STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petitions	:	
of	:	
AMERICAN JET ENGINE CO., INC. AND AMJET AEROSPACE, INC.	:	DETERMINATION DTA NOS. 816998 AND 816999
for Redetermination of Deficiencies or for Refunds of Corporation Franchise Tax under Article 9-A of the Tax Law for the Years 1994, 1995 and 1996.	:	

Petitioners, American Jet Engine Co., Inc. and Amjet Aerospace, Inc., 37 West 39th Street, New York, New York 10018, filed petitions for redetermination of deficiencies or for refunds of corporation franchise tax under Article 9-A of the Tax Law for the years 1994, 1995 and 1996.

A hearing was held before Catherine M. Bennett, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York 10022, on November 30, 1999, at 10:30 A.M., with all briefs to be submitted by July 21, 2000, which date began the six-month period for the issuance of this determination. Petitioner appeared by Stern, Keiser, Panken & Wohl, LLP (Laurence Keiser, Esq., of counsel). The Division of Taxation appeared by Barbara G. Billet, Esq. (Robert A. Maslyn, Esq., of counsel).

ISSUES

Whether the Division properly determined that rents paid by petitioners for space to warehouse their inventory should not be included in the property factor of petitioners' business allocation percentage based on a finding that the space is not designated and under petitioners' control.

FINDINGS OF FACT

1. The Division of Taxation ("Division") issued to American Jet Engine Co., Inc.[1] ("AJE") a Notice of Deficiency dated February 12, 1999, which asserted corporation franchise tax for tax years 1994, 1995 and 1996 in the amounts of $801.00, $1,227.00 and $1,231.00, respectively, plus interest, for a total amount due of $4,150.51.

The Division issued to Amjet Aerospace, Inc. ("Amjet") a Notice of Deficiency dated February 12, 1999, which asserted corporation franchise tax for tax years 1994, 1995 and 1996 in the amounts of $809.00, $1,864.00 and $2,994.00, respectively, plus interest, for a total amount due of $7,052.96.

2. In 1997, the Division commenced a corporation franchise tax field audit of petitioners for tax years 1994 through 1996. The Division reviewed petitioners' bank statements, invoices, cash disbursements journals, sales receipts journals, checks, trial balances, tax returns, warehouse lease and warehouse agreement. The Division concluded that petitioners improperly included in the property factor of their business allocation percentage rent paid for storage space at a warehouse in New Jersey that was neither designated space nor under the control of either petitioner.

3. Petitioners executed consents extending the statute of limitations for the assessment of corporation franchise tax, dated January 23, 1998, which permitted the tax to be assessed for tax year 1994 at any time on or before March 15, 1999, for both petitioners.

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[1] American Jet Engine Co., Inc. and Amjet Aerospace, Inc. will collectively be referred to as "petitioners."

4. Petitioners are brother-sister corporations, incorporated in New York, with offices in New York City, and owned 100% by Paul Varkell. The companies buy and sell airplane parts, which Mr. Varkell stores in a warehouse facility in New Jersey. The warehouse was owned by ASA Apple, Inc. ("ASA"), successor to Apple Freight Systems of America and Apple Leasing Corporation (with whom petitioners' original agreement was made), a company unrelated to petitioners. An employee of ASA, Clarence Scott, was specially trained by Mr. Varkell to inventory, supervise, pack, crate and prepare the airplane items for shipment.

5. Between 1945 and 1960, Mr. Varkell owned the Paul Varkell Company, the predecessor to AJE and Amjet. AJE, formed in 1960 and incorporated in 1967, deals in jet engine parts. Amjet, also formed in 1960 and incorporated in 1967, deals in aircraft bearings and aircraft material. The inventory for both companies is acquired primarily as unused military excess, from the Air Force, Navy, Marines and other sources. Once purchased, the inventory is shipped to the warehouse, brought into inventory, inspected and assigned a lot number. There are approximately 1,300 lots which are designated by a numbering system, which identifies whether the items are the inventory of AJE or Amjet. AJE and Amjet share the leased space that is the subject of the warehouse agreement. However, separate inventory records are maintained for the two companies. The warehouse space is billed to each petitioner monthly on the basis of the cubic feet which it occupies.

6. Mr. Varkell arranged to have iron and steel racks constructed in the warehouse to store petitioners' materials and parts, and provided funds for about half the cost of the racks. The racks are immense in size and form the boundaries on the inside warehouse space. The weight of the inventory stored in the warehouse was estimated to be hundreds of thousands of tons.

7. The racks are separated by aisles and are accessible by forklifts on both sides. The boundaries of petitioners' warehouse space consist of walls, racks and aisles. If petitioners require additional warehouse space, the cubic foot space is enlarged, wherein additional racks are installed as needed. All of petitioners' inventory is stored on such racks.

8. Petitioners insure their inventory, but not the space. ASA has financial responsibility for the maintenance of the warehouse, warehouse utilities and warehouse security. The facility was locked and secured at night.

9. Both AJE and Amjet filed Forms 1120S, U.S. income tax returns for an S corporation and Forms CT-3-S, New York S corporation franchise tax returns for tax years 1994, 1995 and 1996.

SUMMARY OF THE PARTIES' POSITIONS

10. Petitioners maintain that they have designated storage space since the space is set apart and identified for the specific purpose of storing petitioners' inventory parts. Petitioners further argue that inasmuch as petitioners' owner is the dominant influence over the space, the storage space is within the control of petitioners. Consequently, petitioners believe that the rent for such space is properly included in the property factor of the business allocation percentage.

11. The Division takes the position that petitioners' storage space fees are not included in the property factor because the space is not designated space and not under petitioners' control. The Division relies on the fact that petitioners are separate corporations using the same space, and argues that this demonstrates a lack of exclusivity needed to sustain a finding of separate space designation and separate control.

CONCLUSIONS OF LAW

A. In 1990, New York enacted provisions which impose a corporate level tax on New York S corporations (L 1990, ch 190, § 12). Petitioners, both New York S corporations, are subject to taxation pursuant to Article 9-A of the Tax Law with respect to any taxable year for which an election is in effect pursuant to Tax Law § 660(a) (Tax Law § 208 [1-A]). Petitioners filed New York S corporation franchise tax returns for all the years in issue.[2] Pursuant to Tax Law former § 210(1)(g), in effect during the years in issue, the tax imposed is the higher of tax calculated on the basis of entire net income allocated to New York (Tax Law § 210[1][a]), reduced to the differential rate[3] (pertinent in this matter), or on the basis of a fixed-dollar minimum (Tax Law § 210[1][d]). Petitioners' share of business income subject to taxation was computed pursuant to a statutory formula designed to determine the portion of each company's net business income to be allocated to, and thus, taxable by New York (Tax Law § 210[3][a]). The amount of petitioners' entire net income allocable to New York is determined by multiplying petitioners' business income by their business allocation percentage ("BAP"). The BAP is computed based on three factors: property, receipts and payroll. More specifically, the BAP represents the arithmetic average of the ratios of a corporation's property, receipts and payroll values within New York State to those of such corporation as a whole. The issue in this case is whether rent paid for storage space (in New Jersey) for petitioners' inventories is properly included in the property factor of the business allocation percentage under Article 9-A of the Tax Law.

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[2] There is no dispute that proper S corporation elections were in effect.

[3] The differential rate is the difference between the corporate rate under Article 9-A and the Article 22 equivalent rate.

New York State tax regulations at 20 NYCRR former 4-3.2, pertinent herein, provide that in determining the property factor of the BAP, real property rented to the taxpayer is included. However, gross rents, which are the subject of this inclusion, do not include amounts payable for storage, if the amounts are payable for such space which is not designated and not under the control of the taxpayer (20 NYCRR former 4-3.2[c][3]). The burden of proof is on petitioners to show that the space for which the storage fees were rendered is designated space and under petitioners' control.

B. The Division argues that the storage area is not designated in accordance with the regulations since the area was not defined, it changes and it was occupied by two separate entities. In support of its conclusion, the Division relies upon ***Matter of Alconox, Inc. v. State Tax Commission*** (114 AD2d 575, 494 NYS2d 432), where the Division mistakenly claims that the court dealt with the issue of designated space. The court determined that amounts payable for storage in that case were improperly included in the property factor because the taxpayer failed to demonstrate that the storage areas in question were under its control (***id***). There was no mention of whether the space was designated. The decision by the State Tax commission (***Matter of Alconox, Inc., August 9, 1984)*** found factually that 17,300 square feet of space was set aside for storage of Alconox products, but was not specifically designated. As the facts are set forth therein, there is insufficient factual detail to determine whether ***Alconox*** can even be compared to this matter.

On the issue of space designation, a determination would be simplified if the designated space was a completely confined area. The regulations do not define "designated." However, pursuant to common usage, it means "to indicate and set apart for a specific purpose" (Webster's Ninth New Collegiate Dictionary 343 [9th ed 1983]). Mr. Varkell provided credible and detailed

testimony about how the space is situated with respect to boundaries defined by walls, aisles and four high steel racks. Given the volume and weight of petitioners' inventory and the special handling required of such engines and parts, this is clearly designated space. It is not merely an amount of space set aside somewhere in a warehouse. It is space specifically designed by virtue of the storage racks to hold petitioners' inventory, and only petitioners' inventory. The regulations do not prohibit designated space from being expanded or moved. The space occupied by petitioners is expanded to accommodate its inventory by the addition of large steel racks. As modified, the expanded space is also designated space by virtue of its physical definition (walls, aisles and racks) and the fact that it is set aside specifically for petitioners. The fact that both petitioners, as related corporations under one warehousing agreement, share the space set aside for them does not defeat a finding that the space is designated. Accordingly, the Division's argument that the space was not designated is rejected.

C. Concerning the second part of the test, whether the storage space is under petitioners' control, the Division maintains that ASA, provider of the warehouse facility, controlled the space in issue. The storage space was in a warehouse operated by ASA, where ASA agreed to provide security, perform general maintenance and provide utilities. The facility was a locked, secure facility to which Mr. Varkell did not have around the clock access without the assistance of ASA personnel.

Petitioners argue that one must look to who exercised the dominating influence or authority over the storage space. Petitioners argue that clearly Mr. Varkell is the party who was dominant in this instance. Mr. Varkell designed the language for a portion of the contract dealing with special handling of the inventory, he dictated how to store the inventory, and mandated the existence of, and provided part of the funding for, the steel racks. He trained a

single, particular employee of ASA to be responsible for cataloguing the inventory and likewise the maintenance, packaging and shipping of parts. He paid additional fees for such services. He required ASA to keep a locator system for the extensive inventory of 1,300 lots.

"Control" is not defined by the statutes or regulations pertinent to this matter. Further, the situation in which one might assign a particular meaning to the word "control" is not described in Article 9-A, or the associated regulations, as with some other provisions of Title 20 (***see,*** 20 NYCRR 473.8[d]; 20 NYCRR 541.2[p][2]). However, common usage of the term refers to the "power or authority to guide or manage" (Webster's Ninth New Collegiate Dictionary 343 [9th ed 1983]). The facts of this case present a unique situation, and I agree with petitioners that the quality and dominance of Mr. Varkell's authority over the storage space must be considered. Here the substance of the control asserted by petitioners' owner far outweighs the ministerial and ancillary services provided by ASA. I do not believe that the concept of control is limited to 24-hour access or to the services provided, given the unusual facts of this case. Likewise the control being shared by the two corporations which are owned by the same person does not impair this conclusion. Accordingly, it is determined that such space was under petitioners' control. Consequently the rent paid for the storage space is properly included in the property factor of the BAP.

D. The petitions of American Jet Engine Co., Inc. and Amjet Aerospace, Inc. are hereby granted, and the notices of deficiency dated February 12, 1999 are canceled.

DATED: Troy, New York
January 18, 2001

/s/ Catherine M. Bennett
ADMINISTRATIVE LAW JUDGE