

STATE OF NEW YORK
DIVISION OF TAX APPEALS

In the Matter of the Petition :
of :
CONTAINERSHIP AGENCY, 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 1980 :
through 1982. :

Petitioner, Containership Agency, Inc., 96 Morton Street, New York, New York 10004, 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 1980 through 1982 (File No. 803085).

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 October 16, 1989 at 3:15 P.M., with all briefs to be filed by February 22, 1990. Petitioner appeared by Howard Klein, C.P.A. The Division of Taxation appeared by William F. Collins, Esq. (Anne W. Murphy, Esq., of counsel).

ISSUE

Whether payments for support services made by petitioner to its parent corporation are required to be included as "other compensation" in computing the alternative tax base.

FINDINGS OF FACT

Petitioner, Containership Agency, Inc., operates as an agent for foreign steamship companies and provides booking, delivery, loading, unloading, control and claims services. It has offices in New York and various other cities.

Petitioner is a wholly-owned subsidiary of F. W. Hartmann and Company, Inc. ("Hartmann") which is also in the steamship agency business and provides additional shipping-related services which petitioner does not perform.

For 1980, petitioner filed a New York State Corporation Franchise Tax Report on which

tax was computed based on allocated net income. For 1981 and 1982, petitioner filed New York State corporation franchise tax reports on which tax was computed based on the alternative tax method, using entire net income plus salary and other compensation paid to officers and certain shareholders. Petitioner also filed a Metropolitan Transportation Business Tax Surcharge Report for 1982.

For each of the years at issue, petitioner deducted against income certain items which represented payments to Hartmann for what petitioner referred to as "support services". The amounts deducted for each year were as follows:

<u>Year</u>	<u>Support Services</u>
1980	\$474,399.00
1981	538,076.00
1982	608,315.00

Upon audit, petitioner's payments to Hartmann for support services were treated as compensation paid to a shareholder owning in excess of five percent of petitioner's stock and were included in petitioner's alternative base for each year.

Petitioner had filed a refund claim arising from the carryback of a 1981 net operating loss to 1978. The refund claimed was reduced by increasing the alternative base for 1978 by \$465,340.00 in support services paid to Hartmann.

(a) On March 6, 1984, petitioner executed a Consent Extending the Period of Limitation of the Assessment of Tax for the year 1980 to February 28, 1985.

(b) On January 29, 1985, petitioner executed a Consent Extending the Period of Limitation of the Assessment of Tax for the years 1980 and 1981 to December 31, 1985.

(c) On November 7, 1985, petitioner executed a Consent Extending the Period of Limitation of the Assessment of Tax for the years 1980, 1981 and 1982 to November 30, 1986.

On December 6, 1985, the Division of Taxation issued a Statement of Audit Adjustment to petitioner showing the following deficiencies arising from the audit:

<u>Year</u>	<u>Deficiency</u>
1980	\$ 5,306.00
1981	9,580.00

1982	10,798.00
1982 (surcharge)	1,943.00

Also on December 6, 1985, the Division of Taxation issued the following notices of deficiency to petitioner:

<u>Year</u>	<u>Deficiency in Tax</u>	<u>Interest</u>	<u>Total Due</u>
1980	\$ 5,306.00	\$4,046.00 less credit <u>2,265.00</u>	\$ 9,352.00 \$ 7,087.00
1981	9,580.00	5,626.00	15,206.00
1982	10,798.00	3,989.00	14,787.00
1982 (surcharge)	1,943.00	718.00	2,661.00

Support Services

The payments made for "support services" consisted of reimbursement of Hartmann by petitioner for salaries, rent, travel and other expenses paid for by said parent corporation and apportioned after analysis of employees' time attributable to petitioner's operations and analysis of other expenses identifiable as allocable to petitioner.

The following is a breakdown of expenses reimbursed to Hartmann by petitioner:

<u>Item</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>
Officers' salaries, payroll taxes and fringe benefits			\$314,558.00 \$305,690.00 \$315,562.00
Other salaries, payroll taxes and fringe benefits:			
Accounting Department			\$ 68,366.00 \$ 84,828.00 \$ 98,672.00
Operations Department			13,095.00 20,765.00 28,965.00
Claims Department	-0-		23,108.00 50,956.00
Payroll taxes and fringe benefits			<u>10,727.00</u> <u>17,034.00</u> <u>19,491.00</u>
Total other salaries, etc.			\$ 92,188.00 \$145,735.00 \$198,084.00
Other costs:			
Auto & travel (Operations Dept.)			\$ 21,364.00 \$ 27,571.00 \$ 20,781.00
Office rent, postage, computer for agency business, outside professional fees, consultants & miscellaneous			<u>46,289.00</u> <u>59,080.00</u> <u>73,888.00</u>
Total other costs			\$ 67,653.00 \$ 86,651.00 \$ 94,669.00
Total of above items			\$474,399.00 \$538,076.00 \$608,315.00

The payments for support services were included in the computation of the income of

the parent corporation for purposes of computing the parent's alternative base.

CONCLUSIONS OF LAW

A. For the years at issue, Tax Law § 210 (former [1]) provided that a corporation's New York State corporation franchise tax was to be calculated as the sum of the following:

(a) A tax measured by whichever of the following methods yielded the greatest tax:

- (1) allocated entire net income;
- (2) allocated capital;
- (3) an alternative base;
- (4) minimum tax (\$250.00); plus

(b) A tax on allocated subsidiary capital.

The issue in this case involves the tax measured by the alternative base method.

B. During the period at issue, the tax on the alternative base was computed at a rate of 10% on:

"thirty per centum of the taxpayer's entire net income plus salaries and other compensation paid to the taxpayer's elected or appointed officers and to every stockholder owning in excess of five per centum of its issued capital stock [minus \$15,000.00 for 1980 or \$30,000.00 for 1981 and 1982, and with certain exceptions, deductions and modifications not relevant hereto]" (Tax Law § 210.1[former (a)(3)]).¹

C. That 20 NYCRR 3-3.2(f) provides that the term "stockholder owning in excess of five percentum of its issued capital stock", as used in Tax Law § 210.1(a)(3), includes a corporate shareholder.

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Effective January 1, 1987, this alternative was changed to a minimum taxable income base (Laws of 1987, ch 817, § 23). The \$15,000.00 subtraction had been increased to \$30,000.00 by Laws of 1981, ch 41.

D. That 20 NYCRR 3-3.1(b) provides as follows:

"The tax measured by entire net income plus compensation is to prevent tax avoidance by distributing profits in the form of excessive salaries. However, this measure of the tax does not prevent the Tax Commission from disallowing deductions claimed for unreasonable salaries in computing entire net income."

E. The payments made by petitioner to Hartmann were not distributions of profits to avoid tax, within the meaning of 20 NYCRR 3-3.1(b), but represented the reimbursement of the parent corporation for legitimate

expenses incurred by the parent on petitioner's behalf (see Funkhouser Industries, Inc. v. Commissioner, 16 TCM 890).

F. The petition of Containership Agency, Inc. is granted and the notices of deficiency issued to petitioner on December 6, 1985 are cancelled.

DATED: Troy, New York

ADMINISTRATIVE LAW JUDGE