

STATE OF NEW YORK
DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
UNITED CARGO MANAGEMENT, INC.	:	DETERMINATION
for Redetermination of a Deficiency or for	:	DTA NO. 814250
Refund of Corporation Franchise Tax under	:	
Article 9 of the Tax Law for the Years 1992	:	
and 1993.	:	

Petitioner, United Cargo Management, Inc., 1111 Watson Road, Unit C-1, Carson, California 90745, filed a petition for redetermination of a deficiency or for refund of corporation franchise tax under Article 9 of the Tax Law for the years 1992 and 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 April 10, 1996 at 9:15 A.M., with all briefs to be submitted by October 15, 1996, which date began the six-month period for the issuance of this determination. Petitioner appeared by Galland, Kharasch, Morse & Garfinkle, P.C. (Gregory P. Cirillo, Esq. and David P. Street, Esq., of counsel). The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (James P. Connolly, Esq., of counsel).

ISSUE

I. Whether the Division of Taxation properly determined that petitioner, United Cargo Management, Inc., is subject to taxation as a transportation corporation under sections 183 and 184 of the Tax Law.

II. Whether the allocation methodology adopted and applied by the Division of Taxation in this case violates the Commerce Clause of the United States Constitution.

FINDINGS OF FACT

The Division of Taxation ("Division") and petitioner entered into a stipulation of facts which was received into evidence in this matter. The facts as set forth in the stipulation have been substantially incorporated into this determination.

2. Petitioner, United Cargo Management, Inc. ("UCM"), was incorporated in the State of California on April 17, 1987 and began doing business in New York State on August 1, 1987. Petitioner is headquartered in the State of California and has two United States offices: the first is located in Los Angeles, California, while the second is located in New York State at 184-45 147th Avenue, Suite 103, Springfield Gardens, New York. Petitioner's New York office consists of approximately 1,500 square feet of rented office space.

3. Petitioner is a nonvessel-operating common carrier ("NVOCC"). As such, it files tariffs and posts a surety bond with the Federal Maritime Commission ("FMC").

3. UCM contracts for bulk space on oceangoing vessels of about six unrelated vessel-operating common carriers ("VOCCs") and resells the space to its customers. A VOCC is an independent shipping line which files its tariffs and posts a surety bond with the FMC.

4. UCM does not own or lease any ships, barges, or seagoing vessels of any kind; any trucks, trailers, rail cars, or other ground transportation equipment; or any containers, storage or packing equipment. It also does not own or lease any warehouse space. Petitioner's business is conducted mainly by telephone and fax machine.

5. Petitioner must be an NVOCC in order to be able to enter into a service contract with a VOCC. The record includes a representative service contract entered into by petitioner with a VOCC, i.e., the Yangming Marine Transport Corp., covering the transportation of goods from points in Asia to points in the United States. Under the terms of this service contract, petitioner is committed to ship a minimum quantity of cargo throughout the year or pay liquidated damages. The terms also include the classification of specific items of cargo in five commodity groups, i.e., Groups "A" through "E". The rate for shipment of either a 20-foot or 40-foot container to various destinations on the East and West coasts, as well as points in between, is based upon the commodity group of the cargo. In addition, according to the terms of this

service contract, the VOCC provides consolidated freight service or container yard off-dock terminals or both at two locations in Taiwan.

6. There are two types of water-based shipping services to the East Coast from Asia. The first is the all-water route through the Panama Canal and the other is the miniland bridge service by train from the West Coast. The same types of services are also used for shipments from the East Coast to Asia. Some shipping lines sail once a week each way, while others sail twice a week.

Consolidation cargo is always shipped via the miniland bridge route. Time sensitive cargo, such as clothing, is usually shipped via the miniland bridge service because that route is faster than the all-water route.

Cargo is usually packed in 20 or 40-foot containers supplied by the particular shipping line which will be transporting the cargo. A 40-foot container holds about 50 cubic meters ("CBM"). Container ships traveling across the Pacific or the Atlantic can carry approximately 4,000 or 5,000 20-foot containers at one time.

7. Petitioner supplies information about various shipping lines, whose oceangoing vessels travel to and from Asia, to small importers or small exporters of goods ("shippers"). Based on the information supplied by the shipper, i.e., the type and amount of cargo, the time frame for delivery and the amount which the shipper wishes to spend on transportation, UCM advises the shipper about the services supplied by the VOCCs with which UCM has a service contract.

8. Some of petitioner's customers wish to ship cargo sufficient to fill one or more 20 or 40-foot containers, while others wish to ship small quantities of loose freight.

9. The shipper, rather than petitioner, usually chooses the VOCC which will carry the cargo. The exception is when a shipper has loose freight insufficient to fill an entire container ("less than a container load" or "LCL"). In the case of LCL, petitioner attempts to consolidate LCL from a number of its customers to fill a container. In instances where petitioner is unable to fill a container, it transfers its customer's loose freight to one of three major consolidators,

usually KYC Container Line, which consolidates small cargo from a number of sources into a full container for shipment.

10. After a decision is made as to which shipping line will be carrying the cargo, petitioner advises the customer where to obtain the shipping container or where to take the cargo.

11. Petitioner does not load the shipper's cargo into the containers, nor does it transport the loaded containers to the VOCC's container yard. Rather the shipper obtains the container from the shipping line chosen to ship the cargo, loads its freight into the container and returns the filled container to that line's container yard.

12. In instances where a small importer is shipping less than a container load, it contacts petitioner's overseas agent who directs the importer to deliver its cargo to a warehouse chosen by the shipping line. At that warehouse, the cargo is consolidated along with other cargo into a full container for shipment. When the container reaches the destination railhead, petitioner appoints a warehouse to pick up the container from the rail ramp, take it to its facility, strip/unload the container and place the loose freight on different pallets for each importer or its consignee to pick up.

13. According to Nelson Liu, petitioner's New York regional sales manager, petitioner appoints St. George Warehouse, located in New Jersey, to strip about 90% of its consolidated cargo business.

14. In instances where another NVOCC handles petitioner's customer's loose freight, that NVOCC appoints the warehouse which strips the container.

15. Petitioner does not appoint a warehouse to strip a container filled with only one customer's cargo. Rather the customer gets access to the container and its contents once it is off-loaded from the vessel.

16. Petitioner has no control over the arrival, departure or scheduling of any of the carriers with which it has a service contract. Nor does it have any control over the personnel of any of the carriers.

17. Even though petitioner has a service contract with a VOCC, it still must reserve space for a particular sailing. On occasion, petitioner will be "shut out" and petitioner's customer's cargo must remain in a container at the shipping line's container yard until the VOCC's next sailing. This usually happens during the peak season, when a shipping line overbooks a sailing.

18. Petitioner's services are valuable to its customers because of its knowledge of various shipping lines' rates, procedures, schedules and the quality of the services provided. In addition it has the ability to offer small shippers lower container rates than a VOCC would offer them directly. Furthermore, in instances where an importer/shipper and its manufacturer/supplier distrust each other, petitioner's agent in Asia can and does act as the go-between.

19. The fee which petitioner charges and collects from each of its customers includes the fee of the shipping line which actually transports the cargo. Petitioner retains only a small portion of the fee it collects, forwarding the remainder to the shipping line involved. In instances where a customer requests trucking services to its door (so-called "door service"), petitioner may assist the customer in obtaining those services; however, petitioner does not own or lease any trucks.

20. In every transaction involving petitioner, including ones in which petitioner transfers its customer's loose freight to another NVOCC for consolidation, two bills of lading are always issued, i.e., a master bill of lading and a house bill of lading. Either the shipping line or the NVOCC which has consolidated the cargo, issues the master bill of lading to petitioner as shipper. The master bill of lading never identifies the actual shipper. Petitioner, in turn, issues a house bill of lading to its customer, the actual shipper. All house bills of lading identify petitioner as the agent of the shipping line which is transporting the cargo.

21. A bill of lading has many purposes in the international shipment of goods. Not only is it a required record of the shipment of a particular cargo, it is also a valuable piece of customs

documentation. At times, it is presented along with a letter of credit to a bank in order to obtain payment for cargo.

22. Petitioner carries error and omission insurance to protect solely against employee misdirection of the cargo. It does not insure against physical damage or theft of the goods being shipped. Rather the shipping line which transports the goods takes care of any damage claims. According to petitioner's president, Thomas Lee, petitioner has never had a claim brought against it for damage to shipments.

23. If business is very good, petitioner might direct 40 20-foot containers to one vessel for shipment.

24. During the years in issue, petitioner also shipped cargo by air through carriers operating out of JFK International Airport. About 5% of petitioner's shipments during those years went by air.

25. For calendar years 1992 and 1993, petitioner filed general business corporation franchise tax returns (Form CT-3) pursuant to Article 9-A of the Tax Law, in which it listed its principal business activity as "shipping agency".

26. The Division conducted a desk audit of petitioner's 1992 and 1993 returns. Based on correspondence it had received from petitioner in relation to a desk audit it had conducted for tax year 1991, the Division determined that petitioner was a freight forwarder acting as principal ("principal freight forwarder") and, as such, should have filed franchise tax returns for the years 1992 and 1993 under Article 9, as a transportation corporation, rather than under Article 9-A, as a general business corporation.

The Division's determination was based on the following definition of a freight forwarder (principal and agent) as outlined in an October 5, 1993 letter sent to Donald Pan, petitioner's general manager, by Irene Easton, tax technician - advocate.

"FREIGHT FORWARDERS. Freight forwarders are companies that ship, or arrange the shipping of, the goods of another to a specified destination via a third party. Whether the freight forwarder acts as principal or agent determines whether or not its receipts are from transportation activities.

"1. PRINCIPAL. A principal conducts its business so as to lead

the public to believe that it is a carrier of goods. If it does one or more of the following: issues bills of lading, makes contracts in its own name, receives goods for transport, or takes responsibility for the goods being transported, it is providing a transportation service. It is not necessary that the principal own the means of transportation; it may hire independent carriers to transport the goods. If over 50% of the taxpayer's gross receipts are derived from its activities as a principal, it is subject to tax under Article 9, Sections 183 and 184.

- "2. AGENT. An agent merely acts as a conduit between the provider of the goods and the carrier, and receives a fee for the service. It arranges for transportation without taking responsibility for the goods or insuring their safety, and it is only liable for its own negligence and not that of the carrier. If over 50% of the taxpayer's gross receipts are derived from its activities as an agent, it is subject to tax under Article 9-A."

27. By letter dated April 6, 1995, the Division requested that petitioner file tax forms CT-183 and CT-184 for the years 1992 and 1993 under Tax Law §§ 183 and 184. The letter further stated that if petitioner failed to file the requested returns within 30 days, the Division would issue an estimated assessment based on information in its files.

28. Petitioner respectfully declined to file returns under Tax Law §§ 183 and 184 by letter dated June 7, 1995, and further requested expedited assessment by the Division.

29. The Division computed petitioner's tax liability under Tax Law §§ 183 and 184 as follows: (1) it determined petitioner's minimum tax liability under Tax Law § 183, including the surcharge,¹ to be \$86.00 for each year in issue; and (2) it determined petitioner's Tax Law § 184 tax liability, including the surcharge, to be \$37,968.00 and \$8,603.00, respectively, for the years 1992 and 1993. The Division calculated petitioner's liability under Tax Law § 184 for each year in issue by first multiplying .0075 by the income for services performed in New York State, which petitioner reported on line 125 of Schedule A of each Form CT-3, to arrive at the franchise tax and then adding the 15% surcharge.

¹Tax Law § 188 imposes a tax surcharge on transportation and transmission corporations and associations. A 15% tax surcharge applied to taxable years 1990 through 1993. For the years in issue, the surcharge was computed on forms CT-183 and CT-184 on the tax due, after the deduction of tax credits.

30. By Notice of Deficiency (Notice No. L-010523688-6), dated June 22, 1995, the Division asserted a deficiency of \$45,939.00, plus interest and penalty, based on the estimate of applicable Article 9 tax discussed in Finding of Fact "29".

31. In its petition, dated August 15, 1995, petitioner asserted that the Division erred in determining that it is a transportation company subject to tax under Article 9.

32. During the hearing, one of petitioner's representatives made a motion to amend the petition to include the following additional defenses: first, that to the extent petitioner provides any transportation services, they are performed in the State of New Jersey at Port Elizabeth and Port Newark, not in New York State at the Port of New York and New Jersey; second, that petitioner is engaged in international commerce and thus should not be subject to the transportation tax; and third, that the gross receipts for tax year 1992 were incorrectly calculated and therefore the transportation tax, assuming it is due, was incorrectly calculated.

The motion to amend the petition was granted and the record remained open until May 29, 1996 to afford petitioner the opportunity to submit any or all of the following: (1) every arrival notice issued by UCM for the years in issue; (2) the carrier's tariffs on file with the FMC; (3) copies of any carrier lease agreements for berths on file with the FMC; (4) an affidavit from a representative of the Port Authority of New York and New Jersey; (5) affidavits from the carriers identifying either the 1992 and 1993 transactions involving petitioner, or the location of their berths; (6) for the period in issue, any brochures issued by the carriers used by petitioner or any general shipping publications; and (7) the affidavit of Ronald Su, petitioner's accountant, and supporting documentation concerning the recalculation of the gross receipts for the 1992 tax year.

33. Both Thomas Lee and Nelson Liu testified that ocean container carriers dock at either Port Elizabeth or Port Newark, both of which are located in New Jersey, not in the New York State portion of the Port of New York and New Jersey.

34. After the hearing, petitioner submitted, among other things, its arrival notices (i.e., notices announcing to the consignee in an import transaction that the shipment it was waiting

for was ready to be picked up) for the period in issue. The arrival notice always indicates where the cargo can be picked up ("the cargo location"). Those arrival notices showed that all of the ocean cargo was to be picked up at terminals and warehouses outside of New York.

35. Based on this information as to the site of petitioner's shipments, the Division, in its brief, concedes that none of petitioner's ocean freight forwarding pickups or deliveries occur in New York. In its letter remitting its hearing brief in this matter, the Division revised the Notice of Deficiency issued to petitioner to reflect application of an allocation factor calculated in accordance with the method set forth in an Advisory Opinion, TSB-A-94(12)C, issued to S&S Westchester Shipping, Ltd., causing the amount of the deficiency to be reduced to \$28,824.00, plus penalty and interest for 1992, and \$5,455.00, plus penalty and interest for 1993. The worksheet attached to the transmittal letter contained the Division's calculation of the revised Notice of Deficiency as follows:

"1992

Section 184 tax:

receipts per 1120	15,375,938
allocated @ 21.67%	3,331,966
surcharge @ 15%	<u>3,748</u>
total	28,738 ²

3 factors:

property (per CT-3)	31%
pick-ups and deliveries	0%
wages (per CT-3)	<u>34%</u>
total	65%

Section 183 tax: minimum tax: 86

Revised Total: \$28,824

²The calculation fails to include a line for the computation of tax @ .0075 in the amount of \$24,990 (rounded).

1993

Section 184 Tax

receipts per 1120	2,827,045
allocated @ 22.02%	622,515
tax @ .0075	4,669
surcharge @ 155	<u>700</u>
total	\$5,369

3 factors:

property (per CT-3)	25.05%
pick-ups and deliveries	0%
wages (per CT-3)	<u>41 %</u>
total	66.05%
÷ 3	22.02%

Section 183 Tax

Minimum Tax: \$86

Total: \$5,455"

36. The Division submitted 25 proposed findings of fact. In accordance with State Administrative Procedure Act § 307(1), all the proposed findings of fact have been incorporated into the Findings of Fact except numbers 9, 12, 22 and 25 which have been modified to more accurately reflect the record; and numbers 3 and 4 which are conclusory in nature.

CONCLUSIONS OF LAW

A. For the privilege of exercising its corporate franchise, doing business, employing capital, owning or leasing property in New York State in a corporate or organized capacity, or maintaining an office in this State, every domestic or foreign corporation (except those corporations subject to tax under sections 183 through 186 and such other corporations as are specified in Tax Law § 209[4]) must pay an annual franchise tax to New York State (Tax Law § 209[1]). The tax is based on entire net income of the corporation or one of three other alternative basis.

Tax Law § 183 imposes a tax on the capital stock of domestic and foreign transportation and transmission corporations and associations. Tax Law § 184 imposes a tax on the gross earnings of all transportation and transmission corporations and associations. A transportation

or transmission corporation or association is one formed for or principally engaged in the conduct of aviation, railroad, canal, steamboat, ferry, express, navigation, pipeline, transfer, baggage express, omnibus, trucking, taxicab, telegraph, telephone, palace car or sleeping car business or formed for or principally engaged in the conduct of two or more such businesses, and other domestic corporations or associations principally engaged in the conduct of a transportation or transmission business.

B. Whether a given corporation is properly classified and held subject to taxation under Article 9 or under Article 9-A is to be determined from an examination of the nature of its business activities. Neither the laws under which petitioner was incorporated nor the provisions of petitioner's certificate of incorporation are controlling (see, Matter of McAllister Bros. v. Bates, 272 App Div 511, 72 NYS2d 532, lv denied 272 App Div 979, 73 NYS2d 485; Matter of Holmes Electric Protective Co. v. McGoldrick, 262 App Div 514, 30 NYS2d 589, affd 288 NY 635). In Matter of McAllister Bros. v. Bates (supra), the Court set forth a de facto test with respect to such determination as follows:

"[I]t has firmly been established that classification for franchise tax purposes is to be determined by the nature of [the corporation's] business and that the purposes for which the Corporation was organized are immaterial. This rule with respect to classification for franchise tax purposes applies especially to corporations organized under the general business corporation laws which have within their certificates of incorporation a wide variety of chartered powers." (Matter of McAllister Bros. v. Bates, supra, 72 NYS2d at 536 [emphasis added].)

The term "transportation" means "any real carrying about or from one place to another" (Matter of Joseph A. Pitts Trucking, State Tax Commn., July 18, 1984; see, Matter of RVA Trucking v. State Tax Commn., 135 AD2d 938, 522 NYS2d 689).

C. Both petitioner and the Division agree that petitioner is a nonvessel-operating common carrier. However, the parties disagree as to how petitioner should be classified for tax purposes.

The Division argues that petitioner performs the function of a freight forwarder acting as principal and therefore it correctly determined petitioner to be a transportation corporation. Using definitions contained in the Shipping Act of 1984 at 46 USC, Appendix § 1701, the

Division contends that petitioner, as an NVOCC, holds itself out as providing a transportation service, and is financially liable for the goods being shipped because of the bill of lading it issues to each shipper. The Division also contends that the record clearly establishes that petitioner exercises the requisite control over the transportation process to be considered a principal freight forwarder. It points out that in the case of loose freight which must be consolidated for shipment, petitioner or its agent, not the shipper, decides which shipping line will transport the cargo. It also maintains that even in the case of full container load cargo, petitioner influences the selection of the shipping line by steering the shipper to those lines with which petitioner has service contracts.

Petitioner contends that the business of a freight forwarder is similar to, but not identical to that of an NVOCC. It asserts that the functions it performs most closely resemble those of a freight forwarder acting as agent and therefore it is not a transportation company. Petitioner contends that it does not hold itself out as providing transportation; and all parties contracting with it (shippers and shipping lines) view it as an agent for the interests of an independent principal. It maintains that even in the case of consolidated cargo, it discloses on the house bill of lading that it is the agent for the shipping line transporting the cargo. Petitioner also asserts that it is not financially liable for the goods shipped; rather the vessel operator which transports the goods is directly responsible to the shipper for losses affecting the shipped goods.

D. Nonvessel-operating common carriers are involved in the international shipment of goods by water. As noted in Finding of Fact "2" nonvessel-operating common carriers are regulated by the Federal Maritime Commission. 50 USC, Appendix § 1701, contains definitions of both nonvessel-operating common carriers and ocean freight forwarders. The Division, in its brief, relies heavily on the definitions contained in the Shipping Act of 1984 to support its contention that petitioner is a freight forwarder acting as principal, while an ocean freight forwarder is a freight forwarder acting as agent. The Division argues that NVOCCs, such as petitioner, issue bills of lading, while ocean freight forwarders do not. It also contends that the function of consolidation of cargo which petitioner performs, is unique to nonvessel-

operating common carriers. As noted in Finding of Fact "21", the nature of international shipping requires the issuance of bills of lading in all instances. I find nothing in the entire Shipping Act (50 USC, Appendix § 1701 et seq., added by Pub L 98-237, 97 US Stat 67) which prohibits ocean freight forwarders from either issuing bills of lading or performing the consolidation function. The only distinction I find between an NVOCC and an ocean freight forwarder is that the ocean freight forwarder's activities are restricted to the export of goods from the United States only; while there are no such restrictions on an NVOCC's activities.

E. The record here establishes that UCM acts as the conduit between shippers (its customers) and the shipping lines which transport the cargo. Petitioner's expertise is its ability to assist its customers in arranging the ocean transportation of their goods. Its services are analogous to those of a travel agency. The small shipper requests and petitioner supplies information about the schedules, service levels and rates of the various shipping lines with which it has service contracts. The consolidation function which petitioner performs on behalf of some of its customers is akin to the function performed by a travel agent when the agent reserves a space with a group tour for a customer. Once a decision has been made, either by the shipper or, in the case of consolidated cargo, by petitioner and/or its agent, as to which shipping line will be providing transportation, petitioner reserves space with that line for a specific sailing date. On occasion, due to the shipping line's overbooking of a specific sailing, petitioner's customer's cargo is shut out and the cargo's shipment is delayed until the next sailing. Petitioner's customers always know which shipping line will be transporting their goods. Each bill of lading issued by petitioner identifies the shipping line, as well as the specific vessel, which is transporting the goods. Petitioner makes it easy for the small shipper of goods by arranging the transportation and preparing the paperwork and documentation necessary in international ocean shipping.

Viewed from the perspective of its customers, small importers and small exporters, what they buy and pay for, (see, Matter of Capital Cablevision Systems, Tax Appeals Tribunal,

June 9, 1988), petitioner is a freight forwarder acting as agent and as such is a general business corporation. The Division incorrectly determined petitioner to be a transportation company.

F. Since I have determined that petitioner is not a transportation company subject to tax under Article 9, the second issue is rendered moot and will not be addressed.

G. The petition of United Cargo Management, Inc., is granted, and the Notice of Deficiency, dated June 22, 1995, is hereby cancelled.

DATED: Troy, New York
April 10, 1997

/s/ Winifred M. Maloney
ADMINISTRATIVE LAW JUDGE