STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition of MOHASCO CORPORATION for Redetermination of Deficiencies or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Years 1984 through 1986.	:	
In the Matter of the Petition of MOHASCO CARPET CORPORATION for Redetermination of Deficiencies or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Years 1984 through 1986.	:	DETERMINATION DTA NOS. 808901 AND 808956

Petitioners, Mohasco Corporation and Mohasco Carpet Corporation, 4401 Fair Lakes Court, Fairfax, Virginia 22033-3898, filed petitions for redetermination of deficiencies or for refund of corporation franchise tax under Article 9-A of the Tax Law for the years 1984 through 1986.

A consolidated hearing was held before Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, Riverfront Professional Tower, 500 Federal Street, Troy, New York, on May 29, 1992 at 9:30 A.M., with all briefs to be filed by August 31, 1992. Petitioners filed a brief on July 14, 1992 and August 31, 1992. The Division of Taxation filed a brief on August 18, 1992. Petitioners appeared by Philip J. Vecchio, Esq. The Division of Taxation appeared by William F. Collins, Esq. (James Della Porta, Esq., of counsel).

ISSUE

Whether the Division of Taxation properly denied petitioners permission to file combined franchise tax reports for the years 1983, 1984 and 1985.

FINDINGS OF FACT

Petitioner Mohasco Corporation ("Mohasco") filed combined franchise tax reports with its subsidiary, petitioner Mohasco Carpet Corporation ("Carpet"), for the years 1984, 1985 and 1986.

The Division of Taxation ("Division") conducted an audit of the combined franchise tax reports of Mohasco and Carpet over the course of five days at Mohasco's offices in Fairfax, Virginia. In total, the auditor attributed 62 hours to the conduct of the audit at issue herein. Of the total number of hours charged to the audit, 57 hours were charged to Mohasco and 5 hours were charged to Carpet. In the course of the audit, the auditor reviewed petitioners' New York returns, Federal consolidated returns, allocations, workpapers, supporting documents for the returns and annual reports. The auditor was not denied access to any documents he requested.

During the audit, the auditor ascertained that Mohasco did not engage in advertising or distributing of goods on behalf of Carpet. Further, it was the auditor's understanding that Mohasco did not purchase goods or products from Carpet or finance sales of Carpet. Lastly, the auditor did not see any indication that Mohasco engaged in product design or research and development on behalf of Carpet.

The auditor found that more than 95% of the corporations' income was derived from dividends. The precise figures for the years in question are as follows:

	Dividend Income	Total Income
1984	$43,862,735.00	$41,480,935.00[1]
1985	27,472,944.00	27,689,769.00
1986	26,021,752.00	26,323,663.00

The auditor did not examine intercompany charges because the

[1]Losses reported on the return resulted in total income being lower than dividend income.

amount of these charges was not considered substantial in comparison to the total deductions reported on the returns.

During the audit, the auditor found that in 1980 the Division made a determination that Mohasco was required to file a combined report with four other subsidiaries. At the time the Division made this determination, Mohasco was engaged in manufacturing or other business activities and Carpet did not exist.

The Division ascertained that the taxpayers did not receive permission to file a combined report for the years in issue. The Division also found that, although Mohasco had a number of other first-tier subsidiaries, only Carpet was included with Mohasco on the combined reports during the years in issue.

At the conclusion of the audit, the Division determined that petitioners improperly filed a combined report for two reasons. First, the Division concluded that petitioners had failed to obtain permission. The Division also concluded that the parent and subsidiary did not constitute a unitary business and that there was an absence of substantial intercorporate transactions. The auditor reached the conclusion that there was an absence of substantial intercorporate transactions from a review of the Federal

return. This finding was also based on the observation that the income which Mohasco received was predominantly dividends. The conclusion that the activities of Mohasco and Carpet did not constitute a unitary business was based on the Division's finding that Mohasco was a holding company and Carpet was an operating company.

On the basis of the foregoing audit, the Division recalculated Carpet's tax liability as if it had filed separate returns and issued a series of notices of deficiency as follows:

Date of Notice	Period Ended	Tax	Interest	Total
July 10, 1989	December 31, 1984	$18,334.00	$9,264.00	$27,598.00
July 10, 1989	December 31, 1985	3,252.00	1,103.00	4,355.00
July 10, 1989	December 31, 1986	2,904.00	635.00	3,539.00

The Division also issued a series of notices of deficiency to petitioner Mohasco as follows:

Date of Notice	Period Ended	Tax	Interest	Total
August 15, 1989	December 31, 1984	$29,762.00	$15,491.00	$45,253.00
August 15, 1989	December 31, 1985	47,922.00	16,895.00	64,817.00
August 15, 1989	December 31, 1986	25,360.00	5,858.00	31,218.00

After the foregoing notices were issued, the amount of tax asserted to be due from Carpet was adjusted by a Conciliation Order issued by the Bureau of Conciliation and Mediation Services. The recalculation of tax was attributable to the Division's acceding to a request for a net operating loss carryback for Carpet. The tax currently asserted to be due from Carpet is $4,429.00, $3,252.00 and $2,904.00 for the years 1984, 1985 and 1986, respectively.

Prior to the formation of Carpet in 1983, Mohasco manufactured carpeting which it sold through subsidiaries.

In 1983, Mohasco created Carpet as a wholly-owned subsidiary pursuant to Internal Revenue Code § 351. The reason for the corporate reorganization was to save corporate franchise taxes in the states of Texas and Mississippi. It was also thought that it would be conducive to a proper allocation of costs.

After the reorganization, the business practices between Mohasco and Carpet remained the same in that, when Carpet was a division or profit center, it was charged with a corporate burden. After Carpet became a separate entity, it continued to be charged with a corporate burden in the same way as when it was part of Mohasco.

Over time, Mohasco purchased carpet distribution companies from individuals who wished to retire because Mohasco viewed it as profitable to purchase a company rather than lose a distribution point. Normally, the person who served as comptroller and/or office manager of the carpet distribution company went along with the company and became a part of the Mohasco organization.

At the end of 1984, all of the distributors were merged into Carpet. The latter mergers also did not bring about a change in operations or personnel procedure. However, it did result in a small reduction in staff.

The reason Mohasco included Carpet in its combined report and excluded the other subsidiaries was because Carpet had always been included in the combined group and, as far as Mohasco was concerned, nothing had changed.

Uniform administrative policies of Mohasco and its subsidiaries were established by Mohasco's corporate officers. These policies were always carried out because a majority of the directors of Mohasco's subsidiaries were also officers or directors of Mohasco. Uniform policies involved taxes and risk management. Mohasco did not set policies regarding daily operations of subsidiaries.

One uniform administrative policy concerned capital acquisition. When a subsidiary wished to make a capital expenditure of over $2,500.00, it was required to submit an appropriation request to Mohasco. The appropriation request was then reviewed by various departments of Mohasco.

Mohasco was not involved in hiring the manufacturing people who worked in the factories. However, the interviews of officers or high-level professionals would be carried out at Mohasco's headquarters.

Mohasco acted as the conduit of all debt incurred for large capital transactions. Mohasco borrowed the funds from third parties as needed to fund the operations of the subsidiaries. Mohasco also acted as the conduit for all cash receipts of the subsidiaries through a "locked box" system. These funds were fully accounted for, and remained the property of the subsidiary on whose behalf they were received. On an as-needed basis, Mohasco transferred these funds to the bank accounts of the respective subsidiaries through wire transfers. In essence, Mohasco served the working capital needs of the group from this pool of funds by acting as a "bank" or clearinghouse for all of its first and second-tier subsidiaries.

The following schedule reflects the percentage of service and interest revenue from Carpet to total business receipts earned by Mohasco and the actual percentage of service and interest revenue from all subsidiaries to the total business receipts earned by Mohasco for each year:[2]

Gross-up of business receipts			
	1986	1985	1984
Gross royalties	$ 103,774.00	$ 114,349.00	
Net gain	575.00	700.00	$ 5,720.00
Other income	35,710.00	17,335.00	52,178.00
Service Revenue	8,122,000.00	8,232,000.00	7,124,000.00
Interest on working capital	6,372,258.00	6,374,432.00	6,395,057.00
Total business receipts	~~$14,634,317.00~~	~~$14,738,836.00~~	~~$13,576,955.00~~
Carpet - Service expense	$ 2,793,000.00	$ 3,201,000.00	$ 2,917,000.00
Carpet - Interest on working capital	3,159,000.00	3,336,000.00	2,778,000.00
	$ 5,952,000.00	$ 6,537,000.00	$ 5,695,000.00
Percentage of Carpet expense to total business receipts	40.6%	44.4%	41.9%
Percentage of service revenue and interest to total business receipts	99%	99.1%	99.6%

Mohasco and its subsidiaries had an executive incentive plan. The plan was administered at corporate headquarters.

During the years 1984 through 1986, Mohasco made a practice of allocating certain expenses which it incurred to its subsidiaries. The total corporate charges were as follows:

1984	$7,124,000.00
1985	8,232,000.00
1986	8,122,000.00

Mohasco also allocated intercorporate interest charges of approximately $3,000,000.00 or $4,000,000.00 per year.

Mohasco used one of several methods to allocate its expenses. According to an affidavit which was attached to a stipulation, Mohasco followed one of two allocation methods, as follows:

"a. the expense of services provided by Mohasco Corporation to the various

[2]This schedule focuses upon business receipts as opposed to total receipts or revenues. Hence, dividends are excluded.

operating units for the periods referenced above were allocated to Mohasco Carpet Corporation and its subsidiaries on the basis of the estimated 'degree of effort' by each department of Mohasco Corporation. 'Degree of effort' was, and is, defined for purposes of allocation as the estimated expenditures in terms of manpower, travel, consulting fees and other expenses incurred for the benefit of the operating unit in question by a department of the Mohasco Corporation;

"b. interest expense, expenses incurred by Mohasco Corporation of a general nature, and expenses which the various departments of Mohasco Corporation could not (or would not) allocate under the method referenced . . . above, were based upon the 'net assets' of the individual operating units to the sum of the total net assets of the combined Mohasco Domestic Corporation operating units. 'Net assets' for purposes of this allocation method were defined to include accounts receivable, inventories, and property, plant, and equipment, less accounts payable and accrued expenses . . . ."

Certain expenses were not allocated as set forth above. For example, Mohasco paid legal fees directly. The expense would then be charged to the particular subsidiary involved.

The following expenses were allocated by Mohasco to its subsidiaries:

(a) Engineering - This expense was for the office which performed plant design for each of the subsidiaries. Mohasco employed 15 to 20 engineers which were used by the subsidiaries.

(b) Director of Engineering - This expense was for the compensation of the officer in charge of the engineers.

(c) Executives - This item was for the expenses incurred for the Chairman of the Board and the President.

(d) Secretary's Office - This category was for the expenses incurred by the corporate secretary of Mohasco.

(e) Corporate Public Relations - This was the cost of maintaining a staff which disseminated reports. The expense might also include charges from third parties.

(f) Corporate Distribution Services - This was the cost of maintaining the department which leased vehicles for Mohasco's subsidiaries. The vehicles involved were mainly cars which were used by executives and salesmen. The subsidiaries had their own fleet of trucks which was also handled by employees of Mohasco.

(g) Legal - Most of this expense was for legal services of people who were on staff.

The expense also included the cost of legal services provided by outside counsel.

(h) V-P Human Resources - This cost was for salary of the president and the staff of the human resources department. The expense might also include the cost of consultants who assisted on pensions and benefits.

The subsidiaries had their own person who dealt with personnel. However, Mohasco, rather than the subsidiaries, operated the pension plan, health insurance and accident insurance.

(i) Compliance System - At the hearing, petitioners' witness was uncertain what constituted the compliance system.

(j) Compensation and Benefits - This expense arose from part of Mohasco's human resource system. The department handled salary structures and grades.

(k) Industrial Relations - These costs were incurred as part of Mohasco's human resource system. The individuals who worked in this department were employed by Mohasco but their office was in Dublin, Georgia because Carpet was mainly in Georgia and South Carolina. The furniture subsidiaries were mainly located in Mississippi. Consequently, Georgia was a more central location.

The industrial relations expense did not include fees charged by consultants or other third parties.

(l) Occupancy - This category was used for recording the cost of running the Mohasco corporate headquarters which was used exclusively by the officers and employees of Mohasco.

(m) Communications - This item was reserved for recording the costs incurred for telephone and telegram services. It might also include the salaries of people who worked in the communications area.

(n) Real Estate Administration - This category was used to record the costs of a distinct department that handled real estate throughout the country. The department was involved in leasing, buying and selling property. Where applicable, the cost of a broker would be directly attributed to the company.

(o) Interior Design - This item represented the costs associated with the showrooms which were leased by Mohasco throughout the country.

(p) Cafeteria - This category was used to record expenses of the cafeteria at the corporate headquarters. None of the subsidiaries had any employees at the corporate headquarters other than the individuals that were officers of both Mohasco and a subsidiary.

(q) Corporate Accounting - General - The exact nature of this item was not disclosed at the hearing. It is not clear whether the fees charged by outside accountants were included in this item or another category. The subsidiaries also maintained small accounting departments.

(r) Corporate Budget - This item was for the expenses incurred for the corporate budget and financial department. The department established the subsidiaries' budgets and forecasted their performance. To some extent, subsidiaries prepared their own budget with the help of Mohasco.

(s) Comptroller - This item included the costs associated with the comptroller of the corporation and his staff. The comptroller's duties included supervision of certain employees of the subsidiaries. The subsidiaries also had their own comptrollers.

(t) Vice-President Finance - This item was reserved for allocating the costs associated with the office of the vice-president of finance. During a portion of the period in issue, the position of vice-president of finance was vacant. However, the costs associated with maintaining the physical space and those that worked in that area continued to be allocated.

(u) Treasurer's Office - This category was used for allocating the expenses of the treasurer's office including the salary of the treasurer.

(v) Internal Audit - This item was employed for recording the expenses of the office which conducted audits of subsidiaries.

(w) Tax - This item was used to record the expenses of Mohasco's tax department. Said expense included fees for outside consulting of approximately $10,000.00 a year.

(x) Insurance - This item was used to record the expenses of the department which handled risk management. The insurance itself was not included on this line.

(y) Other - It is not clear from the record what items were included in this category.

During the years in issue, Mohasco did not engage in any manufacturing, marketing or sales activity. It never provided services for a fee to an unaffiliated corporation. Mohasco did not engage in product design or research and development of products that were sold by its subsidiaries.

All recurring purchases by Mohasco were made from third parties.

Mohasco's subsidiaries received an economic benefit from having services provided by Mohasco through economies of scale.

Some of the services provided by Mohasco to subsidiaries were rendered outside of New York State. These costs were recorded at corporate headquarters in New York State.

In accordance with State Administrative Procedure Act § 307(1), petitioners' proposed findings of fact have been rejected. The Tax Appeals Tribunal Rules of Practice and Procedure provide that "[t]he proposed findings of fact shall refer, wherever possible, to the relevant pages of the transcript of hearing and exhibits" (20 NYCRR 3000.10[d][5]). Petitioners' proposed findings of fact do not indicate that any attempt was made to comply with this requirement. It is noted that the substance of most of the proposed findings of fact have been included in this determination.

CONCLUSIONS OF LAW

A. In order to properly reflect tax liability, Tax Law § 211(4) authorizes the Division to require or permit taxpayers to file combined reports with other corporate taxpayers where:

> "the parent owns or controls substantially all of the stock of the subsidiary; the corporations are, in substance, part of a unitary business conducted by the entire group of corporations; and if, under all of the circumstances of the intercompany relationship, combined reporting fulfills the statutory purpose of avoiding distortion of and more realistically portraying true income (Matter of Campbell Sales Co. v. State Tax Commn., 68 NY2d 617, 505 NYS2d 54, 54-55; see also, Matter of

> Wurlitzer Co. v. State Tax Commn., 35 NY2d 100, 358 NYS2d 762; Matter of Coleco Industries v. State Tax Commn., 92 AD2d 1008, 461 NYS2d 462; 20 NYCRR 6-2.5[a])." (Matter of Autotote Limited, Tax Appeals Tribunal, April 12, 1990.)

B. The Division's regulations, which were in effect during the years in issue, provide that the Division may require or allow the filing of a combined report where certain conditions have been satisfied: a capital stock requirement (20 NYCRR 6-2.2[a]); a unitary business requirement (20 NYCRR 6-2.2[b]); and a showing that the filing of separate returns would result in distortion (20 NYCRR 6-2.3).

C. Initially, it is noted that since Carpet was a wholly-owned subsidiary of Mohasco, the capital stock requirement has been met (20 NYCRR 6-2.2[a]).

D. Mohasco argues that its transactions with Carpet are the type which are considered in determining whether there is a unitary business. Mohasco notes that it provided centralized management and operating services (e.g., engineering and transportation) for Carpet. Mohasco submits that these services were not incidental to the corporation providing the service. It is further noted that the intercorporate finances demonstrate that Mohasco and Carpet operate as a "unitary business".

E. It is the Division's position that Mohasco does not sell goods or services to third parties and merely provides management services to its subsidiaries. Therefore, it is a holding company which is not part of a unitary business for purposes of 20 NYCRR 6-2.2. Relying upon 20 NYCRR 6-2.3(c) and 20 NYCRR 6-2.3(f), the Division also submits that those service functions which are incidental to the business will not be considered. The Division concludes that the provision of services by a corporation for its subsidiaries which are not provided to third parties is not an intercorporate transaction. It is contended that the reason for this rule is that the regulations recognize that holding companies may perform some management activities, but those activities do not constitute a unitary business. Lastly, the Division posits that 20 NYCRR 6-2.3(f), example 10, is not inconsistent with the foregoing interpretation because, unlike the situation here, the holding company in that example was involved in product development (research of securities), marketing and advertising of its subsidiaries' services.

F. During the years in issue, the Commissioner's regulations set forth the following principles with respect to the unitary business requirement:

> "(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:
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> "(i) manufacturing or acquiring goods or property or performing services for other corporations in the group; or
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> "(ii) selling goods acquired from other corporations in the group; or
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> "(iii) financing sales of other corporations in the group.
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> "(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:
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> "(i) manufacturing or selling similar products; or
>
> "(ii) performing similar services; or
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> "(iii) performing services for the same customers." (20 NYCRR 6-2.2[2][b]; emphasis added.)

G. In this case, petitioners have shown that Mohasco and Carpet are engaged in a unitary business. The regulations of the Commissioner clearly provide that performing services for other corporations in the group is an indicia of a unitary business (20 NYCRR 6-2.2[b][i]) provided that such services are not incidental to the business of the corporation providing such service (20 NYCRR 6-2.3[c]).

Here, Mohasco's business consisted of providing significant services to its subsidiaries including Carpet. These services involved the central activities of Carpet's operations including engineering, transportation, reviewing capital acquisitions, obtaining cash and budgeting. Hence, Mohasco functioned as part of a single unitary operation with Carpet. Furthermore, since, during the years at issue, it was Mohasco's business to provide its subsidiaries with services, the service functions are not "incidental to the business of the corporation providing such service" (20 NYCRR 6-2.3[c]). Therefore, the Division's reliance upon 20 NYCRR 6-2.3(c) is misplaced.

H. Contrary to the Division's argument, the fact that Mohasco does not sell goods or services to third parties does not preclude Mohasco from being considered a part of a unitary business. Example 10 of 20 NYCRR 6-2.3(f) makes it clear that a holding company which does not sell goods or services to third parties may still be considered part of a unitary business. The fact that, unlike here, the holding company in that example engaged in research of securities, marketing and advertising of its subsidiaries' services does not warrant a different result. The Division has not shown why an activity such as marketing and advertising is part of a unitary business and transportation and acquisition of capital equipment is not. Lastly, the Division's reliance upon example 3 in 20 NYCRR 6-2.3(f) is unavailing since that example concerns distortion and not the immediate issue of whether Mohasco and Carpet were parts of a unitary business.

I. The next question presented is whether filing on a separate basis distorts the income of the taxpayers.

J. The regulations of the Commissioner provide that:

> "[t]he 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" (20 NYCRR 6-2.3[a]).

The record is clear that petitioners are not entitled to the benefit of this presumption and petitioners' reply brief is equally clear that they do not claim the benefit of this presumption. Nevertheless, although petitioners will not be given the benefit of this presumption, they still have the option of proving distortion (20 NYCRR 6-2.3[d]).

K. It is petitioners' position that if Mohasco and Carpet were forced to file separate reports, there would be a distortion of the income of both Mohasco and Carpet. It is argued that this distortion arises for two reasons. First, the transactions did not occur at arm's length. Second, the method of allocation leads to distortion. Petitioners submit that Mohasco's separate performance was never an issue because Mohasco and its subsidiaries operated as a unitary business for economic, financial and tax purposes. Consequently, the allocation of charges to its subsidiaries was designed for internal management decisions only.

L. The Division maintains that petitioners have not proven a distortion of their income.

With respect to the administrative and management services, the Division notes that petitioners have not quantified the management costs which merely represent the pass-through of third-party billings. Further, the Division submits that petitioners have not identified the distortion occurring to Carpet from paying a portion of all of its parent's expenses.

The Division also submits that Mohasco purchased goods and services from third parties and passed on these costs to its subsidiaries. Therefore, it is argued that since the subsidiaries are paying the market price for these purchases, there is no distortion on these transactions. Furthermore, the Division contends that petitioners failed to quantify the amount of these transactions.

The Division also argues that Mohasco's internally-generated management and administrative costs alone do not prove distortion because economies of scale do not establish distortion.

The Division submits that any benefit to the subsidiaries from economies of scale is offset by the fact that a portion of the charges from Mohasco is for services, such as the cafeteria, which do not benefit the subsidiaries in any meaningful sense. Thus, the Division surmises that separate reports would not lead to a distortion of income. The Division further argues that the billing of management services at cost would not create distortion because the costs include overhead expenses. The Division contends that the lack of a formal profit margin would not lead to distortion in the form of artificially low income of Mohasco because Mohasco could make a Tax Law § 211.5 adjustment. The Division concludes that there is no distortion in this case because both Mohasco and Carpet profited from this relationship.

M. In Standard Manufacturing Co. (Tax Appeals Tribunal, February 6, 1992), the Tribunal determined that the use of section 482 Federal adjustments to establish arm's-length pricing was appropriate to show that reporting on a separate basis would result in a proper reflection of income. The Tribunal then determined that the taxpayer offered sufficient proof to show that the intercorporate transactions were at arm's length and that reporting on a separate basis resulted in a proper reflection of the taxpayer's liability. It is clear from the foregoing analysis that the pertinent inquiry in determining whether there is a distortion is whether there is arm's-length pricing between Mohasco and Carpet.

N. In this case, the record shows that there was an absence of arm's-length pricing between Mohasco and Carpet. In no instance did the expenses charged to the subsidiaries include a profit. Further, interest expense, expenses of a general nature and expenses which the various departments could not allocate by an estimated "degree of effort" were allocated on the basis of net assets of the individual subsidiary to the total net assets of the combined Mohasco operating units. The absence of arm's-length pricing supports a finding of distortion. It is concluded that the income of Mohasco and Carpet are more accurately reflected by the filing of a combined report.

O. Most of the Division's arguments in opposition to the foregoing analysis are infirm because they are in conflict with the principle that the absence of arm's-length pricing supports a finding of distortion. The Division's other arguments are equally spurious. Although Mohasco made purchases from third parties, it did not rely on these purchases to establish distortion. Therefore, the fact that Mohasco did not show the amount of purchases from third parties is not fatal to petitioners' position. Secondly, the fact that both Mohasco and Carpet gained from their relationship does not show an absence of distortion. Lastly, the Division's reference to Tax Law § 211.5 is misplaced since that section makes reference to adjustments by the Division.

P. The last issue presented is whether the failure of petitioners to request permission to file a combined report pursuant to 20 NYCRR 6-2.4(a) justifies the Division's refusal to permit combined reports during the years in issue.

Q. It is petitioners' position that the Division does not have unbridled discretion to permit or require a combined report and that Matter of Autotote Limited (supra) seriously questions the validity of the 30-day rule of 20 NYCRR 6-2.4(a). Petitioners also submit that Matter of Chudy Paper Co. (Tax Appeals Tribunal, April 19, 1990) is distinguishable because, in this instance, an audit was conducted. They also maintain that the issue of distortion was raised before the issuance of the notices of deficiency and that a combined report would result in less distortion than separate reports.

R. In opposition to petitioners' position, the Division argues that the regulation imposing the 30-day requirement is valid and serves the legitimate administrative function of creating a structure for the Division's review of combined reports. The Division contends that the timing of the requirement increases the likelihood that taxpayers will make decisions on whether to file combined reports based on the substantive requirements of combined reporting, not on whether combined reporting reduces a taxpayer's liability.

The Division posits that Matter of Autotote Limited (supra) is inapplicable. According to the Division, that case applies only where the Division refuses to allow combined reports when its own actions created distortion in the taxpayer's income. The Division submits that if the 30-day rule is waived whenever a field audit is conducted, it would encourage inflexibility and discourage fairness because it would dissuade the Division from conducting an audit.

S. In general, 20 NYCRR 6-2.4(a) provides that a taxpayer must make a written request for permission to file a combined report not later than 30 days after the close of its taxable year. Further, a report filed on a combined basis does not constitute a request for permission to file a combined report.

The general validity of the foregoing regulation has been recognized and applied where a taxpayer did not receive permission to file on a combined basis (Fuel Boss v. State Tax Commn., 128 AD2d 945, 512 NYS2d 595; Matter of Chudy Paper Co., supra).

In Matter of Autotote Limited (supra), the taxpayer was the subject of an audit by the Division which resulted in the Division's rejection of the taxpayer's conduit theory and required the taxpayer to add back 90% of its interest expense to income. The taxpayer countered that the inclusion of the intercompany interest expense in income did not reflect the overall financial position of the taxpayer and distorted its New York taxable income. The taxpayer maintained that a proper reflection of taxable income would be presented if combined returns were permitted because the intercompany interest transactions would be treated as subsidiary capital and, as a result, excluded from the calculation of entire net income. The Division responded that combined returns would not be permitted because the taxpayer did not comply with the 30-day requirement. In this context, the Tribunal framed the issue as follows:

> "The crux of the matter here is whether the Division has abused the discretion accorded it under section 211(4) by refusing to allow or require the petitioner to file on a combined basis where the facts determined upon audit and stipulated to by the parties indicate that petitioner meets the conditions of the Division's regulation on combined reporting."

The Tribunal then proceeded to resolve this issue with the following language:

> "Neither the presumption of distortion nor petitioner's assertions have been rebutted by the Division. Rather, the only ground advanced by the Division for not allowing petitioner to file on a combined basis is the failure to comply with the thirty-day rule. We find this position wholly untenable in this case. The purpose of the thirty-day rule would appear to be to permit the Division to establish the tentative filing status of a taxpayer prior to the time the returns are due. Although the Division reserves the right to require combination or decombine a taxpayer on audit (20 NYCRR 6-2.4[c]), the application and approval process allows the taxpayer to know how it should file and allows the Division to know from whom to expect a return. Even if there are other reasons for the thirty-day rule and the permission process, such reasons cannot be used to prohibit a taxpayer from filing on a combined basis where, as in the instant case, the Division, on its own initiative, has had the opportunity through the audit process to examine and scrutinize petitioner's business activities, in particular intercompany transactions. Under these circumstances, it would appear to us that the thirty-day rule cannot provide a basis for the Division's failure to adhere to the standards in its regulations (Montauk Improvement, Inc. v. Procaccino, supra).
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> "In short, if petitioner here meets the criteria in the regulations for combined reporting, it must be allowed or required to do so.
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> "Any other conclusion would give credence to an 'unwritten fourth rule,' that is, that the discretion accorded to the Division under section 211(4) is to be exercised only when the result will be a larger tax. Surely, that is not the proper result. Rather, the goal is to require a report which is an accurate reflection of the income which should be subjected to taxation in New York State (Matter of Wurlitzer Co. v. State Tax Commn., supra). If the Division determines after an audit that a taxpayer's tax liability in New York State will be properly reflected only if the taxpayer files a combined report, it is arbitrary for the Division to refuse to exercise its discretion to allow the taxpayer to file a combined report because the taxpayer has failed to request permission within a time period not prescribed by statute.
>
> "This situation can be distinguished from that in Fuel Boss, Inc. v. State Tax Commn. (128 AD2d 945 [3d Dept 1987]), where a complete audit was not before the court and the State Tax Commission had not found that the taxpayer met the requirements for the filing of a combined return."

T. In this case, the auditor spent five days at Mohasco's offices reviewing petitioners' records. During the audit, he was not denied access to any records. It follows that the failure to request permission cannot serve as a basis to deny petitioners the right to file a combined report since "the Division, on its own initiative, has had the opportunity through the audit process to examine and scrutinize petitioners' business activities, in particular intercompany transactions" (Matter of Autotote Limited, supra).

U. The Division's attempt to limit the holding of Matter of Autotote Limited (supra) to those situations where the Division makes an adjustment which causes a distortion that can only be corrected by filing a combined report is without merit. The Tribunal was clear that the goal was to require a report which was an accurate reflection of the income subject to New York State tax. If the Division's narrow interpretation of Matter of Autotote Limited (supra) were accepted, this goal would be greatly impeded.

V. The Division's last argument is that it is irrelevant that Mohasco received permission to file combined reports with other subsidiaries in prior years. This argument is accepted and no weight has been given to this fact.

W. The petitions of Mohasco Corporation and Mohasco Carpet Corporation are granted and the notices of deficiency dated July 10, 1989 and August 15, 1989 are cancelled.

DATED: Troy, New York
May 27, 1993

/s/ Arthur S. Bray
ADMINISTRATIVE LAW JUDGE