STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
INTERNATIONAL ORE & FERTILIZER CORPORATION	:	DECISION
for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Years 1974 through 1976.	:	

Petitioner, International Ore & Fertilizer Corporation, 1230 Avenue of the Americas, New York, New York 10020, filed an exception to the determination of the Administrative Law Judge issued on June 29, 1989 with respect to its petition for redetermination of a deficiency or for refund of corporation franchise tax under Article 9-A of the Tax Law for the years 1974 through 1976 (File No. 800249). Petitioner appeared by James R. Ron, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Anne W. Murphy, Esq., of counsel).

Only petitioner filed a brief on exception. Petitioner requested oral argument and later withdrew its request.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUE

Whether Interore Disc Saver, Inc., formerly Interore Corporation, Inc., a wholly-owned domestic international sales corporation of International Ore & Fertilizer Corporation, was a tax-exempt or taxable DISC within the meaning and intent of Tax Law § 208.9(i) for 1975.

FINDINGS OF FACT

We find the facts as stated in the Administrative Law Judge's determination and such facts are restated below.

Petitioner, International Ore & Fertilizer Corporation ("IOFC"), is a Delaware corporation incorporated on November 12, 1963 and principally engaged in business as a dealer in chemicals and fertilizer. During the audit period, the calendar years 1974, 1975 and 1976, IOFC engaged in business in the State of New York.

On February 26, 1974, IOFC incorporated a domestic international sales corporation ("DISC"), Interore Corporation, Inc. (hereinafter "ICI-DISC"), for the purpose of exporting goods produced in the United States. In 1976,ICI-DISC changed its name to Interore Disc Saver, Inc. ICI-DISC filed New York corporation franchise tax reports on a fiscal year basis ending January 31. For the period February 26, 1974 through December 31, 1976, IOFC was a 100 percent shareholder of ICI-DISC, which was a DISC within the meaning and intent of sections 992 through 997 of the Internal Revenue Code of 1954. ICI-DISC filed New York corporation franchise tax reports computing its franchise tax due on the basis that it was a taxable domestic international sales corporation, within the meaning and intent of Tax Law §§ 209.6 and 211.1.

The Division of Taxation conducted a field audit of the books and records of IOFC which resulted in the issuance of three statements of audit adjustment on November 30, 1981 for the following periods and in the following amounts:

Period Ended	Tax Deficiency	Interest	Total
12/31/74	$ 429.00	$ 256.00	$ 685.00
12/31/75	320,035.00	176,496.00	496,531.00[1]
12/31/76	23,770.00	10,130.00	33,900.00

On the same date, the Division issued to IOFC three notices of deficiency setting forth identical periods, tax deficiencies, interest and totals due as set forth on the statements of audit adjustment.

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[1] This amount was reduced by a credit given after consideration of the New York State Corporation Franchise Tax Report filed on behalf of Interore Corporation, Inc. (DISC) for the period ended January 31, 1975 in the sum of $352.53. The actual balance due as stated on the Statement of Audit Adjustment for the period ended December 31, 1975 was $496,178.47.

After a conference, held on April 25, 1984, an adjustment was made in the tax deficiency for the year 1975. A DISC export credit was allowed in the sum of $200,631.00 for the year 1975 thereby reducing the amount in issue for the entire audit period to $143,603.00 plus applicable interest.

Following the incorporation of ICI-DISC on February 26, 1974, IOFC and ICI-DISC entered into an assignment agreement on March 1, 1974 whereby IOFC assigned to ICI-DISC all its right, title and interest in and to certain sales agreements in effect as of March 1, 1974 for fertilizer, petrochemicals, and other industrial products. The agreements provided for the sale of the products by IOFC to the purchasers named in the contracts for delivery outside of the United States. Additionally, the assignment agreement provided that ICI-DISC would discharge all of the obligations of IOFC with respect to each of the contracts assigned. The assignment agreement did not undertake to assign any purchase contracts.

Numerous invoices for products sold pursuant to the assigned contracts were submitted into evidence. These invoices were issued by IOFC not ICI-DISC. Although some bookkeeping changes allegedly were made by IOFC to indicate the correct vendor, it appears that many invoices continued to be billed by IOFC.

The auditor noted that in 1975, IOFC's records indicated that billings from suppliers for export shipments to Vietnam were never changed from IOFC to ICI-DISC, leaving unexplained how the product was transferred to ICI-DISC and in turn to the foreign customers. He further noted that these sales alone accounted for approximately 9% of total shipments by ICI-DISC.

The books and records of IOFC for the fiscal years in issue indicated that commissions were paid to ICI-DISC. Additionally, Schedule M-1 of the Federal Domestic International Sales Corporation Return for the fiscal year ended January 31, 1975, indicated that ICI-DISC received $423,059.00 in commissions which was included in taxable income not recorded on its books and that $726,484.00 in commissions was included in income which was on the books for the year ended January 31, 1975 but not included in the return. Additionally, Schedule B of the same return indicates that ICI-DISC received $14,516,276.00 in commissions on gross receipts

from commission sales totaling $60,054,309.00, while total receipts for the fiscal year ended January 31, 1975 were $62,418,019.00.

For the fiscal year ended January 31, 1976, ICI-DISC indicated in the balance sheet, Schedule L, attached to its New York State Corporation Franchise Tax Report, commissions receivable of $3,812,709.00. In Schedule B of the Federal return for the same period, entitled "Gross Income", ICI-DISC reported commissions of $4,115,492.00 on commission sales of $15,171,928.00. Total gross receipts for the fiscal year ended January 31, 1976 were $19,183,752.00.

For both fiscal years the parent corporation, IOFC, was listed in an addendum to the returns as a member of the controlled group of related United States entities. However, it is noteworthy that petitioner's brief concedes that IOFC was the purchasing agent for ICI-DISC.

For the fiscal years ended January 31, 1975 and 1976, ICI-DISC filed a Schedule P, Computation of Inter-company Transfer Price or Commission with its Federal tax returns. On said schedule, ICI-DISC stated its cost of goods sold attributable to property sold, its related supplier's expenses attributable to transactions yielding gross receipts and its expenses, and determined its taxable income based on the combined taxable income method. From this figure the DISC's commission was derived. However, petitioner never disclosed who the related supplier was or how ICI-DISC received export properties sold pursuant to the sales contracts assigned to it by IOFC.

Although several issues were raised on field audit, the only issue remaining in dispute is whether or not ICI-DISC was a taxable or tax-exempt DISC.

OPINION

In the determination below, the Administrative Law Judge found that petitioner failed to prove that its subsidiary and domestic international sales corporation, ICI-DISC, purchased less than 5% of its inventory from petitioner. Thus, the Administrative Law Judge concluded ICI-DISC was required to file on a consolidated basis with petitioner. The Administrative Law Judge also concluded that whether IOFC's assignment of sales contracts to its ICI-DISC was a

capital contribution to the subsidiary was irrelevant to the issue of whether ICI-DISC purchased the inventory to be sold pursuant to such contracts from petitioner.

On exception, and throughout the audit process, petitioner has maintained that the assignment of its international export sales contracts to ICI-DISC did not constitute a sale and therefore, ICI-DISC did not "purchase" more than 5% of its inventory for export from petitioner, as its parent corporation. Petitioner also asserts that it established that ICI-DISC's related suppliers included corporations other than petitioner. Thus, petitioner asserts ICI-DISC should file on a separate basis.

Domestic International Sales Corporations (DISCs) were created in 1971 when the federal government enacted tax incentive legislation designed to encourage domestic corporations to increase the export of their American products. The legislation provides for special tax treatment for DISCs, corporate subsidiaries of American corporations substantially all of whose assets and gross receipts are export related (see, Westinghouse Electric Corp. v. Tully, 466 US 388; 104 S Ct 1856). In 1972, by Chapter 778 of the Laws of 1972, New York State adopted the federal definition of a "DISC" (Tax Law § 208[1]) but created its own franchise tax treatment of DISCs (Tax Law § 208[9][i]). DISCs, under New York State Tax Law, are characterized as tax-exempt and taxable. Any DISC which "(1) received more than five percent of its gross sales from the sale of inventory or other property which it purchased from its stockholders" is a tax exempt subsidiary DISC (Tax Law § 208[i][A]). As owner of a tax exempt DISC, a stockholder must "adjust each item of its receipts, expenses, assets and liabilities, . . . by adding thereto its attributable share of each of its DISC's receipts, expenses, assets, and liabilities as reportable by each such DISC to the United States Treasury Department" (Tax Law § 208[9][i][B]). Therefore, a tax exempt DISC is taxed in consoldation with its stockholder.[2]

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[2]Without legislation, DISC income would not be taxed directly in New York because the starting point for state taxable income is "Federal taxable income", which does not exist for DISCs by definition. In addition, due to special pricing rules in the federal legislation, parent corporations could sell goods to their DISCs at substantially below market price, thereby lowering their own taxable income. To offset this loss of revenue, New York enacted the system whereby the parent corporation is taxed on the DISC income after a threshold showing that more than 5% of the DISC's gross sales comes from goods bought from the parent corporation. An export tax credit was also

The burden of proving that a corporate franchise tax assessment is improper rests on the petitioner (Bamberger Polymers, Inc. v. Chu, 111 AD2d 589, 489 NYS2d 654, 655-656; Tax Law § 1089[e]). It was therefore incumbent on the petitioner to prove that ICI-DISC did not "purchase" the fertilizer it obtained from petitioner before selling it to overseas customers or alternatively that ICI-DISC purchased the fertilizer it sold from other than petitioner.

Petitioner argues that the March, 1974 transfer of its sales contracts to its wholly-owned subsidiary, ICI-DISC, was not a "purchase" within the meaning of New York Tax Law § 208.9(i). Because the assignment was not a purchase, petitioner argues, the "more than 5%" purchase requirement of § 208.9(i) was not met thus relieving petitioner of having to file on a consolidated basis with ICI-DISC. Petitioner argues that the transfer of the sales contracts was an agency assignment lacking consideration.[3] We find the agreement and petitioner's characterization of the agreement irrelevant. The March 1974 agreement assigned the rights and obligations under IOFC's customer sales contracts to ICI-DISC. It did not, however, assign to ICI-DISC the actual "inventory or other property" from which ICI-DISC received more than 5% of its gross export sales in 1975 (see, Tax Law § 208.9[i]). The "purchase" between IOFC and ICI-DISC would have occurred when the goods themselves were transferred and when ICI-DISC paid compensation to petitioner for those goods.

We agree with the Administrative Law Judge that there is evidence that ICI-DISC purchased more than 5% of the fertilizer it exported from IOFC and that petitioner failed to disprove this fact. Most importantly, the auditor found that at least 9% of ICI-DISC's gross export sales for the fiscal year ending January 31, 1975 were to Vietnam. Bills for the fertilizer sold to Vietnam were all billed from IOFC, leaving unexplained how the products were transferred to ICI-DISC and then to its customer in Vietnam. Petitioner did not prove that it did not supply the fertilizer which ICI-DISC sold to Vietnam, nor did it prove ICI-DISC received fertilizer from IOFC

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created to offset the taxation of DISC income in an attempt to encourage DISC activity in New York (see, Budget Report on Bills A. 12108-A and S. 10544, L 1972, ch. 778).

[3]While the contract may be an agency assignment, we do not agree that it lacked consideration. The agreement recites as consideration the assignee's assumption of all obligations under the assigned contracts (Exhibit I).

without consideration. For these reasons, we agree with the Administrative Law Judge's finding that ICI-DISC "purchased" more than 5% of the fertilizer it exported from IOFC.

Petitioner also argues that Bamberger Polymers, Inc. v. Chu (supra), relied on by the Administrative Law Judge, does not apply. In Bamberger Polymers the parent and its subsidiary DISC had an agreement whereby the parent corporation would purchase the products both corporations sold. The subsequent transfer of the product from the parent corporation to the DISC was held to be a "purchase" within the meaning of the Tax Law. Petitioner seeks to distinguish Bamberger because it did not involve an assignment agreement as here. Since we find the assignment agreement irrelevant because it does not account for the transfer of the inventory from petitioner to ICI-DISC, it follows that the assignment agreement does not meaningfully distinguish this case from Bamberger.

Finally, petitioner asserts that it proved that the related supplier indicated on Schedule P of ICI-DISC's federal return was, in fact, two related suppliers, IOFC and another corporation. Further, petitioner asserts that it proved that of the total amount reported on Schedule P as related supplier's expenses, less than 5% was attributable to petitioner.

First, we note that the evidence petitioner points to in order to establish these assertions is not in the record before us. Petitioner attempted to insert this evidence into the record on exception. As we have consistently held, we cannot consider evidence submitted at this point in the proceeding (Matter of Modern Refractories Service Corporation, Tax Appeals Tribunal, December 15, 1988; Matter of Ronnie's Suburban Inn, Inc., Tax Appeals Tribunal, May 11, 1989). In any event, even if it were established that petitioner was one of two related suppliers to ICI-DISC and that less than 5% of the total of the related suppliers' expenses were those of petitioner, these facts alone would not establish that less than 5% of ICI-DISC's gross sales was from the sale of inventory purchased from petitioner.

Accordingly, it is ORDERED, ADJUDGED, and DECREED that:

1. The exception of petitioner, International Ore and Fertilizer Corporation, is in all respects denied;

2. The determination of the Administrative Law Judge is affirmed;

3. The petition of International Ore and Fertilizer Corporation is denied; and

4. The three notices of deficiency dated November 30, 1981 are sustained as modified in accordance with finding of fact "4" of the Administrative Law Judge's determination.

DATED: Troy, New York
March 1, 1990

/s/John P. Dugan
John P. Dugan
President

/s/Francis R. Koenig
Francis R. Koenig
Commissioner

/s/Maria T. Jones
Maria T. Jones
Commissioner