

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter *of* the Petition

of

WESTINGHOUSE ELECTRIC CORPORATION

for Redetermination of a Deficiency or for
Refund of Corporation Franchise Tax under
Article 9-A of the Tax Law for the Years 1974 :
through 1977.

DECISION

In the Matter of the Petition

of

CREDITFINANCIAL CORPORATION

for Redetermination of a Deficiency or for
Refund of Corporation Franchise Tax under
Article 9-A of the Tax Law for the Years 1974 :
through 1977.

Petitioner, Westinghouse Electric Corporation, Tax Department, Westinghouse Building, Gateway Center, Pittsburgh, Pennsylvania 15222, 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 years 1974 through 1977 (File No. 34053).

Petitioner, Credit Financial Corporation, c/o Westinghouse Electric Corporation, Tax Department, Westinghouse Building, Gateway Center, Pittsburgh, Pennsylvania 15222, 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 years 1974 through 1977 (File No. 33700).

A consolidated hearing was held before Doris E. Steinhardt, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York on October 9, 1985 at 9:15 A.M., with all briefs to be

submitted by January 20, 1987. Petitioners appeared by Cravath, Swaine and Moore (Richard J. Hiegel, **Esq.**, Simon Friedman, Esq. and Lester E. DeBaun, Esq., of counsel). The Audit Division appeared by John P. Dugan, Esq. (Anne W. Murphy, Esq., of counsel).

ISSUES

I. Whether the Audit Division correctly computed the DISC Export Credit to which Westinghouse Electric Corporation was entitled for the period in issue.

II. Whether Credit Financial Corporation was entitled to carry forward to 1976 and 1977 a net operating **loss** from 1973 where there was no corresponding Federal net operating **loss** carryover from 1973 to 1976 and 1977.

FINDINGS OF FACT

1. On March 20, 1981, the Audit Division issued to petitioner Westinghouse Electric Corporation ("Westinghouse") three statements of audit adjustment and three notices of deficiency asserting additional franchise tax due of \$163,152.50 for 1974 plus interest; \$218,779.88 for 1975 plus interest; and \$168,595.76 for 1976 plus interest.

2. On or about November 28, 1980, Westinghouse filed a Claim for Credit or Refund of Corporation Tax Paid for the years 1974 through 1977 in the amount of \$281,902.00. The claim was denied by the Audit Division on the basis of a prior field audit.

3. Sometime after October 9, 1985, Westinghouse and the Audit Division entered into a stipulation of facts whereby Westinghouse conceded certain issues presented in its petition and in its claim for credit or refund. The stipulation also recites adjustments made in the computation of the DISC Export Credit to which Westinghouse is entitled for the years in issue as follows:

<u>Period Ending</u>	<u>DISC Credit</u>
December 31, 1974	\$125,212.00
December 31, 1975	149,574.00
December 31, 1976	1,732.00

4. Based on the recomputation of the DISC Export Credit, Westinghouse's corporation franchise tax liability was recalculated as follows:

<u>Period Ending</u>	<u>Corp. Franchise Tax Liability</u>
December 31, 1974	\$41,764.00
December 31, 1975	76,419 .00
December 31, 1976	(1,632.00)

5. Petitioner Credit Financial Corporation ("Credit Financial") was incorporated in Delaware shortly before 1970. Its stock was wholly owned by Credit Services, Inc., a New York corporation whose stock in turn was owned by Longines-Wittnauer, Inc., a Delaware corporation. The stock of Longines-Wittnauer, Inc. was wholly owned by Westinghouse.

6. Credit Financial was engaged in the business of selling musical records and tapes by mail order. Until 1973 Credit Financial was headquartered in California and was not subject to the New York State corporation franchise tax. In 1973, Credit Financial moved its offices to New Rochelle, New York.

7. From its inception, Credit Financial was included in the consolidated returns filed by Westinghouse for Federal income tax purposes. In 1973, Credit Financial began filing separate returns for New York State franchise tax purposes where it reported Federal items of income, gain or loss as if it had filed on a non-consolidated basis.

8. From the time it began doing business, Credit Financial operated at a Loss. In 1974, the decision was made to abandon the business and liquidate all assets. As a result of its sale of assets, Credit Financial earned some net income beginning in 1976. The following chart shows Credit Financial's net income, or loss, for the entire period of its existence:

<u>Year</u>	<u>Taxable Income or (Loss)</u>	<u>Year</u>	<u>Taxable Income or (Loss)</u>
1971	(\$ 6,411,393)	1977	\$794,879
1972	(9,914,999)	1978	106,099
1973	(11,050,808)	1979	252,360
1974	(14,088,932)	1980	170,974
1975	(2,980,407)	1981	1,556
1976	1,613,706	1982	321,302
		1983	(230)

9. For the years 1976 and 1977, Credit Financial timely filed New York franchise tax reports where it computed **its** tax liability by carrying forward its 1973 net operating loss to 1976 and 1977, thereby reducing its net income for each year to zero.

10. On February 25, 1981, the Audit Division issued to Credit Financial two notices of deficiency. The first asserted additional franchise tax due for 1976 **in** the amount of \$68,441.60 plus interest, and the second asserted additional franchise tax due for 1977 in the amount of \$90,003.48 plus interest.¹

11. The asserted taxes result from the Audit Division's determination that Credit Financial was not entitled to carry forward its 1973 net operating **loss** to offset New York net income earned in 1976 and 1977. The Audit Division's position **is** as **follows**: Federal tax law required Credit Financial to carry forward its 1971 and 1972 losses to 1976; however, since Credit Financial was not subject to New York State tax in 1971 and 1972, the losses from those years were not available as New York net operating **loss** deductions; furthermore, since for Federal purposes the 1973 **loss** would not have been carried forward to 1976, it could not be carried forward for State purposes.

1 A third notice of deficiency for 1975 was issued in the amount of \$710.03. This deficiency apparently resulted from a recalculation of **the** business allocation factor and was not placed in issue.

12. Credit Financial does not seek to carry forward its 1971 or 1972 losses to 1976 and 1977. It does seek to carry forward its 1973 loss.

CONCLUSIONS OF LAW

A. That Tax Law § 208.9(f) permits a net operating **loss** deduction from entire net income, as follows:

"A net operating **loss** deduction shall be allowed which shall be presumably the same as the net operating loss deduction allowed under section one hundred seventy-two of the internal revenue code of nineteen hundredfifty-four, ... except that... (2) such deduction shall not include any net operating loss sustained... during any taxable year in which the taxpayer was not subject to the tax imposed by [Article 9-A], (3) such deduction shall not exceed the deduction for the taxable year allowable under section one hundred seventy-two of the internal revenue code".

B. That the amount of operating **loss** deduction carryback or carryover is determined by the law in effect at the time of **loss** (Treas. Reg. § 1.172-1[e]).

C. That in the **loss** years under consideration, Internal Revenue Code §172(b)(1)(A)(i) provided that for taxable years ending after December 31, 1957 "...a net operating **loss** shall be a net operating **loss** carryback to each of the 3 taxable years preceding the taxable year **of** such **loss**" (emphasis supplied). In addition, section 172(b)(1)(B) provided that, with certain exceptions, a net operating loss for taxable years ended after December 31, 1955 "shall be a net operating loss carryover to each of the five taxable years following the taxable year of such **loss**" (emphasis supplied).

D. That during the loss years at issue, section 172(b)(2) of the Internal Revenue Code provided, **in** part, as follows:

"(2) Amount of carrybacks and carryovers - Except as provided in subsections (i) and (j), the entire amount of the net operating **loss** for any taxable year (hereinafter in this section referred to as the '**loss** year') shall be carried to the earliest of the taxable years to which (by reason of paragraph (1)) such loss may be carried. The portion of such **loss** which shall be carried to each of the other

taxable years shall be the excess, if any, of the amount of such loss over the sum of the taxable income for each of the prior taxable years to which such loss may be carried" (emphasis supplied).

E. That Treasury Regulation § 1.172-4(a)(3) provided in the loss years as follows :

"(3) Amount of loss to be carried. The amount which is carried back or carried over to any taxable year is the net operating loss to the extent it was not absorbed in the computation of the taxable (or net) income for other taxable years, preceding such taxable year, to which it may be carried back or carried over. For the purpose of determining the taxable (or net) income for any such preceding taxable year, the various net operating loss carryovers and carrybacks to such taxable year are considered to be applied in reduction of the taxable (or net) income in the order of the taxable years from which such losses are carried over or carried back, beginning with the loss for the earliest taxable year" (emphasis supplied).

F. That in view of Internal Revenue Code §§ 172(b)(1)(A)(i) and 172(b)(2), as well as Treasury Regulation § 1.172-4(a)(3), it is clear that Credit Financial did not have the option of ignoring the net operating losses incurred in 1971 and 1972. Rather, net operating losses were required to be utilized in the prescribed manner. Accordingly, the Audit Division properly concluded that Credit Financial was not permitted to claim net operating loss carryovers from the year 1973 since such carryovers were not permitted by Internal Revenue Code § 172 (Tax Law § 208.9[f]).

G. That 20 NYCRR 3-8.5 provides, in part, as follows:

"When the net operating losses of two or more years, or the portions of net operating losses of two or more years, are carried back or carried forward to be deducted from the income of one particular taxable year, the Tax Commission requires that an aggregate method of deducting the losses be used. The taxpayer must compute the aggregate of the Federal net operating losses to be carried to the particular taxable year, and, also, compute the aggregate of the net operating losses under article 9-A for such year.

After computing the two aggregate figures, whichever of the two (Federal or State) **is** the smaller is the aggregate net operating loss which is allowable as a carry back or carry forward to the particular taxable year."

H. That 20 NYCRR 3-8.5 does not mandate the use of an "aggregate method" of deducting net operating losses under the facts operating here. The regulation requires that the aggregate method of deducting losses be used where the losses (or portions thereof) of two or more years are necessary to offset the income of one particular year. Since **Credit** Financial's 1971 losses were sufficient to reduce its 1976 Federal income to zero, its 1972 and 1973 losses would not be available as deductions against Federal income (IRC § 172(b)(2); Treas. Reg. § 1.172-4(a)(3)), and 20 NYCRR 3-8.5 would not apply.

I. That it has consistently been held by the State Tax Commission that a net operating loss is deductible for state purposes only in the same manner and amount as is deducted **on** the taxpayer's Federal return for that year (or, where applicable, in that amount necessary to reduce Federal taxable income to zero) (Matter of Hi-Lo Food Centers, Inc., State Tax Commn., March 9, 1970; Matter of Spedcor Electronics, Inc., State Tax Commn., March 9, 1970; Matter of The Employers' Fire Insurance Co., State Tax Commn., April 3, 1981; Matter of Eveready Insurance Company, State Tax Commn., March 19, 1985, confirmed Supreme Ct., Albany County, March 12, 1986, Hughes J.).

J. That Credit Financial relies on Matter of Avien, Inc. (532 F2d 273) to support its argument that because it was not subject to New York State tax prior to 1973, it was not required to carry forward any losses sustained prior to that year. Avien involves a New York City corporation tax statute using language similar to that found in Tax Law § 208.9(f). The Second Circuit Court of Appeals held that, because the city tax was not imposed until 1966, there were **no** "taxable years" prior to 1966 from which a loss could be carried

forward (~~see~~ IRC § 172 [b][1][A][i]). Thus, the taxpayer properly computed its New York City operating loss deduction by claiming post-1966 losses, even though, **on** its Federal return for the same year, it had claimed pre-1966 losses. The Federal Court's decision rests **on** its determination that the City's statutory scheme must be interpreted in conformity with the Internal Revenue Code's equitable goals of income averaging (Matter of Avien, 522 F2d 273, 275-276). However, in the face of similar arguments, the New York Court of Appeals has upheld the State Tax Commission's consistent and long-standing policy of disallowing any substitution of loss figures (Matter of Sheils v. State Tax Commission, 52 NY2d 954; Matter of Gurney v. Tully, 51 NY2d 818. ~~See also~~ Matter of Employer's Fire Insurance Company v. State Tax Commission, Supreme Ct, Albany County, November 12, 1981, Pitt J., confirming State Tax Commn., April 3, 1981, supra). In light of this policy, the Audit Division properly disallowed the net operating **loss** carryover to 1976 and 1977 from the year 1973.

K. That based on the recomputation of the DISC Export Credit, Westinghouse's corporation franchise tax liability **is** determined to be \$41,764.00 for the year 1974 and \$76,419.00 for 1975; in addition, Westinghouse **is** entitled to a credit of \$1,632.00 for the year 1976.


L. That the petition of Westinghouse Electric Corporation **is** granted to the extent indicated **in** Conclusion of Law "K"; that the notices of deficiency issued on March 20, 1981 shall be modified accordingly; and that **in all** other respects, the petition **is** denied.


M. That the petition of Credit Financial Corporation is denied, and the notices of deficiency issued on February 25, 1981 are sustained.

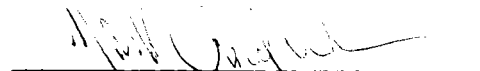
DATED: Albany, New York

STATE TAX COMMISSION

JUN 18 1987


PRESIDENT


COMMISSIONER


COMMISSIONER