STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petitions of FELMONT OIL CORPORATION for a Redetermination of Deficiencies or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Years 1981 through 1985.	: : : : :	DETERMINATION DTA NOS. 802433 AND 804887

Petitioner, Felmont Oil Corporation, 350 Glenborough Drive, Houston, Texas 77067, filed petitions for redetermination of deficiencies or for refund of corporation franchise tax under Article 9-A of the Tax Law for the years 1981 through 1985.

On August 22, 1990 and February 10, 1994, respectively, petitioner, by its representative, Emmet, Marvin & Martin, Esqs. (Jesse Dudley B. Kimball, Esq., of counsel), and the Division of Taxation, by William F. Collins, Esq. (John O. Michaelson, Esq., of counsel), waived a hearing and agreed to submit the matter for determination based on documents, stipulated facts, and briefs to be submitted by June 27, 1994. The stipulation of facts submitted in this case was signed by petitioner's representative on February 4, 1994 and by the Division of Taxation's representative on February 10, 1994. Petitioner's brief was submitted on May 4, 1994. The Division of Taxation filed a responding letter in lieu of a brief on May 26, 1994. Petitioner's reply brief was submitted on June 27, 1994. After review of the evidence and arguments presented, Dennis M. Galliher, Administrative Law Judge, renders the following determination.

ISSUE

Whether the Division of Taxation properly determined that the amounts of windfall profit tax paid by petitioner to the Federal government and deducted for Federal income tax purposes must be added back to petitioner's Federal taxable income pursuant to Tax Law § 208.9(b)(3) in computing petitioner's entire net income for corporation franchise tax purposes under Article 9-A of Tax Law.

FINDINGS OF FACT

The facts stipulated to by the parties have been incorporated in the following Findings of Fact. Supplementary facts have been added where necessary to more completely reflect the record.

During the years 1981 through 1985, petitioner's principal business was the production and sale of unrefined crude oil and natural gas. During these years, petitioner was also engaged in mining and selling gold and in manufacturing and selling ammonia (petitioner's ammonia business was sold in 1982). During the years 1981 through 1985, petitioner carried on business activities in several different states, including New York State. However, petitioner did not produce or sell any crude oil within New York State.

As part of a plan for the phased decontrol of oil prices between June 1, 1979 and September 30, 1981, President Jimmy Carter proposed a tax on the increased revenues which oil producers would generate as a result of such price decontrol. On April 2, 1980, the Crude Oil Windfall Profit Tax Act of 1980 ("the Act") was enacted, adding sections 4986-4998 to the Internal Revenue Code ("IRC") of 1954. The Act was applicable to crude oil removed after February 29, 1980.[1]

Pursuant to section 164(a)(4) of the IRC, a deduction was claimed on petitioner's 1981, 1982, 1983, 1984 and 1985 Federal income tax returns for the following amounts of WPT:

Year	Amount
1981	$5,199,778.00
1982	5,409,443.00
1983	4,298,509.00
1984	4,739,737.00
1985	3,600,460.00

The Division of Taxation ("Division") audited petitioner's State of New York corporation franchise tax reports for each of the taxable years ended December 31, 1981 through December 31, 1985. For each of these five taxable years, the Division adjusted petitioner's reports (and

[1]The windfall profit tax ("WPT") was repealed by the Omnibus Trade and Competitiveness Act of 1988 applicable to crude oil removed on or after August 23, 1988.

increased petitioner's franchise tax liability) by adding back to petitioner's Federal taxable income the deductions for the WPT claimed on petitioner's Federal income tax returns in order to determine petitioner's entire net income for corporation franchise tax purposes.

By a petition dated August 12, 1985, petitioner protested the Division's WPT addback adjustment for the taxable years ended December 31, 1981 and December 31, 1982.

In turn, by letter dated August 15, 1985, petitioner submitted three checks (dated August 16, 1985) payable to the "New York State Department of Taxation and Finance". These checks constituted payment of tax and interest

resulting from the Division's 1981 and 1982 WPT audit adjustments, and were submitted to prevent further accumulation of interest against petitioner. It is undisputed that such payments did not represent agreement by petitioner with the deficiencies resulting from the audit adjustments. The following schedule relates the three checks to the deficiency notice and amount to which each pertains:

Check Number	Deficiency Notice Number	Amount
4642	C850514303F	$ 31,185.00
4643	C850514302F	174,484.00
4644	C850514301F	99,556.00

By a petition dated December 8, 1987, petitioner protested the Division's WPT addback adjustment for the taxable years ended December 31, 1983, December 31, 1984 and December 31, 1985. In turn, in December 1987, petitioner submitted six checks payable to the "State of New York Department of Taxation and Finance". These checks constituted payment of tax and interest resulting from the Division's 1983, 1984 and 1985 WPT audit adjustments, and were submitted to prevent further accumulation of interest against petitioner. As above, it is undisputed that such payments did not represent agreement by petitioner with the deficiencies resulting from the audit adjustments. The following schedule sets forth the deficiency notices and amounts to which these six checks pertain:

Deficiency Notice Number	Amount

C870909500F	$129,351.00
C870909501S	3,933.00
C870909502F	80,773.00
C870909503S	8,766.00
C870909504F	44,342.00
C870909505S	1,543.00

By letters dated March 25, 1988, petitioner submitted ten checks payable to the "New York State Department of Taxation and Finance." These checks constituted additional payments of tax and/or interest resulting from the Division's 1981 through 1985 WPT audit adjustments, and were submitted to pay all tax and/or interest with regard thereto in full. Again, these payments did not represent agreement by petitioner with the deficiencies resulting from the audit adjustments. The following schedule sets forth deficiency notice, amount and period to which each such check relates:

Period	Deficiency Notice Number	Amount
12/31/81	C850514301F	$ 4,309.24
12/31/82	C859514302F	7,553.76
12/31/83	C870909500F	135,820.60
12/31/83	C870909501S	4,139.61
12/31/84	C870909502F	85,115.00
12/31/84	C870909503S	9,237.22
12/31/84	C880329201M	566.26
12/31/85	C880329200N	5,214.32
12/31/85	C870909504F	46,790.12
12/31/85	C870909505S	1,628.19

In light of petitioner's payments as identified above, the Division's asserted deficiencies resulting from the WPT addback adjustments for the years at issue (including interest thereon) have been paid in full.

Petitioner became a wholly-owned subsidiary of Homestake Mining Company on June 20, 1984 and, as a result, filed two Federal income tax returns for 1984.

More specifically, petitioner filed a separate Federal income tax return for the short taxable year beginning January 1, 1984 and ending June 19, 1984, and claimed thereon a deduction for WPT paid in the amount of $2,189,388.00. With respect to the period beginning June 20, 1984 and ending December 31, 1984, petitioner joined in the consolidated Federal income tax return filed by Homestake Mining Company for its taxable year ended December

31, 1984. Homestake Mining Company claimed a deduction on this return for petitioner's WPT in the amount of $2,550,349.00, therefore resulting in a $4,739,737.00 total WPT deduction claimed on petitioner's 1984 Federal income tax returns (see, Finding of Fact "3").

Petitioner filed a Federal claim for refund of overpaid WPT for 1984 and, after the claim was audited by the Internal Revenue Service ("IRS"), received a refund in August 1987 in the amount of $718,665.00. Thus, petitioner's actual WPT liability for 1984 totalled $4,021,072.00 ($4,739,737.00 - $718,665.00). Consequently, the total WPT deduction of $4,739,737.00 claimed on petitioner's 1984 Federal income tax returns exceeded petitioner's actual WPT liability.

The IRS also audited petitioner's separate Federal income tax return for the short taxable year beginning January 1, 1984 and ending June 19, 1984 and made several adjustments to Federal taxable income, to which petitioner agreed. One of these adjustments was an increase of $334,721.00 in petitioner's Federal taxable income, representing a pro rata portion of the $718,665.00 WPT refund for 1984. This pro rata portion of the WPT refund was calculated by multiplying such $718,665.00 refund amount by a fraction, the numerator of which was the number of days in the short taxable year ending June 19, 1984 and the denominator of which was the total number of days in 1984.

The IRS further audited the consolidated Federal income tax return of Homestake Mining Company for the year 1984, which return included the income of petitioner for the period beginning June 20, 1984 and ending December 31, 1984. The IRS made several adjustments to petitioner's separate Federal taxable income for this period, to which Homestake Mining Company agreed. One of these adjustments was an increase of $383,944.00 in petitioner's separate Federal taxable income, representing the portion of the $718,665.00 WPT refund for 1984 that remained after the amount for the short taxable year beginning January 1, 1984 and ending June 19, 1984 was taken into account.

In sum, the 1984 Federal audit adjustments identified in Findings of Fact "11" and "12" have the effect of reducing petitioner's WPT deduction by $718,665.00 -- from $4,739,737.00

(the amount claimed on its Federal income tax returns) to $4,021,072.00 (the amount of petitioner's actual liability as specified in Finding of Fact "10").

A final Federal determination per Tax Law § 211.3, with regard to the adjustments to petitioner's Federal taxable income for 1984 resulting from the above-described IRS audits, was made on September 24, 1991. On December 23, 1991, petitioner timely filed with the Division Form CT-3360 reporting all 1984 Federal audit adjustments. Petitioner prepared the Form CT-3360 for 1984 based upon the numbers resulting from the Division's audit of petitioner's 1984 corporation franchise tax return. Therefore, petitioner reported the $718,665.00 increase to its 1984 Federal taxable income as a Federal audit adjustment not applicable to New York.

If the Division's addback adjustments with respect to the WPT are upheld, the Federal adjustment increasing petitioner's Federal taxable income for 1984 by $718,655.00 will cause no adjustment in petitioner's entire net income for 1984. Likewise, if the Division's adjustments with respect to the WPT are reversed, the Federal adjustment increasing petitioner's Federal taxable income for 1984 by $718,665.00 will cause no adjustment in petitioner's entire net income for 1984. However, assuming reversal, the amount of petitioner's 1984 WPT will, for purposes of calculating petitioner's entire net income for 1984, be $4,021,072.00 ($4,739,737.00 - $718,665.00).

SUMMARY OF THE PARTIES' POSITIONS

Petitioner asserts that the WPT is not a tax "on or measured by profits or income paid or accrued to the United States" as provided in Tax Law § 208.9(b)(3), and therefore need not be added back to Federal taxable income in computing petitioner's "entire net income" for corporation franchise tax purposes. In addition, petitioner argues, specifically for the tax years ended 1981 and 1982, that "terminology does not dictate the nature of a tax", and thus the mere usage of the term "windfall profit" is not enough on its own to support a finding that the WPT is a tax "on or measured by profits or income" under Tax Law § 208.9(b)(3). Rather, petitioner maintains that the WPT is, in actuality, a severance tax levied on the activity of removing taxable crude oil, pointing out that IRC former § 4986(a) explicitly imposes an excise tax on the

windfall profit from taxable crude oil removed from the premises. Petitioner notes that committee reports on the Act state that the WPT is an "excise, or severance, tax applying to crude oil produced in the United States . . ." (citing S Rep No. 394, 96th Cong, 2nd Sess 29). Petitioner avers that the WPT is "no more than a tax on a portion of a producer's receipts and is not a tax on the 'profits or income' which the producer ultimately generates from those revenues." In this regard, petitioner notes that since the WPT can, even after application of the net income limitation (see, Conclusion of Law "B"), be levied in many instances in which a producer fails to realize any revenue whatsoever from the oil which he has produced, much less any actual profits, it is "inconceivable that the windfall profit tax can properly be characterized as a tax on 'profits or income'." Petitioner contends that since neither Tax Law § 208.9(b)(3), the corresponding regulations, nor the case law in New York elaborates on what constitutes a tax "on or measured by profits or income", the definition which controls for Federal purposes under the IRC must control for New York State purposes as well. In turn, using Federal law as a guide, petitioner claims it is "clear that the windfall profit tax is not an income tax for purposes of the Code." Specifically, petitioner points out that the WPT is contained in subtitle "D" of the IRC, which concerns miscellaneous excise taxes, rather than in subtitle "A", which concerns income taxes. Furthermore, petitioner claims there are specific provisions of the IRC which indicate that the WPT is not an income tax, to wit: (1) IRC § 275 denies a deduction for Federal income taxes when computing taxable income, yet IRC § 164(a)(4) specifically makes the WPT deductible in calculating taxable income; and (2) IRC § 901 allows a credit against a taxpayer's Federal income tax for the amount of foreign "'income, war profits, and excess profits taxes paid or accrued during the taxable year'", and in turn defines foreign "income tax" based on three requirements which the WPT does not fulfill.

In addition, with regard to the taxable years 1983, 1984 and 1985, petitioner argues that the determination of the Division's WPT addback requirement "results in 'entire net income' of a multistate corporation being computed . . . by including income that is attributable solely to an out-of-state business activity but excluding associated costs that are also attributable solely to

that out-of-state business activity." As a consequence, petitioner maintains the franchise tax is being imposed on extra-territorial values in violation of the Due Process and Commerce Clauses of the United States Constitution, and that such treatment unlawfully discriminates against out-of-state business activity in violation of the Commerce and Equal Protection Clauses of the United States Constitution.

Finally, petitioner concedes that since Tax Law § 208.9 provides no exclusion from "entire net income" for any refund or credit of overpaid WPT, any item of gross income attributable to a refund or credit of overpaid WPT and which is reportable by a taxpayer for Federal income tax purposes shall be included in the taxpayer's "entire net income" under section 208.9.

The Division, in contrast, requests that the petitions be denied and the notices of deficiency sustained. The Division's principal argument is that since taxes on or measured by profits or income accrued to the United States are not excludable or deductible from "entire net income" per Tax Law § 208.9(b)(3), and since the WPT is a tax measured by profit or income, such tax may not be excluded from entire net income (i.e., it must be added back to arrive at entire net income).

CONCLUSIONS OF LAW

A. IRC former § 4988(a) defines "windfall profit" to mean the excess of the "removal price" of a barrel of taxable crude oil over the sum of its "adjusted base price" and "severance tax adjustment." The key terms quoted are, in turn, defined as follows:

- "removal price" is the actual sales price which a producer receives upon selling a barrel of oil (IRC former § 4988[c]);[2]

- "adjusted base price" is the price of a barrel of oil which would have prevailed in 1979, adjusted for inflation. The adjusted base price varies with the type of oil involved

[2]IRC former § 4988(c) includes in the definition of "removal price" the constructive sales price which a producer is deemed to receive for depletion purposes if the oil is sold between certain related parties, is removed from the premises before it is sold, is converted into refined products before it is sold, etc.

(IRC former § 4899); and

- "severance tax adjustment" is the portion of a state's severance tax imposed on a barrel of oil which is attributable to the

value of that oil in excess of its adjusted base price (IRC former § 4996[c]).

In sum, a producer's "windfall profit" on a barrel of taxable crude oil is the increased revenue (less the increased severance tax) which the producer derives from that barrel in the absence of price controls, over what he could have derived from that barrel in 1979 (adjusted for inflation) when price controls were in effect.

B. To ensure that the WPT would not be imposed on a company when the costs of production exceeded the income from a particular property, IRC former § 4988(b)(1) set a limitation on the amount of a producer's windfall profit which is subject to tax. The "net income limitation" ("NIL") provides that the windfall profit from a barrel of taxable crude oil shall not exceed 90% of the "net income attributable to such barrel." Thus, the WPT is imposed on the lesser of the windfall profit or 90% of the net income per barrel.

C. The WPT is deductible for Federal income tax purposes, pursuant to IRC § 164(a)(4) and former § 4988(b). The matter at issue in this case is whether or not petitioner must add back the amount deducted for Federal income tax purposes to its Federal taxable income in computing entire net income for corporation franchise tax purposes.

D. Tax Law § 208.9 defines "entire net income" as the taxpayer's "total net income from all sources, which shall be presumably the same as the entire taxable income which the taxpayer is required to report to the United States treasury department . . . ." Pursuant to Tax Law § 208.9(b)(3), referred to as the "add-back" provision, entire net income shall be determined without the exclusion, deduction or credit of "taxes on or measured by profits or income paid or accrued to the United States . . . ." Thus, the question at the heart of the dispute at hand is whether or not the WPT is a tax "on or measured by profits or income."

E. Petitioner maintains that the WPT is not a tax "on or measured by profits or income," but rather is an excise or severance tax imposed on the activity of the removal of taxable crude oil,

the amount of which tax is determined by applying the relevant tax rate to a portion of the producer's actual or constructive receipts derived from the removal, rather than to any "profits or income" generated from those receipts citing Landreth v. U.S. (963 F2d 84, 86 ["The tax imposed by the Act is not a tax on profits or income . . . and therefore liability under the Act does not directly depend upon the profitability or income of the producer or interest owner. Rather, it is an excise tax, a tax that burdens the exercise of one or more of the powers incident to ownership."]).[3]

Petitioner cites three reasons why the WPT must be considered an excise tax rather than an income tax. First, a tax on profits or income can attach only if there is a "realization event", such as a sale. The WPT applies without regard to whether a realization event occurs, such as when a

producer does not sell oil but uses the oil to power refining or manufacturing processes, and receives no actual revenues therefrom. In such a case, the producer would be subject to the WPT based on a constructive sales price for crude oil, even though he has not received any revenues from the sale of the oil (citing Temp Treas Reg § 51.4996-1[d][1], [2]; S Rep No. 394, 96th Cong, 2d Sess 53-54). Secondly, the WPT applies with respect to individual barrels of oil, and the producer will be subject to the WPT -- even though there may be corporate losses overall -- as long as when a barrel is removed from the premises, the removal price exceeds the

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[3]IRC former § 4986 provides that an excise tax is imposed on the windfall profit from taxable crude oil removed from the premises during each taxable period, with the tax payable by the crude oil producer based on a percentage of the windfall profit earned by the producer on each barrel of taxable crude oil removed from the premises after February 29, 1980. The highest percentage is 70% and the lowest percentages, those for newly discovered oil, vary yearly, with the lowest at 20% for newly-discovered oil in 1988. The percentages fluctuate depending on the length of time the property has been productive. The tax differentials (oil from newly-productive property is taxed at a lower rate than oil from older wells) were meant to motivate exploration for and discovery of new oil-producing properties by the domestic oil companies, thus reducing dependency on foreign oil (Amerada Hess Corp. v. Director, Division of Taxation, 107 NJ 307, 315 526 A2d 1029, 1033, affd 490 US 66, 104 L Ed 2d 58).

adjusted base price and the severance tax adjustment. Thus, the WPT is not a tax on income or profits. Thirdly, the WPT is structured and operates similarly to other excise taxes appearing in subtitle "D" of the IRC, rather than income taxes under subtitle "A" of the IRC. For instance, oil held by the Federal government is subject to the WPT; therefore the WPT cannot be a tax on profits or income, because the government would be exempt from such a tax, though it is not exempt from a severance tax.

In sum, petitioner argues that since a producer's windfall profit is the difference between the actual or constructive sales price receivable in a price decontrolled environment and a hypothetical sales price receivable in a price controlled environment, and since the WPT is a tax on a portion of a producer's actual or constructive receipts, "it is clear that absolutely no effort is made to reflect the producer's expenses in producing and selling oil and, therefore, to identify whatever actual 'profits or income' the producer earns as a result of removing the oil." Petitioner goes on to argue that it is well settled that a tax on receipts is not a tax on "profits or income" (citing Doyle v. Mitchell Bros. Co., 247 US 179, 62 L Ed 2d 1054; Bank of America Nat. Trust & Sav. Assn. v. U.S., 459 F2d 513, 518, cert denied 409 U.S. 949 ["Income, including gross income must be distinguished from gross receipts . . ."]).

F. The Division counters these arguments by asserting that the WPT is a tax on or measured by profits and income and therefore must be added back to Federal taxable income in calculating "entire net income". In support of its position, the Division cites the U.S. Supreme Court's decision in Amerada Hess Corp. v. Director, Division of Taxation (490 US 66, 104 L Ed 2d 58) in which the U.S. Supreme Court affirmed a ruling of the New Jersey Supreme Court (Amerada Hess Corp. v. Director, Division of Taxation, supra, 107 NJ at 307). The U.S. Supreme Court upheld as constitutional (under the Commerce Clause and the Fourteenth Amendment to the U.S. Constitution) a New Jersey corporate business tax statute which, akin to Tax Law § 208.9(b)(3), provided that in calculating entire net income, a corporation may not

deduct a Federal tax "on or measured by profits or income."[4]

According to the Division, the issue before the U.S. Supreme Court in Amerada Hess and the resolution of that issue were as follows:

> "[w]hether the Windfall Profit Tax must be added back in determining entire net income for computation of the New Jersey Business Corporation Tax. Two separate inquiries were made in
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> resolving the issue. First, whether the WPT is a tax on or measured by the 'profits or income' of the taxpayer. The U.S. Supreme Court held in Amerada Hess that the language in the New Jersey statute included '. . . the federal income tax as well as the Windfall Profit Tax.' The second inquiry is whether the Windfall Profits [sic] Tax was required to be added back in determining the entire net income which was subject to State taxation. The U.S. Supreme Court answered this question in the affirmative."

The Division also contends that in Amerada Hess Corp. v. Director, Division of Taxation (supra, 107 NJ 307), the New Jersey Supreme Court stated that New York's and New Jersey's addback provisions are similar and should, therefore, be subject to similar construction by the courts.

G. Petitioner denies that the U.S. Supreme Court's decision in Amerada Hess stands for the principles asserted by the Division.

In this regard, and contrary to the Division's contention, the U.S. Supreme Court in Amerada Hess did not directly rule that the WPT is a tax on or measured by profits or income for purposes of the addback provision of the New Jersey statute. Rather, the U.S. Supreme Court determined that, "as so construed" by the Supreme Court of New Jersey, the New Jersey statute did not violate the Commerce Clause or the Fourteenth Amendment to the U.S. Constitution. As pointed out in petitioner's reply brief, the issue of whether or not the WPT was subject to the

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[4]The New Jersey statute imposes a tax on a portion of the "entire net income" of a corporation for the "privilege of doing business, employing or owning capital or property, or maintaining an office in [New Jersey]" (NJ Stat Ann § 54:10A-2). Under New Jersey's Corporation Business Tax Act, a corporation's entire net income" is presumptively the same as its Federal taxable income "before net operating loss deduction and special deductions" (NJ Stat Ann § 54:10A-4[k]). Similar to New York's Tax Law § 208.9(b)(3), "entire net income" is determined, for purposes of New Jersey's addback provision, "without the exclusion, deduction, or credit of . . . [t]axes paid or accrued to the United States on or measured by profits or income" (NJ Stat Ann § 54:10A-4[k]).

New Jersey addback provision was not even directly before the Court. Rather, the only issue before the U.S. Supreme Court was whether the New Jersey addback provision, as interpreted by the New Jersey Supreme Court to encompass the WPT, violated the U.S. Constitution. Thus, the U.S. Supreme Court did not engage in an independent analysis of how the New Jersey addback provision should be properly interpreted, nor did it endorse the New Jersey Supreme Court's interpretation of that provision as a matter of proper statutory construction. Rather, the Court "accepted th[e] interpretation as a definitive construction and then addressed the constitutional issues raised by that construction." As petitioner correctly notes, the U.S. Supreme Court's acceptance of the New Jersey Supreme Court's interpretation of the New Jersey statute is in comportment with the U.S. Supreme Court's "long-standing position that the construction of state statutes is to be left entirely to the state courts" (see, R.A.V. v. St. Paul, Minnesota, 112 S Ct 2538, 120 L Ed 2d 305). It follows from this discussion, then, that the Division errs in its assertions that: (1) similar arguments to petitioner's (e.g., that the WPT is an excise tax rather than a tax on income or profits) were rejected by the U.S. Supreme Court; and that (2) the second inquiry of the U.S. Supreme Court -- whether the WPT was required to be added back in determining the entire net income subject to taxation -- was directly answered in the affirmative. As noted, the U.S. Supreme Court did not specifically address these arguments. Furthermore, and contrary to the Division's claim, the New Jersey Supreme Court did not specifically state that the provisions of the New York statute and the New Jersey statute are similar and that, therefore, the New Jersey statute should be subject to similar construction by the New Jersey courts. Instead, the New Jersey Supreme Court stated only that: (1) the Director of the (New Jersey) Division of Taxation, in asserting deficiencies against the taxpayers, relied on TSB-M-82(22)C (July 12, 1985), issued by the New York State Department of Taxation and Finance (discussed, infra); (2) the interpretation in TSB-M-82(22)C is consistent with similar findings in a California case (not concerning the WPT) and by non-judicial entities in South Carolina and New York; and (3) the court was in agreement with the New Jersey Attorney General's observation that ultimately, "the whole excursion into New York

legislative history is beside the point," and resort to New York legislative history is not helpful and is certainly not determinative (Amerada Hess Corp. v. Director, Division of Taxation, supra, 107 NJ at 336).

H. Despite any misstatement as to the U.S. Supreme Court's specific holding in Amerada Hess, the Division's position that the WPT is a tax "on or measured by profits or income" which must, consequently, be added back to Federal taxable income to arrive at "entire net income" is correct. First, while, as noted, the U.S. Supreme Court in Amerada Hess did not address the specific issue of whether the WPT is a tax on or measured by income or profits, the Court did declare that "[a]lthough Congress may have assumed that 'the windfall profit tax generally would be deductible under State income taxes,' the Act does not require a State, in imposing a tax, to allow the deduction" (Amerada Hess Corp. v. Director, Division of Taxation, supra, 490 US at 65, citing HR Rep No. 96-304, p. 9 [1979]). The Court went on to observe that "we certainly do not find the State's treatment of the windfall profit tax as 'on or measured by income or profits' irrational or arbitrary" (id. at 69, n. 9). In support of its decision, the Court explained that the WPT is, "in significant respects," similar to a tax on income, noting that the I.R.S. is in agreement with this view:

> "First, by taxing only the difference between the deregulated and regulated price for the oil, the windfall profit tax was intended to reach only the excess income derived from oil production as a result of decontrol. HR Rep No. 96-304, p 7 (1979). Moreover, although the Act itself characterizes the windfall profit tax as an 'excise tax,' 26 USC § 4986(a) [26 USCS §4986(a)], the Internal Revenue Service states that the tax's 'structure and computation bear more resemblance to an income tax.' IRS Manual Supplement - Windfall Profit Tax Program, 42 RDD-57 (Rev 3) Par. 2.01 (Aug. 28, 1987), reprinted in 2 CCH Internal Revenue Manual - Audit, p 7567 (1987). Because the IRS believes that the windfall profit tax resembles an income tax, it surely is not irrational for New Jersey to classify the windfall profit tax, along with the federal income tax, as part of a general provision relating to federal taxes 'on or measured by income or profits'" (Amerada Hess Corp. v. Director, Division of Taxation, supra, 490 US at 69, 77, n. 9; emphasis added).

Finally, the Court buttressed its decision that New Jersey's treatment of the WPT as not deductible for state tax purposes was not irrational by pointing out that the addback provision applies generally to any such Federal tax, including the Federal income tax (id.).

By stating in its decision that: (1) Congress may have assumed, but the Act did not require,

that "'the windfall profit tax would generally be deductible under state income taxes'" (id. at 73, citing HR Rep No. 96-304, p. 9 [1979]), and (2) the decision by the New Jersey Division of Taxation to treat the WPT as a tax "on or measured by income or profits" is not irrational, and is not violative of the U.S. Constitution, the U.S. Supreme Court in effect left the characterization of the WPT to the discretion of the Director of the Division of Taxation.

I. On July 12, 1982, the (New York Division of Taxation issued TSB-M-82(22)C (the "memorandum") which set forth the Division's opinion that the WPT was a tax "on or measured by profits or income" for purposes of the addback provision. In light of the U.S. Supreme Court's decision in Amerada Hess, this determination of the New York Commissioner of Taxation will control unless the same is found to exceed constitutional parameters. Thus, the question becomes whether the New York addback provision, as construed and applied to the WPT, would be upheld as constitutional.

J. Petitioner argues that the addback provision, as construed, violates its rights under the Commerce Clause and the Due Process and Equal Protection Clauses of the Fourteenth Amendment to the U.S. Constitution. However, the U.S. Supreme Court in Amerada Hess refuted identical arguments challenging a nearly identical addback provision.

- Commerce Clause -

To paraphrase the Supreme Court's discussion of these issues, the Court held that the New Jersey addback provision, as construed, did not violate the Commerce Clause because it passed the four-prong test set out in Complete Auto Transit v. Brady (430 US 274, 51 L Ed 2d 326); to wit, the New Jersey addback provision is applied to an activity having a substantial nexus with the taxing state, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the state. Because, as noted, New York's and New Jersey's addback provisions are nearly identical, and because the circumstances under which the addback provision is applied in New York are not different from those that existed in New Jersey, the New York addback provision causes no Commerce Clause violation. More specifically:

(1) New York has a "substantial nexus" with the activities that generate petitioner's "entire net income," including oil production occurring entirely outside New York, since petitioner's operations in New York are part of an integrated "unitary business" which includes the production of crude oil (see, Finding of Fact "1");

(2) the tax is fairly apportioned, since (a) the portion of the "entire net income" to be taxed is derived according to the standard three-factor apportionment formula that the Supreme Court has "expressly approved," based on an average of the percentages of in-state property, receipts, and payroll (Amerada Hess Corp. v. Director, Division of Taxation, supra, 490 US, at 71, 75, citing Container Corp. of America v. Franchise Tax Bd., 463 US 159, 170, 77 L Ed 2d 545; see Tax Law § 210.3), (b) this formula as applied to petitioner is not invalid on the basis that the WPT is solely an out-of-state expense, since "the costs of a unitary business cannot be deemed confined to the locality in which they are incurred" (Amerada Hess Corp. v. Director, supra, 490 US, at 71, citing Container Corp. of America v. Franchise Tax Bd., supra, 463 US, at 182), and (c) petitioner has not taken the necessary steps to prove that "there is no rational relationship between the income attributed to the State and the intrastate values of the enterprise" (id. at 76, citing Container Corp. of America v. Franchise Tax Bd., supra, 463 US, at 180);

(3) the tax does not discriminate against interstate commerce either on its face or as applied, since (a) the tax is not designed in a clearly discriminatory manner, (b) the provision does not apply solely to a localized industry, in that it "generally excludes any federal tax 'on or measured by income or profits,' including the nationwide federal income tax" (id. at 71), and (c) there does not appear to be a discriminatory motive underlying the provision which would exert pressure on an interstate business to conduct more of its activities in New York (id.); and

(4) the tax is "fairly related" to the benefits New York provides petitioner, "including police and fire protection, a trained work force, and the advantages of a civilized society" (id.).

- Due Process and Equal Protection -

Turning to petitioner's Due Process and Equal Protection Clause arguments, the U.S. Supreme Court in Amerada Hess, again, faced with the same claims, upheld New Jersey's addback provision as constitutionally applied. Because the New Jersey addback provision passed all four prongs of the Complete Auto test (supra), the Supreme Court concluded that the statute did not violate the taxpayer's Due Process rights. As for petitioner's Equal Protection arguments, the Supreme Court held that there was no discriminatory classification underlying the addback provision and that, moreover, there is "unquestionably a rational basis for the state's refusal to allow a deduction for federal windfall profit tax" (Amerada Hess Corp. v. Director, Division of Taxation, supra, 490 US, at 71). Against this background, it is clear that the New York addback provision as applied to the WPT causes no Fourteenth Amendment violation.

K. Petitioner also argued that the WPT must be considered an excise tax because: (1) there is not necessarily a realization event before the WPT is imposed; (2) a producer will be subject to the WPT even though there may be corporate losses overall; and (3) the NIL, specified in IRC former § 4988(b) (see, Conclusion of Law "B"); does not alter the fundamental nature of the WPT (i.e., the NIL does not change the fact that the WPT is imposed without regard to the existence of a realization event and that it is applied on a barrel-by-barrel basis rather than on an overall profits or income basis -- thus it does not convert the WPT into a tax on "income or profits") citing Landreth v. United States (963 F2d at 87, supra ["no evidence that Congress intended for the net income limitation . . . to change the windfall profit tax from an excise tax to an income tax"]).

These same arguments were addressed and refuted by the New Jersey Supreme Court as follows:

> "Under ordinary dictionary definitions of 'income,' i.e., all that comes in without regard to expenditures, the windfall profit clearly constitutes 'income.' The windfall profit also meets a more restrictive definition, i.e., gross receipts less costs of goods sold, because the deduction for the adjusted base price plus severance tax adjustments permits more than the deduction of getting the oil out of the ground (producer's cost of goods), and in cases where the windfall profit exceeds 90% of the net income per barrel, the tax base becomes the lower amount, 90% of net income. Even if the term 'profits' is given its most restrictive meaning, i.e., revenue less expenses, the base of the W.P.T. is within the definition because the N.I.L. permits the deduction of all reasonably allocable expenses before arriving at net income. Because the tax is reasonably geared to establishing realized or realizable gain at an easily-measured stage, we reject the [petitioners'] contention that there must be immediate realization from a sale or exchange, a netting of ultimate gains or losses of an integrated company, a computation of an integrated entrepreneur's income or profit, or an annual or other periodic computation . . . . [T]hat the [petitioners] experienced a realization of income or profit upon extraction of crude oil at the wellhead is amply supported in this record and by common sense. It is very unlikely, if not realistically impossible, given the structure of the W.P.T. and the market conditions under which it was imposed, that any integrated oil company producer would both pay the W.P.T. and suffer a net loss at the end of an annual period, and this was hardly the experience of the parties before us" (Amerada Hess Corp. v. Director, Division of Taxation, supra, 107 NJ, at 330).

Thus, the fact that petitioner may lose barrels of oil and is not entitled to refunds of WPT regarding such losses does not impugn the fact that oil production income is realized when the oil is lifted from the wellhead (id. at 333). Further, there is no merit to petitioner's argument that because the WPT appears in Subtitle "D" of the IRC, along with other excise taxes, the

same should be determinative of the character of the WPT. As the New Jersey Supreme Court correctly pointed out, "[t]he fact that the W.P.T. has been labeled or termed an excise tax (IRC former § 4986[a]) does not prevent it from being a tax on or measured by income or profits," for there are other Federal excise taxes measured by income in Subtitle "D" - Misc. Excise Taxes (e.g., IRC § 4981 - excise tax on the undistributed taxable income of real estate investment trusts; IRC § 4940 - excise tax on investment income of private foundations) (Amerada Hess Corp. v. Director, Division of Taxation, supra, 107 NJ, at 334). State taxes that are called franchise or excise taxes are often measured by income (see, Commissioner of Rev. v. Mass. Mutual Life Ins. Co., 384 Mass 607, 428 NE2d 297 ["income" for purposes of an excise tax may differ from "income" for purposes of an income tax]). The Court of Appeals (2d Dist.) in California, in contemplating the character of the WPT, held that the WPT imposes an excise tax on profit and provides the method by which the profit and the WPT are to be computed (Crocker Natl. Bank v. McFarland Energy, 140 Cal App 3d 6, 9, 189 Cal Rptr 302, 304). That court opined that if Congress had wanted to impose a tax on the removal of crude oil, alternate language would have been used, with no references to profits -- windfall or otherwise -- and with the tax being imposed based on the number of barrels produced. In short, as the New Jersey Supreme Court emphasized, "[t]he label appended to the tax is not conclusive" (Amerada Hess Corp. v. Director, Division of Taxation, supra, 107 NJ, at 334).

L. Finally, petitioner has advanced certain other arguments as follows:

> (1) Federal case law is clear on the issue of WPT's not being income taxes under the IRC (citing U.S. v. Ptasynski, 462 US 74, 76 L Ed 2d 427, as evidence that the Supreme Court itself has indicated that the WPT is not an income tax for purposes of the U.S. Constitution);
>
> (2) IRC §§ 164(a)(4)[5] (which provides that the WPT is deductible) and 275 (which denies a deduction for Federal income taxes when computing taxable income) would directly contradict each other if the WPT were considered to be an income tax, and therefore, this notion must be rejected;

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[5] While petitioner indicated in its brief that the relevant section is IRC § 164(a)(5), the correct subsection is 164(a)(4).

(3) IRC § 901, the "foreign tax credit provision" (which allows a credit against a taxpayer's Federal income tax for the amount of foreign "income, war profits, and excess profits taxes paid or accrued during the taxable year"), is "meant to be read hand-in-glove" with the addback provision of Tax Law § 208.9(b)(3), and since the WPT does not meet the three requirements which define an "income tax" for foreign taxes under section 901, the WPT cannot be considered an income tax for the purposes of Tax Law § 208.9(b)(3);

(4) according to legislative history, Tax Law § 208.9(b)(3) was intended to require only that the Federal income and the Federal excess profits taxes (but not the WPT) be included in the computation of entire net income as taxes "on or measured by profits or income"; and

(5) the Real Property Tax Law draws a clear distinction between WPT's "which are used to reduce gross income," and income taxes, "which are taken into account in the discount rate," with the "implicit assumption underlying this distinction [being] that the windfall profit tax is not an income tax."

Petitioner's reliance on U.S. v. Ptasynski (supra) in support of the claim that "the Supreme Court itself has indicated that the windfall profit tax is not an income tax for purposes of the United States Constitution" is misplaced. Petitioner here attempts to ascribe deep and definitive meaning to the fact that, in Ptasynski, the Supreme Court analyzed the WPT and its Alaskan exemption under the Uniformity Clause of

the U.S. Constitution, thus treating the WPT as an excise tax.[6] "If the WPT were an income tax," petitioner reasons, "then under the Sixteenth Amendment to the Constitution, the Uniformity Clause would not have been an issue."[7] Petitioner avers that had the alternative existed of considering the WPT as a tax on income under the Sixteenth Amendment, the issue before the Supreme Court would have been moot. While this argument is interesting, its impact must be discounted because the Supreme Court itself in Amerada Hess, a case decided six years

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[6]The Uniformity Clause requires that all duties, imposts and excises be uniform throughout the United States. The taxpayers in Ptasynski had argued that the WPT which, by statute, exempts certain Alaskan oil from taxation, violates the Uniformity Clause.

[7]The Sixteenth Amendment provides that Congress has the power "to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration" (US Const, 16th Amend).

after Ptasynski, upheld the notion of the WPT as a tax on or measured by income or profits. In reversing the United States District Court (Wyoming) and rejecting the taxpayer's arguments, the Supreme Court actually laid the seeds for its 1989 Amerada Hess decision, by noting in its discussion of the Congressional intent behind the imposition of the WPT, that Congress "perceived that the decontrol legislation would result -- in certain circumstances -- in profits essentially unrelated to the objective of the program, and concluded that these profits should be taxed" (U.S. v. Ptasynski, supra, 462 US, at 83, 76 L Ed 2d at 436; emphasis added). In turn, with regard to the remainder of petitioner's arguments, the Supreme Court's decision in Amerada Hess makes clear that the ultimate decision as to whether or not the WPT must be added back to Federal taxable income to reach

entire net income lies within the discretion of the Commissioner of Taxation, and as long as the Commissioner's application of the addback provision comports with constitutional standards, it will be upheld. It is important to point out that the Supreme Court in Amerada Hess certainly had the opportunity to decide, based on Congressional intent, that the WPT would be deductible, and that New Jersey's application of the addback provision was irrational or arbitrary. However, the Supreme Court did not do this. The Supreme Court, instead, held that despite Congressional intent, it was not irrational to require that WPT's be added back to Federal taxable income in computing entire net income. Furthermore, Congress has had five years since the Supreme Court's decision in Amerada Hess to clarify the characterization of the WPT -- i.e., as an income or excise tax -- or to remove any doubts that Congress intended the WPT to be deductible for state tax purposes, yet it has not done so. Thus, presumably Congress was satisfied with the Supreme Court's decision to leave the characterization of the WPT to the discretion of the states.

M. Finally, it is not insignificant to note that since petitioner seeks an exemption or deduction urging exclusion from the scope of Tax Law § 208.9(b)(3), petitioner must prove entitlement thereto (Matter of Ader, Tax Appeals Tribunal, September 15, 1994, citing Matter

of Lee, Tax Appeals Tribunal, October 15, 1992, confirmed 202 AD2d 924, 610 NYS2d 330). Since an exemption is not granted as a matter of right, but is only allowed as a matter of legislative grace (Matter of Grace v. State Tax Commn., 37 NY2d 193, 371 NYS2d 715, 719; cf., Colgate v. Harvey, 296 US 404, 435, 80 L Ed 249), statutes providing exemptions from tax are strictly construed against the taxpayer (see, Matter of Cissley v. State Tax Commn., 98 AD2d 899, 470 NYS2d 890, 892, citing Matter of Grace v. State Tax Commn., supra; Matter of Ader, supra). The reason for this rule of construction is that taxes "'are demanded and received in order for government to function'" (Amerada Hess Corp. v. Director, Division of Taxation, supra, 107 NJ, at 320, citing Bloomfield v. Academy of Medicine of N.J., 47 NJ 358, 363, 221 A2d 15). The courts assume a lesser role upon review (of a taxpayer's proof of qualifying for an exemption statute) (Matter of Tripp v. State Tax Commn., 53 AD2d 763, 384 NYS2d 256, 258, citing Matter of Koner v. Procaccino, 39 NY2d 258, 383 NYS2d 295). Petitioner here has failed to carry its burden of clearly establishing entitlement to the Tax Law § 208.9(b)(3) exclusion, especially in the face of the U.S. Supreme Court's decision in Amerada Hess, upholding New Jersey's like treatment of the WPT.

N. The petitions of Felmont Oil Corporation are denied.

DATED: Troy, New York
December 27, 1994

/s/ Dennis M. Galliher
ADMINISTRATIVE LAW JUDGE