STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
FAIRCHILD INDUSTRIES, INC.[1]	:	DECISION DTA NO. 815543
for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Periods Ended December 31, 1988, August 17, 1989, June 30, 1990 and June 30, 1991.	: :	

Petitioner Fairchild Industries, Inc., c/o The Fairchild Corporation, 45025 Aviation Drive, Suite 400, Dulles, Virginia 20166-7516, filed an exception to the determination of the Administrative Law Judge issued on September 24, 1998. Petitioner appeared by Roy H. Crosley, Esq., Tax Counsel for The Fairchild Corporation and McDermott, Will & Emery (Peter L. Faber, Esq., of counsel). The Division of Taxation appeared by Terrence M. Boyle, Esq. (James P. Connolly, Esq., of counsel).

Petitioner filed a brief in support of its exception and a reply brief. The Division of Taxation filed a brief in opposition. Oral argument, at petitioner's request, was heard on September 14, 1999 in New York, New York.

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

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[1]The petition to the Division of Tax Appeals was filed as "Fairchild Holding Corp., as assumer of, and Shared Technologies Fairchild Inc., as successor to Fairchild Industries, Inc."

ISSUES

I. Whether the gains realized by petitioner on the sale of its Space & Defense Business should be included in its entire net income for purposes of determining its New York State franchise tax liability.

II. If the gain on the sale of the Space & Defense Business is subject to New York State apportionment, should the Division of Taxation ("Division") have exercised its statutory discretion to apply a more appropriate formula.

III. Whether the Division erred by refusing to reduce petitioner's entire net income and adjust the property factor to account for an abandonment loss.

IV. Whether it was error for the Division to refuse to permit petitioner to utilize its Federal adjusted tax basis to determine its property factor.

V. Whether the penalty imposed pursuant to Tax Law § 1085(k) should be abated.

FINDINGS OF FACT

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

Introduction

The years in issue are the calendar year ending December 31, 1988, the short period ending August 17, 1989, and the fiscal years ending June 30, 1990, and June 30, 1991.

Fairchild Industries, Inc. ("Fairchild") was incorporated in Maryland in November 1936. It maintained its corporate headquarters in Maryland through December 1984. From December 1984 through the years at issue, its corporate headquarters were located in Virginia. Fairchild became a Delaware corporation in May 1987.

Fairchild, including its consolidated subsidiaries, was a diversified manufacturer and service company.[2]

As of January 1, 1987, Fairchild's business (not including subsidiaries) consisted of the following business segments: (a) the Space & Defense Electronics segment, which was engaged in the design, manufacture and sale of aerospace systems, subsystems and components primarily for the U.S. Government ("Space & Defense Business"); (b) the Industrial Products segment, which was involved in the design, production, and marketing of industrial controls and mechanical transmission devices for a variety of industries; and (c) the Aeronautics segment, which was engaged in the production of airplanes and airplane parts, principally through the Fairchild Republic Division ("Fairchild Republic") headquartered in Farmingdale, New York.

From 1975 through the years indicated below, Fairchild was a New York taxpayer which filed a General Business Corporation Franchise Tax Return, Form CT-3, with New York State that included, among other things, the following: (a) the Space & Defense Business, as defined hereafter, through the year ended June 30, 1990; (b) the Fairchild Republic Company, a division of Fairchild ("Fairchild Republic") through the year ended December 31, 1987; and (c) the activities of the former Fairchild Republic from January 1, 1988 through June 30, 1991.

Fairchild Republic and the Space & Defense Business operated as separate divisions and produced different products for distinct businesses. From at least 1978 through the years in issue, Fairchild's only division or operation located in the State of New York was Fairchild Republic.

Fairchild Republic

[2] Fairchild's subsidiaries are not in issue in this matter.

Historically, Fairchild was a corporation specializing in aircraft development and manufacturing, which, over time, expanded into other businesses including communications and spacecraft. Fairchild's Annual Report states:

> For most of its corporate existence, Fairchild Industries and its predecessor companies have been primarily engaged in the aircraft development and manufacturing business. During the 1960's, that technological background led the company into greater participation in spacecraft development and manufacturing. With the decline in the NASA budget and the perennial uncertainty concerning the Defense Department's commitment to the new hardware programs, Fairchild Industries has recently sought to broaden its business base into new areas capable of utilizing its basic technological expertise, as well as into unrelated industries with good long term growth and with profit margins higher than those usually obtained in the aerospace industry.
>
> These considerations have sparked Fairchild's move into various aspects of the communications business . . . In addition, Fairchild has begun a major real estate development . . . . (Fairchild Industries, Inc./1972 Annual Report, p.12.)

As of January 1, 1987, Fairchild's largest business segment (in terms of employment) was Fairchild Republic. Since 1976, Fairchild Republic was much larger than the Space & Defense segment, in terms of employment, as Fairchild Republic had 5,500 employees while the Space & Defense segment had 500 or 600.

From at least 1970, until it ceased functioning as a separate division, Fairchild Republic was headquartered in Farmingdale, New York, where it also maintained airplane production facilities since at least 1970. At one time, Fairchild Republic also had production facilities in Maryland.

Fairchild Republic was Fairchild's only presence in New York during the years in issue.

Fairchild entered into the airplane production business in New York in 1965, when it acquired Republic Aviation Corporation. At Farmingdale, Fairchild Republic produced the F-105, which saw action during the Vietnam War.

In 1965 Fairchild signed a lease with Grumman Corporation ("Grumman") which permitted Grumman to use land on the premises of Fairchild Republic for a period of 50 years at a fixed price. Grumman used the land to construct a building which was used as a wind tunnel.

In 1973 and 1974, Fairchild Republic secured Department of Defense contracts to develop the A-10 close support aircraft and, thereafter, to produce the airplane. The A-10, known as the "Warthog ," was used in the Persian Gulf War.

Throughout the remainder of the 1970s and the early 1980s, the Farmingdale facility was involved in the production of the A-10 aircraft. In total, Fairchild Republic delivered 713 A-10s and, as of 1981, Fairchild received 2.9 billion dollars pursuant to the A-10 contracts.

From at least 1975 through at least 1979, the sales of A-10 aircraft constituted a significant portion of Fairchild's sales. The following chart shows sales of the A-10 as a percentage of petitioner's total sales (all sales amounts are in thousands).

Year	1979	1978	1977	1976	1975
Sales of A-10 units and parts	$425,824	$325,507	$215,338	$95,961	$49,335
Fairchild Industries Inc.'s Total Net Sales	$717,859	$543,796	$399,341	$263,610	$218,538
Sales of A-10 as a Percentage of Total Net Sales	59.3%	59.9%	53.9%	36.4%	22.6%

During the period of time reflected by the foregoing chart, Fairchild's management continued to invest in research and development in order to diversify the corporation's operations and maintain the company's technological edge. In this vein, petitioner's 1978 Annual Report states:

> Fairchild management has sought to achieve a balance among technological innovation, service to the defense and NASA establishments, domestic satellite communications and commercial/industrial product fields. Among the steps taken over the past few years leading to the Company's present position have been substantial investments in plant renovation, equipment, and personnel training in all business areas. Moreover, Fairchild has concentrated on product and service development and improvement programs, as well as expanded research and development activities. (Fairchild Industries Annual Report 1978, p. 4.)

Fairchild Republic obtained a contract for the development of an Air Force trainer warplane, known as the T-46, in 1982. However, once the last A-10 was delivered in 1984, Fairchild Republic began to lose its position as petitioner's dominant business segment. Petitioner's 1984 Annual Report notes "a marked shift in the relative roles of the Company's major business group, " as the "Government Aerospace" segment lost its "once dominant position" due to the ending of the A-10 prime contract.

Fairchild Republic sustained losses of approximately $375,000,000.00 on its two main programs, the SF-340 and the T-46 from 1984 through 1986.

Official notice is taken that Federal budget outlays for national defense for the Federal fiscal year 1989 increased 4½% over the national defense budget outlays for the prior fiscal year but decreased 1.4% in the succeeding Federal fiscal year. Such outlays continued to decline through at least Federal fiscal year 1994. The 1989 Federal fiscal year budget outlays for national defense were 93% greater than such outlays for Federal fiscal year 1981. According to the Office of Management and Budget, the Federal budget outlay for National defense was approximately $290,361,000,000 for 1988, approximately $303,559,000,000 for 1989 and approximately $299,331,000,000 for 1990.

After the Air Force decided to discontinue the T-46 program, Fairchild announced on March 13, 1987 the closure of Fairchild Republic in Farmingdale, New York to be completed no later than December 31, 1987. For financial reporting purposes to Fairchild Industries' shareholders, depreciation stopped accruing on the machinery, equipment and buildings in Farmingdale, New York on December 31, 1987 because thereafter these items were not used for any purpose.

Space & Defense Business

Petitioner's Space & Defense Business has been in existence since at least 1969.

During the audit period, three companies, which were not incorporated, comprised the Space & Defense Business: (a) Fairchild Space Company, which produced satellites, satellite and spacecraft subsystems and provided technical support for the National Aeronautics and Space Administration ("NASA"); (b) Fairchild Communications & Electronics Company, which manufactured airborne electronics ("avionics") for military aircraft and ground systems for the U.S. Government command, control, communications and intelligence market; and, (c) Fairchild Control Systems Company, which designed and manufactured fluid controls, environmental controls and aerospace subsystems for spacecraft and aircraft applications.

The Space & Defense Business participated on many NASA and Department of Defense contracts. The 1987 Annual Report of Fairchild Industries, Inc. states "[every major space and missile program from Gemini and Minuteman through the Space Shuttle and MX has relied on the [Fairchild Control System] company's fluid control hardware for its compactness, durability, light weight, and reliability." (Fairchild Industries 1987 Annual Report, p.6.)

For its part, the Fairchild Space Company worked closely with NASA in order to advance its role as a prime contractor and to further its position in the area of reusable spacecraft that can be repaired and sustained in orbit. This was pursued through a program to build a space Explorer Platform and a satellite for the "Ocean Topography Experiment." The 1978 Annual Report mentions the Space & Defense Business's involvement as a prime contractor for two components of "the Multimission Modular Spacecraft (MMS) for NASA's Goddard Space Flight Center" (Fairchild Industries Annual Report 1978, p. 8.). The Annual Report describes MMS as "intended to be the standard spacecraft 'bus' for many future NASA missions using the Space Shuttle" (***id***). In the 1981 Annual Report, MMS is defined as a "retrievable and in-orbit refurbishable satellite" (Fairchild Industries Annual Report 1981, p. 6).

The 1979 Annual Report highlights Fairchild Space & Electronics Company as a prime contractor "for the integration of NASA's Multimission Modular Spacecraft (MMS)" (Fairchild Industries Annual Report 1979, p. 8) and notes that, as a result, "FSEC is well-positioned to participate in various mission applications during the space shuttle era." ***(Id.)***

Fairchild Space Company's close work with NASA on the MMS bore fruit in 1986. That year's Annual Report notes that "higher than normal investment in bidding programs . . . paid off as the division won important new projects that could have significant positive impact on the future." (Fairchild Industries 1986 Annual Report, p. 6.) Among the new projects mentioned by the 1986 Annual Report was Fairchild Space Company's "selection by [NASA]'s

Goddard Space Flight Center to build an Explorer Platform that will support the Extreme Ultraviolet Explorer experiment." (***Id*** at p. 4.)

Petitioner's 1987 10-K shows that the company saw the winning of the Explorer Platform contract as related to efforts the company had been making for years, including through the MMS program:

> The Company, through one of its divisions, Fairchild Space Company, produces satellites, satellite systems, spacecraft systems and electronic and mechanical hardware and provides technical support for the National Aeronautics and Space Administration "NASA" and the Department of Defense spacecraft markets. The Company is involved in supplying multimission modular spacecraft ("MMS"), a platform designed to be a standard spacecraft, for use in scientific satellite programs with the capability to allow for on-orbit service and repair. MMS has been used on eight satellites and the Company has been involved in a repair mission on one of the satellites. In 1987, the Company was awarded the Explorer Platform contract by NASA which is the first space platform designed for payload change-out on-orbit and will also have the capacity for on-orbit repair and maintenance. (1987 10-K, p. 202.)

Apart from being chosen to build the Explorer Platform, in 1986 Fairchild through Fairchild Space Company ("FSC"), was also selected by NASA's Jet Propulsion Laboratory to negotiate a contract "to build a satellite for the Ocean Topography Experiment" ("Topex") which was to be used to measure sea level and ocean currents (Fairchild Industries 1986 Annual Report, p. 4).

Petitioner's Annual Reports show that petitioner's campaign that culminated in its selection to build the Topex satellite commenced as early as 1984, during which year FSC completed "a study . . . for the design of a new Topex satellite." (Fairchild Industries 1984 Annual Report, p. 5).

According to Fairchild Industries' 1986 Annual Report, the Topex and Explorer Platform contracts were "vigorously pursued to enable Fairchild Space Company to *return* to the role of a prime contractor and advance its position in the realm of reusable spacecraft that can be maintained and repaired in orbit." (Fairchild Industries 1986 Annual Report, p. 4 [emphasis added].)

In addition to the Topex and Explorer Platform contracts, another source of the success of the Space & Defense Business in 1987 was the "Data Transfer System" produced by the Fairchild Communications & Electronics Company, which had a $220 million "backlog and follow-on business." (Fairchild Industries 1987 Annual Report, p. 8.) The Data Transfer System which "consists of a memory cartridge and cockpit processor that preprogram(s) the mission planning information, including weapons and navigation information, program the all-digital cockpit with that data, and record mission data and systems performance for post-flight analysis," was developed for the U.S. Air Force F-16 aircraft in 1981 (***id***).

As a result of, among other things, winning the Explorer Platform and Topex contracts and the continuing success of the Data Transfer System, Fairchild was able to greatly increase the Space & Defense Business's sales and operating income during the period from 1984 through 1988 as follows:

Tax Year Ending	Sales (in 000's)	Operating Income (in 000's)
December 31, 1988	$200,787	$16,675
December 31, 1987	122,214	5,147
December 31, 1986	142,726	4,972
December 31, 1985	137,632	6,475
December 31, 1984	136,941	14,035

At the end of 1986, the Space & Defense Business had a backlog in the amount of $149,613,000.00 and by the end of 1987 the backlog grew to $280,368,000.00. By the end of 1988, the backlog and follow-up business was about $300,000,000.00.

Neither Fairchild Control Systems Company, Fairchild Space Company nor Fairchild Communications and Electronics Company had any allocation to New York during the years in issue related to property or payroll.

The Federal government examines the historical performance of the applicant when it reviews an applicant's response to a request for proposals ("RFP").

Operation of Fairchild's Unitary Business

During the period 1975 through the years at issue, Fairchild, including its operation in New York, was a unitary business enterprise.

A. ***Centralized Management***

The general manager of the Space & Defense Business, until its sale, and the general manager of Fairchild Republic, until March 1990, reported to a corporate officer of Fairchild who was assigned to the headquarters of Fairchild.

Fairchild conducted general managers' meetings at its corporate headquarters on a monthly basis at which the general managers of each of the divisions (including Fairchild Republic) would present their monthly operating report.

From at least 1975 until they were no longer a part of petitioners' unitary business, Fairchild Republic and the Space & Defense Business prepared their own annual budgets and strategic business plans and submitted the same to Fairchild's corporate headquarters for approval.

Fairchild's Procedures Manual contained the following policies:

(A) All significant issues and decisions facing the corporation are reviewed by the Managing Council, appointed by its Chairman and Chief Executive Officer. Significant issues and decisions included submissions of only those contract bids for contracts that: (a) exceeded 10% of that division's current year's forecasted sales volume; (b) had a face value of $5,000,000.00 or more; (c) had unusual technical risks; (d) had unusual contract obligations for penalties or warranties; and (e) had fixed-price provisions for development-type performance. (Policy No. 1-2.)

(B) Requires "the advance written approval of the Chief Executive Officer and the President for the appointment of divisional officers of the corporation and the Chief Executive Officer, the President and the Corporate Controller for the granting of divisional contract signatory authority." (Policy No. 1-3.)

(C) The Division or Subsidiary Chief Financial Officer is required to submit contract proposals containing certain types of clauses "to the Corporate Controller, or his designee, for review and approval prior to submission to prospective customers." (Policy Memo 3-13.)

(D) Establishment of "an effective method of transferring employees between divisions." (Policy Memo 18.)

(E) "When the Corporation utilizes the advertisement media as a means of communicating with desired publics, a unity of appearance and message content will be maintained so distinctive, easily recognizable impressions are projected . . . The Corporate Public

Relations Department has ultimate responsibility for the advertising programs of the Corporation and subsidiaries." (Policy No. 65.)

B. ***Centralized Services***

Fairchild's headquarters allocated a portion of the expense of providing the following services to each of its operating divisions: (a) electronic data processing; (b) legal services; (c) accounting; (d) payroll; (e) tax return preparation; and (f) human resources management.

For the period 1975 through the years in issue, or in the case of the Space & Defense Business, through the date of its sale, Fairchild maintained one or more of each of the following types of employee benefit plans, in which employees of the Fairchild Republic and the Space & Defense Business, as well as other divisions of the corporation, participated: (a) defined benefit plans; (b) defined contribution plans; and, (c) employee stock ownership plans.

For the period 1975 through the years in issue, or, in the case of Fairchild Republic, through March 1990, and, in the case of the Space & Defense Business, through the date of its sale, Fairchild maintained one or more stock option plans and nonqualified deferred compensation plans, in which certain key employees of Fairchild Republic and the Space & Defense Business, as well as other divisions of the corporation, participated.

For the period 1975 through the years set forth below, Fairchild obtained loans which were used in whole or in part to fund operations or projects of: (a) Fairchild Republic through the year ended December 31, 1987; and (b) the Space & Defense Business through the year ended June 30, 1990.

For the period 1975 through the years in issue or, in the case of the Space & Defense Business, through the date of its sale, Fairchild maintained one or more insurance policies which provided coverage to the operators or property of Fairchild Republic and the Space & Defense Business as well as the other divisions of the corporation.

Fairchild's headquarters also oversaw the financial activity and the running of all contracts, including government contracts, of the divisions.

C. Intra-corporate transactions

During the period 1975 until the discontinuance of manufacturing at Fairchild Republic's Farmingdale facility in 1987, there took place: (a) transfers of services provided by or products manufactured or acquired by Fairchild Republic to other divisions of Fairchild, and (b) transfers of services provided by or products manufactured or acquired by other divisions of Fairchild to Fairchild Republic.

According to the table below, which was obtained from petitioner's 1985 Annual Report at page 13, the level of intra-corporate transactions by the Communications, Electronics & Space segment (whose makeup overlaps somewhat with that of the Space & Defense Business) varied during the period from 1981 through 1985 as follows (amounts are in thousands):

	1985	1984	1983	1982	1981
Intersegment sales included in Communications, Electronics & Space	$3,319	$3,914	$3,332	$6,670	$12,318

Proprietary information developed at Fairchild Republic may have been shared with the Space & Defense Business.

Closing of the Fairchild Republic Facility

During the first quarter of 1987, the Board of Directors of Fairchild authorized the closing of Fairchild Republic's plant in Farmingdale, New York.

The plant shutdown required Fairchild to implement a closure plan for Farmingdale as mandated by Federal and New York State law, which plan was certified as complete in 1988.

Petitioner began the process of winding up production at the Farmingdale facility in April 1987, and production ceased by December 1987. As part of the closure plan, petitioner took steps to eliminate environmental hazards at the site, including cleaning and removing all underground or below-ground storage tanks, except those required for heating fuel.

In July 1987, Mr. Gawronski, who was vice president, contracts and legal, was made the general manager of the Fairchild Republic Division responsible for completion of existing contracts, disposal of the assets of the Farmingdale operations and completion of all actions necessary for the closedown of the facility in Farmingdale and making it available for sale under a contract signed in October 1987.

There were 3000 employees at Fairchild Republic on March 13, 1987. The reports of the General Manager's meetings and internal memoranda thereafter indicated the following number of employees: 349 employees on December 31, 1987; 163 in April 1988; 124 in May 1988; 35 in July 1988; 23 in November 1988; 19 in December 1988; 11 in August 1989, and 1 in March 1990.

In 1987, Fairchild Republic formed a unit known as the Long Island Engineering Center in Farmingdale, New York ("LIEC") to which a group of its engineers was assigned to work on various contracts to support the A-10 aircraft which had been manufactured by Fairchild Republic from 1973 to 1984.

In October of 1987, Fairchild Republic sold the LIEC to Grumman Aerospace Corporation.

In October 1987, Fairchild signed a contract, subject to several contingencies, to sell 88 of the approximately 100 acres that comprised Fairchild Republic's real property in Farmingdale, New York, to Retail Stores Credit Corp. for $41,000,000.00. The 88 acres in the contract of sale were on the east side of Route 110 and included 1.8 million square feet of buildings previously used to manufacture aircraft. Twelve acres on the west side of Route 110 were not included in the contract of sale because the purchaser was not interested in this property which had been classified as environmentally sensitive by the New York State Department of Environmental Conservation ("DEC").

The contract required Fairchild Republic to evacuate each building as production ceased, to remove the material and equipment in each building, and to secure each building after the removal of all material and equipment in a manner satisfactory to the buyer. The tenth section of the contract concerned the environment and provided, in part, that if an adverse condition was found to exist prior to closing the seller would perform "Remediation Work" to the satisfaction of the DEC. If the estimated cost exceeded $4,100,000.00 and the estimated completion date were after November 30, 1989, the contract accorded the purchaser certain rights. Furthermore, the contract required the curing of any violations of land use laws or ordinances created in these same buildings as a result of petitioner's removal of property. Section 21(B) of the contract acknowledged that the seller would remove some tanks and equipment and that the seller intended to sell various fixtures, equipment and personal property. Pursuant to this section, the seller was under no obligation to fill holes or otherwise restore or repair the premises; however, the seller agreed to "restore" any damage to five particular buildings as a result of its closure plan. The contract also provided that, subject to a monetary limit, the seller was expected to cure any violations of law that affected the same buildings as mentioned in paragraph 21(B). Additionally, petitioner was required under the contract to maintain insurance on these structures through the date of closing.

In October 1987, Fairchild Republic sold the composite bonding center in Hagerstown, Maryland.

By July 15, 1988, all of the Fairchild Republic buildings at Farmingdale, New York, had been officially closed, and the remaining office personnel, consisting of 35 employees were relocated to a smaller rental office building. None of the employees at Fairchild Republic was transferred to any other division of Fairchild as a result of the Fairchild Republic shutdown. The remaining 35 employees were involved in a variety of tasks including: resolving matters with government auditors; collecting and archiving records; performing exit interviews and pension distribution procedures; overseeing security; and resolving open environmental issues. The Fairchild Republic facility was vacated in June 1988.

On August 17, 1989, Fairchild and wholly-owned subsidiaries formed a partnership, Fairchild Associated Partners, renamed Fairchild Communications Services Company (“FCSC”), in which Fairchild retained a 49.27% partnership interest.

All the partners of FCSC were wholly-owned subsidiaries of Fairchild during the years in issue.

Fairchild was the managing partner of FCSC during the period August 1989 to November 1989.

Fairchild received a letter from the DEC dated August 2, 1989, notifying Fairchild of the delisting and segmentation of the Fairchild Republic property and that a specified portion of the property would be listed as classification two as mandated by section 27-1305 of the Environmental Conservation Laws.

In November 1989, Retail Stores Credit Corp., the purchaser of the Farmingdale real estate, terminated its contract to purchase the entire 88 acres because of Fairchild's inability to obtain necessary environmental clearance. Fairchild then negotiated a termination of the lease with Grumman.

On November 17, 1989, Fairchild assigned all but a 0.27% interest in FCSC to a wholly-owned subsidiary.

The assessed value for the real estate tax on the vacant unused 100 acres in Farmingdale, New York was reduced in 1989 pursuant to an order signed by the Honorable Arthur M. Cromarty of the Supreme Court, State of New York, County of Suffolk. After applying the appropriate equalization factors to these assessed values, the fair market values of the vacant unused 100 acres in Farmingdale, New York, were as follows:

Tax Year	Value
1989-1990	$21,429,000.00
1990-1991	17,260,000.00
1991-1992	14,671,000.00

The machinery and equipment at the Farmingdale facility were sold in 1987 through 1989.

The Sale and Restructuring of Fairchild

On May 11, 1989, Banner Industries, Inc. made a public tender offer for all of the outstanding stock of Fairchild at $18.00 per share through an indirect, wholly-owned subsidiary pursuant to an Agreement and Plan of Merger ("Merger").

On May 31, 1989, Banner Industries, Inc. ("Banner") and its subsidiary entered into an Asset Purchase Agreement with Matra, S.A., ("Matra") a French corporation, and a U.S. wholly-owned subsidiary of Matra, pursuant to which, subject to the consummation of the Merger, Matra's subsidiary agreed to purchase from Fairchild the assets of Fairchild's Space & Defense Business for $245,000,000.00 plus interest.

Matra was interested only in acquiring the Space & Defense Business because it was familiar with this type of business. It was also interested in acquiring a base from which it could enter the United States market. In this regard, Matra felt that it had a superior technology which it could bring to the United States market. Matra also took into account the fact that the Space & Defense Business had substantially more sales and profits in 1988 than in 1987.

On August 18, 1989, Banner's subsidiary was merged with and into Fairchild, thereby increasing Banner's ownership of Fairchild to greater than the amount necessary to end Fairchild's taxable year for Federal income tax and New York franchise tax purposes.

In 1990, after its acquisition of Fairchild Industries, Inc., Banner changed its name to the Fairchild Corporation. One of the reasons for the change in names was the perception that the name Fairchild was valuable.

As a result of Banner's acquisition of control of Fairchild, Fairchild's unused New York investment tax credits were lost due to a change in New York law effective in April of 1989 which disallowed credits upon a change of control or ownership.

Sale of the Space & Defense Business

On August 25, 1989, Fairchild sold its Space & Defense Business to Matra's subsidiary, Matra Aerospace Inc., resulting in a taxable gain of $209,335,730.00. Fairchild's Board of Directors approved the sale.

As part of the sale to Matra, Matra retained the right to use the "Fairchild" name and eventually created the Fairchild Space and Defense Corp.

Following Matra's acquisition of the Space & Defense Business, the vice chairman and deputy chief executive of the new business segment stated that "we will retain the entire management and workforce in the Germantown, Maryland and Los Angeles operations."

The record does not show what assets were included in the sale.

The Space & Defense Business, excluding Maryland and California real estate, was sold by Matra in 1994 for approximately $82,000,000 in cash and stock.

Valuations

The Carlyle Group, L.P. ("Carlyle") prepared a study, dated October 1988, in conjunction with petitioner's effort to obtain "equity commitments" from investors interested in investing in a partnership formed for the purpose of acquiring 100% of Fairchild's common stock. In discussing the prospects of the Space & Defense Business, the study mentioned Fairchild Space Company's winning of the Topex and Explorer Platform contracts, its backlog of sales, and the expected increase in its sales in 1988. The study also noted that the fluid and control hardware developed by the Space & Defense Business was utilized by every major space and missile program. The Carlyle study included estimates of the value of each of Fairchild's business segments from itself, Drexel, Burnham, Lambert and Balis, Zorn, Gerard, Inc. The estimates of the value of the Space & Defense Business were as follows: Carlyle - $160,000,000.00, Drexel, Burnham, Lambert - $220,000,000.00; and, Balis, Zorn, Gerard, Inc. - $210,000,000.00.

Carlyle also prepared a "Due Diligence" study, dated May 1989, entitled "Acquisition of Fairchild Industries, Inc. by FII Transaction Partners, L.P." ("1989 Carlyle study"). On a page entitled "Investment Considerations" the study noted that Fairchild "has skilled managers in place at the operating level."(Acquisition of Fairchild Industries, Inc. by FII Transaction Partners, L.P., p. C00574). The study also included a page entitled "Acquisition of Fairchild Industries Strategic Plan Overview" which noted as one of its points under the caption "Build an Aerospace/Defense Company" the following: "Capitalize on the Company's historic strengths and the value of the Fairchild 'franchise'"(***id***., at p. C00580).

Fairchild's Filing History

For each of the taxable years from 1979 through the year ended December 31, 1987, Fairchild's franchise tax, as finally agreed by Fairchild and the Division, was the minimum tax of $250.00 per taxable year.

The business allocation percentage ("BAP") reported on petitioner's Forms CT-3 during the years 1975-1986 was above 25% for all years except one year. The business allocation percentages reported by Fairchild during the years in issue were 9.1357%, .5716%, and 11.61%, respectively.

On the Fairchild Industries, Inc. General Business Corporation Franchise Tax Return for the year ending December 31, 1987, an "X" was placed in the "No" box in response to the question "Are you making the election to use fair market value in the property factor?". On each of the general business corporation franchise tax returns for the year ending December 31, 1988 and the period ending August 17, 1989, an “X” was placed in the yes box in response to the question “Did you make an election last year to use fair market value in the property factor?”. On the return for the calendar year ending December 31, 1988, petitioner gave a negative response to the question of whether it was the first year that petitioner was making the election to use fair market value in its property factor. It did not provide a response to this last question on the return for the period ending June 30, 1990. Similarly, on the return for the period ending June 30, 1991, petitioner did not respond to the question of whether this was the first year it was making the election to use fair market value in its property factor. Petitioner gave an affirmative response to the question “Did you make an election to use fair market value in your property factor?” on its General Business Corporation Franchise Tax Return for the period ended June 30, 1990. In each of the foregoing returns, the figures used by petitioner to calculate the property factor were based on net book value as a measure of fair market value.

In its CT-3 for the fiscal years ended December 31, 1988 and August 17, 1989, Fairchild included the figures attributable to the Space & Defense Business in the computation of entire net income and the figures set forth under the “Everywhere” column of Schedule B, Part 1 (Computation of Business Allocation Percentages).

The gain from the sale of Fairchild’s Space & Defense Business was reported on Form CT-3 for the taxable year ended June 30, 1990, as follows:

Form D (Form 1120), Part II	$176,580,756.00
Form 4797, Part II	28,062,444.00
Other Income	4,692,530.00

$209,335,730.00

The portion of the sale price allocated to the real estate was approximately $27.4 million.

For purposes of its Federal tax obligations, Fairchild Industries determined that it sustained a taxable loss of $14,248,174.00 in the tax year ended June 30, 1990.

In calculating the $209 million gain from the sale of the Space & Defense Business, Banner subtracted the tax basis of the Space & Defense Business's property ($70,733,207.00) from the total consideration received from Matra ($208,069,000.00).

Petitioner reported $176,580,756.00 of the gain as a long term capital gain on its U.S. Corporation Income Tax Return for the fiscal year ended June 30, 1990. The tax return distributed the long term capital gain portion of the gain as follows:

Type of Asset	Gross Sales Price	Cost or Other Basis Plus Expense of Sale	Gain (or Loss)
Contract Backlog	$30,908,000	$0	$30,908,000
Proprietary Technology	32,100,000	0	32,100,000
Software/Data Base	1,200,000	0	1,200,000
Research & Development	2,400,000	0	2,400,000
Assembled Workforce	14,632,000	0	14,632,000
Goodwill	68,507,000	0	68,507,000

On its General Business Corporation Franchise Tax Return for the tax year ended June 30, 1990, petitioner excluded the gain from the sale of the Space & Defense Business from its entire net income. The report contained the following statement explaining the exclusion:

> THE SUBTRACTION FROM INCOME LISTED ON LINE 16 IS FOR THE GAIN FROM THE SALE OF NON-UNITARY ASSETS PERSUANT [sic] OF [sic] THE FINDING IN BONNER PROPERTIES, INC. VS. NEW YORK STATE, MAY 15, 1984.

On the same form, Fairchild reported that no receipts were allocable to New York. Following its audit, the Division made no adjustment to that receipts factor.

Abandonment Loss

The Federal income tax return of Fairchild Industries, Inc. and its related subsidiaries for the fiscal year ended June 30, 1992 included an abandonment loss of the Federal adjusted tax basis of certain buildings at the Fairchild Republic site. The buildings that were treated as abandoned in the 1992 Federal return ceased being used in 1988 as a result of the shutdown announced in 1987 and the signing of the contract in October 1987.

Fairchild did not claim an abandonment loss on its Federal or New York return for the year 1988.

Audit History

The major issue on audit was whether Fairchild properly excluded from its entire net income the gain from the sale of the Space & Defense Business segment in its return for the year ending June 30, 1990. The Division determined that the gain from the sale of the Space & Defense Business should be included in petitioner's entire net income. Moreover, the BAP of 4.7351%, which was calculated by the Division during the audit, caused $9,912,256.00 of Fairchild's gain from the sale of the Space & Defense Business to be included in petitioner's allocated taxable net income.

The Division issued a Notice of Deficiency, dated October 31, 1994, stating that tax was due in the amount of $1,329,257.00 plus interest in the amount of $597,927.82 and penalty in the amount of $132,297.00 for a balance due of $2,059,481.82.[3] In a Conciliation Order dated September 13, 1996, the Bureau of Conciliation and Mediation Services modified the Notice of Deficiency by reducing the amount of tax sought to $1,052,219.00. The Conciliation Order further directed that the amount of the penalty be reduced to $105,348.00 and interest be computed at the applicable rate.

The request filed by petitioners with the Bureau of Conciliation and Mediation Services ("BCMS") included an argument that petitioner was entitled to claim an abandonment loss on its return for the year 1988. The abandonment loss claim was based on the following:

Federal adjusted tax basis	$7,118,435.00
Less basis in buildings not abandoned:	
Building 21 (Guardhouse)	(77,980.00)
Building 64 (Archive Storage)	(129,757.00)
Total abandonment loss	$6,910,698.00

The abandonment loss claim was not resolved at BCMS because the Division concluded that there was no provision in the Tax Law for an abandonment loss.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

In his determination, the Administrative Law Judge first considered whether the inclusion of the gain from the sale of the Space & Defense Business resulted in the taxation of extraterritorial values and, if so, whether the Division erroneously failed to exercise its discretion under Tax Law § 210(8) to revise the business allocation percentage. The Administrative Law Judge reviewed the statutory and regulatory basis for imposing franchise

[3]The Division asserted a penalty for substantial underpayment of tax pursuant to Tax Law § 1085(k) for the year ended December 31, 1988 and the period ended June 30, 1990.

tax on the business income of a non-domiciliary corporation. The Administrative Law Judge also noted relevant judicial decisions which upheld the taxation of a proportional share of the interstate income of a unitary enterprise by use of an apportionment formula so long as there was nexus with the taxing state and a rational relationship between the income attributed to the state and the intrastate values of the enterprise. The Administrative Law Judge noted that a state may not tax income "which cannot in fairness be attributed to the taxpayer's activities within the State" (***Matter of British Land (Maryland) v. Tax Appeals Tribunal***, 85 NY2d 139, 623 NYS2d 772, 775, ***quoting Allied-Signal, Inc. v. Director, Div. of Taxation***, 504 US 768, 119 L Ed 2d 533).

The Administrative Law Judge considered petitioner's argument that the gain from the sale of the Space & Defense Business was grossly disproportionate to Fairchild's activities in New York in light of the decision by the New York State Court of Appeals in ***Matter of British Land (Maryland) v. Tax Appeals Tribunal*** (***supra***). The Administrative Law Judge noted that the Court in that case had found the New York statutory apportionment formula to be fair on its face but had rejected the argument "that a tax on extraterritorial values can be established simply by showing that the taxpayer's formula-based intrastate income is many times greater than the income reflected in a separate geographical accounting" (***Matter of British Land (Maryland) v. Tax Appeals Tribunal, supra,*** 623 NYS2d, at 777).

The Administrative Law Judge concluded that, in view of the fact that petitioner had no gross receipts in New York in the year of the sale and the Division attributed nearly $10 million in gain to New York from the sale of the Space & Defense Business, petitioner had established that there was a gross disproportionality between the gain from the sale of the business and petitioner's net income from New York operations. The Administrative Law Judge noted, however, that the taxpayer in ***British Land*** was also able to show certain factors that were responsible for the appreciation in the value of its out-of-state property and that these factors had their economic impact before the taxpayer began its activities in New York. Moreover, in ***British Land***, the taxpayer made the decision to both acquire and dispose of the out-of-state property before it began doing business in New York.

In the present matter, the Administrative Law Judge rejected petitioner's argument that the appreciation of the Space & Defense Business occurred after the closing of Fairchild Republic. Rather, the sales and operating income of the Space & Defense Business demonstrated that when Fairchild Republic ceased operating, the Space & Defense Business was an active, ongoing business whose value far exceeded the adjusted tax basis of its assets. The Administrative Law Judge found that the appreciation in the Space & Defense Business's assets was attributable to Fairchild's unitary business activities prior to Fairchild Republic's shutdown. The Administrative Law Judge concluded that the Fairchild name had significant value which did not arise solely in the period starting with the shutdown of the Farmingdale facility and ending when the Space & Defense Business was sold.

Unlike the petitioner in ***British Land***, where all of the critical decisions with respect to the purchase, management, and subsequent sale of the out-of-state property occurred before the taxpayer's activities in New York began, the Administrative Law Judge concluded that there was an extended period of time when Fairchild Republic and the Space & Defense Business operated as a unitary business. It was this extended period of a unitary relationship which the Administrative Law Judge concluded permitted a countervailing flow of value and rendered the application of the apportionment statute constitutional. Additionally, the Administrative Law Judge accepted the Division's argument that the increases in the sales and operating income of the Space & Defense Business and the increase in its backlog of orders were attributable to the period of time that Fairchild Republic and the Space & Defense Business were operating as a unitary business.

The Administrative Law Judge rejected petitioner's argument that none of the appreciation was attributable to Fairchild Republic, holding that since Fairchild Republic and the Space & Defense Business operated as a unitary business during which time significant corporate decision-making occurred, there was a countervailing flow of value which precludes a determination that there was an unconstitutional application of the apportionment statute. The Administrative Law Judge did accept petitioner's argument that a gain occurred because the sale took place during the time of the defense buildup of the Reagan administration. However, the Administrative Law Judge concluded that since Fairchild Republic and the Space & Defense Business operated together as a unitary business for many years and that the only factor petitioner has been able to point to in order to establish a tax on extraterritorial values is the timing of the sale, petitioner has not established that the gain on the sale of the Space & Defense Business "was attributable in far larger part to 'factors . . . present in other States but not present in [New York]' (***Butler Bros. v. McColgan***, 315 US 501, at 509)" ***(Matter of British Land (Maryland) v. Tax Appeals Tribunal***, ***supra***, 623 NYS2d, at 777).

The Administrative Law Judge also rejected petitioner's contention that the statutory apportionment formula was distorted because the property and wage factors were changed as a result of the sale of the Space & Defense Business. The Administrative Law Judge concluded that whenever an out-of-state business is sold and a domestic enterprise is closed, there will be a change in the allocation percentage because of the way the allocation is computed. However, the Administrative Law Judge did not conclude that this was necessarily evidence of distortion.

The Administrative Law Judge also rejected petitioner's argument that the Division abused its discretion by failing to adjust Fairchild's entire net income for the year ended December 31, 1988 by the amount of the abandonment loss allegedly incurred by Fairchild and by refusing to modify the property factor to reflect the elimination of the abandoned assets in 1988. The Administrative Law Judge concluded that record did not support the conclusion that petitioner intended to abandon the buildings in issue in 1988, a necessary component of entitlement to an abandonment loss for that year. Additionally, petitioner did not claim an abandonment loss on its Federal income tax return until 1992. The Administrative Law Judge found that if petitioner had intended to abandon the property in 1988, it would have claimed the abandonment loss in that year.

The Administrative Law Judge also rejected petitioner's argument that the Division erred by using petitioner's book value to determine the property factor. Petitioner argued that the one-time election to use fair market value rather than the adjusted basis for Federal tax purposes was not made on Fairchild's 1987 return. Therefore, there was no support for using book basis rather than the adjusted tax basis for Federal income tax purposes. The Division argued that it was clear that petitioner intended to use fair market value on its return for its 1987 tax year and that, based on subsequent returns, petitioner intended to use this alternative valuation factor for the property factor.

The Administrative Law Judge noted that prior to 1987, a taxpayer was required by Tax Law former § 210(3)(a)(1) to use the fair market value of its property within and without New York in determining the property factor of the business allocation percentage. In 1987, section 210(3)(a)(1) was amended to provide that the term "value of the taxpayer's real and tangible personal property" meant the adjusted basis of such properties for Federal income tax purposes. However, the taxpayer could make a one-time, revocable election to use fair market value provided that such election is made on or before the due date for filing its 1987 return.

The Administrative Law Judge concluded that despite its response on its 1987 return, the figures used by petitioner to calculate the property factor on the return for the year ending December 31, 1987 were based on net book value as a measure of fair market value rather than on Federal adjusted tax basis. The Administrative Law Judge noted that the Division had a practice of accepting the use of net book value as an approximation of fair market value.

The Administrative Law Judge found that the most convincing indicator of petitioner's intent to use fair market value was the fact that petitioner used net book value as a measure of fair market value in 1987 and in each succeeding year, it being unreasonable to assume that petitioner would have consistently used net book value if it intended to use Federal adjusted tax basis instead.

The Administrative Law Judge rejected petitioner's argument that petitioner had substantial authority for its position that the gain from the sale of the Space & Defense Business should be excluded from its calculation of franchise tax, that its position was adequately described on its return and that there was reasonable cause for the understatement, as required for an abatement of the penalty imposed pursuant to Tax Law § 1085(k). The Administrative

Law Judge noted that the term "substantial authority" is not defined in the statute or regulations pertaining to corporation franchise tax. However, Tax Law § 1085(k) is substantially the same as Internal Revenue Code ("IRC") former § 1661 (now IRC § 1662). Referring to corresponding Federal regulations and case law, the Administrative Law Judge concluded that petitioner did not establish that it had substantial authority for excluding the gain from the sale of the Space & Defense Business for the tax year ended June 30, 1990 at the time it filed said return. Petitioner's alleged reliance upon ***British Land*** was misplaced because the date of that decision was several years after the return for the fiscal year ended June 30, 1990 was due. The Administrative Law Judge found that the other cases upon which petitioner relied as substantial authority were distinguishable because they did not concern a unitary business. Further, the Administrative Law Judge concluded that there was not adequate disclosure by petitioner of its treatment of the sale of the Space & Defense Business on its tax return. The statement on the return erroneously stated that the excluded gain was from the sale of non-unitary assets. This was inadequate to enable the Division to identify the potential controversy involved.

The Administrative Law Judge rejected petitioner's argument that it had established reasonable cause for the waiver of the penalty pursuant to 20 NYCRR 46.1(f)(2), in that petitioner misunderstood or misapplied the law based on a reasonable interpretation of it as applied to the facts. The Administrative Law Judge concluded that after operating as a unitary business for many years, it was an extreme position to assert that after a brief period of inactivity on the part of Fairchild Republic, none of the gain was attributable to Fairchild Republic. Further, the information on petitioner's tax return for the fiscal year ended June 30, 1990 was both unnecessarily brief and erroneous. The Administrative Law Judge concluded that petitioner had not shown that it acted in good faith.

ARGUMENTS ON EXCEPTION

On exception, petitioner argues that formulary apportionment is merely a device for determining a state's fair share of a corporation's income and it cannot be used to tax income that is not attributable to the corporation's activities within the state. If that formula results in taxing income that is not attributable to the state, then it cannot be applied. Relying on ***Container Corp. of America v. Franchise Tax Bd.*** (463 US 159, 77 L Ed 2d 545), petitioner notes that the apportionment formula will be struck down if it either results in attributing income to the state out of all proportions to the business transacted in that state or it has led to a grossly distorted result, such conditions being distinct and separate.

Petitioner maintains that the gain on the sale of its out-of-state business was in no way attributable to its New York operations. Despite the stipulated fact that petitioner's divisions were in a unitary business relationship, petitioner argues that it was not part of a vertically integrated business nor did its New York operations contribute to its out-of-state income or the value of the Space & Defense Business. According to petitioner, Republic and Space & Defense were separate and autonomous operations and there was no flow of value or significant intercompany transactions between them.

Petitioner argues that the amount paid for the Space & Defense Business was premised on its value alone, and had no relationship to Republic. In fact, Republic's operations dragged down the value of Space & Defense.

Petitioner asserts that the Division failed to exercise its discretion, pursuant to Tax Law § 210(8), to apply a more appropriate standard of apportionment to petitioner's gain on the sale of its out-of-state business. It was an undisputed fact that petitioner's New York operations lost significant amounts of money in the years leading up to the sale. Yet, the Division taxed over $9 million of petitioner's income arising from the sale of an out-of-state business, even though petitioner had no gross receipts from New York in that year. Petitioner maintains that this is a grossly distorted result, such as the Supreme Court held cannot stand in ***Container Corp. of America v. Franchise Tax Bd.*** (***supra)***. Petitioner argues that it has established a prima facie case that the result achieved by the Division is unconstitutional. Petitioner argues that the "gross disproportionality" found to exist by the Administrative Law Judge is, by itself, sufficient to strike down the application of the statutory formula.

Petitioner alleges that the Administrative Law Judge has ignored the fact that the existence of a unitary business is not dispositive of whether an otherwise valid apportionment formula is taxing income not attributable to petitioner's activities within the state. Such a position flies in the face of ***Container Corp. of America v. Franchise Tax Bd.*** (***supra***), ***Hans Rees' Sons v. North Carolina*** (283 US 123, 75 L Ed 879) and ***Matter of British Land (Maryland) v. Tax Appeals Tribunal*** (***supra***). Further, petitioner believes that the Administrative Law Judge has misunderstood petitioner's position. Petitioner is not arguing that its gain was not subject to taxation because petitioner had stopped conducting active business operations in the State. Rather, petitioner is arguing that the evidence is unrebutted that petitioner's New York operations did not contribute to the appreciation in the value of the Space & Defense Business that led to the gain in issue. The attempts by the Administrative Law

Judge to show a flow of value between the Space & Defense Business and petitioner are unpersuasive, since petitioner lost money in the years preceding the sale and actually dragged down the enterprise. There was no flow of value from petitioner to the Space & Defense Business. According to petitioner, the Administrative Law Judge has incorrectly concluded that this evidence is irrelevant because petitioner is a unitary business.

Petitioner argues that the Administrative Law Judge erred by giving the ***British Land*** decision an overly restrictive reading and finding it not to be dispositive because of factual differences with the present case. While the facts of this case are different, petitioner argues that the critical facts are the same. While petitioner admits it has the burden of proof to show that the income from the sale of its Space & Defense Business was not fairly attributable to its New York activities, petitioner argues that it has come forward with credible evidence that points directly to such a conclusion. Further, it is not necessary for petitioner to show that its New York activities did not contribute at all to the gain at issue, but merely that the gain was in far larger part attributable to out-of-state factors. Petitioner maintains that the Division, on the other hand, has the statutory duty to determine whether or not the statutory formula reaches the appropriate result, a duty which the Division has not even attempted to perform.

Petitioner argues that the property factor applied by the Division causes distortion because it gives virtually no weight to the property that generated the gain while giving undue weight to property that did not generate the gain. Due to the fact that the gain occurred only eight days into the taxable year in 1990, the payroll and property factors of the Space & Defense Business had little effect on petitioner's apportionment of income. This increased New York's share of petitioner's gain by nearly four times. The Division should have exercised its discretion to achieve a more equitable result and petitioner argues that this case should be remanded for it to do so. Additionally, petitioner's Republic properties should have been excluded from the property factor because it had been shut down for 18 months prior to the beginning of the tax year at issue and was no longer held for the production of income. As held by the Supreme Court in ***Container Corp. of America v. Franchise Tax Bd.*** (***supra***), the apportionment formula should reflect the manner in which income is earned. Property that has nothing to do with the generation of income for the year in question should be disregarded.

Petitioner argues that it did not elect to base its property factor in the allocation percentage on fair market value and, accordingly, Tax Law § 210(3)(a)(1) requires that the factor be based on the property's adjusted basis for Federal income tax purposes. Petitioner argues that while it inadvertently used accounting book value on its 1987 return, this was irrelevant. No election was made by petitioner on that return, as was required in order for fair market value to have been used and statements made in later years are of no account.

Petitioner asserts that since it discontinued use of the buildings on its Farmingdale property in 1988, it was entitled to an abandonment loss for the buildings in that year. The decision to abandon the property was made almost a year before the contract of sale of the property was entered into and the decision to sell was wholly independent of the decision to abandon. Although the loss was not claimed for Federal income tax purposes until a subsequent year, petitioner argues that this is irrelevant. The critical fact is whether petitioner, in fact, abandoned its buildings rather than how it reported such abandonment on its Federal income tax returns.

Petitioner argues that it fully disclosed its position relating to the gain on the sale of the Space & Defense Business on its tax return, it had substantial authority for its position, and it had reasonable cause to take that position. As a result, petitioner argues that the substantial understatement penalty should not have been imposed pursuant to Tax Law § 1085(k). Despite the analysis of the Administrative Law Judge, petitioner argues that the Division was specifically notified of petitioner's position on the nontaxability of the gain from the sale of its out-of-state assets. Petitioner maintains that it is no answer to say that petitioner's position was incorrect, since it was backed by a substantial body of case law and constitutes substantial authority within the meaning of Tax Law § 1085(k). Petitioner also believes that it had reasonable cause for its position.

The Division, in opposition, argues that this case is readily distinguishable from ***Matter of British Land (Maryland) v. Tax Appeals Tribunal*** (***supra***). As the Court of Appeals pointed out in that case, the taxing state does not need to select and identify specific intrastate income producing activities so long as the corporation is operating a unitary business and the income is derived from the unitary business. It may then apply an apportionment formula and tax an appropriate proportional share of the interstate income of the enterprise.

The Division recognizes that the right to use formula apportionment is not unlimited. However, the taxpayer's burden in regard to showing that a formula apportionment reaches an unconstitutional result is a heavy one. Here, based on petitioner's stipulation, the Administrative Law Judge concluded that petitioner was engaged in operating a unitary business from 1975 through the years at issue. The Division maintains that petitioner, conceding on exception that a significant amount of the appreciation in value of the Space & Defense

Business occurred while petitioner was engaged in business in New York, cannot meet its burden of proof in the same way that the taxpayer in ***British Land*** did; i.e., by showing that because of the timing of the decision to make the sale, the gain could not have had anything to do with New York.

The Division asserts that petitioner is attempting to locate where the value was produced in a unitary business by sourcing the contributions to value that led to the appreciation in the value of the Space & Defense Business. To do this, petitioner claims that the two businesses were autonomous. This is inconsistent with its admission that the unitary business was characterized by centralized management. Further, the Division points out that petitioner's headquarters supplied numerous services. The Division disagrees with petitioner's characterization of Republic and Space & Defense as two distinct businesses. The Division argues that they were both government contractors engaged in the aeronautic business. They were involved in some of the same projects and developed some technology jointly. Finally, the Division urges that there was a flow of value, directly or indirectly, between them.

The Division argues that petitioner continues to rely on its separate accounting analysis to show that Republic's net income for the year of the sale was negative. The Court of Appeals rejected this analysis in ***British Land*** finding that application of a statutory apportionment formula has been sustained even when it has resulted in converting separate accounting losses into net profits. The Division disagrees with petitioner's position that Republic actually dragged down the value of the Space & Defense Business and the value of the Fairchild name. However, even if that were true, it still results in an argument for separate accounting, something which is not persuasive and, pursuant to ***Mobil Oil Corp. v. Commissioner of Taxes*** (445 US 425, 63 L Ed 2d 510), something which is not constitutionally required for purposes of state taxation.

The Division disagrees with petitioner's argument that it has established a prima facie case showing that the standard formula has led to an inappropriate and unconstitutional result and that the burden of proof has shifted to the Division to establish a connection between the out-of-state gain and the State of New York. Rather, the Division asserts that the burden of proof remains on petitioner to show that formulary apportionment has reached an unconstitutional result in this case.

The Division maintains that there is no factual or legal basis to alter the property factor in order to more properly reflect petitioner's activity within New York State. The large gain realized on the sale of the Space & Defense Business was a capital gain which resulted from years of its performance as part of the unitary enterprise. If anything, the allocation percentage in the year of the gain is lower than it should have been. However, the application of the formula required this mathematical reduction from its level in prior years. Although the Republic property may not have contributed to the gain on the sale in the year of the sale, petitioner's focus on the year of the sale is misplaced. Rather, Republic contributed for many years to the benefit of the unitary enterprise.

The Division asserts that the Administrative Law Judge properly concluded that petitioner was not entitled to an abandonment deduction in 1988 with regard to the Republic buildings. The Division agrees with the Administrative Law Judge that petitioner had not met the criteria mandated by the IRC for taking an abandonment deduction in 1988 nor did petitioner adequately explain why such a loss was taken in 1992 if petitioner was entitled to take it in 1988. The

Division argues that petitioner never had the requisite intent to abandon the buildings in 1988, as demonstrated by the provisions of its contract to sell the buildings to Retail Stores Credit Corp., the fact that petitioner continued to maintain insurance on the buildings, paid real estate taxes on them and leased such buildings to Grumman.

The Division argues that petitioner has not shown that it is entitled to use its Federal adjusted basis in calculating its property factor as opposed to the fair market value of its property. The Division agrees with the Administrative Law Judge that petitioner's indication on its 1987 return that it was not making the one-time election to use fair market value was belied by the values actually used on that return. Finally, the Division argues that the Administrative Law Judge correctly sustained the imposition of penalty pursuant to Tax Law § 1085(k).

OPINION

Petitioner's primary argument is that the gain from the sale of its out-of-state Space & Defense Business is not subject to New York State franchise tax because, although Space & Defense and Republic were part of the same unitary business, taxation of the gain would either attribute income to New York out of all proportion to the business transacted in this State by the unitary business or produce a grossly distorted result. In support of its argument, petitioner argues that its situation closely resembles that of the taxpayer in ***British Land***. We disagree.

The Administrative Law Judge found that for the year of the sale, there was a gross disproportionality between the gain from the sale of the Space & Defense Business and petitioner's net income from New York operations. This is not the same as concluding that application of the statutory formula produced a grossly distorted result, thus making application of the statutory formula unconstitutional pursuant to ***Container Corp. of America v. Franchise***

Tax Bd. ***(supra***). Further, as pointed out by the Court of Appeals in ***Matter of British Land (Maryland) v. Tax Appeals Tribunal*** (***supra***), this gross disproportionality alone is not sufficient to invalidate the application of the statutory apportionment formula. In ***British Land,*** the Court found that the taxpayer had met its burden of proof to show that by applying the statutory formula and allocating 64% of petitioner's out-of-state income to New York State, the State was taxing extraterritorial value. However, the Court did not hold that none of the out-of-state income should have been allocated to New York. Rather, the Court remitted the matter to this Tribunal for consideration of an appropriate allocation percentage.

In the present case, the State of New York is not attempting to allocate more than 60% of the gain from the sale of the Space & Defense Business to New York, as it did in ***British Land***. Rather, the State has applied an allocation percentage which is significantly lower than the percentage applied in the years prior to the sale. For nearly all of the years preceding the year of assessment, petitioner's allocation percentage was in excess of 25%, although petitioner was only obligated to remit the minimal amount of franchise tax. In the year of the sale of Space & Defense, petitioner's allocation percentage was reduced by well over 80% to approximately 4%. Despite this, however, the application of this lower allocation percentage to the income of the unitary business resulted in a large amount of tax due. The fact that some tax was imposed on an allocated portion of the out-of-state gain does not mean that application of the statutory formula has produced a grossly distorted result any more so than did the application of the formula to petitioner during the years when it was liable for only a minimum amount of tax. As noted above, even in ***British Land*** the Court anticipated that some portion of the out-of-state gain would be subject to New York franchise tax. In short, we find that petitioner has failed to meet its burden to show, by clear and cogent evidence, that application of the statutory formula to it attributes New York income to petitioner out of all appropriate proportion to the business transacted by petitioner within the State.

Each of the issues raised on exception has been considered by the Administrative Law Judge in his determination. We find that the Administrative Law Judge has completely and adequately addressed the issues presented to him and correctly applied the Tax Law and relevant case law to the facts of this case. We see no reason to modify his determination in any respect and we affirm the determination of the Administrative Law Judge.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Fairchild Industries, Inc. is denied;

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

3. The petition of Fairchild Industries, Inc. is denied; and

4. The Notice of Deficiency issued on October 31, 1994, as modified by the conciliation order, is sustained.

DATED: Troy, New York
March 9, 2000

/s/Donald C. DeWitt
Donald C. DeWitt
President

/s/Carroll R. Jenkins
Carroll R. Jenkins
Commissioner

/s/Joseph W. Pinto, Jr.

Joseph W. Pinto, Jr.
Commissioner