

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition	:	
of	:	
INTERNATIONAL ORE & FERTILIZER CORPORATION :		DETERMINATION
for Redetermination of a Deficiency or for	:	
Refund of Corporation Franchise Tax under	:	
Article 9-A of the Tax Law for the Years 1974	:	
through 1976.	:	

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Petitioner, International Ore & Fertilizer Corporation, 1230 Avenue of the Americas, New York, New York 10020, filed a petition for redetermination of a deficiency or for refund of corporation franchise tax under Article 9-A of the Tax Law for the years 1974 through 1976 (File No. 800249).

A hearing was held before Joseph W. Pinto, Jr., Administrative Law Judge, at the offices of the former State Tax Commission, Two World Trade Center, New York, New York, on July 28, 1987 at 9:15 A.M., with all briefs filed by November 7, 1987. Petitioner appeared by James R. Ron. The Audit Division appeared by John P. Dugan, Esq. (Anne W. Murphy, Esq., of counsel).

ISSUE

Whether Interore Corporation, Inc., a wholly-owned domestic international sales corporation of International Ore & Fertilizer Corporation, was a tax-exempt or taxable DISC within the meaning and intent of Tax Law § 208.9.

FINDINGS OF FACT

1. Petitioner herein, International Ore & Fertilizer Corporation ("IOFC"), subsequently known after the audit period as Interore Corporation, is a Delaware corporation incorporated on November 12, 1963 and principally engaged in business as a dealer in fertilizer. During the audit period, the calendar years 1974, 1975 and 1976, IOFC engaged in business in the State of New York.

2. On February 26, 1974, IOFC incorporated a wholly-owned domestic international sales corporation ("DISC"), Interore Corporation, Inc. ("ICI-DISC"), for the purpose of exporting goods produced in the United States.

3. The Audit Division conducted a field audit of the books and records of IOFC which resulted in the issuance of three statements of audit adjustment for the following periods and in the following amounts:

<u>Period Ended</u>	<u>Tax Deficiency</u>	<u>Interest</u>	<u>Total</u>
12/31/74	\$ 429.00	\$ 256.00	\$ 685.00
12/31/75	320,035.00	176,496.00	496,531.00 <sup>1</sup>
12/31/76	23,770.00	10,130.00	33,900.00

On the same date, the Audit Division issued to IOFC three notices of deficiency setting forth the same periods, tax deficiency, interest and totals due as set forth on the statements of audit adjustment.

4. After incorporating ICI-DISC on February 26, 1974, IOFC and ICI-DISC entered into an assignment agreement on March 1, 1974 whereby IOFC assigned to ICI-DISC certain fertilizer and related product, petrochemical, and other industrial product sales agreements, which agreements provided for the sale of products by IOFC to the named purchases in said contracts, all of said products destined for delivery outside of the United States. Pursuant to the agreement, IOFC transferred and assigned to ICI-DISC all its right, title and interest in and to all sales agreements, contracts, including purchase orders, which were in effect on March 1, 1974 in which IOFC was stated to be the seller of the product destined for delivery outside of the United States. Finally, the agreement states that ICI-DISC agreed to discharge all of the obligations of IOFC with respect to the product contracts identified in the agreement from and after March 1, 1974.

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<sup>1</sup>This amount was reduced by a credit given after consideration of the New York State Corporation Franchise Tax Report filed on behalf of Interore Corporation, Inc. (DISC) for the period ended January 31, 1975 in the sum of \$352.53. The actual balance due as stated on the Statement of Audit Adjustment for the period ended December 31, 1975 was \$496,178.47.

5. After the informal conference held on April 25, 1984, an adjustment was made in the tax deficiency for the year 1975. A DISC export credit was allowed in the sum of \$200,631.00 for the year 1975 thereby reducing the amount at issue to \$143,603.00 plus applicable interest.

6. With regard to ICI-DISC, for the fiscal year ended January 31, 1975, the Domestic International Sales Corporation Return, Federal Form 1120-DISC, indicates that \$423,059.00 in commissions was included in taxable income not recorded on books and that \$726,484.00 in commissions was included in income which was on the books for the year ended January 31, 1975 but not included in the return. Additionally, the schedule of gross receipts indicates that commission sales totalled \$60,054,309.00 for the fiscal year ended January 31, 1975.

For the fiscal year ended January 31, 1976, ICI-DISC indicated in its balance sheet attached to its New York State Corporation Franchise Tax Report commissions receivable of \$3,812,709.00 and under gross income, schedule B, it listed commission sales of \$15,171,928.00. For both fiscal years the parent corporation, IOFC, was listed in an addendum to the returns for each year as a member of the controlled group of related United States persons, listed in schedule N.

7. Although several issues were raised on field audit, the only issue remaining in dispute is whether or not ICI-DISC (Interore Discsaver, Inc. as of 1976) was a taxable DISC or a tax-exempt DISC.

#### SUMMARY OF AUDIT DIVISION'S POSITION

8. The Audit Division points out that IOFC had 100 percent ownership of ICI-DISC (later known as Interore Discsaver, Inc.), which ownership began in February of 1974 and for which company a New York State tax return was filed on a fiscal year basis ending January 31.

After scrutinizing the income tax reports filed for the fiscal year ended January 31, 1975 and 1976 and also various invoices for products sold by the DISC, and also the assignment agreement between ICI-DISC and IOFC, it was determined that \_\_\_\_\_ 5 percent of the DISC's gross receipts originated from the sale of inventory or other property which it purchased from its sole stockholder, IOFC. The Audit Division rejected the claim of IOFC that the

contracts for purchase of products assigned pursuant to the assignment agreement was ever effected, particularly in light of the fact that the invoices indicating the sale of those products were billed by IOFC not ICI-DISC. Furthermore, the tax returns of ICI-DISC (later known as Interore Discsaver, Inc.) reflect a substantial amount of income as commissions indicating that ICI-DISC was acting as a commission agent selling on behalf of related parties.

Finally, given the interpretation of the circumstances made by the Audit Division, the Audit Division finds no difference between the facts in the instant case and those in *Bamberger Polymers, Inc. v. Chu* (111 AD2d 589), wherein the evidence did not support a contention that transfers of inventory to a DISC for export sale constituted a sale (i.e., the circumstances contained all of the indicia of a sale and supported the Tax Commission's determination).

#### SUMMARY OF PETITIONER'S POSITION

9. IOFC takes the position that ICI-DISC is a taxable DISC because none of its sales arise from purchases of inventory or other property from its stockholder, IOFC. Therefore, it does not meet the requirements of section 208.9(i) and should be taxed under section 209(6).

IOFC maintains that the assignment of purchase agreements or contracts from IOFC to ICI-DISC qualified as a nontaxable transfer, not a sale, of all of IOFC's right, title and interest in these contracts to ICI-DISC and, in the alternative, asserts that the assignment was a valid contribution to capital pursuant to IRC § 351, and in either case the conclusion would be the same, i.e. that ICI-DISC made no purchases from IOFC and therefore does not become a tax-exempt DISC pursuant to Tax Law § 208.9(i) or the regulation at 20 NYCRR 3-9.2.

10. For the period February 26, 1974 through December 31, 1976, IOFC was a 100 percent shareholder of Interore Discsaver, Inc. (formerly ICI-DISC).

11. During the period in issue, the corporation Interore Discsaver, Inc. was a domestic international sales corporation, within the meaning and intent of sections 992 through 997 of Part IV of the Internal Revenue Code of 1954.

12. During the period in issue, the corporation Interore Discsaver, Inc. filed a New York

Corporation Franchise Tax Report computing its franchise tax due on the basis that it was a taxable domestic international sales corporation, within the meaning and intent of sections 209.6 and 211.1 of the Tax Law.

### CONCLUSIONS OF LAW

A. Tax Law § 208.9(i) states, in relevant part:

"With respect to a DISC which during any taxable year or reporting year (1) received more than five percent of its gross sales from the sale of inventory or other property which it purchased from its stockholders, the following provisions shall apply.

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(B) Supplemental to the provisions of subdivision five of section two hundred eleven of this article, any taxpayer required to compute a tax under this article, which during the taxable year being reported was a stockholder in any DISC meeting the test prescribed in this paragraph, shall for any taxable year ending after December thirty-first, nineteen hundred seventy-one adjust each item of its receipts, expenses, assets and liabilities, as otherwise computed under this article, by adding thereto its attributable share to each such DISC's receipts, expenses, assets and liabilities as reportable by each such DISC to the United States Treasury Department for its annual reporting period ending during the current taxable year of such taxpayer...."

The regulation found at 20 NYCRR 3-9.3 reiterates the 5 percent rule as stated in Tax Law § 208.9(i) and continues in subdivision (b) as follows:

"If a corporation is subject to tax under article nine-A and owns stock in a DISC and such DISC is a tax-exempt DISC, the corporation must file a consolidated report with such DISC."

B. The regulation at 20 NYCRR 3-9.2 defines a taxable DISC as follows:

"A taxable DISC is one which does not meet the requirements for tax exemption as described in section 3-9.3 of this Subpart. A taxable DISC must pay a tax on capital or the minimum tax whichever is greater, plus the tax on subsidiary capital. A taxable DISC must file its report on or before the fifteenth day of the ninth month following the close of its taxable year."

This case is somewhat unique in that petitioner seeks to have its DISC, ICI-DISC, determined to be a taxable DISC which would be required to file its own report and pay a tax on its own capital or the minimum tax, whichever is greater, plus the tax on subsidiary capital. Such a determination would gain the DISC a more favorable tax liability than being determined a tax-exempt DISC whereby the DISC would be required to file on a consolidated basis with its parent or 100 percent stockholder.

C. During the period in issue, the fiscal years ended December 31, 1974, 1975 and 1976, the books and records of IOFC indicate that more than 5 percent of the gross receipts of ICI-DISC came from the sale of inventory or other property which ICI-DISC purchased from IOFC. These purchases were reflected on petitioner's books and records as commissions paid to the DISC which indicated that the DISC was acting as a commission agent for a related supplier. Assuming that the agreement entered into between IOFC and ICI-DISC was either a valid assignment of IOFC's right, title and interest to all their sales agreements or contracts, including purchase offers in effect as of March 1, 1974 and wherein IOFC was the seller of products destined for delivery outside of the United States, or if the agreement is viewed as a contribution to capital pursuant to Internal Revenue Code § 351, there is no evidence in the record which indicates that IOFC or ICI-DISC ever honored the terms of the agreement since their books and records clearly indicated that the invoices for export sales were issued by IOFC and not ICI-DISC after the date of the agreement. Furthermore, petitioner never alleged that its recordkeeping was consistent with the assignment agreement entered into on March 1, 1974 or contends that the invoices for foreign export sales were not issued by IOFC during the audit period and after March 1, 1974.

D. The Audit Division relies upon *Bamberger Polymers, Inc. v. Chu* (111 AD2d 589). In the Bamberger case, the subsidiary DISC distributed plastic resins to manufacturers through export sales. The Audit Division assessed additional corporation franchise tax deficiencies against the parent based upon a finding that the DISC was a tax-exempt DISC under section 208.9(i) contrary to the petitioner's contention that it was a taxable DISC. As in the instant case, the court in Bamberger cited Tax Law § 208.9(i) referring to the 5 percent rule. The court found that Bamberger and its DISC had an agreement which provided that Bamberger would make all the purchases of resin supplied for itself and the DISC which each then sold in different markets. Bamberger contended that the subsequent transfer of inventory to the international DISC was not a sale to the DISC. The evidence in Bamberger did not support the contention and in fact the bookkeeping method utilized by Bamberger indicated that the sale of goods was made by

petitioner to the DISC. In that case, Bamberger made purchases in its own name, its books indicated that the purchased products were marked as petitioner's inventory even when the goods were shipped directly to the DISC's customers, and, when the goods were transferred to the DISC, the corporations' records demonstrated a transfer of funds from the DISC to Bamberger as reimbursement. The court found that these items were indicia of a sale and upheld the Tax Commission's determination that the DISC in Bamberger was tax-exempt.

IOFC contends that Bamberger should be distinguished because there was no assignment agreement of any type in Bamberger, there was no transfer of funds or other consideration in the instant matter as there was in Bamberger, and there was only a single transfer pursuant to the assignment agreement in the instant matter as opposed to Bamberger which consisted of a series of transfers pursuant to a continuing agreement wherein the parent would act as purchasing agent.

However, the books and records of IOFC were not consistent with the terms and provisions of the assignment agreement and numerous invoices for exported products during the audit period indicated billing by IOFC and not ICI-DISC. In the absence of testimony and documentation to the contrary, petitioner has failed to shoulder its burden of proving that the deficiency assessment was improper (Tax Law § 1089[e]; *Del-Met Corp. v. State Tax Commn.*, 102 AD2d 312, 314).

E. Therefore, pursuant to Tax Law § 208.9(i)(B), the Audit Division properly required the consolidation of the receipts, assets, expenses and liabilities of the tax-exempt DISC, ICI-DISC, with those of its parent, IOFC, and properly assessed the additional corporation franchise tax.

F. The petition of International Ore & Fertilizer Corporation is denied and the three notices of deficiency issued against it on November 30, 1981 are hereby sustained as modified in accordance with Finding of Fact " " above.

DATED: Albany, New York

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ADMINISTRATIVE LAW JUDGE