaining a double tax benefit by taking a deduction from interest payments on loans incurred for directly or indirectly financing investments in subsidiaries, the income from which is tax free; (2) the imprecise nature of the task, i.e., the calculation of interest expense which is indirectly attributable to subsidiary capital; (3) the Division's adherence to the language of section 208(4) in structuring its formula; and (4) the recognition in that formula that petitioner may finance investments through third party borrowings as well as through loans and advances between petitioner and its subsidiaries, we conclude the Division's interpretation of the statute is proper.

We deal next with petitioner's advances to and investments in insolvent subsidiaries. We affirm the determination of the Administrative Law Judge that such advances were properly treated as part of the subsidiary capital of the petitioner (Matter of Universal Charge Plan, Inc., State Tax Commn., June 20, 1981). The crux of the matter is that the numerator of the fraction, i.e., investment in subsidiaries is, as noted above, comprised of two separate components, investment in stock of the subsidiaries and loans and advances. The facts here indicate that for each of the subsidiaries at issue, there were investments in the stock and loans or advances. Accordingly, it was correct to include these amounts when calculating the numerator of the disallowance fraction.

Next we examine whether the Administrative Law Judge correctly determined the cost of Richmond Hill Laboratories, Inc. to be $1.00. The Division maintains that the Administrative Law Judge erred and asserts that the cost of Richmond Hill to petitioner was $100,000.00. The Division based its calculation on an alleged statement made by Mr. Warren Kaplan, a former officer of petitioner. The auditor testified that Mr. Kaplan told him that petitioner contributed furniture and fixtures worth approximately $100,000.00 to Richmond Hill. In his audit report, he treated the cost to petitioner of Richmond Hill as $100,000.00 in the years 1977, 1978, and 1979.

However, there is ample evidence to support the Administrative Law Judge's determination that the cost of Richmond Hill was in fact $1.00. First, the balance sheets of both petitioner and Richmond Hill stated that the capital stock of Richmond Hill was $1.00 for all of the years in question. Second, a letter dated August 31, 1977, which was the subject of a stipulation by the parties before the hearing, recited that petitioner purchased Richmond Hill from a Canadian company for $1.00. Third, Unimax's president and chief executive officer, Mr. Tom Scheinman, declared in a sworn affidavit that petitioner paid only $1.00 for Richmond Hill.

The Division submits that the Administrative Law Judge had no basis in disregarding the statements made by Mr. Kaplan to the field auditor. Since Mr. Kaplan did not appear at the formal hearing, the Division argues, they are deprived of the opportunity to pursue the basis for the statements made or to develop any additional facts. We find no merit to this argument because the Division had the authority to call Mr. Kaplan to appear as a witness at the hearing.

Even if Mr. Kaplan refused to appear voluntarily, the Division had the power to request the Administrative Law Judge to issue a subpoena compelling him to appear (20 NYCRR 3000.6).

The Division attacks the validity and authenticity of the letter introduced at the hearing which showed that petitioner purchased the stock of Richmond Hill for $1.00. This letter was the subject of a stipulation by the parties before the hearing. Since the Division did not raise any objections as to the credibility and relevance of the letter prior to the stipulation, when there was ample opportunity to do so, it is now prevented from attacking the letter. We observe, too, that stipulated facts shall be binding in effect and that a "stipulation shall be treated, to the extent of its terms, as a conclusive admission by the parties to the stipulation . . ." (20 NYCRR 3000.7[e]).

Finally, we address the question of whether the Division correctly computed the cost of Barry's Jewelers, Inc. for the purpose of determining petitioner's investment in subsidiaries. Petitioner claims that the Administrative Law Judge erred in failing to correct the inclusion of earn-out payments and other cash amounts as investments in Barry Jewelers, Inc. by petitioner.

Petitioner argues that the second cash payment of $500,000.00 and the cash portion of the earn out payments should not be treated as a cost of acquiring the stock of BJI because these payments were in fact paid by BJI and not by petitioner. We do not accept petitioner's reasoning.

The principal document governing the acquisition of BJI was the stock purchase agreement. Petitioner was a party to the stock purchase agreement and through it petitioner: agreed to the purchase price of BJI; agreed that BPC, a wholly owned subsidiary of petitioner and the Buyer under the agreement, would pay the entire purchase price; guaranteed the payment by BPC; and was required to contribute to the capital of the BPC the amounts required for BPC to make all of the payments under sections 1.3.1 and 1.3.2 for the acquisition of the stock of BJI. In view of these facts, we sustain the determination of the Administrative Law Judge that the payments at issue are an investment by petitioner in BJI for purposes of determining that portion of petitioner's interest expense indirectly attributable to its subsidiary capital.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of The Unimax Corporation is in all respects denied;

2. The exception of the Division of Taxation is granted to the extent that the Division's treatment of loans and advances in calculating the numerator of petitioner's disallowance fraction is upheld, but is otherwise denied;

3. The determination of the Administrative Law Judge is modified to the extent indicated in paragraph "2" above, but is otherwise sustained;

4. The petition of The Unimax Corporation is granted to the extent indicated in conclusions of law "J(1)" and "J(3)" but is otherwise denied; and

5. The Division of Taxation shall modify the notices of deficiency issued on January 8, 1979 and July 29, 1982 accordingly, but such notices are otherwise sustained.

DATED: Troy, New York
November 22, 1989

/s/John P. Dugan
John P. Dugan
President

/s/Francis R. Koenig
Francis R. Koenig
Commissioner

/s/Maria T. Jones
Maria T. Jones
Commissioner