STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
MOD MAID IMPORTS, INC.	:	DECISION DTA No. 809148
for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Fiscal Year ended April 30, 1985.	: :	
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Petitioner Mod Maid Imports, Inc., 500 Seventh Avenue, New York, New York 10018, filed an exception to the determination of the Administrative Law Judge issued on March 18, 1993. Petitioner appeared by William I. Abramson, C.P.A. The Division of Taxation appeared by William F. Collins, Esq. (Robert J. Jarvis, Esq., of counsel).

Petitioner did not file a brief on exception; however, it submitted a letter received on August 9, 1993 responding to the brief filed by the Division of Taxation, which began the six-month period for issuing this decision. Petitioner's request for oral argument was denied.

The Tax Appeals Tribunal renders the following decision per curiam.

ISSUE

Whether the Division of Taxation properly required petitioner to add back certain interest payments made to affiliated corporations pursuant to Tax Law former § 208(9)(b)(5).

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

On or about September 29, 1989, the Division of Taxation ("Division") issued two statements of audit adjustment and two notices of deficiency to petitioner, Mod Maid Imports, Inc. ("Mod Maid"). The first Statement of Audit Adjustment covered the fiscal year ended April 30, 1985 and indicated a tax deficiency of $38,211.00, interest of $18,349.00 and penalty

of $3,821.00, for a total balance due of $60,381.00. The statement indicated that this balance was as a result of a "recent field audit." Based upon this Statement of Audit Adjustment, a Notice of Deficiency was issued to Mod Maid for the same period indicating the same amount of tax, interest and penalty due. The second Statement of Audit Adjustment for the fiscal year ended April 30, 1985 indicated a tax deficiency of $6,207.00, interest of$2,981.00 and penalty of $621.00, for a total balance due of $9,809.00. Once again, the statement indicated that the balance due was as a result of a "recent field audit." A second Notice of Deficiency was issued which set forth the same amount of tax, interest and penalty for the same period as set forth on the second Statement of Audit Adjustment.

The audit conducted in this matter began as a general field verification of the fiscal years ended April 30, 1985 through April 30, 1987. It was discovered that Mod Maid failed to include wages in its allocation percentages for the years audited and corrections were made to include the wage factor in the allocation percentage. Mod Maid did not contest this issue or the additional taxes resulting therefrom at hearing. However, it was discovered that Mod Maid failed to add back interest paid to what the Division categorized as stockholders of Mod Maid. This addback occurred only in the fiscal year ended April 30, 1985 and resulted in the addback of $698,293.00 to entire net income.

The second Notice of Deficiency issued in this matter reflects the additional taxes due pursuant to Tax Law § 209-B, the Temporary Metropolitan Transportation Business Tax Surcharge on additional taxes due.

Mod Maid was one of a group of related corporations referred to by petitioner's representative as the "Lou Levy" group, allegedly the largest manufacturer of women's coats in the country. During the period in issue, there were approximately six or seven corporations in this group and the stock of each of the corporations was owned by the same individuals. The exact number of corporations in the "Lou Levy" group during the period in issue was not divulged in the record nor was the exact number or identity of the shareholders. Several of the

corporations made retail sales, while others performed administrative functions and purchasing functions.

During the period in issue, Mod Maid paid interest to these other corporations.

Although Mod Maid's representative, William I. Abramson, CPA, testified as to the relationship among the corporations in the Lou Levy group, to the extent that he was aware of said corporations, none of the shareholders testified nor was any documentary evidence produced which would have established the corporate structure of the group and the specific relationships among the corporations in the group. Further, there was no evidence with regard to the exact nature or amount of interest paid to specific creditors.

OPINION

In the determination below, the Administrative Law Judge upheld the notices of deficiency issued to petitioner, finding that petitioner failed to prove that its "interest on indebtedness," from which the additional tax was assessed, was not properly includable in petitioner's "entire net income" under Tax Law former § 208(9)(b)(5). The Administrative Law Judge rejected petitioner's argument that the statute's legislative history supports its position that the substance of the transaction, not its form, should control, stating that this position had already been rejected in Friesch-Groningsche Hypotheekbank Realty Credit Corp. v. Tax Appeals Tribunal (185 AD2d 466, 585 NYS2d 867, lv denied 80 NY2d 761, 592 NYS2d 670). The Administrative Law Judge also upheld the assessment on the alternative ground that petitioner simply did not establish the nature of its relationship to its affiliated corporations so as to establish that the interest payments were not required to be includable under Tax Law former § 208(9)(b)(5).

In its exception, petitioner contends that its corporate franchise tax return (and those of other affiliated corporations), which were offered by petitioner for the first time with its exception, establish that the corporations of the "Levy group" were "brother/sister affiliates," rather than "parent/subsidiary . . . rendering the statute not applicable to the intercorporate interest payments" (Petitioner's exception, p. 2). Further, in its letter replying to the Division's

brief on exception, petitioner makes the following points: 1) in light of its accountant's testimony that a brother-sister relationship existed among the corporate entities, the corporate tax returns submitted after the record was closed, which are merely further support of this testimony, should be considered; and 2) the case People ex. rel. Retsoff Mining Co. v. Graves (255 AD 921, 7 NYS2d 769, lv denied 280 NY 853, appeal dismissed 308 US 503) supports its position that interest is fully deductible in this instance, "provided the funds were used in the ordinary course of business" (Petitioner's reply letter, pp. 1-2).

In response, the Division argues that: 1) petitioner has not met its burden of proving by clear and convincing evidence that the interest payments at issue do not fall within the provisions of Tax Law former § 208(9)(b)(5); 2) petitioner's position that the Legislature intended to have the substance of a transaction, not its form, dictate the tax consequences under this statute is in direct conflict with the decision rendered in Friesch-Groningsche Hypotheekbank Realty Credit Corp. v. Tax Appeals Tribunal (supra); 3) petitioner has not established that the interest payments were not made to a person owning, directly or indirectly, at least 5 percent of its stock; and 4) petitioner's attempt to introduce the corporate tax returns into evidence after the record was closed must be disallowed.

We affirm the determination of the Administrative Law Judge.

First, we reject petitioner's attempt to introduce new evidence after the record has been closed. As we held in Matter of Schoonover (Tax Appeals Tribunal, August 15, 1991):

> "[i]n order to maintain a fair and efficient hearing system, it is essential that the hearing process be both defined and final. If the parties are able to submit additional evidence after the record is closed, there is neither definition nor finality to the hearing. Further, the submission of evidence after the closing of the record denies the adversary the right to question the evidence on the record. For these reasons we must follow our policy of not allowing the submission of evidence after the closing of the record [citations omitted]."

We find it necessary to briefly address petitioner's argument that interest is fully deductible in this instance "provided the funds were used in the ordinary course of business" (citing People ex. rel. Retsoff Mining Co. v. Graves, supra). In 1936, the tax year addressed in the Restoff Mining case, the applicable portion of former section 208 specifically excluded from the "addback" requirement "interest on moneys [sic] borrowed for ordinary expenses of the

corporation" (Tax Law former § 208[6]; People ex. rel. Retsoff Mining Co. v. Graves, supra, 7 NYS2d 769, 770). However, such an exclusion did not exist within Tax Law former § 208(9)(b)(5) during the year at issue. Therefore, petitioner's reliance on this case is unpersuasive.

As to petitioner's other arguments raised on exception, we find that they were adequately and correctly addressed by the Administrative Law Judge below. Therefore, in affirming the determination, we do so based on the determination of the Administrative Law Judge.[1]

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Mod Maid Imports, Inc. is denied;

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

3. The petition of Mod Maid Imports, Inc. is denied; and

4. The notices of deficiency dated September 29, 1989 are sustained.

DATED: Troy, New York
December 30, 1993

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

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

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[1]We wish to clarify our position on one aspect of the determination. The Administrative Law Judge concluded that petitioner failed to establish a "brother/sister" relationship among the corporations in the Lou Levy group (Determination, conclusion of law "B"). This statement could be interpreted to mean that if such a relationship was proven, no additional tax would have been due. However, in light of the language of Tax Law former § 208(9)(b)(5), which prohibits the exclusion of "[90 percent] of interest on indebtedness directly or indirectly owed to any stockholder or shareholder . . . [emphasis added]," such a conclusion is not obvious to us. Because petitioner has not proven facts to support this legal argument, we need not and, therefore, do not reach this question.