STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition of **STEWART'S SHOPS CORPORATION** for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Years 2006 through 2009.	: : : : : :	DETERMINATION DTA NO. 825745

Petitioner, Stewart's Shops Corporation, 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 years 2006 through 2009.

A hearing was held before Barbara J. Russo, Administrative Law Judge, in Albany, New York, on February 4, 2015 at 10:30 A.M. and continued on February 5, 2015 at 9:15 A.M., and February 6, 2015 at 9:20 A.M., with all briefs to be submitted by September 28, 2015, which date began the six-month period for the issuance of this determination. Petitioners appeared by McDermott, Will & Emery, LLP (Scott M. Susko, Esq., Lindsay M. LaCava, Esq., and Richard Call, Esq., of counsel). The Division of Taxation appeared by Amanda Hiller, Esq. (Clifford Peterson, Esq., and Bruce Lennard, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation properly disallowed petitioner's reduction of its entire net income by amounts it paid to Black Ridge Insurance Corporation.

II. Whether petitioner has established reasonable cause for the abatement of penalties.

FINDINGS OF FACT [1]

1. Stewart's Shops Corporation (petitioner) is a corporation formed under the laws of New York and has its principal place of business in Saratoga Springs, New York.

2. Petitioner is an employee-owned and family-owned business that owns and operates convenience stores and gas stations in upstate New York and Vermont. Petitioner and its predecessor entities (Stewart's Dairy, Saratoga Dairy and Stewart's Ice Cream Co., Inc.) have been in business since 1945, and started as a family-owned ice cream business that eventually expanded into the current convenience store and gasoline businesses.

3. Petitioner currently owns and operates 330 convenience stores in New York and

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[1] The parties executed and submitted a Stipulation of Facts setting forth 12 numbered stipulated facts and including 94 exhibits of which the parties agreed to the admissibility. The stipulated facts are renumbered and generally incorporated herein. Additionally, pursuant to State Administrative Procedure Act (SAPA) § 307(1), both parties submitted proposed findings of fact. Petitioner submitted 176 proposed findings of fact and the Division submitted 151 proposed findings of fact. Petitioner's proposed findings of fact 1, 2, 4, 43 - 46, 49, 51 - 61, 63, 65 - 72, 75, 76, 78, 79, 81, 82, 84, 86 - 88, 91 - 96, 98, 99, 102 - 105, 107 - 118, 120 - 128, 130 - 132, 134 - 140, 142 - 146, 149 - 153, 155, 158 - 160, 162, 163 and 166 are supported by the record and have been consolidated, condensed, combined, renumbered and substantially incorporated herein. Petitioner's proposed findings of fact 3, 6, 10, 11, 38, 47, 48, 73, 74, and 148 have been rejected as conclusions of law and not proper findings of fact. Petitioner's proposed findings of fact 5, 8, 16, 42, 62, 64, 77, 80, 83, 90, 97, 101, 106, 119, 129, 133, 141, 147, 154, 156, 157, 164, 165, and 167 have been modified to more accurately reflect the record, remove conclusions of law and delete irrelevant and immaterial portions. Petitioner's proposed findings of fact 7, 9, 12 - 15, 17 - 37, 39 - 41, 50, 161 have been rejected as not relevant, material or necessary to the determination herein. Petitioner's proposed findings of fact 85, 100, 131 have been rejected as not supported by the citation provided. Petitioner's proposed finding of fact 89 has been rejected as not supported by the record. Petitioner's proposed findings of fact 168 - 176 have been rejected because they are procedural matters not at issue herein. The Division's proposed findings of fact 7, 8, 15 - 27, 34, 36, 42, 50, 52, 55, 60, 61, 64 - 66, 68 - 73, 75, 81, 83, 86, 87, 89, 92 - 100, 106, 112, 113, 115, 117, 118, 121, 122, 126, 127, 131, 142, 144, 147 - 149, and 151 are supported by the record and have been consolidated, condensed, combined, renumbered and substantially incorporated herein. The Division's proposed findings of fact 1, 2 - 5, 9 - 14, 28 - 30, 37, 38, 43, 44, 46, 54, 59, 62, 67, 74, 76 - 80, 85, 88, 90, 91, 101 - 111, 116, 120, 128 - 130, 132 - 137, 143, and 150 have been modified to more accurately reflect the record. The Division's proposed findings of fact 6 and 141 have been rejected as repetitive. The Division's proposed findings of fact 31 - 33, 35, 39 - 41, 47 - 49, 51, 53, 56 - 58, 82, and 140 have been rejected as conclusions or arguments and not proper findings of fact. The Division's proposed finding of fact 45 has been rejected as not supported by the citation provided. The Division's proposed finding of fact 63 has been rejected as not relevant, material or necessary to the determination herein. The Division's proposed findings of fact 84, 114, 119, 123 - 125, 138, 139, 145, and 146 are rejected as not supported by the record.

Vermont, 276 of which have gas stations. During the years 2006 through 2009 (the years at issue), the number of convenience stores operated by petitioner ranged from 318 to 326 and the number of gas tanks at petitioner's gas stations ranged from 820 to 1,000.

4. During the years at issue, petitioner owned and operated an extensive warehousing and distribution center.

5. During the years at issue, petitioner owned and operated a fleet of automobiles, trucks, and gas tankers. During the years at issue, the number of vehicles petitioner owned ranged from 165 to 195, approximately 10 to 15 of which were gas tankers, which each carried up to 12,500 gallons of gasoline.

6. Petitioner employed 4,000 to 4,500 individuals during the years at issue.

7. The stock of petitioner is owned approximately one-third by its employees through an Employee Stock Ownership Plan (ESOP) and approximately two-thirds by members of the Dake family, including William Dake, who was one of petitioner's witnesses at the hearing in this matter.

8. During the years at issue Black Ridge Insurance Corporation (BRIC), NC PSC Corp., and Texstar Holdings, Inc., were wholly-owned direct subsidiaries of petitioner.

9. BRIC was a pure captive insurance company licensed by the New York State Insurance Department (Insurance Department) and authorized to do business in New York during the years at issue.

10. NC PSC Corp. operates a nonqualified income security plan whose primary purpose is to pay death and optional cash or retirement benefits to former employees of Pine State Creamery Company.

11. Texstar Holdings, Inc., operates a nonqualified income security plan whose primary

purpose is to pay death and optional cash or retirement benefits to former employees of Star Textile Company.

12. During the years at issue, members of the Dake family also owned Stewart's Processing Corporation (SPC), which owns the processing plants that are used to produce the Stewart's-branded food, ice cream, and other dairy products sold by Stewart's convenience stores.

13. SPC was treated as an S corporation for federal and New York income tax purposes.

14. Petitioner timely filed forms CT-3-A, general business corporation combined franchise tax returns for the years at issue. In 2010, petitioner filed amended forms CT-3-A for tax years 2006 and 2007. Attached to petitioner's CT-3-A combined franchise tax returns were its federal consolidated forms 1120, U.S. corporation income tax returns for the years at issue.

15. Petitioner included Texstar Holdings, Inc., and NC PSC Corp. in its CT-3-A combined franchise tax returns for the years at issue.

16. BRIC was not included on petitioner's CT-3-A combined franchise tax returns for the years at issue.

17. During the years at issue, petitioner paid BRIC the following amounts:

Year	Payment Amount
2006	$10,049,125.00
2007	$10,854,918.00
2008	$10,434,985.00
2009	$10,906, 356.00

18. On petitioner's CT-3-A combined franchise tax returns for the years at issue, in computing its entire net income (ENI), petitioner deducted the amounts listed in Finding of Fact

17 that it paid to BRIC.

19. For the years at issue, petitioner filed federal consolidated forms 1120, U.S. corporation income tax returns.

20. Petitioner included BRIC in its consolidated forms 1120 filed for the years at issue.

21. On its consolidated forms 1120 for the years at issue, petitioner showed deductions for insurance and payments received by BRIC on its schedule of combined income and deductions. On the consolidated forms 1120 for the years at issue, petitioner eliminated these amounts as intercompany transactions and the payments were not deducted in calculating its federal taxable income (FTI).

22. During the hearing, petitioner submitted into the record pro forma consolidated forms 1120 for the years at issue (pro forma returns). The pro forma returns were not filed with the Internal Revenue Service (IRS) or submitted to the Division during the audit. On the pro forma returns, petitioner took deductions for “premium” amounts it paid to BRIC when computing FTI.

23. From approximately January 2010 to December 2011, the Division of Taxation (Division) conducted a general verification field audit of petitioner’s CT-3-A combined franchise tax returns for the years at issue.

24. The audit of petitioner’s CT-3-A combined franchise tax returns for the years at issue was the first audit of petitioner that focused on its payments to BRIC.

25. As a result of the audit, for tax year 2006 the Division disallowed petitioner’s claimed insurance expense deduction of $7,990,638.00, which was the amount petitioner paid BRIC minus losses paid by BRIC. The Division similarly disallowed petitioner’s claimed insurance expense deductions for 2007, 2008 and 2009 for New York State tax purposes. The Division disallowed petitioner’s claimed insurance expense deductions for the years at issue,

concluding that these expenses were not allowable deductions for federal tax purposes in computing FTI. The Division determined the payments were not premiums paid for bona fide insurance, because it found that there was no risk shifting or risk distribution.

26. Based on the disallowance, the Division calculated revised FTI amounts and revised combined ENI amounts for petitioner for the years at issue.

27. These computations led to the determination of the additional tax due in this matter.

28. At the conclusion of the audit of petitioner, the Division issued a Notice of Deficiency (assessment number L-037074405-6) dated December 23, 2011, asserting that petitioner owed additional corporation franchise tax under Article 9-A of the Tax Law in the amount of $1,988,142.00, plus interest in the amount of $510,315.27 and penalties in the amount of $198,811.00 for the years at issue. This additional tax consisted of tax on entire net income in the amount of $1,963,460.00 plus additional metropolitan transportation business tax under Tax Law § 209-B (MTA Surcharge) in the amount of $24,682.00.

29. In computing the additional tax reflected on the notice, the Division disallowed the deductions taken by petitioner for payments made to BRIC as indicated in Finding of Fact 17 (net of any claims paid by BRIC to petitioner)[2] in computing its combined entire net income for the years at issue.

30. No materials examined during the audit indicated that there was any compensation of officers paid by BRIC in 2006, 2007 or 2008.

31. No materials examined during the audit indicated that there were any salaries or wages paid to employees of BRIC in 2006, 2007 or 2008.

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[2] During the years at issue, BRIC paid petitioner the following amounts: $2,058,487.00 in 2006; $2,335,262.00 in 2007; $2,578,440.00 in 2008; and $5,302,047.00 in 2009.

32. No materials examined during the audit indicated that any rents were paid for BRIC in 2006, 2007 or 2008.

33. During the audit, petitioner conceded that the alleged insurance contracts between it and BRIC did not qualify as insurance contracts for federal income tax purposes.

34. Petitioner also conceded that its payments made on such contracts did not constitute insurance premiums for federal income tax purposes.

35. Before the audit, petitioner never sought an informal opinion from the Division or requested the Division to issue an advisory opinion on the deductibility of its payments to BRIC.

36. Petitioner never provided the Division with a letter from a tax advisor that predated its filing of its tax returns in which the advisor opined that its payments to BRIC were deductible for federal income tax purposes.

37. Petitioner never provided the Division with a letter from the Insurance Department opining that petitioner's payments to BRIC were deductible for purposes of computation of its combined ENI.

38. The Division's primary contact for petitioner during the audit was Michael Cocca, petitioner's assistant treasurer, who did not testify during the hearing.

Captive Insurance Background

39. In 1997, as part of the 1997 - 1998 budget bill, the New York State Legislature enacted Article 70 of the Insurance Law (Captive Insurance Laws), which allows captive insurance companies to be created in and to operate in New York State, and amended Article 33 of the Tax Law to impose a tax on gross direct premiums and assumed reinsurance premiums of captive insurance companies licensed in New York (captive premiums tax).

40. In 2003, the Insurance Department created a separate captive insurance group (the

Captive Unit) within the Insurance Department, which was responsible for the licensing, oversight, and financial examination of captive insurance companies.

41. The Insurance Department, through the Captive Unit, receives and reviews applications for licensor for New York captive insurance companies and reviews annual reports filed by captives. After review of license applications is completed and satisfactory, the Superintendent of Insurance issues final approval of license applications based on the recommendations from the Captive Unit.

42. All insurance companies licensed in New York, including New York captive insurance companies, are subject to ongoing oversight by the Insurance Department.

43. All insurance companies licensed in New York, including New York captive insurance companies, are required to file annual statements with the Insurance Department.

44. New York captive insurance companies are required to file a New York Captive Insurance Company Annual Statement form (annual statement) and are required to report their assets, liabilities, capital, income, expenses, lines of insurance, premiums, and losses, among other information, on those annual statements.

45. The Captive Unit reviews the annual statements that are filed by New York captive insurance companies. The annual statements are subject to at least a desk audit by the Captive Unit.

46. The Insurance Department is authorized to conduct quinquennial examinations of New York captive insurance companies, but did not start conducting those examinations until after 2007. The quinquennial examinations involve a review of the New York captive insurance company's books and records and other documentation supporting the information reported on

the captive insurance company's annual statements.

47. Petitioner called Gregory V. Serio, former general counsel and superintendent of the Insurance Department, as a witness. Mr. Serio was among the drafters of the Captive Insurance Laws, when he served as First Deputy Superintendent of Insurance.

48. The Captive Unit considered the capitalization of captive insurance companies when reviewing license applications.

49. In reviewing license applications and annual statements, the Captive Unit reviews and ensures that there is enough money in the financial plan of a captive insurance company to support the risks that are being insured by that company.

50. If a captive insurance company does not hear from the Insurance Department following the filing of its annual statement, it means only that the statement did not seem to have a problem that came to the department's attention.

51. The Insurance Department regulates captive insurance companies to ensure they have sufficient financial resources to take care of the claimants who make claims against the insured.

52. A captive insurance company is a separately incorporated entity that has a separate and distinct regulatory relationship with the Insurance Department.

53. Captive insurance companies operate as insurance companies and adjust claims that are made against the coverage they provide.

54. The Insurance Department does not set premium rates of policies issued but reviews proposed premiums to see, in part, if the insurance company is bringing in enough money to cover the risks it insures against and determine if the premiums are too low or too high.

55. Petitioner called Peter J. Molinaro, former Senior Deputy Superintendent of the Insurance Department, as a witness. Mr. Molinaro was among the drafters of the Captive

Insurance Laws when he served as Associate Counsel to the Insurance Department.

56. Mr. Molinaro testified that the Captive Unit would only allow businesses with $100 million dollars of net worth to set up a captive insurance company in New York because these businesses were presumed to be highly sophisticated entities that would hire and have access to the professional expertise it takes to run a captive insurance company.

57. When serving as the Senior Deputy Superintendent of the Insurance Department, Mr. Molinaro met with individuals from petitioner in 2003.

58. Several other members of the Insurance Department's Captive Unit were present at the meeting with petitioner.

59. The members of the Captive Unit discussed the premium tax under Article 33 of the Tax Law and the New York Insurance Law § 332 assessment with representatives of petitioner at the meeting.

60. Mr. Molinaro testified that he does not recall discussing deductibility for federal income tax purposes of premiums while promoting the formation of captive insurance companies.

61. The Captive Unit did not review captive insurance companies' premiums for deductibility for federal income tax purposes.

62. Mr. Molinaro does not recall ever representing that premiums paid to a captive insurance company would be deductible for federal income tax purposes.

63. When a corporation asked the Captive Unit about the deductibility for federal tax purposes of premiums paid to a captive insurance company, it was told to consult its tax advisor.

64. The Captive Unit was not charged with providing tax advice about captive insurance companies.

Petitioner's Business Risks and Historic Insurance Programs

65. Petitioner called William P. Dake, petitioner's Chairman of the Board, as a witness.

66. Mr. Dake was the president of petitioner from the early 1970s until 2003. In 2003, Mr. Dake's son, Gary Dake, became president of petitioner and Mr. Dake became petitioner's Chairman of the Board of Directors. As the president and chairman of the board, Mr. Dake was involved in all aspects of petitioner's operations.

67. In his capacity as president and chairman of the board, Mr. Dake has overseen and managed the risks that petitioner faces in its business operations.

68. Mr. Dake supervised the activities of Mary Ann Macica, who has been the risk manager for petitioner from 1990 to present and who manages petitioner's risks by monitoring, reviewing and managing claims from third parties and by evaluating and managing petitioner's insurance needs. Ms. Macica acted simultaneously as petitioner's vice president and risk manager, and vice president of BRIC during its existence.

69. In 1991, petitioner hired Harry Bucciferro of Marshall & Sterling (an insurance agency) as its insurance broker. Mr. Bucciferro has over 40 years of experience in the insurance industry and has assisted petitioner with its insurance and risk financing needs from 1991 through the present.

70. Petitioner faces a number of risks in its business, including customers and employees suffering personal injuries on its premises (e.g., "slip and fall" accidents), crime (e.g., theft) by third parties and employees, pollution resulting from gasoline leaks or spills, property damage or personal injuries caused by vehicle accidents, and product liability claims.

71. In the early 1990s and prior to the formation of BRIC, petitioner purchased multiple lines of insurance from non-captive insurance companies, including property and casualty

insurance, general liability insurance, workers' compensation insurance, automobile insurance, large truck insurance, employee disability insurance, crime insurance, and umbrella insurance.

72. From 1992 to 2003, petitioner (specifically, Mr. Dake and Ms. Macica, in consultation with Mr. Bucciferro) began exploring alternative forms of risk financing, such as self-insurance (including noninsurance and large self-insured retentions and deductibles), because its insurance premiums had grown significantly and it wanted to reduce the cost of its risk financing and wanted greater control over its claims management. For example, petitioner wanted more control over whether its claims should be paid or settled.

73. Mr. Serio explained that "self-insurance" is when a company pays its own claims and losses as they arise, and described two types of self-insurance arrangements: 1) non-insurance, where a company does not purchase insurance from third parties and is responsible for all of its own claims and losses; and 2) self-insured retentions and deductibles, where a company is responsible for paying losses up to a certain threshold amount (referred to as either the deductible amount or self-insured retention amount) and where losses over that threshold amount are covered by an insurance policy with a third-party insurance company. A company using self-insurance may or may not put funds aside in a designated account from which it will pay future losses.

74. Self-insurance arrangements are not regulated by the Insurance Department.

75. In 1993, petitioner became a qualified self-insurer with the New York State Workers' Compensation Board for workers' compensation and disability insurance purposes.

76. Starting around 1994, petitioner started increasing its use of self-insured retentions as part of its plan to migrate to more self-insurance arrangements.

77. In 1994, petitioner purchased its first insurance policy with a self-insured retention.

78. For several years prior to forming BRIC, petitioner also self-insured several risks using noninsurance (meaning it had no third-party insurance policies covering those risks). For example, petitioner self-insured its pollution risks (such as losses due to gasoline spills or leaks at its gas stations that might require environmental clean-up) through noninsurance because petitioner had controls in place that led it to believe that the cost of third-party insurance was too expensive relative to its risks.

79. In the early 2000s, petitioner became self-insured for its crime risks after its then crime insurance carrier, The Hartford, refused to renew petitioner's crime insurance policy after a large claim was made by petitioner for an incident involving a former employee who embezzled approximately $1,900,000.00 from petitioner. After The Hartford refused to renew its crime policy, petitioner tried to obtain crime insurance from other insurance carriers, but petitioner felt the cost was too high relative to its anticipated future risks due to controls petitioner had put in place following the embezzlement incident.

80. Following the embezzlement incident described above and due to increasing costs, petitioner (specifically, Mr. Dake and Ms. Macica in consultation with Mr. Bucciferro) again began exploring how petitioner could increase its use of alternative risk financing arrangements.

81. Petitioner considered going without insurance but felt that option did not work due to regulatory requirements.

82. At the suggestion of Mr. Bucciferro, petitioner also considered forming a captive insurance company in Vermont, New York or Bermuda. Petitioner dismissed the idea of forming a captive insurance company in Bermuda because it did not have any business operations there and thus narrowed its captive insurance options to a New York or Vermont captive insurance company.

Formation of BRIC

83. Mr. Dake was involved in petitioner's decision to form a New York captive insurance company in 2003.

84. Mr. Bucciferro arranged a meeting in March 2003 with members of the Captive Unit and petitioner to discuss the possibility of petitioner forming a New York captive insurance company.

85. At the March 2003 meeting, Mr. Dake and Mr. Bucciferro met with Mr. Molinaro, Mr. Scala, and Jody Wald from the Insurance Department's Captive Unit to discuss the option of forming a captive insurance company. The members of the Captive Unit explained the regulatory requirements for New York captive insurance companies, the benefits of forming a New York captive insurance company, and the formation and licensor process and provided Mr. Dake with a copy of the Captive Unit's marketing brochure.

86. At the March 2003 meeting, the members of the Captive Unit encouraged petitioner to form a New York captive insurance company and represented that the benefits included providing petitioner with increased control of risk, increased control of claims, and increased incentive for risk management.

87. Mr. Dake described the "sell" of having a captive insurance company was primarily that petitioner would have a fair amount of control.

88. The idea of maintaining control of its risk management program was appealing to petitioner.

89. Mr. Dake described petitioner's decision to form BRIC as a New York captive insurance company as based, in part, on "a little bit of civic service" because it appeared to him that the Insurance Department wanted someone selling their captive insurance program.

90. Petitioner also expected an economic benefit from forming a captive insurance company by offsetting some expenses, the biggest one being claims expenses. Mr. Dake believed that the offset of claims expenses would come partially by some tax savings realized by putting money aside to build a strong balance sheet within BRIC. The idea of tax savings was one of several factors in deciding whether to form BRIC but was not the only factor.

91. After meeting with members of the Captive Unit, it was Mr. Dake's understanding that premiums paid to a New York captive insurance company would be deductible under Article 9-A of the Tax Law. However, Mr. Molinaro did not recall ever representing to petitioner that the payments would be deductible.

92. Mr. Dake believed BRIC could function intelligently as a logical business vehicle.

93. Mr. Dake believed he could not create a stable entity with an effective balance sheet without deducting the payments made to BRIC.

94. After the March 2003 meeting, Mr. Dake, after further consultations with Ms. Macica and Mr. Bucciferro, made the final decision for petitioner to form a New York captive insurance company instead of pursuing the other alternative risk financing arrangements it had been considering because a New York captive insurance company would allow petitioner to use a regulated form of insurance and gain greater control over its risks and claims.

95. Based on a recommendation by the Captive Unit, petitioner engaged Pricewaterhouse Coopers LLP (PWC) to prepare a feasibility and actuarial study (PWC study) and to assist with the formation of and license application for BRIC.

96. In preparing the PWC study, PWC reviewed petitioner's historic insurance policies and its loss history. Based on that historic information, the PWC study proposed the lines of insurance that BRIC should provide to petitioner as well as the premiums that should be charged

for those lines of insurance based on petitioner's projected losses.

97. PWC determined that premiums for "traditional" risks (specifically, general liability, garage and garage keepers liability, auto liability, property liability, boiler and machinery liability, employment practices liability [EPLI], umbrella liability, motor carrier [tanker] liability, and workers' compensation liability) and crime risks should be computed at 135% of the projected losses and determined premiums for "non-traditional" risks (specifically, pollution, product recall, business interruption, reputation risk, identity theft, excess directors and officers liability coverage, and excess umbrella coverage) based on a review of market conditions, including discussions with several insurance brokers that were aware of current pricing.

98. Based on the information in the PWC study, Ms. Macica prepared a license application for BRIC that was then reviewed by PWC.

99. Ms. Macica filed a license application for BRIC (which included a copy of the PWC study) with the Captive Unit on November 19, 2003.

100. Upon receipt, the Captive Unit reviewed BRIC's license application.

101. Over the course of the next several weeks, the Captive Unit engaged in discussions and correspondence with Ms. Macica and PWC regarding BRIC's license application.

102. In BRIC's initial license application, it was proposed that BRIC would be owned 95% by petitioner and 5% by SPC. However, Mr. Wald suggested that BRIC be wholly-owned by petitioner. As a result of that suggestion, petitioner changed the proposed ownership structure of BRIC so that BRIC was wholly-owned by petitoner.

103. The Captive Unit also examined the workers' compensation coverage to be provided by BRIC to petitioner and it was agreed that because petitioner was a qualified self-insurer for workers' compensation purposes, BRIC would indemnify petitioner for its workers'

compensation claims, meaning that petitioner would continue to pay any workers' compensation claims directly to the claimants and BRIC would indemnify petitoner for those claims.

104. Ms. Macica also conferred with Mr. Wald regarding a plan for BRIC to provide indemnity coverage to petitioner for its unasserted workers' compensation claims for the 1992 through 2003 years in exchange for a one-time $6,000,000.00 premium (portfolio transfer) and the Captive Unit did not object to that plan.

105. BRIC was incorporated on December 30, 2003.

106. After completing its review of BRIC's license application and the subsequent amendments and revisions to that application, the Insurance Department issued a license to BRIC effective January 1, 2004 authorizing BRIC to conduct a captive insurance business in New York as a pure captive insurance company.

107. The Insurance Department documented its conclusions regarding BRIC's license application in a memorandum dated January 22, 2004.

BRIC's Operations

108. Mr. Bucciferro was the captive manager of BRIC during the years at issue. As captive manager, Mr. Bucciferro worked with the Insurance Department in order to meet regulatory requirements, prepared BRIC's insurance policies, helped BRIC procure and review its annual actuarial reports, and helped BRIC file its annual statements with the Insurance Department.

109. Mr. Bucciferro was paid $5,000.00 for his services as captive manager in 2009.

110. After BRIC was licensed as a captive insurance company, Mr. Bucciferro and Ms. Macica consulted and finalized the lines of insurance BRIC would provide to petitioner as of January 1, 2004, based on recommendations from PWC and petitioner's historic insurance needs

and loss history, and the premiums that BRIC would charge for those lines of insurance.

111. After the creation of BRIC, petitioner no longer purchased crime insurance from third parties. Petitioner also increased the deductible and self-insurance retention amounts on its non-captive insurance policies.

112. BRIC provided petitioner with the following three categories of coverage: 1) excess follow form insurance; 2) deductible buy-back insurance; and 3) “other” insurance.

113. The excess follow form insurance provided by BRIC to petitioner was umbrella insurance that covered losses incurred by petitioner that exceeded the maximum losses covered by the following insurance policies that petitioner had with non-captive insurance companies: 1) directors and officers liability and EPLI policies; 2) umbrella insurance policies; and 3) property insurance (including business interruption and flood) policies.

114. Although petitioner had never incurred a loss in excess of its existing non-captive insurance policies, petitioner concluded that it had a business need for excess follow form insurance because it faced risks that could result in losses in excess of those covered by its non-captive insurance policies, for example due to the proximity of its seven-acre facility to the Kesselring nuclear power plant and due to the large volume of gasoline that it transported on public roads on a daily basis.

115. The deductible buy-back coverage provided by BRIC to petitioner provided first dollar insurance coverage for losses incurred by petitioner within the deductible and self-insured retention amounts (i.e., coverage for the first dollar of liability through the deductible and self-insured retention amounts) that petitioner had under the following insurance policies with non-captive insurance companies: 1) general liability (including liquor and employee benefits liability) insurance; 2) property liability insurance; 3) boiler and machinery liability insurance; 4)

directors and officers and EPLI insurance; 5) automobile (including gas tanker and garage keepers) liability insurance; and 6) umbrella insurance. If a claim exceeded the deductible or self-insured retention amounts, a non-captive insurer would pay petitioner the excess up to a specified maximum. The deductible buy-back insurance also provided insurance coverage for any New York workers' compensation losses that petitioner incurred in its capacity as a qualified self-insurer.

116. Petitioner concluded that it had a business need for the deductible buy-back insurance described above because it had incurred losses in the seven specified areas in its business operations.

117. Mr. Bucciferro testified that the combined annual aggregate limit for the deductible buy-back coverage on the insurance policies between petitioner and BRIC for the years at issue was $5 million.

118. Petitioner's workers' compensation loss portfolio transfer was a one-time transaction in which petitioner wanted to remove loss reserves from its books by transferring the responsibility for its self-insured workers' compensation claims from 1993 to 2003 to BRIC in exchange for a payment to BRIC.

119. Prior to the formation of BRIC, petitioner maintained a $6 million reserve to pay workers compensation claims arising from the 1993 - 2003 period.

120. In 2004, BRIC charged petitioner $2.5 million for workers' compensation deductible buy-back coverage.

121. In 2004 and 2005, the policies indicate that the deductible buy-back line of coverage provided by BRIC to petitioner was subject to a $5 million combined annual aggregate limit.

122. During the audit, in response to the Division's information document request, Mr.

Cocca stated that the $5 million figure for the combined annual aggregate limit on BRIC's deductible buy-back coverage listed on the insurance policies was a typographical error and should have been $10 million for the years at issue.

123. The Division's auditor concluded that Mr. Cocca's assertion that the figure for the combined annual aggregate limit on BRIC's deductible buy-back coverage was a typo was incorrect based on her review of the policies and declaration pages.

124. The 2004 policy between BRIC and petitioner indicates that for 2004, petitioner paid BRIC $3,850,308.00 for deductible buy-back coverage with a $5 million combined annual aggregate limit.

125. The 2005 policy between BRIC and petitioner indicates that for 2005, petitioner paid BRIC $5,558,000.00 for deductible buy-back coverage with a $5 million combined annual aggregate limit.

126. The 2006 policy between BRIC and petitioner indicates that for 2006, petitioner paid BRIC $5,880,925.00 for deductible buy-back coverage with a $5 million combined annual aggregate limit.

127. The 2007 policy between BRIC and petitioner indicates that for 2007, petitioner paid BRIC $6,524,918.00 for deductible buy-back coverage with a $5 million combined annual aggregate limit.

128. The 2008 policy between BRIC and petitioner indicates that for 2008, petitioner paid BRIC $6,495,922.00 for deductible buy-back coverage with a $5 million combined annual aggregate limit.

129. The 2009 policy between BRIC and petitioner indicates that for 2009, petitioner paid BRIC $6,841,231.00 for deductible buy-back coverage with a $5 million combined annual

aggregate limit.

130. In addition to the deductible buy-back coverage, petitioner purchased the following coverage from BRIC, as indicated in the policies for the years at issue:

Year	Coverage	Limits	Premium
2006	Excess Follow Form Insurance		
	i. Excess D&O/EPLI Including Fiduciary Liability	$ 9,000,000.00 XS $ 1,000,000.00	$225,000.00
	ii. Excess umbrella	$30,000,000.00 XS $20,000,000.00	$270,200.00
	iii. Excess property	$20,000,000.00	$195,000.00
	Other Coverages		
	i. Pollution: Sudden & Accidental: 1ST party	$10,000,000.00/occ. & agg.	$2,000,000.00
	ii. Pollution: Sudden & Accidental: 3rd party	Included above	Included
	iii. Gradual Pollution	Included	Included
	iv. Product Withdrawal	$10,000,000.00	$ 178,000.00
	v. Reputation Risk: 1ST party	$10,000,000.00	$ 100,000.00
	vi. Crime	$10,000,000.00	$ 800,000.00
	vii. Identity Theft Risk	$10,000,000.00	$ 100,000.00
	viii. Accounts Receivable	$10,000,000.00	$ 100,000.00
	ix. Kidnap, Ransom, Extortion	$10,000,000.00	$ 100,000.00
	x. EDP/CYBER Liability	$10,000,000.00	$ 100,000.00

2007	Excess Follow Form Insurance[3]		
	i. Excess D&O/EPLI Including Fiduciary Liability	$10,000,000.00 XS $ 1,000,000.00	$250,000.00
	ii. Excess umbrella	$10,000,000.00 XS $20,000,000.00	$250,000.00
	iii. Excess property	$10,000,000.00	$195,000.00
	Other Coverages[4]		
	i. Pollution: Sudden & Accidental: 1st party	$10,000,000.00/occ. & agg.	$2,025,000.00
	ii. Pollution: Sudden & Accidental: 3rd party	Included above	Included
	iii. Gradual Pollution	Included	Included
	iv. Product Withdrawal	$10,000,000.00	$ 180,000.00
	v. Reputation Risk: 1st party	$10,000,000.00	$ 100,000.00
	vi. Crime	$10,000,000.00	$ 900,000.00
	vii. Identity Theft Risk	$10,000,000.00	$ 100,000.00
	viii. Accounts Receivable	$10,000,000.00	$ 100,000.00
	ix. Kidnap, Ransom, Extortion	$10,000,000.00	$ 100,000.00
	x. EDP/CYBER Liability	$10,000,000.00	$ 100,000.00
	xi. Key Man Replacement	$ 100,000.00	$ 30,000.00

[3] For 2007, the excess follow form insurance coverage was subject to a $10,000,000.00 combined annual aggregate limit.

[4] For 2007, the other coverages were subject to a $10,000,000.00 combined annual aggregate limit.

2008	Excess Follow Form Insurance[5] i. Excess D&O/EPLI Including Fiduciary Liability ii. Excess umbrella iii. Excess property Other Coverages[6] i. Pollution: Sudden & Accidental: 1st party ii. Pollution: Sudden & Accidental: 3rd party iii. Gradual Pollution iv. Product Withdrawal v. Reputation Risk: 1st party vi. Crime vii. Identity Theft Risk viii. Accounts Receivable ix. Kidnap, Ransom, Extortion x. EDP/CYBER Liability xi. Key Man Replacement	 $10,000,000.00 XS $ 1,000,000.00 $10,000,000.00 XS $20,000,000.00 $10,000,000.00 XS $10,000,000.00 AL only $10,000,000.00 $10,000,000.00/occ. & agg. Included above Included $10,000,000.00 $10,000,000.00 $10,000,000.00 $10,000,000.00 $10,000,000.00 $10,000,000.00 $10,000,000.00 $ 100,000.00	 $250,000.00 $250,000.00 $213,000.00 $2,025,000.00 Included Included $ 200,000.00 $ 100,000.00 $ 900,000.00 $ 100,000.00 $ 100,000.00 $ 100,000.00 $ 100,000.00 $ 30,000.00

[5] For 2008, the excess follow form insurance coverage was subject to a $10,000,000.00 combined annual aggregate limit.

[6] For 2008, the other coverages were subject to a $10,000,000.00 combined annual aggregate limit.

2009	Excess Follow Form Insurance[7] i. Excess D&O/EPLI Including Fiduciary Liability ii. Excess umbrella iii. Excess property Other Coverages[8] i. Pollution: Sudden & Accidental: 1st party ii. Pollution: Sudden & Accidental: 3rd party iii. Gradual Pollution iv. Product Withdrawal v. Reputation Risk: 1st party vi. Crime vii. Identity Theft Risk viii. Accounts Receivable ix. Kidnap, Ransom, Extortion x. EDP/CYBER Liability xi. Key Man Replacement	 $10,000,000.00 XS $ 1,000,000.00 $10,000,000.00 XS $25,000,000.00 $10,000,000.00 XS Tanker $10,000,000.00 AL $10,000,000.00 $10,000,000.00/occ. & agg. Included above Included $10,000,000.00 $10,000,000.00 $10,000,000.00 $10,000,000.00 $10,000,000.00 $10,000,000.00 $10,000,000.00 $ 100,000.00	 $250,000.00 $250,000.00 $258,410.00 $2,025,000.00 Included Included $ 200,000.00 $ 100,000.00 $ 900,000.00 $ 100,000.00 $ 100,000.00 $ 100,000.00 $ 100,000.00 $ 30,000.00

131. The "other" insurance coverage provided by BRIC to petitioner provided coverage for losses incurred by petitioner in the following areas and for which petitioner did not have any non-captive insurance at the time BRIC was formed: 1) pollution (including first-party sudden and accidental pollution, third-party sudden and accidental pollution, and gradual pollution);[9] 2) product withdrawal (for losses resulting from petitioner having to withdraw products from the

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[7] For 2009, the excess follow form insurance coverages was subject to a $10,000,000.00 combined annual aggregate limit.

[8] For 2009, the other coverages were subject to a $10,000,000.00 combined annual aggregate limit.

[9] First-party pollution coverage is for losses incurred with respect to petitioner's own property, while third-party pollution coverage is for losses incurred with respect to property owned by a third-party.

market); 3) reputation risk (for losses resulting from negative publicity or damage to petitioner's public reputation); 4) crimes; 5) identity theft risk; and 6) the workers' compensation loss portfolio transfer.

132. Similar to the reasons why petitioner did not have pollution insurance coverage and crime insurance coverage, petitioner did not have coverage from non-captive insurance companies for product withdrawal, reputation risk, or identity theft risk because petitioner felt those types of policies were not readily available at affordable rates in the early 2000s.

133. With respect to the "other" insurance coverages, petitioner concluded that it had a business need for pollution, crime, product withdrawal, and workers' compensation coverage (specifically, the loss portfolio transfer) because it had incurred losses in those areas in its business operations.

134. Although petitioner had never incurred a loss due to reputation risk, it concluded that it had a business need for reputation risk coverage based on losses that similar convenience stores had suffered due to reputation damage. Petitioner's witness gave an example of a convenience store chain in the mid-west that suffered losses due to reputation damage after it sold contaminated tomatoes to consumers, and testified that petitioner was concerned that it faces similar risks in its business operations.

135. Although petitioner had never incurred a loss due to identity theft, petitioner concluded that it had a business need for identity theft insurance because it was concerned about potential losses that might result from the theft of social security numbers and credit card numbers that it maintained in its business operations.

136. All of the lines of insurance that were ultimately provided by BRIC to petitioner for 2004 were included in BRIC's license application that was reviewed and approved by the

Insurance Department.

137. After the lines of insurance were finalized, Mr. Bucciferro determined the insurance premiums that BRIC charged petitioner by comparing the rates recommended in the PWC study with market rates and industry standards for similar insurance lines provided by non-captive insurance companies.

138. At the end of each year, BRIC engaged AON Risk Consultants, Inc. (AON), an independent actuarial firm, to conduct an actuarial review of BRIC's operations.

139. Each year during BRIC's existence, Mr. Bucciferro and Ms. Macica reevaluated the lines of insurance to be provided by BRIC to petitioner and the premiums to be charged for those lines of insurance based on BRIC's experience during the prior year, the actuarial reports prepared by AON, and market rates and industry standards for similar insurance lines provided by non-captive insurance companies.

140. As a result of that annual review, BRIC added: 1) electronic data processing (EDP)/cyber liability insurance coverage; 2) kidnap, ransom, and extortion insurance coverage; and 3) accounts receivable insurance coverage to the "other" coverages sections of the policies beginning in 2005, and added key man insurance to the "other" coverages section of the policies beginning in 2007.

141. Although petitioner had never incurred a loss due to EDP/cyber liability, it concluded that it had a business need for this coverage because it was concerned about potential losses it might incur if it had an issue with its extensive online data processing system, which manages inventory orders for petitioner's convenience stores.

142. Although petitioner had never incurred a loss due to kidnap, ransom or extortion or due to the loss of a key individual, it concluded that, as a family-owned and operated business, it

has a business need for this coverage, based on petitioner's belief that the size and wealth of the Dake family could make members of the family a potential target.

143. Although petitioner had never incurred a loss related to accounts receivables, it concluded that it had a business need for this coverage because of potential risks relating to receivables from its vendors.

144. As a result of the annual review, BRIC occasionally adjusted its premiums based on the AON reports and to account for its loss history (for example, if claims exceeded anticipated levels).

145. The lines of insurance provided by BRIC to petitioner and premiums charged by BRIC for those lines of insurance were memorialized in insurance policies that BRIC issued to petitioner for the years at issue (policies).

146. Mr. Bucciferro prepared the policies for each year at issue.

147. Each December, BRIC submitted copies of its policies for the upcoming year to the Insurance Department.

148. Petitioner paid the premiums set forth in the policies to BRIC by a cash wire transfer to one of BRIC's bank accounts or investment accounts.

149. When petitioner incurred a loss covered by the policies, it filed a claim with BRIC.

150. For general liability claims, petitioner handled all the claims with the claimant and then, at the end of each month, petitioner prepared a bill and submitted it to BRIC.

151. Petitioner's in-house claims adjuster was Joanne McDermott.

152. Petitioner investigated claims made against it. After investigation, petitioner paid claims against it and submitted invoices to BRIC for payment. BRIC's claimant would be petitioner.

153. Ms. McDermott paid the general liability claims for petitioner.

154. With respect to general liability claims, petitioner interfaced directly with the third-party claimant (e.g., a store customer) and then submitted monthly claims to BRIC for any claims paid during the preceding month (general liability invoices). The general liability invoices were prepared by Ms. McDermott and were submitted to Ms. Macica (in her capacity as the Vice President of BRIC) for review and approval. If Ms. Macica had any questions about the general liability invoices, she would discuss them with Ms. McDermott. Once any issues were resolved, Ms. Macica would approve the general liability invoice for payment.

155. With respect to pollution claims, petitioner submitted any pollution claims to BRIC on a yearly basis (remediation invoices). The remediation invoices were prepared by Kim White, who was in charge of gasoline contamination clean-up and remediation situations and worked at the processing plant. The remediation invoices were submitted to Ms. Macica (in her capacity as the Vice President of BRIC) for review and approval. If Ms. Macica had any questions, she discussed them with Ms. White and, in some instances, went to her office to review her files relating to specific claims. Once any issues were resolved, Ms. Macica would approve the remediation invoices for payment.

156. With respect to all other types of claims (other than general liability and pollution), petitioner submitted monthly claims to BRIC for any claims paid by petitioner during the preceding month (other invoices). The other invoices were prepared by Ms. McDermott, who would compile the information from the various departments within petitioner's operations (e.g., crime-related claims originated in the internal auditing and security department) and were submitted to Ms. Macica (in her capacity as the Vice President of BRIC) for review and approval. If Ms. Macica had any questions, she would discuss them with Ms. McDermott. Once any issues were resolved, Ms. Macica would approve the other invoices for payment.

157. Detailed records regarding the claims reflected on the general liability invoices,

remediation invoices, and other invoices were maintained by petitioner and submitted to BRIC upon request.

158. BRIC did not approve all claims submitted by petitioner.

159. After a claim was approved for payment, BRIC paid the claim with cash via a wire transfer to petitioner.

160. During the years at issue, BRIC paid petitioner the following amounts for claims filed by petitioner with BRIC:

Year	Claims Paid
2006	$2,058,487.00
2007	$2,335,262.00
2008	$2,578,440.00
2009	$5,302,047.00

161. A third-party administrator handled workers' compensation claims for petitioner.

162. Petitioner's workers filed workers' compensation claims with petitioner directly, and petitioner paid those claims up to a $400,000.00 self-insured retention amount. Petitioner paid the claims through the third-party administrator. In turn, petitioner was indemnified by BRIC.

163. For workers' compensation claims brought by an employee of petitioner, the third-party administrator investigated the claim to determine if it was legitimate. Petitioner would pay the claim through the third-party administrator and would then, in turn, submit a claim to BRIC, which would then review the third-party administrator's reports, discuss any questions with the third-party administrator, and determine whether to approve the claim.

164. Ms. Macica does not believe that BRIC was necessarily obligated to investigate, adjust, and adjudicate claims.

165. BRIC filed annual statements with the Insurance Department that disclosed, among other information, the lines of insurance provided by BRIC to petitioner and the premiums charged by BRIC for that insurance.

166. The Insurance Department never contacted BRIC with any concerns about its annual statements.

167. The Insurance Department renewed BRIC's license each year during its existence.

168. BRIC had its own officers and directors.

169. BRIC conducted annual board of directors meetings and annual shareholders meetings in New York.

170. Petitioner did not cross-guarantee any of BRIC's debts or any other liabilities. When petitioner cross-guaranteed the debts of its subsidiaries, it executed a written cross-guaranty document with its lending institution or vendor seeking the guarantee and no such documents were executed by petitioner with respect to BRIC.

171. BRIC did not make any loans to petitioner and petitoner did not make any loans to BRIC.

172. BRIC did not make any distributions or dividends to petitioner.

173. Petitioner did not make any contributions to BRIC following the initial formation of BRIC.

174. BRIC had its own bank account.

175. BRIC invested its capital and premium income in various brokerage and investment accounts and held those accounts in its own name.

176. BRIC maintained its own books and records and kept those books and records in BRIC's offices in Ballston Spa, New York. Ms. Macica's office is located at this address. Ms.

Macica kept copies of BRIC's books and records in the audit department area at her desk.

177. BRIC and petitioner have the same address and are in the same building.

178. BRIC reported to the Division captive premiums tax under Article 33 of the Tax Law totaling $211,226.00 on the payments it received from petitioner pursuant to the policies for the years at issue as follows:

Year	Captive Premium Tax Paid
2006	$50,245.00
2007	$54,275.00
2008	$52,175.00
2009	$54,531.00

179. In 2005 BRIC sought a refund of the captive premium tax paid on the $6,000,000.00 payment received from petitioner in connection with the loss portfolio transfer (the 2004 refund claim).

180. In a letter dated November 9, 2005, the Division denied the 2004 refund claim and stated that it had "determined that $6,000,000.00 received from parent company to indemnify them for workers' compensation losses fits the definition of 'premium' as defined under Section 1510(c) and 1502b(c)" of Article 33.

181. BRIC was assessed New York Insurance Law § 332 assessments by the Insurance Department totaling $265,333.04 for the years at issue based on the payments it received from petitioner as follows:

Year	332 Assessment Amount
2006	$40,581.44
2007	$38,855.60
2008	$89,563.70

2009	$96,332.30

182. In addition to the audit of petitioner at issue herein, the Division simultaneously conducted an audit of the captive premiums tax returns filed by BRIC under Article 33 of the Tax Law for the years at issue.

183. The Division concluded that BRIC was properly subject to the captive premium tax under Article 33 of the Tax Law.

184. The Division also determined that BRIC could not be included in the combined Article 9-A returns filed by petitioner for the years at issue because BRIC was an insurance corporation.

185. The Division has not issued a refund to BRIC of the captive premiums taxes paid by BRIC for the years at issue. In the Division's draft schedule of taxes due for BRIC, the Division indicated it would refund the taxes on premiums paid by BRIC under Article 33 of the Tax Law for the years at issue.

186. BRIC was dissolved in 2010.

187. BRIC filed a final tax return for the year 2010.

188. Petitioner decided to cease BRIC's operations due to the increasing cost of business resulting from a rise in Insurance Law § 332 assessments, the annual fees that were paid to AON to conduct actuarial reviews of BRIC's business, and the Division's position with respect to the deductibility of the payments petitioner made to BRIC.

189. Throughout the existence of BRIC, no claim was paid against any of the excess follow form insurance coverage provided by BRIC to petitioner.

190. With the exception of crime coverage, petitioner maintained third-party insurance company policies throughout the lifetime of BRIC. After the creation of BRIC, petitioner

changed the deductible and self-insured retention amounts on its third-party policies.

191. After BRIC was dissolved, petitioner maintained its third-party insurance company policies.

192. In 2006, BRIC had no costs of adjusting claims.

193. BRIC did not pay Ms. Macica a salary as vice president of the company.

194. BRIC did not buy any reinsurance at any time.

195. BRIC filed a protective claim requesting a refund for all taxes it paid under Article 33 of the Tax Law.

CONCLUSIONS OF LAW

A. Article 9-A of the Tax Law imposes a franchise tax on all domestic and foreign corporations doing business, employing capital, owning or leasing property, or maintaining an office in New York State (Tax Law § 209[1][a]). The franchise tax is based on the taxpayer's entire net income (ENI). ENI is generally the same as the taxpayer's federal taxable income (FTI) with certain modifications:

> "The term 'entire net income' means total net income from all sources, which shall be presumably the same as the entire taxable income (but not alternative minimum taxable income), (i) which the taxpayer is required to report to the United States treasury department . . . ." (Tax Law former § 208[9]).

Tax Law § 208(9)(a) - (q), in turn, provides numerous adjustments and modifications that are to be made in arriving at entire net income for purposes of the franchise tax.

The Division argues that based on this section, ENI is presumably the same as the taxpayer's federal taxable income, subject only to the modifications contained within the subsections of Tax Law § 208(9). The Division contends that because Tax Law § 208(9) and the modifications contained therein do not mention insurance premiums available as a deduction or reduction of ENI, bona fide insurance premiums are originally deducted, if at all, at the federal level in computing a taxpayer's FTI, and that deduction is passed through to ENI from the starting point of FTI. If the payment is not deductible as an insurance premium at the federal level, the Division posits that no such deduction is allowed in computing ENI.

Petitioner, on the other hand, argues that the word "presumably" contained in Tax Law § 208(9) and the legislative history of the captive insurance law require a departure from FTI, and that as such, federal case law defining insurance should not control.

It must first be noted that the petitioner generally bears the burden of proof (20 NYCRR 3000.15[d][5]) and bears the burden of demonstrating entitlement to a claimed exemption or deduction "by demonstrating that the only reasonable interpretation of applicable law so provides him" (***Matter of Howes v. Tax Appeals Tribunal***, 159 AD2d 813 [1990]).

> "When . . . it is undisputed that the taxpayer's income is subject to the taxing statute, but he claims an exemption from taxation . . . the party claiming [the exemption] must be able to point to some provision of law plainly giving the exemption . . . . Indeed, if a statute or regulation authorizing an exemption is found, it will be 'construed against the taxpayer', although the interpretation should not be so narrow and literal as to defeat its settled purpose . . . . This is because an exemption is not a matter of right, but is allowed only as a matter of legislative grace . . . .
>
> A deduction is functionally a particularized species of exemption from taxation . . . . The burden is on the taxpayer seeking the deduction to establish his right to it" (***Matter of Grace v. New York State Tax Commn.***, 37 NY2d 193 [1975]).

Contrary to petitioner's argument that the word "presumably" requires a departure from FTI, the Court of Appeals held that the term "presumably" as it appears in the statute "was not intended to afford respondent the freedom to vary the meaning of 'entire net income' insofar as such income is equated with the income a taxpayer reports to the United States Treasury" (***Matter of Dreyfus Special Income Fund, Inc. v. New York State Tax Commn.***, 72 NY2d 874 [1988], ***citing People ex rel. Standard Oil Co. v. Law***, 237 NY 142, 147; ***People ex rel. Barcalo Mfg. Co. v. Knapp***, 227 NY 64). Rather, "Federal law controls for the purpose of defining 'entire net income' . . . ." (***Matter of Dreyfus Special Income Fund, Inc. v. New York State Tax Commn***, 126 AD2d 368, 372 [1987] ***affd*** 72 NY2d 874 [1988]). Discussing the meaning of the word "presumably" as used in the statute, the Court stated:

> "[t]he term 'presumably' was added to the statute in 1918 (L 1918, ch 276, amdg Tax Law former 209). The addition was necessary because without it there was no opportunity afforded a taxpayer to have a hearing if there was a claimed inaccuracy in the figure reported to the Federal Government (see, People ex rel. Standard Oil Co. v. Law, 237 NY 142, 147). The Court of Appeals held in People ex rel. Barcalo Mfg. Co. v. Knapp (227 NY 64) that there was clear legislative intent that the State 'net income' figure was to be the same as the Federal amount" (***Matter of Dreyfus Special Income Fund, Inc. v. New York State Tax Commn***, 126 AD2d at 372).

As such, petitioner's argument that the word "presumably" requires a departure from FTI for purposes of determining ENI is rejected.

B. Petitioner also points to an amendments in the Tax Law regarding "overcapitalized insurance companies" and "combinable captive insurance companies" (Tax Law § 2[11]) to support its argument that federal tax law and case law should not apply to the years at issue. Petitoner argues that the amendment, which defines "combinable captive insurance company" as, among other requirements, a licensed captive insurance company "fifty percent or less of whose gross receipts for the taxable year consist of premiums from arrangements that constitute insurance for federal income tax purposes" (Tax Law § 2[11]) was the first time the taxability of a New York captive insurance company for purposes of Articles 9-A and 33 of the Tax Law was tied to the status of its insurance arrangements for federal income tax purposes. However, contrary to petitioner's argument, Tax Law former § 208(9)(b)(18) specifically lists as an item that shall not be deducted or excluded from entire net income "[p]remiums paid for environmental remediation insurance, as defined in section twenty-three of this chapter, *and deducted in determining federal taxable income*, to the extent of the amount of the environmental remediation insurance credit allowed under such section twenty-three and subdivision thirty-five of section two hundred ten of this article" (emphasis added). If FTI was not the starting point for calculating ENI, this language would be superfluous.

Additionally, petitioner asserts that Tax Law § 208(9), Article 30, the Insurance Law, and the legislative history of captive insurance are in pari materia and were intended to be read together (***see*** McKinney's Cons Laws of NY, Book 1, Statutes § 221). This general rule of construction cannot be invoked, however, where the language of the statute is clear and unambiguous (***id.***; ***see Matter of UniCredit, S.p.A.***, Tax Appeals Tribunal, May 19, 2015). Here, ENI is unambiguously defined as FTI, subject only to the modifications contained within Tax Law § 208(9) (***see Matter of Dreyfus Special Income Fund, Inc. v. New York State Tax Commn***, 126 AD2d at 372). Simply put, the requisite ambiguity compelling combination of the various statutes, as espoused by petitioner, is missing. Moreover, neither the Tax Law § 208(9) definition of ENI nor the additional deductions provided for in Tax Law § 208(9)(a) reference insurance premiums. As such, this article cannot be said to have substantially identical provisions with either the Insurance Law or captive insurance provisions, and petitioner's argument that they be read in pari materia fails.

C. The Division is correct that FTI is the starting point of ENI. As such, it is proper to review federal case law to determine whether the amounts claimed would be deductible for purposes of calculating FTI. Under Internal Revenue Code (IRC) § 63, "taxable income" means gross income minus allowable deductions. IRC § 162(a) allows as a deduction "ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business." Among the items included as deductible business expenses are "insurance premiums against fire, storm, theft, accident, or other similar losses in the case of a business . . ." (26 CFR 1.162-1[a]).

Although insurance premiums may be deductible, amounts placed in reserve as self-insurance are not (***Securitas Holdings, Inc. v. C.I.R.***, TC Memo, 2014-225 [2014]; ***Clougherty Packing Co. v. Commissioner***, 84 TC 948, 964 [1985], ***affd*** 811 F2d 1297 [9th Cir 1987]; ***Steere Tank Lines, Inc. v. Unites States***, 577 F2d 279, 282 [5th Cir 1978]; ***Spring Canyon Coal Co. v. Commissioners***, 43 F2d 78, 80 [10th Cir 1930]). While the Code and Treasury Regulations do not define "insurance premiums," a plethora of federal case law has addressed the issue of what qualifies as an insurance premium for purposes of the business expense deduction.

Insurance has been defined as "an agreement to protect the insured against a direct or indirect economic loss arising from a defined contingency whereby the insurer undertakes no present duty of performance but stands ready to assume the financial burden of any covered loss" (***Allied Fidelity Corp. v. Commissioner***, 572 F2d 1190, 1193 [7th Cir 1987]). The Supreme Court has established that "insurance involves risk-shifting and risk distribution" (***Helvering v. Le Gierse***, 312 US 531, 539 [1941]). Risk shifting "entails the transfer of the impact of a potential loss from the insured to the insurer" (***Clougherty Packing Co. v. Commissioner***, 811 F2d 1297, 1300 [9th Cir 1987]). Risk distribution involves spreading smaller risks over a large number to avoid the possibility that a single costly claim will exceed the amounts taken in as premiums and set aside for the payment of such a claim (***Clougherty Packing Co. v. Commissioner***, 811 F2d at 1300). The courts have looked to four criteria in determining the existence of insurance for federal tax purposes: 1) the arrangement must involve insurable risk; 2) the arrangement must meet commonly accepted notions of insurance; 3) the arrangement must shift the risk of loss to the insurer; and 4) the insurer must distribute the risks among its policyholders (***see Rent-A-Center, Inc. v. C.I.R.***, 142 TC 1 [2014]; ***Securitas Holdings, Inc. v. C.I.R.***; ***Harper Grp. v. Commissioner***, 96 TC 45, 58 [1991], ***affd*** 979 F2d 1341 [9th Cir. 1992];

AMERCO v. Commissioner, 96 TC 18, 38 [1991], ***affd*** 979 F2d 162 [9th Cir 1992]).

Addressing the first criterion, petitioner presented convincing and essentially uncontradicted evidence that it faced actual and insurable risk. During the years at issue, petitioner operated between 318 to 326 convenience stores and had between 820 to 1,000 gas tanks at its stores with gas stations. Petitioner also owned and operated a warehousing and distribution center, a fleet of automobiles, trucks and gas tankers, and employed between 4,000 to 4,500 employees during the years at issue. Petitioner faces a number of risks in its business, including customer and employee personal injuries occurring on its premises, crime, pollution from gasoline leaks or spills, property damage or personal injuries caused by vehicle accidents and product liability claims. Petitioner also faces the risk of identity theft that could result from stolen credit card and social security numbers.

Prior to the creation of BRIC, petitioner purchased multiple lines of insurance from third-party, non-captive insurance companies to cover a number of these risks, including property and casualty insurance, general liability insurance, workers' compensation insurance, automobile insurance, large truck insurance, employee disability insurance, crime insurance and umbrella insurance. Petitioner self-insured its pollution risk prior to the creation of BRIC because the cost of third-party insurance to cover this risk was too costly. Petitioner also became self-insured for crime risks in the early 2000s, after its unrelated insurer refused to renew the policy due to a large claim.

Upon the formation of BRIC, BRIC provided petitioner coverage for a number of the risks it faced, including excess follow-form insurance, which was umbrella insurance that covered losses incurred by petitioner that exceeded the maximum losses covered by policies petitioner had with unrelated, non-captive insurance companies for directors and officers liability, EPLI policies and property insurance. BRIC also provided petitioner deductible buy-back insurance coverage, which provided first dollar insurance coverage for losses incurred by petitioner within the deductible and self-insured retention amounts that petitioner had under policies with unrelated, non-captive insurance companies for general liability insurance, property liability insurance, boiler and machinery liability insurance, directors and officers and EPLI insurance, automobile insurance, umbrella insurance, and workers compensation. Additionally, BRIC provided coverage for pollution, product withdrawal, reputation risk, crime, identity theft, and a workers' compensation loss portfolio transfer. I find that these risks covered by the arrangement between petitioner and BRIC are actual insurable risks (***see Sears, Roebuck & Co. v. Commissioner***, 96 TC 61, ***revd in part on other grounds*** 972 F2d 858 [1992]).

Addressing the second criterion, I find that the arrangement meets commonly accepted notions of insurance. Petitioner presented convincing evidence that BRIC was a bona fide insurance company. In forming BRIC, petitioner made a business decision premised on legitimate nontax considerations, including the desire to reduce insurance costs, obtain otherwise unavailable insurance coverage, increase incentive for risk management, and more efficiently manage and control its insurance program. BRIC was formed consistent with the New York Insurance Law and was licensed and regulated by the Insurance Department. Petitioner engaged PWC to assist in the formation and license application of BRIC, and to prepare a feasibility and actuarial study. In preparing the study, PWC reviewed petitioner's historic insurance policies and its loss history and proposed lines of insurance that BRIC should provide and amounts of premiums that should be charged for those lines on insurance. After BRIC was licensed, its captive manager finalized the lines of insurance BRIC would provide to petitioner, and determined the premiums to be charged based on the PWC study, petitioner's historical insurance needs and losses, market rates and industry standards for similar lines of insurance provided by other companies. At the end of each year, BRIC engaged AON to conduct an actuarial review of BRIC's operations. BRIC's captive manager annually reevaluated the lines of insurance and premiums based on the AON actuarial report, market rates and industry standards. BRIC reviewed and investigated claims submitted by petitioner, determined whether to approve or deny the claim, and paid claims from a separately maintained account. BRIC was adequately capitalized. Based on the foregoing, the evidence supports the conclusion that BRIC was a bona fide insurance company and the arrangement meets the commonly accepted notions of insurance (***see Rent-A-Center, Inc. v. C.I.R.***; ***Humana Inc. & Subs. v. Commissioner***, 881 F2d 247, 253 [6th Cir 1989]).

Although petitioner has established that the arrangement meets the first two criteria, it has failed to meet its burden of proving that the third and fourth criteria required to qualify for the premium deduction are met here. Specifically, the pure captive arrangement does not shift the risk of loss from petitioner to BRIC and BRIC does not distribute the risks among its policyholders. Pure captive arrangements such as that present here have often been equated with self-insurance plans (***Humana Inc. & Subs. v. Commissioner***; ***Stearns-Roger Corp. v. U.S.***, 774 F2d 414 [10th Cir 1985]). Self-insurance plans whereby reserves are created or payments made into funds, accounts or trusts do not constitute "insurance" because there is no shifting of the risk to others but instead reserves for possible losses are created. Payments so made are not deductible as insurance premiums (***Stearns-Roger Corp. v. U.S.***; ***Spring Canyon Coal Co. v. Commissioner***, 43 F2d 78 [10th Cir 1930]. The seminal case that held that for there to be "insurance," there must be a shifting of the risk of loss and a spreading of the risk was the Supreme Court's decision in ***Helvering v. Le Gierse*** (312 US 531 [1941]). Following the Supreme Court's decision, a number of federal cases have addressed the issues of risk shifting and risk distribution in parent-subsidiary captive arrangements over the years. As it has been determined the FTI is the starting point for ENI, it is appropriate to review those decisions.

In ***Carnation Co. v. Commissioner*** (640 F2d 1010 [9th Cir 1981]), the court analyzed a parent-subsidiary captive arrangement involving a subsidiary insurance company, incorporated in Bermuda, and its wholly-owned parent. The subsidiary wrote insurance solely for the parent company and its subsidiaries. The parent, Carnation Company, purchased insurance from an unrelated insurer and the subsidiary insurer then reinsured the unrelated insurer for 90 percent of Carnation's liability. As part of the agreement with the unrelated insurer, the parent company agreed to provide additional capital to the captive upon demand. The court held that the parent-subsidiary arrangement was not insurance because the insurance, reinsurance, and capitalization agreements together operated to neutralize risk in the instances of reinsurance by the subsidiary insurer (***id.*** at 1013).

Stearns-Roger Corp. v. United States involved an insurance company, incorporated under state captive insurance laws. Under those laws the captive insurer could insure only risks of the parent company, its subsidiaries, its affiliates, and associated companies. The parent company, Stearns-Roger Corporation, and one of its wholly-owned subsidiaries owned all the stock of the captive insurer. The parent company provided initial and subsequent capital to the captive insurer and indemnified the captive insurer for up to $3,000,000.00 for losses that it might suffer. The captive company insured risks of the parent, the parent's subsidiaries and affiliates, and participants in projects where the parent had assumed such participants' risks. The parent company paid for this coverage by the captive company. The court noted that insurance must involve risk shifting or risk distribution and focused on the effects of the parent's payments to the captive insurer to resolve whether the payments amounted to insurance. The court asserted that it did not ignore the separate corporate status of the captive and parent companies and that this status was not inconsistent with its findings. The court determined that the parent company's assets were diminished by any casualty loss and, thus, that the economic reality of the situation was that the risk of loss did not leave the parent company. The parent did not receive insurance for its payments, the court concluded, because the parent did not shift its risk of loss.

In ***Mobil Oil Corp. v. United States*** (8 Cl Ct 555 [1985]), the court analyzed an arrangement involving four insurance companies owned indirectly by Mobil Oil Corporation (Mobil). The affiliate insurers were incorporated in the Bahamas, Bermuda and the United Kingdom and wrote insurance for the parent, its affiliates, and for unrelated parties. In determining whether insurance existed, the court analyzed whether Mobil had sufficiently transferred the risk of loss. The court assessed the economic substance of the transaction and determined that any losses or profits realized by the insurance affiliates would be reflected on Mobil's financial statements. The court concluded that this did not amount to a transfer of risk of loss by Mobil, stating that "insurance through a wholly-owned insurance affiliate is essentially the same as setting up reserve accounts. The risk of loss remains with the parent and is reflected on the balance sheet and income statements of the parent" (***id.*** at 567).

Beech Aircraft Corp. v. United States (797 F2d 920 [10th Cir 1986]), involved an insurance company incorporated in Bermuda that was owned by Beech Aircraft Corporation (Beech) and its affiliates. All but 0.5 percent of the insurer's business was insurance issued to Beech. The premium paid by Beech together with the interest the premium earned equaled the liability of the insurer to Beech. The Court, relying on ***Stearns-Roger***, assessed the economic reality of the transaction, and determined that Beech paid for any losses sustained by the insurer and that no shifting of risk occurred. The court held that the separate corporate status of Beech and the insurer did not prevent a finding that risk of loss did not shift.

In ***Clougherty Packing Co. v. Commissioner*** (811 F2d 1297 [9th Cir 1987]), the issue involved a wholly-owned subsidiary incorporated in Colorado under state captive insurance laws. The parties entered into two insurance contracts: an agreement between Clougherty and an unrelated insurer, and a reinsurance agreement between the captive and the unrelated insurer. The court applied a balance sheet and net worth analysis, by which a determination of whether risk shifted depended on whether a covered loss affected the balance sheet and net worth of the insured (***id.*** at 1305). In defining insurance, the court stated that "a true insurance agreement must remove the risk of loss from the insured party" and further explained:

> "we examine the economic consequences of the captive insurance arrangement to the 'insured' party to see if that party has, in fact, shifted the risk. In doing so, we look only to the insured's assets, i.e., those of Clougherty, to determine whether it has divested itself of the adverse economic consequences of a covered workers' compensation claim. Viewing only Clougherty's assets and considering only the effect of a claim on those assets, it is clear that the risk of loss has not been shifted from Clougherty." (***id***.)

The court concluded that "[t]he parent of a captive insurer retains an economic stake in whether a covered loss occurs. Accordingly, an insurance agreement between parent and captive does not shift the parent's risk of loss and is not an agreement for 'insurance.'" (***Id***.)

In ***Humana Inc. v. Commissioner*** (881 F2d 247 [6th Cir 1989]), the court addressed two distinct issues: 1) the deductibility of premiums paid by a parent to its subsidiary captive, and 2) the deductibility of premiums paid by affiliated subsidiaries to the captive (brother-sister arrangement). The captive was incorporated in Colorado under state captive insurance laws and provided coverage for the parent company and its subsidiaries. The parent, Humana, paid the captive a monthly premium, which was allocated among itself and each operating subsidiary. The court adopted the balance sheet and net worth analysis used by the Ninth Circuit Court in

Clougherty, pursuant to which the determination of whether risk had shifted depended on whether a covered loss affected the balance sheet and net worth of the insured, and held that the parent's premiums did not constitute insurance. However, analyzing the brother-sister arrangement, the court determined that the subsidiaries' payments to the captive were deductible. The court examined the effect of a claim on the assets of the insured, and considered the insured to be the subsidiaries and not the parent. When the insurer paid a claim, the assets of the subsidiaries were not affected and, thus, the risk of loss transferred from the insured to the insurer. The court stated that it did not look at the assets of the parent because to do so would be to treat the parent, its subsidiaries, and the insurer as one economic unit and ignore the reality of their separate corporate existence for tax purposes:

> "The legal test is whether there has been risk distribution and risk shifting, not whether Humana Inc. is a common parent or whether its affiliates are in a brother-sister relationship to . . . [the captive]. We do not focus on the relationship of the parties per se or the particular structure of the corporation involved. We look to the assets of the insured. . . . If Humana changes its corporate structure and that change involves risk shifting and risk distribution, and that change is for a legitimate business purpose and is not a sham to avoid the payment of taxes, then it is irrelevant whether the changed corporate structure has the side effect of also permitting Humana Inc.'s affiliates to take advantage of the Internal Revenue Code § 162(a) . . . and deduct payments to a captive insurance company under the control of the Humana parent as insurance premiums " (***id.*** at 255-256).

After determining that risk shifting occurred in the brother-sister arrangement, the court stated that risk distribution must also be present for insurance to exist. The court concluded that risk distribution was present for the brother-sister arrangement since several corporations were insured (i.e., the subsidiaries) and losses could be spread among them. Thus, the court ruled that while the premiums paid by the parent to the subsidiary captive were not deductible insurance expenses, the premiums paid by the subsidiaries of Humana constituted insurance because both risk shifting and risk distribution occurred.

Most recently, two Tax Court decisions have followed the rationale of ***Humana*** and allowed a premium deduction in brother-sister arrangements (***see Rent-A-Center, Inc. v. C.I.R.***; ***Securitas Holdings, Inc. v. C.I.R.***). In both cases, the parent corporations owned numerous subsidiaries, including a captive insurance company. The other subsidiaries entered into a contract with the captive whereby the subsidiaries paid premiums to the captive to provide coverage for certain risks. In analyzing the arrangements, the Tax Court applied the balance sheet and net worth analysis test to determine whether risk had shifted, and "examine[d] the economic consequences of the captive insurance arrangement to determine whether the insured party has shifted the risk. In doing so, we look only at the insured's assets to determine whether the insured 'divested itself of the adverse economic consequences' of a claim covered by the insurance policy" (***Securitas Holdings, Inc. v. C.I.R.***). In both cases, the court determined that risk-shifting was present because a payment on a claim from the captive to the subsidiary did not reduce the net worth of the subsidiaries, because, unlike the parent, the subsidiaries did not own stock in the captive (***Rent-A-Center, Inc. v. C.I.R.***; ***Securitas Holdings, Inc. v. C.I.R.***).

The court also found risk distribution to be present in both cases. In ***Rent-A-Center, Inc.***, the court noted that risk distribution occurs when an insurer pools a large enough collection of unrelated risks. In analyzing risk distribution, the court "look[s] at the actions of the insurer because it is the insurer's, not the insured's, risk that is reduced by risk distribution" (***Rent-A-Center, Inc. v. C.I.R.*** at 24). The court held that a captive may achieve adequate risk distribution by insuring only subsidiaries within its affiliated group. The court found that the captive insured the risks of numerous subsidiaries, which owned thousands of stores, and had thousands of employees and vehicles, thus having a sufficient number of statistically independent risk. The court concluded that by insuring the subsidiaries, the captive achieved adequate risk distribution (***id.***). Similarly, in ***Securitas Holdings, Inc.***, the court found that as a result of the large number of employees, offices, vehicles, and services provided by the subsidiaries, the captive was exposed to a large pool of statistically independent risk exposures, and thus, by insuring the various risks of the subsidiaries, the captive arrangement achieved risk distribution.

The common thread in the above cases is that payments from a parent to a wholly-owned captive do not qualify as deductible insurance premiums because the arrangement lacks risk shifting and risk distribution. Unlike the taxpayers in ***Rent-A-Center***, ***Securitas Holdings***, and ***Humana***, petitioner's stores were not organized as separate subsidiaries. Rather, petitioner owned and operated the stores and vehicles, directly employed the employees, and made payments to its wholly-owned captive to cover the risks of its operations. As petitioner's wholly-owned captive, a payment by BRIC to petitioner for a covered loss will directly affect petitioner's balance sheet and net worth. Thus, risk shifting is not present in this arrangement (***see Humana Inc. & Subs. v. Commissioner***). The arrangement also lacks risk distribution because the risk is not spread among various subsidiaries and any loss by the parent is not subject to the premiums of any other entity (***Id.***). Because the arrangement lacks risk shifting and risk distribution, the amounts paid by petitioner to BRIC do not qualify as deductible premiums.

D. Petitioner argues that the Division's disallowance of a deduction for payments made by petitioner to BRIC violates the Equal Protection Clauses of the Unites States and New York State constitutions. As a preliminary matter, it is well established that this forum lacks jurisdiction to determine the facial constitutionality of statues, and the laws are presumed to be constitutional on their face (***see Matter of Brookfield Power New York Corp***., Tax Appeals Tribunal, November 10, 2010; ***Matter of Eisenstein***, Tax Appeals Tribunal, March 27, 2003; ***Matter of Geneva Pennysaver***, Tax Appeals Tribunal, September 11, 1989; ***Matter of Fourth***

Day Enters., Tax Appeals Tribunal, October 27, 1988). The Division of Tax Appeals does, however, have jurisdiction to consider whether tax law statutes are constitution "as applied" ***(Matter of J.C. Penney Co., Inc.***, Tax Appeals Tribunal, April 27, 1989).

A careful examination of petitioner's contentions with respect to its constitutional challenges reveals that petitioner is, in fact, seeking a ruling that Tax Law § 208(9) is unconstitutional on its face. Petitioner contends that using federal taxable income and the deductions allowed therein as the starting point for purposes of determining ENI is unconstitutional because taxpayers will not be allowed a deduction for payments to pure captive insurance companies. What petitioner seeks then is, in essence, a finding that aforementioned statute is unconstitutional unless a modification or deduction to federal taxable income is read into the statute to specifically allow premium deductions that would not otherwise be allowed for determining federal taxable income. Petitioner is not alleging that this taxing statute was illegally or improperly applied to it; it is contending that following federal case law for purposes of determining deductions allowable from federal taxable income and then using that amount as the starting point of ENI is unconstitutional. As previously indicated, the Division of Tax Appeals is without jurisdiction to determine the facial constitutionality of Tax Law statutes and as such petitioner's argument is improper for this forum.

E. Petitioner also argues that the Division should be estopped from denying the deductibility of the payments petitioner made to BRIC. The doctrine of equitable estoppel may be invoked against a government agency charged with the administration of taxes only where exceptional circumstances are present and application of the doctrine is necessary to prevent a manifest injustice (***see Matter of Sodexho, USA, Inc.***, Tax Appeals Tribunal, November 21, 2007). In order for the doctrine to apply in a specific case, it must be established that:

"(1) there was a misrepresentation made by the government to a party and the government had reason to believe that the party would rely upon the misrepresentation;

(2) the party's reliance on the government's misrepresentation was reasonable; and

(3) prior to the party discovering the truth, the party acted to its detriment based upon the misrepresentation" (***Matter of Ryan***, Tax Appeals Tribunal, September 12, 2013).

Petitioner first bases its argument for estoppel on the premise that the Division represented to it that its payment to BRIC for the 2004 loss portfolio transfer was an insurance premium when the Division denied BRIC's refund request for captive premium tax, and contends that the Division cannot now change its position without required notice. It is first noted that the Division's letter, upon which petitioner contends it detrimentally relied, states that the payment to BRIC fits the definition of "premium" under sections1510(c) and 1502-b(c) of Article 33. The letter does not state that the payment falls within the definition of premium for purposes of deductibility from federal taxable income, nor does the letter make any reference to tax under Article 9-A of the Tax Law.

While it is true that taxpayers are entitled to rely upon longstanding policies of the Division (***see Matter of Howard Johnson Co. v. State Tax Commn.***, 65 NY2d 726 [1985]) unless and until the Division prospectively changes the policy (***see Matter of National Elevator Indus. v. New York State Tax Commn.***, 49 NY2d 538 [1980]; ***Friesch Groningsche Hypotheekbank Realty Credit Corp. v. Tax Appeals Tribunal of State of NY***, 185 AD2d 466 [1992], petitioner has failed to show that it was ever the Division's policy to allow a deduction for purposes of determining ENI of amounts that are not deductible for purposes of determining FTI, beyond the modifications specifically provided for in the subsections of Tax Law § 208(9). Petitioner has likewise not shown that the Division ever treated the payments at issue as deductible premiums for purposes of calculating ENI under Tax Law Article 9-A or any change in policy with regard to the deductibility of premiums paid to captive insurance companies. As petitioner has failed to show any change in a longstanding policy, petitioner's argument that the Division cannot now change its position without required notice is without merit.

Petitioner next argues that the Division should be estopped from denying the deduction of amounts it paid to BRIC because it detrimentally relied on statements made by the Insurance Department. However, the record does not support petitioner's contention that the Insurance Department advised petitioner that payments made to BRIC would be deductible for purposes of calculating ENI. Additionally, petitioner has not shown that it acted to its detriment based on the alleged reliance. While petitioner's argument implies that but for its belief that a deduction would have been allowed for the payments to BRIC, it would not have created BRIC, petitioner's witnesses testified to a number of nontax considerations that led to the formation of BRIC. As such, petitioner has shown neither a misrepresentation by the government nor that it acted to its detriment based on a reasonable reliance on the alleged misrepresentation.

F. Tax Law § 1085(k)(1) provides that if there is a substantial understatement of tax for any taxable year, there shall be added to the tax an amount equal to ten percent of the amount of any underpayment attributable to such understatement (the substantial understatement penalty). For purposes of Tax Law § 1085(k)(1), there is a substantial understatement of tax if the amount of understatement for the year exceeds the greater of ten percent of the tax required to be shown on the return for the taxable year or $5,000.00. The Commissioner may waive all or a part of the substantial understatement penalty if the taxpayer shows that there was reasonable cause for the understatement and that the taxpayer acted in good faith (Tax Law § 1085[k][1]).

The regulation at 20 NYCRR 2392.1(g), dealing with reasonable cause under Tax Law § 1085(k), states:

> "(2) In determining whether reasonable cause and good faith exist, the most important factor to be considered is the extent of the taxpayer's efforts to ascertain the proper tax liability. In addition to any relevant grounds for reasonable cause as exemplified in subdivision (d) of this section, circumstances that indicate reasonable cause and good faith with respect to the substantial understatement or omission of tax, where clearly established by or on behalf of the taxpayer, may include the following:
>
> * * *
>
> (iv) the reliance by the taxpayer on any written information, professional advice or other facts, provided such reliance was reasonable and the taxpayer had no knowledge of circumstances which should have put the taxpayer upon inquiry as the whether such facts were erroneous."

It is determined that, given all the facts and circumstances of this matter, petitioner has established that it acted reasonably and in good faith when it relied on the treatment of the payments as premiums for purposes of Article 33 of the Tax Law and the Insurance Law. BRIC was a licensed New York captive insurance company and the payments it received from petitioner were treated as premiums for purposes of Insurance Law § 332 Assessments to the Insurance Department. Additionally, during a desk audit of BRIC for purposes of Article 33 of the Tax Law (Franchise Tax on Insurance Companies), the Division stated that premiums include amounts received by a captive insurance company as consideration for insurance provided to its parents and affiliated companies, and denied BRIC's refund claim for the premium tax. Petitioner acted reasonably in relying on this statement for its treatment of the payments as deductible premiums for purposes of calculating ENI.

Tax Law § 1085(k)(2) further provides that the amount of the understatement shall be reduced by the portion of understatement that is attributable to: "(A) the tax treatment of any item by the taxpayer if there is or was substantial authority for such treatment, or (B) any item if the relevant facts affecting the item's tax treatment are adequately disclosed in the return or in a statement attached to the return."

The Division does not dispute that petitioner disclosed its deduction of amounts paid to BRIC on its return, in fact noting in its post-hearing brief that this was "obvious," but argues that such disclosure was insufficient without "facts which demonstrated that there was risk shifting and risk distribution." I disagree. Petitioner made full disclosure of its deduction of the payments to BRIC as "insurance" on its returns. The relevant facts are plain on the face of the returns: petitioner attached its consolidated federal returns to its Article 9-A combined franchise tax returns for the years at issue. For federal purposes, petitioner was required to file consolidated returns that included BRIC. However, for state purposes, BRIC, a captive insurance company, could not be included in petitioner's combined franchise return. The attached federal return reflects BRIC's income and the deductions for insurance that were reported by petitioner, such amount being the amount petitioner subtracted for purpose of determining its ENI. While petitioner does not reveal legal authority or legal argument supporting its position on its returns, there was no apparent administrative or judicial precedent in this state that dealt specifically with the treatment of payments to a New York licensed captive insurance company whose income must be reported on consolidated returns for federal purposes but separately for state purposes. Under these circumstances, I cannot conclude that petitioner acted in bad faith or failed to adequately disclose its treatment of the payments to BRIC (***see Matter of International Nickel, Inc. and Inco Alloys International, Inc.***, Tax Appeals Tribunal, October 19, 1995). Accordingly, I conclude that penalty should not be imposed.

G. The petition of Stewart's Shops Corporation is granted to the extent indicated in Conclusion of Law F, but is otherwise denied, penalty pursuant to Tax Law § 1085(k)(1) is canceled, and the Notice of Deficiency, dated December 23, 2011, as modified above, is sustained.

DATED: Albany, New York
March 10, 2016

/s/ Barbara J. Russo
ADMINISTRATIVE LAW JUDGE