STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
LANDAUER ASSOCIATES, INC. N.Y.	:	DECISION
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.	:	

Petitioner Landauer Associates, Inc. N.Y., 335 Madison Avenue, New York, New York 10017, filed an exception to the determination of the Administrative Law Judge issued on April 12, 1990 with respect to its petition 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. 806098). Petitioner appeared by Carter, Ledyard & Milburn, Esqs. (Jerome J. Caulfield, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (James Della Porta, Esq., of counsel).

Both petitioner and the Division of Taxation filed briefs. Oral argument, at the request of petitioner, was heard on October 17, 1990.

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

ISSUES

I. Whether payments made by petitioner to its parent corporation constitute compensation within the meaning and intent of former Tax Law § 210(1)(a)(3).

II. If so, whether the amounts of the deficiencies are correct.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for findings of fact "6" and "8" which have been modified. The Administrative Law Judge's findings of fact and the modified findings of fact are set forth below.

Pursuant to an audit of Landauer Associates, Inc. N.Y. (hereinafter "petitioner"), the Division of Taxation (hereinafter "Division"), on April 23, 1987, issued to petitioner statements of audit adjustment and notices of deficiency as follows:

Period Ended	Tax	Interest	Total
12/31/80	$ 1,487.00	$ 1,507.00	$ 2,994.00
12/31/81	$29,306.00	$23,753.00	$53,059.00
12/31/82	$43,613.00	$24,622.00	$68,235.00
*12/31/82	$ 7,851.00	$ 4,432.00	$12,283.00

* Metropolitan Commuter Transportation District surcharge imposed pursuant to Tax Law § 209-B.

Previously, petitioner had executed consents extending the period of limitation for the assessment of Article 9-A tax as follows:

Executed	Year(s) Ended	Date to Assess Tax
7-16-84	12-31-80	3-31-85
12-24-84	12-31-80, 12-31-81	12-31-85
11-12-85	12-31-80, 12-31-81, 12-31-82	9-30-86
6-9-86	12-31-80, 12-31-81, 12-31-82	6-30-87

For the years at issue herein, petitioner and its affiliated corporations (the "Landauer Group") were engaged in the real estate counselling and advisory business. These corporations performed an appraisal and valuation function for commercial properties. The corporations also performed a marketing and financial services function for their clients, i.e., they made up marketing brochures and attempted to assist the client in divesting itself of the property. During these years, the Landauer Group maintained offices in New York City, Atlanta, Georgia, West Palm Beach, Florida, Chicago, Illinois, Houston, Texas and Santa Ana and Los Angeles, California. Petitioner's affiliates included wholly-owned subsidiary corporations operating in New York, Texas, California and Florida, and a parent corporation, Landauer International, Inc. (hereinafter "LII"). Petitioner and its parent, LII, shared offices at 200 Park Avenue, New York, New York. On its Form CT-3, Corporation Franchise Tax Report, for 1981 and 1982, LII listed its principal business activity as "holding corporation". LII owned 100 percent of petitioner's stock.

For the year 1980, a portion of the tax deficiency resulted from the disallowance of a net operating loss ($332,666.00) by the Internal Revenue Service, failure to deduct contributions

($1,332.00) claimed on Form CT-3360, Report of Change in Taxable Income by U.S. Treasury Department, and allowance of Georgia income taxes ($5,031.00) which petitioner erroneously added back. For 1981, petitioner failed to add back additional New York State franchise tax ($4,265.00), but was allowed Georgia income taxes ($3,000.00) which had been erroneously added back. The Division, for 1982, allowed petitioner the sum of $10,950.00 for Georgia income taxes which it had erroneously added back. None of these adjustments are in dispute herein.

For each of the years at issue, the Division determined that petitioner was liable for New York State corporation franchise tax under the alternate method (then in effect) set forth in Tax Law § 210(1)(a)(3) which method computed the tax on a percentage 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 percent of its issued capital stock.

On its Federal Form 1120, U.S. Corporation Income Tax Return, for 1980, petitioner claimed to have paid compensation to its officers in the amount of $1,532,500.00 (total officers' compensation was $1,841,500.00 which included compensation to officers of its subsidiaries). On its State of New York Corporation Franchise Tax Report (Form CT-3) for 1980, petitioner listed officers' compensation of $1,467,500.00. The difference between the amounts reported on petitioner's Federal and State returns was the salary ($65,000.00) paid to S. Wight, a vice-president who was in charge of the Atlanta, Georgia office of the Landauer Group. The Division deemed this $65,000.00 to be compensation paid to officers which was subject to the alternate method set forth in Tax Law § 210(1)(a)(3) and, along with the adjustments previously noted in Finding of Fact "4", supra, formed the basis of the franchise tax deficiency of $1,487.00 asserted against petitioner for 1980.

We modify finding of fact "6" of the Administrative Law Judge's determination to read as follows:

> In 1981 and 1982, petitioner and LII entered into an arrangement whereby LII would perform certain managerial functions and services for petitioner (and its affiliates) in exchange for the payment of a management fee. The functions and services performed by LII included those such as accounting and

> bookkeeping. LII also paid certain administrative and overhead expenses on behalf of petitioner and other members of the Landauer Group. For 1981, petitioner paid a management fee to LII in the amount of $2,218,501.00 and, for 1982, it paid a management fee of $3,236,171.00. The stated purpose (by petitioner's vice-president and comptroller, Emil F. Renak) of the management fee arrangement was to make administrative matters easier and to enable the profit or loss of petitioner and its affiliates to be presented accurately. The management fee allowed LII to recover its costs (incurred in the payment of the administrative and overhead expenses on behalf of petitioner and its affiliates) and to make a "modest" profit.
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> The method of the calculation of the amount to be paid to LII as a management fee is unclear from the record. Although Mr. Renak testified that each of the members of the Landauer Group (seven in all, including petitioner) paid a management fee based upon a percentage (either 10% or 15%) of the revenues from each, the derivation of these percentages is unknown. Moreover, the profit and loss statements of LII for 1981 and 1982 indicate that, other than certain investment income, LII's total income consisted of management fees received from petitioner only, and not from any of the other members of the Landauer Group.[1]

As previously indicated, for 1981 and 1982, petitioner and LII shared offices at 200 Park Avenue in New York City. In addition, the president, the two executive vice-presidents and the

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[1]The Administrative Law Judge's finding of fact "6" read as follows:

> "In 1981 and 1982, petitioner and LII entered into an arrangement whereby LII would perform certain managerial functions and services for petitioner (and its affiliates) in exchange for the payment of a management fee. The functions and services performed by LII included those such as accounting and bookkeeping. LII also paid certain administrative and overhead expenses on behalf of petitioner and other members of the Landauer Group. For 1981, petitioner paid a management fee to LII in the amount of $2,218,501.00 and, for 1982, it paid a management fee of $3,236,171.00. The stated purpose (by petitioner's vice-president and comptroller, Emil F. Renak) of the management fee was to allow LII to recover its costs (incurred in the payment of the administrative and overhead expenses on behalf of petitioner and its affiliates) and to make a 'modest' profit. The amount of the management fee was determined on a percentage basis of the revenues of each of the members of the Landauer Group.[1] "
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> [1] The method of the calculation of the amount to be paid to LII as a management fee is unclear from the record. Allegedly, each of the members of the Landauer Group (seven in all, including petitioner) paid a management fee based upon a percentage of the revenues from each. However, the profit and loss statements of LII for 1981 and 1982 indicate that, other than certain investment income, LII's total income consisted only of the management fees received from petitioner.

We modify this finding of fact to reflect the record in more detail.

comptroller of LII served in the same capacities for petitioner. For 1981, LII's income consisted of $2,218,501.00 in management fees and $329,508.00 in other income (categorized by Mr. Renak as investment income) for a total income of $2,548,009.00. LII's total expenses for 1981 were $2,488,677.00 for a net income of $59,332.00. Management fees constituted 87.0680 percent of total income for 1981. In 1982, LII's income was $3,236,171.00 from management fees (88.6160 percent of total income) and $415,733.00 from other income for a total income of $3,651,904.00. Total expenses were $3,310,055.00 for a net income of $341,849.00.

We modify finding of fact "8" of the Administrative Law Judge's determination to read as follows:

> The management fees paid to LII were deducted by petitioner on its Federal and State returns for 1981 and 1982 and were included by LII as income on its returns for said years. Because some of its subsidiaries were located outside of New York State, petitioner's business allocation percentages were 88.0053 percent and 86.89411 percent for 1981 and 1982, respectively. LII's business allocation percentage was 100 percent for both years.[2]

In addition to the management fees paid to LII, petitioner claimed deductions for rents in the amount of $287,499.00 for 1981 and $416,845.00 for 1982 and for advertising expenditures of $82,171.00 and $82,971.00 for 1981 and 1982, respectively. Attached to its Federal Form 1120 for each year was a schedule which enumerated other deductions taken on line 26 of such return. These deductions were as follows:

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[2]The Administrative Law Judge's finding of fact "8" read as follows:

> "The management fees paid to LII were deducted by petitioner on its Federal and State returns for 1981 and 1982 and were included by LII as income on its returns for said years. Because some of its subsidiaries were located outside of New York State, petitioner's business allocation percentages were 88.46066 percent and 86.89411 percent for 1981 and 1982, respectively. LII's business allocation percentage was 100 percent for both years."

We modify this finding of fact to clarify that although petitioner's corporation franchise tax return claimed an 88.46066 percent business allocation, this percentage was adjusted on audit to 88.0053 percent.

	1981	1982
Travel and entertainment	$ 106,382.00	$ 126,185.00
Office equipment	2,790.00	3,322.00
Maintenance	9,532.00	16,608.00
Equipment rental	63,117.00	95,939.00
Telephone and telegraph	95,304.00	119,124.00
Postage	13,849.00	18,740.00
Office supplies and forms	41,183.00	46,023.00
Insurance	41,641.00	6,994.00
Professional service	62,632.00	6,877.00
Data processing	4,235.00	21,165.00
Shareholder referral fees	49,491.00	330,212.00
Miscellaneous	48,428.00	105,574.00
Library	7,134.00	10,577.00
Management fees	2,218,501.00	3,236,179.00
Other employee expenses	131,599.00	65,671.00
Licenses	2,546.00	1,556.00
Outside consulting	171,031.00	17,806.00
Messengers and freight	5,852.00	10,273.00
Automobile	-0-	2,142.00
Company meetings	-0-	222.00
Amortization	-0-	54,547.00
Total	$3,075,247.00	$4,295,736.00

The Division determined the franchise tax deficiencies by means of the following computations:

	1980	1981	1982	1982 MTA Surcharge
ENI per CT-3	(247,632)	934,764	504,236	
RAR per CT-3360*	332,666			
Contributions claimed on CT-3360	(1,332)			
Additional NYS franchise tax		4,265		
Tax erroneously added back (Georgia)	(5,031)	(3,000)	(10,950)	
ENI PER AUDIT	78,671	936,029	493,286	
Officers' salaries (per 1120)	1,532,500	2,445,567	2,781,239	
Management Fee (portion subject to alternate base)		1,126,082	1,684,004	
Statutory exclusion	(15,000)	(30,000)	(30,000)	
Net	1,596,171	4,477,678	4,928,529	
30% thereof	478,851	1,343,303	1,478,559	
Business allocation % per audit	89.1512%	88.0053%	86.8941%	

Allocated Income	426,901	1,182,178	1,284,780	
Tax @ 10%	42,690	118,218	128,478	
Tax on Sub Capital per CT-3		5	9	
Total	42,690	118,223	128,487	23,128
Tax per CT-3 and CT-3360	41,203	88,917	84,874	15,277
Asserted Deficiency	$1,487	$29,306	$43,613	$7,851

* Revenue Agent's Report disallowing net operating loss.

The portion of the management fee paid by petitioner to LII for the years 1981 and 1982 which the Division determined must be included in the alternate tax base was determined as follows:

		1981		1982
Officers' Compensation		$ 374,354.00		$ 872,000.00
Salaries & Wages		781,331.00		552,331.00
Pension & Profit Sharing		55,795.00		101,331.00
Other Benefit Plans		22,648.00		32,823.00
LII Net Income		59,332.00		341,849.00
Management Fee in Excess of Reimbursement		$1,293,460.00		$1,900,334.00
Multiply by Ratio:				
Mgmt. Fee/	$2,218,501.00		$3,236,171.00	
LII Gross Receipts	$2,548,009.00		$3,651,904.00	
		0.87068		0.886160
Mgmt. Fee Subject to Alternate Base		$1,126,082.00*		$1,684,004.00*

* The actual mathematical results derived from multiplying the management fees in excess of reimbursement by the above percentages (management fee divided by LII gross receipts) are $1,126,190.00 for 1981 and $1,684,000.00 for 1982. Since the discrepancies are quite small (a total of $104.00) and are to the advantage of petitioner, no adjustments shall be made herein.

On February 11, 1985, petitioner filed a petition for Advisory Opinion which raised the issue relating to the Division's determination of franchise tax deficiencies for 1981 and 1982, i.e.,

> "whether a portion of a management fee paid by a subsidiary to its parent corporation for services rendered by the parent corporation should be included by the subsidiary as compensation paid to every stockholder owning in excess of five percent of its issued capital stock when computing the franchise tax measured by entire net income plus compensation pursuant to section 210.1(a)(3) of the Tax Law, to the extent of salaries paid to officers and employees of the parent corporation, including any profit sharing and employee benefits."

The Advisory Opinion, issued October 22, 1986, concluded as follows:

> "Accordingly, when computing the tax measured by entire net income plus compensation pursuant to section 210.1(a)(3) of the Tax Law, Petitioner must include as 'salaries and other compensation' the portion of the management fee paid to its parent that is in excess of the reimbursement of expenses paid by the parent on behalf of Petitioner. This amount includes salaries and the related expenses of the parent's employees and officers as well as any profit factor included in the management fee."

OPINION

In his determination below, the Administrative Law Judge found that a portion of the payments for management fees made by petitioner to its parent corporation, LII, were "compensation" within the meaning and intent of former Tax Law § 210(1)(a)(3), and that a portion of such payments must be added back to its entire net income to determine its corporation franchise tax liability. Furthermore, the Administrative Law Judge determined that the Division of Taxation (hereinafter the "Division"), in calculating the amount to be added back, properly included an amount relating to salaries and wages, pension plans and employee benefit plans. Thus, the Administrative Law Judge sustained the deficiencies.

On exception, petitioner argues that its payment of management fees to LII did not constitute compensation. It agrees that § 210(1)(a)(3) of the Tax Law required that "salaries and other compensation" paid to officers or shareholders be added to its entire net income to determine its corporate franchise tax liability. However, it argues that since it made payments to a corporate stockholder, and not to an individual, then such payments cannot constitute salary or other compensation. Petitioner argues that only employees receive salaries and a corporation cannot be an employee. In addition, petitioner argues that the term "other compensation" refers to items which are similar to salary and, therefore, that the management fees are not "other compensation."

Furthermore, petitioner contends that even if its payments to LII do constitute compensation to a stockholder, the deficiencies asserted by the Division are too large. Petitioner argues that amounts for salaries and wages, pension plans and employee benefit plans were payroll expenses and, thus, administrative expenses for which it reimbursed LII. Accordingly,

petitioner argues that since such payments were reimbursement, the amounts of such expenses are not required to be added back to entire net income.

In response, the Division agrees with the determination of the Administrative Law Judge. The Division relies on both the regulations and the statute to argue that the management fees paid to LII by petitioner clearly qualify as compensation within the meaning and intent of former § 210(1)(a)(3) of the Tax Law and, therefore, the Division argues that the deficiencies should be sustained.

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

Former § 210(1)(a)(3) of the Tax Law imposed franchise tax:

> " . . . 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 . . . (repealed, L 1987, ch 817, § 23, eff August 7, 1987).

Petitioner argues that the phrase "salaries and other compensation" should be interpreted to mean only amounts paid to individuals for services rendered. Therefore, since LII is not an individual, petitioner argues that payments made to LII do not constitute compensation within the meaning of the statute. We disagree.

The statute's reference to the phrase "salaries and other compensation" cannot be construed as narrowly as petitioner suggests. If the phrase was intended to refer only to types of payments made to an individual for services rendered, the legislators would have used such language. Instead, the phrase "salaries and other compensation" was used without any words of limitation describing the stockholder/recipient of the payment. We conclude that it is correct to interpret this phrase to include compensation payments paid to a corporate stockholder (see, 20 NYCRR 3-3.2[f]).

Petitioner notes that the legislative history behind section 210(1)(a)(3) of the Tax Law indicates that this particular section of the Tax Law "was enacted to counter the practice of

avoiding franchise tax entirely by paying all of a corporation's income to its individual stockholders, officers and directors, calling it salary and other compensation" (Petitioner's brief on exception, p. 9). Given this legislative history, petitioner argues that the section cannot be interpreted to include payments to a corporate stockholder. We disagree.

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).

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:

> "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).

Therefore, we conclude that Tax Law § 210(1)(a)(3) does not require a finding that there exist a tax avoidance scheme, or the possibility of one, in order for "salaries and other compensation" paid to officers or stockholders to be added back within the meaning of the statute. Thus, we agree with the Administrative Law Judge that the Division properly added back a portion of the amounts paid by petitioner to LII.

Next, petitioner argues that even if its payments to LII constitute compensation, the deficiencies issued by the Division are incorrect.

Petitioner notes that the deficiencies were calculated by adding to petitioner's entire net income two distinct components, one relating to compensation (compensation, salaries and wages, pension plan and employee benefit plan expenses paid by LII) and the other relating to LII's profit from rendering the management services. Petitioner asserts that including the compensation component is incorrect and inconsistent with the Division's policy.[3]

On October 22, 1986, the Division issued an advisory opinion to petitioner which addresses this issue. The advisory opinion (Landauer Assoc., TSB-A-86[21]C, October 22, 1986) provides that:

> ". . . the statute has been interpreted to mean that items in the nature of service charges or management fees paid by a subsidiary to its parent are included as 'salaries and other compensation paid to a stockholder' to the extent that such fee or charge exceeds the reimbursement of expenses paid by the parent on behalf of the subsidiary.
>
> "Accordingly, when computing the tax measured by entire net income plus compensation pursuant to section 210.1(a)(3) of the Tax Law, Petitioner must include as 'salaries and other compensation' the portion of the management fee paid to its parent that is in excess of the reimbursement of expenses paid by the parent on behalf of Petitioner. This amount includes salaries and the related expenses of the parent's employees and officers as well as any profit factor included in the management fee" (Landauer Assoc., supra, emphasis added).

Clearly, the language in the advisory opinion explicitly states that salaries and related expenses are to be added back to determine entire net income. Payroll expenses incurred by LII on behalf of petitioner are such "related expenses" and, therefore, are to be added back. Therefore, we see no merit to petitioner's contention that it is not being treated in accordance with the Division's policy.

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[3]Petitioner also complains that although the issue was clearly raised by petitioner, the determination of the Administrative Law Judge fails to address it. Instead, the Administrative Law Judge addressed this aspect of the case as if petitioner were contesting the amount added back by the Division with respect to employee compensation. As we understand petitioner's argument, petitioner is arguing there should not be any addback for employee compensation. Since we see nothing that indicates that petitioner contests the Division's method of calculating the employee compensation addback, we have not addressed the material discussed by the Administrative Law Judge.

Lastly, we conclude that the Division's interpretation of Tax Law § 210(1)(a)(3) was correct. This section requires that "salaries and other compensation paid . . . to every stockholder owning in excess of five percentum of its issued capital stock" must be added back to determine petitioner's entire net income (Tax Law § 210[1][a][3]). Therefore, in a case where the stockholder is an individual who owns in excess of five percent, and that individual was paid a salary, the amount of such salary would have to be added back. In this case, the stockholder owning in excess of five percent of petitioner's stock is a corporation. To reach a consistent result with the case where the stockholder is an individual, we conclude that it is proper to include salaries and other payroll expenses paid to officers and employees of such corporation as part of the amount required to be added back since a corporation functions through its officers and employees.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of petitioner Landauer Associates, Inc. is denied;
2. The determination of the Administrative Law Judge is sustained;
3. The petition of Landauer Associates, Inc. is denied; and
4. The Notices of Deficiency issued on April 23, 1987 are sustained in their entirety.

DATED: Troy, New York
April 11, 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