STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
BTMU LEASING & FINANCE, INC.	:	DETERMINATION DTA NO. 821525
for Redetermination of a Deficiency or for Refund of Franchise Tax on Banking Corporations under Article 32 of the Tax Law for the Years 2000, 2001 and 2002.	: :	
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Petitioner, BTMU Leasing & Finance, Inc., filed a petition for redetermination of a deficiency or for refund of franchise tax on banking corporations under Article 32 of the Tax Law for the years 2000, 2001 and 2002.

A hearing was commenced before Thomas C. Sacca, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on October 5, 2007 at 10:30 A.M., and continued to conclusion at the same location on January 11, 2008, with all briefs to be submitted by May 30, 2008, which date began the six-month period for the issuance of this determination. Petitioner appeared by KPMG, LLP (Russell D. Levitt, Esq., of counsel). The Division of Taxation appeared by Daniel Smirlock, Esq. (Nichloas A. Behuniak, Esq., of counsel).

ISSUES

I. Whether BTMU Leasing & Finance, Inc., properly allocated proceeds from end-of-lease sales of leased property located outside New York State to the situs of the property, pursuant to 20 NYCRR 19-6.3(a).

II. Whether the Division of Taxation properly reallocated the proceeds from end-of-lease sales of leased property based on where the receipts were earned pursuant to 20 NYCRR 19.6-9(b).

III. Whether penalties imposed pursuant to Tax Law § 1085(k) for the substantial understatement of tax for the years 2001 and 2002 should be abated.

IV. Whether the Division of Taxation is prohibited from assessing tax year 2000 based upon federal changes.

FINDINGS OF FACT[1]

1. Petitioner, BTMU Leasing & Finance, Inc. (BTMU), f/k/a BTM Leasing & Finance, Inc., is, and at all relevant times has been, a wholly owned subsidiary of the Bank of Tokyo-Mitsubishi, Ltd. BTMU was initially known as Mitsubishi Capital, Inc,. until 1996, when it changed its name to BTM Leasing & Finance, Inc. In 2006, petitioner changed its name from BTM Leasing & Finance, Inc. to BTMU Leasing & Finance, Inc. (its current name) at the time that the Bank of Tokyo-Mitsubishi, Ltd., merged with the UFJ Bank.

2. Petitioner was incorporated under the laws of the State of Delaware in 1988 and began doing business in New York State on July 26, 1988. BTMU has one office, located at the Bank of Tokyo-Mitsubishi, Ltd. (the Bank) in New York City. Petitioner employed nine or ten individuals during the audit period, and five officers. The employees engaged in client lease

[1] In accordance with New York State Administrative Procedure Act § 307(1), many of petitioner's and the Division of Taxation's proposed findings of fact have been accepted, in whole or in part, and incorporated herein. It is noted that petitioner's proposed findings of fact 33, 47, 48, 51, 52, 53, 54, 55, 57, 59, 60, 61, 62, 63, and 64 and the Division of Taxation's proposed findings of fact 13, 14, 18, and 23 have been rejected as unnecessary for the determination or not clearly supported by the record at the location referenced. Petitioner's proposed findings of fact 9, 10 and 40 are rejected for being in the nature of argument or a conclusion of law.

product solicitations, investigations, negotiations, development of lease structures and proposals, and the execution of lease agreements.

3. Petitioner's principal business activities have always been to engage in equipment leasing (as lessor) and end-of-lease sales (i.e., integrated lease/purchase contracts).

4. Tokyo-Mitsubishi, Ltd., has eight to ten branch locations in the United States, including locations in New York City, Chicago, Houston, Los Angeles and San Francisco.

5. In a typical leveraged lease structure, such as the ones at issue herein, BTMU purchases expensive manufacturing equipment and invests between 20 and 25 percent of the fair market value of the equipment and borrows the balance from a branch of the Tokyo-Mitsubishi, Ltd. Bank, as lender, on a nonrecourse basis. These financing arrangements are solely between petitioner and the Bank, or its branch, and are arms length transactions. Petitioner seeks approval from the Bank for its equity investment in the leased manufacturing equipment. The approval for the loan for the remaining fair market value of the equipment (e.g., 75 to 80 percent) is conducted by the Bank's branches.

6. Each of BTMU's leases was intended to qualify as an "operating lease" (also referred to as a "true lease") rather than a "financing lease" for federal income tax purposes. In a typical operating lease, the lessor is the owner of the equipment and provides the lessee with an option to purchase the property at a time before lease termination at a fixed price estimated to be at least equal to the fair market value or at the end of the lease at fair market value. In contrast, in a financing lease, the ownership of the equipment reverts to the lessee when all payments are made.

7. The leveraged lease model used by BTMU provides its clients with an efficient form of financing, while providing lessors, like BTMU, with certain advantages, including depreciation deductions.

8. Normally, the subject lease structure involves a lessee who may arrange for the acquisition of certain equipment by BTMU, who in turn then leases the equipment to the lessee. BTMU owns title to the equipment at all times during the lease.

9. The lessees are solely responsible for maintaining, operating, insuring and paying taxes on the equipment during the life of the lease up to and including the time they decide to purchase the equipment. As owner of the equipment, BTMU could, nonetheless, suffer an economic loss in the event that the lessee fails to maintain the equipment, since that could negatively impact the residual value.

10. The Bank of Tokyo-Mitsubishi, Ltd., often has a business relationship with the parent company of a potential lessee. As a result, the Bank is familiar with the lessee's business activities and its investment or expansion plans, both in Japan and in the United States. Through this relationship, the Bank may identify a leasing opportunity and refer it to BTMU to contact the potential lessee to promote and structure the lease arrangement. Such contact is usually initiated through a branch of the Bank located nearest the business location of the potential lessee.

11. BTMU typically sends an employee to present an integrated lease/purchase contract proposal to the client at the client's location, and conducts follow up visits as necessary. The Bank's employees of the relevant bank branch review the creditworthiness of the customers. Petitioner engages a third-party appraiser to value the fair market value of the equipment, and the expected residual value of the equipment at the end of the lease.

12. All decisions for approval of the lease arrangement are made by the Bank's employees in Japan, after reviewing each structure and the economics of each transaction. Petitioner, as the owner/lessor of the equipment, signs (denoting its approval) the integrated lease/purchase contracts. The client lessee's parent company generally guarantees the lessee's obligations.

13. At the inception of each lease, petitioner uses third-party software to calculate and schedule lease payments. All of the terms of the lease are locked in at the beginning of the lease.

14. Each of petitioner's leases - except for the lease identified in the record as the "Englewood" lease - provided the lessee with the option to purchase the equipment, either at the end of the lease or at some predetermined time, often year seven, based on the estimated fair market value of the equipment at that time, as determined by the third-party independent appraisers at the inception of the lease.

15. Englewood was a unique lease for the subject matter at hand, in that the lessee did not have an integrated purchase option for the equipment. However, Englewood did purchase the leased equipment from petitioner.

16. The option to purchase is completely under the lessee's control and is never mandatory. If the lessee exercises its purchase option, a bill of sale is executed to transfer title to the equipment from petitioner to lessee. If the lessee does not exercise its purchase option - an occurrence which has never happened with BTMU - petitioner would be permitted to resell or release the equipment.

17. The proceeds from the end-of-lease sale together with the lease rental payments are factored into the up-front integrated pricing model to recoup petitioner's investment. The gain recognized by BTMU upon the sale at the end of the lease is characterized as depreciation

recapture for federal income tax purposes and results from accelerated depreciation methods allowed during the earlier portions of the lease term.

18. During the period 2001 and 2002, six[2] purchase transfers of properties pursuant to integrated lease/purchase contracts occurred, four in 2001 and two in 2002. In all six purchase transfers, the property leased and sold was located outside of the State of New York.

19. At the hearing, petitioner's witness, Mr. Larry K. Morris, who has been a senior vice president and a long-standing leasing professional and functional general manager of BTMU's leasing business since commencing employment with petitioner on January 11, 1999, testified to the terms of each of the leases.

20. In each of the six leases, the client was a subsidiary of a Japanese company engaged in a manufacturing business in the United States, but outside New York State. For example, Optec DD USA, Inc. (Optec), was based in Missouri and engaged in the business of manufacturing electrical wire for motors used in the automotive and communication industries. Englewood Precision, Inc., a subsidiary of Nisshin Kegyo of Japan, was based in Englewood, Ohio, and manufactured television parts.

21. In each of the six leases, petitioner leased equipment to the lessee for a fixed term of generally ten years, with the lessee taking possession of the property outside of New York State. For example, petitioner leased wire drawing equipment located in Missouri to Optec for the period August 30, 1991 through August 30, 2001. For the Englewood lease, the property was located in Englewood, Ohio.

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[2] Although the "Englewood" lease did not contain a specific purchase option for the equipment being leased, the lease provisions and end-of-lease sale provide the basis to treat this transaction the same as the other five transactions at issue. It is noted that no distinction was made by the parties between the "Englewood" lease and the other leases at issue.

22. In each of the lease transactions entered into by BTMU, it was necessary for petitioner to sell the leased property in order to recoup its original investment. At the end of each of the leases or at the option period of the leases in issue, the lessee purchased the leased equipment. For example, Optec purchased the equipment on August 30, 2001, the last day of the lease term.

23. For each of the leases in issue (except for one involving Optec D.D. U.S.A., Inc., where no appraisal was obtained because the equipment was virtually identical to equipment previously and recently leased to the same lessee and for which an appraisal had recently been obtained), a third-party appraiser either visited the lessee's location to determine the fair market value of the equipment and to estimate the residual value of such equipment, or performed such work from its own offices, or both visited the lessee and performed the appraisal work from its own office. For example, Marshall & Stevens, based in Des Plaines, Illinois, valued Optec's leased equipment in Missouri, and valued Englewood's leased equipment and the equipment leased by Matai (U.S.A.), Inc., in Ohio. American Appraisal Associates, based in Milwaukee, Wisconsin, appraised the equipment subject to the lease with Yotec, Inc., in Ohio and the leased equipment of Mitsubishi Chemical America, Inc., in Virginia.

24. BTMU filed New York State franchise tax returns, including Metropolitan Commuter Transportation District surcharge tax returns (forms CT-32 and CT-32M, respectively), under Article 32 of the Tax Law, for the three calendar tax years of 2000, 2001 and 2002.

25. On each of its relevant CT-32 returns filed during the period at issue, BTMU sourced receipts from lease payments to the location of such property, that is, outside New York State, in accordance with 20 NYCRR 19-6.3(a). Petitioner included the periodic lease rental payments in the numerator of the receipts factor of its business allocation percentage based on the physical

location of the leased property. Neither petitioner nor the Division of Taxation (Division) is challenging this treatment.

26. BTMU allocated the proceeds from the sales of end-of-lease property to the numerator of the receipts factor of its business allocation percentage based on the physical location of the subject property, in the same way that BTMU reported the receipts from the periodic lease payments.

27. Petitioner filed income tax returns in each of the other states in which the properties were located and allocated the end-of-lease sale proceeds to the other states (in the other state's receipts factor numerator), or entirely allocated such receipts, as required by the relevant other state.

28. Following a field examination of petitioner's franchise tax returns for the years at issue, the Division issued to petitioner a Notice of Deficiency, dated June 27, 2005, asserting tax due of $256,121.00, plus penalty and interest. Penalty was assessed pursuant to Tax Law § 1085(k) for the substantial understatement of tax for the years 2001 and 2002.

29. The basis of the Division's adjustment for the years 2001 and 2002 concerns the sourcing of the proceeds from end-of-lease sales of equipment to the numerator of the receipts factor of BTMU's business allocation percentage. The Division asserts that the proceeds from these sales should be allocated based upon where the work earning such receipts was performed.

30. In making the determination that the end-of-lease sale proceeds should be allocated 100 percent to New York State, the Division applied the so-called SINAA rules, which expressly apply in the regulations only to income from loans and financing leases (***see*** 20 NYCRR 19-6.2[d]). SINAA is an acronym, which stands for solicitation, investigation, negotiation, administration and approval. The auditor concluded that the SINAA activities performed by

petitioner during the years at issue occurred only in New York, since BTMU's sole office is located in New York City.

31. With respect to BTMU's 2000 calendar year, the identical receipts factor issue had been the focus of a previous petition covering tax years 1998 through 2000, which was settled pursuant to a Stipulation for Discontinuance of Proceeding. After the original notice of deficiency was issued for the 1998 through 2000 tax years, the Internal Revenue Service increased BTMU's federal taxable income for the 2000 tax year, which resulted in an increase to BTMU's New York State taxable income for the same year. As a result, the Division assessed additional taxes in the year 2000 resulting from the changes to petitioner's federal taxable income in the Notice of Deficiency at issue herein.

CONCLUSIONS OF LAW

A. Article 32 of the Tax Law imposes franchise tax on a banking corporation "[f]or the privilege of exercising its franchise or doing business in [New York State] in a corporate or organized capacity" (Tax Law § 1451[a]). Tax Law § 1454 provides the rules for allocation where a banking corporation's entire net income, alternative entire net income or taxable assets are derived from business carried on within and without the state. This section further provides that "[a]ll interest from loans and financing leases is located where the greater portion of income producing activity related to the loan or financing lease occurred" (Tax Law § 1454[a][2][B]). However, Tax Law § 1454(a)(2)(C) states that "[r]eceipts from leases other than financing leases referred to in subparagraph (B) are located where the property subject to the lease is located."

B. The franchise tax on banking corporation regulations (20 NYCRR 19-6.2) set forth the rules applicable to determining the location of a loan or financing lease. 20 NYCRR 19-6.2(c) provides as follows:

> To determine where the greater portion of income-producing activity relating to a loan or financing lease occurred, consideration is given to such activities as the solicitation, investigation, negotiation, final approval and administration of the loan or financing lease. Each loan or financing lease has its own characteristics. In some cases, one or more of the activities to be considered may not be present. The significance to be accorded to each activity depends upon the facts in each case.

The regulation makes clear that the so-called SINAA criteria are to be applied to loans and financing leases in determining where such transaction is located for allocation purposes.

C. 20 NYCRR 19-6.3 provides as follows with regard to operating leases:

> (a) Receipts from real property and tangible personal property leased or rented from the taxpayer are allocated to New York State if such property is located in New York State. Receipts from rentals include all amounts received by the taxpayer for the use or occupation of property, whether or not such property is owned by the taxpayer. Gross receipts received from real property and tangible personal property which is subleased must be included in the receipts factor.
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> (b) For the treatment of income from a financing lease, see section 19-6.2 of this Subpart.

D. For the years 2001 and 2002, the notice of deficiency issued to petitioner is based on a recalculation of BTMU's business allocation percentage, specifically, the receipts factor. The recalculation adds BTMU's sales of end-of-lease property to the numerator of its receipts factor. The Division treated these receipts as "other receipts" pursuant to 20 NYCRR 19-6.9(c), which allocates receipts based upon where they are earned. According to the Division, since BTMU had only one office and all the material work related to the transactions were performed out of that office, the Division allocated all of the sales proceeds to that office in New York State.

Petitioner maintains that the sales proceeds from the property that was leased and ultimately sold under the operating leases should be treated as receipts from lease transactions, which for allocation purposes are located where the property subject to the lease is located, pursuant to Tax Law § 1454(a)(2)(C) and 20 NYCRR 19-6.3(a).

E. The dispute between the Division and BTMU is based upon the determination of how to classify the proceeds from the end-of-lease sales. Tax Law § 1454 sets forth the procedures to be followed in the case of loans and financing leases, which locate the receipts where the greater portion of income producing activity occurred, and in the case of other than financing leases, which locate the receipts where the subject property is located. In making this determination, it must be determined whether Tax Law § 1454(a)(2)(C), when referring to receipts from lease transactions, is limited in its application to the periodic lease payments received by a taxpayer, in this case BTMU, as the Division argues, or whether the receipts referred to in the statute also include the proceeds from the end-of-lease sales, as petitioner contends. The determination rests upon the statutory construction of Tax Law § 1454(a)(2)(C), as well as 20 NYCRR 19-6.3, promulgated thereunder.

F. When construing a statute the primary focus is on the intent of the Legislature in enacting the statute (McKinney's Cons Laws of NY, Book 1, Statutes § 92[a]; ***see Matter of Sutka v. Connors***, 73 NY2d 395, 541 NYS2d 191 [1989]; ***Matter of American Communications Technology v. Tax Appeals Tribunal***, 185 AD2d 79, 592 NYS2d 147 [1993], ***affd*** 83 NY2d 773, 611 NYS2d 125 [1993]). To determine legislative intent, courts must first look at the literal reading of the act itself (***see*** McKinney's Cons Laws of NY, Book 1, Statutes § 92).

Statutory rules of construction provide that "[t]he legislative intent is to be ascertained from the words and language used, and the statutory language is generally construed according to its natural and most obvious sense, without resorting to an artificial or forced construction" (McKinney's Cons Laws of NY, Book 1, Statutes § 94). Where the statute is clear, the courts must follow the plain meaning of its words, and "there is no occasion for examination into extrinsic evidence to discover legislative intent . . ." (McKinney's Cons Laws of NY, Book 1, Statutes § 120; ***see Matter of Raritan Dev. Corp. v. Silva***, 91 NY2d 98, 667 NYS2d 327 [1997]; ***Matter of Schein***, Tax Appeals Tribunal, November 6, 2003).

Courts may look elsewhere to interpret a statute that is not clear. However, a court should not add restrictions or limitations where none exist, nor should it interpret a statute which has no need of interpretation. Where, as here, words of a statute have a definite and precise meaning, it is not necessary to look elsewhere in search of conjecture so as to restrict or extend that meaning (***Matter of Erie County Agricultural Society v. Cluchey***, 40 NY2d 194, 386 NYS2d 366 [1976]). As the language of the statute is clear, it is appropriate to interpret its phrases in their ordinary, everyday sense (***Matter of Automatique v. Bouchard***, 97 AD2d 183, 470 NYS2d 791 [1983]).

G. Tax Law § 1454(a)(2)(C) provides that the "receipts from lease transactions other than financing leases . . . are located where the property subject to the lease is located." The term "receipt" is broadly defined, in part, as "something received" (Webster's Ninth New Collegiate Dictionary 982 [1989]). There is no requirement in the statute that the "receipts" received from a lease transaction be limited to the periodic lease payments. The rent payments and estimated residual value of the property which was the subject of each of the leases were integral components of the pricing model at the inception of the leases. It would be illogical and unreasonable to conclude that the Legislature intended that the ongoing lease rental stream receipts be allocated to the situs of the equipment, yet not achieve an identical methodology for the end-of-lease sales receipts of the same equipment, especially when the lease payments and the purchase price of the equipment at the end of the lease were negotiated together and contained in one integrated contract from the outset. (***See*** McKinney's Cons Laws of NY, Book

1, Statutes § 143.) Furthermore, the expansive definition of the term "receipt" is clearly broad enough to include within its meaning the proceeds from the end-of-lease sale transactions.

If, as the Division argues, the Legislature intended to create the requirement that only the periodic lease payments were to be allocated where the property subject to the lease was located, it could have done so by placing this requirement in the statute. Instead, the Legislature used the broad term "receipt." Words should not be expanded to enlarge their meaning to something which the Legislature could easily have expressed but did not, and new language can not be imported into a statute to give it a meaning not otherwise found therein (***see*** McKinney's Cons Laws of NY, Book 1, Statutes § 94). Therefore, it is concluded that the receipts from the end-of-lease sales of the equipment subject to the lease were properly allocated by petitioner to the location of the leased property pursuant to Tax Law § 1454(a)(2)(C) and 20 NYCRR 19-6.3(a).

H. By virtue of the holding herein, Issue III is moot.

I. Petitioner was audited by the Division of Taxation for the years 1998, 1999 and 2000 resulting in the issuance of assessment number L-024432906. Following the issuance of assessment number L-024432906, the Internal Revenue Service increased petitioner's federal taxable income in the year 2000 resulting in an increase to petitioner's New York State taxable income and tax liability for the same year. Assessment number L-024432906 was settled by the Division and petitioner, but the assessment and settlement did not incorporate the federal changes to the 2000 tax year. Therefore, there is no prohibition on the Division in assessing petitioner for the year 2000 based upon the federal changes.

J. The petition of BTMU Leasing & Finance, Inc. is granted to the extent indicated in Conclusion of Law G, and the Division of Taxation is directed to modify the Notice of

Deficiency issued to petitioner in accordance therewith. In all other respects, the petition is denied.

DATED: Troy, New York
November 26, 2008

/s/ Thomas C. Sacca
ADMINISTRATIVE LAW JUDGE