

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition

of

USINOR STEEL CORPORATION

:
:
:

DECISION

for Redetermination of a Deficiency or for
Refund of Corporation Franchise Tax under
Article **9-A** of the Tax Law for the Fiscal Years
Ended December 31, 1978, December 31, 1979,
March 31, 1981 and March 31, 1982.

Petitioner, Usinor Steel Corporation, 600 Third Avenue, New York, New York
10016, 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 fiscal years
ended December 31, 1978, December **31**, 1979, March 31, 1981 and March 31, 1982
(File No. 53310).

A hearing was held before Daniel J. Ranalli, Hearing Officer, at the
offices of the State Tax Commission, Two World Trade Center, New York, New
York, on October 9, 1985 at 2:45 P.M., with all briefs to be submitted by
January 17, 1986. Petitioner appeared by Alan R. Johnson, Esq. The Audit
Division appeared by John P. Dugan, Esq. (Lawrence A. Newman, **Esq.**, of counsel).

ISSUE

Whether the Audit Division properly determined petitioner's interest
attributable to subsidiary capital.

FINDINGS OF FACT

1. On March 14, 1984, as the result of a field audit, the Audit Division
issued four notices of deficiency pursuant to Article 9-A of the Tax Law
against petitioner, Usinor Steel Corporation, as follows:

<u>Period Ended</u>	<u>Tax</u>	<u>Interest</u>	<u>Total</u>
12/31/78	\$ 3,395.00	\$2,138.00	\$ 5,533.00
12/31/79	\$11,788.00	\$6,348.00	\$18,136.00
3/31/81	\$16,492.00	\$7,011.00	\$23,503.00
3/31/82	\$15,193.00	\$3,925.00	\$19,118.00

2. On audit, adjustments were made to petitioner's business allocation percentage and interest expense indirectly attributable to subsidiary capital. Petitioner does not dispute the business allocation percentage adjustment but argues that the interest attributable to subsidiary capital should have been computed by using the actual fair market value of subsidiary capital during the years in issue rather than the cost or book value of the stock of subsidiary capital which was utilized by the Audit Division.

3. To determine the interest attributable to subsidiary capital, the auditor divided the average cost of investment in subsidiary capital by petitioner's total assets. The resulting percentage was applied to petitioner's total interest expense to arrive at interest attributable to subsidiary capital. With respect to one subsidiary, Vicksburg Steel Service, Inc. ("Vicksburg"), the average cost of investment in subsidiary capital was obtained by adding the beginning and end of year amounts of capital stock of Vicksburg to the average advances to Vicksburg by petitioner. With respect to another subsidiary, Toledo Pickling & Steel Service, Inc. ("Toledo Pickling"), the purchase price of its stock was considered to be the value of subsidiary capital. The purchase price was \$8,697,331.00. The value of the capital stock of Toledo Pickling for each year in issue was \$60,000.00 and there were no advances received from petitioner.

4. Petitioner, Usinor Steel Corporation, is a Delaware corporation engaged in the importation and distribution of steel products manufactured by its parent, Usinor Industries, Inc., a French corporation. During all of the

years in issue, Toledo Pickling was a wholly-owned subsidiary of petitioner. From 1979 through the end of the period in issue, Vicksburg also was a wholly-owned subsidiary of petitioner. Petitioner had no other subsidiaries during the years in issue.

5. Petitioner acquired Toledo Pickling in 1975 for a purchase price of approximately \$8 million. Toledo Pickling is engaged in the business of purchasing, processing and reselling steel. Shortly after petitioner's purchase of Toledo Pickling, the steel industry in general entered an economic downturn, to which the OPEC oil embargo and oil price increases and a crisis in the auto industry contributed. The United States government imposed a trigger price mechanism, which set artificially high minimum prices for imported steel, Toledo's principal raw material, and thus cut the price margins of steel service centers such as Toledo Pickling.

6. Toledo Pickling recorded losses in each of its fiscal years 1979 through 1982, ranging from \$2.8 million to \$7.4 million per year. These losses produced a growing capital deficit. As of December 31, 1978, Toledo Pickling's liabilities exceeded its assets by \$1.9 million; at the close of the year ended March 31, 1982, Toledo Pickling had a negative net worth of \$10.5 million. Toledo Pickling also had a large contingent liability, not shown on its balance sheet, for duties and penalties claimed by U.S. Customs on imports received from 1978 through 1980, in the amount of \$235 million. The existence of this contingent liability was revealed as early as 1978 and became widely known because of investigations of customers and a grand jury proceeding.

7. Petitioner reacted to Toledo Pickling's decline by attempting, beginning in 1979, to sell the stock of Toledo Pickling, but its efforts were unsuccessful.

the company was without value. During 1983, petitioner contributed an additional \$25 million to the capital of Toledo Pickling out of concern for the reputation and credit of the Usinor group, of which Toledo Pickling was known to be a part. An appraisal of the Toledo Pickling stock as of December 31, 1983 was made by the Mellon Bank to assist petitioner's placing a potential sale value on Toledo Pickling and Vicksburg. The appraisal concluded that Toledo Pickling had **no** value as a going concern, and placed a liquidation value on the company of \$750,000.00 to \$1 million. The appraisal also noted a possible value for the tax losses of Toledo Pickling, but because of the company's overall lack of value, no buyer was willing to purchase the stock to obtain the tax loss. The stock of Toledo Pickling never was sold, nor was the business sold as a going concern. In 1984, most of its operating assets were sold to an unrelated purchaser. After this sale (for \$9 million), the sale of remaining assets and the payment of fixed liabilities, Toledo Pickling was left with \$5.1 million. This sale was at the top of the market; Toledo Pickling would have received less if the sale had been during the period in issue, if it could have found a buyer at all.

8. Vicksburg was organized by petitioner in 1979, and began operating in 1981. Its business was buying, processing and reselling steel. Like Toledo Pickling, Vicksburg suffered from the downturn in the steel industry, and had repeated losses, which generated a negative net worth, as soon as its operations began. By the end of the period in question, its net worth was a negative \$841,000.00. From its formation to the end of the period in issue, the capital of Vicksburg consisted of \$5,000.00. Petitioner also made non-interest-bearing advances to Vicksburg which aggregated \$1,522,360.00. In 1983, \$522,360.00 of the advances were repaid, and the balance was written off by petitioner. The

source of the amount repaid was a loan of \$1 million made by Usinor Industries, Inc., to which the stock of Vicksburg was transferred in 1983. Later in 1983, Usinor Industries also contributed \$1 million cash to the capital **of** Vicksburg. The appraisal of the stock of Toledo Pickling made by Mellon Bank also included an appraisal of the stock of Vicksburg as of December 31, 1983. The appraisal found a value of between \$1 million and \$1.2 million. This was the approximate net worth of Vicksburg on that date.

CONCLUSIONS OF LAW

A. That section 208.9 of the Tax Law provides, in pertinent part:

"The term 'entire net income' means total net income from all sources...

* * *

(b) Entire net income shall be determined without the exclusion, deduction or credit of:

* * *

(6) in the discretion of the tax commission, any amount of interest directly or indirectly and any other amount directly attributable as a carrying charge or otherwise to subsidiary capital **or** to income, gains or losses from subsidiary capital."

B. That section 208.4 of the Tax Law defines "subsidiary capital" as follows:

"The term 'subsidiary capital' means investments in the stock of subsidiaries and any indebtedness from subsidiaries, exclusive of accounts receivable acquired in the ordinary course of trade or business for services rendered or for sales of property held primarily for sale to customers, whether or not evidenced by written instrument, on which interest is not claimed and deducted by the subsidiary for purposes of taxation under articles nine-a, nine-b, **nine-c**, thirty-two or thirty-three of this chapter, provided, however, that, in the discretion of the tax commission, there shall be deducted from subsidiary capital any liabilities payable by their terms on demand or within one year from the date incurred, other than loans or advances outstanding for more than a year as of any date during the year covered by the report, which are attributable to subsidiary

ranital. "

C. That 20 NYCRR 3-6.4 provides for the computation of subsidiary capital as follows:

"The amount of subsidiary capital of the taxpayer (parent) is determined by computing the average fair market value during the period covered by the report of all the assets of the taxpayer which constitute subsidiary capital, **less** certain liabilities required to be deducted... Average fair market value is determined in the manner which is described in section 3-4.6 of this Part. In no event may a subsidiary be valued at less than 'zero'."


D. That, in a case such as petitioner's, where the cost of the subsidiary does not accurately reflect the fair market value of Subsidiary capital, the average cost of investment in subsidiary capital may be obtained by adding the beginning and end of year amounts of capital stock of the subsidiary, divided by two, to the advances to the subsidiary by the parent. See Matter of U.S. Summi Corporation, State Tax Commission, May 23, 1985. With respect to Vicksburg, the auditor properly used this method, however, the same method should have been used to determine the cost of investment in Toledo Pickling. Therefore, \$60,000.00, representing the value of the capital stock of Toledo Pickling should have been utilized in Computing the value of subsidiary capital rather than the \$8 million purchase price.

E. That the petition of Usinor Steel Corporation is granted to the extent indicated in Conclusion of Law "D"; that the Audit Division is directed to modify the notices of deficiency issued March 14, 1984 accordingly; and that, except as so granted, the petition is in all other respects denied.

DATED: Albany, New York

STATE TAX COMMISSION

APR 15 1986


PRESIDENT


COMMISSIONER