STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petitions	:	
of	:	
SIEMENS CAPITAL CORPORATION	:	DECISION DTA Nos. 803815
for Redetermination of Deficiencies or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Fiscal Years Ended September 30, 1980 through September 30, 1986.	:	and 806706

The Division of Taxation and petitioner Siemens Capital Corporation, 1301 Avenue of the Americas, New York, New York 10019, each filed an exception to the determination of the Administrative Law Judge issued on January 20, 1994. Petitioner appeared by its vice president, Richard S. Payne. The Division of Taxation appeared by William F. Collins, Esq. (John O. Michaelson, Esq., of counsel).

Each party filed a brief in support of its exception, in opposition to the other party's exception and in reply to the other party's brief in opposition. The Division of Taxation's reply brief was received on May 31, 1994 and began the six-month period for the issuance of this decision. Oral argument was not requested.

The Tax Appeals Tribunal renders the following decision per curiam.

ISSUES

I. Whether the Division of Taxation correctly adjusted entire net income, and the receipts factor of petitioner's reported business allocation percentage, to include interest income it received on financing activities performed in New York State.

II. Whether certain promissory notes of Siecor Development Corporation were correctly characterized by the Division of Taxation as items of business capital.

III. Whether the Division of Taxation erred in not reducing the amount of petitioner's interest expense indirectly attributable to subsidiary capital after reducing the valuation of petitioner's subsidiary capital for the fiscal years ended September 30, 1985 and September 30, 1986.

IV. Whether the Administrative Law Judge erred in cancelling the deficiency for 1986 because the Division of Taxation could not produce a copy of the notice.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for findings of fact "3," "8," "14" and "16 which have been modified. We have also made additional findings of fact. The Administrative Law Judge's findings of fact, the modified findings of fact and the additional findings of fact are set forth below.

Petitioner, Siemens Capital Corporation ("Siemens U.S."), a wholly-owned subsidiary of Siemens Aktiengesellschaft ("Siemens A.G."), was a Delaware corporation engaged in the business of financing. It was set up to be a holding company for related United States affiliates of Siemens A.G.

Siemens U.S. carried out its financing activities through its Treasury Department. These activities included financing, cash management and foreign exchange. Petitioner has done business in New York State since 1969.

We modify finding of fact "3" of the Administrative Law Judge's determination to read as follows:

> During the period in issue, the fiscal years ended September 30, 1980 through September 30, 1986, one of petitioner's primary objectives was to pool and control corporate funds and to utilize them in the most efficient way.[1]

Siemens U.S. also provided support and stewardship services to the United States affiliates. It borrowed money in commercial markets by issuing commercial paper and then relending it at the same interest rate plus a small percentage to cover administrative costs. All

[1]We modified the Administrative Law Judge's finding of fact "3," at the request of petitioner, by adding the words "one of" to more accurately reflect the record.

loans made by Siemens U.S. were guaranteed by Siemens A.G., thus relieving Siemens U.S. of any credit risks and the need to confirm a borrower's creditworthiness.

Siemens U.S. "funnelled" money to subsidiaries, affiliates and entities associated with affiliates on an "as-needed" basis and upon the request of Siemens A.G. Petitioner did not operate as a separate, profit-making enterprise with respect to the loans it placed; rather, it performed a clearinghouse function, acting as a financial conduit facilitating the global operations of Siemens A.G.

Petitioner has identified five general types of financing activities: loans to first-tier subsidiaries; loans to second-tier subsidiaries; loans to foreign affiliates; loans for export financing; and miscellaneous loans. Siemens U.S. received interest income on these financing activities.

The loans listed above are more fully described as follows:

(a) Loans to First-Tier Subsidiaries. Loans to first-tier subsidiaries were not in issue and treatment of first-tier subsidiaries under New York State Tax Law was not contested by petitioner.

(b) Loans to Non-New York Second-Tier Subsidiaries. These loans were not evidenced by any official document of indebtedness. They were all accounted for through intercompany debit and credit account ledgers, with periodic reconciliations made to square accounts and calculate interest charges. The rate of interest charged corresponded with then current costs of borrowing for Siemens U.S. and no profit element was extracted from these subsidiaries. Petitioner submitted internal corporate documents which delineated the role of the Siemens' U.S. Treasury Department as a conduit for funds to the United States operating companies. (This arrangement applied to first-tier subsidiaries as well, but income from such entities is not at issue and petitioner and the Division of Taxation ["Division"] have no dispute with respect to the tax treatment of interest income from such first-tier subsidiaries.) Petitioner

does not dispute that interest income from New York-based second-tier subsidiaries is properly in the numerator of the business receipts allocation formula.

(c) Loans to Foreign Affiliates. Foreign affiliates were those foreign incorporated entities which were owned directly by the German parent or indirectly through any other Siemens entity other than Siemens U.S. Loans by Siemens U.S. to such entities were referred to as "back-to-back" or "participation" loans. Money was deposited by Siemens U.S. in a foreign bank or a foreign branch of an American bank; interest was paid to Siemens U.S. by these banks on such balances. A corresponding amount was then loaned for a short term by the foreign bank to a foreign Siemens entity which in turn paid interest to the foreign bank. The rate of interest earned by Siemens U.S. and that paid to the foreign bank was virtually identical. Petitioner contends that all such interest received by Siemens U.S. in this manner was foreign source, and was earned in furtherance of its business of being a conduit of money for the Siemens A.G. global enterprise. Occasionally, Siemens U.S. would "participate" as a lender in the loan to the foreign affiliate and then the foreign bank received interest as agent for Siemens U.S. The loans were of short duration and little or no profit was realized. All of these loans, both back-to-back and participation, were guaranteed by Siemens A.G.

(d) Loans for Export Financing. As an accommodation, Siemens U.S. loaned money to unrelated customers of Siemens' foreign or domestic affiliates to facilitate the purchase of Siemens' products. Interest on these loans was paid by foreign customers from a foreign situs. These loans were guaranteed by the German parent or the Siemens affiliate vendor, and no credit check was made of the borrower.

(e) Miscellaneous Loans. The last category of loans consisted of those made to unrelated parties in which Siemens A.G. or another Siemens affiliate had a minority stock interest, or had some other commercial relationship which conferred a privileged status on the borrower/third party. The interest rate charged was the same as that extended to Siemens-owned entities and matched the Siemens U.S. cost of borrowing. Little or no profit was realized and the

loan was guaranteed by Siemens A.G. The majority of these types of loans were to entities situated outside New York State.

Also during the audit period, Siemens U.S. extended loans to Siecor Development Corporation ("Siecor") and Threshold Technology, Inc. ("Threshold"), in which it held a 50% minority ownership interest.

We modify finding of fact "8" of the Administrative Law Judge's determination to read as follows:

> In 1980, Siemens U.S. loaned Siecor $9,500,000.00. By the terms of the agreement between the corporations, a promissory note was executed whereby Siecor agreed to repay Siemens U.S. by January 18, 1983, with 8% interest. The note was issued specifically to finance the acquisition of assets; immediate repayment was required if the targeted acquisition was not consummated; and, otherwise, no acceleration of payment of principal or interest was permitted. The original loan was subordinated to 10½% notes issued by Siecor (the "senior debt"). The note stated that it was issued pursuant to the loan agreement of even date herewith between Siecor and petitioner and was subject to the terms and conditions thereof. The note also stated that no payments of any kind could be made on it during the continuation of any default on the payments of the senior debt and that if any such payment was made the payee would hold the payment in trust for the holders of the senior debt. In 1981, the loan agreement and note were amended to extend the term to four years; the interest rate was increased to 12%; and the note was further subordinated to all loans by any United States commercial bank up to an amount of $15,000,000.00. In addition, the note's terms referred to payments of principal and interest in United States dollars and the requirement that they be made to the payee or "then holder of this note."
>
> Siecor Corporation (formerly Siecor Development Corporation) was a joint venture between Siemens U.S. and Corning Glass Works, a corporation unrelated to petitioner. Like petitioner, Corning held Siecor's note in the sum of $9,500,000.00. On October 21, 1983, petitioner and Corning each exchanged its Siecor note for 15,000 shares of Siecor preferred stock and Corning, on November 1, 1983, and Siemens, on January 1, 1985, each converted its Siecor preferred stock into Siecor common stock.[2]

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[2]We modified the Administrative Law Judge's finding of fact "8" by adding the words "(the 'senior debt')" to the fourth sentence of the first paragraph and by adding the fifth and sixth sentences to the first paragraph.

In November 1981, Siemens U.S. loaned Threshold $500,000.00 pursuant to the terms of a note and amended loan/option agreement, which called for the payment of interest at the rate of 10% per annum and a repayment date of November 9, 1983. The loan was made subordinate to "any senior debt", which was defined as the 10% subordinated convertible debenture issued by Threshold to Siemens U.S. on May 28, 1980.

These matters arose as a result of two separate audits performed by the Division. The first audit covered the years 1980 through 1983, while the second covered the years 1984 through 1986.

The first audit became the subject of Division of Tax Appeals case number 803815. The second audit was treated separately under Division of Tax Appeals case number 806706. During the pendency of the latter case, proceedings before the Bureau of Conciliation and Mediation Services were discontinued on May 26, 1989, and a request made by petitioner to join the two cases because the issues for both audit periods were assumed to be identical.[3]

For the first audit period, 1980 through 1983, the Division made several adjustments to petitioner's reported franchise tax liability. Specifically, the Division added back interest income from non-subsidiaries, interest indirectly attributable to subsidiary capital and net capital gain from the sale of non-subsidiary securities. The Division also made consequent adjustments to the business allocation percentage and the investment allocation percentage.

Pursuant to the audit, on May 9, 1986, the Division issued to petitioner a Notice of Deficiency for the fiscal year ended September 30, 1980, setting forth tax due of $475,745.00, plus interest. Credits of franchise tax of $50,204.98 and $61,193.21 for the fiscal years ended September 30, 1982 and September 30, 1983 and a credit of MTA surcharge of $11,014.11 for the fiscal year ended September 30, 1983 were applied against the Notice of Deficiency referred to above, leaving $353,332.70 additional tax due, plus interest.

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[3]Subsequently, other issues were raised by petitioner which only pertained to the second audit period.

On May 9, 1986, the Division issued two additional notices of deficiency to petitioner. The first covered the fiscal year ended September 30, 1981 and set forth additional tax due of $195,300.00, plus interest. The second covered the fiscal year ended September 30, 1983 and set forth additional tax due of $18,173.00, plus interest.

At conference, the Division conceded certain mathematical errors in computation and agreed to correct them. Further, petitioner's investment capital was adjusted to conform with the "new" Division policy set forth in TSB-M-86(6)C, which conformed the Division's policy to the Court of Appeals decision in Forbes, Inc. v. Dept. of Finance (66 NY2d 243, 496 NYS2d 394, cert denied 475 US 1109, 106 S Ct 1517). Essentially, this entailed Federal paper being included in the denominator of the investment allocation percentage and, where the investment allocation percentage is zero, interest income from Federal paper not being allocated by petitioner's business allocation percentage. In such circumstances, income from Federal paper would not be taxable. Only interest from bank accounts and New York paper could be allocated by the business allocation percentage.

Also at conference, the conferee agreed with the Division's adjustment of the receipts factor for 1980, allocating all commission and interest income to New York since all services were deemed performed at petitioner's sole office in New York. It was noted that petitioner allocated 100% of its receipts for the fiscal years ended September 30, 1981, 1982 and 1983 to New York State.

Finally, the conferee agreed with the Division's determination that the notes from Siecor Development and Threshold were business capital and the income from such notes business income.

We modify finding of fact "14" of the Administrative Law Judge's determination to read as follows:

> The second audit was a general verification of the fiscal years ended September 30, 1984, 1985 and 1986. It was noted that petitioner received interest income from its financing activities

which was allocated on the basis of the situs of the borrowing company. The Division adjusted this allocation, attributing the interest income to activities performed by petitioner in New York State, and included said income in the New York portion of the receipts factor. The wages allocated to New York were also increased on audit.

Consistent with its position in the prior audit, the Division continued to characterize the Siecor note as business rather than investment capital and adjusted investment capital accordingly. This applied to the fiscal year ended September 30, 1984 only.

Finally, the Division determined that petitioner had failed to include the average value of retained earnings in the computation of average fair market value of subsidiary capital for all years in the second audit period and an adjustment was made to decrease the value of subsidiary capital for each of these years.[4]

On November 9, 1988, the Division issued six Statements of Audit Adjustment to petitioner which set forth the following information:

Period Ended	Tax Deficiency	Interest	Additional Charge	Total
9/30/84	$ 61,439.00	$ 27,729.00	$ 6,144.00	$ 95,312.00
9/30/84 (MTBTS)[5]	10,445.00	4,714.00	1,045.00	16,204.00
9/30/85	481,218.00	140,485.00	48,122.00	669,825.00
9/30/85 (MTBTS)	81,807.00	23,882.00	8,181.00	113,870.00
9/30/86	1,089.414.00	184,472.00	108,941.00	1,382,827.00
9/30/86 (MTBTS)	185,201.00	31,360.00	18,520.00	235,081.00

Each of the statements indicated that the deficiencies were based on a recent field audit.

We modify finding of fact "16" of the Administrative Law Judge's determination to read as follows:

On November 9, 1988, the Division issued five notices of deficiency to petitioner which set forth the following:

[4]We modified the Administrative Law Judge's finding of fact "14" by adding the words "decrease" and "for each of these years" to the last paragraph.

[5]"MTBTS" refers to the temporary Metropolitan Transportation Business Tax Surcharge which was levied pursuant to Tax Law § 209-B for the years in issue.

Period Ended	Tax	Interest	Additional Charge	Total
9/30/84	$ 61,439.00	$ 27,729.00	$ 6,144.00	$ 95,312.00
9/30/84 (MTBTS)	10,445.00	4,714.00	1,045.00	16,204.00
9/30/85	481,218.00	140,485.00	48,122.00	669,825.00
9/30/85 (MTBTS)	81,807.00	23,882.00	8,181.00	113,870.00
9/30/86 (MTBTS)	185,201.00	31,360.00	18,520.00	235,081.00

Although a sixth Notice of Deficiency was allegedly issued for the period ended September 30, 1986 setting forth a base tax due of $1,089,414.00, it was not submitted into evidence with the other jurisdictional documents. The Division's brief at page 2 stated that the Division was "unable" to provide the sixth Notice of Deficiency for the period ended September 30, 1986 and conceded a lack of jurisdiction. Both parties were made aware of this fact by letter from the Administrative Law Judge dated October 14, 1993.

In accordance with the decision in the case of Matter of Scharff (Tax Appeals Tribunal, October 4, 1990, annulled on other grounds sub nom New York State Dept. of Taxation & Fin. v. Tax Appeals Tribunal, 151 Misc 2d 326, 573 NYS2d 140), the parties were given until December 15, 1993 to address this jurisdictional issue.

In response to the request, the Division was still unable to produce a copy of the Notice of Deficiency. The Division produced the undated affidavit of John Skorenski, supervisor of the control unit of the Bureau of Conciliation and Mediation Services, which described the Bureau's procedures upon receiving a request for conciliation conference and stated that, with regard to the instant matter (years 1984 through 1986), a request for conciliation conference was received, along with an incomplete Notice of Deficiency for tax due for the period ended September 30, 1986. The partial copy set forth no taxpayer and the assessment number was handwritten under the entry "official title", by an unknown author. Mr. Skorenski stated that he could not confirm that the notices were provided to the Bureau by the taxpayer because the cover letter accompanying the request for conference did not specify the enclosures.

The Division also submitted the affidavit of Daniel LaFar, principal mail and supply clerk, sworn to December 14, 1993, which set forth the mailing procedures utilized by the Division with regard to notices of deficiency. However, the affiant did not state how many notices or which particular notices were sent to petitioner on November 9, 1988. Mr. LaFar could only attest to an employee of the mail and supply room delivering "a piece of certified mail addressed to Siemens Capital Corp. . . . to the Roessleville Branch of the United States Post Office . . . ."

Finally, the Division submitted the affidavit of Mary Verald, Clerk I, sworn to December 15, 1993, who worked in the Corporation Tax Assessment Unit during the period in issue. Ms. Verald described the regular procedure followed by the Corporation Tax Assessment Unit to issue notices of deficiency. As part of this procedure, Ms. Verald stated that she personally placed notices in envelopes with the corresponding statements of audit adjustment and sealed the envelopes. She witnessed the assignment of certified numbers and prepared a certified mail record. In the case of multiple notices to one taxpayer, she stated that all the notices were sent in a single envelope, that the same certified number was assigned to each notice and was imprinted thereon. Ms. Verald also stated that three copies of each Notice of Deficiency would be created and that the two of these would be sent to the taxpayer while the third copy would be retained by the Division. She explained that the copy retained by the Division would have a handwritten entry recording the certified mail number of the notice, the date of mailing and the processing clerk's initials. Ms. Verald offered no explanation as to why the third copy of the Notice for the period ending September 30, 1986 was not available to the Division, nor did she explain how the "partial Notice of Deficiency" could come into existence. Nevertheless, Ms. Verald concluded that from inspecting the "partial Notice of Deficiency" setting forth tax due of $1,089,414.00 she believed it to have been mailed with the others. However, she admitted to not having a copy of that notice (relating to assessment number C881109974F; this same assessment number also appears on the Statement of Audit Adjustment for the same period).[6]

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[6]The Administrative Law Judge's finding of fact "16" read as follows:

On November 9, 1988, the Division issued five notices of deficiency to petitioner which set forth the following:

Period Ended	Tax	Interest	Additional Charge	Total
9/30/84	$ 61,439.00	$ 27,729.00	$ 6,144.00	$ 95,312.00
9/30/84 (MTBTS)	10,445.00	4,714.00	1,045.00	16,204.00
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9/30/86 (MTBTS)	185,201.00	31,360.00	18,520.00	235,081.00

Although a sixth Notice of Deficiency was allegedly issued for the period ended September 30, 1986 setting forth a base tax due of $1,089,414.00, it was not submitted into evidence with the other jurisdictional documents. The Division's brief at page 2 stated that the Division was "unable" to provide the sixth Notice of Deficiency for the period ended September 30, 1986 and conceded a lack of jurisdiction. Both parties were made aware of this fact by letter from the Administrative Law Judge dated October 14, 1993.

In accordance with the decision in the case of Matter of Scharff (Tax

During the course of the proceedings herein (the second audit), several issues were raised to which the Division has made certain concessions. The Division agreed that petitioner was entitled to offset a reported capital gain for 1982 by a net operating loss sustained in the 1980

Appeals Tribunal, October 4, 1990, annulled on other grounds sub nom New York State Dept. of Taxation & Fin. v. Tax Appeals Tribunal, 151 Misc 2d 326, 573 NYS2d 140), the parties were given until December 15, 1993 to address this jurisdictional issue.

In response to the request, the Division was still unable to produce a complete copy of the Notice of Deficiency. The Division produced the undated affidavit of John Skorenski, supervisor of the control unit of the Bureau of Conciliation and Mediation Services, which described the Bureau's procedures upon receiving a request for conciliation conference and stated that, with regard to the instant matter (years 1984 through 1986), a request for conciliation conference was received, along with an incomplete Notice of Deficiency for tax due for the period ended September 30, 1986. The partial copy set forth no taxpayer and the assessment number was handwritten under the entry "official title", by an unknown author. Mr. Skorenski stated that he could not confirm that the notices were provided to the Bureau by the taxpayer because the cover letter accompanying the request for conference did not specify the enclosures.

The Division also submitted the affidavit of Daniel LaFar, principal mail and supply clerk, sworn to December 14, 1993, which set forth the mailing procedures utilized by the Division with regard to notices of deficiency. However, the affiant did not state how many notices or which particular notices were sent to petitioner on November 9, 1988. Mr. LaFar could only attest to an employee of the mail and supply room delivering "a piece of certified mail addressed to Siemens Capital Corp. . . . to the Roessleville Branch of the United States Post Office . . . ."

Finally, the Division submitted the affidavit of Mary Verald, Clerk I, sworn to December 15, 1993, who worked in the Corporation Tax Assessment Unit during the period in issue. Ms. Verald stated that she personally placed notices in envelopes with the corresponding statements of audit adjustment and sealed the envelopes. She witnessed the assignment of certified numbers and prepared a certified mail record. In this case, she stated that all the notices were sent to petitioner in a single envelope, that the same certified number was assigned to each notice and was imprinted thereon, and that from inspecting the partial Notice of Deficiency setting forth tax due of $1,089,414.00 she believed it to have been mailed with the others. However, she admitted to not having a copy of that notice (relating to assessment number C881109974F; this same assessment number also appears on the Statement of Audit Adjustment for the same period).

We modified this fact to reflect the record in more detail.

period. The Division also agreed that in the computation of allocated entire net income, it is appropriate to include in the numerator of the business allocation percentage receipts factor, business receipts earned from services performed in New York State. The Division agreed that the findings of the first audit must therefore be adjusted to accommodate these concessions.

It is noted that the Division computed the deficiencies for 1980, 1981, 1982, 1985 and 1986 against an entire net income base and the deficiencies for 1983 and 1984 against a capital base.

On December 23, 1991 and January 25, 1992, representatives for petitioner and the Division, respectively, consented to have the controversy in case number 806706, covering the fiscal years ended September 30, 1984, 1985 and 1986, determined on submission without hearing. Previously, petitioner had withdrawn the matter from the Bureau of Conciliation and Mediation Services and agreed to have it joined with case number 803815, which dealt with an assessment for the fiscal years ended September 30, 1980, 1981, 1982 and 1983.

With regard to all notices issued for the periods ended September 30, 1984, 1985 and 1986,[7] penalty was waived by the Division on the basis that petitioner had already protested the years 1980 through 1983 which encompassed identical issues and had the same basis for adjustment.

Following submission of additional documentation by petitioner, the Division agreed that when the Siecor note was converted to stock it became an item of investment capital. Hence, the deficiencies for the fiscal years ended September 30, 1983 and 1984 should be adjusted to reflect the conversion to stock. The Division continues to argue that up until the conversion the note was an item of business capital.

In addition to the facts found by the Administrative Law Judge, we find the following:

> For the years ending September 30, 1985 and September 30, 1986, petitioner calculated the amount of its interest expense indirectly attributable to subsidiary capital by multiplying its total

[7]As stated above, the Notice of Deficiency for 1986 is not in evidence.

> interest expense for each year by a fraction, calculated for each year, the numerator of which was the average fair market value of its subsidiary capital and the denominator of which was the total of the average fair market values of its subsidiary capital, investment capital and business capital.

OPINION

We will first address the exception of petitioner.

Section 208(5) of the Tax Law defines the term "investment capital" in pertinent part as "investments in stocks, bonds and other securities."

"Other securities is defined by former 20 NYCRR 3-4.2(c) as:

> "securities issued by governmental bodies and securities issued by corporations of a like nature as stocks and bonds, which are customarily sold in the open market or on a recognized exchange, designed as a means of investment, and issued for the purpose of financing corporate enterprises and providing a distribution of rights in, or obligations of, such enterprises. Thus 'other securities' include debentures, notes of a type commonly dealt in upon securities exchanges or markets or commonly dealt in as a medium for investment, and certificates of indebtedness which have many of the essential characteristics of bonds, and certificates of interest and other instruments evidencing proprietary rights in corporate enterprises which have many of the essential characteristics of stock. They do not include corporate obligations not commonly known as securities, such as real property bonds and mortgages, chattel bonds and mortgages, contracts of sale, purchase money obligations, short-term notes acquired in the ordinary course of trade or business for services rendered or for sales of property which is primarily held for sale to customers, bills of lading, bills of exchange, bankers' acceptances and other commercial instruments."

As the Administrative Law Judge noted, in Matter of Czarnikow, Inc. (Tax Appeals Tribunal, April 25, 1991) we identified and applied the following factors from this regulatory definition:

1. That the instruments are of a like nature as stocks and bonds, customarily sold in the open market or on a recognized exchange;

2. That the instruments were designed as a means of investment from the perspective of petitioner;

3. That the instruments were issued for the purpose of financing a corporate enterprise; and

4. That the instruments provided a distribution of rights in or obligations of the corporate enterprise.

The Administrative Law Judge concluded that petitioner failed to prove that the Siecor note satisfied any of these requirements and, thus, was not an item of investment capital but was properly treated by the Division as an item of business capital.

On exception, petitioner makes alternative arguments. First, petitioner, relying on 26 U.S.C.A. § 1274(d) and U.S. Treasury Reg. § 1.1274-6 which define short-term obligations as debt obligations with a maturity of up to three years, argues that the Siecor note "was a short-term note and was not issued for either services or property, [and thus] is clearly within the definition of 'other securities'" as used in the Division's regulations, 20 NYCRR 3-4.2 (Petitioner's brief in support, p. 5). Petitioner's alternative argument is that the Siecor note satisfies the four requirements of Czarnikow.

In response, the Division argues: "[i]t is a fundamental rule of statutory construction that words of common usage are to be given their ordinary meaning"; "[t]he State Tax Commission construed long term liabilities to mean obligations with a maturity date of more than one year"; and this interpretation is in accord with certain Certified Public Accounting standards as well as the definition of business capital in Tax Law § 208.7, prior to its amendment by Chapter 817 of the Laws of 1987 (Division's brief in opposition, p. 6).

We believe petitioner's argument misinterprets former 20 NYCRR 3-4.2. In effect, petitioner interprets the Division's regulation as establishing two alternative tests for determining whether the Siecor note is an "other security": 1) it is a short-term note not acquired in the ordinary course of trade or business for services rendered or for sales of property which are primarily held for sale to customers, or 2) the note meets the four factors we identified and applied in Czarnikow. Our interpretation of the regulation is that short-term notes are within the definition of "other securities" only if 1) the notes satisfy the four requirements discussed in

Czarnikow and 2) the notes were not acquired in the ordinary course of trade or business for services rendered or for sales of property which are primarily held for sale to customers (see, Matter of Czarnikow, Inc., supra). Short term notes are not "other securities" simply because they satisfy the latter requirement. Accordingly, we believe that the Siecor note must first satisfy the four Czarnikow conditions. We address those conditions seriatim.

The Administrative Law Judge concluded that the Siecor note was not of a nature customarily sold in the open market or on a recognized exchange because: the fact that the note had no priority over other unsecured debts diminished its similarity to stocks or bonds; its negotiability was uncertain; and petitioner's argument, i.e., that its failure to offer the note in the private placement market was a reflection that petitioner had little financial need to do so, was not a credible theory to find negotiability.

On exception, petitioner argues that stocks never have priority over unsecured debts; therefore, the fact that the Siecor note was unsecured increases its similarity to corporate stock. Next, petitioner argues that the note was a negotiable instrument under the Uniform Commercial Code because in three places the note makes reference to "the payee or other holder of this Note" and in the last full paragraph refers to "the payee or to the then holder of this Note" (Petitioner's brief in support, p. 7). Finally, petitioner argues that the note need not actually have been traded in the open market to qualify as an other security, it need only be similar to instruments customarily traded on the open market. Petitioner argues that it satisfies this requirement because the Siecor note displayed the essential characteristics of a bond.

The Division's entire response to all of petitioner's arguments with respect to the Czarnikow factors is as follows:

> "In applying the tests described in Czarnikow the ALJ correctly determined that the Siecor Notes were not investment assets but rather constituted business assets. The ALJ determined that the notes were not of a nature which were customarily sold in the open market or on a recognized exchange (Cl: B). Further, the notes were not a means of investment from the perspective of the petitioner (Cl: B). Also the ' . . . notes were merely issued to

> finance affiliated corporations and therefore . . . [not] issued to finance a corporate enterprise (Cl: B). Finally, there was no distribution of rights in or obligations of petitioner or the affiliates (Cl: B). The facts and the analysis of the ALJ support the conclusion that the Siecor notes are not 'other securities' and therefore, are not investment capital" (Division's brief in opposition, p. 5).

We conclude that petitioners have not established that the Siecor note was like stocks or bonds, which are customarily sold on the open market or on a recognized exchange. First, with respect to petitioner's argument that the Siecor note was negotiable, section 3-104(1)(b) of the Uniform Commercial Code requires that a negotiable instrument "contain an unconditional promise or order to pay a sum certain in money" and section 3-105(2)(a) of the Uniform Commercial Code provides that a promise or order is not unconditional if the instrument states that it is subject to or governed by any other agreement. We conclude that the Siecor note was not a negotiable instrument because it was subordinate to, and conditioned upon, the payment of what the note refers to as the "Senior Notes" (see, Fein v. Thompson-Starrett Co., 19 Misc 2d 985, 192 NYS2d 762). In addition, the Siecor note stated that it was subject to the terms and conditions of the loan agreement between Siecor Development and petitioner.

The only other evidence we find in the record as to whether instruments like the Siecor note were customarily traded on the open market or on a recognized exchange is the testimony of petitioner's representative that:

> "there is a private placement market for these types of securities. There is no doubt that Siemens' Treasury Department wants to take that note to Siecor. It could sell this to someone. It would have to privately place it, but there is no definition in the statute as to what constitutes an open market, and certainly no definition about what constitutes a recognized exchange" (Tr., p. 57).

We agree with petitioner that it need not show that this particular note was actually sold (see, Matter of Czarnikow, Inc., supra); however, we reject petitioner's contention that because the note could have been sold to someone, it satisfies the requirement of the regulation. The regulation says "customarily" and has been found to be satisfied by instruments commonly traded

by dealers and marketmakers (Matter of Avon Prods. v. State Tax Commn., 90 AD2d 393, 458 NYS2d 278) and instruments actively traded in the over-the-counter market (Matter of Czarnikow, Inc., supra). We conclude that a note that could be sold to someone has not been shown to be customarily sold on the open market or on a recognized exchange (see, Matter of Mobil Intl. Fin. Corp. v. New York State Tax Commn., 117 AD2d 103, 501 NYS2d 947).

Next, the Administrative Law Judge concluded that from the perspective of petitioner, the instruments were not designed as a means of investment because an "investment committee, separate from petitioner, made that determination and [petitioner] was utilized as a conduit through which funds were channelled" (Determination, conclusion of law "B").

On exception, petitioner argues, relying on Matter of Carret & Co. v. State Tax Commn. (148 AD2d 40, 543 NYS2d 216) that the interest payable on the note results solely from the efforts of Siecor in conducting its business and, thus, is an investment.

We agree with petitioner. We are aware of no authority that supports the Administrative Law Judge's conclusion that whether an instrument is an investment depends upon the source of the decision to advance the funds.

Next, the Administrative Law Judge decided that the Siecor note failed the third condition stated in Czarnikow because the note was merely issued to finance affiliated corporations. Again, we are aware of no authority for the conclusion that an instrument must finance an unrelated corporation in order to satisfy this third condition. We agree with petitioner that because the note was issued by Siecor to finance its purchase of assets, the note was issued for the purpose of financing a corporate enterprise.

Finally, the Administrative Law Judge found that the note did not provide a distribution to petitioner of rights in or obligations of Siecor, because petitioner received only a right to receive a sum certain with interest on a given date. In Matter of Czarnikow, Inc. (supra), we concluded, relying on Matter of Avon Prods. v. State Tax Commn. (supra), that repurchase agreements provided for the distribution of an obligation of the issuing bank because they required the banks

to pay over a fixed sum of money on a certain date. Accordingly, we can see no basis for the Administrative Law Judge's ruling and conclude that the Siecor note satisfied this last condition.

To summarize, we conclude that the Siecor note satisfies all but the first condition of the regulation, i.e., the requirement that the note must be like a stock or bond which was customarily traded on the open market or on a recognized exchange. This was the principal condition of the regulation discussed by the Court in Matter of Mobil Intl. Fin. Corp. v. New York State Tax Commn. (supra), where the Court concluded that the proof "adequately supports the finding that the evidences of indebtedness were intercompany loans to affiliates in the regular course of their businesses rather [than] instruments issued for sale on securities exchanges or markets commonly dealing in investments" (Matter of Mobil Intl. Fin. Corp. v. New York State Tax Commn., supra, 501 NYS2d 947, 950). Similarly, we conclude that the Division's decision to treat the Siecor note as an item of business capital and not one of investment capital was correct.

Petitioner's next point on exception is that the Administrative Law Judge erred in rejecting petitioner's argument that an audit reduction in the value of its subsidiary capital should necessarily result in a reduction in the amount of interest expense attributable to subsidiary capital.

On exception, petitioner articulates its position as follows:

> "For purposes of calculating the amount of tax on subsidiary capital imposed under Section 210.1(e) of the Tax Law, the Audit Division determined that the average fair market value of taxpayer's subsidiary capital to be $334,508,134 for the year ended September 30, 1985 and $470,460,269 for the year ended September 30, 1986. This compares to subsidiary capital as reported by Petitioner of $391,674,559 for September 30, 1985 and $581,564,756 for September 30, 1986.
>
> * * *
>
> "Interest expense of a taxpayer is properly allocable among subsidiary capital, investment capital and business capital. In its return for 9/30/85, Petitioner apportioned interest expense of $38,676,620 to subsidiary capital and $7,302,915 to investment capital; this left a balance of $14,990,429 apportionable to business capital. However, the amount apportioned to subsidiary capital

> was based upon an assumed fair market value of $391,674,559. Now that the Division has reduced that value to $334,508,134, it is incumbent upon [the] Division to reduce the interest expense apportionable to subsidiary capital proportionally.
>
> "The same results occur in the year 9/30/86. Taxpayer apportioned interest expense of $49,182,522 to subsidiary capital, $6,436,776 to investment capital and the balance of $21,175,647 to business capital. Because the Division again reduced the value of subsidiary capital for 9/30/86, it should have made a proportionate interest in the amount of interest expense apportioned to subsidiary capital" (Petitioner's brief in support, p. 9).

The Division did not respond to petitioner's argument on this issue.

We affirm the Administrative Law Judge's determination on this issue for the reasons stated below.

As noted by the Administrative Law Judge, the calculations at issue are made for two different purposes, pursuant to two different provisions of the Tax Law. The audit adjustments to the average fair market value of petitioner's subsidiary capital were made for the purpose of calculating the tax imposed by section 210(1)(b) on subsidiary capital, pursuant to the specific statutory language in section 210(2) of the Tax Law which defines the amount of subsidiary capital as the average fair market value of the assets.

In contrast, the addback for interest directly or indirectly attributable to subsidiary capital is an adjustment that is made to increase entire net income for purposes of calculating the tax imposed by section 210(1) of the Tax Law on the alternative base of entire net income. Section 208(9)(b)(6) gives the Commissioner of Taxation the discretionary authority to require a taxpayer to determine entire net income by including interest "directly or indirectly attributable . . . as a carrying charge or otherwise to subsidiary capital or to income, gains or losses from subsidiary capital."

The formula devised by the Commissioner to calculate the interest indirectly attributable to subsidiary capital is based on a fraction, the numerator of which is the total of the taxpayer's historical cost of the subsidiary plus loans and advances to the subsidiaries (see, Matter of

Unimax Corp. v. Tax Appeals Tribunal, 165 AD2d 476, 568 NYS2d 164, affd 79 NY2d 139, 581 NYS2d 135). This fraction is applied to the gross interest expense of the taxpayer to determine the interest indirectly attributable to subsidiary capital. Because the calculation of interest indirectly attributable to subsidiary capital is based on the historical cost of the subsidiary, rather than the fair market value of the subsidiary, it is clear that an adjustment to the average fair market value of petitioner's subsidiaries does not automatically result in an adjustment to the interest expense directly and indirectly attributable to subsidiary capital (see, Matter of Volt Information Sciences, Tax Appeals Tribunal, October 15, 1992). To establish that the latter must be adjusted, petitioner was required to show that application of the Division's formula resulted in an interest addback that was different from that reported by petitioner for the years at issue. Petitioner has not done this and, thus, is not entitled to an adjustment.

We deal next with the exception filed by the Division.

The Division has taken exception to the Administrative Law Judge's conclusion that the interest income that petitioner received from loans to non-New York second tier subsidiaries and foreign affiliates, loans for export and miscellaneous loans were not receipts from services performed in New York State and, thus, were not includable in the numerator of the business allocation percentage pursuant to section 210(2)(a)(2)(B) of the Tax Law.

Section 210(1) of the Tax Law imposes tax on the alternative base of entire net income allocated to New York State. Section 210(3)(a) and (b) of the Tax Law provides that entire net income will be allocated to reflect apportioned business income and apportioned investment income. Business income is apportioned through the use of a business allocation percentage, which is defined by section 210(3)(a) of the Tax Law and takes into account the relative amounts of property, receipts and payroll attributable to New York. At issue here is the computation of the receipts factor of the business allocation percentage. In pertinent portion, section 210(3)(a)(2)(B) of the Tax Law provides that receipts from services performed within the State will be included in the numerator of the receipts factor, while receipts from services performed

within and without the State are included in the denominator. The parties do not dispute that the interest income in issue is a business receipt, they only argue over whether it is a receipt from a service performed in New York pursuant to section 210(3)(a)(2)(B).

Relying on Matter of American Tel. & Tel. Co. v. State Tax Commn. (61 NY2d 393, 474 NYS2d 434) and Matter of Overseas Natl. Airways v. State Tax Commn. (91 AD2d 162, 458 NYS2d 711), the Administrative Law Judge concluded that "the categorization of interest paid by a foreign or alien obligor as 'sourced' in New York only because it is paid to a New York corporation is not tenable" (Determination, conclusion of law "A"). In the absence of guidance in either Article 9 or 9-A as to how to allocate interest income, the Administrative Law Judge sought counsel from the Article 32 tax on banking corporations and the regulations thereunder. Under section 1454(a)(2)(B) of the Tax Law, the Administrative Law Judge stated that interest from loans is deemed located where the greater portion of income-producing activity related to the loan occurs. Under 20 NYCRR 196.2, the Administrative Law Judge stated that the activities of solicitation, investigation, negotiation, final approval and administration are to be considered to determine where the greater portion of income-producing activities occur. Applying this guideline, the Administrative Law Judge held that "it cannot be said that petitioner solicited loans, investigated obligors (for creditworthiness), negotiated the terms of the loans (since most were wash transactions) or ultimately approved loans (parent appears to have controlled transactions)" (Determination, conclusion of law "A"). Ultimately, the Administrative Law Judge concluded that "petitioner's regular business is essentially passive and that the interest received from its loans and advances does not rise to the level of interest earned from the performance of services in New York and therefore taxable in New York" (Determination, conclusion of law "A").

On exception, the Division does not address the Administrative Law Judge's reliance on the decisions in American Telephone & Telegraph and Overseas National Airways. The Division does state that the Administrative Law Judge erred in relying on regulations relating to

banks subject to tax under Article 32 (Division's brief in support, p. 15), but later the Division acknowledges that these regulations may "be a point of departure for starting an analysis of the situs of the receipts at issue in this matter" (Division's brief in support, p. 16). The error of the Administrative Law Judge, contends the Division, was not going further with his analysis. The Division argues that petitioner's only business is the borrowing and lending of funds and its only place of business is in the State of New York. Therefore, even if the amount of effort expended by petitioner was small, the Division argues that this activity constituted the conduct of a business.

In response, petitioner argues that to be a business receipt earned in New York, the business receipt must have its source in New York and that American Telephone & Telegraph and Overseas National Airways hold that interest paid by out-of-state obligors to New York based taxpayers comes from an out-of-state source. Petitioner also asserts that the Division's contentions about its business are not corroborated by the record. Specifically, petitioner relies on a comparison of the amounts of its subsidiary and investment capital to its business capital to refute the Division's contention that petitioner's only business was the borrowing and lending of money. Petitioner also argues that the Division's point that petitioner's only place of business was in New York is contradicted by the record.

We reverse the determination of the Administrative Law Judge on this issue.

First, we do not agree with petitioner that American Telephone and Telegraph is dispositive of the issue here. That decision addressed two different tax impositions: the tax imposed by sections 183 and 184 of the Tax Law. Although petitioner relies only on the section 184 portion of the decision, we believe that this aspect of the decision can only be understood in the context of the entire decision.

In the first part of the decision, the Court concluded that advances by the taxpayer to subsidiaries for use outside New York were assets employed in the State for purposes of section 183. The key to deciding whether assets were employed in the State, the Court held, was

"whether the parent corporation carries on sufficient activity in New York with respect to the advances made to the subsidiary that it can be said to employ in New York the funds advanced" (Matter of American Tel. & Tel. Co. v. State Tax Commn., supra, 474 NYS2d 434, 438). Because of the extent of the taxpayer's activities in the State managing the funds advanced, the Court concluded that the taxpayer's advances to its subsidiaries were assets employed in New York for purposes of section 183.

In the aspect of the American Telephone and Telegraph decision relied on by petitioner, the Court construed the word "source" as used in section 184 of the Tax Law which imposed tax on the gross earnings of transportation and transmission companies "from all sources within this state." The Court's decision on this issue was extremely narrow, based entirely on the statute's use of "source." The Court contrasted the use of "source" in section 184 with the language used in section 183 which imposed tax based on assets employed in the State. The Court concluded that although the advances to out-of-state subsidiaries were assets employed in New York for purposes of section 183, the interest from the advances were not earnings from a source within New York for purposes of section 184. We believe that the Court's decision in its entirety indicates that it does not create a general rule on the tax treatment of interest, but is instead only relevant where a statute imposes tax based on the "source" of income. Because the statute before us calculates tax based on the receipts from services performed in the State, American Telephone & Telegraph does not resolve the issue.

Similarly, we do not find Matter of Overseas Natl. Airways v. State Tax Commn. (supra) determinative because it was decided under section 184 of the Tax Law and did not interpret the words at issue here.

Turning to the statute involved here, section 210(3)(a)(2)(B), the issue is whether the interest is a receipt from services performed in New York. First, we note that petitioner did perform services with respect to these loans. These services were described by petitioner as the performance of a clearinghouse function, acting as a financial conduit facilitator (Tr., pp. 17-18).

Second, petitioner did not establish that these services took place anywhere other than in New York. As a result, we believe it was appropriate for the Division to treat the interest as a receipt for services performed in New York. This conclusion is in accord with the long established policy of the Division that:

> "where the labor needed to establish and maintain (make and service) a loan is performed at more than a minimal level, in both New York and another state, the interest income derived from such loan is 'earned within' both New York and such other state. To determine what portion of the income is attributable to New York, consideration should be given to such activities as solicitation, investigation, negotiation, approval and administration" (Advisory Opinion, TSB-A-88[2]C, citing Advisory Opinion TSB-A-83[7]C).

Petitioner has argued on exception that it did perform activities outside New York with respect to the loans. The sole support for this claim is petitioner's contention that the audit report for the years 1980-1983 states that petitioner had three satellite offices outside of New York and that each office had two or three employees who performed consulting services for petitioner's parent and affiliated corporations (Petitioner's brief in opposition, p. 3). We have been unable to find the field audit report to which petitioner refers in the record. However, this statement would not be sufficient to satisfy petitioner's burden of proof because it only relates to some of the years at issue and even for those years it does not establish that activities related to the loans at issue took place outside of New York. Because petitioner has failed to prove that any loan related activities took place outside of New York, we conclude that the Division properly treated all of the interest income as receipts from services performed in New York.

Finally, the Division took exception to the Administrative Law Judge's conclusion that the Division was unable to prove the existence of the Notice of Deficiency for corporation franchise tax for the period ending September 30, 1986 in the amount of $1,089,414.00 (hereinafter the 1986 deficiency). The Administrative Law Judge concluded that without the notice in evidence, there was no jurisdictional base to determine the validity of the asserted deficiency. The Administrative Law Judge also held that without an assessment imposing tax pursuant to section

209 of the Tax Law, the assessment of the Temporary Metropolitan Transportation Business Tax Surcharge must be cancelled because it is a surcharge on the tax imposed pursuant to section 209 of the Tax Law.

On exception, the Division states that "[t]he fact that the Division was not able to provide a copy of one of the notices does not divest the Division of Tax Appeals of subject matter jurisdiction regarding that notice where the Division of Taxation has provided evidence as to the existence and contents of the notice and the mailing of it" (Division's brief in support, p. 9).

We agree with this statement. We have consistently held that the Division is required to prove both the fact and date of mailing the notice of deficiency (Matter of Scharff, Tax Appeals Tribunal, October 4, 1990, annulled on other grounds sub nom New York State Dept. of Taxation & Fin. v. Tax Appeals Tribunal, 151 Misc 2d 326, 573 NYS2d 140; Matter of Malpica, Tax Appeals Tribunal, July 19, 1990). However, we have not held that the Division must introduce any particular kind of evidence to prove these facts, but only that the evidence submitted be sufficient to establish that 1) the Division has a standard procedure for the issuance of such notices and 2) to show that the procedure was followed in the particular case at hand (see, Matter of Katz, Tax Appeals Tribunal, November 14, 1991).

In this case, the Division has established that it has a procedure for the creation and mailing of notices of deficiency asserting corporation franchise tax, but the Division has failed to introduce any evidence that this procedure was followed with respect to the 1986 deficiency. In fact, the record suggests the contrary. The procedure for creating the notice of deficiency, as described in the Verald affidavit, indicates that the Division generates three copies of the notice of deficiency, mails two to the taxpayer and retains the third. However, the Division does not have the third copy of the 1986 deficiency and it has offered no explanation why it does not. Thus, the only evidence before us indicates that the Division did not comply with its own procedure for issuing notices of deficiency.

Although the Division has offered into evidence the "partial Notice of Deficiency" it has offered no explanation how this incomplete form which bears no assessment number and which has no taxpayer name, address or identification number on it came into existence, nor how it relates to the Notice of Deficiency the Division claims it issued. The Division's mailing evidence also does not establish that the 1986 deficiency was actually issued, as there is nothing in this mailing evidence that indicates that this particular document, as opposed to the other five notices, was mailed to petitioner. Finally, there is no evidence indicating that petitioner received the 1986 deficiency. In total, we see nothing in the record before us that allows us to conclude that the Division issued this notice.

The facts here are very similar to those in Pietanza v. Commissioner (92 T.C. 729, affd 935 F2d 1287) where the Internal Revenue Service was unable to provide the Tax Court with a copy of a Notice of Deficiency issued to the taxpayer and there was no evidence that the taxpayer had received the Notice. The only evidence the Service could provide was a draft of the notice and a postal form 3877, Application for Registration or Certification. The Tax Court held that this evidence was not sufficient to establish that the Notice of Deficiency had been issued. As a result, the Court granted the taxpayer's motion to dismiss the case for lack of jurisdiction (see also, Magazine v. Commissioner, 89 T.C. 321; United States v. Wright, 658 F Supp 1, 86-1 USTC ¶ 9457). Similarly, we affirm the Administrative Law Judge's determination that we do not have jurisdiction to determine the validity of the asserted deficiency.

The only argument offered by the Division with respect to the Administrative Law Judge's cancellation of the Notice of Deficiency C881109975S for the Metropolitan Transportation Business Tax Surcharge was that this tax "must also be sustained because it is computed at a rate of 17% of the tax imposed pursuant to Tax Law § 209 which was asserted by [the 1986 deficiency]" (Division's brief in support, p. 9). Because we reject the Division's contention that it proved that it issued the 1986 deficiency, we also reject its contention that the Notice of

Deficiency asserting the Metropolitan Transportation Business Tax Surcharge for 1986 must be sustained.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Siemens Capital Corporation is denied;

2. The exception of the Division of Taxation is granted to the extent that this decision holds that the Division of Taxation properly treated interest income received by petitioner as business receipts from services performed in New York State, but is otherwise denied;

3. The determination of the Administrative Law Judge is modified to the extent indicated in paragraph "2" above, but is otherwise affirmed;

4. The petition of Siemens Capital Corporation is granted to the extent indicated in the Administrative Law Judge's conclusion of law "E" except to the extent that this conclusion is modified by paragraph "2" above; and

5. The notices of deficiency dated May 9, 1986, as modified, and the four notices of deficiency dated November 9, 1988 covering the years1984-85, as modified are sustained. The notices of deficiency for the year ending September 30, 1986 are cancelled.

DATED: Troy, New York
November 3, 1994

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

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