STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petitions	:	
of	:	
CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.	:	DECISION
	:	DTA NOS. 821016
for Redetermination of Deficiencies or for Refund of Corporation Tax under Article 9 of the Tax Law for the Year 1999.	:	and 821017

Petitioner, Consolidated Edison Company of New York, Inc., filed an exception to the determination of the Administrative Law Judge issued on July 31, 2008. Petitioner appeared by Alston & Bird, LLP (Richard C. Kariss, Esq., of counsel). The Division of Taxation appeared by Daniel Smirlock, Esq. (Kathleen D. O'Connell, Esq., of counsel).

Petitioner filed a brief in support of its exception. The Division of Taxation filed a brief in opposition. Petitioner filed a reply brief. Oral argument, at petitioner's request, was heard on September 30, 2009 in Troy, New York.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision. Commissioner Tully took no part in the consideration of this decision.

ISSUES

I. Whether the Division of Taxation correctly concluded that a portion of the dividends paid by petitioner during the third and fourth quarters of 1999 were taxable pursuant to Tax Law former § 186.

II. Whether the penalty imposed pursuant to Tax Law § 1085(k) for substantial understatement of liability should be abated.

III. Whether petitioner has satisfied its burden of proof to establish the transfer and original cost of certain retired assets in order to offset the reported gain on the sale of generation assets for purposes of Tax Law § 186-a.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for findings of fact "24", "26" and "31" which have been modified. The Administrative Law Judge's findings of fact and the modified findings of fact are set forth below.

1. Petitioner, Consolidated Edison Company of New York, Inc. (Con Edison), is a regulated utility that was incorporated in New York State in 1884. It maintains its principal office in New York City.

2. Con Edison is engaged in the business of furnishing electricity, gas and steam to the general public in New York City and Westchester County, New York.

3. Based on hearings that began in August 1994, the New York State Public Service Commission (PSC) determined that the New York State electric utility industry should be fundamentally restructured to encourage competition and, thus, directed the existing electric utilities, including Con Edison, to file restructuring plans that addressed retail access, divestiture and corporate reorganization.

4. Petitioner filed a report with the Federal Energy Regulatory Commission (FERC), dated December 31, 1994, which showed the following:

Plant	Date Constructed	Last Unit Installed
Arthur Kill steam plant	1902	1962
Astoria steam plant	1953	1962
Ravenswood	1963	1965
Astoria gas turbine plant	1967	1970

There is no reference in the FERC report to a coal-fired plant, nor does the report contain any reference to coal as a primary or alternative fuel.

5. Ultimately, petitioner entered into an Agreement and Settlement (Agreement), dated September 19, 1997, with the PSC. The Agreement required that petitioner divest itself of at least 50 percent of its New York City electric generation fossil-fuel capacity by 2002. Also pursuant to the Agreement, Con Edison became a subsidiary of Consolidated Edison, Inc., (CEI), a public utility holding company. In 1997, CEI was incorporated in New York State.

6. Con Edison was required to submit an initial restructuring and divestiture plan to the PSC by October 1, 1996.

7. After the submission of its initial restructuring and divestiture plan, Con Edison filed its final restructuring and divestiture plan with the PSC on February 27, 1998.

8. The PSC formally adopted a restructuring and divestiture plan by issuing an order to Con Edison on August 5, 1998 (Divestiture Order), under which Con Edison was required to divest itself of at least 50 percent of its New York City electric generating fossil-fueled capacity to unaffiliated third parties.

9. The Divestiture Order required that Con Edison sell its electric generating assets in bundles that included the entirety of certain generation facilities rather then selling component or segregated assets. The PSC recognized that the asset bundles to be liquidated by Con Edison

would include active and retired assets (i.e., assets that are located at the generating stations but are not in current usage).

10. Con Edison expected that it would distribute some or all of the proceeds from the divestiture of its generation assets to its sole shareholder, the newly-formed holding company, CEI, so that CEI could restructure and potentially diversify its business after the mandated divestiture and deregulation of the industry.

11. Advisory opinions had been previously issued by the Advisory Opinion Unit of the Division of Taxation (Division) to other public utilities that had undergone PSC-mandated restructuring. The Advisory Opinion Unit determined that distributions from those utility companies of proceeds or assets resulting from mandated restructuring would not be subject to the excess dividends tax.

12. After engaging in preliminary discussions with and offering a draft submission to the officials of the Advisory Opinion Unit, Con Edison formally submitted a petition for an advisory opinion on September 29, 1998. Through the petition, Con Edison requested that the Advisory Opinion Unit make binding determinations regarding whether the proceeds from the PSC-mandated sale of electric generation assets were subject to the gross earnings tax and whether the distribution of those proceeds to CEI would be subject to the excess dividends tax. Petitioner asked two specific questions:

(1) Is any portion of the value of the consideration received by Con Edison from the sale of the generating assets, or other property, as mandated by the PSC, considered gross earnings subject to tax under section 186 of the Tax Law?

(2) Is the distribution of the proceeds from the sale of the generating assets or other property from Con Edison to CEI, as mandated by the PSC, considered a dividend subject to the tax on excess dividends under section 186 of the Tax Law?

13. Several months before the PSC-mandated sales were executed, the Advisory Opinion Unit responded to the petition by issuing an advisory opinion, TSB-A-99(1)C, on January 22, 1999. The Advisory Opinion set forth the following determination with respect to the gross earnings tax:

> The sale of the generating assets and other property representing the other potential generating sites, including Astoria, Hellgate, Kent Avenue and Sherman Creek, pursuant to the auction process is part of a series of transactions being entered into by Petitioner as mandated by the PSC pursuant to the Competitive Opportunities Proceeding and the PSC's policy objectives set forth in the Generic Order (Opinion No. 96-12), and implemented under Petitioner's Order dated September 19, 1997 and confirmed by the PSC in Opinion No. 97-16, issued November 3, 1997, and in accordance with the Divestiture Plan, Order issued and effective July 21, 1998, modified by Order issued and effective August 5, 1998, and confirmed by the full PSC by Confirming Order, issued and effective August 19, 1998. Through this series of transactions, Petitioner is to divest itself of all of its in-city electric generating fossil-fueled capacity to third parties and excess property that is available for the purpose of constructing new generating facilities, its two-third interest in the Bowline Point Generating Station and its 40 percent share of the Roseton Generating Station via auction. Like Con Ed, supra, and Central Hudson, supra, Petitioner does not employ its capital within the meaning of section 186 of the Tax Law for the purpose of being forced to restructure its organization and auction its assets. Therefore, the amounts received by Petitioner for these assets as a result of the auction process are not receipts from the employment of capital, and do not constitute "gross earnings". Accordingly, the amounts received from the divestiture of these generating assets and potential generating sites pursuant to the Order are not taxable under the gross earnings tax imposed by section 186 of the Tax Law.

14. The Advisory Opinion made the following determination with respect to the excess dividends tax:

> The distribution of the proceeds from the sale of the generating assets and other property representing the other potential generating sites, including Astoria, Hellgate, Kent Avenue and Sherman Creek, from Petitioner [Con Edison] to CEI

> is part of a series of transactions being entered into by Petitioner as mandated by the PSC pursuant to the Competitive Opportunities Proceeding and the PSC's policy objectives set forth in the Generic Order (Opinion No. 96-12), and implemented under Petitioner's Order dated September 19, 1997 and confirmed by the PSC in Opinion 97-16, issued November 3, 1997, and in accordance with the Divestiture Plan, Order issued and effective July 21, 1998, modified by Order issued and effective August 5, 1998, and confirmed by the full PSC by Confirming Order, issued and effective August 19, 1998. Through this series of transactions, Petitioner is reorganized into the holding company structure and is divesting itself of its generation assets and other potential generating sites. Such distribution of the auction proceeds does not represent a distribution of the profits of Petitioner as contemplated in Adams Electric, supra. [272 N.Y. 77 (1936)] Accordingly, the distribution of the proceeds from the sale, at auction, of the generating assets and other property representing the other potential generating sites, would not be distributions treated as dividends subject to the excess dividends tax under Section 186 of the Tax Law.

15. In compliance with an order of the PSC, Con Edison began auctioning its generation assets. Con Edison identified winning bids through the auction process in January 1999 and subsequently executed sales agreements with respect to three "bundles" of generation assets, including Astoria, Ravenswood and Arthur Kill generating stations and approximately 84 gas turbines located in Brooklyn and Queens.

16. The Arthur Kill bundle included the Arthur Kill Generating Station and the Astoria Gas Turbine site. The station consisted of two generating units designed to burn oil or gas and a black start gas turbine. At the time of the sale, Arthur Kill Unit 1 had been retired and removed from service. The primary fuel of the Arthur Kill Station was natural gas, with No. 8 fuel oil used as a backup. The Arthur Kill steam plant was originally constructed in 1902, and its last unit was installed in 1962. Arthur Kill's gas turbine plant was constructed in 1970, and its last unit was installed in the same year.

17. The Ravenswood bundle consisted of the Ravenswood Generating Station and the Ravenswood Gas Turbine site. It contained three gas and oil-fired steam generating units in

addition to a black start gas turbine. All of the units in this bundle burned natural gas as the primary fuel, with the capacity to burn No. 6 Fuel Oil, No. 2 Fuel Oil or kerosene as alternative fuels. Ravenswood's gas turbine plant was constructed in 1967, and its last unit was installed in 1970.

18. The Astoria bundle included the Astoria Generating Station and the Gowanus and Narrows Gas Turbine sites. The generating units contained in the Astoria bundle burned either natural gas or No. 2 Fuel Oil as a primary fuel, with kerosene as an alternative fuel. The Astoria steam plant was constructed in 1953, and its last unit was installed in 1962. Astoria's gas turbine plant was constructed in 1967, and its last unit was installed in 1971.

19. The three bundles were sold at an auction that realized proceeds as follows: Arthur Kill bundle - $518,122,017.00, Ravenswood bundle - $623,718,627.00 and Astoria bundle - $577,227,445.00.

20. Con Edison divested its interest in the Bowline Point Generating Station located in West Haverstraw, New York, which it co-owned with Orange and Rockland Utilities, Inc. (O & R). The sale of the assets co-owned with O & R was similarly mandated by the PSC, and Con Edison agreed to be bound by O & R's Divestiture Plan.

21. One of the assets, Unit 2 at the Astoria Generating Station, was placed back into service by the purchaser of this asset.

22. The board of directors of Con Edison conducted a meeting and made certain determinations regarding how much it intended for Con Edison to distribute to CEI. Con Edison's board of trustees authorized quarterly dividends for the third and fourth quarters of 1999. The dividend rate for common stock increased by $.005 per share in each year from 1997 to 1999, while the rate for preferred stock was not changed. In addition, the board authorized a

"special dividend to CEI of the generation station proceeds." The amount of the special dividend was not to exceed $1.2 million.

23. The regular dividend rates for the third and fourth quarters of 1999 were the same as the rates for the first and second quarters of 1999. According to petitioner's Securities and Exchange Commission filing, "[c]ommon stock dividends included the dividend to CEI of generation divestiture proceeds of $850 million." It follows that the special dividend issued in the third quarter of 1999 was for $850 million.

We modify finding of fact "24" of the Administrative Law Judge's determination to read as follows:

> 24. In a letter dated October 20, 2000, the Division advised petitioner that it would be conducting an audit of its New York State franchise tax reports filed for the periods 1997 through 1999 under Articles 9 and 9-A of the Tax Law. While the audit was in process, petitioner filed a claim for refund, dated August 6, 2001, for the year 1999. The claim sought a refund of $6,839,015.00 based on a "revised gain on sale of property computation." In a letter dated November 30, 2001, the Division requested documentation to support the claim for a refund. The request for substantiation was repeated on a number of occasions.[1]

25. In order to compute its gross income tax liability for the year 1999 on its originally filed return, Con Edison reduced the sales proceeds of $1,784,959,733.00 from the PSC-mandated sale of the generation assets by an original cost of $1,587,092,000.00 and selling expenses of $20,000,000.00. Therefore, Con Edison reported profits from the sale of property of $177,867,733.00 on its 1999 utility services gross income tax return and reported a gross income tax liability, based upon these profits, of $6,839,015.00. On the refund claim, Con Edison concluded that it had erroneously excluded the cost of certain retired assets that it sold pursuant to the PSC Divestiture Order.

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[1] We modified this fact to more accurately reflect the record.

We modify finding of fact "26" of the Administrative Law Judge's determination to read as follows:

> 26. On July 7, 2003, the Division received a response to its ninth request for documentation supporting the refund claim. In its letter, petitioner stated that the requested Final Settlement of Proceeds from the Sale of Generating Assets "is not relevant to the determination of gain for purposes of computing gain under Tax Law section 186-a" because the Final Settlement of Proceeds from the Sale of Generating Assets is a net number and not a gross number as required by section 186-a. The response further took the position that the requested information packet provided to the bidders and the Offering Memorandum submitted to the PSC are "not relevant." In response to the Division's request for "detail of the liabilities assumed by the buyers of the divested assets," petitioner replied that "the purchasers did not assume any mortgages or other debts of Con Edison as part of the plant sale . . . " and "Con Edison retained all environmental liabilities that occurred prior to the closing as well as all tax liabilities, wages, [sic] personal injury claims which occurred up to closing." Petitioner also noted that "[a]ssumed liabilities and phantom income is a net income concept and not applied to the gross receipts tax."
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> On December 11, 2003, the Division's auditor, Charles Hanny, sent correspondence to Con Edison via telecopier through which the Division confirmed that Con Edison had properly documented original cost of $176,792,000.00 related to the retired assets claimed to have been transferred as part of the PSC-mandated divestiture, which were included in Con Edison's refund claim.[2]

27. The Division issued a Consent to Field Audit Adjustment (Consent), dated January 9, 2004, asserting that additional tax was due for the years 1997 through 1999. The Consent explained that the field audit resulted in an increase in the corporation's tax liability of $18,895,946.00 (consisting of tax of $13,383,094.00 plus penalty and interest) pursuant to Tax Law § 186 and an increase of $33,026.00 (consisting of tax of $22,886.00 plus interest) pursuant to Tax Law § 186-a. The Consent and attached schedules were premised upon the Division's disallowance of petitioner's exclusion of its third and fourth quarter dividends from tax.

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[2] We modified this fact to more accurately reflect the record.

28. On March 8, 2004, the Division issued a Notice of Deficiency (Assessment L-023553919-2) asserting that tax was due in the amount of $13,383,094.00 plus interest in the amount of $4,415,344.90 and penalty in the amount of $1,224,783.00 less payments or credits in the amount of $136,414.00 for a balance due of $18,886,807.90. The notice was premised upon the same finding as the Consent.

29. On or about March 29, 2004, petitioner remitted a check in the amount of $18,886,807.90 based upon the amount of tax, penalty and interest asserted in the notice.

30. On or about May 26, 2004, petitioner filed a request for a conciliation conference protesting the Notice of Deficiency. The conference was conducted on April 6, 2005. A Conciliation Order was issued on December 2, 2005 sustaining the Notice of Deficiency.

We modify finding of fact "31" of the Administrative Law Judge's determination to read as follows:

> 31. As the Division never granted Con Edison's refund claim nor issued a denial of refund, petitioner also filed a request for a conciliation conference regarding its claim for a refund. A conference was held on April 6, 2005 and, in a Conciliation Order dated December 2, 2005, petitioner's claim for refund was denied.[3]

32. On July 14, 2004, while the matter was pending before the Bureau of Conciliation and Mediation Services (BCMS), the Division requested documents from petitioner regarding the refund claim and, in response, petitioner stated that it "had been advised by counsel that since the matter is now in litigation not to respond to any further inquiries on this issue."

33. Petitions were filed challenging the Notice of Deficiency and the denial of the refund claim. After filing its answers, the Division again sought substantiation underlying the refund

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[3] We modified this fact to more accurately reflect the record.

claim. When the records were not forthcoming, the Division requested that the Division of Tax Appeals issue a subpoena requiring the production of the purchase price allocations and any appraisals, valuations, summaries, studies or other documents relating to the value of the retired in place assets. Petitioner declined to provide the documents on the basis that the documents were not relevant.

34. The Division of Tax Appeals issued the requested subpoena, returnable on May 1, 2007, which was the date of the scheduled hearing on the petitions in this matter. Petitioner appeared at the hearing without any of the subpoenaed documents stating that "we have no responsive documents to the subpoena to submit and we have done due diligence and have not found any documents that are responsive to the subpoena that are in Con Edison's possession."

35. The minutes of petitioner's board of trustees meeting, dated January 26, 1999, states "as part of the sales process, the Company provided a full day of management presentations on such topics as environmental issues, personnel, fuel, market power, transmission and the Independent System Operator (ISO), site separation and repowering [sic]; arranged plant presentations and tours and established two data rooms at Irving Place." Petitioner's headquarters were located at 4 Irving Place.

36. Petitioner's pretax valuation of the auctioned assets was performed by Morgan Stanley. Morgan Stanley gave "a fairness opinion on the auction process and the prices." The Offering Memorandum, which was prepared by Morgan Stanley and which petitioner was unwilling to provide to the Division, is contained in the corrected record on appeal to the Court of Appeals in ***Consolidated Edison Co. of New York v. The City of New York***. The record on appeal also includes appraisals for petitioner's Fresh Kills Station and the Arthur Kill Generation Station.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

In his determination, the Administrative Law Judge noted that Tax Law § 171 and 20 NYCRR 2376.1 provide that at the request of a person who is or may be subject to liability under the Tax Law, the Commissioner of Taxation and Finance shall issue an advisory opinion that is binding upon the Commissioner with respect to that person only (***see***, 20 NYCRR 2376.1[a]; 20 NYCRR 2376.4).

The Administrative Law Judge recited the provisions of Tax Law former § 186, which imposed a tax on the gross earnings of and dividends paid by every corporation formed for or principally engaged in the business of supplying gas or electricity in New York. The Administrative Law Judge also observed that based on the Advisory Opinion obtained by petitioner, the amounts received from the PSC-mandated divestiture of its generating assets were not taxable gross earnings pursuant to Tax Law former § 186.

The Administrative Law Judge framed the decisive issue as whether all of the amounts distributed to CEI were proceeds from the mandated divestiture sales. The Administrative Law Judge concluded that the record supported the Division's position that they were not.

The Administrative Law Judge noted that at a meeting of the board of directors of Con Edison, quarterly dividends for the third and fourth quarters of 1999 as well as a special dividend to CEI of the generation station proceeds were authorized. Based on this, the Administrative Law Judge concluded that petitioner's regular third and fourth quarter dividends arose from the distribution of profits earned in the ordinary course of business.

While noting that the Advisory Opinion concluded that the distribution of the proceeds from the sale, at auction, of the generating assets and other property representing the other potential generating sites would not be distributions treated as dividends subject to the excess

dividends tax under former section 186 of the Tax Law, the Administrative Law Judge found that it was improper for petitioner to exclude third and fourth quarter dividends that arose from profits earned in the ordinary course of business from tax.

The Administrative Law Judge concluded that the record did not show reasonable cause for the substantial understatement of the excess dividends tax. While noting that petitioner requested an advisory opinion, the Administrative Law Judge found that petitioner then adopted an aggressive reporting position in interpreting its Advisory Opinion in an attempt to transform taxable regular dividends from profits into exempt proceeds from a divestiture, which demonstrated that petitioner did not act in good faith.

As for petitioner's claim for refund, the Administrative Law Judge noted petitioner's argument that in order to calculate aggregated profit from PSC-mandated sales, all proceeds were combined and then the taxpayer deducted the combined selling expenses and the combined original cost of all assets sold related to the PSC-mandated sales. Under this methodology, the only amounts that are relevant to the computation of the profit are the total gross proceeds from the asset sales, the original cost of the assets sold and the selling expenses related to the asset sales. Gross proceeds related to the sale of individual assets would be irrelevant.

The Administrative Law Judge pointed out that petitioner's refund claim was based on a revised computation of gain on its PSC-mandated divestiture transactions, including the original cost of assets retired in place and removed from petitioner's books and records. The Administrative Law Judge found that the only instance in the record where retired equipment was identified with specificity was in the Asset Purchase and Sale Agreement for the Astoria Bundle. Units 1 and 2 of the Astoria Generating Station were located on the schedule labeled Buyer Personal Property Located on Buyer Real Estate. The Administrative Law Judge noted that Tax

Law § 1096(b) provides that for the purpose of ascertaining the correctness of any return, the Division "shall have the power to examine or to cause to be examined, by any agent or representative designated by it for that purpose, any books, papers, records or memoranda bearing upon the matters required to be included in the return . . . ." The Administrative Law Judge concluded that the failure to provide the information requested to substantiate the claim for refund compelled a conclusion that petitioner had not sustained its burden of proof of establishing that it is entitled to the refund claimed.

ARGUMENTS ON EXCEPTION

On exception, petitioner argues that the Administrative Law Judge's determination that the third and fourth quarter dividends paid to CEI were subject to the excess dividends tax was incorrect because it was based on unsupported findings of fact and the improper application of the relevant legal authority. Petitioner asserts that while the Administrative Law Judge acknowledged the Advisory Opinion issued to petitioner, he failed to apply its holding to the transactions in issue. Further, petitioner maintains that the Administrative Law Judge failed to recognize that Tax Law former § 186 was a tax imposition statute, and not an exemption statute, and, therefore, should have been construed most strongly in favor of petitioner and against the Division.

Petitioner points out that the Advisory Opinion was sought in advance of any of the transactions at issue in this matter. That opinion held that petitioner could distribute all the proceeds received from the PSC-mandated divestiture sales to its parent corporation, CEI, and it did not place any limitations, restrictions, caveats or segregation guidelines with respect to the method or manner of those distributions. Petitioner received proceeds of $1,784,959,733.00

from these sales and, after the divestitures were executed, petitioner distributed $1,083,606,159.00 to CEI during the third and fourth quarters of 1999.

Petitioner argues that, based on the record, the only distinction among the distributions was that $233,606,159.00 was declared payable directly by the board of trustees of Con Edison at its July 1999 meeting, and $850 million was declared payable by certain officers of Con Edison in the third quarter of 1999, pursuant to an authorizing resolution of the board of trustees. Petitioner maintains that all distributions - its quarterly dividends and its special dividend - were paid from the same fungible cash accounts of Con Edison. As a result, petitioner believes that its 1999 third and fourth quarterly dividends were not subject to the excess dividends tax.

Petitioner disagrees with the Division's characterization of the quarterly dividends as "regular dividends" and asserts that this is not supported by petitioner's accounting records or other documents in the record. Petitioner also maintains that the record does not support the Division's assertion that the distributions were funded by "profits earned in the ordinary course of business [citations omitted]" (Petitioner's brief in support, p. 5).

Petitioner argues that the Administrative Law Judge failed to properly scrutinize the unsupported assertions of the Division and failed to properly consider the Advisory Opinion, which is binding on the Division and cannot be modified or otherwise reinterpreted except on a prospective basis.

Petitioner maintains that had the Advisory Opinion instructed petitioner to segregate the proceeds from the sale of the generation assets, to make specific accounting entries, to maintain bank records to establish that all distributions during the third and fourth quarters of 1999 were funded by the sales proceeds, or to declare that all distributions of divestiture funds were to be "special dividends," petitioner would have readily complied. However, petitioner states that for

the Division to attempt to impose such requirements after the fact deprives petitioner of equitable notice and is contrary to Tax Law § 171.24.

Petitioner argues that even if the assessment of excess dividends tax is sustained, the penalty asserted against petitioner should be abated because petitioner acted in good faith and with reasonable cause. Petitioner relies on the fact that it obtained an advisory opinion to confirm its determination that the excess dividends tax should not be imposed with respect to the distribution of the generation asset sale proceeds, as well as relying on several advisory opinions issued to other public utilities on the same topic.

Petitioner asserts that it could not have anticipated that the Division would impose a penalty in a case where petitioner relied on an advisory opinion, nor could petitioner have anticipated that the Administrative Law Judge would affirm the Division's adherence to the Advisory Opinion in several respects (not subjecting $850 million of the distribution to the excess dividends tax) while ignoring it in other respects (subjecting $233,606,159.00 of the distribution to the excess dividends tax). Petitioner disagrees with the Administrative Law Judge's characterization that it adopted an aggressive reporting position, as it actually distributed $701,353,574.00 less than it was permitted to do by the Advisory Opinion.

In terms of the denial of its claim for refund, petitioner argues that the Administrative Law Judge improperly focused on petitioner's failure to document the *value* of assets sold in its divestiture sales and did not review the evidence supplied to document the cost of such assets. Petitioner maintains that, pursuant to Tax Law § 186-a, profit on the sale of assets is computed by reducing the proceeds received by the original cost and the expenses related to the sale. For divestiture sales, petitioner maintains that the Division consistently determined that profit would be computed by aggregating the mandated sales and treating them as a single transaction. Thus,

petitioner states that affected taxpayers are not required to compute profit or loss on an asset-by-asset basis.

Petitioner asserts that it properly reported its profit from the divestiture sales on its returns to the satisfaction of the Division, and there was no consideration of value included in its return. However, petitioner determined that, after filing its return for 1999, it had inadvertently excluded the original cost of certain retired in place assets that were transferred as part of the divestiture sales. As the combined gross proceeds and combined selling expenses did not change, petitioner believed that it had only to document the original cost of the retired in place assets that had been omitted from its return.

To substantiate the original cost, as well as to substantiate that the assets were transferred as part of the PSC-mandated divestiture sales, petitioner claims that it provided voluminous documentation. Petitioner asserts that the Division's audit supervisor indicated in writing to petitioner that petitioner had documented the original cost of the assets and the fact that the assets were transferred as part of the divestiture sales. In addition, petitioner maintains that the auditor sent correspondence to the BCMS Conciliation Conferree indicating that the Audit Division was not challenging the original cost of the assets.

Notwithstanding this, petitioner asserts that the Division and the Administrative Law Judge became fixated on the value of the assets, which is irrelevant to a computation of profit on the sale of the assets for purposes of the gross income tax. The Division requested and the Administrative Law Judge issued a subpoena for documents related to the value of the assets sold, which petitioner attempted to comply with. However, the Administrative Law Judge determined, without explanation or reference to any legal authority, that petitioner had failed to establish the value of the assets transferred, and was not entitled to a refund. Petitioner argues

that, in fact, no appraisal documents had been prepared with respect to the individual assets included in the generation divestiture sales and the Administrative Law Judge's implicit finding that petitioner had failed to respond in good faith to the subpoena is unsupported by the record.

The Division argues, in opposition, that the Administrative Law Judge properly found that petitioner "has attempted to profit beyond acceptable parameters from an extraordinary event . . ." (Division's brief in opposition, p. 2). The Division maintains that petitioner tortured the Advisory Opinion to justify excluding from tax both dividends of the extraordinary profits from the divestiture sale and dividends of ordinary, routine profits from doing business. The Division asserts that petitioner's "aggressive reporting position" is unjustified (Division's brief in opposition, p. 2).

The Division considers petitioner to be claiming an exemption from tax for the proceeds of its divestiture sales, and argues that exemptions from tax are to be construed strictly and narrowly. Further, the Division asserts that as the interpretation of a statute by an agency charged with its enforcement is entitled to great weight, its interpretation of its own guidance should be accorded even greater weight. The Division claims that petitioner has not shown that its interpretation of the Advisory Opinion is the only plausible interpretation. Therefore, the Division asserts that petitioner has not satisfied its burden of proof.

The Division emphasizes that:

> [p]etitioner has excluded nearly *two billion dollars* in profits from the Excess Dividends Tax imposed by § 186 of the Tax Law. It is undisputed that the dividends petitioner paid to CEI in the third and fourth quarters of 1999 constitute excess dividends ordinarily subject to tax (emphasis in original; Division's brief in opposition, p. 6).

The Division posits that the pivotal question is whether the disputed amounts distributed to CEI constitute proceeds from the mandated divestiture sales. The Division states

unequivocally that they do not, based on the fact that the dividend rates for the third and fourth quarters of 1999 were identical to the rates for the first and second quarters of that year.

The Division maintains that the Administrative Law Judge correctly refused to abate the penalty imposed against petitioner as petitioner failed to show reasonable cause and that it acted in good faith in its failure to report and pay excess dividends tax on its third and fourth quarter dividends for 1999.

The Division also supports the Administrative Law Judge's conclusion that petitioner failed to supply the necessary records to substantiate its claim for refund. The Division argues that petitioner refused to supply the Division with documentation substantiating its claim for refund, which included "appear[ing] empty-handed in response to a subpoena" (Division's brief in opposition, p. 13). The Division maintains that petitioner has not established that the retired assets it claims to have transferred were actually sold. The Division asserts that petitioner had a duty to maintain complete and adequate records in order to determine the proper tax due. The Division argues that petitioner refused to comply with the Division's requests for documentation and had no responsive documents to submit in response to the Division's subpoena.

In reply, petitioner argues that, contrary to the Division's assertions, it provided ample documentation and substantiation to the Division to establish its claim for refund. This documentation included accounting records, computational schedules, sales agreements and PSC documents that establish both the original cost of the assets and the fact that the assets were legally transferred as part of the divestiture sales.

Petitioner notes that the documentation provided to support the refund request was more substantial than the documentation provided with its original gross income tax return, which was audited and accepted as filed by the Division. Further, petitioner maintains that the record

demonstrates that the Division's auditor indicated in writing that petitioner had documented the original cost of the assets sold, and the fact that the assets were transferred as part of the divestiture sales. Finally, petitioner argues that even though the Administrative Law Judge specifically found that Unit 2 at the Astoria Generating Station was placed back into service by the purchaser of the station, the Division continues to argue that petitioner failed to prove that Unit 2 was transferred in the first place.

Petitioner asserts that despite the Division's claims to the contrary, the information requested by the Division's subpoena had nothing to do with establishing either the cost of the assets transferred or the fact of their transfer. Rather, the subpoena sought documents that would establish the value of the assets at the time of their sale which were produced in anticipation of and/or in connection with the sale. Petitioner believes that the Administrative Law Judge erred by failing to address the issue of the computation of profit under the gross income tax law, which is based on reducing the sales proceeds received for the assets sold by the original cost of the assets and any related selling expenses.

Concerning its claim that its third and fourth quarter dividends in 1999 were not subject to the excess dividends tax, petitioner maintains that the issue is not whether petitioner is entitled to an exemption from tax. Rather, petitioner frames the issue as whether the proceeds of the divestiture sales are subject to tax in the first place. Petitioner points out that, while exemption statutes are construed narrowly against the taxpayer, statutes that impose tax are to be construed most strongly against the government.

OPINION

Former section 186(1) of the Tax Law imposed a franchise tax upon every corporation, joint-stock company or association formed for or principally engaged in the business of

supplying gas, when delivered through mains or pipes, or electricity, "for the privilege of exercising its corporate franchise or carrying on its business in such corporate or organized capacity in this state . . ." The tax was three-quarters of one percent upon the taxpayer's gross earnings from all sources within New York State, and four and one-half percent upon the amount of dividends paid during each year ending on the thirty-first day of December in excess of four percent upon the actual amount of paid-in capital employed in New York State by the taxpayer. The term "gross earnings" was defined to include "all receipts from the employment of capital without any deduction" (Tax Law former § 186[1]) .

Due to the unique circumstances surrounding the mandatory divestiture of petitioner's electric generating assets, petitioner requested an advisory opinion concerning the taxable nature of the proceeds to be received from its divestiture sales. Petitioner asked the following question: "Is any portion of the value of the consideration received by Petitioner from the sale of the generating assets or other property, in accordance with its mandated divestiture of such assets considered 'gross earnings' subject to tax under section 186 of the Tax Law?"

In its Advisory Opinion, the Division provided a thorough analysis of the issue and concluded that:

> Petitioner does not employ its capital within the meaning of section 186 of the Tax Law for the purpose of being forced to restructure its organization and auction its assets. Therefore, the amounts received by Petitioner for these assets as a result of the auction process are not receipts from the employment of capital, and do not constitute "gross earnings". Accordingly, the amounts received from the divestiture of these generating assets and potential generating sites pursuant to the Order are not taxable under the gross earnings tax imposed by section 186 of the Tax Law (***Matter of Consolidated Edison Co. of New York***, TSB-A-99[1]C, p. 7).

Petitioner asked a second question in its request for the Advisory Opinion: "Is the distribution of the proceeds from the sale of the generating assets or other property from

Petitioner to its holding company in accordance with its mandated corporate restructuring and divestiture of the generating assets considered a dividend subject to the tax on excess dividends ("Excess Dividends Tax") under section 186 of the Tax Law?"

The Division responded:

> Through this series of transactions, Petitioner is reorganized into the holding company structure and is divesting itself of its generation assets and other potential generating sites. Such distribution of the auction proceeds does not represent a distribution of the profits of Petitioner as contemplated in Adams Electric, supra. Accordingly, the distribution of the proceeds from the sale, at auction, of the generating assets and other property representing the other potential generating sites, would not be distributions treated as dividends subject to the Excess Dividends Tax under section 186 of the Tax Law (***Matter of Consolidated Edison Co. of New York***, TSB-A-99[1]C, p. 8).

Pursuant to Tax Law § 171.24, the Commissioner of Taxation and Finance shall be required to render advisory opinions with respect to taxes administered by the Commissioner in response to a petition for such opinion by a person who is subject to a tax or liability under the Tax Law. The opinion is binding upon the Commissioner with respect to the person to whom the opinion is rendered but only about the facts described in the advisory opinion (***see***, 20 NYCRR 2376).

Petitioner received $1,784,959,733.00 in proceeds from the divestiture sales of its generating assets during 1999. From this sum, petitioner claims to have distributed $1,083,606,159.00 to CEI during the third and fourth quarters of 1999, by way of quarterly dividends of $233,606,159.00 declared payable directly by the board of trustees of Con Edison at its July 1999 meeting and a special dividend of $850 million declared payable by certain officers of Con Edison pursuant to an authorizing resolution of the board of trustees.

The Division takes no issue with the non-taxable nature of the divestiture proceeds under the gross earnings tax, nor does it question the non-taxability under the excess dividends tax of

the $850 million special dividend. However, the Division has taken the position that the quarterly dividends of $233,606,159.00 declared payable by the board of trustees did not consist of divestiture proceeds, as claimed by petitioner, but was comprised of ordinary, routine profits from doing business. The Administrative Law Judge sustained the Division's position. We disagree.

By the time that petitioner's third and fourth quarter dividends of 1999 were declared, the generating assets at issue had been sold. Petitioner maintains that the sales proceeds were mingled with other funds in its fungible cash accounts and were not segregated. There is no evidence in the record to dispute this claim. The Advisory Opinion did not require that the divestiture proceeds that petitioner received and intended to distribute to CEI had to be identified or segregated from other assets of petitioner in any way. Nor was there a requirement that petitioner account for the divestiture proceeds in a specific manner or distribute them via a certain method.

The Division is satisfied that by declaring a special dividend, petitioner adequately demonstrated that it was distributing divestiture sale proceeds. Conversely, the Division essentially maintains that by not specifically noting that its quarterly dividends were being paid from divestiture proceeds, there is an unrebutted presumption that such dividends were paid from other sources, consisting of ordinary, routine profits from doing business.

The Division points to no statutory or regulatory authority for its position. In hindsight, it would have been much clearer if petitioner had not only segregated its divestiture proceeds upon receipt but noted, when declaring its quarterly dividends, that such proceeds were the source of such dividends. However, petitioner was under no obligation to do so.

Contrary to the Division's argument, petitioner does not appear to be attempting to profit beyond acceptable parameters from an extraordinary event. Nor does it appear, as the Division claims, that petitioner tortured the Advisory Opinion to justify excluding from tax both dividends of the extraordinary profits from the divestiture sale and dividends of ordinary, routine profits from doing business. Petitioner did not attempt to claim that dividends paid prior to its receipt of the divestiture proceeds were not subject to tax, nor did it claim that an amount in excess of the divestiture proceeds was not subject to tax. Rather, subsequent to its receipt of the proceeds of the divestiture sales, petitioner distributed less than two-thirds of the amount that it was authorized to distribute pursuant to the Advisory Opinion. We do not find this to be over-reaching by petitioner.

Nor do we find any basis in the record for determining that the third and fourth quarter dividends at issue were paid from ordinary business profit. The Division's only argument supporting this position is that the third and fourth quarterly dividend rates were the same as the rates for the first and second quarterly dividends for 1999. While petitioner claims to have commingled the divestiture proceeds with other funds, the Division does not argue that this transformed them into ordinary business profits subject to tax, nor did it argue that it caused the divestiture proceeds to lose their non-taxable nature. If that had happened, the Division surely would not have accepted that the special dividend of $850 million, sourced to the divestiture proceeds but apparently paid from the same fungible cash accounts, was non-taxable.

As a result, we reverse that portion of the Administrative Law Judge's determination that found that the third and fourth quarter dividends for 1999 distributed by petitioner to CEI were subject to the excess dividends tax and we cancel the Notice of Deficiency (Assessment L-023553919-2) issued to petitioner dated March 8, 2004.

Tax Law § 186-a provides for a tax on the furnishing of utility services based on gross income, which includes *profits* from the sale of real property and *profits* from the sale of personal property (other than inventory). The Division provides little guidance for calculating such profits. However, in a 1995 Advisory Opinion issued to a utility company, the Division stated that in order to calculate profits from the sale of real and personal property for purposes of inclusion in gross income pursuant to Tax Law § 186-a:

> the basis for computing the profit on the sale of real or personal property, other than inventory, is the original cost of such property, without the deduction of depreciation that is attributable to such property. The gain is determined by subtracting from the receipts from the sale of the property, the original cost of the property along with the expenses incurred in making the sale. If the sale of such real or personal property results in a loss, rather than a profit, such loss may not be deducted from the taxpayer's other gross income (***Matter of Long Island Lighting Co.,*** TSB-A-95[9]C; ***see also***, TSB-A-98[11]C; TSB-A-98[2]C).

The Division has based its entire position in the instant matter on the fact that petitioner failed to provide information responsive to the Division's requests, and that it has provided no information relative to the *value* of the assets transferred as part of the mandated divestiture sales. Petitioner has maintained throughout this proceeding that, relying on the Division's guidance, it is the cost, and not the value, that must be considered in determining gain or loss on the sale of the divestiture assets.

Although petitioner clearly bears the burden of proof to establish its entitlement to a refund, the Division had the Administrative Law Judge issue a subpoena that requested that petitioner produce the following:

> 1. Copies of any Purchase Price Allocations provided pursuant to the Asset Purchase and Sale Agreements for the Arthur Kill, Ravenswood, and Astoria bundles, together with any documentation supplied by the buyers in support of their allocation.

> 2. Copies of any appraisals, valuations, summaries, studies, or other documents referencing and/or relating to the value of the retired in place assets allegedly conveyed as part of the bundled sales referenced in paragraph 1, produced in anticipation of and/or in connection with the sale.

Despite the fact that petitioner failed to provide any documentation in response to this subpoena, we fail to see how the information requested relates to the calculation of profit for purposes of reporting gross income pursuant to Tax Law § 186-a.

Further, we note that in response to requests for information by the Division during the review of the refund claim, petitioner provided voluminous information allegedly related to the cost of the retired in place assets that form the basis of its refund claim.

The Administrative Law Judge found that petitioner did not respond to a November 30, 2001 information request made by the Division. That request was for information regarding several different topics related to the ongoing audit of petitioner, as well as for information related to the refund claim. The portion of the request concerning the refund claim consisted of the following:

> 1. Per the refund claim for 1999 of $6,839,015.00, please provide detail of the revised gain on the sale of property computation. Provide substantiation/ documentation of the revised amounts used in the computation (Exhibit "I," p. 2225).

While the record does not disclose a direct response to this inquiry, there are numerous examples in the record that indicate that an ongoing exchange of information was occurring between the Division and petitioner regarding the refund claim. For example, the auditor's log shows that from June 5 - 7, 2002, the Division's auditor met with petitioner's representatives for three days on a field audit (***see,*** Exhibit "I," p. 1009).

Further, the following excerpt from a letter dated January 23, 2003 from the auditor to petitioner demonstrates this continuing colloquy:

> 11. CT-186-P. Thank you for the information previously submitted for the refund claim for the gain on the sale of the generating assets. Unfortunately, it is not detailed enough. I would like to examine the asset ledger or other records that are maintained for these assets. . . . . I realize this documentation is voluminous, so I will call to schedule a field visit with you to examine these records (Exhibit "I," p. 2129).

The auditor's log shows that from April 7 - 11, 2003, the Division's auditor spent a week in the field meeting with petitioner's representatives and reviewing petitioner's records.

The Administrative Law Judge references a letter submitted to the Division by petitioner dated July 7, 2003 that, in part, refuses to supply certain requested documentation, as petitioner believed (and explained to the Division) that the documents were irrelevant to its refund claim. However, petitioner did supply a great deal of documentation it deemed pertinent to its claim with that letter, and agreed to supply other documentation, which was quite voluminous, at the Division's request.

Apparently, petitioner supplied sufficient information for the Division to conclude that it had established the cost of nearly all of the retired in place assets forming the basis of its refund claim, as a fax to petitioner from the Division's auditor, Charles Hanny, dated December 11, 2003, reads as follows: "Attached is a summary of the additional cost for which I received documentation. Do you wish to obtain additional documents or leave it at the value documented?" (Exhibit "I," p. 1804.) The summary attached to the fax contains a handwritten notation indicating that the claimed original cost of the "Coal and Ash Handling Equip Boiler 30" of the Arthur Kill Generating Station, "Unit No. 1 and 2" of the Astoria Generating Station, and the "Coal and Ash Handling Equip Boiler 30" of the Ravenswood Generating Station were found to be "Documented" (Exhibit "I," p. 1805). These documented costs totaled $176,792,000.00 and offset nearly all of the $177,867,733.00 profit originally reported as subject

to gross income tax. The amount of the reported profit that was not offset by additional documented cost, involving "Unit No. 1" of the Arthur Kill Generating Station, was $1,075,733.00.

In a letter from petitioner's Assistant General Counsel to auditor Hanny, dated February 12, 2004, petitioner writes: "Con Edison also requests that the Department formally approve the refund claim filed on or about August 6, 2001 in the amount of $6,839,105 for the tax year ended December 31, 1999 . . . . It is our understanding that the Department has approved this claim, but the Department refuses to issue a formal approval because it is waiting to see if Con Edison challenges any of the proposed adjustments in the 30-day letter" (Exhibit "I," p. 1737).

On February 18, 2004, auditor Hanny responded to petitioner regarding the claim for refund as follows: "the review of this claim is continuing and I cannot recommend formal approval at this time. The Department has not approved this claim and is not refusing approval pending any separate action of Con Edison" (Exhibit "I," p. 1735).

Despite the apparent agreement in writing by auditor Hanny that petitioner had documented nearly all of its claim for refund, the Division never issued either a formal approval or disapproval of petitioner's refund claim.

The Administrative Law Judge found that "[t]he only instance in the record where retired equipment is identified with specificity is in the Asset Purchase and Sale Agreement for the Astoria Bundle. Units 1 and 2 of the Astoria Generating Station are located on the schedule Labeled Buyer Personal Property Located on Buyer Real Estate" (conclusion of law "D," Determination of the Administrative Law Judge). However, we note that "coal and ash handling equipment" is specifically listed at section 2.02(a)(iii) of the Asset Purchase and Sale Agreement for Ravenswood as being part of the "Auctioned Assets," as are Unit Nos. 1 and 2 in the

Agreement for the Astoria Generating Station and "coal and ash handling equipment" in the Agreement for the Arthur Kill Generating Station.

Further, the Administrative Law Judge found that Unit 2 at the Astoria Generating Station, was placed back into service by the purchaser of this asset. Having found that Unit 2 was actually transferred, it appears that based on the auditor's fax of December 11, 2003, the Division was also satisfied that cost documentation had been supplied. Yet, the Administrative Law Judge failed to find that petitioner had satisfied its entitlement to refund for at least this unit of retired in place equipment.

Relying on the Division's own documents, which demonstrate that the Division's auditor found nearly all of petitioner's claim for refund to have been adequately documented, we reverse the Administrative Law Judge's determination and approve petitioner's claim for refund insofar as it is based on the documentation of $176,792,000.00 in additional original cost for retired in place assets transferred as part of the 1999 PSC-mandated divestiture sales.

The unresolved issue is whether petitioner has shown that the remaining assets forming the basis of the refund claim were transferred as part of the PSC-mandated sales and whether the cost of such assets was adequately documented. In order to have the benefit of the Administrative Law Judge's findings and analysis on this issue, we find that a remand of this issue to the Administrative Law Judge is appropriate.

A remand will allow the issue to be fully developed through the two stages of our tax appeals process. As we stated in ***Matter of Taft Partners Dev. Group*** (Tax Appeals Tribunal, January 23, 2003):

> The fullest possible development of an issue occurs in our two-stage hearing/exception process when the Administrative Law Judge renders a determination on an issue stating a complete

> rationale for the conclusion and the litigants debate the correctness of the Administrative Law Judge's rationale and conclusion on exception. This two-stage process gives the Tribunal, and ultimately the courts, the benefit of the Administrative Law Judge's research and analysis as well as the parties' research and analysis in response to the Administrative Law Judge's determination. To the extent that an Administrative Law Judge does not address an issue explicitly raised by the parties in the proceeding or does not state a rationale for a conclusion that is reached, we are either deprived of this benefit or we must remand the case to obtain the Administrative Law Judge's opinion and the parties' responses to it (***see, e.g., Matter of Plymouth Tower Assocs.***, Tax Appeals Tribunal, December 27, 1991; ***Matter of Air Flex Custom Furniture***, Tax Appeals Tribunal, September 12, 1991). In either case, the hearing/exception process does not perform in its most effective and efficient manner (***Matter of United States Life Ins. Co. in the City of New York***, Tax Appeals Tribunal, March 24, 1994).

Therefore, we remand this matter to the Administrative Law Judge solely for a determination as to whether petitioner has adequately documented the transfer of, and the claimed original cost of, Unit No. 1 of the Arthur Kill Generating Station so as to justify a refund of all or a part of the gross income tax paid in relation thereto.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Consolidated Edison Company of New York, Inc. is granted to the extent that the third and fourth quarter dividends for 1999 distributed by it to CEI are not properly subject to the excess dividends tax;

2. The exception of Consolidated Edison Company of New York, Inc. is granted to the extent that of the $177,867,733.00 profit it originally reported as arising from the 1999 PSC-mandated divestiture sales and on which it paid gross income tax, Consolidated Edison Company

of New York has established $176,792,000.00 in additional original cost for retired in place assets transferred as part of such sales and, as such, it is entitled to a refund of so much of the gross income tax paid in relation to such additional original cost;

3. The determination of the Administrative Law Judge is reversed to the extent indicated in paragraphs "1" and "2" above;

4. The petitions are granted to the extent indicated in paragraphs "1" and "2" above;

5. The Notice of Deficiency, L-023553919-2, issued to petitioner dated March 8, 2004 is cancelled; and

6. This matter is remanded to the Administrative Law Judge for the issuance of a supplemental determination on the remaining issue, i.e., whether petitioner has adequately documented the transfer of, and the claimed original cost of, Unit No. 1 of the Arthur Kill Generating Station.

DATED: Troy, New York
March 29, 2010

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

/s/ Charles H. Nesbitt
Charles H. Nesbitt
Commissioner