STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
VARRINGTON CORPORATION	:	DECISION DTA No. 810048
for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Years 1984 through 1988.	:	
	:	

Petitioner Varrington Corporation, c/o 41 East 42nd Street, Suite 1610, New York, New York 10017, filed an exception to the determination of the Administrative Law Judge issued on May 26, 1994. Petitioner appeared by Curtis, Mallet-Prevost, Colt & Mosle (William L. Bricker, Jr. and Michelle A. Rice, Esqs., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (James Della Porta, Esq., of counsel).

Petitioner did not file a brief on exception. The Division of Taxation filed a brief in opposition. Petitioner's reply brief was received on October 11, 1994, which date began the six-month period for the issuance of this decision. Oral argument was not requested.

Commissioner Dugan delivered the decision of the Tax Appeals Tribunal. Commissioner Koenig concurs.

ISSUE

Whether the Division of Taxation properly determined that petitioner, a foreign corporation, was doing business in New York during the years at issue and was, therefore, subject to corporation franchise tax pursuant to Tax Law § 209(1).

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for findings of fact "19" and "20" which have been modified. The Administrative Law Judge's findings of fact and the modified findings of fact are set forth below.

Petitioner, Varrington Corporation, was incorporated in the Netherlands Antilles in March 1983. During the years 1984, 1985 and 1986, petitioner was a Netherlands Antilles corporation. On December 31, 1986, petitioner became a Delaware corporation.

Petitioner is owned by two corporations, Beachwood, Ltd. and Mapledale, Ltd. Beachwood and Mapledale shared a Cayman Islands mailing address and each owned 50% of the voting stock of petitioner. Frank Tsao, Peter Tan and J. P. Tsao were the directors and officers of petitioner during the years 1984 through 1988. None of the officers or directors of petitioner were present in New York during the years involved in this matter.

Shipcentral Realty, Inc. ("Shipcentral") is one of a group of companies (the "Shipcentral Group") owned by Franklin Tsao and his wife, Jean Rose Tsao. During the years 1984 through 1988, Franklin Tsao, Jean Rose Tsao, Marco Wong, Helena DiSenna and Andrew Russnok were the officers of Shipcentral. For the same years, Franklin Tsao, Jean Rose Tsao, Paul Caramella and Andrew Russnok were the directors of Shipcentral.

For the relevant taxable years, petitioner did not own any shares of Shipcentral or the Shipcentral Group. In addition, for the same period, Frank Tsao was not an officer or director of Shipcentral.

For the relevant taxable years, Franklin Tsao and Jean Rose Tsao were not shareholders of Beachwood Ltd. or Mapledale Ltd., nor was Franklin Tsao an officer or director of petitioner.

Frank Tsao and Franklin Tsao are brothers.

For the relevant period, petitioner did not have (a) employees in New York; (b) an office in the building at 41 East 42nd Street or otherwise in New York; (c) a listing in the directory of said building; or (d) a telephone or telephone listing in New York. For the same period,

petitioner also did not own or lease property in New York. Nor did petitioner maintain any inventory or employ any assets in New York for this period. During this period, the only mail received by petitioner at 41 East 42nd Street was tax notices and unsolicited advertisements.

For the tax years in issue, petitioner appointed an agent in New York, Andrew Russnok, to sign its tax returns.

Richfield Investment Company (the "limited partnership" or "Richfield") owned the building at 41 East 42nd Street, New York, New York (the "Building") from 1984 through 1988. During those years, petitioner was a limited partner in Richfield. During the years 1984 through 1988, Shipcentral was a general partner in Richfield.

Petitioner was not involved in identifying or selecting the property that was ultimately acquired by Richfield. Petitioner also was not involved in the negotiations concerning the financing of the acquisition of the Building.

For the relevant period, Shipcentral, as general partner, was responsible for the day-to-day operations of the Building. To that end, it was responsible for (a) overseeing the management company hired to manage the Building; (b) leasing space in the Building; and (c) securing insurance for the Building. In addition, Shipcentral had responsibility for reviewing and signing the limited partnership's tax returns and for reviewing and maintaining Richfield's accounting books and records.

Petitioner was not involved in any of the day-to-day operations or activities of Richfield during the relevant taxable years. Petitioner was not involved in (a) overseeing the management of the Building; (b) leasing the premises; (c) securing or maintaining insurance for the Building; (d) reviewing or signing the tax returns filed by Richfield; or (e) reviewing or maintaining the accounting books and records of the limited partnership. During the years at issue, petitioner's involvement in the limited partnership was strictly limited to its monetary investment. Additionally, petitioner's involvement in the limited partnership was its sole business activity.

Richfield was formed in June 1983. Petitioner, as limited partner, and Shipcentral, as general partner, formed the limited partnership. Petitioner contributed $16,200,000.00 to the limited partnership.

Petitioner does not challenge the Division of Taxation's ("Division") assertion that it contributed more than 50% of the limited partnership's capital for the period in issue. The 1987 and 1988 Federal partnership returns of Richfield indicate that petitioner owned 97.5% of the capital of the limited partnership and that Shipcentral owned 2.5% of the capital. These same returns indicate that petitioner's share of profits was 97.5% and its share of losses was 5%. The returns further indicate that Shipcentral's share of profits was 2.5% and its share of losses was 95%.

The partnership agreement was not entered into evidence.

The evidence presented at hearing by petitioner consisted of the testimony of Andrew Russnok. Mr. Russnok is and was during the period at issue an officer and director of the corporations which comprise the Shipcentral Group. Mr. Russnok also is and was an employee of Shipcentral Limited, a member of the Shipcentral Group. During the period at issue, Mr. Russnok was responsible for all day-to-day operations of Richfield.

With respect to the negotiations of the limited partnership agreement, Mr. Russnok testified that, to the best of his knowledge, he was not aware of petitioner's participation in such negotiations. Mr. Russnok did not testify that he participated in the partnership agreement negotiations.

Petitioner timely filed franchise tax returns for 1984 through 1987. Petitioner did not file a franchise tax return for 1988.

We modify finding of fact "19" of the Administrative Law Judge's determination to read as follows:

> In August 1988, petitioner filed amended franchise tax returns for the years 1984 through 1986, which included petitioner's statement of its position that it was not subject to the franchise tax. On December 7, 1988, the Division issued a "Statement of Tax Reduction or Overpayment" to petitioner for the period ending 1984 (Exhibit "C"). Such statements were

also issued on February 1, 1989, for the periods ending 1985, 1986 and 1987 (Exhibits "D," "E" and "F").[1]

We modify finding of fact "20" of the Administrative Law Judge's determination to read as follows:

On September 14, 1990, the Division issued to petitioner ten notices of deficiency which asserted additional corporation franchise tax and metropolitan transportation business tax surcharge, plus interest, as follows:

Tax Period	Tax Deficiency	Interest	Total
1984	$ 52,302.84	$ 0.00	$ 52,302.84
1984	8,955.00	0.00	8,955.00
1985	48,031.07	0.00	48,031.07
1985	8,222.07	0.00	8,222.07
1986	72,253.78	18,651.13	90,904.91
1986	12,333.98	3,218.19	15,552.17
1986	10.00	3.87	13.87
1987	47,736.72	5,174.99	52,911.71
1987	8,161.15	898.55	9,059.70
1988	36,285.76	6,391.49	42,677.25
1988	6,202.58	1,092.54	7,295.12
	$300,494.95	$35,430.76	$335,925.71

Issued at the same time as the notices were statements of audit adjustments for each of the years at issue which stated in relevant part as follows:

"Recapture of erroneous refund.

"Your corporation has a Capital ownership of 97.5% in a New York State Partnership whose principal Business Activity is Real Estate.

"Based on an Audit of the Franchise Tax Reports for the periods 1984 thru 1988 and the expanded Regulations Section 1-3.2, concerning partnerships that were adopted on June 25, 1990, it has been determined that Varrington Corporation, N.V. is taxable in New York State" (Exhibits "C" through "E").[2]

OPINION

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[1] We modify finding of fact "19" of the Administrative Law Judge's determination by adding the last two sentences in order to more fully reflect the record.

[2] We modify finding of fact "20" of the Administrative Law Judge's determination by adding the paragraph following the chart in order to more fully reflect the record.

Tax Law § 209(1) imposes an annual franchise tax upon every domestic or foreign corporation for the privilege of exercising its corporate franchise, or of doing business, or of employing capital, or of owning or leasing property or of maintaining an office in the State of New York.

Tax Law § 209-B imposes a metropolitan transportation business tax surcharge upon every domestic or foreign corporation for the privilege of exercising its corporate franchise, or of doing business, or of employing capital, or of owning or leasing property or of maintaining an office in the metropolitan commuter transportation district.

Under the Division's regulations at 20 NYCRR 1-3.2(a)(6), petitioner, as a limited partner foreign corporation, is considered to be doing business, employing capital, owning or leasing property or maintaining an office in New York, if it participates in, or controls or dominates all or any portion of the business activities of the partnership.

Whether petitioner, as a limited partner, has the requisite participation, domination or control of the partnership is determined by reference to two categories of factual situations in the regulations. The first category lists factual situations which conclusively determine that the requisite "participation, domination or control" exists. With one exception, all the factual situations are applicable "during the taxable year or . . . any previous taxable year."

The second category lists "other factual situations" which are "to be considered as indications" of the presence of the requisite participation, domination or control.

Initially, we deal with the first category of factual situations. The first issue is whether the threshold level of interest test in clause (a) of section 1-3.2(6)(i), i.e., either 1% or more interest as a limited partner and/or more than a $1,000,000.00 interest, as determined under section 705 of the Internal Revenue Code, is applicable to the years at issue, 1984 through 1988.

The following language precedes clause (a):

> "(6)(i) . . . A foreign corporation [participates in or dominates or controls] the business activities or affairs of the partnership if one or more of certain

> factual situations, including but not limited to the following, exist during the taxable year or, except for clause (a). . . any previous taxable year" (20 NYCRR 1-3.2[6][i], emphasis added).

The Administrative Law Judge rejected petitioner's contention that this language indicates that clause (a) is applicable only on a prospective basis from the effective date of the regulations and, therefore, cannot be applied to the years at issue herein. The Administrative Law Judge, relying on Matter of Varrington Corp. v. City of New York Dept. of Fin. (201 AD2d 282, 607 NYS2d 630, affd ___NY2d___ [Feb. 14, 1995]), determined that, although the regulations relied upon by the Division were not effective until 1990, they are applicable to the tax periods at issue in this matter, i.e., 1984 through 1988. He determined further that the language cited by petitioner does not relate to the effective date of the regulation but merely states that a corporation is deemed doing business in New York during a given taxable year where it has an interest exceeding $1,000,000.00 during that year. Thus, in order to trigger taxability, the $1,000,000.00 interest level must be present during the year at issue. In contrast, if certain other factors existed during any previous year, the corporation is deemed doing business in a later year.

On exception, petitioner reiterates its assertion at hearing that:

> "clause (i)(a) -- which constituted a change in position regarding the taxability of passive and disinterested foreign corporate limited partners investing in limited partnerships in New York -- plainly states that it is to be applied only on a prospective basis....
>
> * * *
>
> "it is clear from the face of the regulation that the $1,000,000 tax basis test was excepted from the facts and circumstances tests contained in clauses (b) through (j) -- which could be applied to previous taxable years -- and was only meant to be applied on a going forward basis" (Rider to exception, pp. 1-2).

The Division's brief in opposition to petitioner's exception does not respond to petitioner's argument.[3]

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[3]Petitioner raised the issue at hearing in its post-hearing brief. The Division did not address the issue in its post-hearing brief.

We reverse the determination of the Administrative Law Judge.

Matter of Varrington Corp. v. City of New York Dept. of Fin. (supra) dealt with the retroactive application of the New York City franchise tax regulations, not the New York State regulations at issue in this case. The effective date of the State regulations is July 11, 1990, except for the 1% or $1,000,000.00 threshold portion of the regulation which is prospective only (New York State Register, July 11, 1990, of which we take official notice). More specifically, the effective date clause of the regulations reads as follows:

> "**[f]iling date**: June 26, 1990.
>
> "**Effective date**: July 11, 1990, except that the amendments made by section 5 of this regulation regarding the taxability of a foreign corporation being based solely on the provisions set forth in section 1-3.2(a)(6)(i)(a) of the Business Corporation Franchise Tax regulations shall apply to taxable years ending on or after the effective date of this regulation and the amendments made by section 11-1.3 of such regulations shall apply to searches and certificates issued on or after the effective date of this regulation" (New York State Register, July 11, 1990).

The reason for prospective application of the ownership test is stated in the Notice of Adoption in the Register, as follows:

> "[t]he effective date clause of the proposal provides that the regulation shall take effect immediately, except that the amendments regarding the taxability of a foreign corporation being based solely on the 1% or $1 million levels of interest in the partnership apply to taxable years ending on or after the effective date of the regulations. The provisions regarding this 1% or $1 million standard are being made prospective because they constitute a change in Departmental policy, as such policy was previously represented by several Advisory Opinions on the subject. The other provisions in the amendments regarding foreign corporate limited partners do not constitute a change of policy but rather are a formalization of existing policy reflected in these Advisory Opinions, so that these provisions are made to be effective immediately" (New York State Register, July 11, 1990).

Since the years at issue here are 1984 through 1988, the ownership portion of the regulations is not applicable to petitioner. Further, since the notices here were based solely on provisions of the regulations not in effect for the years at issue, it is clear that the Division proceeded upon a fundamentally erroneous theory.

More specifically, the statements of audit adjustment indicate the basis for the notices as follows:

> "Recapture of erroneous refund.
>
> "Your corporation has a Capital ownership of 97.5% in a New York State Partnership whose principal Business Activity is Real Estate.
>
> "Based on an Audit of the Franchise Tax Reports for the periods 1984 thru 1988 and the expanded Regulations Section 1-3.2, concerning partnerships that were adopted on June 25, 1990, it has been determined that Varrington Corporation, N.V. is taxable in New York State" (Exhibits "C" through "E").

As we stated in Matter of Locy Develop. (Tax Appeals Tribunal, May 14, 1991), the law is clear that:

> "'[i]f the taxpayer demonstrates that "the [Division] in stating the account has proceeded upon a principle or theory fundamentally erroneous," the assessment may be set aside (People ex rel. Charles Kohlman & Co. v. Law, 239 NY 346, 352, 146 N.E. 622, 625). The same rule prevails in the Federal courts (Gasper v. Commissioner of Internal Revenue, 6 Cir., 225 F2d 284)' (Babylon Milk & Cream Co. v. Bragalini, 5 AD2d 712, 169 NYS2d 124, 126, affd 5 NY2d 736, 177 NYS2d 717; see also, Matter of Chartair, Inc. v. State Tax Commn., 65 AD2d 44, 411 NYS2d 41)."

Therefore, we cancel the notices.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Varrington Corporation is granted;

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

3. The petition of Varrington Corporation is granted; and

4. The Division of Taxation is directed to cancel the notices of deficiency dated September 14, 1990.

DATED: Troy, New York
March 23, 1995

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

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