STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
H & S HOLDINGS LIMITED	:	DETERMINATION DTA NO. 813573
for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Fiscal Year ended July 31, 1993.	:	

Petitioner, H & S Holdings Limited, 808 Seneca Street, Buffalo, New York 14210, 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 year ended July 31, 1993.

A hearing was held before Winifred M. Maloney, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on December 28, 1995 at 9:15 A.M., with all briefs to be submitted by May 22, 1996, which date began the six-month period for the issuance of this determination. Petitioner appearing by Nathan Ostroff, Esq., submitted a brief on February 19, 1996. The Division of Taxation appearing by Steven U. Teitelbaum, Esq. (Andrew J. Zalewski, Esq., of counsel), submitted its brief on March 25, 1996. Petitioner submitted its reply brief on May 22, 1996.

ISSUE

Whether the Division of Taxation's denial of petitioner's claim for investment tax credit was proper.

FINDINGS OF FACT

1. The record in this matter is rather sparse. Neither the Division of Taxation (the "Division") nor petitioner presented any witnesses. Only the Division submitted documentary evidence into the record.

2. 981617 Ontario, Inc. ("Ontario") is a Canadian corporation whose principal place of business is located at 7030 Woodbine Avenue, Suite 102 Markham, Ontario L3R 6G2.

3. During the period in issue, all of Ontario's issued and outstanding stock was owned by Jack Slatter and Joel Hoffman.[1]

4. Incorporated on February 27, 1992, petitioner H & S Holdings Limited (petitioner or "Holdings") is a New York corporation. Its principal place of business is located at 808 Seneca Street, Buffalo, New York 14210.

5. During the period in issue, Ontario owned one hundred percent of petitioner's equity and voting power.

6. Thorner Press Inc. ("Thorner"), also incorporated on February 27, 1992, is a New York corporation located at 808 Seneca Street, Buffalo, New York 14210.

7. During the period in issue, Thorner was petitioner's wholly-owned subsidiary.

8. During the period in issue, Joel Hoffman was president of both petitioner and Thorner.

9. Statement #5 attached to the Form AU-2.1 request (Division's Exhibit "G") included descriptions of both petitioner's and Thorner's business activities. Review of this statement reveals that petitioner's only business activities consisted of "leasing printing equipment and lending money to its wholly-owned subsidiary, Thorner"; while Thorner engaged in the printing business and leased all of its printing equipment from petitioner. According to the statement, all of Thorner's sales were to unrelated third parties.

10. On April 6, 1992, petitioner, as lessor, and Thorner, as lessee, entered into a "Master Equipment Lease" agreement ("master lease") for the rental of equipment described as "print plant equipment purchased by Lessor from Uniform Corp. as per Schedule A." Review of the terms of the master lease indicates that the lease term was one year. The terms and conditions of the master lease included inter alia the following:

> "4) RENEWAL: This Agreement shall be automatically renewed on a month-to-month or year-to-year basis upon the expiration of the initial term, upon the

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[1]According to Statement #1 FORM AU-2.1, GENERAL INFORMATION-CORPORATION 3, attached to Form AU-2.1 Request for Permission to File a Combined Report or to Change an Existing Combined Group ("Form AU-2.1 request") (Division's Exhibit "G"), filed for the taxable year ended July 31, 1993, both Jack Slatter and Joel Hoffman were non-resident Canadians. Mr. Hoffman owned twenty percent of Ontario's equity and voting power (20 shares), while Mr. Slatter owned eighty percent of Ontario's equity and voting power (80 shares).

same terms and conditions set forth herein, unless cancelled by either party as provided in paragraph 10 hereof.

* * *

"6) USE, REPAIR AND ALTERATIONS: The Lessee agrees to use the equipment in a reasonable, prudent and careful manner, and the Lessee agrees to keep the equipment in good repair, condition and working order, at its own expense, and to furnish all parts and labor required for that purpose. The Lessee shall not make any material alterations or improvements to the equipment without the Lessor's prior written consent.

"7) LOSS, THEFT AND DAMAGE: The Lessee shall bear the entire risk of loss, theft and damage of the equipment from any cause whatsoever, and no loss, theft or damage of the equipment shall relieve the Lessee of the obligation to pay rent under the terms and conditions of this Agreement. At the Lessor's option, the Lessee shall either repair the equipment to its previous condition, or if lost, stolen or damaged beyond repair, reimburse the Lessor for the full replacement value of the equipment.

"8) TITLE AND OWNERSHIP: All title and ownership of the equipment and any replacement equipment shall at all times remain in the Lessor, and the Lessee shall have no right, title or interest in the equipment, except as expressly set forth in this Agreement.

* * *

"12) CONSTRUCTION: This Agreement shall in all respects be governed by and construed in accordance with the laws of the State of New York.

"13) ENTIRE AGREEMENT: This Agreement constitutes the entire agreement between the parties. All prior negotiations have been merged into this Agreement, and there are no understandings, representations or agreements, oral or written, express or implied, other than those set forth herein. This Agreement cannot be modified or amended except by a writing, signed by both parties. . . ." (See, Division's Exhibit "E".)

Review of the master lease agreement indicates that Mr. Hoffman executed this agreement as president of both petitioner/lessor and Thorner/lessee.

11. Addendums to the master lease were made on November 1, 1992, March 1, 1993, April 1, 1993, May 5, 1993, October 1, 1993 and November 4, 1993. In each of these addendums, various pieces of print plant equipment, purchased by petitioner, were leased to Thorner. In addition, the rental schedule on each addendum listed the master lease monthly payments, as well as the monthly payments due for all prior addendums.

12. By letter dated August 24, 1993, the Division granted petitioner tentative permission to file a combined report with Thorner. The Division's representative, Henry I. Lowenski, Jr., wrote, in pertinent part:

> "This tentative permission may be revised or revoked on audit of the combined returns as provided by New York State Tax Regulation Section 6-2.4(c). To ensure a proper determination on audit, please complete the financial data for the entire tax period on the enclosed Form AU-2.1 and attach it to your combined return.
>
> "Each corporation included in the combined report is required to file a separate return on Form CT-3. In addition, the taxable corporation, H & S Holdings Limited #16-1412816, is responsible for paying the combined tax and must file a Combined Franchise Tax Return, Form CT-3A."

13. The Division's Exhibit "G" is the 1992 CT-3-A Combined Franchise Tax Return with attachments filed by petitioner for fiscal year ended July 31, 1993. Review of page 1 of the Form CT-3-A reveals that petitioner computed the combined tax as follows:

Combined tax before tax credits	$2,225.00
Tax Credits	---
Balance	2,225.00
Combined minimum for one taxable subsidiary	325.00
Total combined tax	2,550.00
Tax surcharge rate 15%	383.00
Total combined tax and tax surcharge	2,933.00
First installment for next period - line 16b	733.00
Total tax, surcharge and required installment	$3,666.00

It is noted that on this Form CT-3-A, petitioner claimed a refund of unused investment tax credit of $21,928.00.

14. Included as part of the Division's Exhibit "G" is petitioner's 1992 Form CT-46 Claim for Investment Tax Credit and Employment Incentive Credit for the period August 1, 1992 through July 31, 1993. Schedule A of this form describes the New York property eligible for the investment tax credit as follows: printing presses, acquired in November 1992, having a ten-year life, with an investment credit base of $511,873.00 and an investment tax credit of $25,594.00.

Also included as part of the Division's Exhibit "G" is petitioner's 1992 Form CT-46.1 Claim for Refund of Unused Investment Tax Credit by a New Business ("Form CT-46.1") for

the period August 1, 1992 through July 31, 1993. The following computation of the refund of unused investment tax credit appeared on the attachment to Form CT-46.1:

"INVESTMENT TAX CREDIT FROM FORM CT-46	$25,594
LESS TAX DUE, LINE 11 of FORM CT-3A	(2,225)
LESS COMBINED MINIMUM TAX ON SUBSIDIARIES, LINE 12 CT-3A	(325)
LESS TAX SURCHARGE, LINE 14 CT-3A	(383)
LESS FIRST REQUIRED INSTALLMENT, LINE 16B CT-3A	(733)
TOTAL TAX, SURCHARGE AND REQUIRED INSTALLMENT	(3,666)
NET REFUND REQUESTED PER FORM CT-46.1 AND INSTRUCTIONS FOR FORM CT-46.1 AMOUNT TO LINE 29, CT-3A	$21,928"

15. During the period in issue, Holdings received rental income from Thorner in the aggregate amount of $273,537.00 (see, Division's Exhibit "G").

16. Review of the Division's Exhibit "G" reveals that petitioner claimed "depreciation of tangible property placed in service after 1986" in the amount of $108,786.00.

17. On February 22, 1994, the Division issued a Notice of Disallowance to petitioner concerning its "claim for investment tax credit, resulting in a claim for refund," for the period ended July 31, 1993. In the notice, the Division representative, Mr. John O'Hanlon, wrote in pertinent part:

> "Section 210.12(b)(i) of the New York Tax Law states in part that the tangible property must be principally used by the taxpayer in the production of goods. Section 210.12(a) provides that in the case of a combined report the term investment credit base shall mean the sum of the investment credit base of each corporation included on such report. In effect, each corporation must meet the criteria on its own in order to qualify for the investment tax credit.
>
> "Sec. 208.2 of the New York State Tax Law states that a 'taxpayer' means any corporation subject to tax under Article 9-A. Per Tax Regulation 6-2.1, each corporation is required to file a separate franchise tax report, pertaining to its own business, although it might be in a combined report.
>
> "As each corporation is treated as a separate taxable entity under Article 9-A of the Tax Law, and since the Tax Law does not contain a provision that allows the combined group to be treated as an individual entity in regards to investment tax credit, each corporation in a combined group must individually qualify for the investment tax credit.
>
> "Section 210.12(d) states in pertinent part, that a taxpayer shall not be allowed a credit on such property, which it leases to any other person or corporation.

> "In light of the above, because H & S Holdings Limited leases the property in question to Thorner Press, Inc., H & S Holdings Limited is not eligible for the claimed investment tax credit nor is it allowed a refund of $21,928.00 for unused investment tax credit for the property shown on the Form CT-46." (See, Division's Exhibit "B".)

18. On June 2, 1994, the Division issued Notice of Deficiency (L-008706536-4) to Holdings for corporation franchise taxes due in the amount of $2,933.00, interest due of $132.26, zero penalty for a total amount due of $3,065.26 for the fiscal year ended July 31, 1993.

19. After a conciliation conference, the conferee issued a Conciliation Order (CMS No. 139257), dated December 16, 1994, sustaining the statutory notices -- the Notice of Disallowance and the Notice of Deficiency (L008706536).

20. Petitioner filed a petition dated February 10, 1995, which requested a redetermination of a deficiency of corporation franchise tax for the fiscal year ended July 31, 1993 in the amount of $2,933.00 and also sought a refund of tax in the amount of $24,861.00. Petitioner is challenging the Division's disallowance of the investment tax credit which it had claimed on Form CT-46 and Form CT-3-A for the period in issue. In the petition, it asserted that it is entitled to the investment tax credit because the combined group is the taxpayer. Petitioner also asserted that if it, as the parent corporation, did not elect to be taxed under Tax Law § 211(4), and if it had shown taxable income, the income would have been considered passive.

21. The Division, in its answer, dated April 14, 1995, stated inter alia that its determination "was in all respects proper and correct" since petitioner leased tangible personal property to Thorner and therefore petitioner was not eligible for the claimed investment tax credit nor was it allowed a refund "for unused investment tax credit for the property shown on the Form CT-46."

22. Petitioner submitted eleven proposed findings of fact. In accordance with State Administrative Procedure Act § 307(1), all the proposed findings of fact have been incorporated

in to the Findings of Fact herein except number two which has been modified to more accurately reflect the record; and numbers seven and eight which are not reflected in the record.

SUMMARY OF THE PARTIES' POSITIONS

23. Petitioner contends that the Division's disallowance of the investment tax credit it had claimed on its return, the denial of its claim for refund of the unused investment tax credit and the issuance of the Notice of Deficiency were improper. It argues that the transaction in issue "is not a lease, but rather is a sale pursuant to which Thorner owns and uses the equipment" (Petitioner's brief, p. 4). Petitioner also argues that the Division's interpretation of Tax Law § 210(12)(a) is incorrect. It asserts that the combined report it filed in essence created a single entity for tax purposes, which both owned and used the equipment and therefore would qualify for the investment tax credit. Furthermore, petitioner argues that a denial of the investment tax credit in this case "would frustrate the purpose of the public policy of encouraging investment in plant and equipment in New York State to grow our economy and to save and create jobs" (Petitioner's reply brief, p. 2).

24. The Division maintains that its disallowance of petitioner's investment tax credit, its denial of petitioner's claim for refund and its issuance of a notice of deficiency for the period in issue were all proper. It asserts that the record clearly shows that petitioner, as the lessor of equipment to Thorner, is not entitled to the investment tax credit. The Division also maintains that the record does not support petitioner's contention that the transaction in issue was a sale rather than a lease. Lastly, the Division maintains that its interpretation of Tax Law § 210(12)(a) is correct. It argues that the statute clearly states that each member of a combined group should individually calculate its investment tax credit base. The Division requests that its Notice of Deficiency be sustained in its entirety and that Holdings petition should be dismissed.

CONCLUSIONS OF LAW

A. Tax Law § 208(2) defines "taxpayer" to be "any corporation subject to tax under" Article 9-A.

B. Chapter 817 of the Laws of 1987 amended, among others, subdivision (a) of Tax Law § 210(12). The amendments to subdivisions (a), (b), (c), (e) and (f) of Tax Law § 210(12) lowered the rate for the investment tax credit; staggered the rate based on investment; added anti-abuse provisions and interest on recapture; and applied the proper period for recapture.

Tax Law § 210(12)(a) provides, in pertinent part, that:

> "A taxpayer shall be allowed a credit, to be computed as hereinafter provided, against the tax imposed by this article. The amount of the credit shall be the percent provided for hereinbelow of the investment credit base. The investment credit base is the cost or other basis for federal income tax purposes of tangible personal property and other tangible property, including buildings and structural components of building, . . . less the amount of nonqualified nonrecourse financing with respect to such property to the extent such financing would be excludible from the credit base pursuant to section 46(c)(8) of the internal revenue code . . . . In the case of a combined report the term investment credit base shall mean the sum of the investment credit base of each corporation included on such report."

C. Tax Law § 210(12)(d) provides as follows:

> "A taxpayer shall not be allowed a credit under this subdivision with respect to tangible personal property and other tangible property, including building and structural components of buildings, which it leases to any other person or corporation. For purposes of the preceding sentence, any contract or agreement to lease or rent or for a license to use such property shall be considered a lease. Provided, however, in determining whether a taxpayer shall be allowed a credit under this subdivision with respect to such property, any election made with respect to such property pursuant to the provisions of paragraph eight of subsection (f) of section one hundred sixty-eight of the internal revenue code, as such paragraph was in effect for agreements entered into prior to January first, nineteen hundred eighty-four, shall be disregarded."

D. 20 NYCRR 5-2.3 states that:

> "Tangible personal property and other tangible property, including buildings, and structural components of buildings, which a taxpayer leases to any other person or corporation does not qualify for the investment tax credit. For purposes of the preceding sentence, any contract or agreement to lease or rent or for a license to use such property will be considered a lease. However, in cases where production property is leased in form and the lessee is in fact the beneficial owner and entitled to take Federal depreciation on the property and the property qualifies pursuant to section 5-2.2 of the Subpart, the lessee may be entitled to take the investment tax credit."

E. 20 NYCRR 5-2.2 defines "qualified property" as:

> "tangible personal property and other tangible property, including buildings and structural components of buildings, which:
>
> (1) is acquired, constructed, reconstructed or erected by the taxpayer after December 31, 1968;

(2) is depreciable pursuant to section 167 of the Internal Revenue Code;

(3) has a useful life of four years or more;

(4) is acquired by the taxpayer by purchase as defined in section 179(d) of the Internal Revenue Code;

(5) has a situs in New York State; and

(6) is principally used by the taxpayer in the production of goods by manufacturing . . . ."

F. In the instant matter, petitioner claimed an investment tax credit, on its Form CT-3-A for the period in issue, for equipment which it leased to Thorner. Pursuant to Tax Law § 210(12)(b) and (d), the Division disallowed petitioner's claim of an investment tax credit.

Petitioner contends that the Division improperly disallowed its investment tax credit. It asserts that "for tax purposes the transaction in question is not a lease, but rather is a sale pursuant to which Thorner owns and uses the equipment" (petitioner's brief, p. 4). Petitioner contends that whether a transaction is considered to be a lease or a sale, for income tax purposes, is determined by looking at all of the facts and circumstances in the particular case. It asserts that, in the instant case, a sham transaction occurred and that a sale should be inferred because the lease has an indefinite term, and the rental required to be paid is not reasonable. Petitioner argues that this transaction occurred only because Thorner is its wholly-owned subsidiary and subject to its control. Furthermore, petitioner contends that its transaction with Thorner lacks a business purpose, as well as "economic substance", both of which, it maintains, are required in order to classify a transaction as a lease. Petitioner claims that since the transaction is really a sale, Thorner, as lessee, should be entitled to the investment tax credit. In support of its position, it cites 20 NYCRR 5-2.3.

The Division argues that petitioner fails to qualify for the investment tax credit. It maintains that petitioner owns and depreciates the equipment it leased to Thorner. The Division disagrees with petitioner's contention that the lease transaction was a sham and that a sale to Thorner should be inferred. It contends that the record in this matter "does not provide any explanation for the leasing transaction entered into" by petitioner and Thorner (Division's brief,

pp. 6-7). It further argues that there is no evidence in the record that the transaction was without economic substance inasmuch as the record reflects an aggregate payment of $273,537.00 to petitioner by Thorner. Furthermore, the Division notes that petitioner, not Thorner, claimed depreciation on its tax return.

G. A tax credit is a particularized species of exemption from taxation and therefore, the petitioner bears the burden of showing clear cut entitlement to the statutory benefit (Matter of Grace v. New York State Tax Commn., 37 NY2d 193, 371 NYS2d 715, 719; Golub Service Station v. Tax Appeals Tribunal, 181 AD2d 216, 585 NYS2d 864, 865).

Tax Law § 210(12)(a) provides that a taxpayer is allowed an investment tax credit against the tax imposed by Article 9-A. However, a taxpayer is not allowed an investment tax credit with respect to tangible personal property which it leases to another corporation (see, Conclusions of Law "B" and "C").

In the instant matter, petitioner claims that it is entitled to an investment tax credit. Petitioner has failed to met its burden of proof. As noted in Finding of Fact "1", petitioner did not present any witnesses, nor did it present any documentary evidence. It is clear from the rather sparse record that petitioner leased the equipment to Thorner. The master lease was submitted as part of the Division's jurisdictional documents (see, Finding of Fact "10"). Review of paragraph 8 of the master lease reveals that the petitioner, as lessor, retained ownership of the equipment. In addition, petitioner, on its federal return, claimed depreciation on the equipment which it leased to Thorner (see, Finding of Fact "16"). Petitioner, as lessor, fails to qualify for the investment tax credit (see, Tax Law § 210[12][d]; 20 NYCRR 5-2.3; see, also Matter of Ranero Corp., State Tax Commission, February 29, 1980; Matter of Three C Realty Corporation, State Tax Commission, October 2, 1981.)

Petitioner has also argued that Thorner is the beneficial owner of the equipment and would be entitled to the investment tax credit. Petitioner relies upon Matter of Mitnick (Tax Appeals Tribunal, January 25, 1991) and 20 NYCRR 5-2.3 in support of its position. The Division is correct, petitioner's reliance upon Matter of Mitnick is misplaced. Both Mitnick and

20 NYCRR 5-2.3 recognize that in instances where property is leased in form and the lessee is the beneficial owner, an investment tax credit may be claimed by the lessee. Both the regulation and the decision note that the issue of beneficial ownership is resolved by whether the lessee is entitled to claim federal depreciation on the property. As noted above, the only evidence in the record concerning the transaction in issue is the master lease which specifically states that ownership of the equipment remains with petitioner Holdings. There is also no evidence to support petitioner's contention that the lease payments Thorner made to it were unreasonable and were the result of the parent wholly-owned subsidiary relationship. In addition, Holdings claimed the depreciation on its federal return, not Thorner. Petitioner has failed to prove that Thorner was the beneficial owner of the equipment. Therefore, Thorner would not be entitled to the investment tax credit (see, Matter of Mitnick, supra).

H. Petitioner has also asserted that the combined report it filed for the period in issue created a single entity for tax purposes, which both owned and used the equipment. It argues that the single entity would qualify for the investment tax credit. Furthermore, it claims that the Division's interpretation of Tax Law § 210(12)(a) is incorrect. The Division's interpretation of Tax Law § 210(12)(a) is in issue here. Interpretation of a statute by the agency charged with its enforcement is, as a general matter, given great weight and judicial deference so long as the interpretation is neither irrational, unreasonable nor inconsistent with the governing statute (Matter of Trump Equitable Fifth Ave. Co. v. Gliedman, 62 NY2d 539, 478 NYS2d 846, 849).

In construction of statutes, the intention of the Legislature is first to be sought from a literal reading of the act itself or of all statutes relating to the same general subject matter. The legislative intent is to be ascertained from the words and language used in the statute, and if language thereof is unambiguous and the words plain and clear, there is no occasion to resort to other means of interpretation (McKinney's Cons Laws of NY, Book 1, Statutes § 92(b); see, DiMarco v. Hudson Valley Blood Services, 147 AD2d 156, 542 NYS2d 521, 522-523). Tax Law § 210(12)(a) is set forth in Conclusion of Law "B". It was amended by chapter 817 of the

Laws of 1987 to include the language concerning a combined report and the investment credit base used in the case of a combined report.

The language of this statute is unambiguous and the words plain and clear. Each individual corporation which is part of a combined group must calculate its own investment credit base. The sum of the individual corporation's investment credit bases is the investment credit base of the combined group. The Division's interpretation of Tax Law § 210(12)(a) is reasonable and consistent with the governing statute.

Petitioner has failed to establish that it is entitled to the investment tax credit pursuant to Tax Law § 210(12).

I. The petition of H & S Holdings Limited is denied; the Division's disallowance of petitioner's claim for refund of the unused investment tax credit and the Notice of Deficiency issued June 2, 1994 are sustained.

DATED: Troy, New York
November 7, 1996

/s/ Winifred M. Maloney
ADMINISTRATIVE LAW JUDGE