STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
FORD MOTOR CREDIT COMPANY	:	
for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Years 1976, 1977 and 1978.	:	
	:	DECISION
In the Matter of the Petition	:	
of	:	
FORD LEASING DEVELOPMENT COMPANY	:	
for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Years 1976, 1977 and 1978.	:	
	:	

Petitioner Ford Motor Credit Company, The American Road, Dearborn, Michigan 48121, filed an exception to the determination of the Administrative Law Judge issued on October 20, 1988 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 1976, 1977 and 1978 (File No. 802173).

Petitioner Ford Leasing Development Company, 300 Renaissance Center, P.O. Box 43317, Detroit, Michigan 48243, filed an exception to the determination of the Administrative Law Judge issued on October 20, 1988 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 1976, 1977 and 1978 (File No. 802172).

Petitioners appeared by DeGraff, Foy, Conway, Holt-Harris and Mealey (James H. Tully, Jr., Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Thomas C. Sacca, Esq., of counsel).

Both petitioners and the Division filed briefs and reply briefs on exception. Oral argument was heard on May 23, 1989 at the request of petitioners.

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

ISSUE

Whether the liabilities represented by certain promissory notes which by their terms were payable on demand or within one year, were discharged within one year or renewed.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge and such facts are stated below.

Petitioner Ford Motor Credit Company is the captive finance company of Ford Motor Company. Its predominant business is the financing of retail purchases of automotive vehicles from Ford Motor Company. During the audit years, petitioner Ford Leasing Development Company provided wholesale financing of lease cars to Ford dealerships. In order to raise capital to operate their businesses, petitioners entered into short-term borrowing agreements with the trust departments of various banks, such as Morgan Guaranty Trust Company and Manufacturers Hanover Trust Company. These agreements were executed by the banks, acting as fiduciaries for the estates, trusts and pension funds they managed. Once entered into, a short-term borrowing agreement remained in effect until terminated by one of the parties. A typical agreement included the following provisions:

(a) At any time and from time to time, the lender could offer to lend funds to the borrower (either Ford Credit or Ford Leasing) who was free to borrow all or a portion of the funds offered. Loans were to be made in multiples of $1,000.00.

(b) Each outstanding loan was to bear interest at a rate which was the equivalent of the rate adopted by the borrower as the discount rate for its 180-day commercial paper.

(c) All loans made during the months of January through June of each year were to be repaid in full on the next succeeding July 1, and all loans made during the months of July through December were to be repaid in full on the next succeeding January 1. At any time, the lender had the right to demand payment of all or a part of the principal amount of the loans outstanding. At any time, the borrower had the right to repay all or a part of the principal amount of the loans outstanding.

(d) Upon the making of the initial loan, the borrower was to issue and deliver to the lender its promissory note in the amount of the initial loan. Each time an additional loan was made or repaid, an appropriate entry was to be made on the note under the column "principal amount outstanding". Upon the lender's request, the borrower would issue and deliver to the lender a new promissory note in exchange for the note then held by the lender. The new note was to be in an amount equal to the then outstanding principal amount of the note being surrendered by the lender. Each note was to be dated as of its issue and was to mature on the earlier of July 1 or January 1 next following the date of issuance.

In practice, petitioners would issue and deliver a new promissory note to a lender every six months. When the new note was exchanged for the note being surrendered, the lender stamped the surrendered note "cancelled" or "paid". The new note was executed in an amount equal to the outstanding principal amount of the note being surrendered.

In the management of the trust accounts for which they acted as fiduciaries, the bank trust departments used the short-term borrowing agreements as a short-term haven for cash. As a result, a single trust account might move cash in and out of a short-term borrowing agreement several times during the six-month term of a promissory note. The total amount available for borrowing under the terms of a short-term borrowing agreement was determined by the aggregate amounts invested by the trust accounts. A single trust account's participation in a short-term

borrowing agreement might fluctuate considerably in a six-month period. Petitioners' liabilities under the terms of the agreement would also fluctuate in that period, but to a lesser extent.

As evidence of the intentions of the parties regarding the significance of the replacement of an old promissory note with a new one, petitioners submitted a letter from a vice-president of Manufacturers Hanover Trust Company. It states:

> "To the extent that the old, extinguished note may be replaced by a new master note, such replacement constitutes payment of the old note as far as the holders of interests in the old note are concerned."

In calculating their business capital for purposes of the New York State corporation franchise tax, petitioners excluded liabilities incurred under the terms of the short-term borrowing agreements. On audit, the auditors concluded that liabilities outstanding for more than a year should have been included in each petitioner's business capital tax base. Adjustments were made accordingly, and as a result, the Division of Taxation issued the following notices of deficiency:

(a) On April 9, 1985, three notices were issued to Ford Leasing, asserting tax deficiencies of $22,409.00 for 1976, $19,643.00 for 1977 and $15,657.00 for 1978.

(b) On April 10, 1985, three notices were issued to Ford Credit, asserting tax deficiencies of $18,423.00 for 1976, $66,608.00 for 1977 and $53,217.00 for 1978.

Petitioners paid the asserted tax plus interest and timely filed claims for refund or credit of the amounts paid.[1] The basis of their refund claims was their contention that the liabilities resulting from the short-term borrowing agreements were deductible from their business capital tax bases because: (1) the loans made pursuant to the short-term borrowing agreements were payable by their terms on demand or within one year from the date the liability was incurred; and (2) the liabilities incurred under the terms of the agreement were in fact paid within one year from the date they were incurred.

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[1]Tax and interest due were actually paid before the notices of deficiency were issued. The notices show credit given for taxes paid and no balances due.

On March 6, 1985, the Division denied petitioners' claims for refund on the ground that the promissory notes evidencing the loans were renewed every six months so as to be outstanding for more than one year.

OPINION

In the determination below the Administrative Law Judge decided that the promissory notes executed by petitioners were renewed so as to be outstanding for more than one year. Specifically, it was concluded that petitioners did not offer sufficient evidence to overcome a presumption that the new notes constituted renewals or extensions of the older notes. As a result, the liabilities incurred by petitioners under the terms of the short-term borrowing agreements at issue were properly included in petitioners' business capital in the computation of the petitioners' franchise tax liability.

On exception, petitioners contend that the notes at issue should not be included in "business capital" for franchise tax computations. In particular, petitioners argue that the notes at issue were loans from individual trusts for which the bank acted only in a fiduciary capacity. Further, petitioners assert that the notes were not renewed, but were discharged within one year from the date incurred, as evidenced by the fact that new notes were issued in the amount of the outstanding liability and the old notes were then marked "cancelled" or "paid."

In response, the Division claims that the notes should be included in petitioners' business capital as they were renewed so as to be outstanding for more than one year. Specifically, the Division argues that the mere fact that the notes were marked "paid" or "cancelled" does not independently establish that the notes were not renewed. Rather, the Division contends that the terms and conditions under which the notes were executed support the presumption that the notes were renewed.

We affirm the determination of the Administrative Law Judge.

Tax Law § 209.1 imposes a franchise tax on every corporation doing business in New York State. Every corporation subject to the tax is required to pay a tax calculated by whichever of four alternative methods results in the greatest tax (Tax Law § 210.1). The method used by

petitioners for measuring the tax is based on the total of business capital and investment capital allocated to New York State (Tax Law § 210.1[a][2]). The term "business capital" means the total average fair market value of those assets of a corporation that are neither subsidiary capital nor investment capital, "less liabilities not deducted from subsidiary capital or investment capital which are payable by their terms on demand or within one year from the date incurred" (Tax Law § 208.7; 20 NYCRR 3-4.3[a]).

Among the liabilities listed in 20 NYCRR 3-4.3(a) as deductible are "notes and other written obligations . . . payable by their terms on demand or within one year from the date incurred." (Emphasis added.) While such notes may qualify as deductible liabilities, those notes which appear to be of a duration not more than a year by their terms may not be deducted from business capital if they are renewed so as to be outstanding for more than one year (20 NYCRR 3-4.3[b][1]).

The facts indicate that the notes at issue were exchanged for new notes pursuant to a standard agreement entered into by petitioners which required that, "Upon Lender's request, FMCC shall issue and deliver to Lender, in exchange for the promissory note then held by Lender, a new promissory note, in the form attached hereto as Exhibit A, in a principal amount equal to the then outstanding principal amount of the note being surrendered by Lender in exchange." The issue here is whether the new note represents a new debt separate from that evidenced by the old note or whether it works to renew the liability of the old debt. Stated alternatively, was the petitioners' liability satisfied by issuing the new notes or merely extended.

The general rule is that a new note issued for the same amount as a prior note does not extinguish the original debt nor change the debt other than to postpone the time of payment (Cohen v. Rossmore, 225 AD 300, 233 NYS 196; 10 C.J.S. Bills and Notes § 444). Further, there is a presumption that the new note serves as a renewal rather than as a discharge of the debt evidenced by the first note (Cohen v. Rossmore, supra citing Garfield National Bank of City of New York v. Wallach, 223 AD 303, 228 NYS 184; Dibble v. Richardson, 171 NY 131; Jagger Iron Co. v. Walker, 76 NY 521; Bates v. Rosekrans, 37 NY 409; see also, 10 C.J.S. Bills and

Notes § 444). Case law indicates that the presumption of renewal is even more difficult to overcome when the debt evidenced by the initial note has some underlying security attached to it (Cohen v. Rossmore, supra; Bank of New York v. Cerasaro, 98 AD2d 902, 470 NYS2d 894; Skaneateles Savings Bank v. Herold, 50 AD2d 85, 376 NYS2d 286). While no security interest is present in the case at hand, petitioner still bears the burden of overcoming the presumption that the notes were renewal notes (see, Garfield National Bank of City of New York v. Wallach, supra). In reaching a decision on this issue we look to the facts and circumstances surrounding the transaction in order to determine the intent of the parties when they entered into the subject agreement (see, Resource Holding Corporation v. Goldstein, 216 NYS 753, 754; 10 C.J.S. Bills and Notes § 444).

A review of the facts compels the conclusion that the liabilities at issue extended beyond one year. The agreement between the lender and petitioners requires petitioners to issue promissory notes to the lender periodically "in exchange for the promissory note then held by Lender . . . in a principal amount equal to the then outstanding principal amount of the note being surrendered by Lender in exchange." Two specific portions of this part of the agreement indicate that the debt was renewed. First, the agreement states that the first note is to be exchanged for the subsequent note. This language contradicts petitioners' claim that the subsequent note was issued as evidence of an independent and separate liability from that represented by the first note. The requirement of such an exchange illustrates the parties' intent at the time the debt was created to allow for its continuation by the subsequent note. The subsequent note only comes into existence as a result of the liability represented by the first note being carried over in the exchange of notes.

The second aspect of the agreement which indicates a renewal is the requirement that the new note be issued "in a principal amount equal to the then outstanding principal amount of the note being surrendered". This requirement, taken in conjunction with the language requiring an exchange, clearly indicates that the substance of the transaction was a rollover of the debt evidenced by the initial note into the subsequent note. This rollover of the exact amount of debt

remaining illustrates the interest that the lending party has in maintaining the existence of the debt that was undertaken in the first note. In substance, the exchange of the notes works merely as an extension of time for petitioners to pay off the underlying liability. As a result, we conclude that the liabilities at issue were outstanding for more than a year as they were renewed by the notes issued in exchange for the initial notes.

Petitioners' argument that the liabilities were of a duration less than a year is not persuasive. In particular, petitioners place a great deal of emphasis on the application of UCC § 3-605 to the case at hand. The relevant portion of § 3-605 provides:

> "(1) The holder of an instrument may even without consideration discharge any party
>
> (a) in any manner apparent on the face of the instrument or the indorsement, as by intentionally cancelling the instrument or the party's signature by destruction or mutilation, or by striking out the party's signature."

We agree with petitioners that the marking of the initial notes as either "cancelled" or "paid" works to discharge any claim for the debt that the lender may have by way of the initial notes. It does not follow from this conclusion, however, that the debt evidenced by the initial notes has been extinguished. On the contrary, the debt has been continued through its renewal in the subsequent notes. As was noted earlier, the initial notes are only marked "cancelled" or "paid" and returned to petitioners once they have been exchanged for subsequent notes which carry over the exact amount of liability remaining on the initial notes. Petitioners would have us believe that two separate and independent transactions have occurred while the facts clearly indicate otherwise.

Petitioners' reliance on the case of Peterson v. Crown Financial Corporation (476 F Supp 1155 [E.D. PA 1979]) in support of its argument that the mere marking of the notes alone suffices to indicate that the debts were not renewed is misplaced. In Peterson, the court concluded that the marking of an earlier note as cancelled worked to discharge such earlier note. Petitioners fail to point out, however, that the court in Peterson did not address the issue as to whether the debt had been discharged. The court's decision was limited to the conclusion that the

note which was cancelled was discharged. Having decided that this was the case, it was not necessary for the court to address whether the underlying debt itself had been discharged.

Lastly, petitioners' argument that various individual trusts and estates were parties to the notes and such trusts and estates were in and out of the subject transactions in less than a year must be dismissed for lack of proof. Petitioners have failed to provide any documentation or other evidence sufficient to prove which particular entities were parties to which specific notes. Rather, all petitioners have provided is the bare statement that various trusts and estates are parties to such notes for short periods of time in general. Without more specific proof of the individual entities' participation, we must conclude that petitioners have failed to meet their burden of overcoming the assessment at issue (Allied New York Services, Inc. v. Tully, 83 AD2d 727, 442 NYS2d 624; 20 NYCRR 3000.10[d][4]).

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exceptions of petitioner, Ford Motor Credit Company, and petitioner, Ford Leasing and Development Company, are denied;

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

3. The petitions of Ford Motor Credit Company and Ford Leasing and Development Company are denied; and

4. The Division's denial of the refund claim is sustained.

DATED: Troy, New York
October 26, 1989

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

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

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