

STATE OF NEW YORK

STATE TAX COMMISSION

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 In the Matter of Petition :
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 of :
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WORLD WIDE VOLKSWAGEN CORP. :
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 for redetermination of deficiencies of :
 franchise tax under Article 9-A :
 of the tax law for the fiscal years :
 ended November 30, 1968 to November 30, :
 1971, inclusive :

World Wide Volkswagen Corp. having filed petition for redetermination of deficiencies of franchise tax under Article 9-A of the tax law for the fiscal years ended November 30, 1968 to November 30, 1971, inclusive, and a hearing having been held in connection therewith at the office of the State Tax Commission, 80 Centre Street, New York City, at which hearing Bernard S. Cooper, Certified Public Accountant, appeared personally and testified on behalf of the taxpayer, and the record having been duly examined and considered by the State Tax Commission.

It is hereby found:

(1) The taxpayer was incorporated in New York State on July 24, 1953 and is a distributor of automobiles pursuant to a franchise agreement with Volkswagen of America, Inc., which imports the automobiles.

(2) Based on a field audit examination and subsequent conferences, the Corporation Tax Bureau issued notices of deficiencies, a portion of which for each year is in dispute as follows:

<u>Fiscal Year Ended</u>	<u>Added Tax Per Notice of Deficiency</u>	<u>Amount of Added Tax in Dispute</u>
11/30/68	\$6,189.20	\$5,996.00
11/30/69	11,617.14	9,437.00
11/30/70	17,733.11	14,260.00
11/30/71	18,204.02	14,340.00

The amount of added tax in dispute represents that portion of each deficiency which is based on disallowing as a deduction interest expense attributable to subsidiary capital as follows:

Fiscal Year Ended

Interest Expense Disallowed

11/30/68	\$87,218.00
11/30/69	185,996.00
11/30/70	283,975.00
11/30/71	222,058.00
Total	<u>\$779,247.00</u>

(3) The following information was used in arriving at the above disallowances:

- (a) Total interest expense deducted on the returns was \$277,951 for fiscal year ended 11/30/68, \$648,942 for fiscal year ended 11/30/69, \$1,010,416 for fiscal year ended 11/30/70 and \$810,280 for fiscal year ended 11/30/71.
- (b) Interest expense incurred on Federal income tax liabilities was \$52,914 for fiscal year ended 11/30/69 and \$2,721 for fiscal year ended 11/30/70. Interest expense incurred on loans to acquire stock of a deceased shareholder was \$135,697 for fiscal year ended 11/30/70 and \$42,260 for fiscal year ended 11/30/71.
- (c) Subtracting the amounts in (b) from those in (a) resulted in adjusted interest expense of \$277,951 for fiscal year ended 11/30/68, \$596,028 for fiscal year ended 11/30/69, \$871,998 for fiscal year ended 11/30/70 and \$768,020 for fiscal year ended 11/30/71.
- (d) The average cost of investments in the capital stock of the subsidiaries plus average advances to subsidiaries was \$7,134,104 for fiscal year ended 11/30/68, \$8,153,946 for fiscal year ended 11/30/69, \$9,976,194 for fiscal year ended 11/30/70 and \$10,137,183 for fiscal year ended 11/30/71.
- (e) The average total assets of the taxpayer were \$22,735,101 for fiscal year ended 11/30/68, \$26,129,286 for fiscal year ended 11/30/69, \$30,633,589 for fiscal year ended 11/30/70 and \$35,061,517 for fiscal year ended 11/30/71.
- (f) The ratio of average subsidiary capital assets to average total assets was arrived at by dividing (d) by (e) resulting in percentages of 31.206% for fiscal year ended 11/30/68, 31.379% for fiscal year ended 11/30/69, 32.566% for fiscal year ended 11/30/70 and 28.913% for fiscal year ended 11/30/71.
- (g) The amount of interest expense disallowed at (2) above was arrived at by multiplying (c), which is adjusted interest expense, by the percentages computed in (f), which is the ratio of average subsidiary capital assets to average total assets.

(4) The franchise tax returns disclose that the taxpayer excluded from entire net income interest income from subsidiary capital as follows:

<u>Fiscal Year Ended</u>	<u>Interest Income Excluded</u>
11/30/68	\$197,394
11/30/69	366,649
11/30/70	262,866
11/30/71	211,045
Total	<u>\$1,037,954</u>

The above income was eliminated by the taxpayer pursuant to Section 208.9(a) (1) of the tax law, which reads in part:

- "(a) Entire net income shall not include;
- "(1) Income, gains and losses from subsidiary capital ..."

(5) The amount of interest expense disallowed by the Corporation Tax Bureau totaled \$779,247 as indicated in Item 2. Such adjustment was based on Section 208.9(b) (6) of the tax law which reads:

"(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;"

(6) Section 208 of the tax law reads in part:

"3. The term 'subsidiary' means a corporation of which over fifty per centum of the number of shares of stock entitling the holders thereof to vote for the election of directors or trustees is owned by the taxpayer;

"4. The term 'subsidiary capital' means investments in the stock of subsidiaries and any indebtedness from subsidiaries ..."

The State Tax Commission hereby

DECIDES:

(A) The taxpayer's investments in the stock of and advances to subsidiaries constitute subsidiary capital pursuant to Section 208 of the tax law. A corporation acquires its assets over the years by borrowings, other forms of liabilities, sale of capital stock, earned surplus from operations, and capital surplus. Each asset held by the taxpayer bears its prorata share of such borrowings, other liabilities and net worth. Accordingly, a proportionate part of the interest expense on borrowings is indirectly attributable to subsidiary capital to the extent of the percentage arrived at by dividing average subsidiary capital assets by average total assets.

(B) It has been the consistent policy of the Commission to disallow interest expense attributable to subsidiary capital in accordance with Section 208.9(b)(6) of the tax law. Such disallowance is required to prevent the taxpayer from receiving a double benefit since Section 208.9(a)(1) provides that the taxpayer may exclude income from subsidiary capital. The taxpayer has consistently enjoyed the benefit of the exclusion of income from subsidiaries as shown in Item (4).

(C) The interest expense of \$135,697 for fiscal year ended 11/30/70 and \$42,260 for fiscal year ended 11/30/71, which were incurred on loans to acquire stock of a deceased shareholder, should not have been allowed as deduction in computing the amount of interest expense attributable to subsidiary capital. Accordingly, revised deficiencies are computed as follows:

	<u>Fiscal Year Ended</u> <u>11/30/70</u>	<u>Fiscal Year Ended</u> <u>11/30/71</u>
Interest expense involved	\$135,697.00	\$42,260.00
Ratio of average subsidiary capital assets to average total assets as shown at Item (3)(f)	32.566%	28.913%
Allocated interest	44,191.00	12,219.00
Business allocation %	71.7371%	73.1079%
Taxable base	31,701.00	8,933.00
Added tax at 7%	2,219.00	
Added tax at 8.833%		789.05
Original tax deficiency	17,733.11	18,204.02
Revised tax deficiency	19,952.11	18,993.07

(D) The foregoing revised tax deficiencies for fiscal years ended 11/30/70 and 11/30/71, and the tax deficiencies for fiscal years ended 11/30/68 and 11/30/69 set forth at Item 2 are affirmed together with interest in accordance with Section 1084 of the tax law.

Dated: Albany, New York

this 30th day of April, 1974.

STATE TAX COMMISSION

Wayne H. Fineman

President

Bruce Mandley

Commissioner

Milton Kohn

Commissioner