

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :  
of  
Colonial Hardware Corp. :

AFFIDAVIT OF MAILING

for Redetermination of a Deficiency or Revision :  
of a Determination or Refund of Corporation Franchise  
Tax under Articles 9-A and 27 of the Tax Law  
for the Fiscal Years Ended 8/31/76 - 8/31/79. :

State of New York }

ss.:

County of Albany }

David Parchuck, being duly sworn, deposes and says that he is an employee of the State Tax Commission, that he is over 18 years of age, and that on the 26th day of July, 1984, he served the within notice of Decision by certified mail upon Colonial Hardware Corp., the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Colonial Hardware Corp.  
163 Varick St.  
New York, NY 10038

and by depositing same enclosed in a postpaid properly addressed wrapper in a post office under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the petitioner herein and that the address set forth on said wrapper is the last known address of the petitioner.

Sworn to before me this  
26th day of July, 1984.

David Parchuck

James A. [Signature]  
Authorized to administer oaths  
pursuant to Tax Law section 174

STATE OF NEW YORK

STATE TAX COMMISSION

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In the Matter of the Petition :  
of :  
Colonial Hardware Corp. : AFFIDAVIT OF MAILING

for Redetermination of a Deficiency or Revision :  
of a Determination or Refund of Corporation :  
Franchise Tax under Article 9A of the Tax Law :  
for the Fiscal Years Ended 8/31/76 - 8/31/79. :

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State of New York }  
                          } ss.:  
County of Albany }

David Parchuck, being duly sworn, deposes and says that he is an employee of the State Tax Commission, that he is over 18 years of age, and that on the 26th day of July, 1984, he served the within notice of Decision by certified mail upon Robert M. Spilky, the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Robert M. Spilky  
150 Broadway  
New York, NY 10038

and by depositing same enclosed in a postpaid properly addressed wrapper in a post office under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the representative of the petitioner herein and that the address set forth on said wrapper is the last known address of the representative of the petitioner.

Sworn to before me this  
26th day of July, 1984.

David Parchuck

James A. Hannan  
Authorized to administer oaths  
pursuant to Tax Law section 174

STATE OF NEW YORK  
STATE TAX COMMISSION  
ALBANY, NEW YORK 12227

July 26, 1984

Colonial Hardware Corp.  
163 Varick St.  
New York, NY 10038

Gentlemen:

Please take notice of the Decision of the State Tax Commission enclosed herewith.

You have now exhausted your right of review at the administrative level. Pursuant to section(s) 1090 of the Tax Law, a proceeding in court to review an adverse decision by the State Tax Commission may be instituted only under Article 78 of the Civil Practice Law and Rules, and must be commenced in the Supreme Court of the State of New York, Albany County, within 4 Months from the date of this notice.

Inquiries concerning the computation of tax due or refund allowed in accordance with this decision may be addressed to:

NYS Dept. Taxation and Finance  
Law Bureau - Litigation Unit  
Building #9, State Campus  
Albany, New York 12227  
Phone # (518) 457-2070

Very truly yours,

STATE TAX COMMISSION

cc: Petitioner's Representative  
Robert M. Spilky  
150 Broadway  
New York, NY 10038  
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

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In the Matter of the Petitions  
of  
COLONIAL HARDWARE CORP.

DECISION

for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Articles 9-A and 27 of the Tax Law for the Fiscal Years Ended August 31, 1976 through August 31, 1979.

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Petitioner, Colonial Hardware Corp., 163 Varick Street, New York, New York 10038, filed petitions for redetermination of a deficiency or for refund of corporation franchise tax under Articles 9-A and 27 of the Tax Law for the fiscal years ended August 31, 1976 through August 31, 1979 (File Nos. 28897 and 32015).

On September 12, 1983, petitioner, by its representative, Robert M. Spilky, Esq., filed a waiver of formal hearing and requested that this matter be decided by the State Tax Commission on the basis of the existing record with all briefs to be submitted by December 31, 1983. After due consideration, the Tax Commission renders the following decision.

ISSUES

I. Whether petitioner was entitled to file a combined return with its wholly-owned subsidiaries for the years in issue when no prior permission had been requested of the State Tax Commission.

II. Whether petitioner was required to include in its income 100 percent of the income of a subsidiary which was a tax-exempt DISC pursuant to section 208.9(i) of the Tax Law.

III. Whether petitioner was properly subject to the tax measured by subsidiary capital imposed by section 210.1(b) of the Tax Law.

IV. Whether the Audit Division properly computed the deemed distribution to petitioner from the DISC for the fiscal year ended August 31, 1976.

V. Whether the Audit Division properly applied an overpayment for the fiscal year ended August 31, 1979 against a previous deficiency.

FINDINGS OF FACT

1. For fiscal years ended August 31, 1977 through August 31, 1979, petitioner, Colonial Hardware Corp., filed combined New York State corporation franchise tax reports with two of its wholly-owned subsidiaries, Colonial Hardware Export Corp. ("Export") and O'Connell-Varick Corp. ("O'Connell"). Export was and is a qualified tax-exempt Domestic International Sales Corporation ("DISC") organized pursuant to section 992 of the Internal Revenue Code. Petitioner did not make a written request of the State Tax Commission for permission to file on a combined basis prior to so filing. Since petitioner filed on a combined basis with Export, it failed to file a consolidated return with Export for the aforesaid three years. For fiscal year ended August 31, 1976, petitioner did not file on a combined basis and did not include the DISC income and capital in its own income for the year by filing a consolidated return with Export.

2. On February 1, 1980, the Audit Division issued a Notice of Deficiency against petitioner in the amount of \$14,602.00, plus interest of \$3,987.80, for a total due of \$18,589.80 for the period ended August 31, 1976. On March 13, 1980, the Audit Division issued a Notice of Deficiency against petitioner in the amount of \$10,471.00, plus interest of \$2,093.62, for a total due of \$12,564.62 for the period ended August 31, 1977. On June 2, 1980, the Audit

Division issued a Notice of Deficiency against petitioner in the amount of \$11,740.00, plus interest of \$545.91, for a total due of \$12,285.91 for the period ended August 31, 1979. The total amount due for 1979 was offset by a credit allowed from a 1978 overpayment.

3. Statements of audit adjustment issued February 1, 1980 and June 2, 1980 explained that, for fiscal years ended August 31, 1977 and August 31, 1979, the Audit Division was disallowing the tax computed on a combined basis with O'Connell and Export because "combined reports are discretionary with the Tax Commission and permission to file in this manner must be requested within 30 days after the close of the taxable year." Additionally, for fiscal years ended August 31, 1976, August 31, 1977 and August 31, 1979, the statements explained that the income of Export was included in petitioner's entire net income because "the stockholder of a tax-exempt DISC must include 100 percent DISC income and capital in its New York return" by filing a consolidated return with the DISC.

4. Petitioner made a mathematical error on its tax report for fiscal year ended August 31, 1978. It filed an amended return correcting the error and computing the tax on a combined basis with O'Connell and Export and claiming a refund of \$40,826.00. The Audit Division, in a Statement of Tax Reduction or Overpayment issued May 15, 1980, again disallowed the computation of tax on a combined basis and reduced the refund to \$38,840.97 including interest. Of this amount, \$12,238.95 was credited toward the 1979 deficiency, leaving a net refund of \$26,602.02.

5. Petitioner and Export are engaged exclusively in the sale of industrial hardware. Petitioner sells to the domestic trade while Export limits itself to export sales. Both corporations maintain a common office and warehouse in New

York City. Title to the real property is held by O'Connell which receives rent from petitioner and Export as well as other tenants. O'Connell's sole function is to hold title to said real property. During the years in issue, the space requirements of petitioner and Export increased to the point that they were virtually the sole tenants, comprising 83 percent of O'Connell's rental income.

Petitioner and Export operate, physically, as one entity. The same employees occupy the same offices, utilize the same equipment, furniture and fixtures, and store merchandise in the same warehouse. All expenses of payroll, payroll taxes, benefits, overhead, selling, office and administration are paid by Export and allocated between petitioner and Export in proportion to their respective net sales. There are various inter-corporate loans, joint investments, credits for income and charges for acquisition of fixed assets, merchandise and expenses among all three corporations which are reflected in the inter-company accounts.

6. Petitioner argues that the Audit Division may not deny the right of two or more fully integrated corporations to file combined returns and that prior permission to do so need not necessarily be required. The Audit Division maintains that a taxpayer must make a written request for permission to file a combined report and that, since petitioner did not receive the proper permission to file a combined report with O'Connell and Export, it is precluded from doing so. Petitioner also argues that the requirement that the income of a DISC be included in the tax return of the parent corporation is improper. Petitioner did not explain why it takes this position.

7. Petitioner failed to compute and report the tax on subsidiary capital on its tax reports for any of the four years in issue. The Audit Division computed and included said tax in determining the tax due for each year.

Petitioner maintains that the imposition of the tax on subsidiary capital is improper.

8. In its fiscal year ended September 30, 1975, Export paid two dividends, one in the amount of \$292,292.00 which represented the deemed dividend portion of its net income for the fiscal year ended September 30, 1974, and \$320,099.00 which represented the deemed dividend portion of its net income for the fiscal year ended September 30, 1975. The \$292,292.00 was reported as income on petitioner's Federal return for fiscal year ended August 31, 1975. The \$320,099.00 was reported as income on petitioner's Federal return for fiscal year ended August 31, 1976. In determining petitioner's adjusted consolidated entire net income for fiscal year ended August 31, 1976, the Audit Division eliminated the \$292,292.00 from petitioner's entire net income rather than the \$320,099.00. The Audit Division gave no explanation for its action and petitioner maintains that the correct deemed dividend for fiscal year ended August 31, 1976 is \$320,099.00. The DISC export credit for fiscal year ended August 31, 1976 would thus be computed as follows:

DISC taxable net income	\$640,198.00
Deemed dividend	320,099.00
Undistributed dividend	<u>\$320,099.00</u>
Tax rate (incl. surcharge)	12%
	<u>\$ 38,411.88</u>
Export credit	70%
DISC export credit	<u>\$ 26,888.32</u>

The Audit Division computed a DISC export credit of \$20,454.00.

9. Petitioner's final argument is that the Audit Division improperly applied the overpayment of tax for fiscal year ended August 31, 1978 to the deficiency for fiscal year ended August 31, 1979 as described in Finding of Fact "2", supra. The Audit Division maintains that its action was proper pursuant to section 1086 of the Tax Law.



CONCLUSIONS OF LAW

A. That section 211.4 of the Tax Law provides, in relevant part:

"In the discretion of the tax commission, any taxpayer, which owns or controls either directly or indirectly substantially all the capital stock of one or more other corporations...may be required or permitted to make a report on a combined basis covering any such other corporations...".

B. That 20 NYCRR 6-2.4(a), applicable to taxable years beginning on or after January 1, 1976, provides:

"A taxpayer must make a written request for permission to file a combined report. The request must be received by the Tax Commission not later than thirty (30) days after the close of its taxable year. A report filed on a combined basis does not constitute a request for permission to file a combined report."

For fiscal years ended August 31, 1977 through August 31, 1979, petitioner failed to comply with the requirements of the aforesaid regulation. The Audit Division, therefore, properly disallowed the combined filing of petitioner and its subsidiaries, Export and O'Connell.

C. That for fiscal year ended August 31, 1976, petitioner did not file on a combined basis nor did it request permission to do so. The first time petitioner raised the issue of combined filing for fiscal year ended August 31, 1976 was in its petition filed in March, 1980 in conjunction with fiscal year ended August 31, 1977. Combined reports are not permitted to be filed retroactively except under unusual circumstances (Matter of Walker Engraving Corporation, State Tax Commission, June 6, 1971). At the time petitioner filed its separate report for the fiscal year ended August 31, 1976, it was aware of those circumstances which would warrant seeking permission from the Commission to file on a combined basis for said period and there existed no unusual circumstances which would give rise to a need on the part of petitioner for an extended period to

determine whether permission should be requested for the filing of a combined return (Matter of Carter-Wallace, Inc., State Tax Commission, June 5, 1981).

D. That section 208.9(i)(B) of the Tax Law provides that a stockholder of a tax-exempt DISC must adjust each item of its receipts, expenses, assets and liabilities by adding its attributable share of each such DISC's receipts, expenses, assets and liabilities. Intercorporate transactions are eliminated, and the stockholder's entire net income is reduced by subtracting the amount of the deemed distribution of current income, if any, from each such DISC already included in Federal taxable income (see also 20 NYCRR 3-9.4). Petitioner, as the 100 percent stockholder of Export, a tax-exempt DISC, clearly falls within the intendment of section 208.9(i)(B) and its argument, that inclusion of the DISC income in the income of the parent is improper, is without merit and, accordingly, petitioner should have filed a consolidated return with Export for each of the years in issue.

E. That section 210.1(b) of the Tax Law imposes a tax measured by subsidiary capital as part of the corporation franchise tax. This separate tax on subsidiary capital is in addition to the tax measured by entire net income. Section 211.4 provides for the elimination of intercorporate stockholdings in computing combined subsidiary capital when a taxpayer files on a combined basis. In this case, however, petitioner could not properly file on a combined basis and therefore the tax on subsidiary capital was properly imposed.

F. That, pursuant to 20 NYCRR 3-9.4(b), a stockholder of a tax-exempt DISC must eliminate any deemed or actual distributions received from the DISC to the extent already included in entire net income. For the fiscal year ended August 31, 1976, petitioner included in its entire net income a distribution of \$320,099.00 from the DISC. Inasmuch as the Audit Division had no explanation

for changing the aforesaid figure to \$292,292.00 (the distribution included in the prior year), the deemed distribution is to be corrected to \$320,099.00 for the fiscal year ended August 31, 1976. Additionally, the DISC export credit is to be recomputed as set forth in Finding of Fact "8".

G. That section 1086(a) of the Tax Law provides, in relevant part, that:

"The tax commission, within the applicable period of limitations, may credit an overpayment of tax and interest on such overpayment against any liability in respect of any tax imposed by the tax law on the taxpayer who made the overpayment..."


Therefore, the Audit Division properly credited the 1978 overpayment against the 1979 deficiency.

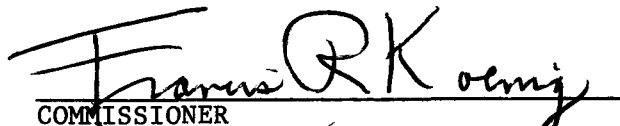
H. That the petitions of Colonial Hardware Corp. are granted to the extent indicated in Conclusion of Law "F"; that the Audit Division is directed to modify the Notice of Deficiency for the fiscal year ended August 31, 1976 issued February 1, 1980 accordingly; and that, except as so granted, the petitions are in all other respects denied.

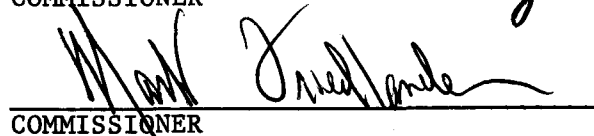
DATED: Albany, New York

STATE TAX COMMISSION

JUL 26 1984

  
PRESIDENT

  
COMMISSIONER

  
COMMISSIONER