

STATE OF NEW YORK
DIVISION OF TAX APPEALS

In the Matter of the Petition :
of :
BELDING HEMINWAY CO., INC. : DETERMINATION
for Redetermination of a Deficiency or for :
Refund of Corporation Franchise Tax under :
Article 9-A of the Tax Law for the Years :
1977 through 1982.

Petitioner, Belding Heminway Co., Inc., 1430 Broadway, New York, New York 10018, 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 1977 through 1982 (File No. 802043).

A hearing was held before Robert F. Mulligan, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York on February 2, 1988 at 9:15 A.M., with all briefs to be submitted by April 18, 1988. Petitioner appeared by Ernst & Whinney (Walter J. Lambert, C.P.A.). The Audit Division appeared by William F. Collins, Esq. (Thomas Sacca, Esq. of counsel).

ISSUE

Whether intercompany charges made by petitioner to its subsidiaries for administrative services and other specialized services constituted business receipts.

FINDINGS OF FACT

1. Petitioner, Belding Heminway Co., Inc., through several divisions and subsidiaries, manufactures textiles, fabrics, threads, zippers, household items and industrial products. Inventory is kept at plants in various states. Petitioner's main administrative headquarters is in New York City.

2. On March 29, 1985 the Audit Division issued statements of audit adjustment and notices of deficiency to petitioner for the years 1978, 1980, 1981 and 1982, asserting additional taxes due for said years as follows:¹

| Year | Amount of Tax Due |
|------|----------------------|
| 1978 | \$ 424.00 |
| 1980 | 4,819.00 |

¹Petitioner executed a series of consents extending the period of limitation of assessment to June 30, 1985.

| | |
|------|--------------------------|
| 1981 | 1,555.00 |
| 1982 | 8,602.00 |
| 1982 | 1,228.00 (MTA Surcharge) |

The deficiencies were based upon a field audit which had resulted in several adjustments. Petitioner disagreed with two of the adjustments, one pertaining to valuation of assets for the calculation of interest expense indirectly attributable to subsidiary capital and the other pertaining to the inclusion of certain management fees as business receipts used in computing its business allocation percentage.

3. Petitioner timely protested the deficiencies and requested refunds as follows:

| Year | Refund <u>Requested</u> |
|------------|----------------------------|
| 1977 | |
| \$5,906.00 | |
| 1978 | |
| 4,415.00 | |
| 1978 | |
| 5,241.00 | |
| 1979 | |
| 6,535.00 | |
| 1979 | |
| 6,906.00 | |
| 1980 | |
| 5,734.00 | |
| 1981 | |
| 4,788.00 | |

4. The portion of each deficiency arising from interest expense indirectly attributable to subsidiary capital was adjusted at a Tax Appeals Bureau conference. Additional taxes and reduced refunds were recomputed following said conference as follows:

| Tax Per <u>Year</u> | Tax Prior Adjusted <u>Schedule</u> | Additional to Audit _____ | Tax (Refund) | |
|------------------------|--|---------------------------------|------------------|-----|
| 1977 | | \$ 23,036.00 | \$ 23,036.00 | -0- |
| 1978 | | 39,984.00 | 40,698.00 | |
| (\$ 714.00) | | | | |
| 1979 | | 18,943.00 | 26,871.00 | |
| (7,928.00) | | | | |
| 1980 | | 29,426.00 | 25,882.00 | |
| 3,544.00 | | | | |
| 1981 | | 18,580.00 | 18,221.00 | |
| 359.00 | | | | |
| 1982 | | 22,069.00 | <u>14,998.00</u> | |
| 7,071.00 | | | | |

| | | |
|---------------|--------------|---------------------|
| Sub-Totals | \$152,038.00 | \$149,706.00 |
| \$ 2,332.00 | | |
| 1982 9-A | | |
| MTA Surcharge | 3,151.00 | <u>2,142.00</u> |
| 1,009.00 | | |
| Totals | \$155,189.00 | <u>\$151,848.00</u> |
| \$ 3,341.00 | | |

5. Only one adjustment remains at issue. The auditor determined that petitioner had omitted receipts consisting of administrative and service fees from subsidiaries in the computation of its business allocation percentage. Accordingly, the auditor added such amounts one hundred percent to New York and everywhere and recalculated the business allocation percentage. This was done because the charges were not dollar-for-dollar reimbursements.

6. Petitioner charges back certain expenditures to its subsidiaries and operating divisions. There are two types of charge-backs:

(a) General Management Expenses. This category includes board of directors expenses, expenditures for meetings, New York Stock Exchange membership and other costs of public ownership. The total of such expenses is charged back to the subsidiaries and operating divisions based on their proportionate sales to third parties.

(b) Specific Expenses. These expenses include computer costs, accounting charges, credit and collection costs, etc. Petitioner performs an annual study determining the amount of such expenses used by each subsidiary or operating division and allocates such expenses accordingly.

7. The general and specific expenses are billed to each subsidiary and operating division by monthly statements of intercompany charges.

8. The statements of intercompany charges are not paid by the subsidiaries² on a regular basis. Petitioner gives and takes cash to and from its subsidiaries without regard to the statements of intercompany charges. Petitioner evaluates each subsidiary, its operations and its needs on an individual basis and, if it finds that a subsidiary has a cash surplus, petitioner will usually withdraw cash. If it finds that a subsidiary has no surplus cash, petitioner does not make a withdrawal, and in fact may have to advance cash to the subsidiary. When petitioner withdraws funds, it credits the intercompany account and debits cash.

9. The auditor based the deficiencies on the accounting entries, not actual receipts.

CONCLUSIONS OF LAW

A. That Tax Law § 210.3 provides that the portion of the entire net income of a taxpayer to be allocated within New York is to be determined by multiplying its business income by a business allocation percentage and its investment income by its investment allocation percentage and adding the two products. The business allocation percentage, which is the allocation at issue

²Chargebacks to the operating divisions are not at issue herein.

herein, is determined by an average of three factors:

- (1) the percentage of the average value of the taxpayer's real and tangible personal property located in New York;
- (2) the percentage of the taxpayer's total receipts attributable to New York; and
- (3) the percentage of the taxpayer's total wages, salaries and other compensation attributable to taxpayer's employees within New York.

Computation of the allocation percentage requires that the receipts factor ([2] above) be weighed twice in the calculation.

B. That Tax Law § 210.3(a)(2) provides that the receipts factor (as relevant hereto) is to be determined as follows:

"ascertaining the percentage which the receipts of the taxpayer, computed on the cash or accrual basis according to the method of accounting used in the computation of its entire net income, arising during such period from

(A) sales of its tangible personal property where shipments are made to points within this state,

(B) services performed within the state...,³

(C) rentals from property situated, and royalties from the use of patents or copyrights, within the state, and receipts from the sales of rights for closed-circuit and cable television transmissions of [certain events] taking place within the state...and

(D) all other business receipts earned within the state, bear to the total amount of the taxpayer's receipts, similarly computed, arising during such period from all sales of its tangible personal property, services, rentals, royalties, receipts from the sales of rights for closed-circuit and cable television transmissions and all other business transactions, whether within or without the state...."

C. That 20 NYCRR 4-4.1 provides as follows:

"(a) The percentage of the taxpayer's business receipts allocable to New York State is determined by:

(1) ascertaining the taxpayer's business receipts within New York State during the period covered by the report; and

(2) dividing the sum of the New York State business receipts by the taxpayer's total business receipts within and without New York State during such period.

³Omitted portion applicable to years commencing on or after January 1, 1982 deals with allocation of advertising receipts by publishers.

For purposes of this section, the term business receipts means gross income received in the regular course of the taxpayer's business, provided such receipts are includible in the computation of the taxpayer's entire net income for the taxable year.

(b) All business receipts for the period covered by the report, computed on a cash or accrual basis according to the method of accounting used in the computation of its entire net income, must be taken into account. The following business receipts are allocable to New York State:

- (1) 100 percent of receipts from sales of tangible personal property where shipments are made to points within New York State;
- (2) 100 percent of receipts from services performed in New York State;
- (3) 100 percent of rentals from property situated in New York State;
- (4) 100 percent of royalties from the use of patents or copyrights in New York State; and
- (5) all other business receipts earned in New York State."

D. That 20 NYCRR 4-4.3 provides, in pertinent part, as follows:

"Receipts from compensation for services. [Tax Law, § 210(3)(a)(2)] (a) The receipts from services performed in New York State are allocable to New York State. All receipts from such services are allocated to New York State, whether the services were performed by employees, agents or subcontractors of the taxpayer, or by any other persons. It is immaterial where such receipts are payable or where they are actually received.

(b) Commissions received by a taxpayer are allocated to New York State if the services for which the commissions were paid were performed in New York State. If the services for which the commissions were paid were performed for the taxpayer by salesmen attached to or working out of a New York State office of the taxpayer, the services will be deemed to have been performed in New York State."

E. That 20 NYCRR 4-4.6 provides, in pertinent part, as follows:

"Other business receipts. (Tax Law, § 210, subd. 3[a][2]) (a) All business receipts earned by the taxpayer in New York State are allocated to New York State. Receipts from the sale of real property held by the taxpayer as a dealer for sale to customers in the regular course of its business are business receipts and are allocated to New York State if the real property was located in New York State. Receipts from the sale of intangible personal property included in business capital, held by the taxpayer as a dealer for sale to customers in the regular course of its business, are business receipts and are allocated to New York State if the sales were made in New York State or through a New York State office of the taxpayer.

* * *

(e) Receipts from sales of capital assets are not business receipts and are not

included in the receipts factor of the business allocation percentage. For example, the receipts from the sale of a capital asset as scrap or at a gain is not included in the receipts factor of the business allocation percentage. The term capital assets means property that is not held by the taxpayer for sale to customers in the regular course of its business."

F. That the Audit Division improperly characterized the charges to subsidiaries as business receipts. The term "business receipts" clearly connotes gross income received from a transaction made in the ordinary course of business (20 NYCRR 4.4-1(a), supra). It is noted that receipts from real property not held by a taxpayer as a dealer for sale to customers are not business receipts (20 NYCRR 4.4-6(a), supra), nor are receipts from the sale of capital assets (20 NYCRR 4.4-6(e), supra). The charge-backs at issue did not result in business receipts. Allocation of expenses by a parent company among its subsidiaries does not result in income from a transaction made in the ordinary course of business. The charge-backs made by petitioner were merely accounting entries made for the purpose of equitably apportioning expenses among its divisions and subsidiaries.

G. That the petition of Belding Heminway Co., Inc. is granted to the extent of the adjustments made at the Tax Appeals Bureau conference (Finding of Fact "4") and as set forth in Conclusion of Law "F". The notices of deficiency issued March 29, 1985 are to be modified accordingly and any refunds due to petitioner after the recalculation are to be authorized and paid.

DATED: Albany, New York

September 9, 1988

/s/ Robert F. Mulligan
ADMINISTRATIVE LAW JUDGE