STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
PENTHOUSE INTERNATIONAL, LTD.	:	DECISION DTA No. 806745
for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Years 1978 through 1981.	:	
	:	

Petitioner Penthouse International, Ltd., 1965 Broadway, New York, New York 10023 filed an exception to the determination of the Administrative Law Judge issued on November 5, 1992. Petitioner appeared by Lefrak, Newman & Myerson (Joseph S. Lefrak, Thomas A. Holman and Louis Wollin, Esqs., of counsel) and Rosenman & Colin (Stephen L. Ratner and Howard J. Rothman, Esqs., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Anne W. Murphy and John O. Michaelson, Esqs., of counsel).

Both petitioner and the Division of Taxation filed briefs on exception. Petitioner filed a supplemental brief. The Division of Taxation also filed a supplemental memorandum of law. Oral argument was heard on July 8, 1993. Further correspondence on the substance of the case was received in the Office of the Secretary to the Tax Appeals Tribunal from petitioner on July 26, 1993. On July 30, 1993, a procedural objection to the acceptance of this correspondence was received from the Division of Taxation. The Division of Taxation was allowed until August 25, 1993 to respond to the substance of petitioner's comments and elaborate on its procedural objections. No response having been received, August 25, 1993 began a 5.5-month time period for the issuance of this decision (i.e., the six-month time period minus the two week period between July 8 and July 26, 1993).

Commissioner Dugan delivered the decision of the Tax Appeals Tribunal. Commissioner Koenig concurs.

ISSUES

I. Whether petitioner may properly file a combined franchise tax report with certain affiliated corporations for the year 1978 and thereby properly deduct from its entire net income certain losses attributable to said affiliates.

II. Whether petitioner has established entitlement to a claimed investment tax credit for the year 1981.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for finding of fact "5" which has been modified. The Administrative Law Judge's findings of fact and the modified finding of fact are set forth below.

Petitioner, Penthouse International, Ltd., was incorporated under the laws of the State of New York on September 28, 1967.

For its taxable year 1978, petitioner filed Form CT-3, State of New York Corporation Franchise Tax Report, reporting Federal taxable income of $2,725,893.00. On its pro forma Federal income tax return for the same year, petitioner reported Federal taxable income of $14,487,487.00.

Petitioner filed a consolidated Federal income tax return with certain affiliated corporations for the taxable year 1978. No copy of this return was entered into the record and the identity of such subsidiaries and affiliates is not contained in the record.

Petitioner filed a separate New York State Corporation Franchise Tax Report for the taxable year 1978. Petitioner calculated its tax liability for 1978 on the basis of its entire net income.

We modify finding of fact "5" to read as follows:

> On its 1978 Federal return, petitioner indicated $14,487,487.00 as "taxable income before net operating loss deduction and special deductions" (see, Exhibit "F," 1978 Federal Form 1120, line 28). On its 1978 New York Franchise Tax Report, petitioner indicated that its "federal taxable income before net operating loss and special deductions" was $2,725,893.00 (see, Exhibit "F," 1978 New York State Corporation

Franchise Tax Report, Form C-3, line 18). The difference is due to the fact that in calculating Federal taxable income for purposes of filing its 1978 New York State Corporation Franchise Tax Report, petitioner deducted from its pro forma Federal taxable income of $14,487,487.00 an amount totalling $11,761,594.00 which was characterized by petitioner as losses of various affiliates in amounts as follows:

Affiliate	Claimed Losses
Viva International, Ltd.	$ 2,755,611
Penthouse Films International, Ltd.	4,751,731Omni
Publications International, Ltd.	4,167,276
C-P Records	68,563
Bravo International, Ltd.	4,719
Penthouse Communications, Ltd.	6,658
Penthouse/Viva Leisure Club, Ltd.	3,288
Unlocated Difference[1]	3,748
	$11,761,594

These amounts are shown on a worksheet attached to petitioner's 1978 State tax return (Exhibit "F").[2]

The Division of Taxation ("Division") conducted an audit of petitioner for the years 1978 through 1981. For 1978, the Division made certain adjustments in petitioner's franchise tax report. Primary among these adjustments was the Division's disallowance of petitioner's deduction of claimed losses of the affiliate corporations from petitioner's individually filed pro forma Federal taxable income (see above). The Division thus added back $11,761,594.00 to petitioner's reported entire net income for 1978. This adjustment was disputed by petitioner.

Another adjustment to the 1978 report disputed by petitioner was the Division's adjustment to petitioner's reported receipts factor. On Schedule G (Business Allocation) of its 1978 report, petitioner reported sales of tangible personal property in New York of $4,732,783.00 and sales of tangible personal property everywhere of $75,785,162.00 for a reported receipts factor of 6%. (The actual result of the computation is 6.24%.) Petitioner

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[1] There is no explanation in the record for this amount.

[2] The first two sentences and the last sentence were added to the Administrative Law Judge's finding of fact "5" to more fully reflect the record.

reported no other receipts on the Schedule G. On audit, the Division increased petitioner's sales of tangible personal property everywhere by $30,181,295.00 to $105,966,457.00. These figures appear to have been taken from petitioner's individual pro forma 1978 United States corporate income tax return, line 1 ("Gross receipts or gross sales $105,966,457 . . . Less: Returns and allowances $30,181,295"). The Division also increased petitioner's sales in New York by $12,403,864.00. The only explanation for this adjustment in the record is the following statement contained in the audit report:

> "For 1978 and 1981 sales were understated both in New York and Everywhere. This was due to taxpayer's reporting of advertising sales on the lower basis of circulation sales."

The foregoing adjustments resulted in an audited receipts factor of 16.17%. Coupled with small adjustments to petitioner's reported property factor (not contested herein) and petitioner's reported wage factor the total adjustment resulted in an audited business allocation percentage of 42.05%. Petitioner reported a business allocation percentage of 36.75%.

Also noteworthy with respect to 1978, petitioner reported no subsidiary capital on Schedule C of the report and therefore computed no tax on subsidiary capital. On audit, the Division computed petitioner's 1978 tax on subsidiary capital as follows:

	Avg. FMV	Issuer's Alloc. %	Value Alloc. to NYS
Omni	$1,574,002	0%	$ 0
Forum	3,000	100%	3,000
Viva	6,498,900	100%	6,498,900
Follycons, Inc.	19,035	100%	19,035
Penthouse[3]	11,641	100%	11,641
Penthouse	22,230	100%	22,230
Penthouse	82,498	100%	82,498
Value allocated to NYS	$8,211,306	80.83%	$6,637,304
Tax @ .0009			5,974

[3] The audit report lists what are apparently three separate entities as "Penthouse." The audit report provides no further information regarding the identity of these entities.

As a result of the foregoing adjustments, the Division determined a corporation franchise tax deficiency for petitioner with respect to 1978 of $522,059.00.

For the year 1981, petitioner filed a consolidated New York State Franchise Tax Report with its wholly-owned subsidiary, Penthouse Export Corp., a domestic international sales corporation ("DISC"). Petitioner calculated its tax liability for 1981 on the basis of its capital. As part of said report, petitioner claimed an investment tax credit of $14,706.00, additional investment tax credit of $43,839.00 and unused investment tax credit from a preceding period of $803.00, for a total investment tax credit of $59,348.00. Petitioner's calculation of its tax liability for 1981 resulted in tax due of $46,424.00. Petitioner used $46,174.00 of its claimed credit to offset its 1981 liability (except for $250.00 minimum tax).

On audit, the Division made certain adjustments to petitioner's 1981 report. Pursuant to such adjustments, the Division calculated total tax due of $3,617.00 and applied $3,367.00 in tax credits against such liability, leaving minimum tax due of $250.00. Also on audit, the Division disallowed petitioner's claimed investment tax credit of $14,760.00 for 1981. Accordingly, after allowing for such disallowance and the application of credit per the Division's computations, the Division determined a tax credit available for carryforward of $40,472.00.

With respect to the credit disallowed by the Division, on its claim for investment tax credit for 1981, petitioner described the property upon which credit was claimed as "equipment" with a manufacturing and productive use of "production of magazine" acquired in 1981 at a cost of $367,662.00.

The investment tax credit disallowance was the only adjustment challenged by petitioner with respect to the 1981 report.

As a result of the adjustments made by the Division with respect to petitioner's 1978 New York Corporation Franchise Tax Report (see above), on October 23, 1985 the Division issued to

petitioner a Notice of Deficiency which asserted additional tax due under Article 9-A of $522,059.00, plus interest, for the year 1978.

Petitioner did not request permission to file its franchise tax reports for 1978 or the 1978-1981 period on a combined basis during the course of the field audit. Additionally, on audit the Division did not analyze whether such combination should be permitted. Further, petitioner did not formally make a request for combination within 30 days of the close of any of the taxable periods at issue. Petitioner also did not request combination in its petition in the instant matter.

At the hearing in this matter, petitioner requested permission to file franchise tax reports on a combined basis with the corporations listed above for the year 1978.

During 1978, petitioner, Viva International, Ltd. ("Viva") and Omni Publications International, Ltd. ("Omni") were each engaged in the business of publishing magazines.

The business of Penthouse Films International, Ltd. ("Films"), Penthouse Communications, Ltd. ("Communications"), Bravo International, Ltd. ("Bravo"), Penthouse/Viva Leisure Club, Ltd. ("Leisure") and C-P Records was described in the record as publishing and entertainment. There is no evidence in the record regarding what these entities published.

There is evidence in the record that Films was involved in film production and, pursuant to an agreement dated December 3, 1975, had produced a film for petitioner entitled "Caligula." There is no evidence in the record of Films' business activities during 1978.

Leisure was described in the record by petitioner's controller as having "attempted to form a leisure club" that "never got off the ground."

Other than the general description of entertainment, there is no evidence in the record as to the activities of Communications, Bravo or C-P Records during 1978.

Omni, Communications and Leisure were New York corporations. Viva, Films and Bravo were Delaware corporations.

Regarding C-P Records, the record is unclear as to whether this entity is in fact a corporation. In contrast to the numerous references made to the other affiliates, the sole reference to this entity contained in the documentation submitted into the record herein is contained in the schedule attached to petitioner's 1978 franchise tax report listing the losses set forth above.

There is conflicting evidence in the record regarding the ownership of Viva, Omni and Films. Petitioner took the position that all three entities were its wholly-owned subsidiaries and the record contains evidence to support this contention.

It appears that, on audit, the Division considered at least Omni and Viva to be petitioner's subsidiaries. This is evidenced by the Division's assertion of tax on petitioner's subsidiary capital (see above). Also, the Division did not contest this issue in its answer (which made reference to "subsidiaries") or at hearing. Additionally, while the identity of the consolidated group with which petitioner filed its Federal returns was not entered into the record, a Closing Agreement between petitioner and the Internal Revenue Service dated February 7, 1987 refers to Films as petitioner's subsidiary.

The record also contains evidence indicating that Omni, Viva and Films were not wholly-owned subsidiaries of petitioner. Specifically, petitioner entered into the record audited financial statements of "Penthouse International, Ltd. and Wholly-Owned Subsidiaries" for the years 1977 and 1978. (The statements do not name the referred-to wholly-owned subsidiaries.) These statements were prepared by Fiddler and Rukin, P.C., C.P.A.'s. Among the notes to these statements was the following:

> "Penthouse International, Ltd. has a financial interest in FORUM International, Inc., VIVA international [sic], Ltd., EVELYN RAINBIRD, Ltd., P-H Construction Corporation, OMNI Publications International, Ltd. and PENTHOUSE Films International, Ltd., by virtue of an investment in the non-participating preferred stock of each company. Penthouse International, Ltd. does not participate in the equity of these companies, and, accordingly, they are not consolidated for financial reporting purposes." (Emphasis supplied.)

Petitioner also entered into the record "Consolidated Financial Statements Viva International, Ltd. and Wholly-Owned Subsidiary December 31, 1978 and 1977." This statement also indicated that petitioner had an interest in Viva by virtue of an investment in Viva's non-participating preferred stock, but that petitioner did not participate in the equity of Viva.

Also, on petitioner's 1978 franchise tax report, schedule C (subsidiary capital and allocation), petitioner listed no corporations in which it owned more than 50% of the voting stock. In contrast, on petitioner's 1981 report, petitioner listed 80% ownership of the voting stock in Omni, Viva and Forum International.

The consolidated financial statement of Viva entered into the record indicates that, as of December 31, 1978, Viva had 200 shares of common stock and 400 shares of preferred stock authorized, issued and outstanding. According to documents submitted into the record, as of February 13, 1973, Viva had accepted petitioner's offer to purchase 400 shares of preferred stock and the offer of the R. C. Guccione Family Trust No. 1 to purchase 200 shares of common stock.

The record indicates that as of July 20, 1978 petitioner owned 20 shares of preferred stock of Omni and the R. C. Guccione Family Trust No. 1 owned 10 shares of common stock of Omni. There is no evidence in the record as to the total number of shares of Omni common and preferred stock authorized, issued and outstanding. There is no evidence in the record identifying the trustees or beneficiaries of the R. C. Guccione Family Trust No. 1.

Bravo, Communications and Leisure were each wholly-owned subsidiaries of petitioner.

The record does not indicate whether any members of the proposed combined group filed franchise tax reports for 1978. The record also does not contain separate basis reports for 1978 for any members of the proposed group.

The consolidated financial statement of petitioner indicates $29,301,399.00 due from affiliated companies to petitioner for 1978. The consolidated financial statement of Viva indicates $13,126,743.00 due to affiliated companies for 1978.

Pursuant to an Agreement of Lease, dated November 30, 1976, petitioner entered into a three-year lease for the entire 20th floor and a portion of the 21st floor at 909 Third Avenue, New York, New York. During 1978, petitioner and the entities which comprise the proposed combined group conducted business at this location. Petitioner paid the rent for the entire premises.

Petitioner provided certain administrative and management services to the members of the proposed combined group. Specifically, petitioner's purchasing department handled all purchases of paper, supplies and other materials for petitioner, Omni and Viva. All bills for purchases were handled by petitioner's accounts payable department. Petitioner maintained a single checking account in its name at Manufacturer's Hanover Trust and issued checks from that account to pay any bills on behalf of itself and the members of the proposed combined group. Additionally, petitioner's accounting department maintained records for petitioner and the group. Petitioner's payroll department paid all employees who worked for petitioner and the group. Also, petitioner, Viva and Omni used the same production department, subscription department and public relations department.

Each of the magazines (i.e., Penthouse, Omni and Viva) maintained separate editorial departments.

As noted, petitioner made purchases and paid bills on behalf of the proposed combined group. Petitioner then charged the appropriate entity for such payments through accounting entries on petitioner's books and records. Where a bill was incurred directly by a particular corporation, that corporation was charged the full amount of such bill. If the bill constituted an indirect or general charge, petitioner attempted to charge the various entities a proportionate share.

None of the members of the proposed group maintained a checking account.

To the extent that outside financing was required in connection with the operations of the members of the proposed combined group, such financing was obtained by petitioner. In such cases, the group members guaranteed the loans made to petitioner or provided collateral for such loans.

Petitioner provided financing for the operations of certain of the members of the proposed group through intercompany loans.

On September 19, 1977, petitioner and Viva (along with other entities not among the group listed in above) entered into a distribution agreement with Curtis Circulation Company whereby Curtis agreed to distribute the magazines published by petitioner, Viva and the other entities. In 1978, the distribution agreement was modified to include Omni.

The magazines published by Viva and Omni each advertised in the magazine published by petitioner. In such cases, petitioner charged Omni or Viva for the paper and printing costs of running the particular advertisement in petitioner's magazine.

Mr. Robert C. Guccione, Mr. Anthony J. Guccione and Mr. Irwin E. Billman comprised the board of directors of the following corporations: Penthouse International, Ltd.; Viva International, Ltd.; Omni Publications, Ltd.; Penthouse Communications, Ltd.; Bravo International, Ltd.; and Penthouse/Viva Leisure Club, Ltd.

Mr. Robert C. Guccione was president and chairman of petitioner and was president of each of the members of the proposed combined group. The 1978 pro forma Federal income tax return of petitioner indicated that Mr. Guccione owned 66-2/3% of petitioner's stock. Mr. Irwin E. Billman was executive vice president of petitioner and Viva.

Additionally, Mr. Marc Bendesky, who was petitioner's controller during 1978, also served as controller for the members of the proposed group. Mr. Bendesky and his staff were responsible for maintaining the books and records for petitioner and the affiliated corporations.

Petitioner was not compensated for the general and administrative services it provided to the members of the proposed combined group.

The nature and extent of the general and administrative services petitioner provided to Films, Bravo, Communications, Leisure and C-P Records is unclear given the dearth of information in the record regarding the activities of these entities during the year at issue (see above).

At a point prior to January 1979, petitioner acquired a leasehold interest in property located at 67th Street, New York, New York. Petitioner undertook a complete renovation of the property for the purpose of converting it for use as an office for Mr. Robert Guccione, as a production facility in connection with the publication of magazines, and for non-business use. The improvements were made by Cauldwell-Wingate Co., Inc., an independent contracting firm. The property contained approximately 15,000 square feet of space. Of this amount, petitioner estimated that 8,000 square feet were used for business purposes. Of this 8,000 square feet, petitioner estimated that 5,000 square feet were used in connection with the production of magazines, including a film laboratory, photo library and a 600-square foot room containing slide equipment. Petitioner's records (Exhibit "19") indicate expenditures totaling $4,699,963.17 classified as leasehold improvements to the "67th Street mansion" for 1979. Petitioner claimed an investment tax credit for 1979 based upon expenditures totaling $4,881,684.00. The difference between these two figures appears from the record herein (specifically Exhibit "22") to result from expenditures classified as furniture and fixtures.[4] For 1980, petitioner's records (Exhibit "20") indicate leasehold improvements to the 67th Street mansion of $1,246,860.62. The summary of petitioner's tax credit computations for 1980 entered into the record (Exhibit "22") indicates leasehold improvements with respect to the 67th Street mansion of $1,449,031.00, furniture and fixtures expenditures for the mansion of

[4]Exhibit "22," a workpaper summarizing petitioner's investment tax credit computations for the years 1979, 1980 and 1981, lists this expenditure as "F + F Mansion."

$362,248.00, and $31,790.00 for what appears to be an additional furniture and fixtures expenditure. For 1981, petitioner's records (Exhibit "21") indicate leasehold improvements to the 67th Street mansion of $195,986.28. With respect to 1981, Exhibit "22" indicates leasehold improvements for the mansion of $195,986.00, furniture and fixtures for the mansion of $140,695.00 and an additional furniture and fixtures expenditure of $30,981.00, for a total expenditure of $367,662.00 from which petitioner's claim of $14,706.00 in credit for 1981 was calculated. In contrast to its investment tax credit calculations for 1979 and 1980, it does not appear that petitioner made an allocation with respect to the relative square footage of the mansion used in production in its calculation of its 1981 investment tax credit claim.

Petitioner introduced into the record certain documents (Exhibit "17") listing certain of the alterations to the 67th Street property. Among the items so listed were the following: structural alterations; windows; skylights; bath accessories/sauna; greenhouse; elevator/dumbwaiter; tile and stone; HVAC; and electric.

No evidence was presented to tie the $367,662.00 of expenditures which formed the basis of the 1981 investment tax credit claim to specific purchases of specific items. In other words, the items which comprise the $367,662.00 of purchases were not identified in the record.

On January 10, 1990, General Media International, Inc., a successor corporation to petitioner, filed a formal request for permission to file a combined franchise tax report with several affiliated corporations commencing with the year 1989. Three of the corporations for which petitioner requests combination in the instant proceeding were included in this January 10, 1990 request: Penthouse International, Ltd.; Viva International, Ltd.; and Omni Publications, Ltd.

By letter dated January 22, 1990, the Division granted tentative permission to General Media International, Inc. to file a combined report with a number of subsidiary corporations, including Penthouse International, Ltd.; Omni Publications, Ltd.; and Viva International, Ltd.

Such tentative permission to file a combined report was subject to subsequent audit by the Division.

General Media International did not include within the proposed combined group Penthouse Films International, Ltd., which appears from the record (Exhibit "14") to have been an active corporation at the time of General Media's application. Penthouse Communications, Ltd. was also not included within General Media's proposed combined group. General Media's application lists this entity as "inactive." General Media's application makes no reference to C-P Records, Bravo International, Ltd. or Penthouse/Viva Leisure Club, Ltd.

In its petition, petitioner alleged that the Commissioner of Taxation and Finance erred by not accepting a Report of Change in Taxable Income by the U.S. Treasury Department, filed May 13, 1987, and the resulting claims for refunds of overpaid tax arising therefrom. Inasmuch as petitioner did not further raise this issue either at hearing or on brief, it is concluded that petitioner has abandoned this allegation of error.

Petitioner submitted proposed findings of fact numbered "1" through "37." Throughout the proposed findings petitioner referred to the members of the proposed combined group as "the subsidiaries." This characterization is rejected as the facts as found herein distinguish among the members of the proposed combined group and do not find that all such members were, in fact, subsidiaries of petitioner. With that proviso, the following proposed findings are generally accepted and have been, in substance, incorporated into the Findings of Fact herein: "1" through "4," "6," "7," "11," "12," "14" through "19," "21" through "33," "36" and "37." Proposed finding "8" is, in substance, accepted except for the third sentence thereof. Proposed finding "9" is, in substance, accepted except for the first sentence thereof. Proposed finding "10" is, in substance, accepted except for the second sentence thereof. Proposed findings "5," "13," "20," "34" and "35" are rejected. These proposed findings are rejected (in whole or in part) because they are unsupported by the record.

OPINION

The Administrative Law Judge dealt first with petitioner's assertion, in effect, that its failure to request permission to file a combined report until the hearing is of no import and that the Division abused the discretion granted under Tax Law § 211(4) by not permitting or requiring petitioner to file a combined report. Petitioner asserts that Matter of Autotote Ltd. (Tax Appeals Tribunal, April 12, 1990) is dispositive of this case because the Division's audit of petitioner's business necessarily involved its dealings with its subsidiaries, thus, clearly presenting the issue of combination to the Division both by the manner in which petitioner filed its returns for the years at issue and by the extensive documentation that was provided to the Division during the course of the audit. The Administrative Law Judge rejected this assertion on the basis that 1) petitioner, unlike the petitioner in Autotote, did not request combination during the course of the audit and 2) "[t]he fact that petitioner improperly computed its entire net income does not constitute raising the combination issue. As to the purported voluminous documentation reviewed on audit, the record in this matter does not reveal what documentation was reviewed by the Division on audit" (Determination, footnote 5).

The Administrative Law Judge also found that unlike Autotote, the Division here has disputed the propriety of combination on substantive, not solely procedural, grounds. The Administrative Law Judge concluded that while Tax Law § 211(4) invests the Division with discretion to require or permit combined reporting under certain circumstances, the Division

> "must have a meaningful opportunity to exercise this discretion. Where, as here, the issue of combination is not raised until the hearing, the Division has not had such an opportunity and the request must be considered untimely within the meaning of Fuel Boss [Matter of Fuel Boss v. New York State Tax Commn., 128 AD2d 945, 512 NYS2d 595] and Chudy Paper [Matter of Chudy Paper Co., Tax Appeals Tribunal, April 19, 1990]" (Determination, conclusion of law "F").

The Administrative Law Judge went on to determine that "[e]ven assuming that the merits of the combination issue" were properly at issue, petitioner failed to establish that it and the members of the proposed combined group meet the requirements of filing on a combined

basis under the Division's regulations or that combined reporting would fulfill the statutory purpose of avoiding distortion of, and more realistically portraying, true income. Specifically, the Administrative Law Judge concluded that petitioner failed to meet the threshold test of ownership with respect to Viva, Omni and Films, and that with respect to C-P Records, no evidence of ownership or control by petitioner is shown, nor is it clear that the entity was even a corporation.

With respect to Bravo, Communications and Leisure, the Administrative Law Judge concluded that petitioner failed to show that they were part of a unitary business and that they engaged in substantial intercorporate transactions as required by the regulations.

The Administrative Law Judge also determined that petitioner failed to establish entitlement to the investment tax credit claimed on its 1981 corporation tax report on the basis that the record does not show that the expenditures were principally used by petitioner in production as required by Tax Law § 210(12)(b).

On exception, petitioner asserts that this case comes within Autotote in that there was an in-depth field audit and that:

> "[t]o the extent a request at audit is required, it was made. It is established and, in fact, conceded by [the Division] that information itself -- without any magic incantation -- can raise the issue of combination, and that a formal request for combination is not always necessary . . . . That is the case here. As discussed in the Record (e.g., Findings of Fact No. 5,6), Petitioner deducted $11,934,037 in calculating its entire net income for 1978. These deductions were the principal subject of the audit, and in fact, represent the losses of the seven subsidiaries. Thus, in filing its return, Petitioner included substantially all of the income and expenses of its subsidiaries; thus effectively requesting combination" (Petitioner's supplemental brief, p. 21).

Petitioner argues further that: "[j]ust as combination was necessarily before the Division at audit, its opportunity to examine that question -- indeed, its obligation to do so -- was meaningful. There is no dispute that the [Division], 'on its own initiative, has had the opportunity through the audit process to examine and scrutinize petitioner's business activities,

in particular intercompany transactions'" (Petitioner's supplemental brief, citing Determination, conclusion of law "F," quoting from Matter of Autotote, Ltd., supra).

Finally, petitioner asserts that:

> "[e]ven if the issue [of combination] were not raised at audit, a finding with which we strongly disagree, the statutory purpose of combined reporting -- to prevent distortion and fairly reflect income -- requires that Petitioner nevertheless prevail.
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> * * *
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> "When considered against the backdrop of this statutory purpose, there is neither reason nor logic to deny combined reporting -- if the substantive tests therefor are met -- on the basis of an arbitrary regulatory time limit.
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> * * *
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> "Thus, if the [Division's] regulation were read to preclude consideration of combination here, it must be invalidated and set aside" (Petitioner's supplemental brief, pp. 27-28).

Petitioner asserts that it has met the substantive requirements of the Division's regulations and, thus, should be permitted to file a combined report.

With regard to stock ownership, petitioner asserts that the Division necessarily had before it, and examined, evidence showing petitioner's ownership of each of the seven subsidiaries and that common ownership is clearly shown by the evidence establishing that petitioner filed consolidated Federal returns with these subsidiaries since:

> "[i]n the years at issue, ownership of at least 80% of the voting stock and at least 80% of all other classes of stock (except for certain classes of non-voting stock which are limited and preferred as to dividends) was needed in order to file federal consolidated returns. Section 1504 of the Internal Revenue Code of 1954, as amended" (Petitioner's supplemental brief, p. 5).

With regard to the factors of unitary business and substantial intercompany transactions, petitioner points to "[t]he sharing of employees, departments and business location, Petitioner's financing of the subsidiaries' activities through intercompany loans, and the services provided without arms length charges" as establishing that it satisfies these elements of the Division's regulations (Petitioner's supplemental brief, p. 17).

The crux of the Division's argument on exception is reflected in the following passage from its reply brief:

> "[o]n field audit of Penthouse International, Ltd., however, there were no facts presented to the Division which would establish that Petitioner's reported entire net income and franchise tax liability were not accurately reflected on the separate basis return filed. In fact, the only adjustments to the report filed involved specific computational adjustments to items which were incorporated on the return. (Findings of Fact 6 through 9.) The Division was not afforded an opportunity to examine in depth any intercorporate relationships between Petitioner and affiliates: Petitioner had not included an affiliation schedule in the filed return, and on field audit simply provided information to substantiate the income adjustment for losses attributed to its investment in related corporations. (Ex. E.)
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> "If Petitioner Penthouse International were to succeed in arguing that the Division abused its Section 211.4 discretion by failing to require Petitioner to file on a combined basis for 1978, the Division submits the grant of discretionary authority will be rendered meaningless. The Petitioner, on this argument, would have the Division 'grant permission' (or 'require') to file on a combined basis in each and every instance where there is an allusion of affiliation and a suggestion of intercorporate relationship. Evidently this is Petitioner's position, as Penthouse International, Ltd. has established neither the requisite ownership relationship between itself and all corporations for which combinations is requested, nor has it provided any evidence that the corporations were engaged in a unitary business and had between and among themselves substantial intercorporate transactions" (Division's reply brief, pp. 13-14).

We affirm the determination of the Administrative Law Judge in its entirety.

We deal first with the issue of whether, under the circumstances of this case, the Division's refusal to allow or require petitioner to file on a combined basis was an abuse of its discretion under section 211(4). We agree with the Administrative Law Judge that petitioner's reliance on Autotote is misplaced. In Autotote, the taxpayer did not request permission to file on a combined basis within 30 days after the close of its taxable year as required by the Division's regulation (20 NYCRR 6-2.4[a]). However, the taxpayer raised the issue of a required filing on a combined basis during the audit and requested permission to file on a combined basis prior to the end of the audit. Moreover, the audit showed, and the parties stipulated, that the taxpayer met all of the criteria for filing on a combined basis. We stated that:

> "[e]ven if there are other reasons for the thirty-day rule and the permission process, such reasons cannot be used to prohibit a taxpayer from filing on a combined basis where . . . the Division, on its own initiative, has had the opportunity through the audit process to examine and scrutinize [the taxpayer's] business activities, in particular intercompany transactions. Under these circumstances [i.e., the request during the audit and the results of the audit], it would appear to us that the thirty-day rule cannot provide a basis for the Division's failure to adhere to the standards in its regulations [cite omitted]" (Matter of Autotote Ltd., supra, emphasis added).

Thus, we concluded that it was "arbitrary for the Division to refuse to exercise its discretion to allow the taxpayer to file a combined report [merely] because the taxpayer has failed to request permission within a time period not prescribed by statute" (Matter of Autotote Ltd., supra).

Petitioner apparently relies on one portion of our decision in Autotote, i.e., that the "Division, on its own initiative, . . . had the opportunity through the audit process to examine and scrutinize [the petitioner's] business activities" for the proposition that the conduct of the audit is sufficient to constitute the request for combination. In so doing, petitioner divorces our conclusion in Autotote from the critical fact that there the taxpayer's failure to comply with the thirty-day rule did not deprive the Division of the opportunity it would have had if a timely application had been filed (i.e., to determine whether the taxpayer met the substantive requirements of the regulations) since the taxpayer twice raised the issue of combined reporting during the audit. Thus, the Division was on notice and was able to fully examine the taxpayer's business activities, including intercompany transactions, and conclude that Autotote met the regulatory criteria.[5]

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[5]The application and approval process allows the taxpayer to know how it should file and the Division to know from whom it should expect a return. Specifically, the application (form AU 2.1) requires the name, address, employer identification number and the state of incorporation of each corporation to be included in the combined report; information showing that each corporation meets the capital stock and unitary business requirements and distortion tests of the regulations; the name of all corporations which meet the capital stock requirements but which are not to be included in the combined report, together with a statement of details as to why a combined report, which would include only the corporations listed, will equitably reflect the New York State activities of the corporations which meet the capital test and why the other corporations should be excluded.

The request must also include the nature of the business conducted by each corporation, the source and amount of gross receipts of each corporation and the portion derived from transactions with each of the other

Here, the situation is far different since the audit was conducted without any knowledge by the Division that petitioner had any intention to request permission to file on a combined basis, and there is no agreement between the parties, nor did the audit determine, that petitioner met the regulatory criteria for filing on a combined basis.

We reject petitioner's assertion that the concept of "meaningful opportunity," as coined by the Administrative Law Judge, is not relevant. The mechanics of the Division's regulations concerning combined reporting on either a permissive or required basis say otherwise. In short, satisfaction of the three regulatory criteria merely creates a presumption of distortion when the taxpayer files on a separate basis (see, Matter of Campbell Sales Co., Tax Appeals Tribunal, December 2, 1993; Matter of Standard Mfg. Co., Tax Appeals Tribunal, February 6, 1992 [i.e., stock ownership, unitary business and substantial intercorporate transactions]). A taxpayer can rebut the presumption by showing, for example, that the substantial intercorporate transactions between the parent and its subsidiaries are at arms length so that there is no distortion of income, if separate reports are filed (Matter of Campbell Sales Co., supra; Matter of Standard Mfg. Co., supra).

Similarly, where a taxpayer requests permission to file on a combined basis asserting that it satisfies the three regulatory criteria, a presumption is created which the Division can rebut by showing, for example, that the substantial intercorporate transactions are at arm's length such that filing on a separate basis properly reflects income. The difference between the two situations is that where the Division seeks to require combination, the taxpayer has the information necessary in its own records to rebut the presumption. However, where the taxpayer requests permission, the information necessary for the Division to rebut the presumption must be obtained by audit. Where, as here, the taxpayer filed its 1978 return on a separate basis and the Division was not made aware of the request until hearing, the Division

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corporations, the source and amount of total purchases, services and other transactions of each corporation and the portion related to transactions with each of the other corporations and any other data that shows the degree of involvement of the corporations with each other (20 NYCRR 6-2.4).

was denied the "meaningful opportunity" on audit to gather the information needed to rebut the presumption.

We also agree for the reasons stated in the determination of the Administrative Law Judge that petitioner has not shown that it satisfies all the regulatory criteria to require that it file on a combined basis. In particular, petitioner has not demonstrated that there are substantial intercorporate transactions. We agree with the Administrative Law Judge that "[t]he nature and extent of the general and administrative services petitioner provided to Films, Bravo, Communications, Leisure and C-P Records is unclear given the dearth of information in the record regarding the activities of these entities during the year at issue (see Findings of Fact '19' through '22')" (Determination, finding of fact "48"). Accordingly, we conclude that the Division did not abuse its discretion by failing to allow or require petitioner to file on a combined basis.

Finally, we reject petitioner's assertion that "if the [Division's] regulation were read to preclude consideration of combination here, it must be invalidated and set aside" (Petitioner's supplemental brief, p. 28). Tax Law § 211(4) clearly gives the Division the discretionary authority to determine when to permit or require filing on a combined basis. And, clearly, the Division has the authority to adopt rules and regulations necessary to allow it to carry out its authority under the statute (Tax Law § 1096). Administrative regulations which fill in the details of broad legislation describing the overall policy to be implemented are not inconsistent with the statute nor do they constitute an exercise of rulemaking power in excess of the statutory grant of power to an agency (see, Matter of Mercy Hosp. of Watertown v. New York State Dept. of Social Servs., 79 NY2d 197, 581 NYS2d 628). The Division here has exercised its rulemaking authority to provide procedural and substantive requirements to guide both the Division and taxpayers with regard to when, how and under what circumstances combined reports may be filed. We find nothing in the thirty-day notice requirement of the Division's regulation which constitutes an exercise of rulemaking power in excess of the statutory grant of power (cf., Boreali v. Axelrod, 71 NY2d 1, 523 NYS2d 464). Moreover, for the reasons stated

earlier, we find nothing in the application of the regulation to the facts herein which render it inconsistent with the statutory purpose of section 211(4) (i.e., proper reflection of income) and which requires that that application be set aside.

Also, we find that the Administrative Law Judge fully and correctly dealt with the issue of the investment tax credit. We affirm his determination for the reasons stated therein.

Finally, we reject petitioner's post oral argument submission.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Penthouse International, Ltd. is denied;

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

3. The petition of Penthouse International, Ltd. is denied; and

4. The Division of Taxation is directed to modify the Notice of Deficiency dated October 23, 1985 in accordance with conclusion of law "I" of the Administrative Law Judge's determination, but such Notice is otherwise sustained.

DATED: Troy, New York
January 20, 1994

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

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