STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
LENDLEASE AMERICAS HOLDINGS, INC. & SUBSIDIARIES	:	DETERMINATION DTA NO. 829540
for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Tax Years ended June 30, 2007, June 30, 2008 and June 30, 2009.	:	

Petitioner, Lendlease Americas Holdings, Inc. & Subsidiaries, 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 tax years ended June 30, 2007, June 30, 2008 and June 30, 2009.

A hearing was held in Albany, New York, on August 9, 2022 and continued to completion on August 10, 2022, with all briefs to be submitted by January 27, 2023, which date began the six-month period for the issuance of this determination. Petitioner appeared by Lowenstein Sandler, LLP (Edmund Cohen, Esq., of counsel) and the Division of Taxation appeared by Amanda Hiller, Esq. (David Markey, Esq., of counsel). After reviewing the entire record in this matter, Winifred M. Maloney, Administrative Law Judge, renders the following determination.

ISSUES

I. Whether the Division of Taxation properly determined that petitioner should have filed on a combined basis with Yarmouth Lend Lease KOP, Inc. for the tax years ended June 30, 2008, and June 30, 2009.

II. If so, whether penalties imposed herein should be sustained.

FINDINGS OF FACT

The parties entered into a stipulation of facts in connection with this matter. Such stipulated facts, except for stipulated facts 56 and 57 that are unnecessary, have been substantially incorporated into the findings of fact set forth herein.[1]

1. Lendlease Corporation Limited (formerly, Lend Lease Corporation Ltd.) (LL Limited) is a publicly traded Australian corporation that conducts business operations in numerous countries through its direct and indirect subsidiaries. LL Limited and all its subsidiaries are collectively "Lend Lease Worldwide Group." Lendlease Americas Holdings, Inc. (formerly, Lend Lease [U.S.] Inc.) (LLAH), a Delaware corporation, wholly owns a group of subsidiaries (collectively, petitioner or Lendlease U.S. Group).

2. Since the late 1950s, LL Limited has been a leading real estate services business. LL Limited's entry into the United States (U.S.) real estate investment management business began in 1993 with the acquisition of the Yarmouth Group. The Yarmouth Group was a real estate investment advisory company. In 1996, it had approximately $5 billion in commercial real estate under management in the U.S. The Yarmouth Group had an operating subsidiary that was in the business of providing retail property management and leasing services for approximately 12 malls in the U.S. The Yarmouth Group did not own properties, but rather served as an advisor to third party investors in real estate.

3. One of LLAH's subsidiaries was Yarmouth Lend Lease Properties, Inc. (YLLP), a Delaware corporation. YLLP wholly owned all the shares of Yarmouth Lend Lease Acquisition,

[1] Petitioner submitted post-hearing errata sheets listing proposed corrections or modifications to the transcripts of proceedings held herein. The Division of Taxation had no objection to the proposed corrections and modifications. Petitioner's proposed corrections or modifications are adopted as set forth on the errata sheets that have been appended to the transcripts of proceedings (***see*** 20 NYCRR 3000.15 [d] [7]).

Inc. (YLLA), a Delaware corporation. YLLA wholly owned all the shares of Yarmouth Lend Lease KOP, Inc. (YLL KOP), a Delaware corporation. All the shares of YLLP, YLLA and YLL KOP were ultimately owned by LLAH.

4. YLL KOP was a single-purpose investment entity and was formed to hold only one asset, a 50% partnership interest in King of Prussia Associates (KOP), a Pennsylvania partnership that owned the King of Prussia Mall (KOP Mall) in Pennsylvania.

5. KOP had owned the KOP Mall since January 27, 1967. Located on approximately 125.46 acres of land in Upper Merion Township, Montgomery County, Pennsylvania, the KOP Mall was one of the largest shopping malls in the U.S. and the largest mall on the East Coast, with approximately 2.7 million square feet of space and four hundred tenants comprising retail stores and food establishments.

6. On December 19, 1996, YLL KOP acquired its 50% general partnership interest in KOP from an unrelated third party, NLI Properties Inc., which had owned the 50% general partnership interest since March 31, 1988. At the time of NLI Properties, Inc.'s sale of its 50% general partnership interest, the total valuation of KOP was approximately $451,000,000.00. The total purchase price for the 50% general partnership interest in KOP was $225,500,000.00.

7. A mortgage of $240,000,000.00 was also placed on the KOP Mall at or around the time of YLL KOP's acquisition of the 50% general partnership interest. Total costs to YLL KOP to acquire the interest in KOP were approximately $109,700,000.00, comprised of $105,500,000.00 (50% of the $211,000,000.00 value of KOP [$451,000,000.00 valuation for the entire partnership less the $240,000,000.00 mortgage]), plus some additional closing costs, legal fees, and capital requirements. YLL KOP financed the acquisition through an approximately

$22,000,000.00 capital contribution from YLLA and an intercompany loan of $87,500,000.00 provided by Lend Lease US Finance, Inc., a Delaware corporation formed in fiscal year 1997.[2]

8. On December 19, 1996, YLL KOP entered into a "Joint Venture Agreement" with Kingmak Associates (Kingmak), a Pennsylvania partnership, unrelated to the Lendlease U.S. Group, that owned the other 50% general partnership interest in KOP (KOP Partnership Agreement).[3] The KOP Partnership Agreement provided that

> "[T]he respective interests of [YLL KOP and Kingmak] in and to all real and personal property, monies and profits of [KOP] and their respective shares of all losses, expenses, obligations and liabilities of [KOP] shall be 50% for YLL [KOP] and 50% for Kingmak."

9. Based upon representations in the KOP Partnership Agreement, Kingmak had owned its partnership interest in the KOP Mall since the inception of KOP in 1967. In 1996, Kingmak was owned by members of the Powell, Shaffer and Frost families. No member of the Lendlease Worldwide Group ever owned an interest in Kingmak.

10. The principal place of business of KOP was located at the KOP Mall, and at least initially was located at Kingmak's address: c/o Kravco Company (Kravco), 234 Mall Boulevard, King of Prussia, Pennsylvania. In 1996, Kravco, a Pennsylvania partnership, was owned by members of the Powell family and other parties, unrelated to the Lendlease U.S. Group.

11. Pursuant to Article VII of the KOP Partnership Agreement, Kingmak served as the "Administrative Venturer" of KOP. While decisions as to KOP's business generally required the unanimous decision of both partners, i.e., the "Co-managing Venturers," Kingmak, as the

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[2] Lend Lease Corporation Limited, the Australian corporate parent, provided a $109,700,000.00 capital contribution to LLAH, which provided the same to its subsidiaries.

[3] The Joint Venture Agreement, dated December 19, 1996, was amended by the Amendment to the Joint Venture Agreement dated as of August 24, 1998. The Joint Venture Agreement as amended will be referred to as the KOP Partnership Agreement throughout this determination. The KOP Partnership Agreement remained in effect for the fiscal years ended June 30, 2007 through June 30, 2009.

Administrative Venturer, was "responsible for the implementation of the decisions of the Co-managing Venturers and for conducting the ordinary and usual business and affairs of [KOP]" as established and approved by the partners. As the Administrative Venturer, Kingmak had the authority to, among other acts: (i) negotiate and enter into contracts in the name of KOP; (ii) maintain all funds of KOP in bank accounts; (iii) distribute funds of KOP as authorized under the agreement; and (iv) prepare a proposed agenda of topics to be covered at meetings held by the KOP partners.

12. Kingmak had rights under the KOP Partnership Agreement that YLL KOP did not have. As Administrative Venturer, Kingmak could, without YLL KOP's consent or approval, enter into contracts for terms of up to a year for utilities and other services that Kingmak "shall deem advisable [and that are] normally furnished in regional shopping centers similar to the [KOP Mall]." Any acts taken by Kingmak consistent with its authority as Administrative Venturer under the KOP Partnership Agreement bound both YLL KOP and KOP itself.

13. Pursuant to section 8.03 of the KOP Partnership Agreement, Kingmak engaged Kravco to "assist Kingmak in the performance of its duties and responsibilities as Administrative Venturer." Kingmak engaged Kravco pursuant to an Amended and Restated Management Agreement, dated March 31, 1988, (Kravco Management Agreement), that placed the responsibility on Kravco for nearly all aspects of the day-to-day operations of the KOP Mall, and provided Kravco with an arm's length fee as remuneration for its services.

14. Under the Kravco Management Agreement, Kravco's responsibilities included, among others:

(a) Negotiating leases, renewals, extensions, and modifications to leases for tenants of the KOP Mall, enforcing performance by the tenants of all requirements under those leases, and collecting the rents of the tenants of the KOP Mall.

(b) "To cause the [KOP Mall] to be maintained in a first class operating condition and repair consistent with the highest standards of shopping center management procedures used by major developers . . . and to supervise the maintenance and operation thereof."

(c) Monitoring and upkeep of the physical condition of the KOP Mall, including janitorial services and repairs.

(d) Hiring employees, "including without limitation a [KOP Mall] manager and public relations, security, and maintenance personnel."

(e) Participating on behalf of KOP in any local merchants' associations.

(f) Advising KOP of the due dates of applicable taxes, mortgage payments, and similar obligations.

(g) Keeping the books and records and submitting monthly financial statements, statements of cash receipts and disbursements, and accounts receivable analyses.

(h) Preparing quarterly cash flow reports and marketing reports.

(i) Procuring insurance coverage at the request of KOP.

15. Pursuant to Article XVIII of the KOP Partnership Agreement, "neither YLL [KOP], nor [Lend Lease Corporation Limited], nor any subsidiary of [Lend Lease Corporation Limited] shall become involved, directly or indirectly, in a Competitive Venture without first affording Kingmak an opportunity to participate in such Competitive Venture on reasonable commercial

terms."[4] Pursuant to the KOP Partnership Agreement, a "Competitive Venture" was defined, subject to limited exceptions, as:

> "the acquisition or development of any real property located in whole or in part in Upper Merion Township, Montgomery County, Pennsylvania, for the purpose of owning, leasing, operating or selling or leasing real property to, any retail commercial establishment or enterprise which real property will be competitive with the [KOP Mall]."

16. The KOP Partnership Agreement also provided, among other things, for monthly distributions of "Net Cash Flow" to YLL KOP and Kingmak, quarterly meetings of the Co-managing Venturers, and the right of first refusal that required any offer made by a third party to purchase all or part[5] of a general partner's interest be subject to a 90-day period in which the other general partner had the right to acquire the selling partner's interest on the same terms as the third-party offer.

17. As required under the terms of the KOP Partnership Agreement, KOP held quarterly meetings in the months of March, June, September and December during the tax years ended June 30, 2007 through June 30, 2009 to discuss the management and operation of the KOP Mall.

18. The KOP Mall owners' meeting notes for the fourth quarter of 2007 through the third quarter of 2009 establish that during tax years ended June 30, 2008 and June 30, 2009, each quarterly meeting was held at Kravco's offices in Pennsylvania, with between two and four representatives from YLL KOP in attendance, and between twelve and fifteen representatives from Kingmak and/or Kravco in attendance. Kingmak prepared the agendas for the quarterly

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[4] Article XVIII also provided that so long as YLL KOP or any affiliate thereof "shall remain a Venturer, neither Arthur L. Powell, Harold G. Schaeffer, or John L. Frost, individually, nor the trustees of their respective families, acting in their capacity as trustees, shall become involved, directly or indirectly," in a Competitive Venture without first affording YLL KOP the opportunity to participate in such Competitive Venture on reasonable commercial terms.

[5] A minimum of 5% of a partnership interest could be offered for sale; however, the selling partner must retain at least 5% of its partnership interest or offer to sell its entire interest.

meetings, and the presentations at the meetings were made predominantly by Kingmak and Kravco personnel. YLL KOP's role at the quarterly meetings "was predominantly to listen . . . to what the Administrative Venture[r] and the property manager presented."

19. KOP incurred substantial expenses during the calendar years 2006, 2007 and 2008 in operating the KOP Mall. KOP's form 1065, U.S. return of partnership income (KOP US partnership tax return), for each of the calendar years 2006, 2007 and 2008 report expenses in the total amount of $46,708,272.00, $46,026,678.00, and $47,941,535.00, respectively, on form 8825, rental real estate income and expenses of a partnership or an S corporation, with respect to the operation of the KOP Mall. During the calendar years 2006, 2007 and 2008, the expenses included: (i) advertising expenses (average of $2,639,219.67); (ii) cleaning and maintenance (average of $1,922,847.00); (iii) insurance (average of $1,164,733.33); (iv) legal and other professional fees (average of $262,559.00); (v) interest (average of $3,845,273.67); (vi) taxes (average of $5,897,570.67); (vii) utilities (average of $6,094,317.67); (viii) depreciation (average of $12,315,126.33); and (ix) landscaping, maintenance support, management fees, security, and other expenses (average of $12,750,515.33).

20. KOP's tax returns and the schedules K-1 issued to YLL KOP were prepared by Kingmak as the tax managing partner of KOP. KOP's audited financial statements were prepared by Kravco on behalf of KOP.

21. At the hearing, petitioner provided the testimony of John Allman, an Australian certified practicing accountant, who began working for the Lendlease Worldwide Group in March 1991. From January 1996 until October 2015, Mr. Allman worked for the Lendlease U.S. Group, in various roles.

22. From January 1996 until June 1997, Mr. Allman was the chief financial officer (CFO) of the Yarmouth Group. Mr. Allman testified that YLL KOP acquired its interest in KOP in 1996 as part of a strategy "to accumulate a portfolio of high quality . . . retail mall assets, and form a fund." The Yarmouth Group, comprising the Lendlease U.S. Group's entire investment management business at the time, would serve as a manager and advisor and earn fees for its services.

23. The Lendlease U.S. Group made several other significant acquisitions in the late 1990s and early 2000s in efforts to grow its investment management business. In June 1997, the Lendlease U.S. Group acquired Equitable Real Estate Investment Management, Inc. (ERE). In 1999, the Lendlease U.S. Group acquired "the Boston Financial Group, and its affordable housing syndication business was transformed into Housing and Community Investing (HCI)." In addition, on March 20, 2000, a Lendlease U.S. Group subsidiary, Lend Lease Real Estate Investments, Inc. (LL REI), acquired five of Amresco, Inc.'s (AMRESCO) commercial mortgage businesses: AMRESCO Capital Limited Partnership, Holliday Fenoglio Fowler, Real Estate Structured Finance, AMRESCO Services Limited Partnership, and Asset Management. The total value of these investment management acquisitions was over $800,000,000.00. At its peak in or about March 2000, LL REI had approximately 2,000 employees.

24. In June 1997, Mr. Allman became a senior vice president with the Lendlease U.S. Group. From June 1997 until early 2004, Mr. Allman worked in the Lendlease U.S. Group's mergers and acquisitions team. Mr. Allman explained that the Lendlease U.S. Group's investment management business provided a wide variety of services to investor clients, including monitoring and directing the operation of a real estate asset already owned by a client. The investment management business also participated in acquiring, divesting, and/or financing

real estate assets on behalf of investor clients. In addition, it created investment funds, participated in these funds as an investor, and attracted other third-party investors to the funds, in order to acquire different types of real estate. Depending upon the fund and the strategy, the Lendlease U.S. Group's investment management business made co-investments as the general partner of a fund and supervised the management of the investment funds. The investment management business did not typically buy interests in real estate directly, but instead generally acquired interests in real estate through participation as a general partner of a real estate fund.

25. YLL KOP's 50% general partnership interest in KOP could not be contributed to a real estate investment fund as part of the Lendlease U.S. Group's investment management business due to legal issues arising from the acquisition of ERE in 1997. Specifically, following the acquisition of ERE in 1997, YLL KOP's interest in KOP could not be used in a real estate investment fund due to conflict of interest prohibitions under the Employee Retirement Income Security Act (ERISA). Because of those ERISA conflicts, "the fund idea was terminated, closed down" as of 1997. The Lendlease U.S. Group sold the ERE Compass property management business at a small premium to Jones Lang LaSalle in 1998.

26. Ultimately, the Lendlease U.S. Group's investment management business was not successful, and the Lend Lease Worldwide Group's Australian senior management made the decision to exit the investment management business entirely in the U.S. In its "2003 Annual Report to Shareholders," the Lend Lease Worldwide Group's senior management announced, in part, as follows:

> "This year Lend Lease resolved to exit the Real Estate Investments business in the US following a strategic review. . . .
>
> **Investment management in the US**

> The real estate investment management business was clearly unsuccessful for Lend Lease in the US. With the benefit of hindsight, the strategy was a flawed undertaking and contained many deficiencies. The most telling factors were the lack of a well thought through business model and the failure of management to integrate the businesses and execute the business plans.
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> After the strategic review, Lend Lease resolved to exit the Real Estate Investments (REI) business in the US, and entered into a series of agreements to sell various parts of the business, including CapMark Services, HCI, Holliday Fengolio Fowler, Lend Lease Mortgage Capital and most of the equity advisory business."

27. In 2003, Lend Lease Corporation Limited sold the majority of the investment management business to Morgan Stanley Realty Incorporated and Morgan Stanley Real Estate Advisor, Inc. (Morgan Stanley) for $1.00, pursuant to a purchase and sale agreement, dated June 16, 2003. In connection with the sale of the U.S. management business, the Lend Lease Worldwide Group recognized write downs in 2003 of A$945,000,000.00, the equivalent of approximately $630,000,000.00, using the exchange rate in effect on June 30, 2003.

28. One of the investment advisory contracts purchased by Morgan Stanley was a Real Estate Investment Advisory Agreement, dated January 1, 2003, between LL REI and YLL KOP (2003 Advisory Agreement). The terms of the 2003 Advisory Agreement did not change when it was assigned to Morgan Stanley. The 2003 Advisory Agreement provided for the same services and the same fees when Morgan Stanley rendered the services as it did when LL REI rendered the services to YLL KOP.

29. From early 2004 through June 2011, Mr. Allman was involved in winding down legacy investments and receivables and other assets and other legal entities left behind from Lendlease U.S. Group's sale of its U.S. investment management business. Mr. Allman testified that the large majority of the real estate related investments, aside from YLL KOP's 50%

partnership interest in KOP, "had been liquidated by June of 2006, June of 2007." Excluding the 50% partnership interest in KOP, as of the tax year ended June 30, 2003, the Lendlease U.S. Group retained 32 co-investments of the former investment management business, which, along with certain receivables and other assets, had a book value of $313,500,000.00. As of the tax year ended June 30, 2007, the Lendlease U.S. Group had retained only three co-investments of the former investment management group, which, along with certain receivables and other assets, had a book value of only $2,000,000.00. As of the tax year ended June 30, 2007, excluding the 50% partnership interest in KOP, the Lendlease U.S. Group retained only 0.63% of the former investment management business as measured by the book value of the assets.

30. Following the divestment of the U.S. investment management business, less than five employees of that business remained employed by the Lendlease U.S. Group as of the tax year ended June 30, 2006. That is, although the number of employees of the U.S. investment management business peaked at 2,000 around March 2000, less than one quarter of one percent of that workforce remained employed by the Lendlease U.S. Group as of the tax year ended June 30, 2006.

31. As provided in the Lend Lease "2007 Annual Report to Shareholders," the Lend Lease Worldwide Group operates three core businesses: project management and construction; real estate investment management; and real estate development. Its development business focuses on three key areas: retail, communities, and privatization. Its key markets are Asia Pacific, the Americas, the United Kingdom, Europe and the Middle East.

32. The Lend Lease "2009 Annual Report to Shareholders" states: "[i]n Asia Pacific, Lend Lease holds a direct ownership interest in two development opportunities and two operating retail centres. The business is currently undertaking master-planning and development

management of six centres in Australia and one in Singapore." This annual report also states that "[i]n Europe, Lend Lease's Retail business includes an ownership interest in five retail centres in the UK." The Lend Lease 2009 Annual Report further states that "[i]n the Americas, Lend Lease's retail business comprises a 50% ownership interest in the partnership that owns the King of Prussia Mall in Pennsylvania."

33. The Lendlease U.S. Group engaged in the project management and construction business during the tax years ended June 30, 2007 through June 30, 2009. The Lendlease U.S. Group first entered this business in late 1999 following the acquisition of a group of international construction companies that generally operated under the brand name "Bovis." The Lendlease U.S. Group's project management and construction business provided construction services with respect to vertical projects that were typically high-rise multi-family or condominium properties. The project management and construction business also provided construction services on projects involving office buildings, hotels, and hospitals.

34. The Lendlease U.S. Group also engaged in the communities business during the tax years ended June 30, 2007 through June 30, 2009, which provided construction, property management, and development services with respect to private residential and military housing projects. The Lendlease U.S. Group first entered the communities business in the early 2000s when it became a co-developer and provided construction management services on a condominium project in San Francisco. The Lendlease U.S. Group later expanded its communities business when it acquired a majority interest in a company called Actus. Actus was a military contractor, and the Lendlease U.S. Group acquired an interest in Actus to enter into the military family housing business following the U.S. Department of Defense's Military Privatization Initiative. Through Actus, the Lendlease U.S. Group bid on and won a series of

projects to enter into ground leases with the military and provide development and construction management services for military family housing.

35. The Lendlease U.S. Group engaged in a retail real estate business before tax years ended June 30, 2007 through June 30, 2009, and had completely exited that business prior to those years. When it had been in operation prior to the tax years ended June 30, 2007 through June 30, 2009, the retail real estate business had engaged in three main activities. First, the retail real estate business had engaged in retail property management through The Yarmouth Group, which managed several malls. Second, the retail real estate business had engaged in retail property development that was limited to one joint venture in California. Third, the retail real estate business had engaged in real estate investment management. The Lendlease U.S. Group exited the retail property management business in 1998 when it sold the business to Jones Lang LaSalle. The Lendlease U.S. Group exited the retail property development business in the early 2000s. The Lendlease U.S. Group exited the retail investment management business in 2003. The Lendlease U.S. Group did not conduct any retail real estate operating businesses in the U.S. during the tax years ended June 30, 2008 and June 30, 2009.

36. YLL KOP did not have or need employees. The officers of YLL KOP performed "administrative" functions, such as "compliance related activities for annual meetings and other sort of activities required as a corporation." Major decisions regarding YLL KOP's business, including the decision to acquire and dispose of the interest in KOP, were made by the Board of Directors of Lend Lease Corporation Limited in Australia, which as a corporation organized outside the U.S., was not required or permitted to file as part of a combined group under the Tax Law.[6]

[6] Tax Law § 211 (5) provides that "[a] corporation organized under the laws of a country other than the United States shall not be required or permitted to make a report on a combined basis."

37. Pursuant to a Real Estate Asset Management Agreement between LL REI and YLL KOP, dated July 1, 2007 (2007 Advisory Agreement), during the tax years ended June 30, 2008 and June 30, 2009, LL REI was engaged by YLL KOP to do the following: monitor Kingmak's compliance with the KOP Partnership Agreement; consult with Kingmak with regard to YLL KOP's rights under such agreement; and oversee Kravco's operation of the KOP Mall. The 2007 Advisory Agreement provided that the advisor was entitled to an annual asset management fee and a disposition fee in exchange for the asset management services that it provided under the agreement. LL REI received an annual asset management fee equal to 0.23% of the gross value of YLL KOP's share of KOP's interest in the KOP Mall. The disposition fee was equal to 0.5% of YLL KOP's share of the gross sales price of the KOP Mall.

38. The 2007 Advisory Agreement was entered into following the termination in October 2006 of the 2003 Advisory Agreement. The fee paid by YLL KOP to LL REI under the 2007 Advisory Agreement was identical to the fee paid by YLL KOP to Morgan Stanley for identical services under the 2003 Advisory Agreement. When LL REI entered into the 2007 Advisory Agreement, it provided the same services for the same fees as when Morgan Stanley rendered such services under the 2003 Advisory Agreement. The 2007 Advisory Agreement shows John Allman as president of both YLL KOP and LL REI.

39. Prior to entering into the 2007 Advisory Agreement, LL REI did not have the necessary staff to perform the services because the Lendlease U.S. Group had entirely exited the investment management business in the U.S. As of July 1, 2007, the only other businesses operating in the U.S. were the construction and development, and communities businesses, "and there was nobody with the requisite skills to oversee investment in a retail mall like [the KOP Mall]."

40. The Lendlease U.S. Group hired Tom Dodge and an assistant to perform services pursuant to the 2007 Advisory Agreement. Both Tom Dodge and his assistant were located in Atlanta, Georgia. Neither Mr. Dodge, nor his assistant provided services to any entities other than YLL KOP, and the services provided to YLL KOP were Mr. Dodge and his assistant's sole job responsibilities. When Mr. Dodge passed away in August 2009, the Lendlease U.S. Group hired a replacement who was not an existing Lendlease U.S. Group employee, because "there was nobody with the skills needed in the United States" to perform the necessary services under the 2007 Advisory Agreement. The replacement worked out of Chicago, Illinois.

41. During each of the tax years ended June 30, 2008, and June 30, 2009, YLL KOP paid an advisory fee to LL REI in accordance with the 2007 Advisory Agreement. For the tax year ended June 30, 2008, the fee paid to LL REI, in accordance with the 2007 Advisory Agreement, was $1,347,800.00; LL REI's total income was $12,829,858.00 for that period; approximately 10.5% of that income was from YLL KOP. For the tax year ended June 30, 2009, the fee paid to LL REI, in accordance with the 2007 Advisory Agreement, was $1,340,900.00; LL REI's total income was $3,038,534.00 for that period; approximately 44.1% of that income was from YLL KOP.

42. YLL KOP's ownership of assets and operations did not change from the time it acquired its interest in KOP through the tax years ended June 30, 2007 through June 30, 2009. The KOP Partnership Agreement remained in effect during the tax years ended June 30, 2007 through June 30, 2009.

43. During the tax years ended June 30, 2007 through June 30, 2009, Mr. Allman worked out of an office in Parsippany, New Jersey. Mr. Allman testified that the other officers

of YLL KOP were located in Georgia, California, North Carolina, and New Jersey during the tax years ended June 30, 2007 through June 30, 2009.

44. YLL KOP's interactions with other members of the Lendlease U.S. Group during the tax years ended June 30, 2008, and June 30, 2009 were limited to: (i) an intercompany promissory note; (ii) a shared bank account; and (iii) the 2007 Advisory Agreement. The promissory note was for $87,500,000.00, dated July 15, 2005, made by YLL KOP to Lend Lease (U.S.) Capital, Inc.[7] The promissory note bore the agreed-upon interest rate of 7.5% per annum. For July 2005, the applicable federal rate for a long-term obligation with an annual compounding period was 4.35%. The principal of the loan from Lend Lease (U.S.) Capital, Inc. remained unchanged during the tax years ended June 30, 2007 through June 30, 2009. YLL KOP made annual interest-only payments to Lend Lease (U.S.) Capital, Inc. during those years in the amount of $6,343,750.00 per annum, which translates to a 7.25% interest rate, based upon the loan amount of $87,500,000.00.

45. YLL KOP did not maintain its own bank account during the tax years ended June 30, 2007 through June 30, 2009. YLL KOP did not require its own bank account because it had very few bank transactions, and it was common in the Lendlease U.S. Group for only its main operating businesses to have their own bank accounts. YLL KOP's funds, as well as any distributions to YLL KOP from KOP, were deposited into the bank account of petitioner's affiliate, Actus Lend Lease LLC (Actus Lend Lease). To the extent YLL KOP held a positive cash balance in Actus Lend Lease's account, YLL KOP would record an intercompany receivable from Actus Lend Lease's bank account and a debit to the balance of the account with Actus Lend Lease. YLL KOP's balances held in the Actus Lend Lease account were credited

[7] Mr. Allman testified that Lend Lease (U.S.) Capital, Inc. was formed in 2005 and was the successor to Lend Lease U.S. Finance, Inc., which originally held the note in 1997 when it was first issued.

with interest during the tax years ended June 30, 2008 through June 30, 2009 at the rate of interest earned by Actus Lend Lease on the account, which was held with a third-party financial institution. Mr. Allman testified that any interest credited to YLL KOP approximated the same interest that YLL KOP would have earned from a third-party financial institution had YLL KOP had its own bank account and provided the following example. If the Actus Lend Lease account held $300.00 in total funds, and $200.00 of that amount was YLL KOP's cash, and $100.00 was attributable to another affiliate, and the account earned $3.00 in interest, YLL KOP would earn $2.00 of that interest ($3.00 X $200.00/$300.00). The deposits held in the Actus Lend Lease account were swept daily into Lend Lease (U.S.) Capital, Inc.

46. Mr. Allman testified that apart from the promissory note, the shared bank account, and the 2007 Advisory Agreement, there were no other transactions between YLL KOP and other members of the Lendlease U.S. Group.

47. The business of YLL KOP was different from the business of the rest of the Lendlease U.S. Group. Mr. Allman testified that no other members of the Lendlease U.S. Group ever owned real estate where there was no other business motivation apart from the pure ownership of real estate. There was no relationship between YLL KOP and the project management and construction business conducted by the Lendlease U.S. Group through the Bovis entities. Although Bovis had the ability to provide services to the KOP Mall, and sought to do so in at least one instance, it was never hired to provide those services. The KOP Mall owners' quarterly minutes for December 2009 indicate that YLL KOP proposed that Bovis provide services to the KOP Mall; however, Mr. Allman testified that those services were never actually provided. There was also no relationship between YLL KOP and the communities business conducted by the Lendlease U.S. Group. Neither the project management and

construction business, nor the communities business ever developed any retail malls similar to the KOP Mall.

48. The Lendlease U.S. Group received some unsolicited offers to sell its 50% interest in KOP. Shortly after YLL KOP's purchase of the partnership interest in 1996, it received a purchase offer for that partnership interest. On March 30, 2001, LL REI received an unsolicited written offer from Kingmak, in which Kingmak offered to purchase YLL KOP's 50% partnership interest in KOP at a discounted price. In this written offer, the majority of the partners of Kingmak expressed to LL REI that they intended to retain their interest in KOP and the ownership of the KOP Mall indefinitely to preserve wealth for future generations of the families that owned interests in KOP.

49. YLL KOP attempted to sell its interest in KOP several times before and during fiscal years ended June 30, 2008, and June 30, 2009. In 1998, the Lendlease U.S. Group engaged a broker to sell YLL KOP's interest in KOP. In May 2003, the Lendlease Worldwide Group's Chief Executive Officer publicly announced in an Australian newspaper article that he planned to sell YLL KOP's interest in the KOP Mall. In 2008, the Lendlease U.S. Group again engaged a broker to actively try to sell YLL KOP's 50% partnership interest in KOP. Mr. Allman testified that these efforts reflected the fact that "for the longest time King of Prussia . . . had no other connection to the [Lendlease U.S. Group's] business . . . it was non-strategic to the Lendlease global business, there was no other type of operation going to come of it."

50. Mr. Allman explained that there were a number of reasons why it took so long to sell YLL KOP's 50% partnership interest. One reason was the KOP Partnership Agreement contained an "onerous" right of first refusal. In addition, there was no "buy/sell clause," in the KOP Partnership Agreement, and the pre-existing property manager, Kravco, would remain

engaged due to the common ownership Kravco shared with Kingmak. There were also market cycles such as the global financial crisis in 2008 that impacted potential buyers.

51. In August 2011, YLL KOP's 50% partnership interest was sold to Kingmak after it exercised its right of first refusal based upon a third-party purchase agreement for YLL KOP's partnership interest in KOP. When YLL KOP finally sold its interest in KOP, both employees of the Lendlease U.S. Group responsible for providing services under the 2007 Advisory Agreement left their jobs with the Lendlease U.S. Group. No employees of the Lendlease U.S. Group moved to either Kravco or Kingmak when YLL KOP sold its interest in KOP.

52. After the sale of YLL KOP's partnership interest in KOP was completed, the intercompany loan in the amount of $87,500,000.00 was paid in full.

53. In July 2011, Mr. Allman became the head of integrated solutions, where he "oversaw a team of analysts and transaction people who raised equity and debt capital for Lendlease's business."

54. YLL KOP was included in a combined New York State corporate franchise tax return with the Lendlease U.S. Group for every taxable year beginning with its incorporation through the taxable year ended June 30, 2007. YLL KOP was audited during this period and combined filing was accepted by the Division of Taxation (Division).

55. Petitioner filed a New York State form CT-3-A, general business corporation franchise tax return, and a form CT-3M/4M, general business corporation MTA surcharge return (collectively, combined returns), with all its U.S. affiliates, including YLL KOP, for the tax year ended June 30, 2007. For each of its tax years ended June 30, 2008 and June 30, 2009, petitioner filed combined returns with all of its U.S. affiliates, except YLL KOP.

56. As a 50% partner in KOP, YLL KOP received a 50% allocable share of the items of income and expense derived by KOP, with only one exception: a special allocation of depreciation was made to YLL KOP during the tax years ended June 30, 2007 through June 30, 2009 as a result of an election made pursuant to Internal Revenue Code (IRC) (26 USC) section 754. In all taxable years through the taxable year ended June 30, 2007, the income and expenses derived by YLL KOP through its partnership interest in KOP were included in YLL KOP's New York State taxable income or loss.

57. Because YLL KOP was included on petitioner's New York State combined returns through the tax year ended June 30, 2007, petitioner included YLL KOP's 50% share of KOP's gross receipts in the denominator of the receipts factor of the combined group's business allocation percentage (BAP) through the tax year ended June 30, 2007.

58. The only assets reflected on YLL KOP's balance sheet for the tax years ended June 30, 2007 through June 30, 2009 were (i) the book value of YLL KOP's interest in KOP and (ii) an intercompany receivable representing the right to receive cash generated from KOP. During the tax years ended June 30, 2007 through June 30, 2009, the book value of the KOP partnership interest calculated pursuant to U.S. Generally Accepted Accounting Principles (GAAP) represented approximately 75% to 80% of the book value of YLL KOP's total assets.

59. During the tax years ended June 30, 2007 through June 30, 2009, YLL KOP was a wholly owned subsidiary of YLLA; YLLA had no income or expenses for that period.

60. During the tax years ended June 30, 2007 through June 30, 2009, YLLA was a wholly owned subsidiary of YLLP; YLLP had no income or expenses for that period.

61. During the tax years ended June 30, 2007 through June 30, 2009, YLLP was a wholly owned subsidiary of Lend Lease Investments, Inc. (LLI); LLI had no income or expenses

for the taxable year ended June 30, 2007; LLI had $15,685,165.00 of dividend income from subsidiaries and no expenses for the taxable year ended June 30, 2008; LLI had $675,394.00 of dividend income from subsidiaries and no expenses for the taxable year ended June 30, 2009.

62. During the tax years ended June 30, 2007 through June 30, 2009, LLI was a wholly owned subsidiary of Lend Lease (U.S.) Holdings, Inc. (LLH); LLH had no income but had $12,182,500.00 of interest expense for the taxable year ended June 30, 2007; LLH had $89,539,773.00 of dividend income from subsidiaries and $12,182,500.00 of interest expense for the taxable year ended June 30, 2008; LLH had $47,000,000.00 of dividend income from subsidiaries and $12,249,284.00 of interest expense and $166,095.00 in state income tax expense for the taxable year ended June 30, 2009.

63. During the tax years ended June 30, 2007 through June 30, 2009, LLH was a wholly owned subsidiary of Lend Lease (U.S.) Inc. (LLUS); LLUS earned only $62.00 of interest income and incurred no expenses for the taxable year ended June 30, 2007; LLUS had $89,062,787.00 of dividend income from subsidiaries and no expenses for the taxable year ended June 30, 2008; LLUS had $55,000,000.00 of dividend income from subsidiaries and no expenses for the taxable year ended June 30, 2009.

64. During the tax years ended June 30, 2007 through June 30, 2009, the expenses incurred by YLL KOP to other members of the Lendlease U.S. Group were comprised of interest expense paid to Lend Lease (U.S.) Capital Inc. and advisory fees paid to LL REI. YLL KOP paid no rent expense and no wage expense during those tax years.

65. For the tax year ended June 30, 2007, LL REI, Bovis Lend Lease Holdings, Inc. (BLL Holdings), Bovis Lend Lease LMB, Inc. (BLL LMB), and Bovis Lend Lease, Inc. (BLL Inc.) were the only corporate entities with wage expenses in the combined franchise tax group

that was reported to New York State on petitioner's combined returns. The other 29 entities in the group did not reflect any employee expenses.

66. For the taxable year ended June 30, 2008, LL REI, BLL Holdings, BLL LMB and BLL Inc. were the only corporate entities with wage expenses in the combined franchise tax group that was reported to New York State on petitioner's combined returns. The other 27 entities in the group did not reflect any employee expenses.

67. For the taxable year ended June 30, 2009, Lend Lease Americas, BLL Holdings, BLL LMB and BLL Inc. were the only corporate entities with wage expenses in the combined franchise tax group that was reported to New York State on petitioner's combined tax returns. The other 27 entities in the group did not reflect any employee expenses.

68. LL REI reported $879,698.00 in wage expenses on petitioner's federal form 1120, U.S. corporation income tax return (consolidated U.S. tax return), for the tax year ended June 30, 2007. On its consolidated U.S. tax returns, LL REI reported wage expenses in the amount of $140,628.00 and $0.00 for the tax years ended June 30, 2008, and June 30, 2009, respectively.

69. On March 28, 2011, the Division commenced a general field verification audit of petitioner's combined returns for the tax years ended June 30, 2007 through June 30, 2009 (audit years). By letter dated March 30, 2011, the auditor informed petitioner that its New York State tax returns for the period July 1, 2006 through June 30, 2009 were selected for audit. The letter also contained 10 detailed requests for information and documentation regarding, among other things, "intercompany transactions between Lend Lease Inc[.] [sic] and its affiliates including FTI, assets and liabilities eliminations."

70. In her letter, dated July 18, 2011, to petitioner, the auditor indicated that based upon a review of information provided earlier, YLL KOP should be part of the "combined group

reported in the FYE 06/30/08 and 06/30/2009." The letter stated the reason for combination was "that the company has more than 50% of intercompany transactions with Lend Lease (US) Holdings, Inc[.] [sic], a member of combined group. The company was part of the combined group in 2006 and facts did not significantly change since."

71. Subsequently, petitioner provided the auditor with its own substantial intercorporate transactions (SIT) analysis for the tax years ended June 30, 2008 and June 30, 2009. Petitioner's calculation of its SIT analysis for those years set forth: (i) YLL KOP's total revenues (both from its interest in KOP and, for the tax year ended June 30, 2009, from another member of the Lendlease U.S. Group); (ii) YLL KOP's total expenses (both from KOP on a flow-through basis and all other expenses); and (iii) identified the revenue or expense as "external," in which case it would not be considered to arise from an intercompany transaction, or "internal," in which case it would be considered to arise from an intercompany transaction. Petitioner's SIT analysis showed that YLL KOP's intercorporate receipts were 0.00% and 1.97% during the tax years ended June 30, 2008 and June 30, 2009, respectively, and YLL KOP's intercorporate expenses were 26.46% and 22.21% during the tax years ended June 30, 2008 and June 30, 2009, respectively.

72. During the course of the audit, the auditor issued information document requests (IDRs) that described the documents and information requested and detailed letters that responded to the information provided by petitioner and requested additional information and documentation.

73. Petitioner filed combined returns with the following affiliates for the taxable years ended June 30, 2007, June 30, 2008 and June 30, 2009: BLL Holdings; BLL LMB; and BLL Inc. The auditor noted that these entities lacked substantial intercorporate transactions with their

affiliates and issued a letter, dated March 26, 2015 (March 26, 2015 letter). Subsequently, petitioner provided detailed information as to why those affiliates should be part of the combined group.

74. In the Report of Audit (audit report), the following findings, in relevant part, were made:

> "<u>Combined Reporting/Intercompany Activity:</u>
>
> The t/p filed a combined return with all US Affiliates for the period ended 6/30/07. For the periods ended 6/30/08 and 6/30/09 one company Yarmouth Lend Lease King of Prussia (YLL KOP) . . . was not a part of the combined return.
> The requirements of combination, as set forth by TSB-M-08(2)C, were reviewed for FYE 6/30/08 and 6/30/09. It was determined that the YLL KOP should be a part of the combined return as it was in all prior years of filing.
>
> <u>Entire Net Income:</u> [ENI]
>
> Federal taxable income was verified with line 28 of the Federal 1120 and was correctly reported for all years under audit.
> Adjustments to ENI include:
> - Increase in ENI due to add back of YLL KOP FTI to reflect combination
> - Increase in ENI due to add back of YLL KOP tax reported on Ln 17 of 1120
> - Increase in ENI due to add back of income from the combined subsidiary
> - Decrease in ENI due to removal of interest and non-interest expenses indirectly attributable to subsidiary t/p capital in FYE 6/30/08 and 6/30/09 since the only non-combined subsidiary t/p had was combined as part of this audit
> - Decrease in ENI due to NOL adjustments.
>
> <u>Capital:</u>
>
> Average total assets and average total liabilities were reconciled with Schedule L of the Federal 1120 and were correctly reported in all years.
>
> Adjustments in capital for the FYE 6/30 08 [sic] and 6/30 09 [sic] include:
> - Increase in assets due to YLL KOP combination
> - Increase in assets due to reduction in intercompany eliminations
> - Increase in liabilities due to YLL KOP combination
> - Decrease in liabilities due to increase in intercompany elimination
> - Increase in business capital due to reduction of subsidiary capital to zero as a result of combination.
>
> * * *

<u>Business Allocation Percentage:</u>

Property Factor was verified and accepted as filed in FYE 6/30/07.
Receipts Factor was increased in FYE 06/30/07 due to the interest disallowance and decreased in FYE 6/30/08 and 6/30/09 due to the inclusion of YLL KOP receipts into calculation.
Wage factor was increased in FYE 6/30/07 as a result of re-calculation based on t/p workpapers,

<u>Minimum Taxable Income Base:</u>

Minimum taxable income was adjusted to reflect the changes to ENI.

<u>MTA Surcharge:</u>

MTA tax was adjusted to reflect the audit changes.

* * *

<u>Penalties:</u>

The penalties have been imposed under 1085(K) [sic] Substantial Underpayment of Liability[.] [sic]"

75. The Division prepared and mailed to petitioner a Consent to Field Audit Adjustment, dated July 27, 2015, which included a computation of the additional tax due from petitioner, including interest and penalties, for each of the tax years ended June 30, 2007 through the tax year ended June 30, 2009. A review of schedules reflecting the details of the proposed audit adjustments indicates that the auditor concluded that the tax on capital base was the highest tax computed in each of the tax years ended June 30, 2007 through June 30, 2009. After adding the sum of fixed dollar minimum taxes from subsidiaries from form CT-3A to the highest tax computed for each of those years, the auditor computed total tax due in the amounts of $191,285.00, $302,154.00, and $233,179.00 for the tax years ended June 30, 2007, June 30, 2008, and June 30, 2009, respectively. After subtracting the tax paid with the returns from the computed tax due for each of those years, the auditor computed additional tax due in the amounts

of $3,517.00, $152,931.00, and $99,527.00 for the tax years ended June 30, 2007, June 30, 2008, and June 30, 2009, respectively. As a result of her computation of additional MTA surcharge due, the auditor determined additional MTA surcharge due in the amounts of $289.00, $24,427.00, and $19,108.00 for the tax years ended June 30, 2007, June 30, 2008, and June 30, 2009, respectively.

76. The audit continued after the schedules detailing the proposed audit changes were sent to petitioner on July 27, 2015. A review of the tax field audit record (audit log) indicates that the auditor sent additional IDRs and letters requesting information to petitioner's representative, Ernst & Young LLP (EY).

77. In response to the auditor's IDR dated January 22, 2016, petitioner's representative, in a letter dated April 14, 2016 (April 14, 2016 letter), provided the following information related to a "'Routine on Call' decision to de-combine YLL KOP, Inc."

> "Please note that we do not have the actual date of the meeting documented, but it took place sometime in late 2007 or early 2008. Michael Goldsmith met with Lend Lease to discuss working with EY [to] [sic] update the tax team in connection with recent state and local tax changes that may have been relevant to the company's business.
>
> During the course of the meeting, EY briefly reviewed the company's business and combined filing group. Based on this review, it was clear that YLL KOP was not in the same line of business as the rest of the group, as it was merely a passive investor in a partnership and was not involved in the construction management business that every other entity was an active member in. The fact that they were not in the same unitary business as the rest of the group prompted a brief review of any shared services, personnel, customers, and the like and it was determined that YLL KOP should not be included in the combined group."

This letter also provided information related to "whether a comprehensive ten steps [sic] analysis was performed in accordance with TSB-M-07(6)C and TSB-M-08(2)C."

> "YLL KOP never met the substantial intercorporate transaction test with any other entity within or without the New York Combined Group. Therefore, even if the comprehensive ten step analysis was performed, King of Prussia would have

> been excluded. Nonetheless, it was determined that combining YLL KOP with the unitary group would have been distortive and therefore improper (see comprehensive responses dated December 23, 2014 and June 23, 2015)."

78. The April 14, 2016 letter also included information detailing a correction to the Division's adjustments to petitioner's BAP for the tax year ended June 30, 2008.

79. After reviewing the information provided by petitioner's representative in previous correspondence, the auditor sent a letter dated October 14, 2016, to petitioner's representative, that stated, in part, as follows:

> "Upon review of this information, we did not find any indication that YLL KOP is treated differently from the other members of the consolidated return and should be treated differently when determining its inclusion in a combined group. In particular:
>
> - YLL KOP did not have its own bank account and was part of the central cash management system[.] [sic]
> - YLL KOP did not report any salary or rent expenses meaning that the company must have shared the office space with the affiliated entities and the employees of affiliated entities must have performed necessary functions on YLL KOP['s] [sic] behalf.
>
> - The copy of the Treasury Policy states that the management and governance of treasury activities are provided across the Lend Lease Group, without excluding the YLL KOP. Therefore, YLL KOP is part of [a] [sic] common decision making and management system.
>
> - AIG insurance policy provided does not have a list of all companies, but there is no indication that the YLL KOP is not a part of it.
> - The agreement between Lend Lease Americas Inc. and Guy Brown Management, LLC refers to Lend Lease Americas and **all of its Affiliates**, without any exclusion.
>
> - The statement that the American Express travel agreement does not cover YLL KOP is not a relevant argument as the company has no employees. Employees of affiliated entities that might travel on the company's behalf are covered by the agreement.
>
> - The YLL KOP is in a [sic] business of the Real Estate investment, as [are] [sic] a number of other companies included in the combined return. Therefore, we do not consider it being engaged in a different business, as you claimed earlier.

- In addition to the above, the Joint Venture agreement, in its Article XVIII *Disclosure, Conflicts, Waiver,* binds not only YLL KOP but also its affiliates by the competitive clause. It is one more indication that this company should be treated in the same way as the other members of the combined group.

Based on the above, we uphold our position that the YLL KOP should be part of the combined return in FYE 6/30/08 and 6/30/09, as it has been in all prior years" (emphasis in original).

80. Petitioner, "Lend Lease (U.S.) Inc. and Combined Affiliates," executed 11 consents extending the period of limitations for assessment of corporation franchise tax under article 9-A of the Tax Law that collectively extended the period in which to assess corporation franchise tax due for the "taxable period(s) 07/01/2006 through 06/30/2009" to "12/31/2016."

81. At the conclusion of the audit, the Division determined that YLL KOP should have been included in the combined returns with the Lendlease U.S. Group for the tax years ended June 30, 2008 and June 30, 2009. As a result of combination, the Division included the income of YLL KOP in petitioner's entire net income and its business receipts in the denominator of the BAP in accordance with the relevant schedules.

82. On November 4, 2016, the Division issued to Lendlease U.S. Group a notice of deficiency, assessment ID L-045657620, (Notice), in the amount of $498,731.78, including a total tax amount assessed in the amount of $299,799.00 plus interest and penalties for the tax periods ended June 30, 2007 through June 30, 2009. The Notice included the following detailed "**COMPUTATION SUMMARY SECTION**:"

Tax Period Ended	Tax Amount Assessed	(+) Interest Amount Assessed	(+) Penalty Amount Assessed	(-) Assessment Payments/Credits	(=) Current Balance Due
06-30-2007	3,517.00	2,631.77	0.00	0.00	6,148.77
06-30-2007	289.00	214.88	0.00	0.00	503.88
06-30-2008	152,931.00	93,575.00	15,293.00	0.00	261,799.00
06-30-2008	24,427.00	14,945.97	2,442.00	0.00	41,814.97
06-30-2009	99,527.00	48,630.53	9,952.00	0.00	158,109.53

06-30-2009	19,108.00	9,336.83	1,910.00	0.00	30,354.83
TOTALS	299,799.00	169,335.78	29,597.00	0.00	498,731.78

83. Following the issuance of the Notice, petitioner informed the Division of its intention to file a request for conciliation conference (Request) with the Bureau of Conciliation and Mediation Services (BCMS). Petitioner filed a Request with BCMS, dated January 24, 2017. By conciliation order, dated July 26, 2019, the Notice was sustained.

84. Following the issuance of the conciliation order, the Division concluded that a correction to its adjustments to petitioner's BAP should be made for the tax year ended June 30, 2008. As a result of the correction, the amount of additional tax due should be $274,437.00 for the tax years ended June 30, 2007 through June 30, 2009. The parties agree that if the Notice is sustained, the amount of additional tax due would be $274,437.00 for the tax years ended June 30, 2007 through June 30, 2009.

85. The auditor testified that her October 14, 2016 letter to petitioner's representative was the final statement of "the Department's position on why [YLL KOP] should be combined." The auditor also testified that she focused on the business of YLL KOP and did not review the business activities of all other members of the Lendlease U.S. Group because she did not think the business activities of the other members of the Lendlease U.S. Group were relevant to the unitary analysis.

86. Pursuant to State Administrative Procedure Act (SAPA) § 307 (1), petitioner submitted 58 proposed findings of fact and 45 proposed conclusions of law. Proposed finding of fact 1 is unnecessary. Petitioner's proposed findings of fact 2 – 10, 12 – 22, 24 – 27, 30 – 32, 43 – 48, 50, 54 and 57 are supported by the record and have been consolidated, condensed, combined, renumbered and substantially incorporated herein. Proposed findings of fact 11, 23, 28, 29, 33 – 42, 51 – 53 and 56 have been modified to more accurately reflect the record; as

modified, they have been consolidated, condensed, combined, renumbered and substantially incorporated herein. Proposed finding of fact 49, 55 and 58 are unsupported by the record. In ruling on proposed findings of fact, if any part of a proposed finding of fact is unsupported by the record, the proposed finding of fact has been rejected in its entirety. SAPA does not require rulings with respect to proposed conclusions of law and none have been made herein with respect of petitioner's 45 proposed conclusions of law.

87. Pursuant to State Administrative Procedure Act § 307 (1), the Division proposed 57 proposed findings of fact. Proposed findings of fact 56 and 57 are unnecessary. The Division's proposed findings of fact 1 – 5, 7 – 15, 17, 18, 20 – 24, 26, 32 – 37, 39 – 42 and 45 – 55 are supported by the record and have been consolidated, combined, renumbered and substantially incorporated herein. Proposed findings of fact 16, 19, 27 – 30 and 44 have been modified to more accurately reflect the record; as modified, they have been consolidated, condensed, combined, renumbered and substantially incorporated herein. Proposed findings of fact 6, 25, 31, 38 and 43 have been accepted in part and rejected in part as conclusory, irrelevant and/or not supported by the record; to the extent accepted they have been consolidated, condensed, combined, renumbered and substantially incorporated herein.

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 (***see*** Tax Law § 209 [1]). Corporations located or doing business within the Metropolitan Commuter Transportation District are also subject to an additional surcharge tax (***see*** Tax Law former § 209-B). While, as a general principle, every corporation is considered a separate taxpayer and must file its own report, under certain circumstances combined reporting may be permitted or required (***see*** 20 NYCRR 6-2.1).

B. For taxable years commencing prior to January 1, 2007, Tax Law former § 211 (4) and the regulations promulgated thereunder gave the Division the discretion to permit or require combined filing where substantial ownership, unitary business and distortion tests were met (20 NYCRR former 6.2-1 [a]). Under this former regime, distortion was presumed where "substantial intercorporate transactions" were present (20 NYCRR former 6-2.3 [a]). Such a presumption could be rebutted by a showing that the transactions giving rise to the presumption were conducted at arm's length (***see Matter of Silver King Broadcasting of N.J.***, Tax Appeals Tribunal, May 9, 1996). In the absence of substantial intercorporate transactions, combined filing was permitted or required where "the filing of a report on a separate basis . . . results in a distortion of such taxpayer's activities, business, income or capital . . ." (20 NYCRR former 6-2.3 [d]).

C. Effective for taxable years commencing on or after January 1, 2007, Tax Law former § 211 (4) (a) was amended (***see*** L 2007, ch 60) to require combined reporting where the substantial ownership requirement is met,[8] and where "there are substantial intercorporate transactions among the related corporations, regardless of the transfer price for such intercorporate transactions."

To determine whether substantial intercorporate transactions exist, the statute further provides as follows:

> "the commissioner shall consider and evaluate all activities and transactions of the taxpayer and its related corporations. Activities and transactions that will be considered include, but are not limited to:

[8] The substantial ownership requirement was not in dispute and the parties agreed that this requirement has been met (***see*** 20 NYCRR 6-2.2).

> (i) manufacturing, acquiring goods or property, or performing services, for related corporations; (ii) selling goods acquired from related corporations; (iii) financing sales of related corporations; (iv) performing related customer services using common facilities and employees for related corporations; (v) incurring expenses that benefit, directly or indirectly, one or more related corporations, and (vi) transferring assets from one or more related corporations" (Tax Law former § 211 [4] [a]).

D. The Division issued guidance on the amendment to Tax Law former § 211 (4) in Technical Services Memorandum, dated March 3, 2008, (TSB-M-08[2]C), *Combined Reporting for General Business Corporations (including Real Estate Investment Trusts and Regulated Investment Companies) and Insurance Companies*, which defined "substantial" as, generally, more than 50% and provided the following guidance regarding substantial intercorporate expenditures:

> "The substantial intercorporate transactions requirement will be met when, during the taxable year, 50% or more of a corporation's expenditures included in the computation of entire net income, including for inventory (but excluding nonrecurring items), are from one or more related corporations. However, if a corporation's expenditures, including for inventory (but excluding recurring items), from one or more related corporations are between 45% and 55%, the multi-year test . . . applies.
>
> Expenditures incurred by a corporation that directly or indirectly benefit a related corporation can constitute substantial intercorporate transactions. For example, when a related corporation is incurring expenditures that benefit another related corporation and the amount of those expenditures represent 50% or more of the direct and indirect expenditures of the beneficiary corporation, the substantial intercorporate transaction requirement is satisfied." (TSB-M-08[2]C, March 3, 2008).

The Division's regulations promulgated under the amended statute, although not effective until 2013, provide for a similar test (***see*** 20 NYCRR 6-2.3 [b] [3]).

E. The technical services memorandum, like the Division's former and current regulations (***see*** 20 NYCRR former 6-2.3 [c] and 20 NYCRR 6-2.3 [b] [2]) also provides that service functions like accounting, legal and personnel services are not considered when determining whether substantial intercorporate transactions exist when such services are incidental to the business of the corporation providing such service.

F. As amended, Tax Law former § 211 (4) also provides for the filing of combined reports in the absence of substantial intercorporate transactions:

> "Except as provided in the first undesignated paragraph of this paragraph [i.e., except where there are substantial intercorporate transactions], no combined report covering any corporation shall be required *unless the commissioner deems such a report necessary, because of inter-company transactions or some agreement, understanding, arrangement or transaction referred to in [Tax Law § 211 (5)], in order to properly reflect the tax liability under [article 9-A]*" (Tax Law former § 211 [4] [a] [4] [emphasis added]).

The italicized portion of the quoted paragraph is identical to language contained in Tax Law former § 211 (4) (a) (4). The Tax Appeals Tribunal (Tribunal) has consistently interpreted this language to mean that, assuming all other requirements are met, combined filing is required to avoid distortion and to properly reflect income (***see Matter of Knowledge Learning Corp.***, Tax Appeals Tribunal, September 18, 2014). This interpretation is consistent with the Division's former regulations (***see*** 20 NYCRR former 6-2.3).

G. The technical services memorandum interprets the amended statute in a similar manner. Specifically, the technical services memorandum notes that the Division "may require or permit" combined filing "even where substantial intercorporate transactions are absent" pursuant to the italicized statutory language quoted above in order to properly reflect income (***see*** TSB-M-08[2]C, March 3, 2008). Additionally, although not effective until 2013, the Division's regulations, interpreting the same statute, provide that a combined report "may be required or permitted" in the absence of substantial intercorporate transactions where ownership and unitary business conditions are met, and where a combined report is necessary to properly reflect income (***see*** 20 NYCRR 6-2.1 [b]; 6-2.3 [d]).

H. Petitioner included YLL KOP in its combined returns for every taxable year beginning with YLL KOP's incorporation through the tax year ended June 30, 2007. However, for the tax years ended June 30, 2008 and June 30, 2009, petitioner filed combined returns with all of its U.S. affiliates, except YLL KOP. As a result of its audit, the Division concluded that YLL KOP should have been included in petitioner's combined returns for tax years ended June 30, 2007 through June 30, 2009. It is petitioner's position that it properly filed its combined returns for tax years ended June 30, 2008 and June 30, 2009, and YLL KOP should not be included in its combined returns for those years.

I. Combined reporting is required if the capital stock requirement is met; substantial intercorporate transactions exist between the taxpayer and other related corporations; and the taxpayer and other members of the combined group are engaged in a unitary business (***see*** Tax Law former § 211 [4] [a]; ***Matter of Whole Foods Market Group, Inc.***, Tax Appeals Tribunal, September 11, 2017). As noted above, the capital stock requirement is not at issue. However, both the existence of substantial intercorporate transactions and engagement in a unitary business are at issue in this matter.

J. The first issue to be addressed is whether substantial intercorporate transactions exist between petitioner and YLL KOP. During the audit, petitioner provided the auditor with its SIT analysis for the tax years ended June 30, 2008 and June 30, 2009. Petitioner's calculation of its SIT analysis set forth: (i) YLL KOP's total revenues (both from its interest in KOP and, for tax year ended June 30, 2009, from another member of the Lendlease U.S. Group); (ii) YLL KOP's total expenses (both from KOP on a flow-through basis and all other expenses); and (iii) identified the revenue or the expense as "external" or "internal" (***see*** finding of fact 71). Petitioner's SIT analysis showed that YLL KOP's intercorporate receipts were 0.00% and

1.97%, respectively, and YLL KOP's intercorporate expenses were 26.46% and 22.21%, respectively, during the tax years ended June 30, 2008 and June 30, 2009, respectively (***id.***). The Division asserts that petitioner's SIT analysis is flawed because it included partnership expenses to show that substantial intercorporate transactions do not exist between petitioner and YLL KOP. The Division claims that the SIT analysis "applies to corporations and 'not flow through entities,'" and that the SIT analysis cannot take into account income and expenses from partnerships.

The Division's assertions are without merit. Its claim that the SIT test applies only to corporations says nothing about whether the SIT test takes into account items of income and loss recognized by a corporation subject to tax on a flow-through basis from a partnership in which the corporation owns an interest. Pursuant to 20 NYCRR 3-13.1 (a), a corporation that is a partner in a partnership must compute its franchise tax with respect to the interest in the partnership under either the aggregate method or the entity method. "Under the aggregate method, a corporate partner is viewed as having an undivided interest in the partnership assets, liabilities and items of receipts, income, gain, loss and deduction" (20 NYCRR 3-13.1 [b]). The aggregate method treats the corporate partner "as participating in the partnership's transactions and activities" (***id.***). In contrast, "[u]nder the entity method, a partnership is treated as a separate entity and a corporate partner is treated as owning an interest in the partnership entity" (20 NYCRR 3-13.1 [c]). Under the entity method, "[t]he partner's interest is an intangible asset" (***id.***). A corporate partner is required to use the aggregate method if it has access to the information necessary to compute its tax using the aggregate method (***see*** 20 NYCRR 3-13.2 [a]). A corporate partner is presumed to have access to such information if, among other things, it is a general partner of the partnership or its partnership interest constitutes more than 50% of its total assets (***see*** 20 NYCRR 3-13.2 [a] [2], [5]). Here, YLL KOP was required to use the aggregate method of reporting with respect to its interest in KOP because YLL KOP was a general partner in KOP and YLL KOP's interest in KOP constituted more than 50% of YLL KOP's total assets.

Using the aggregate method, a corporate partner's:

> "distributive share . . . of each partnership item of *receipts*, income gain, loss and *deduction* and the taxpayer's proportionate part of each partnership asset and liability and each partnership activity are included in the computation of the [corporate partner's] entire net income base, capital base, minimum taxable income base and the fixed dollar minimum *and shall have the same source and character in the hands of the partner for article 9-A purposes as such item has in its hands for Federal income tax purposes*" (20 NYCRR 3-13.3 [a] [1] [emphasis added]).

In addition, a corporate partner's "proportionate part of the partnership's assets and liabilities and activities is determined in accordance with the taxpayer's capital interest in the partnership" (***see*** 20 NYCRR 3-13.3 [a] [2]).

Clearly, YLL KOP properly included KOP's receipts and expenses when performing its SIT analysis. The technical services memorandum states that the SIT test will be met when "50% or more of a corporation's receipts included in the computation of entire net income . . . are from one or more related corporations" (TSB-M-08[2]C). As noted above, under the aggregate method of reporting that YLL KOP was required to use, a corporation's distributive share of partnership receipts is included in the computation of the corporate partner's entire net income base (***see*** 20 NYCRR 3-13.3 [a] [1]). Therefore, YLL KOP correctly included its distributive share of KOP's receipts in the SIT analysis. Similarly, the SIT test will be met "if 50% or more of a corporation's expenditures included in the computation of entire net income . . . are from one or more related corporations" (***id.***). As described above, under the aggregate method of reporting, YLL KOP was required to include its distributive share of each KOP deduction in calculating its entire net income base (20 NYCRR 3-13.3 [a] [1]). Therefore, YLL KOP correctly included expenses from KOP in the SIT analysis.

Petitioner's SIT analysis establishes that YLL KOP's intercorporate receipts were 0.00% and 1.97% during the tax years ended June 30, 2008 and June 30, 2009, respectively. The SIT analysis also establishes that YLL KOP's intercorporate expenses were 26.46% and 22.21% during the tax years ended June 30, 2008 and June 30, 2009, respectively. Since the SIT test under TSB-M-08(2)C was not met, it is concluded that there were no substantial intercorporate transactions between petitioner and YLL KOP during the tax years ended June 30, 2008 and June 30, 2009.

K. The next issue to be addressed is whether petitioner and YLL KOP were engaged in a unitary business during the tax years ended June 30, 2008 and June 30, 2009. The unitary business principle is the "linchpin of apportionability" for State income taxation of an interstate enterprise (***Mobil Oil Corp. v Commissioner of Taxes of Vt.***, 445 US 425, 439 [1980]). The principle holds that if an interstate enterprise is determined to be a unitary business, then a State may use an apportionment formula to tax that portion of the enterprise's total income that is reasonably related to the enterprise's intrastate activity (***see e.g. Exxon Corp. v Department of Revenue of Wisc.***, 447 US 207, 223 [1980]). The "prerequisite to a constitutionally acceptable finding of a unitary business is a flow of value" between the subject entities (***Container Corp. of America v Franchise Tax Bd.***, 463 US 159, 178 [1983]***, reh denied*** 464 US 909 [1983]). The "hallmarks" of a unitary relationship among businesses are "functional integration, centralized management and economies of scale" (***MeadWestvaco Corp. v Illinois Dept. of Revenue***, 553 US 16, 30 [2008]). These "essentials" may be shown, respectively, by "transactions not undertaken at arm's length; a management role by the parent which is grounded in its own operational expertise and operational strategy; and the fact that the corporations are engaged in the same line of business (***Allied-Signal, Inc. v Director, Div. of Taxation***, 504 US 768, 789 [1992]).

Federal unitary business doctrine is relevant in addressing unitary business issues arising under article 9-A and is in harmony with the Division's unitary business regulations (***see Matter of SunGard Capital Corp.***, Tax Appeals Tribunal, May 19, 2015, citing ***Matter of IT USA***, Tax Appeals Tribunal, April 16, 2014). Such regulations require consideration of the following factors in determining whether a group of corporations comprise a unitary business:

> "(1) [W]hether the activities in which the corporation engages are related to the activities of other corporations in the group, such as:
>
> (i) manufacturing or acquiring goods or property or performing services for other corporations in the group; or
>
> (ii) selling goods acquired from other corporations in the group; or
>
> (iii) financing sales of other corporations in the group.
>
> (2) [W]hether the corporation is engaged in the same or related lines of business as the other corporations in the group, such as:
>
> (i) manufacturing or selling similar products; or
>
> (ii) performing similar services; or
>
> (iii) performing services for the same customer" (20 NYCRR former 6-2.2 [b] renum 20 NYCRR 6-2.3 [e] eff. Jan. 2, 2013).

"[T]here is no single test for determining whether a unitary business exists; rather, there are a wide range of constitutionally acceptable variations of the unitary business theme" (***Matter of Medtronic***, Tax Appeals Tribunal, September 23, 1993 citing ***Container Corp. of America v Franchise Tax Bd.***, 463 US at 178). Therefore, "a unitary business analysis necessarily depends on the facts of each case" (***Matter of SunGard Capital Corp.***).

L. Applying the foregoing standards to the instant matter results in a conclusion that petitioner and YLL KOP were not engaged in a unitary business during the tax years ended June 30, 2008 and June 30, 2009. There was no flow of value between YLL KOP and any other members of the Lendlease U.S. Group because YLL KOP's minimal transactions with other members of the Lendlease U.S. Group were limited to oversight of a valuable investment, and they were all conducted at arm's length (***cf. Matter of British Land Maryland, Inc. v Tax Appeals Trib.***, 85 NY2d 139, 147 [1995] [where the Tribunal's conclusion that a unitary business existed was upheld because of petitioner's functional integration (the New York City property acquisition loan transaction was not at arm's length), centralization of management (petitioner's vice-president oversaw the management and made the strategic decisions with respect to both properties) and economies of scale (the New York City and Baltimore activities were in the same line of business)]). The Tribunal has held on numerous occasions that the principles of IRC (26 USC) § 482 should be used to determine whether activities are conducted at arm's length (***see Matter of Sears, Roebuck and Co.***, Tax Appeals Tribunal, April 28, 1994; ***Matter of USV Pharmaceutical Corp.***, Tax Appeals Tribunal, July 16, 1992). Pursuant to Treas Reg (26 CFR) § 482-1 (b) (1), a related party transaction meets the arm's length standard of IRC (26 USC) § 482 "if the results of the transaction are consistent with the results that would have been realized if uncontrolled taxpayers had engaged in the same transactions under the same circumstances." Here, all of the transactions between YLL KOP and other members of the Lendlease U.S. Group met the arm's length standard. During tax years ended June 30, 2007 through June 30, 2009, YLL KOP's transactions with other members of the Lendlease U.S. Group were limited to (i) an intercompany promissory note; (ii) a shared bank account; and (iii) the 2007 Advisory Agreement. The intercompany promissory note was for $87,500,000.00

between YLL KOP and Lend Lease (U.S.) Capital, Inc. and bore the arm's length agreed-upon interest rate of 7.5% per annum. YLL KOP's use of a shared bank account with Actus Lend Lease was also a transaction undertaken at arm's length. YLL KOP earned interest on any cash amounts that were held in Actus Lend Lease's bank account that approximated the same interest that YLL KOP would have earned from a third-party financial institution had YLL KOP held its own bank account. Lastly, the 2007 Advisory Agreement was also a transaction undertaken at arm's length. YLL KOP paid an arm's length fee to LL REI for services pursuant to the 2007 Advisory Agreement that was identical to the fee that YLL KOP paid to an unrelated third party, Morgan Stanley, for identical services under a predecessor agreement, the 2003 Advisory Agreement.

There was also no flow of value between YLL KOP and any other member of the Lendlease U.S. Group because there was no management role undertaken by any other member of the Lendlease U.S. Group with respect to YLL KOP that was grounded in its own operational expertise and operational strategy. During the tax years ended June 30, 2008 through June 30, 2009, YLL KOP's business was an orphaned remnant of Lendlease U.S. Group's former investment management business that lacked any operational connection to the other members of the Lendlease U.S. Group. The other businesses engaged in by the Lendlease U.S. Group during the tax years ended June 30, 2007 through June 30, 2009, were the project management and construction business and the communities business. The project management and construction business provided construction services with respect to vertical projects such as high-rise condominiums, office building, hotels, and hospitals. The communities business provided development, asset, and construction management for military family housing pursuant to ground leases entered into with the U.S. military. YLL KOP, on the other hand, was a single-purpose investment entity that held a passive investment in KOP. Neither the project management and construction business, nor the communities business ever developed any retail malls similar to the KOP Mall. They serviced entirely different customer bases that had nothing to do with the business of the YLL KOP, KOP or the KOP Mall. There was no retail real estate operating business conducted by the Lendlease U.S. Group during the tax years ended June 30, 2007 through June 30, 2009. Although the Lendlease U.S. Group had previously engaged in a retail real estate business, it exited that business completely in the late 1990s and early 2000s. YLL KOP engaged in a completely different line of business than the business conducted by other members of the Lendlease U.S. Group during the audit years. The Lendlease U.S. Group had largely exited the investment management business prior to the tax years ended June 30, 2007 through June 30, 2009 pursuant to a deliberate and public strategy to divest its entire investment management business. Even when one considers the underlying business conducted by KOP: owning, managing and maintaining the KOP Mall, there was no operational overlap between YLL KOP and other members of the Lendlease U.S. Group. YLL KOP's participation in the management of KOP was that of a passive investor, and the business of KOP lacked any substantive connection to the rest of the Lendlease U.S. Group. Kingmak, the other 50% general partner and Administrative Venturer, was under common ownership with Kravco, the entity responsible for the day-to-day management of the KOP Mall. Finally, YLL KOP had attempted to sell its interest in KOP several times both before and during the tax years ended June 30, 2007 through June 30, 2009. These efforts to sell the KOP interest reflected the fact that "for the longest time King of Prussia . . . had no other connection to the [Lendlease U.S. Group's] business . . . it was non-strategic to the Lendlease global business, there was no other type of operation going to come to it." YLL KOP was not an integrated operating business that was connected to the other businesses of the Lendlease U.S. Group. YLL KOP owned a valuable asset that the Lendlease U.S. Group actively sought to dispose of because it was non-integral and did not align with the Lendlease U.S. Group's other business strategies. YLL KOP operated independently of the rest of the Lendlease U.S. Group. Its operations were conducted through KOP that was substantially managed by an unrelated third party.

M. The Division claims that because YLL KOP did not have its own bank account and was part of a centralized cash management system, there was a flow of value between YLL KOP and the other members of the Lendlease U.S. Group. The Division cites to ***Matter of SunGard Capital Corp.***, as support for its argument that a centralized cash management system can serve as a basis for combination. It claims that the centralized cash management system in this matter is similar to the arrangement that the Tribunal described in ***SunGard Capital***. In ***SunGard Capital***, the Tribunal found that the non-arm's length, interest-free component of the Group's cash management system resulted in a flow of value (***id.***). The lack of an arm's length rate of interest in the cash management system was therefore an explicitly identified material fact that led to the Tribunal's finding that "a flow of value" from the interest-free deposits justified combined reporting. In the present matter, there was an arm's length rate of interest earned by YLL KOP on its cash deposits, which makes it fundamentally different from ***SunGard Capital*** and means that there was no similar "flow of value" that would justify including YLL KOP in petitioner's combined returns.

The Division also claims that centralized management existed between YLL KOP and the other members of the Lendlease U.S. Group because YLL KOP did not report any salary or officer expenses, rent expenses or advertising expenses. It contends that YLL KOP "relied on the employees and officers of other members of the group to perform its functions." The record does not support the Division's claims that centralized management existed between YLL KOP and the other members of the Lendlease U.S. Group. YLL KOP was a holding company formed to hold a single asset, the 50% partnership interest in KOP. As such, it had no employees, and there was no need for salary expenses. Rather, YLL KOP entered into the 2007 Advisory Agreement with an affiliate, LL REI, to provide necessary services on arm's length terms, identical to those entered into with a third party, Morgan Stanley. The operation of the KOP Mall was managed by KOP itself, and Kingmak, the other general partner and Administrative Venturer of KOP, was responsible for implementing the actions and decisions of KOP through its relationship with Kravco. KOP incurred millions of dollars in expenses each year with respect to the operation of the KOP Mall. With respect to the Division's assertion that "YLL KOP relied on intercompany financing," it appears to imply that YLL KOP received intercompany financing in the regular course of its business operations. Other than the intercompany loan that was entered into in 1996 as part of the acquisition of the interest in KOP, there is no evidence of any other loans.

The Division asserts that "YLL KOP was part of a common decision-making and management system" and that "decisions for YLL KOP were made by the officers of other members of the Lendlease U.S. Group." The record does not support the Division's assertions. Mr. Allman, YLL KOP's president, testified that the officers of YLL KOP performed "administrative" functions, such as "compliance related activities for annual meetings and other sort of activities required as a corporation." Indeed, review of the KOP Mall owners' meeting notes indicate that Mr. Allman regularly attended the meetings during the tax years ended June 30, 2008 and June 30, 2009. Further review of those meeting notes also indicates that YLL KOP's role at the meetings "was predominately to listen . . . to what the Administrative

Venture[r] and the property manager presented." In addition, major decisions about YLL KOP's business, including the decisions to acquire and dispose of YLL KOP's interest in KOP, were made by the Board of Directors of the Lend Lease Corporation Limited in Australia that was not required or permitted to file as part of petitioner's combined returns. The management of YLL KOP was limited to the type of oversight any parent company gives to an investment in a valuable subsidiary.

The Division contends that there were economies of scale between YLL KOP and the other members of the Lendlease U.S. Group. It points to the fact that "YLL KOP was in the business of real estate investment," and argues that this business was "complimentary" [sic] to the other members of the Lendlease U.S. Group. There is no evidence that YLL KOP was engaged in the active conduct of making multiple real estate investments in the regular course of business. To the contrary, YLL KOP was a single-purpose investment entity that held a passive investment in a partnership interest. The assets on YLL KOP's balance sheet during the audit years were the book value of YLL KOP's interest in KOP and an intercompany receivable representing the right to receive cash generated from KOP. There were three limited types of intercompany transactions between YLL KOP and the other members of the Lendlease U.S. Group, (i) the promissory note related to the acquisition of the partnership interest in KOP; (ii) a shared bank account; and (iii) the 2007 Advisory Agreement between LL REI and YLL KOP, all of which were conducted on arm's length terms. Apart from the three limited intercompany transactions, there was no operational overlap between YLL KOP and any other member of the Lendlease U.S. Group. No other members of the Lendlease U.S. Group ever owned any other real estate unless there was another business motivation, such as an intended contribution to an investment fund. There was no relationship between YLL KOP and the project management and construction business conducted by the Bovis entities. Moreover, there was no relationship between YLL KOP and the communities business, and no other members of the Lendlease U.S. Group ever developed or owned any retail malls. The Division's assertion that YLL KOP's line of business was clearly "complimentary" [sic] to other businesses of the Lendlease U.S. Group lacks foundation and substance.

The Division's assertion that there was functional integration between YLL KOP and other members of the Lendlease U.S. Group is baseless. The Division contends that the $87,500,000.00 intercompany loan made to YLL KOP in connection with YLL KOP's acquisition of an interest in KOP "did not serve an investment function; the group was not investing in [KOP] by making the loan to YLL KOP. Rather, the purpose of the loan was to permit YLL KOP to perform its business function as a member of the group; the loan served an operational function." The Division relies on the Court's decision in ***Container Corp.*** that made a distinction between investment functions and operational functions in the case of capital transactions (***Container Corp. of America v Franchise Tax Bd.***, 463 US at 180, n. 19). The Division's reliance on ***Container Corp.*** is misplaced. In ***Container Corp.***, it was the lack of arm's length pricing that created a "flow of value," which is "the prerequisite to a constitutionally acceptable finding of unitary business" (***id.***, at 178). In this case, there is no flow of value because the transaction was conducted at arm's length. The Division, in its brief, incorrectly describes the Supreme Court's distinction between an operational function and an investment function, and the import of that distinction on a unitary analysis. In ***MeadWestvaco Corp. v Illinois Dept. of Revenue***, the Court explained the distinction:

> "[O]ur references to 'operational function' in ***Container Corp.*** . . . were not intended to modify the unitary business principle by adding a new ground for apportionment. The concept of operational function simply recognizes that an asset can be part of a taxpayer's unitary business even if what we may term a

> ‘unitary relationship’ does not exist between the ‘payor and the payee’” (***MeadWestvaco Corp. v Illinois Dept. of Revenue***, 553 US 16, 29 [2008] citing ***Allied-Signal, Inc. v Director, Div. of Taxation***, 504 US 768, 791– 792 [1992]).

For example, a taxpayer may not be unitary with an unrelated third-party banker, “but the taxpayer’s deposits (which represented working capital and thus operational assets) were clearly unitary with the taxpayer’s business” (***MeadWestvaco Corp. v Illinois Dept. of Revenue***, 553 US at 29). The “relevant unitary business inquiry” therefore, is “one which focuses on the objective characteristics of the asset’s use and its relation to the taxpayer and its activities within the taxing State” (***Allied-Signal, Inc. v Director, Div. of Taxation***, 504 US at 785). The fact that there was a “business purpose,” for a transaction does not necessarily change the character of a transaction or asset, because “*all* of [a corporation’s] operations, including any investment made, in some sense can be said to be ‘for the purposes related to or contributing to the [corporation’s] business’” (***id.***, at 789 quoting ***ASARCO Inc. v Idaho Tax Comm’n***., 458 US 307, 326 [1982] [emphasis in original]). The Supreme Court has been clear on this issue: “the mere fact that an intangible asset was acquired pursuant to a long-term corporate strategy of acquisitions and dispositions does not convert an otherwise passive investment into an integral operational one” (***id.***, at 788).

In ***MeadWestvaco***, the Court went on to clarify that if “the asset in question is another business, we have described the ‘hallmarks’ of a unitary relationship as a functional integration, centralized management, and economies of scale” (***MeadWestvaco Corp. v Illinois Dept. of Revenue***, 553 US at 29). Here, the issue is whether YLL KOP, a business, was in a unitary business relationship with the Lendlease U.S. Group. Given the foregoing, it is clear that YLL KOP was not in a unitary business with the Lendlease Group during the tax years ended June 30, 2008 and June 30, 2009.

N. The final requirement to permit or require the filing of combined reports in this matter is a showing of distortion. Even if the substantial intercorporate transactions test is not met, related businesses that are engaged in a unitary business can be required to file a combined return if a separate filing would distort the activities, business, income or capital of the taxpayers in New York State (***Matter of Knowledge Learning Corp.***). The unitary business and the distortion requirements for combined filing are considered interrelated factors (***Matter of SunGard Capital***, citing ***Matter of Autotote Ltd***, Tax Appeals Tribunal, April 12, 1990). The existence of the factors that support the existence of a unitary business, taken together, often give rise to or cause distortion of income. Petitioner argues that it would be distortive to include YLL KOP in its combined tax group because YLL KOP had no connection to New York State. The Division contends that excluding YLL KOP from petitioner's combined reports for the tax years ended June 30, 2008 and June 30, 2009 would result in distortion. It asserts that YLL KOP was part of a common decision-making and management system and a centralized cash management system operated by petitioner. It asserts that YLL KOP relied on the employees and officers of the other members of the group to perform its functions. It argues that even using petitioner's SIT analysis, intercorporate transactions for the tax years ended June 30, 2008 and June 30, 2009 would be 26.46% and 22.21%, respectively. It further argues that this level of integration far exceeds that found in ***Matter of SunGard Capital***, "where the Tribunal nevertheless found distortion ('the Group had few cross-selling or intercompany transactions during the period at issue'; 'less than five percent,' according to the Administrative Law Judge's determination)." The Division also claims that the investment in KOP and thereby in the KOP Mall, "specifically YLL KOP's role in that investment, also contributes to distortion." It further claims that "the circumstances of the loan demonstrate that Petitioner and YLL KOP were part of a unitary business; likewise, since the factors and analysis are similar for distortion . . . the loan also demonstrates that excluding YLL KOP from Petitioner's combined report results in distortion."

O. Upon review of the record herein, it is concluded that petitioner has established that the inclusion of YLL KOP in its combined reports for the tax years ended June 30, 2008 and June 30, 2009 would distort petitioner's true income and tax liability. Intercompany transactions are not distortive if they are entered into at arm's length and satisfy the standards of IRC (26 USC) § 482. (***Matter of Silver King Broadcasting***). As noted above, the three intercompany transactions at issue in this matter were all conducted at arm's length. The Division argues that distortion exists because YLL KOP did not have its own bank account and was part of petitioner's centralized cash management system. As petitioner points out in its reply brief, YLL KOP earned an arm's length rate of interest on all funds held by an affiliate; the cash management system was supported by journal entries evidencing a liability owed to YLL KOP from the affiliate holding YLL KOP's cash; because YLL KOP was a holding company, there were few bank transactions required of it and therefore, it did not have the need for a bank account as an operating business; and KOP had its own bank accounts. The cash management system at issue in this matter is very different from the cash management system in cases where distortion has been found (***see e.g Matter of SunGard Capital*** [where the cash management system allowed members to benefit "from a decrease in borrowing costs as a result of the availability of no-interest loans"]). The Division's assertions that YLL KOP was part of a common decision-making and management system, and that "YLL KOP relied on the employees and officers of other members of the group to perform its functions," are meritless. As noted above, all the services provided to YLL KOP by LL REI, another member of the Lendlease U.S. Group, were provided pursuant to the 2007 Advisory Agreement, an arm's length contract. The officers of YLL KOP performed “administrative” functions, such as “compliance related activities for annual meetings and other sort of activities required as a corporation.” YLL KOP’s president, Mr. Allman, regularly attended the KOP Mall owners’ meetings during the tax years ended June 30, 2007 and June 30, 2008. In addition, major decisions about YLL KOP’s business, including the decision to acquire and dispose of YLL KOP’s interest in KOP, were made by the Board of Directors of the Lend Lease Corporation Limited in Australia. The management of YLL KOP was limited to the type of oversight any parent gives to an investment in a valuable subsidiary. With regard the $87,500,000.00 intercompany loan, there was no flow of value because the intercompany loan bore an arm’s length rate of interest.

P. YLL KOP’s activities, business income, or capital are distorted by including YLL KOP in petitioner’s combined group. YLL KOP had no substantive connection to New York State whatsoever. KOP was a Pennsylvania general partnership. KOP’s sole asset, the KOP Mall, was located in Pennsylvania. The other 50% partner, Kingmak, was a Pennsylvania partnership with a business address in Pennsylvania. Kravco, which managed the day-to-day operations of the KOP Mall, was a Pennsylvania partnership with a business address in Pennsylvania. All the quarterly owners’ meetings of KOP were held in Pennsylvania. All activities conducted by YLL KOP or on YLL KOP’s behalf were also conducted outside of New York during the tax years ended June 30, 2008 and June 30, 2009. Mr. Allman, who served as an officer of YLL KOP and performed oversight functions on behalf of YLL KOP, worked in Parsippany, New Jersey, during the audit years. The other officers of YLL KOP were located in Georgia, California, North Carolina, and New Jersey. In addition, the employees who performed services for YLL KOP pursuant to the 2007 Advisory Agreement were located in Georgia and Illinois. As noted above, KOP’s only substantive connections were to Pennsylvania. KOP conducted its business in Pennsylvania, the KOP Mall was located in Pennsylvania, and Kravco, the KOP Mall manager, and Kingmak, the other 50% owner had businesses addresses and conducted their operations in Pennsylvania. Therefore, YLL KOP's income that flowed through from KOP was attributable only to property owned in Pennsylvania and business operations conducted only in Pennsylvania.

Q. There was no centralized management between YLL KOP and the other members of the Lendlease U.S. Group. To determine whether centralized management exists, the Supreme Court examines whether businesses operated as distinct business enterprises "at the level of fulltime management" (***F.W. Woolworth Co. v Taxation & Revenue Dept. of N.M.***, 458 US 354, 364-372 [1982]). The occasional oversight that a parent gives to any investment in a subsidiary does not support a finding of a unitary business (***id.*** at 369). In ***Woolworth***, the Court found no centralized management to exist despite the fact that the parent company shared directors with some of the subsidiaries in question, as well as "'frequent' mail, telephone, and teletype communication between the upper echelons of management of the parent and the subsidiaries" (***id.*** at 368-369). In addition, "major financial decisions," such as the amount of dividends to be paid and the creation of substantial debt had to be approved by the parent (***id.***, at 369). Despite this evidence of "some managerial links," the Court nonetheless held that there was no centralized management because "each subsidiary possessed autonomy to determine its own policies respecting its primary [business] activity" (***id.*** at 368). As in ***Woolworth***, the Lendlease U.S. Group's management of its investment in YLL KOP reflected only high-level stewardship over a holding company and did not reflect a strong centralized management structure. Mr. Allman's testimony established that the functions of YLL KOP's officers "were administrative," and limited to "compliance related activities for annual meetings and other sort of activities required as a corporation." The decisions to acquire and sell the interest in KOP were made by the Board of Directors of Lend Lease Corporation Limited in Australia, which was not a member of the Lendlease U.S. Group. These are similar to the "major financial decisions" referenced in ***Woolworth*** that the Court concluded that did not rise to the level of "centralized management" in a unitary business (***id.*** at 369).

There was no functional integration between YLL KOP and the other members of the Lendlease U.S. Group. Functional integration is demonstrated by a flow of value, including "some sharing or exchange of value not capable of precise identification or measurement – beyond the mere flow of funds arising out of a passive investment or a distinct business operation" (***Container Corp. of America v Franchise Tax Bd.***, 463 US at 166). The Supreme Court has found functional integration to exist in closely integrated companies, such as where the business segments engaged in a "highly integrated business" of locating, processing, and marketing petroleum, as was the case in ***Exxon Corp. v Department of Revenue of Wisc.*** (447 US at 224). Conversely, in ***Woolworth***, the Supreme Court found that there was no functional integration in a retail business because the foreign subsidiaries at issue were responsible for their own store site selection, advertising, and accounting, and there was no centralized purchasing or manufacturing (***F.W. Woolworth Co. v Taxation & Revenue Dept. of N.M.***, 458 US at 370). The Court reached this conclusion even though the companies at issue were all engaged in retail business operations (***id.***). The Court has also found functional integration to exist where there was a flow of capital from a parent to a subsidiary and there was no evidence that the transactions were entered into at arm's length (***see Container Corp. Corp. of America v Franchise Tax Bd.***, 463 US at 179). YLL KOP and the rest of the Lendlease U.S. Group were engaged in completely different lines of business, and the Lendlease U.S. Group had made a deliberate decision to exit the investment management business several years before the tax years ended June 30, 2008 and June 30, 2009. YLL KOP and the rest of the Lendlease U.S. Group were not closely integrated in operations, and YLL KOP did not participate in the intercompany services provided by the other members of the Lendlease U.S. Group such as legal and insurance services. In addition, the transactions entered into between YLL KOP and the other members of the Lendlease U.S. Group were entered into at arm's length. There was no flow of value between YLL KOP and the other members of the Lendlease U.S. Group. As such, there were two distinct business operations that lacked any type of close integration.

There were no economies of scale between YLL KOP and the other members of the Lendlease U.S. Group. Economies of scale are present when companies achieve lower costs by spreading fixed costs over larger volume. For example, the Supreme Court has found that a central purchasing office demonstrated economies of scale where its "obvious purpose was to increase overall corporate profits through bulk purchases and efficient allocation of supplies among retailers (***Exxon Corp. v Department of Revenue of Wisc.***, 447 US at 244). YLL KOP and the other members of the Lendlease U.S. Group did not benefit from economies of scale. YLL KOP did not participate in any centralized purchasing function, and there were no other indicia of creating cost efficiencies as a result of the combination of the two businesses.

R. Based upon the foregoing, there were not any substantial intercorporate transactions between petitioner and YLL KOP; petitioner and YLL KOP were not engaged in a unitary business during the tax years ended June 30, 2008, and June 30, 2009; and the inclusion of YLL KOP in petitioner's combined reports for the tax years ended June 30, 2008, and June 30, 2009, would result in distortion. Accordingly, petitioner correctly excluded YLL KOP from the combined reports that it filed for the tax years ended June 30, 2008, and June 30, 2009, and the

Division's determination to include YLL KOP in petitioner's combined returns for such years was improper. The Division is directed to cancel the additional tax determined due for the tax years ended June 30, 2008 and June 30, 2009.

S. The Division imposed penalties for substantial understatement of tax in the amount of ten percent of the underpayment attributable to such understatement pursuant to Tax Law § 1085 (k) for the tax years ended June 30, 2008, and June 30, 2009. The Division imposed those penalties because of petitioner's purportedly improper exclusion of YLL KOP from the combined reports that it filed for the tax years ended June 30, 2008, and June 30, 2009. Since the combination issue has been resolved in petitioner's favor, the Division is directed to cancel the penalties assessed for the tax years ended June 30, 2008, and June 30, 2009.

T. As a result of its audit, the Division determined that petitioner was required under Tax Law former § 211 to file combined reports with YLL KOP for the tax years ended June 30, 2007 through June 30, 2009, and assessed additional tax due for those tax years. The Division imposed penalties for substantial understatement of tax in the amount of ten percent of the underpayment attributable to such understatement pursuant to Tax Law § 1085 (k) for the tax years ended June 30, 2008, and June 30, 2009. Although the issue of the imposition of penalties is rendered moot by the conclusion that petitioner was not required to include YLL KOP in its combined returns for the tax years ended June 30, 2008, and June 30, 2009, it will nevertheless be addressed for the sake of a complete record (***Matter of Riehm v Tax Appeals Trib.***, 179 AD2d 970 [3d Dept 1992], ***lv denied*** 79 NY2d 759 [1992], ***reargument denied*** 80 NY2d 893 [1992]). Petitioner argues that if it is held liable for the additional tax asserted to be due for the tax years ended June 30, 2008, and June 30, 2009, then the penalty for substantial understatement of tax should be abated. Petitioner asserts that there was more than substantial authority for excluding YLL KOP from petitioner's combined returns for the tax years ended June 30, 2008, and June 30, 2009. Petitioner contends that its tax position "was supported by a reasonable and good faith reading of New York statutes, regulations, case law, as well as case law from the United States Supreme Court regarding the unitary business principle."

The Division points out that the technical services memorandum advises taxpayers to "determine whether a combined report is required and, if so, which corporations are in the combined group" (TSB-M-08[2]C). The Division notes that there is no evidence in the record that petitioner used the 10-step analysis provided for in that technical services memorandum to determine which corporations were required to be included in its combined reports.

U. The penalty imposed in the instant matter must be sustained. Tax Law § 1085 (k) provides:

> "Substantial understatement of liability. . . 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. For purposes of this subsection, there is substantial understatement of tax for any taxable year if the amount of the understatement for the taxable year exceeds the greater of ten percent of the tax required to be shown on the return for the taxable year or five thousand dollars. For purposes of the preceding sentence, the term 'understatement means the excess of the amount of tax required to be shown on the return for the taxable year, over the amount of the tax imposed which is shown on the return reduced by any rebate (within the meaning of subsection (h) of section one thousand eighty-one). The amount of such understatement shall be reduced by that portion of the understatement which is attributable to the tax treatment of any item by the taxpayer if there is or was substantial authority for such treatment, or any item with respect to which the relevant facts affecting the item's tax treatment are adequately disclosed in the return or in a statement attached to the return. The tax commission may waive all or any part of the addition to tax provided by this section on a showing by the taxpayer that there was reasonable cause for the understatement (or part thereof) and that the taxpayer acted in good faith."

The Division of Taxation does not have the burden of providing a rationale to prove that penalties should be imposed (***Matter of Philip Morris, Inc.***, Tax Appeals Tribunal, April 29, 1993). Rather than leaving it to the Commissioner's discretion, the law provides that penalties are to be imposed under specified circumstances and it shall be the burden of the taxpayer to demonstrate that reasonable cause exists for the abatement of penalties.

It has been held that the most important factor in determining whether reasonable cause and good faith exist is the extent of the taxpayer's efforts to ascertain its proper tax liability (***see*** 20 NYCRR 2392.1 [g] [2]; ***see also Matter of Interaudi Bank***, Tax Appeals Tribunal, April 14, 2011). While petitioner claims that its interpretation was reasonable, it stops short of stating it relied on professional advice, saying only that its tax position was supported by a reasonable and good faith reading of New York statutes, regulations, case law, as well as case law from the United States Supreme Court regarding the unitary business principle.

Indeed, as the Division noted, there is no evidence that petitioner used the 10-step analysis provided for in the technical services memorandum to determine which corporations were required to be included in its combined report. Petitioner mentions no professional advice, informal advice from the Division or the request for a Division advisory opinion. In light of these failures, it cannot be said that petitioner made a good faith effort (***Matter of Interaudi Bank***).

V. The petition of Lendlease Americas Holdings, Inc. & Subsidiaries is granted in accordance with conclusions of law R and S, but in all other respects is hereby denied; the notice of deficiency, dated November 4, 2016, as modified in accordance with conclusions of law R and S, is hereby sustained.

DATED: Albany, New York
July 27, 2023

/s/ Winifred M. Maloney
ADMINISTRATIVE LAW JUDGE