

STATE OF NEW YORK

STATE TAX COMMISSION

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In the Matter of the Petition :  
of :  
General Mills Restaurant Group, Inc. :

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 5/29/77, 5/28/78 & 5/27/79. :

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AFFIDAVIT OF MAILING

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 9th day of November, 1984, he served the within notice of Decision by certified mail upon General Mills Restaurant Group, Inc., the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

General Mills Restaurant Group, Inc.  
ATTN: Henry Duitsman, Tax Manager  
P.O. Box 1113  
Minneapolis, MN 55440

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  
9th day of November, 1984.

David Parchuck

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

STATE OF NEW YORK

STATE TAX COMMISSION

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 for Redetermination of a Deficiency or Revision :  
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 Franchise Tax under Article 9A of the Tax Law for :  
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 \_\_\_\_\_ :

AFFIDAVIT OF MAILING

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 9th day of November, 1984, he served the within notice of Decision by certified mail upon Hartley James Chazen, the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:


Hartley James Chazen  
 777 Third Avenue  
 New York, NY 10017

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  
 9th day of November, 1984.

*David Parchuck*

  
 \_\_\_\_\_  
 Authorized to administer oaths  
 pursuant to Tax Law section 174

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

November 9, 1984

General Mills Restaurant Group, Inc.  
ATTN: Henry Duitsman, Tax Manager  
P.O. Box 1113  
Minneapolis, MN 55440

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  
Hartley James Chazen  
777 Third Avenue  
New York, NY 10017  
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

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In the Matter of the Petition :  
of :  
GENERAL MILLS RESTAURANT GROUP, INC. : DECISION  
for Redetermination of a Deficiency or for :  
Refund of Corporation Franchise Tax under :  
Article 9A of the Tax Law for the Fiscal Years :  
Ended May 29, 1977, May 28, 1978 and May 27, :  
1979. :

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Petitioner, General Mills Restaurant Group, Inc., P.O. Box 1113, Minneapolis, Minnesota 55440, filed a petition for redetermination of a deficiency or for refund of corporation franchise tax under Article 9A of the Tax Law for the fiscal years ended May 29, 1977, May 28, 1978 and May 27, 1979 (File No. 34875).

A formal hearing was held before Robert F. Mulligan, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York on July 1, 1983 at 9:30 A.M., with final briefs submitted on February 7, 1984. Petitioner appeared by Hartley James Chazen, Esq. The Audit Division appeared by John P. Dugan, Esq. (Michael Gitter, Esq., of counsel).

ISSUE

Whether the equipment, fixtures and systems purchased and placed into service by the petitioner for the preparation of food for sale at its New York "Red Lobster" restaurants, qualifies for the investment tax credit provided by section 210.12(b) of the Tax Law and the employment incentive tax credit provided by section 210.12-A of the Tax Law.

FINDINGS OF FACT<sup>1</sup>

1. Petitioner, General Mills Restaurant Group, Inc., is a corporation organized under the laws of the State of Florida and is duly qualified to do business in New York State. Its principal office is in Orlando, Florida.

2. Petitioner is a wholly owned subsidiary of General Mills, Inc., a national distributor of processed foods and other consumer products.

3. Petitioner filed New York State Corporation Franchise Tax Reports for the fiscal years ended May 29, 1977 and May 28, 1978 under the name Red Lobster Inns of America, Inc. and for the fiscal year ended May 27, 1979 under petitioner's present name. On its reports, petitioner claimed the following amounts as investment tax credits:

<u>Fiscal Year Ended</u>	<u>Amount</u>
5/29/77	\$46,266.00
5/28/78	3,913.00
5/27/79	1,622.00

4. Audit of petitioner's reports for the years at issue resulted in the following adjustments:

- (a) For the fiscal year ended 5/27/79 petitioner had added back 90 percent of interest paid to its parent. An adjustment was made to add back interest paid to the parent at 100 percent (the parent had deducted 100 percent of interest received from petitioner). This adjustment resulted in increased income of \$775,357.00.
- (b) For the fiscal year ended 5/29/77 the tax surcharge was correctly computed and the \$5,000.00 tax surcharge credit was correctly taken. For fiscal years ended 5/28/78 and 5/27/79, the \$5,000.00 credit was taken even though no surcharge was computed. Accordingly, taxes were increased by \$5,000.00 for each of the fiscal years ended 5/28/78 and 5/27/79.

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<sup>1</sup> Findings of Fact "1", "2", "3", "6" and "7" are based on a stipulation between the parties.

- (c) During each of the years at issue, petitioner took investment tax credits on restaurant buildings and equipment. The credits were disallowed on the grounds that the "properties do not qualify for investment tax credit purposes".

Accordingly, the investment tax credits (as set forth in Finding of Fact "3", supra) were disallowed.

5. On July 29, 1981 the Audit Division issued notices of deficiency to petitioner in the following amounts:

<u>Fiscal Year</u>	<u>Deficiency in Tax</u>	<u>Interest</u>	<u>Total</u>
5/29/77	\$46,266.00	\$15,554.00	\$61,820.00
5/28/78	8,913.00	2,239.00	11,152.00
5/27/79	8,683.00	1,443.00	10,126.00

6. On August 11, 1981 petitioner filed a timely petition for redetermination of that portion of the aforesaid deficiencies attributable to the disallowance of investment tax credits. Such petition has been deemed to be a Perfected Petition within the meaning of 20 NYCRR 601.5.

7. Petitioner owns a national chain of seafood restaurants known as "Red Lobster". During all or part of the years at issue, petitioner operated seven of such restaurants in New York State at the following locations:

Store #145 opened 7/29/75 - 905 North Main Street, North Syracuse, New York 13212

Store #180 opened 3/9/76 - 1200 Vestal Parkway East, Vestal, New York 13850

Store #183 opened 6/22/76 - 25 Hempstead Turnpike, Farmingdale, New York 11735

Store #189 opened 6/15/76 - 655 Jefferson Road, Henrietta, New York 14467

Store #199 opened 7/6/76 - 1557 Central Avenue, Colonie, New York 12205

Store #217 opened 11/16/76 - 2220 Nesconset Highway, Stony Brook, New York 11790

Store #264 opened 4/3/79 - 211-217 Old Country Road, Carle Place, New York 11514.<sup>2</sup>

8. Petitioner acts as its own seafood supplier and processor.

(a) It purchases frozen seafood from its agents operating in major buying areas such as Brazil, Ecuador, Honduras and Asia. Its agent in Brazil, for example, works exclusively for petitioner. This agent employs seven quality control inspectors whose responsibilities are to insure that the quality from the local seafood plants meets petitioner's standards.

At the foreign plants, the seafood is put in an institutional form (e.g., in the case of shrimp or lobster, removing the heads and grading the tails by size, or in the case of fish, removing the heads, tails and bones) and packed and frozen in five or ten pound cartons. The imported seafood is shipped to five primary warehouses in the United States for distribution to Red Lobster restaurants.

(b) Petitioner also purchases fresh seafood.

The operations of petitioner's Pinellas Seafood Division were described at the hearing in the testimony of its general manager. The Pinellas, Florida, plant mainly processes shrimp which it receives fresh from local boats and other sources. After the heads are removed, the shrimp are classified by size, graded and packed in five pound boxes, then frozen. The five pound boxes are put into fifty pound master cartons for distribution to restaurants or other institutions. Some of the shrimp is shelled at the Pinellas plant but none is breaded. The shrimp shipped to the petitioner's New York State stores in the years at issue were not shelled or deveined but were in the shell and in institutional packs.

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<sup>2</sup> Although the stipulation states that Store #264 was opened on 4/3/79, which is during the fiscal year ended 5/27/79, the record contains no specific costs as to this store and thus it is not treated in Findings of Fact 17, 18 and 19, infra.

Petitioner also apparently purchases fresh seafood which is not subsequently frozen, but sold fresh in its restaurants. Although this aspect of petitioner's operation was not treated at the hearing, petitioner's Food Production Manual "Fresh Fish of the Day" section indicates that petitioner's restaurants acquire fresh fish from fish vendors. The Manual describes the restaurant manager's role in purchasing, receiving, handling and storing fresh fish.

(c) Petitioner also has domestic purchasing operations similar to its international purchasing operations, i.e. it engages domestic plants to pack seafood products to petitioner's standards and specifications.

(d) Petitioner maintains an active sales organization at St. Petersburg, Florida, to sell seafood which petitioner cannot use, but purchases under contracts with its suppliers.

9. The seafood is supplied to the Red Lobster restaurants directly from petitioner at a charge of cost plus transportation expenses. This differs from the standard seafood restaurant practice where one to three middlemen, such as distributors or wholesalers, are between the primary buyer and the restaurant or retailer. This direct purchasing system enables Red Lobster restaurants to purchase seafood at prices 25.9% to 28.5% lower than if it had to purchase it through normal channels.

The supermarket markup on prepared items such as breaded shrimp represents about 35% of the retail price.

10. A Red Lobster restaurant orders its food on a once a week basis. When the food is delivered, the dry goods are stored and the perishable items are put into one of three boxes: (a) freezer (0° to -10° F) (b) "wet box" - a refrigerator with high humidity (38° to 40° F) (c) "dry box" - a refrigerator



with low humidity (38° to 40° F). All products are rotated, i.e. the new products are placed in back, the older items to the front.

11. At the end of each day, each Red Lobster restaurant manager calculates how many dinners he expects to serve the next day. Based upon this calculation, an adequate supply of seafood packed in solid frozen blocks is removed from the freezer that evening ("evening pull") and placed in the wet box. It is partially thawed when the staff comes in the next morning. The thawing is completed under running water. Products which are individually wrapped or packed in layers or "snap packs" are removed in the morning of the day they are to be used ("morning pull") and also thawed under running water. This thawing procedure is used to minimize waste and keep the seafood as fresh as possible. The slow, even thawing helps preserve natural juices and flavor. After thawing, an eight or ten pound fillet of fish would be proportioned for production that day i.e., it would be cut into pieces weighing approximately 115 grams, and the pieces would either be breaded or prepared for the broiler. The breaded fish would then be put into the dry box until ordered by the customer.

12. The only seafood delivered to Red Lobster restaurants in finished form is clam strips. All fish is prepared at the restaurant from a raw fillet.

13. Red Lobster restaurants are low-price full service restaurants specializing in seafood, designed to appeal to the broadest section of middle America. The average Red Lobster customer is between 18 and 59 years of age and has a family. The mean income is \$15,000.00 and up. Petitioner's customers are very price sensitive and petitioner considers fast food restaurants and supermarkets selling prepared seafood as its major competitors.

14. The following is a comparison of the weighted averages of Red Lobster seafood menu items and the prices charged at grocery stores:

	<u>Market Area</u>	<u>Red Lobster Price</u>	<u>Grocery Store Price</u>	<u>Percentage of Difference</u>
<u>1977</u>	New York	\$3.96	\$3.48	13.8
	Buffalo	3.98	3.48	14.4
	Albany	3.96	3.49	13.5
<u>1978</u>	New York	4.36	3.88	12.4
	Buffalo	4.36	3.46	26.0
	Albany	4.36	3.58	21.8
<u>1979</u>	New York	5.59	4.83	15.7
	Buffalo	5.59	4.78	16.9
	Albany	5.59	5.16	8.3

For example, in the Albany market area for 1977, the menu item "broiled stuffed shrimp" was sold for \$3.49. The retail price of six large fantail shrimp was \$1.60 and three ounces of deviled crab 25¢ with "other small food items" (evidently the non-seafood items completing the serving) 53¢ for a total retail price of \$2.38. The retail price was 68% of the Red Lobster price.

15. Petitioner contends that its Red Lobster restaurants are distinguishable from conventional restaurants in that Red Lobster restaurants are the "last stop" in an integrated purchasing and specialty seafood processing business in which they are the "stores" or points of sale of petitioner's products to customers and that the amounts paid by customers at Red Lobster restaurants are predominantly for food and not for services.

16. Petitioner originally claimed investment tax credits pursuant to section 210.12(b) of the Tax Law upon the same property for which it had claimed credit on its federal returns. Petitioner has now abandoned any claim for property used in the service of food (e.g. booths, chairs, decorations, etc.) and has restricted its claim to property which it contends is principally used in food preparation: kitchen equipment, electric and plumbing systems

(part), heating, ventilating and air conditioning systems (part), exhaust hoods, fire protection, fire protection in food processing areas, concrete truck slabs, concrete dumpster slabs, concrete freezer slabs and grease traps.

The annual total purchase prices for the property on which petitioner is now claiming investment tax credits are as follows:

<u>Fiscal Year Ended</u>	<u>Amount</u>
5/29/77	\$736,308.00
5/28/78	6,533.00
5/27/79	36,178.00

17. During the years at issue, petitioner purchased and placed into service in its New York locations food processing, handling, storage, and related equipment at the following total costs per store per year:

<u>Fiscal Year Ended</u>	<u>Store</u>	<u>Cost</u>
5/29/77	#183	\$ 71,848.00
	#189	70,748.00
	#199	71,278.00
	#217	70,751.00
TOTAL		<u>\$284,625.00</u>
5/28/78	#183	\$ 1,193.00
	#189	1,664.00
	#199	1,114.00
	#217	1,281.00
TOTAL		<u>\$ 5,252.00</u>
5/27/79	#183	\$ 12,309.00
	#217	2,002.00
	#145	10,305.00
	#180	11,562.00
TOTAL		<u>\$ 36,178.00</u>

These purchases included such items as ovens, ranges, broilers, fryers, heat lamps, hush puppy machines, shrimp machines, coffee makers, refrigerators, freezers, shelves, work tables, water heaters, dish washers and

sinks. Most of the equipment was acquired through petitioner's SigmaCon division

Petitioner conceded that all of the above equipment would be found in the typical seafood restaurant, except for the hush puppy machines, as hush puppies are usually not offered by the typical seafood restaurant.

SigmaCon builds Red Lobster restaurants and supplies equipment. Red Lobster reimburses SigmaCon for its actual costs through an interdivisional accounting technique.

18. The following are the costs for building systems servicing food production areas for particular Red Lobster New York State restaurants (all costs incurred in 1977):

<u>SYSTEM DESCRIPTION</u>	<u>STORE #183</u>	<u>STORE #189</u>	<u>STORE #199</u>	<u>STORE #217</u>	<u>TOTAL</u>
Plumbing & Waste Water Treatment	\$ 34,642.00	\$ 27,500.00	\$ 22,865.00	\$ 26,047.00	\$111,054.00
Heating, ventilating & air conditioning	35,500.00	35,000.00	35,076.00	32,946.00	138,522.00
Hood	9,526.00	10,076.00	10,000.00	13,000.00	42,602.00
Electrical	49,809.00	47,751.00	48,057.00	41,465.00	187,082.00
Fire Protection	1,323.00	1,386.00	1,250.00	5,933.00	9,892.00
TOTAL	<u>\$130,800.00</u>	<u>\$121,713.00</u>	<u>\$117,248.00</u>	<u>\$119,391.00</u>	<u>\$488,602.00</u>

19. The following is a schedule of costs for building, land and site improvements for particular Red Lobster New York restaurants:

<u>DESCRIPTION</u>	<u>#183</u>	<u>#189</u>	<u>#199</u>	<u>#217</u>	<u>TOTAL</u>
Land	\$227,469.00	\$135,755.00	\$146,015.00	\$301,706.00	\$ 810,945.00
Building	275,194.00	275,058.00	260,519.00	267,627.00	1,078,398.00
Site Improvements	63,494.00	73,403.00	65,945.00	44,182.00	247,024.00
TOTAL	<u>\$561,157.00</u>	<u>\$484,216.00</u>	<u>\$472,479.00</u>	<u>\$613,515.00</u>	<u>\$2,136,367.00</u>

20. Petitioner contends that certain site improvements and capital costs are entitled to the credit to the extent they are directly related to production facilities. These items are as follows:

- (a) Kitchen or food preparation area duct work, the average cost of which in 1977 was \$7,351.00 per store. This is separate from the service area duct work.
- (b) Dumpster pad and drain. This is a reinforced concrete pad with drain required to receive garbage dumpsters. The average cost in 1977 was \$2,980.00 each.
- (c) Concrete truck slabs, which are reinforced concrete slabs associated with the dumpster pads. These cost \$1,259.00 each.
- (d) Concrete freezer slabs which are required to separate the freezer from the structural slab. These cost an average of \$1,385.00 each.
- (e) Grease traps in the food production area which are required to separate grease from water and are mandated by building codes. These cost \$3,712.00 each.

All of these items would commonly be found in any restaurant.

21. Petitioner depreciated buildings over 25 years, site improvements over 20 years and equipment over 10 years.

22. Each Red Lobster restaurant has three heat pumps with auxiliary electric heating coils. One system serves the food production area, the other two the remainder of the building.

The food production area has an exhaust hood system used for fire protection and is also mandated by the building codes.

76% of each restaurant's electrical system is devoted to the food production area.

63% of each restaurant's water and sewer system is devoted to the food production area (dishwashing is not included in food production).

40.8% of the square footage of each of the buildings were used for food production.

23. All six New York Red Lobster restaurants are of the same design and construction.

24. Petitioner employed the following average numbers of non-management personnel in New York State:

<u>FISCAL YEAR</u>	<u>AVERAGE NON-MANAGEMENT PERSONNEL</u>
5/26/76	76
5/29/77	368
5/28/78	424
5/27/79	419

Although it did not do so in its reports for the years at issue, petitioner now also claims the employment investment tax credit under section 210.12-A of the Tax Law.

CONCLUSIONS OF LAW

A. That during the years at issue, section 210.12(b) of the Tax Law provided for a credit with respect to tangible personal property and other tangible property, including buildings and structural components of buildings, which were: depreciable pursuant to section 167 of the Internal Revenue Code, had a useful life of four years or more, were acquired by purchase, as defined in section 179(d) of the Internal Revenue Code, had a situs in New York State and were principally used by the taxpayer in the production of goods by manufacturing, processing, assembling, refining, mining, extracting, farming, agriculture, horticulture, floriculture, viticulture or commercial fishing.

B. That the property for which credit is now claimed by petitioner was depreciable pursuant to section 167 of the Internal Revenue Code, had a useful life of four years or more, was acquired by purchase, as defined in section

179(d) of the Internal Revenue Code and had a situs in New York State. The major issue in this case can be narrowed to whether the property was principally used by petitioner in the production of goods by one of the means set forth in the statute. Petitioner argues that the property was principally used in or related to the processing by petitioner of its prepared seafood products in the "processing areas" of its restaurants.

The term "principally used" means more than 50 percent [20 NYCRR 5-2.4(c)]. Petitioner contends that equipment is principally used in production when more than 50 percent of its use is devoted to food processing activities such as performed by petitioner.

C. That while petitioner clearly has highly efficient purchasing and distribution systems to which the typical seafood restaurant would not have access, the fact remains that the "processing" which takes place at petitioner's Red Lobster restaurants is nothing more than the preparation of restaurant meals for service to Red Lobster customers. This does not constitute the production of goods by processing within the meaning of section 210.12(b) of the Tax Law. Thus, the investment tax credit was properly denied. (See: Holiday Houses of New Jersey, Inc., State Tax Commission, March 25, 1983; John F. and Sarah Mahoney, State Tax Commission, April 1, 1976.)

D. That during the years at issue, section 210.12-A(a) of the Tax Law provided for an additional employment incentive tax credit where a taxpayer had been allowed a credit under section 210.12 with respect to property the acquisition, construction, reconstruction or erection of which commenced on or after January 1, 1976, provided certain employment criteria were met. Since credit under section 210.12 of the Tax Law has been denied (Conclusion of Law "C", supra), petitioner is not eligible for the employment incentive tax credit.

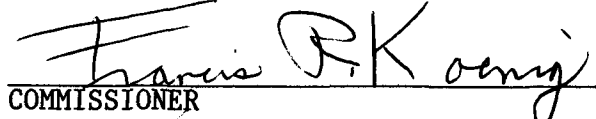
E. That the petition of General Mills Restaurant Group, Inc. is denied and the notices of deficiency issued on July 29, 1981 are sustained.


DATED: Albany, New York

STATE TAX COMMISSION

NOV 09 1984

  
PRESIDENT

  
COMMISSIONER

  
COMMISSIONER