STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition of CAMPBELL SALES COMPANY for Redetermination of Deficiencies or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Fiscal Years Ended July 31, 1978, July 29, 1979, August 3, 1980, August 2, 1981, August 1, 1982 and July 31, 1983.[1]	:	DETERMINATION DTA NOS. 805017 AND 805018

Petitioner, Campbell Sales Company, P.O. Box 391, Camden, New Jersey 08101, filed petitions for redetermination of deficiencies or for refund of corporation franchise tax under Article 9-A of the Tax Law for the fiscal years ended July 31, 1978, July 29, 1979, August 3, 1980, August 2, 1981, August 1, 1982 and July 31, 1983.

A hearing was held before Catherine M. Bennett, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on October 31, 1990 at 9:15 A.M., with all briefs to be filed by August 23, 1991. Petitioner submitted its brief on March 21, 1991. The Division of Taxation submitted its brief on June 18, 1991 and petitioner's reply brief was submitted on August 23, 1991. Petitioner appeared by Whitman & Ransom (George J. Noumair, Esq., of

counsel). The Division of Taxation appeared by William F. Collins, Esq. (Anne W. Murphy, Esq., of counsel).

[1]According to the report prepared by Price Waterhouse (discussed infra), Campbell Sales Company reports for financial and tax purposes on a 52/53 week year ending on or about July 31. Accordingly, the last day of a year is different from year to year. In some cases, the July 31 year end which is nearest to the August date ending in the same fiscal time frame is used for purposes of convenience.

ISSUE

Whether the Division of Taxation properly required Campbell Sales Company to file a franchise tax report on a combined basis with its parent corporation, Campbell Soup Company, and numerous other Campbell Soup Company subsidiaries for the fiscal years at issue.

FINDINGS OF FACT

On May 6, 1983, the Division of Taxation ("Division") issued to petitioner, Campbell Sales Company ("Campbell Sales"), separate notices of deficiency asserting additional franchise tax due under Article 9-A of the Tax Law for the fiscal years ended July 31, 1978, July 29, 1979 and August 3, 1980 in the following amounts:

Fiscal Year Ended	Tax	Interest	Total Due
7/31/78	$421,026.00	$221,262.00	$642,288.00
7/29/79	320,417.00	141,153.00	461,570.00
8/3/80	420,213.00	149,398.00	569,611.00

The statements of audit adjustment also issued on the same date merely indicate that the assessments are based on a recent field audit with no further explanation. These notices were the reflection of the Division's determination, after an audit of the books and records of petitioner, that the income and the New York State franchise tax of Campbell Sales should be computed on the basis of a combined return with Campbell Soup Company ("Soup") and several other subsidiaries of Soup. On July 25, 1983, petitioner timely filed a petition with the former New York State Tax Commission protesting such deficiencies.

A consent extending the period of limitation on the assessment of tax in this matter was executed on behalf of Campbell Sales by its Director of Corporate Tax Administration, F. W. Magann, on August 18, 1982, thereby extending the time period for assessment of tax for the fiscal years ended July 30, 1978 and July 29, 1979 to any time on or before October 15, 1983.

On January 16, 1987, the Division issued to petitioner separate notices of deficiency asserting additional franchise tax due under Article 9-A of the Tax Law for the fiscal years ended August 2, 1981, August 1, 1982 and July 31, 1983 in the following amounts:

Fiscal Year Ended Tax Interest Total Due

8/2/81	$421,786.00	$369,259.00	$791,045.00
8/1/82	419,324.00	263,773.00	683,097.00
7/31/83	436,826.00	187,076.00	623,902.00

The above-referenced notices were issued subsequent to a field audit of petitioner's books and records with respect to such years and are the result of the Division's determination that the income and New York State franchise tax of petitioner should be computed as though petitioner filed a combined return with Soup and several other subsidiaries of Soup. On April 13, 1987, petitioner filed timely petitions with the former State Tax Commission protesting the notices of deficiency dated January 16, 1987.

On July 17, 1987, petitioner paid the deficiencies asserted by the Division in full for the six fiscal years plus interest to the date of payment and converted both petitions into claims for refund. The matter was thereafter reviewed by the Bureau of Conciliation and Mediation Services. Correspondence was submitted in lieu of a request for a conciliation conference. On October 9, 1987, two conciliation orders were issued covering the six fiscal years sustaining the statutory notices.

On January 6, 1988, petitioner timely filed two petitions with the Division of Tax Appeals with respect to the conciliation orders issued for the fiscal years ended July 31, 1978 through 1980 and a second petition for the fiscal years ended August 2, 1981, August 1, 1982 and July 31, 1983.[2]

The Division submitted its answers to the petitions as filed with respect to fiscal years ended July 31, 1978 through August 3, 1980 and with respect to fiscal years ended August 2, 1981 through July 31, 1983 dated March 28, 1988 and March 30, 1988, respectively.

Petitioner, a wholly-owned subsidiary of Soup, is a New Jersey corporation with its

[2]The parties stipulated to numerous facts in this matter. Stipulation of fact number "10" reflects the timely filing of the petition on January 6, 1988 and refers to Exhibit "20" attached to the stipulation. The parties have provided as Exhibit "20" only the petition reflecting fiscal years ended July 31, 1978 through 1980. However, the files maintained by the Division of Tax Appeals in fact reveal that both petitions were date stamped as having been received by the Division of Tax Appeals on January 12, 1988 having been transmitted by certified mail, return receipt requested, bearing a U.S. postmark of January 6, 1988.

principal office in Camden, New Jersey, qualified to do business in New York. Petitioner maintains 40 offices in 34 states, including two sales offices in New York.

Soup, a New Jersey corporation, is a processor and manufacturer of food and food products. Since its organization in 1922, petitioner has been engaged in the business of acting as sales representative or broker in the food business, representing Soup in the solicitation of orders for food products throughout the United States. Petitioner has not represented other food manufacturers due to the large volume of work it handles for Soup. Petitioner's employees solicit orders from unrelated parties for goods sold by Soup. Such orders are transmitted to Soup's offices in Camden for acceptance and credit approval. No part of the credit-related activities are performed by petitioner's employees. Goods are then shipped directly

from Soup to wholesalers, distributors or customers and payment therefor is made directly to Soup.

Petitioner is completely autonomous and has a separate corporate existence from Soup maintaining its own offices, employees and facilities, none of which are shared. However, its president, who works for petitioner full time, also has the title of vice-president of Soup. All of petitioner's services are performed by its own employees or persons hired by it except for certain administrative functions such as accounting and tax services.

From its inception in 1922, Campbell Sales has had its own staff of employees and, during the years at issue, it had approximately 1,000 employees who worked exclusively for petitioner. There are no persons who are employed by both Campbell Sales and Soup, or by Campbell Sales and an unrelated party. All such employees identify themselves and are identified for all purposes as employees of Campbell Sales and not Soup or some other entity. There is rarely, if ever, a transfer of any employee from petitioner to Soup or vice versa.

Petitioner utilizes other brokers periodically to solicit orders for new products. In Alaska and Hawaii petitioner retained food brokers to solicit orders for Soup's products and Campbell Sales paid a commission to its Hawaii broker of 2% of sales. Petitioner is a separate and independent company from an operations and accounting standpoint maintaining its own books of account and bank accounts and paying its own expenses. The compensation received by petitioner for the work that it does is governed by an agreement between petitioner and Soup entered into in 1947. There are no other agreements or understandings between petitioner and Soup or any of Soup's subsidiaries regarding petitioner's income or expenses. The agreement provides for a payment to petitioner equivalent to petitioner's costs plus 4% thereof:

> "The Soup Company agrees to pay to the Sales Company for the services which shall be performed by the Sales Company under this Agreement, the actual net cost to the Sales Company of the operation and carrying on of the business of the Sales Company so far as the same shall relate to the sale of the products above mentioned while this Agreement shall be in force and effect, including all salaries and wages of officers and employees of the Sales Company, all payments made by the Sales Company to the Prudential Insurance Company of America under the Campbell's Soups Retirement and Pension Plan, effective July 1, 1938, as amended, and all payments made by the Sales Company to The Travelers Insurance Company under the Campbell's Soups Group Life Insurance Plan, effective March 1, 1947; plus four (4) per cent of such actual net cost...."

The compensation paid by Soup to petitioner for each of the fiscal years 1954 through 1983 expressed as a percentage of Soup's sales generated by petitioner was as follows:

Compensation paid by
Soup to Campbell Sales, as a
Percentage of sales made by Soup

FYE July 31	Percentage
1954	2.0921%
1955	2.3572
1956	2.6862
1957	2.7520
1958	2.3505
1959	2.4290
1960	2.3796
1961	2.3790
1962	2.3057
1963	2.3398
1964	2.2702
1965	2.4143
1966	2.3769
1967	2.4164
1968	2.4295
1969	2.4785
1970	2.4752
1971	2.5253
1972	2.5937
1973	2.4802

1974	2.4165
1975	2.4735

1976	2.4851
1977	2.5112
1978	2.8684
1979	2.8256
1980	3.0176
1981	3.1398
1982	3.2968
1983	3.4322

The payments have been, for most years, the equivalent of sales commission to petitioner in the 2 to 3% range. A 2 to 3% commission for the work which Campbell Sales does has been established to be a fair and reasonable commission and is not less than, and is probably more than, the equivalent of the amount that would be paid for such work on an arm's-length basis involving unrelated parties. The New York State Tax Commission held in a similar case involving Campbell Sales' 1977 fiscal year that the compensation petitioner receives for services rendered to Soup was equal to or greater than amounts comparable persons receive from independent, unrelated parties for the performance of substantially similar services. Other than the 1947 agreement between petitioner and Soup there are no transactions, agreements, understandings or arrangements between petitioner and Soup or between petitioner and any other company.

Petitioner's only activities in New York are operating two sales offices out of which salesmen operate to solicit sales. Soup is a non-New York taxpayer having no activities in New York, and its only connection with New York being the shipment of goods from outside New York to customers in New York.

Since 1941, as reflected by its New York State franchise tax returns as filed, petitioner has calculated its New York franchise tax liability pursuant to a formula agreed upon and modified in 1947 by petitioner and the Division. Pursuant to this agreement, petitioner computes its gross income as 4% (adjusted in the event Soup's advertising expenses fall below 3½% of its sales) of Soup's total sales for the year, subtracts its expenses, and allocates the net income to New York in the proportion which petitioner's expenses incurred with respect to New York bear to petitioner's total expenses. Petitioner's computation of its New York franchise tax liability for the fiscal years at issue is reflected on a statement attached to its returns for the respective years and reproduced in Exhibit "A" herein (see, Appendix "A").

The tax that would have been computed under the statutory formula and the tax computed and actually paid by petitioner pursuant to the 1947 agreement for the fiscal years 1978 through 1983 were as follows:

Fiscal Year Ended	Tax Per Agreement	Tax Per Statutory Formula
7/31/78	$80,282.00	$ 9,252.00
7/29/79	94,743.00	8,799.00
8/3/80	64,199.00	8,568.00
8/2/81	51,261.00	9,177.00
8/1/82	49,318.00	15,904.00
7/31/83	66,207.00	19,318.00

As a result of the two field audits, the Division determined that petitioner must file a combined return for the fiscal years in issue with Soup and up to 10 other subsidiaries of Soup, all except one of which are not New York taxpayers. None of the subsidiary corporations have any transactions with petitioner. The corporations the Division sought to include in the New York franchise tax combined report with petitioner were as follows:

(1) Soup (incorporated in New Jersey in 1922) - the parent corporation. (Not a N.Y.S. taxpayer)

(2) Joseph Campbell Company (incorporated in New Jersey in 1972) - a wholly-owned subsidiary of Soup which grows and purchases vegetables, all of which it sells to its parent. (Not a N.Y.S. taxpayer)

(3) Champion Valley Farms, Inc. (incorporated in New Jersey in 1969) - a wholly-owned subsidiary of Soup which produces pet foods, all of which it sells to its parent. (Not a N.Y.S. taxpayer)

(4) Valley Tomato Products, Inc. (incorporated in California in 1966) - a wholly-owned subsidiary of Soup which manufactures tomato paste, all of which it sells to its parent. (Not a N.Y.S. taxpayer)

(5) Southeastern Wisconsin Products Company (incorporated in Wisconsin in 1965) - a wholly-owned subsidiary of Soup which sells food flavorings to its parent. All sales are to the parent. (Not a N.Y.S. taxpayer)

(6) Campbell Soup Co. (Sumter Plant), Inc. (incorporated in South Carolina in 1965) - a wholly-owned subsidiary of Soup which manufactures frozen dinners and processes poultry. Approximately 70 percent of its sales are to the parent. (Not a N.Y.S. taxpayer)

(7) Campbell Frozen Foods Distributing Co. (incorporated in New Jersey in 1955) - a wholly-owned subsidiary of Soup which purchases frozen dinners

from the parent and resells them to institutional customers under the name "EfficienC". All of its purchases are from Soup. This corporation is the only N.Y.S. taxpayer besides Sales but Sales has engaged in no transactions with this corporation.

(8) Campbell Foreign Sales, Inc. - DISC (according to the Department, consolidated but not combined). (Not a N.Y.S. taxpayer)

(9) Dixon Canning Corp. - (Not a N.Y.S. taxpayer)

(10) Campbell Finance Corp. - (Not a N.Y.S. taxpayer) (1979, 1980 only)

(11) Herider Farms - (Not a N.Y.S. taxpayer) (1981, 1982, 1983 only)

(12) Domsea Farms - (Not a N.Y.S. taxpayer) (1982, 1983 only)

(13) Campbell Investment Co. - (Not a N.Y.S. taxpayer) (1982, 1983 only)

The phrases "Not a New York taxpayer" or "Not a N.Y.S. taxpayer" as used above should be interpreted to mean that the corporation referred to did not file a New York franchise tax report on the grounds that it is not subject to New York franchise tax in its own right, a conclusion with which the Division agrees. However, the Division included such corporations in a combined report with petitioner with regard to Soup because of its relation to Campbell Sales and with regard to the other corporations because of their relation to Soup. As to the other subsidiary corporations, Soup owns 100% of their stock and there were substantial intercompany transactions between each of them and Soup such that the corporations should be combined with petitioner and Soup under the Division's interpretation of the relevant statutes and regulations. Petitioner does not agree with the Division's interpretation in this regard and it is such disagreement that is the principal issue in this proceeding.

The parties to this matter presented the Administrative Law Judge with a Stipulation of Fact comprised of 51 statements. Facts "1" through "36" have been adopted and incorporated into this determination and are reflected above in Findings of Fact "1" through "15". Facts "37" through "51" essentially refer to computations made pursuant to the audits in this matter and petitioner's interpretation of what those figures represent with the exception of Stipulation of Fact number "43", which is incorporated in Finding of Fact "11" above. Amounts which are obtained from the field audit reports or from the tax returns as filed by petitioner are not in dispute; however, petitioner presents its view as to imputed income, imputed gross income and imputed compensation with which the Division does not agree or disagrees as to the correctness of such derived or imputed figures or the import of such figures as to this matter. The charts and figures set forth below represent petitioner's view as to the impact of the determination reached as a result of the field audits and how such determinations impacted the ultimate calculation of petitioner's franchise tax liability.

SUMMARY OF PETITIONER'S ANALYSIS OF THE AUDIT RESULTS

Petitioner advances the argument, which will be set forth more completely later in the determination, that the facts of this record demonstrate that a combined return with a non-New York taxpayer as proposed by the Division creates a massive distortion. In support of that argument, petitioner presents an analysis of the computational results of the audit findings. This section of the determination sets forth such analysis.

Petitioner asserts the Division based its determination that petitioner must include its parent company in a combined return solely on the facts of substantial intercompany transactions between the two in addition to stock ownership. The Division did not make any quantitative or qualitative analysis to determine whether there was a distortion by filing a separate return or whether a combined return was necessary to cure the distortion or whether there would be a distortion by filing a combined return.

The computation begins with the calculation of combined entire net income. As a point of reference petitioner notes that the actual entire net income of Campbell Sales on a separate company basis during the years in issue was as follows:

Year	Amount
1978	$ 941,149.00
1979	1,023,186.00
1980	1,298,185.00
1981	1,499,526.00
1982	2,500,580.00
1983	2,538,431.00

The individual entire net income for each member of the combined group was determined using Federal taxable income as a starting point. In addition to the addback of the New York

State franchise tax deducted on separately filed tax reports of Campbell Sales and Campbell Foods Distributing Corp., other adjustments were made which will not be detailed in this determination and are not in dispute. Thus, combined entire net income was the resulting calculation. Separately calculated was a combined business allocation percentage which was the result of the computation of combined property, receipts and wage factors. The combined business allocation percentage was applied to the combined entire net income to result in income allocated to New York State per audit. The field audit report supplied the following information with regard to the computation of the combined business allocation percentage. The following information is extracted from the audit report:

> "The combined property factor was computed per audit using the average net book values for land, inventory, and fixed assets for each company included in the combined report. Rented real estate was computed by capitalizing annual rent expense on real property by eight. An intercompany elimination was allowed for intercorporate rent expense on applicable companies.
>
> * * *
>
> The combined receipts factor was computed using sales rents and royalties. The only companies on the combined report that had New York destination sales were Campbell Sales, Campbell Soup, and Campbell Foods Distributing Corp. All intercompany receipts and rental income were eliminated per audit.
>
> * * *
>
> The only company on the combined report that had New York wages was Campbell Sales Company. Everywhere wages for the combined companies were obtained off of the individual Federal 1120's and officers wages were deducted when applicable."

The combined entire net income and corresponding combined business allocation percentages with the resulting computation of allocated entire net income per audit is set forth for each of the years below:

<u>Fiscal Year Ended July 31, 1978</u>

Combined Entire Net Income	$112,006,218.00
Combined Business Allocation Percentage	x 4.46014%
Allocated Entire Net Income	$ 4,995,634.00

<u>Fiscal Year Ended July 31, 1979</u>

Combined Entire Net Income	$ 96,547,903.00

Combined Business Allocation Percentage	x 4.2515%
Allocated Entire Net Income	$ 4,104,734.00

Fiscal Year Ended July 31, 1980

Combined Entire Net Income	$112,905,820.00
Combined Business Allocation Percentage	x 4.23233%
Allocated Entire Net Income	$ 4,778,547.00

Fiscal Year Ended August 2, 1981

Combined Entire Net Income	$114,258,966.00
Combined Business Allocation Percentage	x 4.0872%
Allocated Entire Net Income	$ 4,669,992.00

Fiscal Year Ended August 1, 1982

Combined Entire Net Income	$106,871,127.00
Combined Business Allocation Percentage	x 4.3696%
Allocated Entire Net Income	$ 4,669,841.00

Fiscal Year Ended July 31, 1983

Combined Entire Net Income	$121,521,898.00
Combined Business Allocation Percentage	x 4.1637%
Allocated Entire Net Income	$ 5,059,807.00

Petitioner asserts that as a result of the combined business income allocated to New York, as calculated by the Division, that the Division, in essence, imputed net income to petitioner. The imputed net income can be viewed by dividing the income of petitioner allocated to New York by the separate return allocation factor of petitioner. The separate return allocation factors for each of the years in issue are inherently a part of the computation of the New York State franchise tax on a statutory basis as referred to in Finding of Fact "14". The separate return allocation factor is essentially a percentage of New York business income allocable to New York which is established on the basis of the property, receipts and payroll factors which are employed in such computation. The following is a chart set forth by petitioner with respect to the imputed net income:

FYE	Net Income Allocated to N.Y.S. by Department	Separate Return Allocation Factor	Imputed Net Income

7/31/78	$4,995,634	9.83%	$50,820,285
7/31/79	4,104,734	8.60	47,729,465
7/31/80	4,778,547	6.62	72,183,489
7/31/81	4,669,992	6.12	76,307,059
7/31/82	4,669,841	6.36	73,425,173
7/31/83	5,059,807	7.61	66,488,922

Petitioner asserts if the net income allocated to New York by the Division is $4,778,547.00 for 1980, and if this amount represents 6.62% of the entire net income of petitioner for such year, then the entire net income before apportionment to New York would be $72,183,489.00 as reflected in the column entitled "Imputed Net Income". Petitioner notes that the imputed earnings as reflected in this chart are in some cases 50 times greater than the actual earnings by petitioner and, thus, the imputation of net earnings to petitioner from a combined reporting basis results in a material and massive distortion.

Petitioner takes the computation one step further with a calculation of total gross imputed income of petitioner based on the imputed net income determined in the chart above plus total actual deductible expenses as follows:

Year	1 Total Net Income As Imputed by Department	2 Actual Expenses	3 Imputed Gross Income (Col. 1 + 2)
7/31/78	$50,820,285	$35,289,519	$ 86,109,804
7/31/79	47,729,465	35,552,041	83,281,506
7/31/80	72,183,489	42,059,918	114,243,407

7/31/81	76,307,059	45,346,699	121,653,758
7/31/82	73,425,173	50,473,177	123,898,350
7/31/83	66,488,922	59,131,398	125,620,320

The gross compensation of petitioner as reflected above is portrayed as a percentage of sales made by Soup as follows:

	1	2	3
FYE	Sales of Soup	Imputed Gross Compensation of Petitioner	Imputed Gross Compensation of Petitioner Computed As A Percentage of Sales of Soup (Col. 2 Divided by 1)
7/31/78	$1,256,011,321	$ 86,109,804	6.9%
7/31/79	1,397,490,683	83,281,506	6.0
7/31/80	1,433,019,468	114,243,407	8.0
7/31/81	1,489,900,817	121,653,758	8.2
7/31/82	1,604,716,775	123,898,350	7.7
7/31/83	1,794,895,609	125,620,320	7.0

Such percentages exceed the rate of commission actually paid to petitioner by Soup ranging from 2.8256 to 3.4322% by 200 to 300%.

Petitioner next portrays the computation of petitioner's imputed net income as a percentage of consolidated net income of Soup in the chart:

	1	2	3
	Actual Consolidated Net Income of Soup	Total Imputed Net Income of Petitioner	Total Imputed Net Income of Petitioner As A Percentage of Consolidated Net Income of Soup
7/31/78	$112,006,218	$50,820,285	45.37%
7/31/79	96,547,903	47,729,465	49.44
7/31/80	112,905,820	72,183,489	63.93
7/31/81	114,078,373	76,307,059	66.89
7/31/82	106,936,345	73,425,173	68.66
7/31/83	121,308,629	66,488,922	54.81

Petitioner concludes that the percentages set forth in this chart represent the percentages of total consolidated income of Soup attributable to the selling functions of Campbell Sales. It is asserted by petitioner that it is not realistic to believe that the mere sales function, important as it may be, would be entitled to over one-half the total earnings of the entire unitary enterprise as reflected in the combined report proposed by the Division.

Petitioner further utilizes the imputed net income to contrast the actual return on equity with the return on equity computed on a combined basis using the imputed net income computation. Where the actual returns on equity range from 23.3% to 67.4% on the basis of actual net income, by way of contrast imputed net income, as a percentage of actual net worth, ranges from 1507% to 2441%, an unrealistic result.

THE NEW YORK STATE AUDITS

The corporation tax field audit of Campbell Sales for the fiscal years ended in 1978, 1979 and 1980 took place between early 1982 and the end of March 1983 according to the field audit report. The field audit report for these fiscal years included comments regarding a previous audit involving Campbell Sales. A portion of that report is extracted and reproduced below:

> "The previous New York audit originally included the fiscal years ended 7/74, 7/75, and 7/76. During that audit, consideration was given to require combination under Section 211.4 for these years but was not pursued due to the agreement with the Tax Commission mentioned previously. The taxpayer, however, was advised by the A. D. O. that a combined report should be filed rather than using the 211.5 adjustment beginning with year ended 7/77. The taxpayer has continued to file his New York reports based on 211.5. Consequently, the franchise tax was recomputed on a combined basis per audit using the statutory formula for FYE 7/77. The taxpayer disagreed and a formal hearing was held in June of 1982. No decision has been rendered as of this time.
>
> Our audit disclosed that several of the affiliated companies were acting in a unitary capacity and that there are also substantial intercompany transactions. These facts form the basis for requiring combined reports; that is existence of a unitary business and sufficient intercompany transactions that meet the 50% test pursuant to the statute and regulations.
>
> Consequently, our determination is similar to that arrived at for FYE 7/77 in the previous New York State audit. There is no basis for continuing to allow filing under this method for which there is no justification. Furthermore, a combined report is recommended for the taxpayer and several of its affiliated companies to properly reflect its business activity in New York State and to insure a degree of equity among competing manufacturing firms. The 211.5 method provides a competitive advantage in the State, since all of the sales of Campbell Soup Company (a non-New York taxpayer) are solicited by the Campbell Sales Company while most expenses and responsibilities of the group are borne by the parent.
>
> Since this is certainly a unitary business as described in Section 211.4 of the Tax Law, a combined report is a better measure of the company's tax liability and consequently there is no need to continue the 211.5 adjustment.

* * *

> In order to reflect the proper New York tax liability of the subject group of corporations, combined reports are necessary since these companies are involved in a unitary business due to the fact that Campbell Sales Company and the others exist only to facilitate the manufacture and sale of the parent's products. In fact, they operate as departments of the same unitary business. Campbell Sales Company, as the exclusive sales agent of the parent, only solicits orders for Campbell Soup Company's products. Due to the nature of the business, it is virtually impossible for customers to distinguish between the two companies. The remaining combined corporations are suppliers of raw materials and semi-finished goods for other members of the combination. In view of the above, a combined report will serve to better measure the New York activity."

The field audit report for the fiscal years ending in 1981, 1982 and 1983 is signed and dated February 10, 1986. The general findings of the report were nearly identical to the commentary reproduced above from the prior audit and it was again recommended that the taxpayer be assessed in accordance with schedules computing franchise tax liability on a combined basis. It was noted that the audit was to be held in abeyance pending the outcome of the Campbell Sales court decision for fiscal year ended 1977.

The Division called as its witness the team leader of the field audit covering the fiscal years ending in 1978, 1979 and 1980 being conducted with regard to Campbell Sales. The auditor is presently in charge of the corporation tax audit section for franchise tax in the Buffalo District Office and has maintained the position with the Division in the franchise tax bureau for 27 years. The auditor testified that the field audit was performed at the Campbell Soup office in Camden, New Jersey at its tax office and headquarters. The Division examined the books and records for all of the affiliated corporations in order to make a determination of whether any of the corporations not filing in New York were in fact performing a taxable activity in New York, or if one or more corporations should be permitted or required to file a combined report. The auditor testified that the findings on audit were generally consistent with a previously conducted audit which recommended a combination of Campbell Sales, the parent Soup and numerous other subsidiary corporations. It was noted that, in a few cases, companies that had been included in the previous audit did not maintain sufficient intercompany transactions to require a combined filing in the current period and vice versa. The auditor further testified as to the mechanics of the computation of the franchise tax as a result of the combined reporting requirement. Petitioner's analysis of the audit results contained herein summarizes such computation as well and a portion of the field audit report relating to such computation is presented in Finding of Fact "19". With the exception of a brief discussion regarding elimination of intercompany receipts between the corporations when combined reporting is applied, the auditor's testimony merely confirmed the approach taken by the Division in its computation for combined reporting purposes. When the auditor was questioned as to the general basis for the determination by the Division to require a combined report which included certain subsidiaries and Soup, the auditor responded as follows:

> RICHARD H. STEIN: "Basically under the Statute 211.4 and under the Regulation 6-2, all of the tests were met. The ownership of stock test was met. We combined Campbell Soup Company and subsidiaries and eight or nine other subsidiaries of Campbell Soup Company which they had a hundred percent control or ownership. They were a unitary business. They were in the same lines of business. They were selling to each other or servicing for each other.
>
> For instance, the Sales Company's total business was to solicit sales of Campbell products. All of their revenue was coming from the parent company and there were substantial intercompany transactions between the companies we combined."

The auditor was questioned whether he made a calculation to show distortion or that the tax was not properly reflected. He responded that he reviewed the fact that there were substantial intercompany transactions. He indicated a full review of the operations of petitioner, which was a company set up to facilitate the sale of the parent company products. When questioned regarding what he considered in his decision besides the intercompany transactions and the stock ownership, he answered that he looked at how everything was being operated on the whole. The agreement, for instance, was reviewed and the conclusion was drawn that it was not the type of arrangement a company would have with an independent broker. The auditor was uneasy with the fact that the agreement between Soup and petitioner was not the same agreement maintained with independent brokers. The auditor admitted not having gone through the exercise of translating the dollars paid from Soup to petitioner into a commission, the way it has been presented by petitioner. The auditor believed that a determination could not be made in this regard because one could not take into consideration all of the risk factors and the different types of products that are involved in this arrangement. In his view, what exists in this case is one large company that is in the business of manufacturing and processing soup and food products. The auditor did not believe that transactions can be at arm's length where they are between related parties. The audit for prior fiscal periods involving fiscal years 1974, 1975 and 1976, as well as the agreement between the Division and petitioner, was raised. During the questioning regarding the section 211.5 agreement, petitioner described the same as an adjustment made to attempt to correct a situation when the tax is not properly computed. The auditor testified that discretionary adjustments pursuant to section 211.5 were frequently used during the 1940's and 1950's by the Division. He testified that even though the statute has not changed significantly, that over the last 10 or 20 years the Division has attempted to refrain from making special agreements and agreeing to arrangements that are contrary to the statutory formula. He suggested there was a policy change which discourages discretionary adjustments. He further stated that a discretionary adjustment would not necessarily be a method considered prior to a determination that certain corporations should file on a combined basis since usually a discretionary adjustment would require a determination of what would be arm's length.

In addition to a determination that the ownership requirement and the substantial intercompany transactions were met, the auditor believes that a view to the total situation contributed to the determination that petitioner should file on a combined basis with the other corporations. He stated that petitioner could not stand alone as a corporation and the Division reviewed factors like such dependency. He testified that the parent company could not exist the way it is set up without petitioner, and that petitioner, with its only customer the parent, could not exist on its own. Petitioner's representative posed the question whether if Soup, instead of hiring petitioner, hired an independent company operating in New York in the same manner as petitioner, the conclusion would be the same. The auditor responded that where there is no relationship between the companies, then the income would be properly measured.

The auditor noted in his testimony that the business of "Campbell" was nationwide and, with the way the parent company has been set up, it only has to pay taxes in one or two states. When the auditor was asked whether it was relevant whether tax was being paid to 49 states or one state, he responded that where business is being conducted throughout the United States and generating income nationwide, including in New York, it is proper that New York State receive a fair apportionment of the business and activities being performed in New York. Petitioner noted that among the comments in the field audit report was one that made a reference to the recommendation for combined reporting being based on "insuring a degree of equity among competing manufacturing firms". The auditor had no knowledge of a factual basis for such statement and believed it to be a part of the findings of the prior audit.

The auditor admitted in his testimony that, as a team, the Division did not attempt to make a calculation in any qualitative or quantitative way to show distortion and the reason stated was because they had determined that the findings were the same as the previous audit.

SUMMARY OF PETITIONER'S POSITION

Petitioner sets forth as its first argument that the statute, the regulations and the court decisions uniformly require distortion arising from the filing of a separate company return as the predicate for the Division to require a combined return with a non-New York taxpayer and such distortion must arise from either intercompany transactions or an agreement which distorts income. The statutory language requiring distortion is found in the phrase "in order properly to reflect the tax liability...." Petitioner points out that the current statute relating to compulsory combination with non-taxpayers has remained in essentially the same form since the 1944 amendments. Section 211.4 of the Tax Law retains the distortion test in the form of the mandate to "properly reflect" the tax liability. Petitioner asserts that it is clear from this statutory language that the Division may not arbitrarily and capriciously deem a combined report necessary in every case of intercompany transactions or an agreement, but only where it is necessary in order to properly reflect the tax liability. Thus, the Division must fairly and rationally conclude, based upon the particular facts of a record before it in a given case, that intercompany transactions or some agreement require a combined report in order properly to reflect the tax liability. It is submitted that under the facts and circumstances of this case, no conclusion can rationally be drawn that a combined report is necessary properly to reflect the tax liability.

In conformity with the statute, the regulations of the Division interpreting the statute also contain a distortion requirement, i.e., that the Division could not mandate that a non-New York taxpayer be included in the return of a New York taxpayer unless the return of the New York taxpayer was distorted because of intercompany transactions or some agreement. Petitioner points to regulation 6-2.3(a) which deals with permissive and compulsory combination with taxpayers and permissive combination with non-taxpayers. Petitioner notes that regulation 6-2.5, dealing with compulsory combination of non-taxpayers, likewise contains a distortion requirement in the form of proper reflection of income. Petitioner points to the following language of section 6-2.5: "...and the Tax Commission determines that inclusion is necessary to properly reflect...." Petitioner also notes that the Division's revision of its combined reporting regulations in 1976 made no significant change in the language of the regulation dealing with compulsory combination of non-taxpayers from the 1945 version, which was applicable in the years involved in Matter of Wurlitzer Company v. State Tax Commn. (42 AD2d 247, 346 NYS2d 471, affd 35 NY2d 100, 358 NYS2d 762). In a further discussion of the regulations dealing with combined reports, petitioner pointed out that when the regulations were subsequently amended in 1983, the amended version of section 6-2.3 substituted the word "distorts" for the former "proper reflection" requirement and also added the reference to a presumption of distortion. This has been viewed as an effort by the Division to reflect the case law governing the conclusion which the Division could prima facie presume, i.e., what it could appropriately do in the absence of facts of record on the issue of distortion. Petitioner noted that the 1983 regulation section 6-2.5, dealing with compulsory combination with non-taxpayers, similarly provided for distortion phrased in the form of the "properly reflect" test. The purpose of the 1983 amendments was clearly not to change the law in this area, but simply to better conform the language of the regulations to the language of the court decisions allowing combined reporting based on distortion as a critical element. This is supported by the intention clearly stated in the regulatory impact statement of the Division accompanying the 1983 amendments to the regulations. Petitioner asserts that the presumption provided for in the regulation, even if it is assumed to be valid despite the absence of any reference to a presumption in the statute, is at most a prima facie presumption that must give way in the face of facts showing the contrary.

Petitioner discusses the relevant case law and states that it follows the statutory and regulatory scheme by mandating that the presence of distortion, while it may be initially presumed from intercompany transactions or an agreement, is a condition that must be met on the whole record before a combined return with a non-New York taxpayer may be required. Petitioner asserts that in this case the facts of record show that a separate return, far from resulting in distortion, produces a more rational reflection of the economic facts. Petitioner believes, in accordance with long-established precedent, that the purpose of requiring and/or permitting a combined return is to avoid the distortion of income which would otherwise result from the filing of separate returns and that all of the circumstances of the intercompany relationship in the particular case must be factually examined to determine the distortion question.

Petitioner asserts that the facts of record demonstrate there is no distortion of petitioner's income and the resulting New York franchise tax liability on a separate company return basis on account of either intercompany transactions or an agreement which distorts income. Thus, accordingly, any prima facie presumption of distortion under the regulations disappears. In addition, the facts of record demonstrate that the combined return with a non-New York taxpayer proposed by the Division creates a massive distortion. Petitioner poses what it believes to be a critical question in this regard: Based on all the facts of record, did the payment of the commission pursuant to the agreement for such sales services cause a distortion in petitioner's income on a separate company basis such that its New York tax could not be properly reflected without the inclusion of the parent, the payer of the commission, in a combined return? The only transaction between the parent and the subsidiary is the payment of the commission pursuant to the agreement for the sales representative services rendered. The testimony and documentary evidence introduced by petitioner regarding the rate of commission, the manner in which it was paid, as well as the issue of separate reporting with regard to the competency and relative credibility, are key factors.

Testimony with regard to the commission paid as well as the brokerage arrangement between Soup and petitioner was presented in testimony by John Cloherty, who is currently the director of sales planning for Campbell Sales. He has maintained a position with the company for approximately 18 years and has had various sales management positions over that period of time. He testified as having worked with food brokers over the past 15 years and currently is required to stay abreast of industry rates pertaining to food companies. He testified that he is familiar with amounts paid by food manufacturers or processors to food brokers such as those who perform services for Campbell Sales. Brokers are used in cases where a particular product line requires additional attention for effective marketing. An independent broker was employed in Hawaii at the rate of 2%. Mr. Cloherty testified as to being a member of the National Food Brokers Association and, through such association, as well as the review of trade journals, he is familiar with the rates other companies pay brokers for handling a similar product line in a similar manner.

Mr. Cloherty was called upon to give an opinion as to whether the rates paid by Soup to petitioner during the years in issue, which ranged from approximately 2.8 to 3.4% were competitive rates. He deemed such rate an "excellent rate" and stated that any broker in the country would be willing to work for those rates. Mr. Cloherty unequivocally stated that Soup would be able to hire a comparable broker to perform comparable services for this commission rate or less in all cases. The independent brokers being referred to, such as those in Hawaii and others in Alaska as mentioned, are not employed by petitioner; however, they do report to Campbell Sales. They are not a division of Campbell Sales, but rather are separate businesses organized on a local basis in the area in which they are employed. Generally, petitioner manages the brokers but the contract for payment is with Soup.

Mr. Cloherty was further questioned regarding the competitiveness of the commission payment. In response to a question with regard to why brokers are not used, to whom less commission would be paid, Mr. Cloherty responded that it is often preferable to have Campbell's own sales people that focus strictly on Campbell products. In a brokerage situation, he testified they have to juggle many more brands at other times of the year and when a company wants to focus the energy of the sales force on particular products, it is often more preferable to work with a direct sales force in terms of focus and control.

Further testimony was provided by Mr. Cloherty regarding the percentage of commission and how it varied according to product. When questioned whether he had any sense of what the range of payment would be to an independent, non-direct broker, he responded that it would probably be in a range from 1½% to 3½ or 4%, but that 4% would be the upper limit of commission paid for brokering by an independent broker for a company like Soup. He was uncertain whether any product lines paid a commission at the upward end of that range. It was also established that an independent broker's commission is computed on the basis of net dollar sales, which is sales less certain price discounts. The testimony of Mr. Cloherty was concluded with the following point: that Campbell Sales does precisely what the other independent sales brokerage companies do, whether they work for Soup or for someone else. The point was made that whether a company such as petitioner works for Soup and has one customer with a well-established line of products or whether they are situated like other brokers working for 10 different food companies with numerous lines of products, the function of the direct sales force is identical to that of the brokerage community.

Petitioner submitted into evidence a report prepared by Price Waterhouse which was explained by the testimony of Michael Gagnon, a CPA and partner with the accounting firm of Price Waterhouse. The report covered the fiscal years in issue and provides an opinion on three issues:

> "1. Whether it is impossible to determine the income and resulting income tax on Campbell Sales on other than a combined basis;

2. Whether it is necessary to combine the parent and subsidiary in order to properly reflect the income and determine the resulting income tax of Campbell Sales; and

3. Whether the income (and resulting income tax) of Campbell Sales as determined by New York State on a combined return basis with its parent, creates a material distortion and results in income and New York income tax based thereon which is out of all proportion to its activities in New York."

Price Waterhouse was presented with the same stipulation of facts introduced in this matter. The report assumes as true, for the purpose of their opinion, facts which are set forth in detail or in summary in the decision of the former New York State Tax Commission regarding Campbell Sales and its fiscal year ended July 31, 1977, the findings of the Commission and additional findings requested by both parties in that proceeding, with limited exceptions, as are incorporated in the Commission's decision, the summary of the underlying facts in the opinion of the Appellate Division in that matter, as well as those summarized in the opinion of the New York State Court of Appeals in the same matter (see, Campbell Sales Company v. State Tax Commission, 68 NY2d 617, 505 NYS2d 54, revg 111 AD2d 995, 490 NYS2d 313, reinstating TSB-H-83[22]C, June 7, 1983). The report is a 25-page report which was submitted as an opinion on the above-referenced questions in the context of customary financial analysis and accepted accounting principles, and normal and customary business practices based on the stated facts which the accounting firm assumes to be true for the purpose of the report. The analysis of the report is divided into two parts:

"A. Whether and to what extent generally accepted accounting principles (GAAP) and other accepted principles and practices provide authoritative guildelines [sic] prescribing how revenues, expenses, net income and related financial statement components should be determined for a separate entity which is part of a larger enterprise so as to measure and report in a manner which fairly and 'properly' reflects the underlying economic realities?

B. Whether the combined report formula applied by the New York State Department of Taxation in determining the income of Sales (and the portion allocable to New York State) fails to fairly and 'properly' reflect the underlying economic realities?"

Mr. Gagnon described himself as having had a wide range of experience in auditing, consulting and accounting work dealing with a variety of industries. The report prepared under the direction of Mr. Gagnon, as well as his testimony, is presented by petitioner in an attempt to overcome the factual finding by the former State Tax Commission that it is impossible to obtain a fair reflection of the tax without requiring combination.

The report indicated that authoritative guidance for preparing separate company financial statements and their components to fairly and "properly" reflect underlying economic realities has been generally prescribed by certain authoritative sources in a variety of contexts. The report summarized the authoritative sources and gives guidance as to how separate company financial data is developed, measured and used. The concepts discussed by the report are as follows:

(1) financial accounting and principles of GAAP (generally accepted accounting principles;

(2) contract accounting;

(3) management accounting;

(4) Security and Exchange Commission guidelines;

(5) bankruptcy accounting;

(6) incentive/bonus plan accounting; and

(7) tax accounting.

Mr. Gagnon uses these authoritative guidelines to demonstrate that guidance exists for the preparation of separate company financial statements. For example, in his discussion of financial accounting and GAAP, the report states that "[t]he single most important concept underlying such principles is that [financial] statements should fairly reflect the underlying economic realities so that the users thereof can make rational business and economic decisions based thereon." GAAP used in the preparation of separate company financial statements are basically the same for any financial statements prepared with such principles as their guidance. As with the application of GAAP and within the contexts of the other examples provided by the report, the effort is to fairly reflect or fully disclose the underlying economic reality. In Conclusion of Point A, the report, in pertinent part, makes the following comments:

> "In these circumstances, it is not in any sense accurate to state that it is 'impossible' to determine the income (or taxes based on income) of a separate

company except on a combined (consolidated) basis with its parent with which it has intercompany transactions. The above authorities demonstrate that, rather, it is not only possible, but necessary for a wide variety of purposes to compute income on a separate company basis rather than on a combined basis. Indeed, for most purposes, it is usually necessary or desirable to compute the separate components, whether it be a separate business, separate corporation or separate division. Such separate accounting is mandated in many cases and necessary or desirable in others. It is done in order to 'properly' and separately reflect the income or activities of a separate company or other entity.

* * *

In our opinion, the notion that, because Sales was part of a unitary group, it was impossible to determine its true income and properly reflect the tax thereon without computing its liability on a combined basis is not based on any facts of which we are aware and is both arbitrary and certainly not impossible."

The report advances the argument under Point B that once it is determined that it is not "impossible" to determine a separate company's income on other than a combined basis in order to properly reflect its income and the resulting tax thereon, the question remains as to whether, in the particular circumstances here, the determination of income of petitioner on a combined basis is necessary to properly reflect its income and tax or whether a proper reflection of such income and tax can be determined on a separate company basis. The report reflects upon the record which establishes that the commission actually paid by Soup to petitioner during the years in issue well exceeds an arm's-length commission that would be paid by one unrelated party to another for a similar service. The report then cites examples of the effect of determining the income and taxes of petitioner on a combined basis as illustrative of the distortion resulting from combined reporting. The report made a comparison between the actual net earnings of Campbell Sales on a separate basis and the imputed earnings as calculated by petitioner.

It is noted that the report prepared by Price Waterhouse does not on its own advance a theory by which imputed income is calculated nor does it comment on the appropriateness of such calculation. It merely uses the imputed figures at face value as presented to the firm in certain exhibits prepared by petitioner. The report then concludes Point B as follows:

"The effect of Campbell Sales Company reporting taxable income to New York State on a combined basis with Campbell Soup Company results in a significant distortion of the sales commission percentage and income of the Sales

> Company and the resulting tax thereon. In our opinion, combined reporting as proposed here causes massive distortions. It departs in an impermissible manner from the basic rule that allocations should be reflective of economic reality and should not be arbitrarily assigned. In our view, the distortion caused by the combined report method would cause such report to be rejected as not properly reflecting income and the resulting tax."

Petitioner acknowledged the prior Campbell Sales decision involving the same parties for a prior year. It was concluded that there were substantial intercompany transactions and the corporations were part of a unitary business in that matter and the Commission further stated that:

> "where the businesses of the corporations are so unified and interassociated (having due regard for their separate corporate existences), a proper reflection of New York franchise tax is impossible without combination." (Matter of Campbell Sales Co., State Tax Commn., June 7, 1983.)

Petitioner asserts that was a conclusion of fact based upon the factfinder's view of the nature and state of proof in that case. Since the issues in this matter are factual ones and since the factual record herein is different, fuller and more complete than in the earlier Campbell Sales decision, petitioner submits it has met the burden of proof imposed upon it.

Petitioner asserts that the actual commission rate paid to petitioner by its parent for the only intercompany transaction does not cause a distortion. The unrebutted evidence in the record indicates that over a long period of years the commission amount has ranged between 2 and 3% of sales and during the years in issue ranged from 2.825% to 3.432%. It has been shown that a commission in this range is equal to and more likely greater than that which would have been paid to an unrelated third party for similar services. In addition, unrelated third-party brokers in Alaska and Hawaii were paid commissions substantially less than such amounts for similar services.

Along the same line, petitioner also advances the argument that the commission rate actually paid would also meet the Internal Revenue Code § 482 test and, under the standards applied by prior cases, would not cause a distortion. Admittedly, a test of whether payments on intercompany transactions caused a distortion or not, as measured by section 482 of the Internal Revenue Code, is not in issue in this matter. However, the basic standard of section 482 is an arm's-length standard, i.e., was the payment between related parties the equivalent to what the payment would have been had the parties not been related? Petitioner asserts this can be answered in the affirmative.

Petitioner spent a considerable amount of time in setting forth its position that the rate proposed by the Division does not cure a distortion but rather creates a massive distortion. The Division did not adjust the amount of commissions paid with respect to the intercompany transactions as such. Petitioner further states that the Division produced no analysis demonstrating that the actual commission rate produced a distortion or that the adjustment proposed by the Division, in the nature of combined returns, corrects a distortion. Thus, to determine the effect of the Division's determination one must work in a reverse direction from known factors to ascertain what the adjustments mean. By way of illustration, petitioner selected the fiscal year 1980 and analyzed the adjustments made by the Division. Such analysis has been extracted from petitioner's brief and is presented below:

> "For purposes of simplicity and illustration, we shall refer to one year only, although each of the six would produce a similar result. We shall use 1980 in which the New York tax on Petitioner on the combined return is $486,830. This is essentially 10% of the entire income of Petitioner allocable to New York of $4,778,547. Using the separate return allocation factor, as determined by the Department of 6.6% for 1980 (and as to which there is not disagreement), would result in entire net income for the Petitioner on its entire nationwide operation of $72,183,489. For convenience, we shall refer to such amount as the imputed income derived directly from the Department's own determination. If that imputed net income is then added to the actual expenses of Petitioner of $42,059,918 incurred and paid to outside, independent third parties, it results in a gross income (or commission income) of $114,243,407 (i.e., net income of $72,183,489 plus $42,059,918 of expenses). This contrasts with the actual gross income (or commission income) of Petitioner for 1980 of $43,242,130. This Department-imputed gross commission income represents 8% of the total sales generated by Campbell Soup (commission income derived by Petitioner divided by total sales of Soup), i.e., an 8% commission on sales as contrasted to the actual commission of 3.0176%, or 265% greater than the actual commission.
>
> If, as is established by the record, the actual commission of 3.0176% of sales is not less than but very probably more than an arm's-length commission, increasing that commission by 265% would have an unmistakeably distortive effect on the net income on which the New York tax is based. In any event, there is absolutely no evidence in the record or elsewhere suggesting that one could reasonably increase the commission by 265%, or from 3% to 8%, to avoid a distortion, particularly here, where no distortion exists in the first place."

Petitioner takes this argument one step further and indicates that if you consider net income itself using the same year, petitioner's entire net income on an imputed basis is increased to $72,183,489.00 in contrast with the actual net income of $1,298,185.00. This represents an increase of entire net income to a level which is over 55 times greater than actual entire net income. A return on sales of 63.2% is contrasted with the actual return on sales of 3%. Portrayed as a percentage of net worth, the Division's proposed net income translates to a return of 2296% on the actual net worth of petitioner in contrast with its actual return on net worth of 38% when efficient and profitable companies are satisfied with 15% on equity.

Petitioner next asserts that the tax imposed by the Division is out of all appropriate proportion to the business transacted by petitioner in New York and, accordingly, violates the due process clauses of the United States and New York State Constitutions. Petitioner sets forth the New York corporate income tax proposed by the Division as compared to the tax that would result on a separate company basis pursuant to a statutory formula as follows:

	1	2	3
FYE	Actual Tax Per Statutory Formula	Tax Per Audit Report	Percentage
7/31/78	9,252	499,563	5,400%
7/31/79	8,799	410,473	4,665
7/31/80	8,568	477,855	5,577
7/31/81	9,177	466,999	5,089
7/31/82	15,904	466,984	2,936
7/31/83	19,318	505,981	2,619

Petitioner states that the Federal constitutional issue presented by this case is whether, through the device of a combined return, the additional tax can be levied on petitioner where it substantively exceeds the limits expressed in the case of Container Corporation of America v. Franchise Tax Board (463 US 159, 77 L Ed 2d 545). Petitioner presented two charts comparing the tax on a separate basis and on a unitary basis in both the cases of Container Corporation and Wurlitzer (supra) where the differences in tax increase ranged from 8½% to 24½%. Petitioner cited Hans Rees' Sons, Inc. v. North Carolina (283 US 123, 75 L Ed 2d 879) where an increase of 250% was held to be objectionable on the grounds that it was "out of all appropriate proportion" to the business done by petitioner in North Carolina. The tax sought to be imposed by the Division in this case is from 26 to 54 times greater than the tax on a separate return basis and, in light of the Supreme Court's guidelines set forth in Container Corporation, it is clear that the tax imposed by the Division on a combined basis far exceeds any fair apportionment and is unconstitutional under Hans Rees' and Container Corporation.

Petitioner also asserts that the Division's proposed assessment violates the fairness doctrine set forth in Container Corporation as it relates to the apportionment formula. Petitioner believes the double weighting of sales receipts by New York State violates the intent of the internal consistency rule set forth in Container Corporation and, as to the external consistency factor referred to in Container Corporation, the application of the New York combined return formula as applied by the Division does not reflect any reasonable view of how income is generated.

SUMMARY OF THE DIVISION'S POSITION

The Division begins its presentation with a brief description of three corollary issues raised by the proceeding:

(1) Whether the Division must determine that the income/capital of Campbell Sales is improperly or inaccurately reflected before the Division may require reporting on a combined basis, or whether combined reporting may be required when it is determined that the statutory and regulatory requirements have been met, i.e., stock ownership, that the corporations are engaged in unitary business and that there are among them substantial intercompany transactions.

(2) Also important is the effect of the 1986 Court of Appeals decision in a matter involving the Division's required combination of petitioner with its parent and related corporations for a prior period.

(3) Also raised is the question whether the tax as imposed against a basis of the allocated combined entire net income of the stated group of corporations is fairly apportioned and reflects the nature and extent of petitioner's business activity in New York State.

The Division presents as its primary argument that Campbell Sales' franchise tax liability for the years in issue, as with its 1977 franchise tax liability, is properly reflected only by reports filed on a combined basis with its parent and several affiliated corporations since these corporations are engaged in the unitary business of manufacture and sale of food products and there are between and among such corporations substantial intercorporate transactions. The Division maintains that the unity of stock ownership by Soup of petitioner and the named affiliates as well as the conceded substantial intercorporate transactions are sufficient bases to permit the Division to require computation of petitioner's franchise tax liability on a combined basis. The presumption of improper reflection of such liability which may arise from the facts of unity of ownership and substantial intercorporate transactions has not been rebutted by the evidence submitted in this proceeding. Further, there is no burden placed on the Division to prove that petitioner's franchise tax liability was not properly reflected when Campbell Sales filed on a separate basis and petitioner has not demonstrated that reporting on a separate basis more properly reflects its tax liability.

The Division asserts that the statutory and regulatory criteria for requiring Campbell Sales to file on a combined basis with Soup and other affiliated corporations have been met. The Division points to Tax Law § 211.4 with regard to the threshold capital stock ownership requirement and the corresponding franchise tax regulations dealing with ownership and control. A taxpayer corporation under Tax Law § 211.4 may be required to compute New York franchise tax liability on a combined basis with a non-New York ("foreign") corporation. The Division notes that the extent of intercorporate transactions between New York and foreign corporations which will precipitate combined reporting is not specifically stated in the statute. Guidance in the form of a threshold of 50% as well as guidelines concerning the form or kind or transaction is offered by the regulations. With that the Division concludes it was proper and reasonable to require Campbell Sales to compute franchise tax liability for the period in issue on a combined basis with its parent, Soup, and several affiliated Soup subsidiaries. Petitioner concedes that the stock ownership and intercompany transaction requirements of the statute, as defined by franchise tax regulation, have been met. The Division alleges that, on the facts presented in this proceeding, the relationship between petitioner, its parent and the affiliates is evidenced by a high degree of intercorporate transactions which demonstrate a "symbiotic relationship to each other and that [the subsidiary is] a vital link in the overall enterprise" (Division's Brief at 15, citing Matter of Campbell Sales Company, 68 NY2d 617, 505 NYS2d 54). Thus, the Division believes that it is appropriate to require petitioner to compute its tax liability on the basis of the allocated combined income of the group and a report filed in this capacity will accurately reflect petitioner's liability.

The Division next asserts that a regulatory presumption of distortion arises from the conceded substantial intercorporate transactions between Soup and petitioner and between Soup and the other subsidiaries. However, "[a] finding that entire net income, or the tax liability of [petitioner] is distorted is neither a statutory nor a regulatory condition precedent to the Division's exercise of discretion to require a combined filing between the taxpayer and its non-taxpayer parent and...affiliates in this case." (Division's Brief at 15.) The Division asserts it is not required to affirmatively identify distortion before mandating combination. The only two alternative "conditions precedent" to the requirement of combination of New York and non-New York filers are intercompany transactions or a section 211.5 agreement. The Division concedes, however, that the cases and the regulations establish that more is required for mandatory or permissive combination than a unity of ownership and unqualified intercorporate transactions. Regulation § 6-2.5 prescribes the conditions for the required combination of taxpayer and non-taxpayer foreign corporations. The Division points to the following language: "...necessary to properly reflect the tax liability of one or more taxpayers included in the group" (20 NYCRR 6-2.5[a]). However, the necessity for combination is established by either the presence of substantial intercorporate transactions or an agreement or arrangement pursuant to section 211.5. The Division articulates that the regulatory scheme for required combination, which includes foreign corporations, does not specify a "presumption" of distortion. The presumption language only appears in provisions which apply to any combination of taxpayers and permissive combination of non-taxpayers. Section 6-2.5, instead, predicates required combination of non-taxpayers on the Division's determination that a proper reflection of petitioner's franchise tax liability requires inclusion of the foreign corporation. Thus, the Division concludes that since the preliminary criteria for all forms of combination are the same, it would not be unreasonable to infer that if the same criteria which gives rise to the stated presumption of distortion in the case of combination of taxpayers and permissive combination of non-taxpayers are present in the circumstances of required combination with non-taxpayers, there is also a presumption of distortion, perhaps in the form of an inference, an inference that flows from the presence of substantial intercorporate transactions. The Division believes such interpretation is consistent with New York case law and can coexist with the specific limitation of the Wurlitzer and former Campbell Sales decisions. The Division submits that distortion is not a condition precedent but rather is, at most, a presumption which arises from the facts of the intercorporate relationship between the entities which are being combined, and whether this presumption is sustained or rebutted is a question of fact.

The Division believes the regulatory presumption of distortion flowing from the facts of unity of ownership and substantial intercorporate transactions is a presumption founded on probability. The Division believes that the situation presented by the facts of this proceeding create a situation where it is entirely probable that the New York franchise tax liability of petitioner will not be properly reported unless the basis against which the liability is computed reflects the allocated income or capital of the combined group. The Division finds this high degree of probability grounded in the following facts of the intercompany relationship:

(1) the fact that the product manufactured by the parent and related subsidiaries is sold to third parties exclusively by the taxpayer corporation;

(2) the fact that the taxpayer is reimbursed by the parent for its exclusive sales function according to an arrangement which is not predicated on actual sales made, but rather on the subsidiary's costs;

(3) the fact that the taxpayer/subsidiary maintains direction and control over the few unrelated agents selling to third parties; and

(4) the fact that the only products sold are those which are manufactured, in whole or in part, by affiliates.

The Division believes it is entitled to the presumption that petitioner's tax liability is inaccurately reflected on reports filed on a separate basis.

Petitioner responds to the Division's claims of distortion on the basis of these other factors. As to (1), petitioner notes that it is Soup or the other manufacturing companies making the sale directly to the customer. Campbell Sales merely acts as a representative in soliciting the sale, and since petitioner receives compensation for such service at an arm's-length or greater rate, there is nothing in the intercompany relationship which distorts petitioner's income.

Regarding the commission arrangement (2), petitioner notes that the Division fails to show why this particular agreement would distort petitioner's income since payments to third parties have been less than amounts paid to Campbell Sales, and not more.

Petitioner does not understand what correlation there is between petitioner maintaining direction and control over the unrelated agents (3) and a distortion of Campbell Sales' income. Lastly, petitioner notes that Soup undoubtedly could employ many companies to represent its products and those of its affiliates, especially in light of its wide name recognition; however, it chooses to deal with one sales representative company, Campbell Sales. If other companies were chosen, they would actually receive less than petitioner. If petitioner represented other manufacturers, its net income would probably be less. Thus, petitioner believes the Division failed to show the significance of this issue in relation to the distortion of income of Campbell Sales.

The Division argues it does not bear the burden of proving that petitioner's franchise tax liability is inaccurately reflected when petitioner files on a separate basis. The Division believes it is the position of petitioner that the burden of going forward to establish that a combined report should be required is upon the Division once petitioner offered the testimony of certain witnesses, a position which the Division argues is without merit. The Division further states that the burden upon petitioner is to establish by the evidence that, notwithstanding all the elements in existence in this case, the New York franchise tax liability is accurately reflected by petitioner's filing on a separate basis. Petitioner may overcome the presumption only by an affirmative showing that a separate filing accurately reflects its New York franchise tax liability and petitioner has not done this in the eyes of the Division. The Division concedes, however, if evidence is presented which establishes that the franchise tax reports of related corporations filed on a separate basis accurately reflect franchise tax liability, there is no presumption of distortion and combination is not required. The Division asserts petitioner has not, on the facts, overcome the presumption that its liability is inaccurately reflected by reports filed on a separate basis. The Division states that Campbell Sales has not overcome a presumption of distortion which arises from the extensive substantial intercorporate transactions between itself, its parent and the Soup subsidiaries.

The Division claims that petitioner's assertion that it is the franchise tax deficiency which results in distortion rather than the undisputed facts of unity of ownership and substantial intercorporate transactions is based upon an unsupported premise that the Division has attributed the combined income of the Soup group to petitioner alone. The Division spoke to the series of computations prepared in support of petitioner's position and noted that similar hypothetical computations were presented at the prior administrative hearing in 1977 which were rejected by the former State Tax Commission. The Division submits that these arguments should similarly be rejected in this proceeding for the following reasons:

(1) The Division claims that petitioner misrepresents the substance of the field audit adjustments. The deficiencies in issue were assessed to Campbell Sales since it is the sole New York taxpayer of the proposed group. The allocated combined entire net income against which franchise tax was applied is that portion of the group's adjusted income allocated by a combined business allocation percentage which reflects the group's activity in the State. The Division asserts that the characterization of the field audit determination as imputing income directly to petitioner is not supported.

(2) The Division submits that the succession of schedules introduced by petitioner is

based upon critical syllogistic errors. The Division points out that petitioner errs in its computations where it proposes as an initial premise that the allocated combined entire net income is "imputed" to petitioner. The first part of the computation performed by the Division is set forth in Finding of Fact "19". Having computed allocated entire net income, petitioner then proposes that the Division has imputed net income to Campbell Sales in accordance with the following computation:

Total Net Income Imputed to Campbell Sales Based on Determination by Department of New York Income Allocated to Campbell Sales

FYE	1 Net Income Allocated to N.Y.S. by Department	2 Separate Return Allocation Factor	3 Imputed Net Income (1 divided by 2)
7/31/78	$4,995,634	9.83%	$50,820,285
7/29/79	4,104,734	8.60	47,729,465
8/03/80	4,778,547	6.62	72,183,489
8/02/81	4,669,992	6.12	76,307,059
8/01/82	4,669,841	6.36	73,425,173
7/31/83	5,059,807	7.61	66,488,922

Imputed net income appearing in Column "3" represents the mechanical application of petitioner's individual business allocation percentage derived from the field audit reports to the group's allocated entire net income. This was not the computation performed by the Division on field audit which is the basis for each deficiency. Many of the succeeding schedules and computations offered by petitioner in support of its position that the Division's combination would cause a massive distortion are premised upon the figures appearing in the chart above. The Division rejects the computations based on imputed net income as inaccurate, irrelevant and unsupported by the record.

The Division asserts that the imposition of franchise tax against combined entire net income of the group allocated to New York State is constitutional and the tax imposed against the income of a group of corporations with nexus to New York is fairly apportioned and does not discriminate against interstate commerce as it is fairly related to the activities of the group within the State. The Division points out that the United States Supreme Court in review of state taxation of the income of a combined or consolidated group of corporations has considered whether the challenged tax provisions met general commerce clause requirements. Four tests have been applied as articulated by the Court in Complete Auto Transit, Inc. v. Brady (430 US 274). The tests set forth in Complete Auto are as follows:

(1) whether the activity or event to which the tax is applied has a substantial nexus with the taxing state;

(2) whether the tax is fairly apportioned;

(3) whether the tax discriminates against interstate commerce; and

(4) whether the tax is fairly related to services provided by the state.

The Division asserts the tax imposed against petitioner meets these requirements for the following reasons:

(a) petitioner, doing business in New York, has nexus with the State sufficient to subject it to the franchise tax;

(b) the tax is fairly apportioned by application of combined allocation percentages to the specific tax bases; that is, the tax reflects the degree of the group's business transacted in New York; and

(c) the franchise tax does not, per se, discriminate against interstate commerce and, as applied, in this matter is fairly related to services provided by New York.

The Division reviewed the case law and its commentary on the concept of "unitary business" where the courts examine the facts which explicate the relationship between the corporations being combined. The Division noted that state courts have been accorded a fair degree of latitude in their articulation of activities which will evidence that a unitary business exists between in-state and out-of-state corporations. The general constitutional proscriptions on a state's taxation of interstate commerce is as follows:

(1) there must be a "minimal connection" or "nexus" between the taxing jurisdiction and the interstate activities; and

(2) there must be a rational relationship between the income attributed to the particular state and the intrastate values of the specific enterprise.

The Division asserts that Tax Law § 211.4 is constitutional. The New York provisions are in accord with parameters established by the U.S. Supreme Court in decisions which have addressed the constitutionality of a state's application of the unitary business principle and the Division believes that requiring petitioner to compute franchise tax liability on a combined basis with the related corporations is constitutional and consistent with the principles expressed by the Supreme Court.

The affidavit of Francis Magann, Tax Manager of Soup, was introduced into evidence by petitioner to clarify certain amounts as furnished to the Division which reflected property related to Soup as being located in New York State during the fiscal years ended July 31, 1978 through July 31, 1980. The resulting effect of the affidavit is that the property factor on Soup's tax returns for the years stated should reflect zero. Correspondence dated February 11, 1983 from Soup's Manager of State and Local Taxes to the company's attorney explains the items in question as follows:

> "The 7/77 figure, $263,701, was reported in error. It represents cookbooks which were in fact in Minnesota. The 7/78 figure of $108 represents a small lot of refused product which was returned to the sending plant and not sold to customers. The 7/79 figure represents $206 of refused product subsequently returned to the shipping plant and two premium items, recipe boxes and training books, which were produced in New York and held for distribution outside the state."

The recipe boxes and training books purchased from a New York manufacturer were temporarily located at the manufacturer's plant until the time of shipment. Soup recorded the purchase before receipt and believes it should have correctly excluded the items from inventory as property in transit to a destination outside New York, thereby excluding them from the numerator of the property factor.

The items of refused product represented merchandise which had been rejected by a customer and was either on its way back to New Jersey or in the process of being destroyed if defective. Soup believes it to be excludible as merchandise in transit, the destination of which was outside New York State.

Appendix "B" represents a schedule attached to the affidavit which shows the correct treatment of the property. The Division does not dispute the accuracy of the explanation for these changes and agrees that the property factor for Soup in those years should reflect zero.

CONCLUSIONS OF LAW

A. Tax Law § 211.4 provides, in part, as follows:

> "In the discretion of the tax commission,[3] any taxpayer, which owns or controls either directly or indirectly substantially all the capital stock of one or more other corporations...may be required or permitted to make a report on a combined basis covering any such other corporations...; provided, further, that no combined report covering any corporation not a taxpayer shall be required unless the tax commission deems such a report necessary, because of intercompany transactions, or some agreement, understanding, arrangement or transaction referred to in subdivision five of this section, in order properly to reflect the tax liability under this article."

B. The following corporation franchise tax regulations promulgated by the former State Tax Commission on August 31, 1976, applicable to tax years beginning on or after January 1, 1976, were in effect during the period in issue and provided, in pertinent part, as follows:

> "6-2.1 General (Tax Law, § 211, subd. 4). -- (a) The reporting requirements of article 9-A contemplate that each corporation is a separate taxable entity and shall file its own report. However, the Tax Commission, in its discretion, may require a group of corporations to file a combined report or may grant permission to a group of corporations to file a combined report where the requirements of stock ownership or control are met. In addition, in deciding whether it will require or permit combined reporting, the Tax Commission will consider whether the group of corporations is engaged in a unitary business and whether there are substantial intercorporate transactions among the corporations.
>
> (b) Each corporation in the combined report must compute and show the tax which would have been required to be shown if filed on a separate basis.
>
> 6-2.2 Initial Requirement -- Capital Stock (Tax Law, § 211, subd. 4). -- (a) In deciding whether to permit or require a group of corporations to file a combined report, the Tax Commission will first determine whether:
>
> (1) the taxpayer owns or controls, either directly or indirectly, substantially all of the capital stock of all the other corporations which are to be included in the combined report;
>
> (2) substantially all of the capital stock of the taxpayer is owned or

---

3

Effective September 1, 1987, under Tax Law § 2026 references to the State Tax Commission in the Tax Law, in all instances other than in relation to the administration of the administrative hearing process, are deemed to refer to the Division of Taxation or Commissioner of Taxation and Finance.

controlled, either directly or indirectly, by other corporations which are to be included in the combined report;

(3) substantially all of the capital stock of the taxpayer and substantially all of the capital stock of the other corporations which are to be included in the combined report are owned or controlled, either directly or indirectly, by the same interests.

* * *

6-2.3 Other Requirements -- Exercise of Discretion (Tax Law, § 211, subds. 4 and 5). -- (a) After the requirement described in section 6-2.2 of this Subpart has been met, the Tax Commission may permit or require a group of corporations to file a combined report if this method of reporting properly reflects the activities in New York State of the corporations. If the income or capital of a taxpayer is improperly or inaccurately reported because of intercorporate agreements, understandings or arrangements, the Tax Commission may permit or require the corporations to file a combined report. In deciding whether to permit or require combined reports the following two (2) broad factors must be met:

(1) the corporations are in substance parts of a unitary business conducted by the entire group of corporations, and

(2) there are substantial intercorporate transactions among the corporations.

(b) In deciding whether each corporation is a part of a unitary business, the Tax Commission will consider whether the activities in which the corporation engages are related to the activities of the other corporations in the group, such as:

(1) manufacturing or acquiring goods or property for other corporations in the group; or

(2) selling goods acquired from other corporations in the group; or

(3) financing sales of other corporations in the group.

The Tax Commission will consider a corporation to be a part of a unitary business if it is engaged in the same or related lines of business as the other corporations in the group, such as:

(4) manufacturing similar products; or

(5) performing similar services; or

(6) performing services for the same customers.

(c) In determining whether the substantial intercorporate transaction requirement is met, the Tax Commission will consider only transactions directly connected with the business conducted by the taxpayer, such as described in paragraph (1), (2), or (3) of subdivision (b) of this section. Service functions, such as accounting, legal, and personnel will not be considered. The substantial intercorporate transaction requirement may be met where as little as fifty percent (50%) of a corporation's receipts are from any qualified activities. It is not necessary that there be substantial intercorporate transactions between any one member with every other member of the group. It is, however, essential that there be substantial intercorporate transactions among all members of the combined group.

(d) The decision to permit or to require a combined report or to require separate reports must be based on the facts in each case... [examples omitted].

6-2.5 Corporations Not Required or Permitted to File a Combined Report (Tax Law, § 211, subd. 4). -- (a) A foreign corporation not subject to tax will not be required to be included in a combined report unless the requirement described in section 6-2.2 of this Subpart has been met and the Tax Commission determines that inclusion is necessary to properly reflect the tax liability of one or more taxpayers included in the group because of:

(1) intercorporate transactions; or

(2) some agreement, understanding, arrangement or transaction whereby the activity, business, income or capital of any taxpayer is improperly or inaccurately reflected [example omitted]."

C. The regulations were amended by new provisions filed November 30, 1983 effective for all taxable years ending on or after December 31, 1983, which are still in effect. While these regulations were not in effect during the period at issue herein, it is noted that the Tax Appeals Tribunal, in Matter of Autotote, Ltd. (Tax Appeals Tribunal, April 12, 1990), applied same to a period which would have been covered by the 1976 regulations. The current regulations provide, in pertinent part, as follows:

"6-2.1 General. [Tax Law, § 211(4)] (a) Every corporation is a separate taxable entity and shall file its own report. However, the Tax Commission, in its discretion, may require a group of corporations to file a combined report or may grant permission to a group of corporations to file a combined report where:

(1) the requirement of stock ownership or control (as described in section 6-2.2[a] of this Part) is met;

(2) the group of corporations is engaged in a unitary business (as described in section 6-2.2[b] of this Part); and

(3) the other requirement set forth in section 6-2.3 or section 6-2.5(a) of this Part, as the case may be, has been met.

(b) Each corporation in the combined report must compute and show the tax which would have been required to be shown if filed on a separate basis.

(c) The decision to permit or require a combined report will be based on the facts in each case using the requirements set forth in this Part.

6-2.2 Capital stock and unitary business requirements. [Tax Law, § 211(4)]

(a) Capital stock requirement. (1) In deciding whether to permit or require a group of corporations to file a combined report, the Tax Commission will first determine whether:

(i) the taxpayer owns or controls, either directly or indirectly, substantially all of the capital stock of all the other corporations which are to be included in the combined report; or

(ii) substantially all of the capital stock of the taxpayer is owned or controlled, either directly or indirectly, by other corporations which are to be included in the combined report; or

(iii) substantially all of the capital stock of the taxpayer and substantially all of the capital stock of the other corporations which are to be included in the combined report are owned or controlled, either directly or indirectly, by the same interests.

* * *

(b) Unitary business requirement. (1) In deciding whether a corporation is part of a unitary business, the Tax Commission will consider whether the activities in which the corporation engages are related to the activities of the other corporations in the group, such as:

(i) manufacturing or acquiring goods or property or performing services for other corporations in the group; or

(ii) selling goods acquired from other corporations in the group; or

(iii) financing sales of other corporations in the group.

(2) The Tax Commission, in deciding whether a corporation is part of a unitary business, will also consider whether the corporation is engaged in the same or related lines of business as the other corporations in the group, such as:

(i) manufacturing or selling similar products; or

(ii) performing similar services; or

(iii) performing services for the same customers [examples omitted].

6-2.3 Other requirement. [Tax Law, § 211(4) and (5)].

* * *

(b) If the requirements described in section 6-2.2 of this Part have been met, the Tax Commission may permit a corporation which is not a taxpayer to be included in a combined report if reporting on a separate basis distorts the activities, business, income or capital of one or more taxpayers. (For rules for requiring a corporation which is not a taxpayer to be included in a combined report, see subdivision [a] of section 6-2.5 of this Part.) The activities, business, income or capital of a taxpayer will be presumed to be distorted when the taxpayer reports on a separate basis if there are substantial intercorporate transactions among the corporations.

(c) In determining whether there are substantial intercorporate transactions, the Tax Commission will consider transactions directly connected with the business conducted by the taxpayer, such as:

(1) manufacturing or acquiring goods or property or performing services for other corporations in the group;

(2) selling goods acquired from other corporations in the group;

(3) financing sales of other corporations in the group; or

(4) performing related customer services using common facilities and employees.

Service functions will not be considered when they are incidental to the business of the corporation providing such service. Service functions include, but are not limited to, accounting, legal and personnel services. The substantial intercorporate transaction requirement may be met where as little as 50 percent of a corporation's receipts or expenses are from one or more qualified activities described in this subdivision. It is not necessary that there be substantial intercorporate transactions between any one member with every other member of the group. It is, however, essential that each corporation have substantial intercorporate transactions with one other corporation or with a combined or combinable group of corporations. [Example omitted.]

* * *

6-2.5 Corporations not required or permitted to file a combined report. [Tax Law, § 211(4)] (a) A foreign corporation not subject to tax will not be required to be included in a combined report unless the requirements described in section 6-2.2 of this Part have been met and the Tax Commission determines that inclusion is necessary to properly reflect the tax liability of one or more taxpayers included in the group because of:

(1) substantial intercorporate transactions (see subdivision (c) of section 6-2.3 of this Part); or

(2) some agreement, understanding, arrangement or transaction whereby the activity, business, income or capital of any taxpayer is improperly or inaccurately reflected [example omitted]."

20 NYCRR 6-2.5 was not changed in any significant way by the promulgation of the 1983 regulations. Thus, whether the 1976 or 1983 regulations are applied in the instant matter is not of any consequence. Though the regulations in effect during the periods in issue, i.e., the 1976 regulations, are correctly applied, the similarity between the two versions for this purpose makes the issue academic.

D. Mandatory combination of non-New York taxpayers with New York taxpayers and the circumstances under which the Division can require a combined filing among such corporations has been a hotly contested issue in the area of New York State corporation franchise tax. Numerous cases involving this issue have been dealt with by the New York State Court of Appeals including a prior tax year of this petitioner. At the heart of the matter is the issue of "distortion", a term which is undefined by the regulations. The regulations provide that the Division cannot require a nontaxpayer to file a combined report unless it finds that certain ownership and unitary business tests are met and that inclusion is necessary to properly reflect the tax liability of the taxpayers because of the existence of either substantial intercorporate transactions or specifically defined agreements. Although the Division has attempted in prior matters to argue a position which essentially places New York under a classic unitary tax jurisdiction rather than a limited unitary tax jurisdiction by requiring nontaxpayer combination where a unitary business exists without the resolution of the distortion issue, the Tax Appeals Tribunal, in its February 6, 1992 decision of Matter of Standard Manufacturing Company, Inc. (hereinafter "Standard II"), rejected the position taken by the Division that the question of income distortion is not applicable where the Division seeks to require combination between a nontaxpayer and a taxpayer corporation on the basis of substantial intercorporate transactions between them.

Standard II involved a New York corporation and a Delaware subsidiary corporation located in Puerto Rico. The taxpayer conceded there were substantial intercorporate transactions between it and the subsidiary and that the two corporations were part of a unitary business. The taxpayer argued, however, that it should not be required to file combined returns with the subsidiary since a combined report was neither necessary to truly reflect income nor avoid distortion. The Division took the position in that matter that the question of distortion is not applicable where the Division seeks to require combination between a nontaxpayer and a taxpayer corporation on the basis of substantial intercorporate transactions between them and relied on the following language in Campbell for its position:

> "as we made clear [in Wurlitzer] 'it is not a condition precedent that the income or capital of the taxpayer be improperly or inaccurately reflected' before the Commission may exercise [its] discretion [under Tax Law § 211(4)] and require combined reports because of intercompany transactions" (Matter of Campbell Sales

Co. v. State Tax Commn., supra, 505 NYS2d at 55).

The Wurlitzer case involved a parent corporation conducting a manufacturing operation in New York and its out-of-state subsidiary which provided financing by purchasing the parent's receivables. The parent performed all of the duties involved in collecting the receivables and received a fee from the subsidiary for doing so. All of the activities were carried out by employees of the parent since the subsidiary had no employees of its own. The taxpayer argued that the former State Tax Commission could not require a combined report because Tax Law § 211, subdivisions (4) and (5), require a showing of unfair transactions between two corporations in this position as a prerequisite to a combined report. The Commission argued that it need not show that the intercompany transactions were unfair as between the two corporations but rather that such transactions result in an inaccurate reflection of the entire net income of the taxpayer. The Appellate Division affirmed the Tax Commission finding:

> "that the purpose of subdivisions 4 and 5 of section 211 is to prevent the distortion of the net income of a taxpayer. Such distortion, so as to inaccurately reflect the taxpayer's entire net income, can occur either through intercompany transactions or an unfair agreement. There is nothing in the statute or its legislative history which mandates a showing that intercompany transactions were unfair as a prerequisite to requiring a combined report. The instant case is proof of this proposition" (Matter of Wurlitzer Co. v. State Tax Commn., supra, 346 NYS2d at 475; emphasis added).

The Court of Appeals affirmed as follows:

> "[t]he use in subdivision 4 of the word 'or' with reference to subdivision 5, under which the Commission, where it appears that a taxpayer's income within the State is improperly or inaccurately reflected, may, in its discretion, require combined reports or may include fair profits in entire net income, makes it clear that when the Commission acts pursuant to the power conferred by subdivision 4, it is not a condition precedent that the income or capital of the taxpayer be improperly or inaccurately reflected. The statute envisions and covers separate situations.
>
> * * *
>
> "On this record, the Commission could properly conclude that separate reports would not accurately reflect the taxable income or the taxable liability. Neither in the statute nor the regulations promulgated under it, is there any requirement of 'unfairness' in transactions between the affiliated corporations.... Requiring a combined report is an accurate reflection of the income which is subject to taxation" (Matter of Wurlitzer Co. v. State Tax Commn., supra, 358 NYS2d at 766; emphasis added).

E. The prior case involving this petitioner, Campbell Sales Company v. State Tax

Commission (supra), involved essentially the same basic set of facts with regard to the relationship between the corporations sought to be combined by the Division in this matter. The State Tax Commission in that case did not make a specific finding that Campbell Sales' income was improperly reflected or as to what would be a proper share of income to New York. It held that the corporations' business dealings with each other were so intertwined that an accurate calculation of Campbell Sales' New York income was impossible without its combination with Soup. The Tax Commission stated as follows:

> "[w]here the businesses of corporations are so unified and interassociated (having due regard for their separate corporate existences), a proper reflection of their New York franchise tax liability is impossible without combination."

The Commission's decision was reversed by the Appellate Division where the Court stated that there was no evidence in the record to support the Division's position that the calculation of tax, based on the returns filed by the taxpayer, improperly reflected its liability and noted the fact that the Commission arrangement was based on arm's-length rates. The Appellate Division did not address the Tax Commission's conclusion that it was impossible to compute separate tax liabilities because of the intercompany transactions. The Court of Appeals reversed the Appellate Division in Campbell Sales and reinstated the Commission's decision without dwelling on the relationship of the corporations stating that "a proper reflection of...New York franchise tax liability is impossible without combination" and found that to be a rational conclusion. It is interesting and perhaps noteworthy to mention the fact that when the Tax Commission concluded that "a proper reflection of their New York franchise tax liability is impossible without combination", it used the term "their" presumably referring to petitioner, its parent and the other subsidiaries even though the only corporation bearing a New York franchise tax liability was Campbell Sales. Although the Court of Appeals deferred to the expertise of the administrative body in that case, it deleted the word "their" in its approval of the Tax Commission's conclusion presumably recognizing the fact that it is not "their" franchise tax liability that was in issue.

Judge Kaye vigorously dissented from the New York State Court of Appeals' holding in

Campbell Sales. She argued that the majority opinion ignored the requirement of the statute that a combined report must be necessary to properly reflect the tax liability of the parties. She indicated that the Commission's statement that accurate, separate reporting of each corporation's income would be "impossible" was merely a legal conclusion and that the Division should be required to give reasons for its conclusions.

F. Approximately six months after the Court of Appeals decided Campbell Sales it unanimously affirmed the judgment of the Appellate Division in the Matter of Standard Manufacturing Company, Inc. v. State Tax Commission ("Standard I") (114 AD2d 138, 498 NYS2d 724, affd 69 NY2d 635, 511 NYS2d 229, appeal dismissed 481 US 1044) for the reasons stated in the Appellate Division opinion. The Appellate Division found that the undisputed facts set forth in the record provided ample evidence to support the Tax Commission's conclusion that petitioner and its subsidiary were engaged in a unitary business and had substantial intercorporate transactions. With that conclusion the Court then reasoned:

> "[W]e turn next to the ultimate question of whether, under all of the circumstances of the intercompany relationship in this case, combined reporting fulfills the statutory purpose of avoiding distortion of and more realistically portraying true income. In answering this question, no single factor is decisive (Matter of Coleco Indus. v. State Tax Commn., 92 AD2d 1009, 461 NYS2d 462). Here, in view of the substantial extent and nature of the intercorporate transactions between [parent and subsidiary], we conclude that combined reporting would, in this case, result in a more realistic portrayal of true income, thus avoiding any distortion" (Id. at 141.)

G. In its most recent decision in this area, the Tax Appeals Tribunal views Campbell, Wurlitzer and the Division's regulations as supporting the conclusion that:

> "the existence of intercorporate transactions is sufficient to allow the Division to require filing on a combined basis; that the Division does not, as a 'condition precedent' to such requirement, have to show that such transactions were unfair; but that the taxpayer does have the opportunity to show that filing on a combined basis is not necessary to properly reflect tax liability." (Standard II, supra.)

The Tribunal in Standard II did not find support for the conclusion that the existence of a unitary business and substantial intercorporate transactions creates an irrebutable presumption that a combined report is necessary in order properly to reflect tax liability. Thus, the Tribunal concluded that the issue of whether the Division properly required combination is not resolved simply by the finding that there were substantial intercorporate transactions. The inquiry must be extended to determine whether sufficient evidence was introduced to show that income would be properly reflected if reported on a separate basis.

H. Petitioner also discussed two former State Tax Commission cases, Matter of Digital Equipment Corporation (State Tax Commission, October 14, 1985) and Matter of Boehringer Ingelheim Pharm. (State Tax Commission, April 30, 1986), whereby the former Commission took the position that the existence of intercorporate transactions between a taxpayer and nontaxpayer did not result in a finding that filing on a combined basis was necessary to properly reflect tax liability. In Digital, the IRS had conducted an extensive examination of the corporations' tax returns and required adjustments under section 482 of the Internal Revenue Code for the taxable years that were in issue in the New York State tax case. The Commission held that the section 482 adjustments of the Internal Revenue Service, after an extended audit, insured that arm's-length standards were met and held that "combined reports were not necessary in order to properly reflect Digital's franchise tax liability". Although Digital involved a unique situation with facts not likely to frequently repeat, the significance of the case is the determination that combination will not be required where the taxpayer can accurately compute its New York tax liability with the use of a measuring rod that the Division views is as reliable as an extensive IRS audit involving section 482 adjustments.

In Boehringer, a combination was not required where the transactions between a New York parent corporation and its non-New York subsidiary were conducted pursuant to an agreement that had been negotiated in its original state by independent parties and later assumed by the parent and the subsidiary. The Commission was convinced that the arm's-length nature of the arrangement between the corporations was sufficient to conclude that combination was not necessary to accurately reflect each corporation's income.

Having set forth the pertinent statute, regulations and case law, the query at this point must turn to whether petitioner has introduced sufficient evidence to show that its income would be properly reflected if reported on a separate basis from Soup.

I. The parties are in complete agreement that the corporations under scrutiny in this case are engaged in a unitary business and maintain substantial intercorporate transactions. The parties also agree there is at least an inference of distortion that may even rise to the level of a presumption that exists in the regulatory language "necessary to properly reflect the tax liability...." There is much discussion about the presumption, though ultimately there is no dispute between the parties that the presumption is rebuttable notwithstanding the existence of a unitary business relationship and substantial intercorporate transactions. The parties, however, differ on their opinion as to whether the evidence introduced was sufficient to show that the income and resulting tax liability of Campbell Sales would be properly reflected if reported on a separate basis. A review of the evidence follows.

J. Petitioner focuses a significant portion of its evidence on the question of whether the payment of the commission pursuant to the agreement caused a distortion in petitioner's income on a separate company basis such that its New York tax liability could not be properly reflected without the inclusion of Soup and other subsidiaries. The arrangement between Soup and petitioner was converted to a commission-equivalent rate which ranged between 2.8 and 3.4% for the periods in issue. Testimony was provided by John Cloherty, director of sales planning for Campbell Sales. Mr. Cloherty presented a straightforward and informed opinion as to the rate of commission paid to independent food brokers and unequivocally offered favorable comments regarding the competitiveness of the rate paid by Soup to petitioner. He presented himself as having long-term experience with food brokers and an expertise in the food industry. Through his membership in the National Food Brokers Association and by frequently reviewing trade journals he testified that he remains knowledgeable about the industry and maintains his familiarity with rates charged under like arrangements. He confidently fielded questions regarding utilization of a direct sales force versus independent broker organizations vis-a-vis the commission arrangement, the role of product lines in the formulation of a commission rate, and the range of rates likely to be paid to an independent broker of a company with a Soup-type product line. Mr. Cloherty's credible testimony was sufficiently persuasive to conclude that Campbell Sales, with a direct sales force, essentially functions in the same manner as does an independent broker organization and receives payment at an arm's-length competitive rate for such services.

The parties' stipulation of fact agrees upon the autonomy of Campbell Sales, the existence of the long-standing agreement between Soup and petitioner, the expression of that agreement as a percentage of Soup's sales and the arm's-length characterization of the compensation. The Division did not refute Mr. Cloherty's testimony by the introduction of other evidence or conflicting testimony.

K. Petitioner also introduced a report prepared by Price Waterhouse and offered the testimony of Michael Gagnon, a partner with the same firm, to explain the nature of the report and its conclusions. The testimony of this witness was offered for the purpose of overcoming the factual finding by the former Tax Commission that it is impossible to obtain a fair reflection of the tax liability without combining these companies. Mr. Gagnon was qualified as an expert in financial accounting matters and presented his opinion by way of examples he referred to as authoritative guidelines that demonstrate the usefulness of separate company financial data and financial statements. The common element throughout these illustrations is that separate company reporting in the various contexts seeks to attain a fair reflection of the underlying economic reality. In general terms, the report concluded that it was not in any sense accurate to state that it is impossible to determine income (or taxes) of a separate company except on a combined basis with its parent where intercompany transactions exist. In addition, it is necessary for many reasons to report on a separate basis rather than combined to properly reflect the activities of the separate entity. The report concluded that the former Commission's statement regarding the "impossibility" of proper reflection was arbitrary.

In addressing its second point, Mr. Gagnon testified that, for purposes of the report, the accounting firm adopted at face value the calculations presented by petitioner with respect to imputed income amounts. Neither Mr. Gagnon nor the report commented on the calculations made by petitioner, though it is believed by his presentation that Mr. Gagnon adopted such calculations as valid. The report concluded in this regard that combined reporting causes massive distortion and impermissibly departs from the rule that allocations should reflect economic reality.

Mr. Gagnon's credible testimony and the report prepared by his firm certainly support petitioner's position in this matter. Although both speak to separate reporting in more general terms and in other contexts, the finer points regarding the disclosure of economic reality, which are at the heart of the illustrations, is essentially what "proper reflection of the tax liability" also seeks to achieve.

Although the Division initially objected to the relevancy of Mr. Gagnon's testimony, he was ultimately recognized as a qualified expert in his field and little challenge was made to the substance of his testimony about the report prepared under his direction.

L. Petitioner, though noting that an Internal Revenue Code § 482 test was absent in this matter, advances the argument that the commission rate paid by Soup to petitioner would meet the basic arm's-length standard imposed by section 482. Treasury Regulation § 1.482-1(b)(1) sets forth the scope and purpose of this provision as follows:

> "The purpose of section 482 is to place a controlled taxpayer on a tax parity with an uncontrolled taxpayer, by determining, according to the standard of an uncontrolled taxpayer, the true taxable income from the property and business of a controlled taxpayer. The interests controlling a group of controlled taxpayers are assumed to have complete power to cause each controlled taxpayer so to conduct its affairs that its transactions and accounting records truly reflect the taxable income from the property and business of each of the controlled taxpayers. If, however, this has not been done, and the taxable incomes are thereby understated, the district director shall intervene, and, by making such distributions, apportionments, or allocations as he may deem necessary of gross income, deductions, credits, or allowances, or of any item or element affecting taxable income, between or among the controlled taxpayers constituting the group, shall determine the true taxable income of each controlled taxpayer. The standard to be applied in every case is that of an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer."

The basic premise of these rules is that, in any transaction involving a controlled group, the party receiving a benefit must provide adequate reimbursement to the party furnishing the benefit. If the parties fail to transact in this manner, the Internal Revenue Service may adjust items within the group by applying an arm's-length charge or price to the transaction.

One of the goals of section 482 is to achieve a proper reflection of the taxable income of the members of the group by the utilization of allocation rules or formulas that, when applied, result in an arm's-length transaction. Clearly, the flavor of section 482 is consistent with the goal of avoiding distortion by the implementation of arm's-length standards between related parties. In Standard II, the section 482 adjustment introduced into evidence to establish arm's-length pricing was as the result of an Internal Revenue Service audit change made to tax years prior to those in issue in that case. The taxpayer offered testimony to support its position that the formula being used retained its economic validity for the years in issue and resulted in an arm's-length transaction. The Tribunal in Standard II affirmed the finding of the Administrative Law Judge that the taxpayer offered "sufficient proof to show that its intercorporate transactions with [its subsidiary] were at arm's-length and that reporting on a separate basis resulted in a proper reflection of petitioner's tax liability."

The Division did not refute or offer any comments on this argument.

M. The Tax Law requires more than a mere finding that affiliated corporations are engaged in a unitary business and have substantial intercorporate transactions to require combination. The case law, especially the recent Standard II decision, have brought us to that point. Given New York's limited unitary tax jurisdiction, absent an expansion of the regulations or more detailed definitions of pertinent terms, the creation of a factual record which is sufficient to overcome allegations of distortion is critical. Petitioner herein has created a record of documents and testimony which, taken in its entirety under these facts and circumstances, meets the burden placed upon it to show that a separate filng would properly reflect the tax liability of Campbell Sales, and that inclusion of the parent and subsidiary corporations is not necessary to achieve proper reflection.

The record as developed in this matter carries significant weight when evaluating the effect of the prior Campbell decision. Given this body of evidence and testimony, and proper application of the distortion standard, I do not believe the same conclusion would be reached today by the adjudicators.

N. Petitioner asserted in further support of its position that the Division's determination, when reduced to a commission rate, does not cure a distortion, but rather creates a massive distortion. Petitioner argued that, to determine the effects of the Division's adjustments, one has to work in reverse order from the tax as computed to a commission rate that would have been paid to produce a certain level of income resulting in such tax. Finding of Fact "43" sets forth the mathematics employed by petitioner to support its position.

The Division asserts that petitioner misrepresents the substance of the field audit adjustments by characterizing what the Division has done as attributing the combined income of the group to petitioner alone. The Division explains that the allocated combined entire net income against which franchise tax was applied is that portion of the group's adjusted income allocated by a combined business allocation percentage which reflects the group's activity in the State. The Division claims the computation of an imputed net income amount which is then used in further computations is unsupported and irrelevant. Thus, the Division rejects all computations set forth by petitioner that were intended to show that combination results in massive distortion.

The Division asserts that such computations were offered and rejected by the former Tax Commission in the prior Campbell case. The conclusions of that decision did not address them at all. However, there should at least be a brief discussion of the impact of such computations on this determination. The computations performed by petitioner do not necessarily show that the Division's determination would result in a massive distortion. Petitioner manipulated numerics to result in grossly distorted comparisons. Though it is perhaps possible to do, petitioner did not successfully prove a massive distortion with these computations. However, the failure of these computations to show massive distortion is not detrimental to petitioner's position since petitioner has clearly carried its burden of showing a separate filing will properly reflect its tax liability in New York.

O. Petitioner's constitutional argument regarding the resulting tax imposed in this matter is premised upon a required combination by the Division. Since it has been determined herein that petitioner may file on a separate basis, the unconstitutionality of required combination becomes academic.

It is presumed at the administrative level that statutes are constitutional; thus, petitioner's constitutional challenges to the New York statutory apportionment formula are not herein addressed.

P. In accordance with the information contained in the affidavit of Francis Magann (see Finding of Fact "53" and Appendix "B"), corresponding adjustments where pertinent should be reflected.

Q. The petitions of Campbell Sales Company are granted and the refund claims for the fiscal years ending July 31, 1978, July 29, 1979, August 3, 1980, August 2, 1981, August 1, 1982 and July 31, 1983 are hereby granted in their entirety.

DATED: Troy, New York

ADMINISTRATIVE LAW JUDGE

APPENDIX "A"

CAMPBELL SALES COMPANY

New York State Corporation Franchise Tax Report

Schedule A - Taxpayer's Calculation of Tax

The amount of the tax computed on the basis of reapportionment of income as between the taxpayer and its parent company, allocated to the State of New York on the basis of expenses incurred in New York:

FYE July 30, 1978

FYE July 29, 1979

1. Campbell Soup Company sales

$1,132,113,195

$1,250,218,670

2. Amount computed thereon for apportionment purposes at agreed-on rate as follows:

4% of sales, plus the number of percentage points by which advertising expenses fall short of 3½% of sales but not exceeding 5%

a. Advertising expenses	$ 59,258,257
	$ 57,559,031
b. Sales	$1,132,113,195
	$1,250,218,670
c. Advertising expenses %	5.2%
	4.6%
d. Amount under 3.5%	--
	--
e. Agreed-on rate for period	
	4%
	4%
	$ 45,284,528
	$ 50,008,147

3. Expenses of the Company (as per Federal Income Tax Return)

	<u>35,289,519</u>
	<u>38,552,041</u>
4. Amount computed for apportionment	
	$ 9,995,009
	$ 11,456,706
5. Total expenses of the taxpayer (exclusive of state franchise taxes)	$ 35,090,187
	$ 38,471,040
6. Amount of expense incurred with relation to New York State (Exclusive of franchise tax)	$ 2,818,852
	$ 3,181,436
7. Percentage relation of New York expense to total expense	
	<u>8.033163</u>
	<u>8.269691</u>

8. Product of line 4 multiplied by line 7	$ 802,915	$ 947,434
9. Computation of tax @ 10%	~~$ 80,292~~	~~$ 94,743~~
Net Income of Campbell Soup Company for fiscal period	$ 85,478,898	$ 97,315,430

APPENDIX "A" (cont.)

CAMPBELL SALES COMPANY

New York State Corporation Franchise Tax Report

Schedule A - Taxpayer's Calculation of Tax

The amount of the tax computed on the basis of reapportionment of income as between the taxpayer and its parent company, allocated to the State of New York on the basis of expenses incurred in New York:

	FYE August 3, 1980	FYE August 2, 1981
1. Campbell Soup Company sales	$1,267,523,587	$1,319,926,335
2. Amount computed thereon for apportionment purposes at agreed-on rate as follows:		
4% of sales, plus the number of percentage points by which advertising expenses fall short of 3½% of sales but not exceeding 5%		
a. Advertising expenses	$ 65,100,187	$ 80,614,594
b. Sales	$1,267,523,587	$1,319,926,335
c. Advertising expenses %	5.1%	6.1%

d. Amount under 3.5%	--		--	
e. Agreed-on rate for period		4%		4%
		$ 50,700,943		$ 52,797,053
3. Expenses of the Company (as per Federal Income Tax Return)		42,059,918		45,346,699
4. Amount computed for apportionment		$ 8,641,025		$ 7,450,354
5. Total expenses of the taxpayer (exclusive of state franchise taxes)	$ 41,954,916		$ 45,292,214	
6. Amount of expense incurred with relation to New York State (Exclusive of franchise tax)	$ 3,117,084		$ 3,116,761	
7. Percentage relation of New York expense to total expense		7.429604		6.881144
8. Product of line 4 multiplied by line 7		$ 641,994		$ 512,670
9. Computation of tax @ 10%		~~$ 64,199~~		~~$ 51,267~~
Net Income of Campbell Soup Company for fiscal period		$ 119,478,433		$ 114,588,307

APPENDIX "A" (cont.)

CAMPBELL SALES COMPANY

New York State Corporation Franchise Tax Report

Schedule A - Taxpayer's Calculation of Tax

The amount of the tax computed on the basis of reapportionment of income as between the taxpayer and its parent company, allocated to the State of New York on the basis of expenses incurred in New York:

	FYE August 1, 1982	FYE July 31, 1983
1. Campbell Soup Company sales	$1,421,393,656	$1,642,787,881
2. Amount computed thereon for apportionment purposes at agreed-on rate as follows:		
4% of sales, plus the number of percentage points by which advertising expenses fall short of 3½% of sales but not exceeding 5%		
a. Advertising expenses	$ 107,010,628	$ 123,106,101
b. Sales	$1,421,393,656	$1,642,787,881
c. Advertising expenses %	7.5%	7.5%

d. Amount under 3.5%	--		--	
e. Agreed-on rate for period		4%		4%
		$ 56,855,746		$ 65,711,515
3. Expenses of the Company (as per Federal Income Tax Return)		50,473,177		59,131,398
4. Amount computed for apportionment		$ 6,382,569		$ 6,580,117
5. Total expenses of the taxpayer (exclusive of state franchise taxes)	$ 50,428,843		$ 59,090,081	
6. Amount of expense incurred with relation to New York State (Exclusive of franchise tax)	$ 3,896,644		$ 5,945,431	
7. Percentage relation of New York expense to total expense		7.727014		10.061640
8. Product of line 4 multiplied by line 7		$ 493,182		$ 662,068
9. Computation of tax @ 10%		~~$ 49,318~~		~~$ 66,207~~
Net Income of Campbell Soup Company for fiscal period		$ 65,019,291		$ 124,507,932

APPENDIX "B"

CAMPBELL SOUP COMPANY - New York Inventory

Average From Audit Report	8/1	7/31	TOTAL
FYE 7/31/78			
Reported in error - Item actually in Minnesota	263701		
Refused Product		108	
TOTAL	~~263701~~	~~108~~	~~263809~~ divided by 2 = ~~131905~~
FYE 7/31/79			
Refused Product	108	206	
Purchase Price - Premium Items [Recipe boxes and training books pruchased from New York manufacturer on hand at their			

plant at year end awaiting

shipment out of state] 62500

TOTAL ~~108~~ ~~62706~~ ~~62814~~ divided by 2 =

~~31407~~

FYE <u>7/31/80</u>

Refused Product 206

Purchase Price - Premium Items

[Recipe boxes and training

books purchased from New York

manufacturer on hand at their

plant at beginning of year

awaiting shipment out of state] 62500

TOTAL ~~62706~~ ~~0~~ ~~62706~~ divided by 2 =

~~31353~~