STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
CONTAINERSHIP AGENCY, INC.	:	DECISION DTA No. 803085
for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Years 1980 through 1982.	:	

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on June 28, 1990 with respect to the petition of Containership Agency, Inc., 96 Morton Street, New York, New York 10004, for redetermination of a deficiency or for refund of corporation franchise tax under Article 9-A of the Tax Law for the years 1980 through 1982 (File No. 803085). Petitioner appeared by Howard Klein, C.P.A. The Division of Taxation appeared by William F. Collins, Esq. (Anne W. Murphy, Esq., of counsel).

The Division of Taxation filed a letter brief in support of its exception and petitioner filed a letter brief in response. Oral argument, at the request of the Division of Taxation, was held on January 30, 1991.

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

ISSUE

Whether certain payments made by petitioner to its parent corporation were "salaries and other compensation" which must be included in computing petitioner's tax pursuant to former Tax Law § 210(1)(a)(3).

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for finding of fact "10" which has been modified. We have also made an additional finding of fact. The Administrative Law Judge's findings of fact, the modified finding of fact and the additional finding of fact are set forth below.

Petitioner, Containership Agency, Inc., operates as an agent for foreign steamship companies and provides booking, delivery, loading, unloading, control and claims services. It has offices in New York and various other cities.

Petitioner is a wholly-owned subsidiary of F. W. Hartmann and Company, Inc. ("Hartmann") which is also in the steamship agency business and provides additional shipping-related services which petitioner does not perform.

For 1980, petitioner filed a New York State Corporation Franchise Tax Report on which tax was computed based on allocated net income. For 1981 and 1982, petitioner filed New York State corporation franchise tax reports on which tax was computed based on the alternative tax method, using entire net income plus salary and other compensation paid to officers and certain shareholders. Petitioner also filed a Metropolitan Transportation Business Tax Surcharge Report for 1982.

For each of the years at issue, petitioner deducted against income certain items which represented payments to Hartmann for what petitioner referred to as "support services". The amounts deducted for each year were as follows:

Year	Support Services
1980	$474,399.00
1981	538,076.00
1982	608,315.00

Upon audit, petitioner's payments to Hartmann for support services were treated as compensation paid to a shareholder owning in excess of five percent of petitioner's stock and were included in petitioner's alternative base for each year.

Petitioner had filed a refund claim arising from the carryback of a 1981 net operating loss to 1978. The refund claimed was reduced by increasing the alternative base for 1978 by $465,340.00 in support services paid to Hartmann.

On March 6, 1984, petitioner executed a Consent Extending the Period of Limitation of the Assessment of Tax for the year 1980 to February 28, 1985.

On January 29, 1985, petitioner executed a Consent Extending the Period of Limitation of the Assessment of Tax for the years 1980 and 1981 to December 31, 1985.

On November 7, 1985, petitioner executed a Consent Extending the Period of Limitation of the Assessment of Tax for the years 1980, 1981 and 1982 to November 30, 1986.

On December 6, 1985, the Division of Taxation issued a Statement of Audit Adjustment to petitioner showing the following deficiencies arising from the audit:

Year	Deficiency
1980	$ 5,306.00
1981	9,580.00
1982	10,798.00
1982 (surcharge)	1,943.00

Also on December 6, 1985, the Division of Taxation issued the following notices of deficiency to petitioner:

Year	Deficiency in Tax	Interest	Total Due
1980	$ 5,306.00	$4,046.00	$ 9,352.00
		less credit 2,265.00	
			$ 7,087.00
1981	9,580.00	5,626.00	15,206.00
1982	10,798.00	3,989.00	14,787.00
1982 (surcharge)	1,943.00	718.00	2,661.00

SUPPORT SERVICES

The payments made for "support services" consisted of reimbursement of Hartmann by petitioner for salaries, rent, travel and other expenses paid for by said parent corporation and

apportioned after analysis of employees' time attributable to petitioner's operations and analysis of other expenses identifiable as allocable to petitioner.

The following is a breakdown of expenses reimbursed to Hartmann by petitioner:

Item	1980	1981	1982
Officers' salaries, payroll taxes and fringe benefits			
Salary	$275,629.00	$247,620.00	$249,573.00
Related payroll taxes and fringe benefits	38,929.00	58,070.00	65,989.00
	$314,558.00	$305,690.00	$315,562.00[1]
Other salaries, payroll taxes and fringe benefits:			
Accounting Department		$ 68,366.00	$ 84,828.00	$ 98,672.00
Operations Department		13,095.00	20,765.00	28,965.00
Claims Department		-0-	23,108.00	50,956.00
Payroll taxes and fringe benefits		10,727.00	17,034.00	19,491.00
Total other salaries, etc.		$ 92,188.00	$145,735.00	$198,084.00
Other costs:				
Auto & travel (Operations Dept.)		$ 21,364.00	$ 27,571.00	$ 20,781.00
Office rent, postage, computer for agency business, outside professional fees, consultants & miscellaneous		46,289.00	59,080.00	73,888.00
Total other costs		$ 67,653.00	$ 86,651.00	$ 94,669.00
Total of above items		$474,399.00	$538,076.00	$608,315.00

We make the following additional finding of fact:

> Peter W. Hartmann, Ralph D. Hartmann and Joseph Daly were officers of both petitioner and Hartmann, the parent corporation. The amounts denominated "Officers' salaries, payroll taxes and fringe benefits" above represented reimbursement to Hartmann by petitioner for the portion of the salaries paid to these officers by Hartmann attributable to services which

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[1] The Administrative Law Judge's finding of fact "10" has been modified at the request of the Division of Taxation to provide separate figures for the salary amounts and the related payroll taxes and fringe benefits. The original finding of fact contained only the total amounts.

these individuals performed for petitioner. These individuals did not receive a separate salary or other compensation directly from petitioner.[2]

The payments for support services were included in the computation of the income of the parent corporation for purposes of computing the parent's alternative base.

OPINION

The Administrative Law Judge determined that the assessments issued to petitioner should be cancelled because the payments made by petitioner to its parent were not made in order to avoid tax, but were reimbursement for legitimate expenses incurred by the parent on petitioner's behalf.

In its exception, the Division of Taxation (hereinafter the "Division") asserts that the franchise tax does not require that the Division establish that the payments were made for the purpose of tax avoidance in order for the alternative base to apply, but rather that the alternative base is imposed whenever it produces the greatest amount of tax. The Division argues that since individuals who were officers of petitioner were paid salaries or other compensation by petitioner's parent corporation for work performed for petitioner, the payments made by petitioner to its parent which represent reimbursement for these salary expenses are compensation paid to officers within the meaning of former Tax Law § 210(1)(a)(3), and are includable when calculating the amount of income plus compensation subject to tax. The Division specifically does not except to that part of the Administrative Law Judge's determination which held that amounts paid to petitioner's parent for other expenses (including nonsalary expenses and salaries to nonofficer employees) were legitimate expenses which should not be included for purposes of computing petitioner's tax under the alternative base (Division's letter in support of its exception, dated September 28, 1990, page 2).

Petitioner asserts that the determination of the Administrative Law Judge is correct and contends that the Administrative Law Judge did not decide this matter on the question of tax avoidance alone. Petitioner argues that the amounts paid by petitioner to its parent were

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[2] We make this additional finding to more fully reflect the record.

legitimate business expenses which did not include a management fee or profit to the parent. In addition, petitioner asserts that, since the amounts were included by the parent in calculating its net income subject to tax, requiring petitioner to include these amounts in its net income would result in the compensation paid to the officers being included in the alternative base of two corporations, a result the law did not intend.

We reverse in part the determination of the Administrative Law Judge.

For the years at issue, Tax Law § 210(1) provided four alternative methods for the computation of the corporation franchise tax imposed under Article 9-A. The four methods were:

1) on the basis of the corporation's entire net income;

2) on the basis of the corporation's total business capital and investment capital;

3) on the basis of the corporation's entire net income plus compensation; and

4) a flat minimum tax (Tax Law § 210[1][former(a)]).

A taxpayer was required to pay its tax using the method which resulted in the greatest amount of tax. The parties agree that petitioner was required to use the third alternative, also known as the "income plus compensation" or "alternative" base. This alternative provided that the tax be:

> "computed at the rate of ten per centum on thirty per centum of the taxpayer's entire net income plus salaries and other compensation paid to the taxpayer's elected or appointed officers and to every stockholder owning in excess of five per centum of its issued capital stock minus thirty thousand dollars (except as hereinafter provided) and any net loss for the reported year, or on the portion of such sum allocated within the state as hereinafter provided for the allocation of entire net income, subject to any modification required by paragraphs (d) and (e) of subdivision three of this section" (Tax Law § 210[1][a][3] repealed, L 1987, ch 817, sec. 23, eff August 7, 1987, emphasis added).

We first address whether a showing of tax avoidance is required before "salaries and other compensation" paid to officers or stockholders must be added back in computing tax

under the alternative base. As we stated in Matter of Landauer Assocs. (Tax Appeals Tribunal, April 11, 1991):

> "Although the legislative history does indicate that the addback provision of section 210(1)(a)(3) was enacted to thwart tax evasion schemes, there is nothing to indicate that this enactment was intended to require an addback only when such a scheme was identified. To the contrary, the legislative history suggests that an automatic addback requirement was sought so that enforcement efforts would not be required to identify and deal with tax evasion schemes (Bill Jacket, L 1929, ch 385, Memorandum from Commr. Merrill to Counsel to the Governor).
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> "In Matter of W.H. Morton & Co. v. New York State Tax Commn. (91 AD2d 1080, 458 NYS2d 91, affd 59 NY2d 690, 463 NYS2d 437), the Third Department addressed the meaning and intent of the addback required by § 210(1)(a)(3) of the Tax Law. The petitioner in Morton argued that since the salaries paid its officers were not taken as Federal deductions because it was fully reimbursed by a related corporation, the payments to its officers were not 'salaries and other compensation' within the meaning of § 210(1)(a)(3). In response, the court stated that:
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> > 'This misconception is premised upon petitioner's view that respondent's notices of deficiency of additional franchise taxes due are based upon respondent's conclusion that petitioner had attempted to avoid tax by distributing profits in the forms of excess salaries . . . To the contrary, the finding of franchise tax deficiency was made on the basis of the statutory language of section 210 (subd. 1, par. [a]) of the Tax Law that requires the computation to be made that produced the highest tax (Matter of W.H. Morton & Co. v. New York State Tax Commn., supra, 458 NYS2d 91, 93).' "

We, therefore, conclude that former Tax Law § 210(1)(a)(3) did not require a finding of tax avoidance before the alternative base could apply or before particular payments were required to be included in the alternative base calculations.

We next address whether the payments remaining at issue here are required by the statute to be included.

The Division argued on audit and at the hearing below that the payments made by petitioner to its parent were includable in the alternative base calculation in their entirety as salaries and other compensation paid to a stockholder within the meaning of former Tax Law § 210(1)(a)(3). On exception, the Division concedes that petitioner does not have to include in its alternative base calculation, payments which represent reimbursement for legitimate business

expenses (see, Advisory Opinion, TSB-A-86[21]C; Matter of Funkhouser Indus. v. Commissioner, T.C. Memo 1957-197, 16 TCM 890; Matter of Landauer Assocs., supra). By only excepting to the part of the Administrative Law Judge's determination relating to officers' salaries, the Division apparently accepts that the other payments made by petitioner were reimbursements for such expenses. However, the Division asserts that the amounts representing officers' salaries and related expenses must be included in the alternative base. While not abandoning the theory that these payments were compensation to a stockholder, the Division now also argues that these payments are includable as salaries and other compensation paid to officers of a taxpayer within the meaning of former Tax Law § 210(1)(a)(3).

Petitioner argues that all the payments it made to its parent should not be added back because they were reimbursement for legitimate business expenses, citing Matter of Funkhouser Indus. (supra), and because its parent included these payments in its net income for purposes of calculating its tax under the alternative base.

We agree with the Division that former Tax Law § 210(1)(a)(3) requires that the payments at issue here be included in petitioner's alternative base calculation. Tax Law § 210(1)(a)(3) requires that salaries and other compensation paid to a taxpayer's officers or to a stockholder owning in excess of five per cent of the taxpayer's stock be included in calculating the amount subject to tax. As petitioner paid its parent corporation amounts which included reimbursement for salaries and other payroll expenses, it is proper to require that these amounts be included in the alternative base (Matter of Landauer Assocs., supra). The holding in Matter of Funkhouser Indus. (supra) that payments made to a parent corporation for office space and overhead services can be treated as deductible business expenses, is inapplicable, as the Division has conceded that overhead expenses similar to those in Matter of Funkhouser Indus., 0as well as salaries and related expenses for employees who were not officers of petitioner, are not includable in petitioner's alternative base.[3]

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[3]It appears that the Division need not have allowed the salaries and related payroll expenses of the nonofficer employees. The Division's Advisory Opinion (TSB-A-86[21]C) holds that reimbursement to a parent of certain business expenses need not be included. However, the Advisory Opinion and our decision in Matter of Landauer

However, the language of former Tax Law § 210(1)(a)(3) is unequivocal that salaries and other compensation paid to a taxpayer's officers or a stockholder must be added back. The court in Matter of W.H. Morton & Co. (supra), in discussing the inclusion of salary and compensation paid to a taxpayer's officers, noted that the language of Tax Law § 210 was unambiguous and clearly provided for inclusion without regard to the actual duties or functions of the individual officers (Matter of W.H. Morton & Co., supra, 458 NYS2d 91, 93). The same analysis applies to payments to stockholders. There is no statutory support for excluding such amounts because they can be characterized as bonafide reimbursement for services rendered.

In addition, there is nothing in the language of the statute or Matter of W.H. Morton & Co. (supra) (the only case cited by petitioner) that supports petitioner's argument that the parent's tax treatment of the payments controls whether petitioner must include them in its alternative base calculation. If anything, Morton supports the opposite conclusion. In that case, the petitioner's argument that, because the salaries it paid to its officers were not taken as Federal deductions, the payments should not be added to petitioner's net income under the alternative base, was rejected based on the unambiguous language of the statute requiring inclusion.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the Division of Taxation is granted;

2. The determination of the Administrative Law Judge, except with regard to the treatment of amounts representing expenses for officers' salaries and related payroll taxes and fringe benefits, is upheld;

3. The petition of Containership Agency, Inc., except as indicated in paragraph "2" above, is denied; and

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Assocs. (supra) hold that amounts representing reimbursement for salaries and related expenses of a parent's employees and officers must be added back as the statute requires that all salaries and compensation paid to a stockholder be added back without regard to whether the salaries were for officers or other employees.

4. The notices of deficiency dated December 6, 1985 are to be modified consistent with this decision, but are otherwise sustained in full.

DATED: Troy, New York
June 27, 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