STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition of **CAMPBELL SALES COMPANY** for Redetermination of Deficiencies or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Fiscal Years Ended July 31, 1978, July 29, 1979, August 3, 1980, August 2, 1981, August 1, 1982 and July 31, 1983.[1]	: : : : : :	DECISION DTA Nos. 805017 and 805018

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on June 11, 1992 with respect to the petition of Campbell Sales Company, P.O. Box 391, Camden, New Jersey 08101. Petitioner appeared by Whitman & Ransom (George J. Noumair, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Anne W. Murphy, Esq., of counsel).

Both the Division of Taxation and petitioner filed briefs. Oral argument, requested by the Division of Taxation, was heard on June 3, 1993, which began the six-month period to issue this decision.

The Tax Appeals Tribunal renders the following decision per curiam.

ISSUE

Whether the Division of Taxation properly required Campbell Sales Company to file a franchise tax report on a combined basis with its parent corporation, Campbell Soup Company,

1

According to the report prepared by Price Waterhouse, Campbell Sales Company reports for financial and tax purposes on a 52/53 week year ending on or about July 31. Accordingly, the last day of a year is different from year to year. In some cases, the July 31 year end which is nearest to the August date ending in the same fiscal time frame is used for purposes of convenience.

and numerous other Campbell Soup Company subsidiaries for the fiscal years at issue.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for findings of fact "1" and "16" which have been combined and modified, finding of fact "11" which has been modified and findings of fact "17" through "24" and "28" through "30" which have been deleted because they are not relevant to the issues raised on exception. We have also made additional findings of fact which are collectively numbered as finding of fact "11(a)." The Administrative Law Judge's findings of fact, the modified findings of fact and the additional finding of fact are set forth below.

We modify the Administrative Law Judge's finding of fact "16" to become the first sentence in finding of fact "1," and it reads as follows:

On May 6, 1983, the Division of Taxation ("Division") issued to petitioner, Campbell Sales Company ("Campbell Sales"), separate notices of deficiency asserting additional franchise tax due under Article 9-A of the Tax Law for the fiscal years ended July 31, 1978, July 29, 1979 and August 3, 1980 in the following amounts:

Fiscal Year Ended	Tax	Interest	Total Due
7/31/78	$421,026.00	$221,262.00	$642,288.00
7/29/79	320,417.00	141,153.00	461,570.00
8/3/80	420,213.00	149,398.00	569,611.00

The statements of audit adjustment also issued on the same date merely indicate that the assessments are based on a recent field audit with no further explanation. These notices were the reflection of the Division's determination, after an audit of the books and records of petitioner, that the income and the New York State franchise tax of Campbell Sales should be computed on the basis of a combined return with Campbell Soup Company ("Soup") and several other subsidiaries of Soup. On July 25, 1983, petitioner timely filed a petition with the former New York State Tax Commission protesting such deficiencies.

2. A consent extending the period of limitation on the assessment of tax in this matter was executed on behalf of Campbell Sales by its Director of Corporate Tax Administration,

F. W. Magann, on August 18, 1982, thereby extending the time period for assessment of tax for the fiscal years ended July 30, 1978 and July 29, 1979 to any time on or before October 15, 1983.

3. On January 16, 1987, the Division issued to petitioner separate notices of deficiency asserting additional franchise tax due under Article 9-A of the Tax Law for the fiscal years ended August 2, 1981, August 1, 1982 and July 31, 1983 in the following amounts:

Fiscal Year Ended	Tax	Interest	Total Due
8/2/81	$421,786.00	$369,259.00	$791,045.00
8/1/82	419,324.00	263,773.00	683,097.00
7/31/83	436,826.00	187,076.00	623,902.00

The above-referenced notices were issued subsequent to a field audit of petitioner's books and records with respect to such years and are the result of the Division's determination that the income and New York State franchise tax of petitioner should be computed as though petitioner filed a combined return with Soup and several other subsidiaries of Soup. On April 13, 1987, petitioner filed timely petitions with the former State Tax Commission protesting the notices of deficiency dated January 16, 1987.

4. On July 17, 1987, petitioner paid the deficiencies asserted by the Division in full for the six fiscal years plus interest to the date of payment and converted both petitions into claims for refund. The matter was thereafter reviewed by the Bureau of Conciliation and Mediation Services. Correspondence was submitted in lieu of a request for a conciliation conference. On October 9, 1987, two conciliation orders were issued covering the six fiscal years sustaining the statutory notices.

5. On January 6, 1988, petitioner timely filed two petitions with the Division of Tax Appeals with respect to the conciliation orders issued for the fiscal years ended July 31, 1978 through 1980 and a second petition for the fiscal years ended August 2, 1981, August 1, 1982 and July 31, 1983.[2]

2

6. The Division submitted its answers to the petitions as filed with respect to fiscal years ended July 31, 1978 through August 3, 1980 and with respect to fiscal years ended August 2, 1981 through July 31, 1983 dated March 28, 1988 and March 30, 1988, respectively.

7. Petitioner, a wholly-owned subsidiary of Soup, is a New Jersey corporation with its principal office in Camden, New Jersey, qualified to do business in New York. Petitioner maintains 40 offices in 34 states, including two sales offices in New York.

8. Soup, a New Jersey corporation, is a processor and manufacturer of food and food products. Since its organization in 1922, petitioner has been engaged in the business of acting as sales representative or broker in the food business, representing Soup in the solicitation of orders for food products throughout the United States. Petitioner has not represented other food manufacturers due to the large volume of work it handles for Soup. Petitioner's employees solicit orders from unrelated parties for goods sold by Soup. Such orders are transmitted to Soup's offices in Camden for acceptance and credit approval. No part of the credit-related activities are performed by petitioner's employees. Goods are then shipped directly from Soup to wholesalers, distributors or customers and payment therefor is made directly to Soup.

9. Petitioner is completely autonomous and has a separate corporate existence from Soup maintaining its own offices, employees and facilities, none of which are shared. However, its president, who works for petitioner full time, also has the title of vice-president of Soup. All of petitioner's services are performed by its own employees or persons hired by it except for certain administrative functions such as accounting and tax services.

10. From its inception in 1922, Campbell Sales has had its own staff of employees and,

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The parties stipulated to numerous facts in this matter. Stipulation of fact number "10" reflects the timely filing of the petition on January 6, 1988 and refers to Exhibit "20" attached to the stipulation. The parties have provided as Exhibit "20" only the petition reflecting fiscal years ended July 31, 1978 through 1980. However, the files maintained by the Division of Tax Appeals in fact reveal that both petitions were date stamped as having been received by the Division of Tax Appeals on January 12, 1988 having been transmitted by certified mail, return receipt requested, bearing a U.S. postmark of January 6, 1988.

during the years at issue, it had approximately 1,000 employees who worked exclusively for petitioner. There are no persons who are employed by both Campbell Sales and Soup, or by Campbell Sales and an unrelated party. All such employees identify themselves and are identified for all purposes as employees of Campbell Sales and not Soup or some other entity. There is rarely, if ever, a transfer of any employee from petitioner to Soup or vice versa.

We modify finding of fact "11" to read as follows:

> 11. Petitioner utilizes other brokers periodically to solicit orders for new products. In Alaska and Hawaii petitioner retained food brokers to solicit orders for Soup's products and Campbell Sales paid a commission to its Hawaii broker of 2% of sales. Petitioner is a separate and independent company from an operations and accounting standpoint maintaining its own books of account and bank accounts and paying its own expenses. The compensation received by petitioner for the work that it does is governed by an agreement between petitioner and Soup entered into in 1947. There are no other agreements or understandings between petitioner and Soup or any of Soup's subsidiaries regarding petitioner's income or expenses. The agreement provides for a payment to petitioner equivalent to petitioner's costs plus 4% thereof:
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> > "The Soup Company agrees to pay to the Sales Company for the services which shall be performed by the Sales Company under this Agreement, the actual net cost to the Sales Company of the operation and carrying on of the business of the Sales Company so far as the same shall relate to the sale of the products above mentioned while this Agreement shall be in force and effect, including all salaries and wages of officers and employees of the Sales Company, all payments made by the Sales Company to the Prudential Insurance Company of America under the Campbell's Soups Retirement and Pension Plan, effective July 1, 1938, as amended, and all payments made by the Sales Company to The Travelers Insurance Company under the Campbell's Soups Group Life Insurance Plan, effective March 1, 1947; plus four (4) per cent of such actual net cost...."
>
> The compensation paid by Soup to petitioner for each of the fiscal years 1954 through 1983 expressed as a percentage of Soup's sales generated by petitioner was as follows:

Compensation paid by
Soup to Campbell Sales, as a
Percentage of sales made by Soup

FYE July 31	Percentage
1954	2.0921%
1955	2.3572
1956	2.6862
1957	2.7520
1958	2.3505
1959	2.4290
1960	2.3796
1961	2.3790
1962	2.3057
1963	2.3398
1964	2.2702
1965	2.4143
1966	2.3769
1967	2.4164
1968	2.4295
1969	2.4785
1970	2.4752
1971	2.5253
1972	2.5937
1973	2.4802
1974	2.4165
1975	2.4735
1976	2.4851
1977	2.5112
1978	2.8684
1979	2.8256
1980	3.0176
1981	3.1398
1982	3.2968
1983	3.4322

The payments have been, for most years, the equivalent of sales to petitioner in the 2 to 3% range. The New York State Tax Commission held in a similar case involving Campbell Sales' 1977 fiscal year that the compensation petitioner receives for services rendered to Soup was equal to or greater than amounts comparable persons receive from independent, unrelated parties for the performance of substantially similar services. Other than the 1947 agreement between petitioner and Soup there are no transactions, agreements, understandings or arrangements between petitioner and Soup or between petitioner and any other company.[3]

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The ninth sentence of finding of fact "11" was deleted. This sentence read as follows:

"A 2 to 3% commission for the work which Campbell Sales does has been

We find an additional finding of fact to read as follows:

> 11(a). During the period at issue, Soup assembled a national network of independent brokers that it retained periodically to solicit orders for selective product lines and in certain geographic locations (Tr., pp. 18, 26-27). It was not revealed whether Tanaka Dodge provided brokerage services to companies other than Soup. Campbell Soup set a national commission rate for each of its products. These rates uniformly governed all of these independent brokerage arrangements in which individual product commission rates were used (Tr., p. 36).[4] The commission rates were arrived at based on the market recognition of the particular product to be brokered, and were applied to the net sales generated by the brokers (Tr., pp. 36, 37). These rates ranged from 1.5 percent to 3.5 to 4 percent.
>
> The determination of whether independent brokers were to be retained was based on the market recognition of a specific product, as well as geographic considerations (Tr., p. 18). Market recognition of a product has a significant impact on sales volume and, consequently, the amount of effort required of a broker to approach a sales volume that would be acceptable to both Campbell Soup and the broker. Where petitioner would determine that certain products required more broker involvement than it could provide,[5] or if a geographic area has been identified as possessing lesser volume opportunities (Tr., p. 41) or was otherwise not desirable to petitioner, it would then use independent brokers.
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> These independent brokers were paid by Soup, but managed by petitioner (Tr., p. 28). The brokerage services performed by petitioner were identical in nature to the services performed by the independent brokers (Tr. pp. 51-52). Unlike many of Soup's independent brokers who served as brokers for several food manufacturers and a variety of products, petitioner provided brokerage services only for Soup.

12. Petitioner's only activities in New York are operating two sales offices out of which

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> established to be a fair and reasonable commission and is not less than, and is probably more than, the equivalent of the amount that would be paid for such work on an arm's-length basis involving unrelated parties."

This sentence has been deleted because it is significantly different from the facts stipulated to by the parties.

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The only deviation from this method stated in the record is the 2 percent commission arrangement Soup had with its Hawaiian broker, Tanaka Dodge.

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This is the reason that independent brokers were awarded higher rates of commission for new product lines than for the more established lines, to reflect the additional costs likely to be incurred by the broker (Tr., pp. 41, 42).

salesmen operate to solicit sales. Soup is a non-New York taxpayer having no activities in New York, and its only connection with New York being the shipment of goods from outside New York to customers in New York.

13. Since 1941, as reflected by its New York State franchise tax returns as filed, petitioner has calculated its New York franchise tax liability pursuant to a formula agreed upon and modified in 1947 by petitioner and the Division. Pursuant to this agreement, petitioner computes its gross income as 4% (adjusted in the event Soup's advertising expenses fall below 3½% of its sales) of Soup's total sales for the year, subtracts its expenses, and allocates the net income to New York in the proportion which petitioner's expenses incurred with respect to New York bear to petitioner's total expenses. Petitioner's computation of its New York franchise tax liability for the fiscal years at issue is reflected on a statement attached to its returns for the respective years and reproduced in Exhibit "A" herein (see, Appendix "A").

14. The tax that would have been computed under the statutory formula and the tax computed and actually paid by petitioner pursuant to the 1947 agreement for the fiscal years 1978 through 1983 were as follows:

Fiscal Year Ended	Tax Per Agreement	Tax Per Statutory Formula
7/31/78	$80,282.00	$ 9,252.00
7/29/79	94,743.00	8,799.00
8/3/80	64,199.00	8,568.00
8/2/81	51,261.00	9,177.00
8/1/82	49,318.00	15,904.00
7/31/83	66,207.00	19,318.00

15. As a result of the two field audits, the Division determined that petitioner must file a combined return for the fiscal years in issue with Soup and up to 10 other subsidiaries of Soup, all except one of which are not New York taxpayers. None of the subsidiary corporations have any transactions with petitioner. The corporations the Division sought to include in the New York franchise tax combined report with petitioner were as follows:

(1) Soup (incorporated in New Jersey in 1922) - the parent corporation. (Not a N.Y.S. taxpayer)

(2) Joseph Campbell Company (incorporated in New Jersey in 1972) - a wholly-

owned subsidiary of Soup which grows and purchases vegetables, all of which it sells to its parent. (Not a N.Y.S. taxpayer)

(3) Champion Valley Farms, Inc. (incorporated in New Jersey in 1969) - a wholly-owned subsidiary of Soup which produces pet foods, all of which it sells to its parent. (Not a N.Y.S. taxpayer)

(4) Valley Tomato Products, Inc. (incorporated in California in 1966) - a wholly-owned subsidiary of Soup which manufactures tomato paste, all of which it sells to its parent. (Not a N.Y.S. taxpayer)

(5) Southeastern Wisconsin Products Company (incorporated in Wisconsin in 1965) - a wholly-owned subsidiary of Soup which sells food flavorings to its parent. All sales are to the parent. (Not a N.Y.S. taxpayer)

(6) Campbell Soup Co. (Sumter Plant), Inc. (incorporated in South Carolina in 1965) - a wholly-owned subsidiary of Soup which manufactures frozen dinners and processes poultry. Approximately 70 percent of its sales are to the parent. (Not a N.Y.S. taxpayer)

(7) Campbell Frozen Foods Distributing Co. (incorporated in New Jersey in 1955) - a wholly-owned subsidiary of Soup which purchases frozen dinners from the parent and resells them to institutional customers under the name "EfficienC". All of its purchases are from Soup. This corporation is the only N.Y.S. taxpayer besides Sales but Sales has engaged in no transactions with this corporation.

(8) Campbell Foreign Sales, Inc. - DISC (according to the Department, consolidated but not combined). (Not a N.Y.S. taxpayer)

(9) Dixon Canning Corp. - (Not a N.Y.S. taxpayer)

(10) Campbell Finance Corp. - (Not a N.Y.S. taxpayer) (1979, 1980 only)

(11) Herider Farms - (Not a N.Y.S. taxpayer) (1981, 1982, 1983 only)

(12) Domsea Farms - (Not a N.Y.S. taxpayer) (1982, 1983 only)

(13) Campbell Investment Co. - (Not a N.Y.S. taxpayer) (1982, 1983 only)

The phrases "Not a New York taxpayer" or "Not a N.Y.S. taxpayer" as used above should be interpreted to mean that the corporation referred to did not file a New York franchise tax report on the grounds that it is not subject to New York franchise tax in its own right, a conclusion with which the Division agrees. However, the Division included such corporations in a combined report with petitioner with regard to Soup because of its relation to Campbell Sales and with regard to the other corporations because of their relation to Soup. As to the other subsidiary corporations, Soup owns 100% of their stock and there were substantial intercompany transactions between each of them and Soup such that the corporations should be combined with petitioner and Soup under the Division's interpretation of the relevant statutes and regulations. Petitioner does not agree with the Division's interpretation in this regard and it is such disagreement that is the principal issue in this proceeding.

THE NEW YORK STATE AUDITS

25. The corporation tax field audit of Campbell Sales for the fiscal years ended in 1978, 1979 and 1980 took place between early 1982 and the end of March 1983 according to the field audit report. The field audit report for these fiscal years included comments regarding a previous audit involving Campbell Sales. A portion of that report is extracted and reproduced below:

> "[t]he previous New York audit originally included the fiscal years ended 7/74, 7/75, and 7/76. During that audit, consideration was given to require combination under Section 211.4 for these years but was not pursued due to the agreement with the Tax Commission mentioned previously. The taxpayer, however, was advised by the A. D. O. that a combined report should be filed rather than using the 211.5 adjustment beginning with year ended 7/77. The taxpayer has continued to file his New York reports based on 211.5. Consequently, the franchise tax was recomputed on a combined basis per audit using the statutory formula for FYE 7/77. The taxpayer disagreed and a formal hearing was held in June of 1982. No decision has been rendered as of this time.
>
> Our audit disclosed that several of the affiliated companies were acting in a unitary capacity and that there are also substantial intercompany transactions. These facts form the basis for requiring combined reports; that is existence of a unitary business and sufficient intercompany transactions that meet the 50% test pursuant to the statute and regulations.
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> Consequently, our determination is similar to that arrived at for FYE 7/77 in the previous New York State audit. There is no basis for continuing to allow filing under this method for which there is no justification. Furthermore, a combined report is recommended for the taxpayer and several of its affiliated companies to properly reflect its business activity in New York State and to insure a degree of equity among competing manufacturing firms. The 211.5 method provides a competitive advantage in the State, since all of the sales of Campbell Soup Company (a non-New York taxpayer) are solicited by the Campbell Sales Company while most expenses and responsibilities of the group are borne by the parent.
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> Since this is certainly a unitary business as described in Section 211.4 of the Tax Law, a combined report is a better measure of the company's tax liability and consequently there is no need to continue the 211.5 adjustment.

* * *

> In order to reflect the proper New York tax liability of the subject group of corporations, combined reports are necessary since these companies are involved in a unitary business due to the fact that Campbell Sales Company and the others exist only to facilitate the manufacture and sale of the parent's products. In fact, they operate as departments of the same unitary business. Campbell Sales Company, as the exclusive sales agent of the parent, only solicits orders for Campbell Soup Company's products. Due to the nature of the business, it is virtually impossible for customers to distinguish between the two companies. The remaining combined corporations are suppliers of raw materials and semi-finished goods for other members of the combination. In view of the above, a combined report will serve to better measure the New York activity."

26. The field audit report for the fiscal years ending in 1981, 1982 and 1983 is signed and dated February 10, 1986. The general findings of the report were nearly identical to the commentary reproduced above from the prior audit and it was again recommended that the taxpayer be assessed in accordance with schedules computing franchise tax liability on a combined basis. It was noted that the audit was to be held in abeyance pending the outcome of the Campbell Sales court decision for fiscal year ended 1977.

27. The Division called as its witness the team leader of the field audit covering the fiscal years ending in 1978, 1979 and 1980 being conducted with regard to Campbell Sales. The auditor is presently in charge of the corporation tax audit section for franchise tax in the Buffalo District Office and has maintained the position with the Division in the franchise tax bureau for 27 years. The auditor testified that the field audit was performed at the Campbell Soup office in Camden, New Jersey at its tax office and headquarters. The Division examined the books and records for all of the affiliated corporations in order to make a determination of whether any of the corporations not filing in New York were in fact performing a taxable activity in New York, or if one or more corporations should be permitted or required to file a combined report. The auditor testified that the findings on audit were generally consistent with a previously conducted audit which recommended a combination of Campbell Sales, the parent Soup and numerous other subsidiary corporations. It was noted that, in a few cases, companies that had been included in the previous audit did not maintain sufficient intercompany transactions to require a combined filing in the current period and vice versa. The auditor further testified as to the mechanics of the computation of the franchise tax as a result of the combined reporting

requirement. Petitioner's analysis of the audit results contained herein summarizes such computation as well and a portion of the field audit report relating to such computation is presented above. With the exception of a brief discussion regarding elimination of intercompany receipts between the corporations when combined reporting is applied, the auditor's testimony merely confirmed the approach taken by the Division in its computation for combined reporting purposes. When the auditor was questioned as to the general basis for the determination by the Division to require a combined report which included certain subsidiaries and Soup, the auditor responded as follows:

> RICHARD H. STEIN: "Basically under the Statute 211.4 and under the Regulation 6-2, all of the tests were met. The ownership of stock test was met. We combined Campbell Soup Company and subsidiaries and eight or nine other subsidiaries of Campbell Soup Company which they had a hundred percent control or ownership. They were a unitary business. They were in the same lines of business. They were selling to each other or servicing for each other.
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> For instance, the Sales Company's total business was to solicit sales of Campbell products. All of their revenue was coming from the parent company and there were substantial intercompany transactions between the companies we combined."

OPINION

In the determination below, the Administrative Law Judge held that petitioner presented evidence sufficient to establish that its separate filing of its corporate franchise tax return and exclusion of its parent, Campbell Soup, properly reflected its tax liability under Article 9-A as required under Tax Law § 211(4) (Determination, conclusion of law "M").

On exception, the Division asserts that petitioner's franchise tax liability is properly reflected only when it computes its entire net income on a combined basis with its parent, Campbell Soup, and other affiliated corporations. In support of this position, the Division asserts that: a) petitioner has not overcome the presumption that its income for the period at issue is not properly reflected in the filing of separate reports;[6] b) although an analysis of

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[6]In its brief on exception, the Division discusses the authority allowing it to tax a resident corporation and its nonresident affiliates on a combined basis, then examines the facts and concludes that combination was warranted here (i.e., a presumption of distortion existed). However, this point was conceded by petitioner at hearing (see, Determination, conclusion of law

"arm's-length" pricing under the regulations interpreting Internal Revenue Code section 482 ("section 482") is often a relevant inquiry in cases such as this, this standard may not be substituted for the actual standard -- whether separate reporting results in a proper reflection of income (citing Matter of USV Pharm. Corp., Tax Appeals Tribunal, July 16, 1992; Matter of Standard Mfg. Co., Tax Appeals Tribunal, February 6, 1992) and "the suggestion that section 482 principles apply does not resolve the issue of whether the presumed distortion of petitioner's income and franchise tax liability has been overcome"; c) if a section 482 analysis is relevant here, petitioner has failed to establish that the transactions undertaken with its parent were at arm's-length prices; d) because petitioner is a member of a vertically integrated group of corporations, benefits flow to petitioner which are not readily quantified on review of intercorporate pricing and, therefore, require combined reporting. Specifically, the Division notes that petitioner, by virtue of this expense-based agreement with Campbell Soup, is guaranteed: (i) a profit, (ii) supply requirements, and (iii) the quality of the product marketed, and despite recent combined reporting decisions issued by the Tax Appeals Tribunal, the facts of this case are not substantially different from Matter of Campbell Sales Co. v. New York State Tax Commn. (68 NY2d 617, 505 NYS2d 54 revg 111 AD2d 995, 490 NYS2d 313) to justify a different result.

In response, petitioner makes the following arguments: 1) the statute, regulations, and decisional law uniformly require an improper reflection of tax liability (i.e., distortion) arising from intercompany transactions or some other arrangement as the predicate for a New York taxpayer to file a combined return with a non-New York taxpayer; 2) although the law is clear that the presumption of distortion is overcome by substantial evidence to the contrary, petitioner has overcome this presumption by submitting overwhelming and uncontradicted evidence as against the Division's failure to submit any evidence or consider the issue of distortion in making its assessments; 3) the Tribunal should reject the Division's "assertions . . . outside the record" to discredit the Administrative Law Judge's findings and conclusions were based on

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"I"). Therefore, it is not necessary to address this point.

credible and uncontradicted evidence; 4) "the Division's determination constitutes the imposition of a tax on petitioner's parent, a non-New York taxpayer, in contravention of Public Law 86-272, 15 USCA § 381" (Petitioner's brief on exception, p. 67) and 5) "the tax sought to be imposed by the Division is out of all appropriate proportion to the business transacted by petitioner in New York and, accordingly, violates the Due Process Clauses of the United States (14th Amend) and New York State Constitutions (art I, § 6)" (Petitioner's brief on exception, p. 68).

We affirm the determination of the Administrative Law Judge.

We are presented with the issue of whether petitioner has overcome the presumption existing in this case that its filing of a separate corporate franchise tax report under Article 9-A of the Tax Law results in an improper reflection of its New York tax liability.

Tax Law § 211(4), which is the governing statute in this dispute, provides in part:

> "[i]n the discretion of the [Division], any taxpayer, . . . substantially all the capital stock of which is owned or controlled either directly or indirectly by one or more other corporations . . . may be required or permitted to make a report on a combined basis covering any such other corporations . . .; provided, further, that no combined report covering any corporation not a taxpayer shall be required unless the [Division] deems such a report necessary, because of inter-company transactions or some agreement, understanding, arrangement or transaction referred to in [Tax Law § 211(5)], <u>in order to properly reflect the tax liability under this article</u>" (emphasis added).

We have held where a taxpayer corporation and related corporations are found to meet the requirements[7] set forth in the Division's regulations interpreting section 211(4), a rebuttable

[7]The requirements necessary to give rise to the presumption of distortion in this case are as follows:

1) "substantially all of the capital stock of the taxpayer and substantially all of the capital stock of the other corporations which are to be included in the combined report are owned or controlled, either directly or indirectly, by the same interests" (20 NYCRR former 6-2.2[a][3]);

2) "the corporations are in substance parts of a unitary business conducted by the entire group of corporations" (20 NYCRR former 6-2.3[a][1]); and

presumption arises that the taxpayer corporation's New York income will not be properly reflected without reporting on a combined basis (Matter of Standard Mfg. Co., supra). This is commonly referred to in the case law and regulations as "a presumption of distortion." If this presumption arises, the burden is on the taxpayer to overcome this presumption by establishing that separate reporting results in the proper reflection of income (Tax Law § 211[4]; Matter of Standard Mfg. Co., supra). Because petitioner has conceded that the requirements necessary to give rise to the presumption are present during the years at issue, we must only address whether petitioner has provided evidence sufficient to overcome this presumption.

In two recent combined reporting cases, Matter of USV Pharm. Corp. (supra) and Matter of Standard Mfg. Co. (supra), we concluded that although the presumption of distortion existed, the petitioners had overcome the presumption by establishing, through the use of section 482 adjustments resulting from a Federal audit, that its intercompany transactions were at arm's-length prices. Because the petitioners used the adjusted prices in computing their New York tax liability, such liability in both cases was found to be properly reflected and, thus, separate reporting was allowed.

In another combined reporting case recently decided by the Tribunal, Matter of Medtronic, Inc. (Tax Appeals Tribunal, September 23, 1993), we again found a presumption of distortion to exist. However, in this case we found that although the petitioner was the subject of a Federal audit, it had failed to prove that the Internal Revenue Service had examined its intercorporate transactions and found no section 482 adjustments to be necessary. Therefore, in the absence of such proof, we applied the "arm's-length" principles of section 482 to these transactions.

The transactions at issue in Medtronic were purchases and sales of tangible goods and materials. Therefore, under the section 482 regulations, the petitioner's task was to prove that the transactions between itself and its subsidiaries were "at a price that an unrelated party would

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3) "there are substantial intercorporate transactions among the corporations" (20 NYCRR former 6-2.3[a][2]).

have paid under the same circumstances for the same property involved in the controlled sale" (26 CFR 1.482-2[e][1][i]). The regulations further required that if a like transaction could not be found, any differences between the two transactions being compared "can be measured and eliminated by making a reasonable number of adjustments" (26 CFR 1.482-2[e][2][ii]). In its attempt to prove arm's-length pricing, the petitioner presented the testimony of an expert witness, who, after examining similar transactions, concluded that petitioner's transactions with its subsidiaries were arm's length. In upholding the assessment, we concluded, as did the Administrative Law Judge below, that the expert's testimony was not entitled to significant weight due to his failure to disclose the underlying factual basis for his conclusions (Matter of Medtronic, Inc., supra).

Because, like in Medtronic, there are no Federal transfer pricing adjustments made to the transactions at issue, we will follow the approach set out in Medtronic, examining the arm's-length nature of these transactions by applying the principles of section 482. The Federal regulations under section 482, which address how the performance of services should be valued, state the following:

> "(1) General rule. Where one member of a group of controlled entities performs marketing, managerial, administrative, technical, or other services for the benefit of, or on behalf of another member of the group without charge, or at a charge which is not equal to an arm's length charge as defined in subparagraph (3) of this paragraph, the district director may make appropriate allocations to reflect an arm's length charge for such services" (26 CFR 1.482-2[b][1]).

Subparagraph (3) provides in part:

> "an arm's length charge for services rendered shall be the amount which was charged or would have been charged for the same or similar services in independent transactions with or between unrelated parties under similar circumstances considering all relevant facts" (26 CFR 1.482-2[b][3]).[8]

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This subparagraph goes on to state that where the services at issue are not an integral part of the business activity of either the service provider or recipient "the arm's length charge shall be deemed equal to the costs or deductions incurred with respect to such services . . ." (26 CFR 1.482-2[b][3], emphasis added). However, because "[s]ervices are an integral part of the business activity of a member of a controlled group where [inter alia] the renderer renders

As we commence with an evaluation of the evidence, we would like at the outset to address the testimony of John P. Cloherty, petitioner's director of sales planning. In the determination below, the Administrative Law Judge concluded the following with regard to the testimony of Mr. Cloherty:

> "Mr. Cloherty presented a straightforward and informed opinion as to the rate of commission paid to independent food brokers and unequivocally offered favorable comments regarding the competitiveness of the rate paid by Soup to petitioner. He presented himself as having long-term experience with food brokers and an expertise in the food industry. Through his membership in the National Food Brokers Association and by frequently reviewing trade journals he testified that he remains knowledgeable about the industry and maintains his familiarity with rates charged under like arrangements. He confidently fielded questions regarding utilization of a direct sales force versus independent broker organizations vis-a-vis the commission arrangement, the role of product lines in the formulation of the commission rate, and the range of rates likely to be paid to an independent broker of a company with a Soup-type product line. Mr. Cloherty's credible testimony was sufficiently persuasive to conclude that [petitioner], with a direct sales force, essentially functions in the same manner as does an independent broker organization and receives payment at an arm's-length competitive rate for such services" (Determination, conclusion of law "J").

We agree with the Administrative Law Judge that Mr. Cloherty's considerable experience and familiarity with both the rate structure of, and services performed under, the commission arrangements entered into by Soup qualifies him as a witness competent to testify with regard to these specific facts. However, our review of Mr. Cloherty's testimony indicates that he failed to explicitly state the basis for his conclusion regarding the arm's-length nature of the commission-equivalents paid to petitioner. In prior cases, an expert witness' failure to disclose the facts which were (or which should have been) considered in formulating his opinion has proven fatal to the petitioner's case (see, Matter of Medtronic, Inc., supra; Matter of Bernstein, Tax Appeals Tribunal, December 24, 1992). This result is avoided here, however, because the record reveals a basis to conclude that the commission-equivalent paid by Soup to petitioner was at an arm's-

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services to one or more related parties as one of its principal activities" (26 CFR 1.482-2[b][7][ii][a] [first sentence]), and petitioner's brokerage services for Soup were clearly its principal activity, these services are an integral part of its business activity. Therefore, this alternate standard under this portion of the regulation is not applicable.

length rate, even though Mr. Cloherty did not himself refer to these facts to support this conclusion.

In determining whether the amount petitioner charged Soup for brokerage services is an amount that was charged for the same or similar services in an arm's-length transaction under the same or similar circumstances, we find three facts in the record to be of primary significance. First, it was established through the uncontroverted testimony of Mr. Cloherty that the brokerage services performed by petitioner were identical in <u>nature</u> to the services performed for Soup by independent brokers (Tr., p. 51-52).

The second critical fact is drawn from a stipulation entered into by the parties, which states:

> "[Petitioner] utilizes other brokers from time to time to solicit orders for new products. In Alaska and Hawaii, [petitioner] retained food brokers to solicit orders for Soup's products, and [petitioner] paid a commission to its Hawaii broker of 2 percent of sales" (Parties' stipulation of facts, p. 5).

In determining whether these brokerage services performed by Tanaka Dodge represent "the same or similar services" so as to qualify the two percent commission that it received as an "arm's length charge" (26 CFR 1.482-2[b][3]), the <u>scope</u> of these services, specifically the range of products sold by Tanaka Dodge on Soup's behalf, is of critical importance. The stipulated fact cited above is the only information in the record concerning this arrangement. When interpreting a stipulation, we have stated that the meaning of a stipulation "is determined by ascertaining the intent of the parties, and such intent is a question of fact [citations omitted]" (<u>Matter of J & L Home Improvement Corp.</u>, Tax Appeals Tribunal, August 1, 1991, <u>quoting</u> <u>Stamos v. Commissioner</u>, 87 TC 1451). Additionally, words in a stipulation should be given their plain meaning (<u>see</u>, <u>Chicago & North W. Ry. Co. v. Commissioner</u>, 29 TC 989, 1005; <u>Estate of Meyer v. Commissioner</u>, 200 F2d 592, 53-1 USTC ¶ 9138 at 129, <u>revg</u> 15 TC 850). With these principles in mind, we will attempt to ascertain the parties' intended meaning of the words used in the above stipulated fact.

In the stipulation, the parties referred to Tanaka Dodge as "<u>[petitioner's] Hawaiian</u>

broker," which solicited orders for "Soup's products." Giving these words their plain meaning, paying particular attention to the singular usage of "broker," we interpret these words to mean that Tanaka Dodge was the sole broker of Soup's products in Hawaii, for which it was paid a flat 2 percent commission rate for selling the entire range of Soup's products.

Further support for this interpretation can be found in Campbell I. "[S]tipulations, like other contracts, must be interpreted in light of the circumstances under which the agreement was made" (National Audubon Socy., v. Watt, 678 F2d 299, 306). In Campbell I, the only facts found by the State Tax Commission regarding the Soup-Tanaka Dodge arrangement were that

> "[i]n Alaska and Hawaii, petitioner retained food brokers to solicit orders for Soup's products . . ." and that "petitioner paid its broker in Hawaii a 2 percent commission on the sale of Soup's products" (Matter of Campbell Sales Co., State Tax Commn., May 20, 1983 [findings of fact "4" and "5"]).[9]

From these facts, the State Tax Commission concluded that petitioner's brokerage services were so similar in scope to those performed by Tanaka Dodge as to classify the latter as an arm's-length equivalent. In the present case, the language in the stipulation describing the Tanaka Dodge arrangement is virtually identical to the corresponding facts found in Campbell I. In our view, this strongly suggests that the parties intended to express the Tanaka Dodge arrangement as factually indistinguishable from the Soup-petitioner arrangement with respect to arm's-length factors other than price.

Third, it was established through the uncontroverted testimony of Mr. Cloherty that Soup set a national commission rate for each of its products governing all of its independent brokerage arrangements, with commission rates set on a product-by-product basis (Tr., p. 36). The fact that these commission rates were applied uniformly throughout the contiguous 48 states serves to refute any suggestion that the independent brokerage commissions established by Soup could vary based on geographic location or the number of

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This State Tax Commission decision, and the subsequent court decisions (Matter of Campbell Sales Co. v. New York State Tax Commn., 111 AD2d 995, 490 NYS2d 313, revd 68 NY2d 617, 505 NYS2d 54, cert denied 479 US 1088) will hereinafter be referred to collectively as "Campbell I."

clients represented by a given broker. Therefore, the geographic location of Tanaka Dodge's sales territory (Hawaii) and the possibility that Tanaka Dodge provided brokerage services for firms other than Soup would have had no impact on the commission rate.

In light of the above facts, we conclude that petitioner has established that the commission-equivalent charged to Soup for brokerage services was not less than what was charged for similar services in an arm's-length transaction under similar circumstances (i.e., the Tanaka Dodge transactions).

The Division contends that because petitioner is a member of a vertically integrated group of corporations, benefits flow to petitioner which are not readily quantified on review of intercorporate pricing, and therefore, require combined reporting. Specifically, the Division states:

> "Petitioner Campbell Sales, by virtue of the expense-based reimbursement agreement with Campbell Soup Company, is guaranteed a profit which does not depend upon the volume of sales which it eventually solicits. Further, since [petitioner] only solicits sales of Campbell Soup products, it is guaranteed not only its supply requirements, but it is assured of the quality of the product marketed" (Division's brief on exception, p. 63, emphasis added).

With regard to petitioner's cost-based arrangement with Soup, the Division apparently contends that because petitioner was guaranteed a profit regardless of the amount of sales it generated, an arm's-length analysis is ineffective in this instance and, therefore, the presumption cannot be overcome. We disagree. Although quantifying the impact of such a guarantee on intercorporate pricing may be difficult, we find such a task unnecessary to refute the Division's argument in this instance, as explained by the application of section 482 principles below.

In analyzing the Division's argument, we must first assume that such a profit guarantee would entitle petitioner to a smaller commission equivalent (due to the elimination of risk) than it would receive under an otherwise identical "pure" commission arrangement. This would require a downward adjustment of the commission-equivalent rate in order to be properly aligned with the "pure" commission from an arm's-length standpoint. Therefore, the only potential effect of the profit guarantee is that it caused petitioner's income and, thus, its tax liability, to be overstated. Because the Division does not explicitly argue that tax liability is not properly reflected within the meaning of section 211(4) where a taxpayer's income is overstated, and because the correctness of such a position is not obvious to us, we conclude, based on the record before us, that the overstatement of tax to New York State is not a basis to require combined reporting.[10]

As to the other factor cited by the Division, we simply fail to see how petitioner's sole activity of proving brokerage services secures for it a guarantee that its orders will be filled or that the product will be of high quality any more than an independent broker who contracts with Soup to sell Soup's products. Therefore, we conclude that this factor does not impact price.

Finally, the Division argues that despite recent combined reporting decisions issued by the Tax Appeals Tribunal, the facts of this case are not substantially different from Campbell I

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[10]We note that in Campbell I the State Tax Commission, which concluded that combined reporting was required under Tax Law § 211(4), found the commission-equivalent existing in that case to be:

> "a fair and reasonable commission and is not less than, and is probably more than, the equivalent of the amount that would be paid for such work on an arm's length basis involving unrelated parties" (Matter of Campbell Sales Co., supra [finding of fact "5"], emphasis added).

Despite this finding, the sole basis for the Commission's conclusion was that petitioner and Soup acted in a highly unitary manner, thus, a proper reflection of petitioner's New York franchise tax liability would be "impossible without combination." It did not determine that the probable overstatement of petitioner's income would render it unable to "properly reflect [its] tax liability" under section 211(4). This argument was similarly not addressed on appeal, where the sole issue was "whether there [w]as substantial evidence in the record to justify [the Commission]'s determination . . ." (Matter of Campbell Sales Co. v. New York State Tax Commn., supra, 490 NYS2d 313, 317 [dissenting opinion], revd on dissenting opn below 68 NY2d 617, 505 NYS2d 54).

to warrant a different result. Campbell I involved the same taxpayer and facts nearly identical to those present here. In upholding an assessment requiring petitioner and Soup to report on a combined basis for franchise tax purposes, the State Tax Commission found that these corporations were functioning as a unitary business. Further, it found that:

> "[w]here the businesses of corporations are so unified and interassociated (having due regard for their separate corporate existences), a proper reflection of their New York franchise tax liability is impossible without combination" (Matter of Campbell Sales Co., supra, emphasis added).

This decision was annulled by the Appellate Division, Third Department, which stated that there was no evidence in the record to support the Commission's conclusion that separate reporting improperly reflected petitioner's tax liability. However, it did not address the Commission's factual conclusion that it was impossible to compute separate tax liabilities of petitioner and Soup because of intercompany transactions. The Court of Appeals reversed; however, the Court did not address whether the "substantial intercompany transactions" were at arm's length. Instead, it held that a rational basis existed for the Commission's finding that a proper reflection of petitioner's New York franchise tax liability was impossible without combination (Matter of Campbell Sales Co. v. New York State Tax Commn., supra, 505 NYS2d 54, 55).

Shortly after Campbell I, the Court of Appeals decided another combined reporting case, Matter of Standard Mfg. Co. v. Tax Commn. (69 NY2d 635, 511 NYS2d 229, affg 114 AD2d 138, 498 NYS2d 724, appeal dismissed 481 US 1044) ("Standard I"). There, the State Tax Commission concluded that petitioner was required to file a combined report based on the facts of that case, and its decision was confirmed by the Appellate Division. The Court of Appeals affirmed based on the court's opinion below. By doing so, the Court of Appeals explicitly adopted the analysis set out by the Appellate Division, which stated:

> "the ultimate question [is] whether, under all of the circumstances of the intercompany relationship . . . combined reporting fulfills the statutory purpose of avoiding distortion of and more realistically portraying true income" (Matter of Standard Mfg. Co. v. Tax Commn., 114 AD2d 138, 498 NYS2d 724, 726).

Viewing the Court of Appeals' decision in Campbell I in light of Standard I, it is evident that the Court did not endorse a view that where the prerequisites of combination are met, an irrebuttable presumption of distortion arises. Rather, the decision was based on the conclusion that the Commission's finding (that a proper reflection of petitioner's tax liability was "impossible" without combination) was supported by substantial evidence and, thus, could not be disturbed (Matter of Campbell Sales Co. v. New York State Tax Commn., supra, 505 NYS2d 54; see, CPLR § 7803[4]). Therefore, Campbell I does not compel us to arrive at a similar conclusion here.

Because we conclude that petitioner has met its burden of proof in this case, we find it unnecessary to address petitioner's remaining arguments.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

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

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

3. The petition of Campbell Sales Co. is granted; and

4. The notices of deficiency dated May 6, 1983 and January 16, 1987 are cancelled.

DATED: Troy, New York
December 2, 1993

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

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

APPENDIX "A"

CAMPBELL SALES COMPANY

New York State Corporation Franchise Tax Report

Schedule A - Taxpayer's Calculation of Tax

The amount of the tax computed on the basis of reapportionment of income as between the taxpayer and its parent company, allocated to the State of New York on the basis of expenses incurred in New York:

FYE July 30, 1978
FYE July 29, 1979

1. Campbell Soup Company sales

$1,132,113,195

$1,250,218,670

2. Amount computed thereon for apportionment purposes at agreed-on rate as follows:

   4% of sales, plus the number of percentage points by which advertising expenses fall short of 3½% of sales but not exceeding 5%

   a. Advertising expenses — $ 59,258,257

   $ 57,559,031

   b. Sales — $1,132,113,195

   $1,250,218,670

   c. Advertising expenses % — 5.2%

   4.6%

   d. Amount under 3.5% — --

   --

   e. Agreed-on rate for period

   4%

   4%

	$ 45,284,528
	$ 50,008,147
3. Expenses of the Company (as per Federal Income Tax Return)	35,289,519
	38,552,041
4. Amount computed for apportionment	$ 9,995,009
	$ 11,456,706
5. Total expenses of the taxpayer (exclusive of state franchise taxes)	$ 35,090,187
	$ 38,471,040
6. Amount of expense incurred with relation to New York State (Exclusive of franchise tax)	$ 2,818,852
	$ 3,181,436
7. Percentage relation of New York expense to total expense	8.033163
	8.269691
8. Product of line 4 multiplied by line 7	$ 802,915
	$ 947,434
9. Computation of tax @ 10%	$ 80,292
	$ 94,743
Net Income of Campbell Soup Company for fiscal period	$ 85,478,898
	$ 97,315,430

APPENDIX "A" (cont.)
CAMPBELL SALES COMPANY

New York State Corporation Franchise Tax Report

Schedule A - Taxpayer's Calculation of Tax

The amount of the tax computed on the basis of reapportionment of income as between the taxpayer and its parent company, allocated to the State of New York on the basis of expenses incurred in New York:

FYE August 3, 1980 FYE August 2, 1981

1. Campbell Soup Company sales $1,267,523,587
$1,319,926,335

2. Amount computed thereon for apportionment purposes at agreed-on rate as follows:

4% of sales, plus the number of percentage points by which advertising expenses fall short of 3½% of sales but not exceeding 5%

a. Advertising expenses $ 65,100,187 $ 80,614,594
b. Sales $1,267,523,587 $1,319,926,335
c. Advertising expenses % 5.1% 6.1%
d. Amount under 3.5% -- --
e. Agreed-on rate for period 4%
4%
$ 50,700,943 $ 52,797,053

3. Expenses of the Company (as per Federal Income Tax Return)
42,059,918 45,346,699

4. Amount computed for apportionment $ 8,641,025
$ 7,450,354

5. Total expenses of the taxpayer (exclusive of state franchise taxes) $ 41,954,916 $ 45,292,214

6. Amount of expense incurred with relation to New York State (Exclusive of franchise tax) $ 3,117,084
$ 3,116,761

7. Percentage relation of New York expense to total expense
7.429604 6.881144

8. Product of line 4 multiplied by line 7 $ 641,994
$ 512,670

9. Computation of tax @ 10% $ 64,199
$ 51,267

Net Income of Campbell Soup Company for fiscal period
$ 119,478,433 $ 114,588,307

APPENDIX "A" (cont.)
CAMPBELL SALES COMPANY
New York State Corporation Franchise Tax Report

Schedule A - Taxpayer's Calculation of Tax

The amount of the tax computed on the basis of reapportionment of income as between the taxpayer and its parent company, allocated to the State of New York on the basis of expenses incurred in New York:

FYE August 1, 1982 FYE July 31, 1983

1. Campbell Soup Company sales $1,421,393,656
$1,642,787,881

2. Amount computed thereon for apportionment purposes at agreed-on rate as follows:

4% of sales, plus the number of percentage points by which advertising expenses fall short of 3½% of sales but not exceeding 5%

a. Advertising expenses $ 107,010,628 $ 123,106,101
b. Sales $1,421,393,656 $1,642,787,881
c. Advertising expenses % 7.5% 7.5%
d. Amount under 3.5% -- --
e. Agreed-on rate for period 4%
4%
$ 56,855,746 $ 65,711,515

3. Expenses of the Company (as per Federal Income Tax Return)
50,473,177 59,131,398

4. Amount computed for apportionment $ 6,382,569
$ 6,580,117

5. Total expenses of the taxpayer (exclusive of state franchise taxes) $ 50,428,843 $ 59,090,081

6. Amount of expense incurred with relation to New York State (Exclusive of franchise tax) $ 3,896,644
$ 5,945,431

7. Percentage relation of New York expense to total expense
7.727014 10.061640

8. Product of line 4 multiplied by line 7	$ 493,182	$ 662,068
9. Computation of tax @ 10%	$ 49,318	$ 66,207
Net Income of Campbell Soup Company for fiscal period	$ 65,019,291	$ 124,507,932

APPENDIX "B"

CAMPBELL SOUP COMPANY - New York Inventory

	8/1	7/31	TOTAL	Average From Audit Report
FYE 7/31/78				
Reported in error - Item actually in Minnesota	263701			
Refused Product		108		
TOTAL	263701	108	263809 divided by 2 =	131905
FYE 7/31/79				
Refused Product	108	206		
Purchase Price - Premium Items [Recipe boxes and training books pruchased from New York manufacturer on hand at their plant at year end awaiting shipment out of state]		62500		
TOTAL	108	62706	62814 divided by 2 =	31407
FYE 7/31/80				
Refused Product	206			
Purchase Price - Premium Items [Recipe boxes and training books purchased from New York manufacturer on hand at their plant at beginning of year awaiting shipment out of state]	62500			
TOTAL	62706	0	62706 divided by 2 =	31353

Commissioner