STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
ALLIEDSIGNAL INC., AS SUCCESSOR-IN-INTEREST TO THE BENDIX CORPORATION	:	DETERMINATION DTA NO. 806120
	:	
for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Fiscal Years Ended September 30, 1981 and September 30, 1982	: .:	

Petitioner, AlliedSignal Inc., as successor-in-interest to The Bendix Corporation, 101 Columbia Road, Morristown, New Jersey 07962, filed a petition for redetermination of a deficiency or for refund of corporation franchise tax under Article 9-A of the Tax Law for the fiscal years ended September 30, 1981 and September 30, 1982.

On July 30, 1993 and August 12, 1993, respectively, petitioner, appearing by Paul H. Brownstein, Esq., and the Division of Taxation by William F. Collins, Esq. (Anne W. Murphy, Esq., of counsel) consented to have the instant controversy determined on submission without hearing. Documentary evidence was submitted by the Division of Taxation on September 28, 1993. Petitioner submitted its brief on October 28, 1993. The Division of Taxation by William F. Collins, Esq. (Robert Tompkins, Esq., of counsel) submitted its brief on December 23, 1993 and petitioner filed its reply brief on January 21, 1994. After review of the entire record, Thomas C. Sacca, Administrative Law Judge, renders the following determination.

ISSUE

Whether the business presence and activities in New York State of corporations whose securities generated investment income for petitioner provide the requisite nexus for the State's tax on the investment income.

FINDINGS OF FACT

Stipulated Facts

The parties have stipulated and agreed that, for purposes of this action, the following statements shall be accepted as facts; provided, however, that either party may object to the admission of such facts into evidence on the grounds of materiality or relevance and either party may offer other further evidence not inconsistent with this stipulation. All references to exhibits have been deleted.

This matter concerns the correct amount of New York State franchise tax payable by The Bendix Corporation ("Bendix") for its fiscal years ending September 30, 1981 and September 30, 1982.

As of January 1, 1983, Bendix was acquired by and became a wholly-owned subsidiary of Allied Corporation ("Allied"). Bendix was merged into Allied as of April 1, 1985. Allied was merged into its parent, AlliedSignal Inc. ("AlliedSignal"), as of September 30, 1987. AlliedSignal, petitioner herein, is the successor-in-interest to Bendix and is liable for any New York State franchise tax assessed against Bendix for the periods in question.

On or about August 12, 1982, Bendix timely filed a New York State Corporation Franchise Tax Report, Form CT-3, for its fiscal year ending September 30, 1981. On or about August 15, 1983, Bendix timely filed a New York State Corporation Franchise Tax Report, Form CT-3, for its fiscal year ending September 30, 1982. For both of these reports, Bendix computed its New York franchise tax against an allocated entire net income basis, pursuant to Tax Law § 210.3. On both of these reports, Bendix excluded from its computation of entire net income certain income which Bendix received which the corporation believed could not, under the United States Constitution, be made subject to the franchise tax imposed by New York State.

The New York State Department of Taxation and Finance, Division of Taxation ("Division"),[1] by two notices of deficiency dated September 25, 1987, asserted franchise tax

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[1]The term "Respondent" appearing in the Stipulation of Facts has been replaced by the "Division" to comply with 20 NYCRR 3000.1(c).

deficiencies against Bendix in the base tax amount of $494,135.00 for Bendix's fiscal year ending September 30, 1981 (the "1981 fiscal year") and in the base tax amount of $219,223.00 for Bendix's fiscal year ending September 30, 1982 (the "1982 fiscal year").

The deficiencies resulted from various adjustments made by the Division to Bendix's fiscal 1981 and fiscal 1982 franchise tax reports. Among those adjustments was the restoration to Bendix's allocated entire net income of all income Bendix had excluded therefrom as set forth in Finding of Fact "3".

On or about November 23, 1987, petitioner timely filed a Request for Conciliation Conference with the Bureau of Conciliation and Mediation Services ("BCMS") of the Division, with respect to the two notices of deficiency.

A conciliation conference was held on May 12, 1988 before BCMS. On or about July 8, 1988, a Conciliation Order was issued by the

conciliation conferee. The Conciliation Order sustained the two notices of deficiency in all respects.

On October 3, 1988, petitioner timely filed a petition with the Division of Tax Appeals. The petition was received by the Division of Tax Appeals on October 11, 1988. By that petition, petitioner protested the Conciliation Order and the notices of deficiency that the Conciliation Order sustained.

On February 3, 1989, the Division timely filed its answer to the petition.

In this proceeding, petitioner renews its objections to the inclusion of certain items of income in Bendix's entire net income in the calculation of Bendix's franchise tax liability for the 1981 and 1982 fiscal years. The items of income which petitioner maintains are not subject to taxation by New York State are the following:

	FYE 9/30/81	FYE 9/30/82
Net gains from the sale of stock or securities in:		
Asarco Inc.	$211,513,354.00	

Lockheed Corporation		$6,012,275.00
General Dynamics Corporation		70,895.00
Dividends from stock or securities in:		
Asarco Inc.	2,795,187.00	
RCA		356,004.00
Total	$214,308,541.00	$6,439,174.00

Petitioner accepts, for purposes of this proceeding, the Division's restoration to Bendix's entire net income of all items of income other than those set forth in Finding of Fact "10". Petitioner also accepts, for purposes of this proceeding, all other adjustments (other than the restoration to entire net income of the income set forth in Finding of Fact "10") made by the Division to Bendix's fiscal 1981 and 1982 franchise tax reports.

In 1987, the Division completed a field audit of the books and records of Bendix as they pertained to Bendix's New York franchise tax reports for fiscal years 1981 and 1982.

On field audit, the Division included the income set forth in Finding of Fact "10" as investment income, pursuant to Tax Law § 208.6. Further, the Division allocated this income by an adjusted investment allocation percentage pursuant to Tax Law § 210.3(b). For the 1981 fiscal year, the Division determined the adjusted New York investment allocation percentage to be 4.355%; for the 1982 fiscal year, the Division determined the adjusted New York investment allocation percentage to be 11.0085%.

Bendix was incorporated under the laws of the State of Delaware in 1929 as a manufacturer of aviation and automotive parts. Over the years, Bendix developed into a multinational corporation with activities, either directly or through subsidiaries or other operating units, in all 50 states and 22 foreign countries. Bendix's core businesses expanded along several basic lines so that by the 1970's there were four major Bendix operating groups or sectors: (a) automotive, (b) aerospace/electronics, (c) industrial/energy and (d) forest products.

At all times relevant to this proceeding, Bendix's corporate headquarters and commercial domicile were in Southfield, Michigan.

At all times relevant to this proceeding, Bendix's activities within New York State were those conducted by its International Group, a division of Bendix, at rented offices in Manhattan, and those conducted by manufacturing facilities of the following four Bendix divisions: the Electrical Components Division of Bendix's aerospace/electronics group in Sidney, New York; the Engine Products Division of Bendix's aerospace/electronics group in Sidney, New York; the Fluid Power Division of Bendix's aerospace/electronics group in Utica, New York; and the Friction Materials Division of Bendix's automotive group in Troy, New York.

Asarco Inc. ("Asarco") is a New Jersey corporation with its principal offices in New York City. Asarco is one of the world's leading producers of nonferrous metals.

Both Bendix and Asarco were corporations that did business, employed capital, owned property and maintained offices in New York State during the tax periods in issue.

From December 1977 through November 1978, Bendix acquired 20.6% of Asarco's common stock, through purchases on the open market and by purchase from Asarco.

During its 1981 fiscal year, Bendix received $2,795,187.00 in dividends from its investment in Asarco. Prior to the end of that same fiscal year, Bendix sold its Asarco stock back to Asarco, realizing a gain of $211,513,354.00.

At all times relevant to this proceeding, Bendix was not involved, either directly or indirectly, in the nonferrous metal production business, or any other business activity, in which Asarco was involved.

All statements of fact contained in the opinion of the United States Supreme Court in <u>Allied-Signal Inc., as successor-in-interest to The Bendix Corporation v. Director, Division of Taxation</u> (504 U.S. ___, 112 S Ct 2251, 119 L Ed 2d 533 [1992]) are incorporated herein by reference.

All statements of fact contained in the opinion of the New York Court of Appeals in <u>Allied-Signal Inc. v. Commissioner of Finance</u> (79 NY2d 73, 580 NYS2d 696, 588 NE2d 731 [1991]) are incorporated herein by reference.

In or about 1981, Bendix began considering a major acquisition of a high technology company. Bendix began making open market purchases of stock in companies that Bendix viewed as potential acquisition candidates. Among these companies were RCA, Lockheed Corporation ("Lockheed") and General Dynamics Corporation ("General Dynamics").

In or about 1982, Bendix decided to attempt to acquire Martin Marietta Corporation. During its 1982 fiscal year, Bendix sold its stock in Lockheed and General Dynamics and realized capital gains of $6,012,275.00 and $70,895.00, respectively. During its 1982 fiscal year, Bendix received $356,004.00 in dividends from its investment in RCA.

During the period that Bendix held its investments in RCA, Lockheed and General Dynamics, Bendix and each of those three corporations were unrelated business enterprises. Bendix's businesses and activities had nothing to do with the businesses and activities of RCA, Lockheed or General Dynamics. Bendix did not control RCA, Lockheed or General Dynamics in any way, and RCA, Lockheed and General Dynamics did not control Bendix in any way. Bendix's investments in RCA, Lockheed and General Dynamics did not serve any function related to or benefiting Bendix's business operations.

All of Bendix's activities connected with the planning for, effectuation and management of its investments in Asarco, RCA, Lockheed and General Dynamics took place at its corporate headquarters in Southfield, Michigan.

The Division considered Bendix's dividend and capital gain income from its investments in Asarco, Lockheed, General Dynamics and RCA to be investment income within the meaning of Tax Law § 208.6. The Division included that dividend and capital gain income in its calculation of Bendix's allocated entire net income for the 1981 and 1982 fiscal years.

SUMMARY OF THE PARTIES' POSITIONS

Petitioner maintains that the Division may not impose a tax on capital gains or dividends that a non-domiciliary corporation receives from an investment in another corporation, unless petitioner is engaged in a unitary business with such other corporation or the investment was made for purposes related to the business operations of petitioner.

In a related argument, petitioner contends that the Division may not impose a tax on income that is not fairly related to petitioner's income-producing activities in the State.

Petitioner relies for support on Allied-Signal Inc., as successor-in-interest to The Bendix Corporation v. Director, Division of Taxation (supra; hereinafter referred to as "Allied-Signal NJ").

The Division maintains that the presence and activities in New York of the issuers of the investments provides the necessary basis for imposing tax on the income at issue, relying on Allied-Signal Inc. v. Commissioner of Finance (supra; hereinafter referred to as "Allied-Signal NYC").

The Division also contends that the Division of Tax Appeals does not have jurisdiction to rule on the questions presented in this matter because it does not have jurisdiction to rule on the facial constitutional validity of a statute.

CONCLUSIONS OF LAW

A. Addressing the issue of the jurisdiction of the Division of Tax Appeals as it relates to issues of constitutionality, the Tax Appeals Tribunal stated, in Matter of Brussel (Tax Appeals Tribunal, June 25, 1992), as follows:

> "The jurisdiction of this Tribunal, as prescribed in its enabling legislation, does not encompass challenges to the constitutionality of a statute on its face [Matter of Wizard Corp., Tax Appeals Tribunal, January 12, 1989; Matter of Fourth Day Enterprises, Tax Appeals Tribunal, October 27, 1988]. At this level of review we presume that statutes are constitutional."

In contrast, the Tax Appeals Tribunal has considered whether the application of a valid statute to a particular set of facts violates the constitution (see, Matter of General Electric Co., Tax Appeals Tribunal, March 5, 1992). Therefore, although not empowered to determine the constitutionality of Tax Law § 210.3(b), the issue of its constitutional application will be examined.

B. New York State imposes an annual tax on all corporations for the privilege of exercising a corporate franchise, doing business, employing capital, owning or leasing property or maintaining an office in the State (Tax Law § 209). The tax is usually based upon a taxpayer's "entire net income", which is generally the same as the taxpayer's Federal taxable income with certain modifications, less income from investments in subsidiary corporations

(Tax Law §§ 208[9]; 209). Once entire net income is determined, it is separated into "investment income", which is income from investments in stocks, bonds and other securities, and "business income". Business income is entire net income less investment income (Tax Law § 208[5], [6], [8]).

The portion of a taxpayer's business income allocable to New York State is determined by multiplying the taxpayer's total business income by its "business allocation percentage" ("BAP") (Tax Law § 210.3[a]). The BAP represents the arithmetic average of the ratios of the taxpayer's receipts, payroll and property values within New York State to those of the corporate taxpayer as a whole.

A corporate taxpayer's investment income, in contrast, is allocated to New York State by multiplying the taxpayer's total investment income by its "investment allocation percentage" ("IAP") (Tax Law § 210.3[b]). Unlike the taxpayer's BAP -- which reflects the taxpayer's own activities in the State -- the taxpayer's IAP reflects the degree of New York State presence of the issuers of the securities in which the taxpayer has invested (i.e., the corporations which have generated the taxpayer's investment income).

The taxpayer's IAP is determined by first multiplying the amount of each of the taxpayer's investments by the percentage of the issuer's entire capital allocated to the State on the issuer's own New York State return, if any, for the preceding year. The amounts thus determined, i.e., the portion of each of the taxpayer's investments apportioned to New York by each such issuer's allocation percentage, are then added together and divided by the taxpayer's total investments, yielding the taxpayer's IAP (Tax Law § 210.3[b]). It is this percentage that is utilized to apportion the taxpayer's investment income to New York State.

C. A fundamental constitutional principle of state taxation holds that a state has the right to tax income earned by a business activity conducted within its own borders because the state has afforded protection and benefits to that activity. It follows that a state is permitted to tax income earned within its borders when it is subsequently received in the form of dividend, interest or capital gain by investors in the income-producing entity (International Harvester Co.

v. Wisconsin Dept. of Taxation, 322 US 435, 88 L Ed 1373 [1944]; Wisconsin Dept. of Taxation v. J. C. Penney Co., 311 US 435, 85 L Ed 267 [1940]).

In Allied-Signal NYC, the New York Court of Appeals, relying upon the above-cited cases, upheld a New York City statute which taxed investment income received by a nondomiciliary corporate taxpayer. The New York State statute, Tax Law § 210.3(b), has substantially the same provisions as the New York City statute, Administrative Code of the City of New York § 11-604, which was at issue in Allied-Signal NYC and which dealt with the same circumstances of including investment income received by the same nondomiciliary corporate taxpayer from an investment in a corporation doing business in New York State. As petitioner claims that Allied-Signal NYC is no longer valid following the U.S. Supreme Court's decision in Allied-Signal NJ, a review of the New York Court of Appeals' decision in Allied-Signal NYC is appropriate.

D. The court began its analysis in Allied-Signal NYC by stating the basic requirement of the Due Process and Commerce Clauses that applies to a state or municipal statute taxing income of corporations that do business or earn income in multiple jurisdictions. The Due Process and Commerce Clauses prevent a state or municipality from taxing the income that a nondomiciliary corporation earns unless there is some "minimal connection" or "nexus" between the income and the taxing jurisdiction (Allied-Signal v. Commr. of Fin., supra, citing Container Corp. v. Franchise Tax Bd., 463 US 159, 77 L Ed 2d 545; Exxon Corp. v. Wisconsin Dept. of Revenue, 447 US 207, 65 L Ed 2d 66).

The court, in considering this requirement, stated the issue to be whether the business activities conducted in New York City by ASARCO -- the corporation which generated Bendix's investment income -- provided the requisite nexus for the City's imposition of a tax on a portion of that income. The exact same factual setting occurs in the present matter: New York State's statute is taxing the investment income received by petitioner (Bendix) from its investments in ASARCO, RCA, Lockheed and General Dynamics based upon the activities in New York State of these issuing corporations.

The Court of Appeals agreed with the City's position that the activities of ASARCO provided the requisite nexus with New York City. The court stated:

> "In determining whether a sufficient nexus exists between a taxing jurisdiction and the income it seeks to tax, the Supreme Court has emphasized that the inquiry should focus upon whether 'the taxing power exerted . . . bears fiscal relation to protection, opportunities and benefits given by the state. The simple but controlling question is whether the state has given anything for which it can ask return.' (Wisconsin v. Penney Co., 311 US 435, 85 L Ed 267; Norwalk & W. Ry. Co. v. Tax Commn., 390 US 317, 19 L Ed 2d 1201)." (Allied-Signal v. Commr. of Fin., supra, at 82.)

The court added that New York City has afforded privileges and opportunities to ASARCO which contributed to ASARCO's capital appreciation and thus inured to the benefit of its shareholders, including Bendix. Therefore, the City gave Bendix something for which it could ask return, and a sufficient nexus existed between the investment issuer, ASARCO, and New York City to support the City's tax on income generated by ASARCO and received by Bendix.

The court found support for its conclusion in International Harvester Co. v. Wisconsin Dept. of Taxation (supra) where the Supreme Court upheld the Wisconsin Privilege Dividend Tax. The court stated that the Wisconsin tax worked very similarly to the New York City tax on investment income in that both were imposed on nondomiciliary shareholders based on the presence in the taxing jurisdiction of the corporation which generated the investment income sought to be taxed. In International Harvester, the Supreme Court stated:

> "[A state] may impose the burden of the tax . . . upon the stockholders who derive the ultimate benefit from the corporation's [state] activities. Personal presence within the state of the stockholder-taxpayers is not essential to the constitutional levy of a tax taken out of so much of the corporation's [state] earnings as is distributed to them. A state may tax such part of the income of a non-resident as is fairly attributable either to property located in the state or to events or transactions which, occurring there, are . . . within the protection of the state and entitled to the numerous other benefits which it confers . . . . And the privilege of receiving dividends derived from corporate activities within the state can have no greater immunity than the privilege of receiving any other income from sources located there." (Id., at 441-442.)

The Court of Appeals stated that this language was a clear rejection of the notion that the taxing power exerted by a state had to be premised on Bendix's own activities within the state (Allied-Signal v. Commr. of Fin., supra, at 83).

The court next addressed the taxpayer's alternative argument that the tax imposed by the

City was nevertheless unconstitutional since it did not fairly reflect Bendix's own presence and activities in the City, that it was "out of all appropriate proportion to the business transacted in [the City]" (citing Hans Rees' Sons v. North Carolina, 283 US 123, 75 L Ed 879), and "led to a grossly distorted result" (citing Norfolk & W. Ry. Co. v. Tax Commn., supra). The court dismissed this argument because it was premised on a fallacy that the tax had to be fairly related to Bendix's own activities within the City. The court explained that since this tax is premised on the presence of ASARCO in the taxing jurisdiction, the tax needs to fairly relate to the activities of ASARCO within the City -- not the activities of Bendix. The court stated that such a focus is constitutionally required, citing Trinova Corp. v. Michigan Dept. of Treasury (498 US 358, 112 L Ed 2d 884 [the tax imposed "'must actually reflect a reasonable sense of how the income is generated'" (quoting Container Corp. v. Franchise Tax Bd., supra)]), Goldberg v. Sweet (488 US 252, 102 L Ed 2d 607 [the tax imposed must "reasonably reflect the in-state component of the activity being taxed"]) and Woolworth Co. v. Taxation and Revenue Dept. (458 US 354, 73 L Ed 2d 819 ["the income attributed to a state for tax purposes must be rationally related to 'values connected with the taxing State'"]) (Allied-Signal v. Commr. of Fin., supra, at 84-85).

As with the New York City statute, the New York State tax on investment income is based on the presence and activities in the State of the corporation or corporations which generated the investment income sought to be taxed. The degree of presence and activities of ASARCO, Lockheed, RCA and General Dynamics in New York determines the proper portion of investment income to be taxed. The issuer's allocation percentage in Tax Law § 210.3(b) is a numerical measurement of the degree of each investment-issuing corporation's presence in New York State and this percentage limits the investment income taxable by New York to the amount fairly attributable to their presence and activities in New York.

Just as New York City afforded privileges and opportunities to ASARCO in Allied-Signal NYC, the State of New York afforded privileges and opportunities to ASARCO, RCA, Lockheed and General Dynamics which contributed to their capital appreciation and earnings, and thereby inured to the benefit of their shareholders, including Bendix. Since New York State gave these investment issuers something for which it can ask return, sufficient nexus existed between the investment issuers and New York State to support New York State's tax on the portion of investment income that benefited from privileges and opportunities afforded by New York State. As stated by the Supreme Court in International Harvester Co. v. Dept. of Taxation (supra, at 442):

> "[A state] may constitutionally tax the [state] earnings distributed as dividends to the stockholders. It has afforded protection and benefits to [the corporation's] activities and transactions within the state. These activities have given rise to the dividend income of [the corporation's] stockholders and this income fairly measures the benefits they [i.e., the stockholders] have derived from these [state] activities."

E. The New York State Court of Appeals decision in Allied-Signal NYC is not contrary to the U.S. Supreme Court decision in Allied Signal NJ because the New Jersey statute[2] looked to Bendix, as the investor, for nexus while the New York City statute,[3] similar to the New York State statute at issue, looked to ASARCO as the source of the investment income. In Allied-Signal NJ, the Supreme Court reviewed New Jersey's taxation of investment income received by Bendix, a nondomiciliary corporation, and decided that New Jersey did not have the requisite nexus or contact to include the capital gain income Bendix received from the sale of ASARCO stock in the apportionable tax base (i.e., income to be allocated by Bendix's business allocation percentage). The Supreme Court held that this income could be included in the apportionable tax base if there was a unitary business relationship between Bendix and ASARCO, or if the gain resulted from a capital transaction which served an operational rather than an investment function. The court found that neither circumstance existed (Allied-Signal v. Director, supra,

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[2]Under New Jersey's tax statute, entire net income (defined in NJ Stat Ann § 54:10A-4[k] as "total income from all sources . . . and shall include gain derived from the employment of capital, or labor . . .") was allocated by an allocation factor which was the average of the three fractions representing the portion of property, receipts and wages within New Jersey, similar to New York's business allocation percentage in Tax Law § 210.3(a) (NJ Stat Ann § 54:10A-6).

[3]Administrative Code § 11-604.

119 L Ed 2d at 552).

The Supreme Court's decision on New Jersey's inclusion of the capital gain in the apportionable tax base is unrelated to New York State's (and New York City's) method of taxing investment income. New York State's tax law concerning investment income, which is the same as the New York City tax law

on investment income that was reviewed in Allied-Signal NYC (supra), taxes investment income according to the presence and activities of the investment issuer in New York State. In contrast, the New Jersey tax on investment income reviewed in Allied-Signal NJ was based upon the presence and activities of Bendix, as the result of including the investment income in a base which was apportioned on the basis of Bendix's own activities in New Jersey. Therefore, the focus of the Supreme Court with respect to the nexus issue was only on the activities of Bendix and whether the investment income had the requisite relationship to those activities.

It is the position of petitioner that Allied-Signal NJ has, in effect, overruled Allied-Signal NYC. The Court of Appeals did not believe this to be the case as it indicated that the New Jersey case (as decided by the New Jersey Supreme Court, 125 NJ 20, 592 A2d 536), was distinguishable (Allied-Signal v. Commr. of Fin., supra, at 81, n. 11).

F. Petitioner initially points to a segment of the New York Court of Appeals decision where the court found Mobil Oil Corp. v. Commissioner of Taxes (445 US 425, 63 L Ed 510), ASARCO v. Idaho State Tax Commn. (458 US 307, 73 L Ed 2d 787) and F. W. Woolworth Co. v. Taxation and Revenue Dept. of New Mexico (458 US 354, 73 L Ed 2d 819) distinguishable from the case before it because those decisions dealt with a nondomiciliary state's ability to apportion income derived from investments in corporations that themselves had no connection with the taxing jurisdiction. ASARCO conducted business and owned property in New York City. Petitioner argues that, since ASARCO was conducting business in New Jersey in the Allied-Signal NJ case, and the Supreme Court found that there was not the required nexus to include the investment income from ASARCO in the apportionable business income of Bendix, Allied-Signal NYC is no longer good law.

It must be noted that the cases relied upon by petitioner (Mobil Oil, ASARCO, F. W. Woolworth and Allied-Signal NJ) are distinguishable from the present matter in that they were concerned with tax statutes which allocated investment income based on the taxpayer's (investor's) activity in the taxing jurisdiction. In the present matter, however, the allocation is based on the investment issuer's activity in the taxing jurisdiction. As the Court of Appeals stated, in reference to the Supreme Court cases relied upon by petitioner:

> "The State in each case relied solely on the corporate taxpayer's own presence within the borders as providing the state with a sufficient nexus with the 'foreign source' income that it sought to tax." (Allied-Signal v. Commr. of Fin., supra, at 81.)

In contrast, the court stated, in comparing the situation in Allied-Signal NYC with that presented in International Harvester Co. v. Dept. of Taxation (supra), that:

> "Both [taxes at issue] were imposed on nondomiciliary shareholders based on the presence in the taxing jurisdiction of the corporation which generated the investment income sought to be taxed." (Allied-Signal v. Commr. of Fin., supra, at 83.)

Both the New York City and State statutes are different from the cases relied upon by petitioner in that they apportion investment income on the basis of the activity of the corporation which generated the investment income, and that activity is measured by the issuer's allocation percentage.

The absence from the New Jersey tax statute of a method of taxing investment income similar to New York State's resulted in the Supreme Court in Allied-Signal NJ having no opportunity and no reason to consider ASARCO's activities in New Jersey as the basis for the necessary nexus between the state and the investment income. The Court, therefore, did not have the opportunity to discuss the precedents in Wisconsin v. J. C. Penny Co. (supra) and International Harvester Co. v. Wisconsin Dept. of Taxation (supra), which provide support to a tax statute like New York's. The Court was limited to considering the issue of the nexus of the investment income to Bendix's activities in New Jersey, as the statute apportioned the investment income on the basis of Bendix's activities in New Jersey.

G. Petitioner claims that the Court of Appeals was also influenced by its belief that the Supreme Court had never indicated that the existence of a unitary business relationship was the exclusive means of establishing the necessary nexus with the state. According to petitioner, a unitary business and the operational function standard are the only bases for the necessary nexus, relying on the Supreme Court's statement in Allied-Signal NJ that:

> "We agree that the payee and the payor need not be engaged in the same unitary business as a prerequisite to apportionment in all cases . . . . What is required instead is that the capital transaction serve an operational rather than an investment function." (Allied-Signal v. Director, supra, 119 L Ed 2d at 552.)

It is petitioner's position that this statement limits the methods of establishing nexus and that the Court of Appeals went beyond that limit in finding nexus through ASARCO. Therefore, petitioner concludes, nexus cannot be established in the present matter.

The Supreme Court decision does not state or imply that a state may not look to the activity of the issuer of an investment to establish the requisite nexus between income and activity within the state. Instead, the decision only addresses the rules for nexus which are appropriate where a state attempts to apportion investment income on the basis of activity in the state by the investing corporation. The decisions in Wisconsin v. J. C. Penney Co. (supra) and International Harvester Co. v. Wisconsin Dept. of Taxation (supra) established that the requisite nexus can result from the relationship between the activity of the investment-issuing corporation in the taxing state and the investment income. It was these cases which the Court of Appeals relied upon in Allied-Signal NYC in finding the necessary nexus because of the similarities in the taxing structures found in all three cases.

The correct context of the sentence requiring that investment income be for an operational function is that if a state wants to include passive income in income apportioned based on the investor corporation's presence in the taxing state, then where there is not a unitary relationship, the capital transaction must serve an operational rather than an investment function.

Petitioner contends that the Allied-Signal NYC decision is no longer good law because Allied-Signal NJ does not mention or even suggest that the in-state presence of the issuer of an investment can support the apportionment of income from the investment. In further support of its position, petitioner points out that there was no mention of the International Harvester Co. (supra) decision or any other decision suggesting that nexus could be provided by the activities of the payor of the income in question. As previously discussed, there was no reason for the Supreme Court to consider International Harvester Co. (supra) as the New Jersey tax statute was different from that of New York's. The Supreme Court in Allied-Signal NJ was concerned only with the question of a state's power to include capital gain in the business income of a nondomiciliary corporation where it would be apportioned under a formula based upon the activities of that corporation within the state. However, Allied-Signal NJ did mention Wisconsin v. J. C. Penney Co. (supra) for the principle that a state's power to tax an activity is justified by the "protection, opportunities and benefits the state confers on those activities." In Wisconsin v. J. C. Penney Co., the Supreme Court upheld the Wisconsin Privilege Dividend Tax which was again the subject of constitutional challenge in International Harvester Co. (supra).

H. It is the contention of petitioner that the income actually taxed by the State does not fairly reflect the activities of Bendix within the State. The Court of Appeals responded to similar arguments presented in Allied-Signal NYC by explaining that because it held that the New York City statute looks to the activity of the issuer corporation in New York, the income taxed should be fairly reflective of the activities of ASARCO in New York. Similarly herein, the statute at issue looks to the activity of the issuer corporation in New York, so that the income taxed is fairly reflective of the activities of ASARCO, General Dynamics, Lockheed and RCA. The amount that is subjected to New York tax is fairly reflective of and appropriately proportionate to the activity of those companies within New York as the result of New York's use of their issuers' allocation percentages in computing the taxable portion (Tax Law § 210.3[b]).

I. The petition of AlliedSignal Inc., as successor-in-interest to The Bendix Corporation, is denied, and the notices of deficiency issued on September 25, 1987 are sustained.

DATED: Troy, New York
July 21, 1994

/s/ Thomas C. Sacca
ADMINISTRATIVE LAW JUDGE