STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
REUTERS LTD.	:	DECISION
for Redetermination of Deficiencies or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Years 1977, 1978 and 1979.	:	

Petitioner Reuters Ltd., 1700 Broadway, New York, New York 10105 filed an exception to the determination of the Administrative Law Judge issued on February 22, 1990 with respect to its petition for redetermination of deficiencies or for refund of corporation franchise tax under Article 9-A of the Tax Law for the years 1977, 1978 and 1979 (File No. 800880). Petitioner appeared by Weil, Gotshal & Manges (Philip T. Kaplan, Esq. of Counsel). The Division of Taxation appeared by William F. Collins, Esq. (Anne W. Murphy, Esq. of Counsel).

Both parties filed briefs in this matter. Oral argument, at petitioner's request, was heard on September 26, 1990.

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

ISSUES

I. Whether the Division of Taxation constitutionally applied Tax Law §§ 208 and 210 and the regulations at 20 NYCRR 3-2 and 3-8 in computing petitioner's franchise tax liability for the years in issue against an allocated worldwide entire net income base.

II. Whether computation of petitioner's franchise tax liability for the years in issue against an allocated worldwide entire net income base violated Article 24 of the US-UK Tax Convention (the "Treaty").

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.[1]

At all times relevant herein, the years 1977, 1978 and 1979 (the "audit period"), petitioner, Reuters Ltd. ("Reuters"), was a corporation organized in the United Kingdom engaged in the business of supplying news and economic and financial information by electronic means to newspapers, banks, insurance companies and others interested in such information. Reuters' operations were worldwide, doing business in approximately 80 countries, mainly through branch offices of the English company. The principal offices of the corporation were located in the United Kingdom, while its New York office was the main office in the United States. During the period in issue, Reuters was not incorporated in the State of New York.

Pursuant to the terms of the Convention between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and Capital Gains (the "Treaty"), Reuters maintained a United States branch, with offices in New York. Its office was a "permanent establishment", defined by the convention as a "fixed place of business through which the business of an enterprise is carried on." (Tax Convention, Article 5[1]; Article 5[2][a].)

For purposes of the franchise tax imposed by section 209 of the Tax Law, Reuters is an "alien" corporation, i.e., a corporation "organized under the laws of a country other than the United States." (20 NYCRR 3-8.3.)

During the period in issue, Reuters filed corporation franchise tax reports with the State of New York and United States income tax returns of a foreign corporation with the Federal government. Said reports were also filed with the government of the United Kingdom. United Kingdom tax liability was computed against a basis comprised of income earned by Reuters from

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[1]For consistency and ease of reference, we refer to the US-UK Tax Convention as the "Treaty." The Administrative Law Judge used both terms.

its operations throughout the world. The tax imposed by the United States Internal Revenue Code was computed against a basis of income, gain or loss attributable to United States sources only. For the purposes of this determination, such a computational basis will be referred to as "water's edge" income, which is in compliance with the specific provisions of the U.S.-U.K. Tax Convention. The New York franchise tax liability of Reuters was imposed against a basis comprised of allocated Federal taxable income plus all other income earned outside of the United States, as adjusted by specific deductions. These adjustments were made in accordance with the regulation at 20 NYCRR 3-2.3(9).

As stated above, Reuters filed corporation franchise tax reports for each of the calendar years in issue. For the year 1977, Reuters computed its New York liability against an allocated worldwide income base. The original return was prepared by Coopers and Lybrand which stated in an attached page that the return was true, correct and complete, based on all information relating to the matters required to be reported in the return. For the years 1978 and 1979, Reuters computed its New York tax liability against only the United States source income. In 1981, Reuters amended its 1977 filing to conform to the subsequent reports, using the United States income base. For each of the years in issue, taxable net income on the corporation franchise tax reports reflected a loss.

The gross revenues of the United States permanent establishment represented a maximum of 15% of Reuters' worldwide gross revenues for each of the years in issue.

An audit was performed by the Division of Taxation between September of 1980 and September of 1983 covering the period in issue. Although all aspects of the corporation franchise tax reports for each year were analyzed, the only disputed issue was whether the Division was restricted by the tax convention from calculating Reuters' income for corporate income tax purposes by applying the three-factor formula (property/receipts/payroll) to worldwide income.

Although it was suggested that Reuters file using a worldwide basis for its entire net income, it chose to amend its 1977 corporation franchise tax report and file for each of the three years of the audit period based upon United States income alone. Therefore, for the year 1977,

Reuters is claiming a refund of $30,011.00, representing the difference between tax recomputed using a United States basis of income (a loss) versus a worldwide basis as used in the computation of tax on the original 1977 report.

The Division of Taxation recomputed New York entire net income for each of the years in issue against a base of allocated worldwide income, gain, and loss. The Division computed 1977 franchise tax liability against the income base as originally reported. For the years 1978 and 1979, the Division used worldwide income as reflected in Reuters' published annual reports, since other sources were not provided by Reuters, despite requests by the Division.

On October 14, 1983, the Division issued to Reuters Ltd., three statements of audit adjustment and three notices of deficiency which set forth the following:

Period Ended	Tax Deficiency	Interest	Total Due
12/31/77	$ 814.00	$ 519.00	$ 1,333.00
12/31/78	$385,982.00	$212,614.00	$598,596.00
12/31/79	$464,407.00	$215,764.00	$680,171.00

Following a conference held on November 7, 1985, and based upon additional information provided by Reuters, additional tax due was recomputed for each of the years in issue, as follows:

Year	Additional Tax Due
1977	$ 973.00
1978	$50,609.00
1979	$44,586.00
Total	$96,168.00

Therefore, the amount of additional tax due remaining in dispute is $96,168.00. The additional information supplied by Reuters only 13 days after the informal conference included data on the worldwide net profit of Reuters, excluding foreign subsidiaries, and calculated the allocable business income by reference to the aggregate of the percentages of New York as compared to worldwide property, sales and wages. The information was sent by Michael Crombie, Taxation Manager of Reuters, to Ms. Regina Jaffe, conferee, on November 20, 1985. The letter stated, in pertinent part:

> "The attached schedules provide data on the worldwide net profit of Reuters Limited, excluding foreign subsidiaries and calculates the

> allocable business income by reference to the aggregate of the percentages of New York as compared to worldwide property, sales and wages."

An analysis was performed by Reuters to demonstrate additional costs which would be incurred were it to be directed to comply with the Tax Law and corporation tax regulations relating to the calculation of corporation franchise tax based on worldwide income. Reuters' analysis included a partial list of adjustments to local book income in nearly 80 countries including currency conversion, accounting methods, depreciation, compensation and fringe benefits, gains and losses on sales and exchanges of assets, and interest expenses and losses on transactions between related taxpayers. These would be Federal adjustments while for New York purposes Reuters would have to eliminate dividends and interest received from its subsidiaries, add back interest and other amounts attributable as carrying charges to subsidiary capital and eliminate 50% of any dividends from corporations which were not subsidiaries during the periods in issue. The study also calculated the costs of complying with tax filing requirements for the years 1977 through 1979 including an estimate of local costs of making book conversions, the cost of establishing a U.S. staff to supervise the work of overseas personnel in making conversions, and various estimated departmental costs. By way of summary, the analysis estimated a start-up cost for the accounting changes of approximately $86,000.00 and recurring annual costs of over $680,000.00 in order to calculate Reuters' New York entire net income in the manner desired by the Division pursuant to the New York State Tax Law and regulations promulgated thereunder. Additionally, the analysis indicated that Reuters would have to value its worldwide real property and tangible personal property at fair market value on a quarterly basis in order to properly calculate its New York business allocation percentage. Said process was projected to cost no less than $300,000.00 per year.

For each of the three years in issue, Reuters had a subsidiary, IDR, Inc., which was a New York corporation. Reuters held 99.5% of the voting stock of IDR, Inc. in the years 1978 and 1979 and 93.8% of the voting stock in 1977. For all three years, 100% of IDR, Inc.'s value was allocated to New York State.

Reuters did approximately 15% of its business in the U.S. during the period in issue. For 1977, Reuters reported a worldwide business allocation percentage for New York State of 9.3853%. (The amended return reported 56.0999% based on United States source income.) The 1978 Franchise Tax Report indicated a business allocation percentage of 53.689% and 60.515% for 1979. Subsequently, Reuters conceded business allocation percentages for 1978 of 10.19% and 1979 of 8.39%, using worldwide income as a denominator.

OPINION

We believe it useful to briefly review the relevant provisions of the New York Tax Law, the United States Constitution, and the Treaty as a preface to the analysis of the issues in this case.

Article 9-A of the Tax Law imposes a franchise tax on every domestic or foreign corporation for the privilege of doing any of the following: exercising its corporate franchise; doing business; employing capital; owning or leasing property in New York State in a corporate or organized capacity; or maintaining an office in New York State (Tax Law § 209[1]; 20 NYCRR 1-1.1).

The tax may be imposed upon entire net income or upon one of several alternative bases (Tax Law § 209[1]).

Entire net income is the "total net income from all sources, which shall be presumably the same as the entire taxable income which the taxpayer is required to report to the United States treasury department" (Tax Law § 208[9]). From the starting point of Federal taxable income, the Tax Law provides that in computing entire net income, certain items are to be included and other items are to be excluded.

As relevant here, Tax Law section 208(9)(c) provides that "[e]ntire net income shall include income within and without the United States" (Tax Law § 208[9][c] [emphasis added]; 20 NYCRR 1-3.2[2]).

The Commissioner's regulations provide that in computing entire net income, Federal taxable income must be adjusted by adding to it "in the case of a taxpayer organized outside the United States, all income from sources outside the United States less all allowable deductions

attributable thereto which were not taken into account in computing Federal taxable income" (see, 20 NYCRR 3-2.3[a][9]).

Article I, section 8, clause 3 of the United States Constitution gives Congress the power "[t]o regulate Commerce with foreign Nations, and among the several States."

Article VI, clause 2 of the United States Constitution provides that:

> "This Constitution and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding."

Article 24(2) of the Treaty provides that:

> "The taxation on a permanent establishment which a (United Kingdom enterprise) has in the other Contracting State (the United States) shall not be less favorably levied in that other State then the taxation levied on enterprises of that other State carrying on the same activities" (emphasis added).

Article 2(4) of the Treaty provides that for the purposes of Article 24, the Treaty "shall also apply to taxes of every kind and description imposed by each Contracting State, or by its political subdivisions or local authorities."

Article 5(2)(a) of the Treaty defines the term "permanent establishment" to include a "branch."

The Administrative Law Judge determined that the Division of Tax Appeals had jurisdiction in this case because the issue concerned the application of the statute to petitioner and not a challenge to the validity of the statute as enacted by the Legislature.

The Administrative Law Judge further determined that the application of the law and regulations by the Division of Taxation (hereinafter the "Division") to petitioner did not violate the Foreign Commerce Clause of the United States Constitution or the non-discrimination clause of the Treaty.

With regard to the Foreign Commerce Clause, the Administrative Law Judge concluded that the application of the tax to petitioner met the two stage analysis laid down by Japan Line v. County of Los Angeles (441 US 434, 60 L Ed 2d 336). First, the tax met the four part test

applicable to interstate commerce, i.e., the tax was applied to an activity with a substantial nexus to New York State, the tax was fairly apportioned, the tax did not discriminate against interstate commerce, and the tax was fairly related to services provided by the State. Second, the tax satisfied the two inquiries added by Japan Line with regard to foreign commerce, i.e., that there was no enhanced risk of multiple taxation and that the tax did not impair Federal uniformity in an area where Federal uniformity is essential.

The Administrative Law Judge determined that the facts here could not be distinguished from those in Bass, Ratcliff & Gretton v. State Tax Commn. (266 US 271, 69 L Ed 282) in which the Supreme Court held that a United Kingdom company doing business in New York State through a branch was subject to New York franchise tax on the basis of allocated income.

With regard to the Treaty, the Administrative Law Judge determined a) that since the political subdivisions of the United Kingdom do not impose income taxes comparable to those imposed by the United States' state governments, the nondiscrimination provision of the Treaty did not apply, b) that the legislative history of the Treaty indicates that it was not intended to apply where the United Kingdom company was doing business in the United States in branch form rather than subsidiary form, and c) petitioner could have elected to do business in the United States in subsidiary form rather than branch form thus avoiding the consequences of the tax to which it now objects.

Petitioner asserts that the Administrative Law Judge erred and that the application of the law and regulations by the Division violates both the Foreign Commerce Clause and the non-discrimination clause of the Treaty.

With regard to the Commerce Clause, petitioner asserts that "[t]he question is whether the Commerce Clause permits a state to employ formulary apportionment of worldwide income of a foreign-based multinational enterprise. That question is unaffected by the form (branch or subsidiary) in which the foreign-based multinational conducts its U.S. operations" (petitioner's brief at hearing, p. 27).

Petitioner asserts that New York's tax violates the Federal uniformity requirements of Japan Line because foreign policy is necessarily implicated where the taxpayer subjected to formulary apportionment of worldwide income is a branch or United States subsidiary of a foreign corporation such as petitioner.

Petitioner also asserts that the tax as applied to it is unconstitutional on the grounds of burdensome compliance.

With regard to the Treaty, petitioner asserts that during the years at issue it did business in New York through a branch and, thus, maintained a "permanent establishment" in the United States and the State of New York within the meaning of the Treaty.

Petitioner asserts that Article 24 of the Treaty applies to local taxes as well as to Federal taxes. Petitioner asserts that subdivision 2 of that Article forbids the use of the worldwide income of petitioner whether or not apportioned within and without the state as the basis for New York taxation if a New York corporation, located entirely in New York and performing the same activities as petitioner's New York branch, would have paid a smaller tax.

The Division asserts that it is proper to determine petitioner's entire net income by including income from within and without the United States as required by section 208(9)(c) of the Tax Law and apportioning such income to New York through the application of the statutory formula. Imposition of the tax on this basis, argues the Division, is not violative of the Federal Commerce Clause and is not more burdensome on petitioner than the tax imposed on corporations transacting business in New York State on a similar basis.

We affirm the determination of the Administrative Law Judge for the reasons stated below.

The Administrative Law Judge and the parties concluded that the issue for resolution was the application of the tax, a matter within the jurisdiction of the Tribunal and the Division of Tax Appeals.

We deal first with the non-discrimination clause of the Treaty.

Article 24(2) of the Treaty provides that:

> "The taxation on a permanent establishment which a (United Kingdom enterprise) has in the other Contracting State (the United

> States) shall not be less favorably levied in that other State then the taxation levied on enterprises of that other State carrying on the same activities" (emphasis added).

The Administrative Law Judge determined that the clause was not applicable because the United Kingdom did not have a subnational tax similar to those imposed by the individual states of the United States. We find nothing in the Treaty which conditions application of the nondiscrimination clause on the existence of symmetrical taxing systems in the United States and the United Kingdom. The purpose of the clause is to insure equal tax treatment of businesses engaged in similar activities by the contracting states and by their political subdivisions or local authorities.

With respect to whether the tax is discriminatory, petitioner asserts that "[t]he comparison mandated by the Treaty is between the [petitioner's] New York branch and a New York corporation performing the same activities as that branch" (petitioner's brief at hearing, p. 12).[2]

To determine the scope of activities to be used in measuring the income to be allocated, petitioner construes the Treaty phrase "carrying on the same activities" as referring to the activities of the permanent establishment, i.e., the branch, but not the activities of the corporation of which the branch is a part. In short, petitioner's interpretation would not consider the worldwide activities of petitioner.

We cannot agree. The tax imposed here is a corporation franchise tax measured in this case by income. The corporation here is petitioner. A corporation carrying out "similar activities" under the terms of the Treaty would be a New York corporation with a New York office and worldwide branch activities. That is the proper comparison for purposes of the Treaty. We see

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[2]Petitioner offers an elaboration on this point in its brief at hearing as follows:

> "[t]he comparison necessary to test the application of the non-discrimination Article is made by substituting for the (United States) branch of the non-resident (United Kingdom) corporation a (United States) resident company related to the first company exactly as the branch is related -- i.e. through the common ownership and control of the (United Kingdom) corporation" (petitioner's brief at hearing, p. 12 [citing Gifford, Permanent Establishments Under the Nondiscrimination Clause in Income Tax Treaties, 11 Cornell Intl. L J 51, 61 fn 32] [emphasis added]).

no tax discrimination resulting from this comparison since a New York corporation operating worldwide through foreign branches would be taxed in the same manner as petitioner here, i.e., on the basis of apportioned worldwide income.

Instead of trying to obtain comparable treatment, petitioner is really asking that it be treated more favorably than a New York corporation organized in the same manner as petitioner, that is, that its branch be treated as if it were a subsidiary of a foreign parent. Since New York does not require or permit foreign corporations to file combined tax reports with New York corporations (20 NYCRR 6-2.5[b]), petitioner's interpretation would require that its branch be taxed as a separate entity without the inclusion of worldwide income. This treatment would clearly be more favorable than that accorded to New York corporations organized in the same manner as petitioner.

We deal next with whether the imposition of the tax by the Division violates the Commerce Clause.

To test the validity of a tax affecting foreign commerce, two additional considerations beyond those articulated in the doctrine governing the Interstate Commerce Clause come into play.[3] The first consideration is the enhanced risk of multiple taxation. The second consideration is the possibility that the state tax will impair Federal uniformity in an area where Federal uniformity is essential or will violate a clear Federal directive (Container Corp. of Am. v. Franchise Tax Bd., 463 US 159, 77 L Ed 2d 545; Japan Line v. County of Los Angeles, supra).

Petitioner does not argue the multiple taxation issue but asserts only that imposition of the tax here prevents essential Federal uniformity. Petitioner's principal argument is that "foreign policy is necessarily implicated where the taxpayer subjected to formulary apportionment of worldwide income is a branch or U.S. subsidiary of a foreign corporation" (petitioner's brief on appeal, p. 7).

Petitioner relies on the fact that the Supreme Court in Container refrained from addressing "the constitutionality of combined apportionment with respect to state taxation of domestic

[3]The parties agree that the four part test applicable to interstate commerce has been met.

corporations with foreign parents" (Container Corp. of Am. v. Franchise Tax Bd., supra, 77 L Ed 2d 545, 568 fn 26). Petitioner also points to the decision of the California Court of Appeals in Barclays Bank Intl. v. Franchise Tax Bd. (225 Cal App 3d 1342, 275 Cal Rptr 626) in which the Court, dealing with the same tax at issue in Container but applied to a foreign taxpayer, concluded that imposition of the tax violated the Commerce Clause of the Constitution. The combination of these two factors, urges petitioner, forms a basis for this Tribunal to reach a decision that imposition of the tax on petitioner here is unconstitutional because it impairs Federal uniformity.

We cannot agree.

A "state tax at variance with Federal policy will violate the 'one voice' standard if it either implicates foreign policy issues which must be left to the Federal Government or violates a clear Federal directive" (Container Corp. of Am. v. Franchise Tax Bd., supra, 77 L Ed 2d 545, 571-572).

Imposition of the tax here violates no clear Federal directive. There is no assertion or evidence here that Federal tax statutes themselves provide the necessary preemptive force. Moreover, the Treaty (with the exception of the non-discrimination clause which we have determined is not violated by the imposition here) clearly does not affect the method of taxation employed by the states (Container Corp. of Am. v. Franchise Tax Bd., supra, 77 L Ed 2d 545, 573).

With regard to foreign policy, it appears that petitioner's position is that taxation of a branch or subsidiary of a foreign corporation always "implicates foreign policy issues which must be left to the Federal Government."

We find no affirmative basis for petitioner's assertion.

We do not find the reservation of this issue by the Court in Container, relied upon by petitioner, an indication that state taxation of a subsidiary of a foreign corporation per se implicates foreign commerce in an unconstitutional manner. We believe it more prudent to rely on what analysis the Court did provide rather than to speculate on its response to issues it did not address.

In this context, the Court stated that the most obvious foreign policy implication of a state tax was the threat of possible retaliation by foreign governments, something the Court felt it had "little competence in determining . . . and even less competence in deciding how to balance a particular risk of retaliation against the sovereign right of the United States as a whole to let the States tax as they please" (Container Corp. of Am. v. Franchise Tax Bd., supra, 77 L Ed 2d 545, 572).

Our competence on this subject is certainly no greater than the Court in Container; however, we fail to see how imposition of the tax on petitioner under the facts herein raises the threat of retaliation, nor are we presented with any evidence on the subject. In contrast, the Court in Barclays was presented with explicit evidence of retaliation. The Court in that case noted that: "[e]very single nation in the industrialized western world has sent letters to the United States government protesting the use of WWCR (Worldwide Combined Reporting) by American States" (Barclays Bank Intl. v. Franchise Tax Bd., supra, 275 Cal Rptr 626, 638). The Court also pointed to retaliatory legislation passed in 1985 by Great Britain. British corporations have incurred a tax in New York similar to the instant imposition at least since 1924 (see, Bass, Ratcliff & Gretton v. State Tax Commn., supra, 69 L Ed 282). Therefore, there has been plenty of time for retaliatory acts. Nonetheless, petitioner has failed to prove that any such acts have occurred.

Petitioner also asserts that the Administrative Law Judge erred in distinguishing the instant case from Container and Barclays on the grounds that petitioner here operated as a single entity through a branch and not as a unitary business operating through a subsidiary corporation. Petitioner asserts that the decision in Bass, relied on by the Administrative Law Judge, should not be viewed as persuasive case law because Bass is "a sixty-year old decision predating modern treaties and involving an entirely different and much less interconnected world economy and different political and economic climate" (petitioner's brief at hearing, p. 27), and that if Bass were dispositive of the issue, the Container Court would have reached its decision on that basis. We disagree with petitioner's rationale. Bass represents direct precedent from the United States Supreme Court sustaining the imposition of the New York franchise tax on a British company

doing business in New York State on the basis of allocated income on the same basic facts as exist here. The principles enunciated by the Court in Bass retain their vitality (see, Mobil Oil Corp. v. Commissioner of Taxes of Vermont, 445 US 425, 63 L Ed 2d 510, 521 [where the Court relied upon Bass to uphold a state's right to tax dividends from foreign subsidiaries]).

We note further that New York does not allow nor require foreign corporations to be included in combined reports (20 NYCRR 6-2.5[6]). The State thus avoids the fundamental issue of taxing a corporation which has contact with the state only through the activities of a subsidiary corporation, the principal issue in Container and Barclays.

Petitioner also asserts that the imposition of the tax violates the Commerce Clause because of the burden of compliance in its case. Again, petitioner relies on Barclays where the Court determined that foreign commerce is unconstitutionally interfered with if the effect of a state tax is to place an unreasonably high cost of compliance on taxpayers engaged in foreign commerce.

Petitioner asserts that the Administrative Law Judge erred by not giving "due weight" to facts concerning the cost of its compliance as demonstrated by petitioner and not disputed by the Division and the testimony of petitioner's witness concerning the absence of "an accounting system that would permit recasting of accounting records in a manner that would conform with Federal and New York tax-reporting standards" (petitioner's brief on appeal, p. 5). We do not agree.

The Court in Barclays is clear to point out that costs alone are not enough to invalidate the tax. In essence, the Court dealt with the issue as an integral part of its conclusion that the California tax interfered with foreign commerce. We have determined that the tax as applied here does not interfere with foreign commerce and agree with the California court that cost alone is not enough to invalidate the tax.

In summary, we find the tax herein imposed does not violate the nondiscrimination clause of the Treaty nor the Foreign Commerce Clause of the Constitution.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Reuters Ltd. is denied;

2. The determination of the Administrative Law Judge is affirmed;

3. The petition of Reuters Ltd. is denied; and

4. The three notices of deficiency dated October 14, 1983, as modified at the conciliation conference, are sustained.

DATED: Troy, New York
March 21, 1991

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

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

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