

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition

of :

BROOKLYN UNION GAS COMPANY

DECISION

for Redetermination of a Deficiency or for
Refund of Corporation Franchise Tax under
Article 9 of the Tax Law for the Fiscal Years :
Ended December 31, 1977 through December 31,
1981.

Petitioner, Brooklyn Union Gas Company, 195 Montague Street, Brooklyn, New York 11201, filed a petition for redetermination of a deficiency or for refund of corporation franchise tax under Article 9 of the Tax Law for the fiscal years ended December 31, 1977 through December 31, 1981 (File No. 50779).

A hearing was held before Jean Corigliano, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on January 31, 1986 at 9:30 A.M. Petitioner appeared by Charles Klein. The Audit Division appeared by John P. Dugan, Esq. (Anne W. Murphy, Esq., of counsel).

ISSUES

I. Whether gain realized by petitioner on the reacquisition of its own bonds at discount was includible in its gross earnings pursuant to section 186 of the Tax Law.

II. Whether gross income, as defined by Tax Law 5186-a, includes only gross receipts from sales or exchanges, thus excluding gain realized by petitioner upon the reacquisition of its bonds at discount.

111. Whether the Tax Commission is bound by the erroneous opinion of an employee of the Department of Taxation and Finance.

FINDINGS OF FACT

1. Petitioner, Brooklyn Union Gas Company ("BUG"), is a New York corporation in the business of supplying natural gas and related services. During the periods under consideration, BUG was subject to the franchise tax imposed on gas companies by section 186 of the Tax Law and to the tax imposed on the furnishing of utility services pursuant to section 186-a of the Tax Law.

2. On December 15, 1981, the Audit Division issued against BUG two statements of audit adjustment and two notices of deficiency pursuant to Article 9, section 186 of the Tax Law, asserting a tax due of \$1,948.35 plus interest for the period ended December 31, 1977 and a tax due of \$4,953.12 plus interest for the period ended December 31, 1978.

3. The notices of deficiency arose from the Audit Division's determination that profit realized by BUG on certain bond transactions was to be included in computing the tax on gross earnings imposed by Section 186 of the Tax Law.

4. During the 1977 and 1978 fiscal years, BUG realized a gain of \$920,194.00 on the reacquisition of its own bonds at a discount. BUG offered the following illustration of such a transaction: "For example, BUG reacquired an 8% bond it had issued at \$100 with a maturity price of \$100 for \$65...".

5. BUG paid the assessed tax plus interest, but subsequently requested a letter of instruction and interpretation from the Technical Services Bureau regarding the discount bond transactions at issue. BUG was advised as follows:

"Amounts received on the original issuance of bonds are not receipts received from the employment of capital and are not includible as gross earnings under Section 186 or gross income under Section 186-a. Amounts paid out in order to reacquire the bonds are not receipts. Therefore, if an 8% bond which was originally issued for \$100 is reacquired for \$65, the \$35 profit on the redemption of the Bond is not subject to tax under either Section 186 or Section 186-a,"

6. By letter dated March 10, 1983, BUG requested a credit on the tax and interest paid in the amount of \$8,883.20 plus statutory interest for the fiscal years ended December 31, 1977 and 1978. The request was predicated upon the Technical Services Bureau's letter of instruction and interpretation.

7. By letter dated August 26, 1983, the Audit Division denied BUG's request, offering the following explanation:

"The Audit Division contends, the gain realized from the retirement of bonds at a 'discount' constitutes 'gross earnings from all sources within this state.'

Any amount given for the cancellation of a contractual liability is an employment of capital. The amount originally received which *is* in excess of the consideration actually paid to cancel the debt, is a receipt from the employment of capital."

8. For the fiscal years ended December 31, 1979, 1980 and 1981, BUG reported the gain realized on reacquired bonds on its Report of Gross Income filed in compliance with section 186-a of the Tax Law, paying a tax on this gain of \$104,734.46. On or about February 28, 1983, BUG filed a claim for refund of the tax paid, again predicated its claim on the Technical Services Bureau letter.

9. By letter dated August 25, 1983, the Audit Division denied BUG's claim on the ground that gain realized from the retirement of bonds at a discount is includible in the definition of gross income found in section 186-a of the Tax Law.

10. The illustration quoted in Finding of Fact "4" was the only information BUG offered regarding the bond transactions at issue.

CONCLUSIONS OF LAW

A. That section 186 of the Tax Law imposes a franchise tax upon every corporation, joint-stock company or association formed for or principally

exercising its corporate franchise or carrying on its business **in** such corporate or organized capacity in this state" (Tax Law §186). The tax imposed consists of two parts, a gross earnings tax and an excess dividends tax. Only the gross earnings tax is pertinent to the issues raised by BUG. In its original form, section 186 provided for a franchise tax upon various types of utility companies measured by their "gross earnings from all sources within this state." In interpreting the statute, the Appellate Division held in 1906 that in order to arrive at gross earnings, the cost **of** raw materials used in producing the utility service had to be deducted from the company's gross receipts (People ex rel. Brooklyn Union Gas Co. v. Morgan, 114 App Div 266). In 1907, the legislature amended section 186 by adding the following definition: "The term 'gross earnings' as used in this section means all receipts from the employment of **capital without any deduction**" (L 1907, ch 734, § 3). **Shortly thereafter, the** Court of Appeals, construing the new amendment, found that its purpose was "to enlarge the scope of the franchise tax by including all moneys that were received as products of all uses of corporate capital, 'without any deduction'" (People ex rel. Westchester Light Co. v. Gaus, 199 NY 147, 149). Almost sixty years later, the Court held that the amendment did not contemplate a substitution of "gross receipts" for "'gross earnings" as the basis for taxation; rather it "merely sought to include [in gross earnings]... that portion of 'gross earnings' which represents the 'employment of capital' to manufacture, distribute and sell various public utility services" (Matter of Consolidated Edison Co. v. State Tax Commn., 24 NY2d 114,119).

B. That BUG realized a profit when it reacquired its own obligations at less than their issue value, and that profit was properly included in its gross earnings pursuant to section 186 of the Tax Law.

the fact that BUG is not an investment company does not mean that financing activity which it undertakes in furtherance of its public utility business is not the employment of capital. Extensive and sustained investment activities in New York by corporations whose purposes encompass investment in relation to their business have been held subject to the corporation franchise tax because these corporations are employing assets in New York through investment activity (American Tel & Tel Co. v. State Tax Commn., 61 NY2d 393,401-402). Inasmuch as BUG has not asserted otherwise, it is concluded that BUG issued bonds in order to finance its primary activities as a public utility company. The amount BUG received upon the issuance of its bonds was not subject to the gross earnings tax because the issuance of bonds does not require employment of capital and does not result in earnings. However, BUG did employ capital when it used corporate capital to cancel a pre-existing liability; moreover, it received **earnings, or income, from the transaction easily quantifiable in monetary terms**, as its own illustration demonstrates. This recognition of earnings certainly satisfied the statutory definition of "gross earnings". Furthermore, without suggesting that "gross earnings" under Tax Law 5186 is the equivalent of Federal taxable income, it is noted that the Audit Division's treatment of the gain realized by BUG on its discount bond transactions is consistent with Federal tax law where it has long been recognized that a solvent corporate debtor realizes income when it purchases its obligations at less than face value (see, e.g., United States v. Kirby Lumber Co., 284 US 1; Tennessee Consol. Coal Co. v. Commr. of Internal Revenue, 145 F2d 631; Central Paper Co. v. Commr. of Internal Revenue, 158 F2d 131; Treas. Reg. § 1.61-12[a]).

C. That section 186-a of the Tax Law levies upon utility corporations subject to the supervision of the Department of Public Utility Control

three percent of the corporation's gross income. Gross income as defined in Tax Law §186-a(2)(c) consists of the following elements:

1. receipts from any sale made or service rendered for ultimate use or consumption by the purchaser in this state;
2. profits from the sale of securities;
3. profits from the sale of real property;
4. **profit from the sale of personal property (other than inventory);**
5. receipts from interest, dividends, and royalties derived from sources within this state; and
6. "profits from any transaction (except sales for resale and rentals) within this state whatsoever".

The broad language of the statute belies BUG's contention that section 186-a taxes only gross receipts arising from sales and exchanges. The statute taxes the profits from any utility transaction, except sales for resale and rental, within New York State. BUG realized a profit when it reacquired its own obligations at less than their issue value, and that profit was includible in its gross income pursuant to Tax Law 5186-a.

D. That the Tax Law provides a mechanism by which a person may petition the Tax Commission for an advisory opinion binding upon the Commission with respect to the person to whom such opinion **is** rendered (Tax Law §171(24)). BUG did not avail itself **of** this procedure; rather, it requested and received a letter of Interpretation and Instruction. The letter merely states the erroneous opinion of an employee of the Department of Taxation and Finance and **has no** binding effect upon the State Tax Commission (see In the Matter of Ellen Cubbin d/b/a Jericho Sandwich Shop, State Tax Commission, January 10, 1986; cf. United Block Co., Inc. v. Helvering, 123 F2d 704, 706).

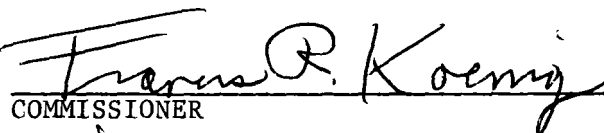
E. That the petition of Brooklyn Union Gas Company *is* denied, and the denials of petitioner's claims for refund or credit are sustained.

DATED: Albany, New York

STATE TAX COMMISSION

NOV 20 1986


PRESIDENT


COMMISSIONER


COMMISSIONER