STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
MCDONNELL DOUGLAS CORPORATION	:	DECISION DTA No. 813275
for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Years 1977 and 1980 through 1985.	:	

The Division of Taxation filed an exception to the amended determination of the Administrative Law Judge issued on October 3, 1996 with respect to the petition of McDonnell Douglas Corporation, P.O. Box 516, Mail Code 100-2190, St. Louis, Missouri 63166-0516. Petitioner appeared by Reid & Priest, LLP (Diana A. Steele, Esq., of counsel). The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (James P. Connolly, Esq., of counsel).

The Division of Taxation filed a brief in support of its exception. Petitioner filed a brief in opposition and the Division of Taxation filed a reply brief. Oral argument, at both the Division of Taxation's and petitioner's request, was heard on July 8, 1997 in Troy, New York.

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

ISSUES

I. Whether, upon reporting to New York certain final Federal audit adjustments to income, petitioner also properly adjusted the receipts factor of its business allocation percentages (and, as a consequence, adjusted its business allocation percentages) for the years involved based on suchchanges to income and was not precluded from making such adjustments by Tax Law § 1083(c)(7).

II. Whether the Division of Taxation's assessments should have been sustained because they were not self-assessments, but rather, were issued in response to the amended returns by way of notices of deficiency.

III. Whether the refund provisions of the Tax Law are consistent with Tax Law § 1083(c)(7) and, therefore, do not prohibit petitioner from adjusting its business allocation percentage to reflect Federal changes.

IV. Whether petitioner has established that its recalculated receipts factors properly attributed all of the Federal audit changes to activities or sources outside of New York.

V. Whether the Administrative Law Judge placed a finding of fact in his conclusions of law and, if so, what the legal effect is on the determination.

FINDINGS OF FACT

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

On April 26, 1993, the Division of Taxation ("Division") issued to petitioner, McDonnell Douglas Corporation, two notices of deficiency assessing additional tax, in the aggregate, of $177.00 for the taxable years 1977 and 1980 through 1982, and $207,416.00 for the taxable years 1983 through 1985, plus interest (these notices are sometimes referred to collectively as "the 1993 notices"). Penalties were not assessed on these notices and are not an issue in this proceeding.

Petitioner is a Maryland corporation with its corporate headquarters and principal place of business in St. Louis, Missouri. Petitioner is authorized to conduct business in New York State and/or conducts business in New York State. Petitioner is primarily engaged in the manufacture and sale of commercial and military aircraft throughout the United States. Petitioner also engages in related business activities, including the sale of spare aircraft parts, the sale of information systems, and the sale of information system services. Petitioner's business is carried out through eight to ten different operating divisions. Some of petitioner's divisions have sales based on long-term contracts, while others do not. The majority of petitioner's business in New York State consists of sales of parts and services, rather than long-term contracts for the manufacture and sale of aircraft. Petitioner's operating divisions which are

involved in long-term contract work are located in California (Long Beach and Huntington Beach), Florida (Titusville), Missouri (St. Louis), and Oklahoma (Tulsa).

Petitioner files New York State franchise tax reports in which it allocates its business income between New York and other jurisdictions in which it is authorized to do business and/or does business based upon its business allocation percentage ("BAP") calculated pursuant to Tax Law § 210(3).

The BAP is a percentage based upon a weighted average of three factors: a receipts factor (the "Receipts Factor"), a property factor, and a payroll factor. The Receipts Factor is equal to a fraction, the numerator of which is the taxpayer's total receipts, including sales, sourced in New York ("New York Receipts"), and the denominator of which is the taxpayer's total receipts, including sales, everywhere ("Total Receipts").

Prior to 1977, petitioner reported its long-term aircraft manufacturing contracts for Federal income tax purposes pursuant to either the percentage of completion method of accounting or pursuant to a specific delivery method. In 1977, petitioner requested and received permission from the Internal Revenue Service (the "IRS") to report all of its long-term contracts pursuant to the "completed contract" method of accounting.

In its New York State franchise tax reports for the taxable years 1977, 1978 and 1979 as originally filed, petitioner calculated the Receipts Factor using sales other than as reflected on its Federal corporate income tax returns for such taxable years ("Book Sales"). Petitioner's New York Receipts, Total Receipts and Receipts Factor for the taxable years 1977 through 1979, as originally reported, were as follows:

YEAR	N.Y.RECEIPTS	TOTAL RECEIPTS	RECEIPTS FACTOR
1977	$11,269,865.00	$3,597,273,804.00	.3133%
1978	$ 9,394,838.00	$4,154,256,849.00	.2262%
1979	$14,995,379.00	$5,226,531,926.00	.2869%

In 1980, the Division conducted a field audit of petitioner's 1977 through 1979 franchise tax reports. By a letter dated January 27, 1981, the Division proposed adjustments to such reports, specifically with regard to the calculation of petitioner's BAP on such reports. The Division's proposed adjustments changed the calculation of the Receipts Factor by replacing

Book Sales with the amount of sales reported by petitioner on its Federal corporate income tax returns ("Federal Sales"). The adjusted Total Receipts and adjusted Receipts Factor proposed in the January 27, 1981 letter were as follows:

YEAR	N.Y. RECEIPTS	ADJ. TOTAL RECEIPTS	ADJ. RECEIPTS FACTOR
1977	$11,269,865.00	$1,896,362,802.00	.5943%
1978	$ 9,394,838.00	$4,573,797,687.00	.2054%
1979	$14,995,379.00	$5,617,594,248.00	.2669%

The Division did not make any changes to the New York Receipts portion (the numerator) of petitioner's Receipts Factor for the years 1977 through 1979, noting in its field audit report that petitioner's receipts sourced to New York consisted mainly of receipts from sales of spare parts and information systems as opposed to long-term manufacturing contracts and, thus, were not affected by the change to a completed contract method of accounting.

By notices of deficiency dated May 15, 1981, the Division asserted deficiencies against petitioner for its 1977 and 1979 taxable years based upon the above-described adjustments ("the 1981 notices"). Petitioner challenged the 1981 notices by filing a petition with the Tax Appeals Bureau of the former State Tax Commission. Following a prehearing conference, which resulted in no adjustments to the 1981 notices, petitioner decided to withdraw its petition and consent to a discontinuance of its protest to the 1981 notices.

The Division conducted an audit of petitioner's franchise tax reports for the taxable years 1980 through 1982 ("the 1980 - 1982 Audit"). In this audit, the Division required that petitioner use the completed contract method of accounting in calculating its Receipts Factor, and adjusted petitioner's Total Receipts to reflect Federal sales for such years. No change was made to petitioner's New York Receipts, however, since such receipts were mainly from sales of parts and services rather than long-term contracts. Since the 1980 - 1982 Audit, petitioner has calculated its Receipts Factor based upon Federal sales as required by the Division.

Petitioner timely filed New York State franchise tax reports for the taxable years 1980 through 1985. Such reports, as initially filed for the taxable years 1980 through 1982, based the calculation of the Receipts Factor on petitioner's Book Sales. However, after the 1981 petition

was withdrawn, a correction was made to reflect calculation of the Receipts Factor based on sales as reported for Federal income tax purposes. With regard to the balance of such reports (i.e., pertaining to the taxable years 1983 through 1985), petitioner calculated the Receipts Factor based upon its sales as reported for Federal income tax purposes, that is in a manner consistent with petitioner's withdrawal of its petition against the 1981 notices. The New York Receipts, Total Receipts and Receipts Factor reflected in petitioner's franchise tax reports for the years 1980 through 1985 as originally filed were as follows:

YEAR	N.Y. RECEIPTS	TOTAL RECEIPTS	RECEIPTS FACTOR
1980	$ 15,389,196.00	$5,922,339,699.00	.2598%
1981	$ 14,485,318.00	$7,075,046,520.00	.2047%
1982	$ 16,835,195.00	$5,608,499,623.00	.3002%
1983	$ 48,506,801.00	$8,365,850,763.00	.5798%
1984	$227,469,846.00	$4,045,212,887.00	5.6232%
1985	$ 61,999,226.00	$7,498,816,822.00	.8268%

The 1980 through 1982 New York Receipts, Total Receipts and Receipts Factors, after the correction to sales per federal income tax returns versus sales per books, were as follows:

YEAR	N.Y. RECEIPTS	TOTAL RECEIPTS	RECEIPTS FACTOR
1980	$15,389,196.00	$3,811,150,752.00	.4038%
1981	$14,485,318.00	$5,738,293,477.00	.2524%
1982	$16,835,195.00	$5,599,000,224.00	.3007%

During 1987, petitioner was subjected to a Federal audit of its 1977 through 1985 Federal income tax returns. As described hereinafter, the IRS proposed numerous changes to petitioner's income for such years, the most significant of which involved the timing of income recognition under the completed contract method of accounting. In general, under petitioner's interpretation of such method of accounting, a contract would be held open and income thereunder would not be recognized until all of the specifications under the contract had been met. In contrast, the IRS proposed, and petitioner ultimately agreed, that income under such contracts should be recognized when the final primary subject matter of the contract had been fulfilled (for example upon delivery of the final aircraft ordered under the contract) rather than as of the date when all final contract specifications were met. As a consequence, income recognition for Federal income tax purposes was accelerated on many of petitioner's long-term

contracts. Examples of the types of and/or reasons for the IRS adjustments included: determinations that a long-term contract was completed when the firm number of aircraft ordered per contract were delivered as opposed to when any option for additional aircraft was fulfilled; splitting long-term manufacturing contracts into manufacturing parts and service parts; and converting (reclassifying) long-term manufacturing contracts into service contracts (in such latter instances causing such contracts to be accounted for, in part or in whole, under accrual accounting as opposed to completed contract accounting).

In 1987, revenue agent's reports ("RARs") were issued by the Internal Revenue Service ("IRS") with respect to petitioner's taxable years 1977 through 1980 ("the First RARs"). These RARs proposed adjustments to petitioner's total sales as reported on its Federal corporate income tax returns for the years 1977 through 1980 ("the Federal Adjustments"). The proposed adjustments involved primarily the acceleration of sales income under petitioner's long-term manufacturing contracts.

On June 4, 1987, petitioner filed summary schedules representing amended franchise tax reports for the years 1977 through 1980 ("the 1977 - 1980 Amended Reports"). These reports were filed, as required under Tax Law § 211(3), to report the changes in income resulting from the Federal Adjustments for the years 1977 through 1980. On its 1977 - 1980 Amended Reports, petitioner conceded the accuracy of the Federal Adjustments with respect to such years and included the adjustments in its calculation of entire net income for such years.

In the 1977 - 1980 Amended Reports, petitioner also adjusted the denominator of its Receipts Factor to reflect the changes made by the Federal Adjustments. For one of the years involved, 1980, such adjustments were an increase to Total Receipts by the amount of the Federal Adjustments for such year. Petitioner did not change its New York Receipts (i.e., the numerator of the Receipts Factor) for any of such years.

For the 1980 taxable year, petitioner reported the adjustments to Total Receipts to reflect the Federal Adjustments, and as a consequence recalculated its Receipts Factor as follows:

YEAR	NY RCPTS	ADJS TO TOTAL RCPTS	ADJ TOTAL RCPTS	ADJ RCPTS FACTOR
1980	$15,389,196.00	$1,485,761,106.00	$5,296,911,858.00	.2905%

Assuming petitioner is entitled to change its BAP, the "Adjustments to Total Receipts" and the "Adjusted Total Receipts" shown above are accurate reflections of the Federal Adjustments. However, the Division does not concede or agree that petitioner properly sourced all of such adjustments outside of New York State, and thus does not concede or agree to the accuracy of the "New York Receipts" or the "Adjusted Receipts Factor" as set forth above.

On November 27, 1991, RARs were issued by the IRS with respect to the taxable years 1981 through 1985 ("the Second RARs"). These RARs proposed adjustments to petitioners total sales as reported on its Federal corporate income tax returns for the period 1981 through 1985 ("the Additional Federal Adjustments"). Again, the changes proposed by the Additional Federal Adjustments were primarily the acceleration of sales income under petitioner's long-term manufacturing contracts.

On February 25, 1992, petitioner filed summary schedules representing amended franchise tax reports for the years 1977 through 1985 ("the 1977 - 1985 Amended Reports"). The 1977 - 1985 Amended Reports were filed as required under Tax Law § 211(3), to report the changes in income resulting from the Additional Federal Adjustments. In the 1977 - 1985 Amended Reports, petitioner conceded the accuracy of the Additional Federal Adjustments with respect to taxable years 1981 through 1985 and included such adjustments in its calculation of entire net income for such years.

In the 1977 - 1985 Amended Reports, petitioner adjusted the denominator of its Receipts Factor to reflect the changes made by the Additional Federal Adjustments. For two of such years, 1982 and 1985, such adjustments were an increase to Total Receipts by the amount of the Federal Adjustments for each year. Petitioner did not change its New York Receipts (i.e., the numerator of the Receipts Factor) for any of such years. Petitioner reported the adjustments to Total Receipts to reflect the Additional Federal Adjustments and, as a consequence, recalculated its Receipts Factor as follows:

YEAR	N.Y. RCPTS	ADJS TO TOTAL RCPTS	ADJ TOTAL RCPTS	ADJ RCPTS FACTOR
1981	$ 14,485,318	($ 872,326,692.00)	$ 4,865,966,785	.2977%
1982	$ 16,835,195	$ 521,756,599.00	$ 6,120,756,823	.2751%
1983	$ 48,506,80	($1,359,961,725.00)	$ 7,764,781,250	.6247%

1984	$227,469,846	($ 191,809,209.00)	$ 3,853,403,678	5.9031%
1985	$ 61,999,226	$3,042,347,676.00	$10,541,164,498	.5882%

Assuming petitioner is entitled to change its BAP, the "Adjustments to Total Income" and "Total Receipts" amounts above are accurate reflections of the Additional Federal Adjustments. For the years 1982 and 1985, the Division does not concede or agree to the accuracy of petitioner's sourcing the Additional Federal Adjustments outside of New York State and, therefore, does not concede or agree to the accuracy of the "New York Receipts" or the "Adjusted Receipts Factor" shown above. However, for the years 1981, 1983 and 1984, the Division does not dispute the accuracy of petitioner's sourcing the Additional Federal Adjustments outside of New York State or the Adjusted Receipts Factors resulting therefrom.

In 1992, the Division performed a desk audit of the 1977 - 1980 Amended Reports and the 1977 - 1985 Amended Reports ("the 1992 Audit"). During the 1992 Audit, the Division made a number of adjustments to petitioner's amended reports. One of the Division's adjustments was to disallow petitioner's changes to Total Receipts made, as described above, following the Federal Adjustments and Additional Federal Adjustments. As a result, the Division effectively disallowed petitioner's changes to its Receipts Factor which, in turn, disallowed the resultant changes to petitioner's BAP. In sum, the Division changed the BAP on petitioner's 1977 - 1985 Amended Reports to reflect the BAP reported by petitioner on its corporation franchise tax reports as originally filed or as determined by or following the 1980 Audit.

On September 14, 1992, the Division issued a Notice of Assessment Resolution with respect to the 1992 Audit ("the Notice of Assessment Resolution"). The Notice of Assessment Resolution set forth the adjustments described above and provided, in explanation of the Division's disallowance of the petitioner's Receipts Factor changes which resulted in the described changes to petitioner's BAP, as follows:

> "Sec. 1083(c)(7), of the New York Tax Law, prohibits a change in the allocation percentage once the three year statute has expired. Please refer to [TSB-H-82(6)C]."

On April 26, 1993, the Division issued the 1993 Notices of Deficiency. For the taxable year 1977, the 1993 notices of deficiency calculated petitioner's BAP using petitioner's Receipts Factor as adjusted by the Division pursuant to the 1981 notices of deficiency, while for the taxable years 1980 through 1985, the 1993 notices of deficiency calculated petitioner's BAP using petitioner's Receipts Factor as reported in petitioner's originally filed or corrected franchise tax reports. In sum, the 1993 notices of deficiency incorporated the disallowance of the adjustments to petitioner's BAP as proposed in the Notice of Assessment Resolution, and provided in explanation thereof the following:

> "No change in the allocation is allowed after the 3 year statute has expired. The business allocation percentage allowed reflects prior audit findings; or as originally filed."

The primary factual issue dealt with at hearing was the question of whether all of the income adjustments resulting from the Federal audit were properly treated as involving non-New York source income. On this issue, petitioner provided the testimony of one Robert K. Evans. Mr. Evans, who currently serves as petitioner's tax manager, has been employed in petitioner's tax department from June 1981 through the present and, over such time period, has been promoted from assistant audit tax accountant through a number of different employment titles each with an increased sphere of responsibility to his present title. Mr. Evans testified that the Federal adjustments related primarily to petitioner's long-term contract sales and, that since petitioner's sales in New York were not the result of long-term contracts but rather consisted of sales of aircraft spare parts and computer systems and related services, the same would have been accounted for on an accrual basis as opposed to the completed contract method of accounting and would not have been affected by the RARs. Mr. Evans further testified that the Federal adjustments resulted mainly from the acceleration of closing dates for long-term contracts, both in the sense of earlier-than-reported closing of the contracts or of severance of a contract into manufacturing and services segments. Specifically, Mr. Evans stated that all of the significant Federal changes ". . . were associated with our long-term contracts, the completion applicable to our commercial aircraft deliveries and had to do with military missile contracts, all

of which were long-term contracts". Mr. Evans noted that with respect to adjustments related to other types of income, the same was not New York source income because either the subject matter of the contract was not delivered to New York or that the services under the contract were not performed in New York. Mr. Evans displayed through his testimony a strong familiarity with petitioner's various operating divisions and the subject matter and location of the endeavors in which each was involved. Finally, he noted that the divisions involved with the contracts which were the subject of the RARs had never reported any New York sales and, that while not every RAR and underlying contract with which the RAR dealt was offered in evidence by petitioner, the same would be prohibitively voluminous to offer into evidence. On this score, petitioner noted that the Federal audit was a comprehensive audit covering all of the members of petitioner's consolidated group of corporations. However, petitioner did provide at hearing all of the RARs that resulted in a Federal adjustment which impacted petitioner's Receipts Factor. There is no evidence that the Division was precluded from conducting a field audit with regard to the documents underlying the Federal changes or that the Division requested but was refused access to any of such documentary information. Finally, petitioner noted that in its earlier audits, the Division accepted and made no changes to petitioner's New York Receipts as reported (i.e., when changing Total Receipts from book to Federal income tax amounts the numerator of the Receipts Factor was not changed), pointing to the statement in the Division's prior audit report that petitioner's New York Receipts were from sales of parts and services rather than long-term contracts.

Petitioner and the Division have agreed that in light of the small dollar amount involved ($177.00 plus interest) the 1993 notices with respect to the 1977 taxable year will not be contested.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

Noting that the requirement of Tax Law § 211(3) to report Federal changes or corrections lead to an exception to the statute of limitations imposed by Tax Law § 1083(c)(3), the Administrative Law Judge determined that the Division was not precluded from auditing

Federal change reports and assessing tax, but was precluded by Tax Law § 1083(c)(7) from changing the allocation of income or capital on which the taxpayer's return was based. As succinctly stated by the Administrative Law Judge, the essential question was whether petitioner could "allocate its entire net income to New York, as finally changed or corrected per Federal audit, based on its BAP as existing prior to such Federal changes" and if petitioner was required to reflect the changes in its receipts factor, has petitioner established that all of the changed receipts were non-New York source receipts and properly excluded from the numerator of the receipts factor (Determination, conclusion of law "E").

After rejecting petitioner's constitutional due process and commerce clause arguments, finding that petitioner did not show that the apportionment formulae employed herein were not reasonable attempts to estimate the economic activity of petitioner in New York (***citing Matter of British Land (Maryland) v. Tax Appeals Tribunal***, 85 NY2d 139, 623 NYS2d 772 and ***Matter of Allied Signal v. Tax Appeals Tribunal***, 229 AD2d 759, 645 NYS2d 895, ***appeal dismissed*** 89 NY2d 859, 653 NYS2d 281), the Administrative Law Judge determined that it was the Division which was precluded by Tax Law § 1083(c)(7) from making the income allocation as part of any audit and assessment during the two-year period after a report of Federal change was filed by a taxpayer. The Administrative Law Judge reasoned that the Division was the assessing party and, therefore, it was the Division that was prohibited by Tax Law § 1083(c)(7) from changing the BAP when an assessment was made. The Administrative Law Judge concluded that the plain language of the statute does not so prohibit the taxpayer from adjusting its receipts factor to reflect the sources of the changes to receipts arising during the period covered by the report as required by Tax Law § 211(3), subject to challenge by the Division on any such change in the receipts factor.

The Administrative Law Judge rejected the Division's burden of proof argument, saying that such problems are inevitable given the timing of reports on Federal changes and the two-year additional assessment period. Further, it is petitioner that must bear the burden of establishing the propriety of changing the BAP based upon the sourcing of the additional

receipts reported with the Federal changes. The Administrative Law Judge reasoned that an inability to demonstrate the source of the receipts would result in the application of the BAP as originally reported or as changed on a prior audit.

The Administrative Law Judge determined that it was significant that the source of the changes in this matter were due to the change in timing on recognition of gain from long-term contracts for planes and missiles which were not included in the determination of the original receipts factor (and, therefore, the BAP) since such contracts were not sourced to New York. Further, the Administrative Law Judge held that the policy of finality urged by the Division must be balanced with consistency and fairness under the circumstances of the Federal changes, and in the instant matter such a balance could only be achieved by acknowledging that the changes in income had a direct impact on the formula for allocating and taxing income. Ultimately, the Administrative Law Judge held that to prohibit petitioner's adjustment to BAP would be to ignore the requirement of Tax Law § 210(3)(a) that a taxpayer's BAP be based on all receipts which arose during the period covered by the report, and that petitioner's adjustment was more properly entitled a "required" adjustment than a "prohibited" change under Tax Law § 1083(c)(7).

Finally, the Administrative Law Judge found that petitioner met its burden of proving that the Federal changes were due to non-New York source income, despite the fact that every Federal audit RAR was not submitted into evidence. The Administrative Law Judge accepted the testimony of petitioner's witness with regard to the sources of the Federal income, including the timing of recognition of income on the long-term contracts, the sales traditionally sourced to New York, and that all other items included in the Federal adjustment were ***de minimus*** and were accounted for under accrual accounting and not completed contract accounting, rendering them without impact in this matter.

The Administrative Law Judge granted the petition of McDonnell Douglas to the extent that the 1993 notices of deficiency were revised consistent with his determination, with exception of the notice for 1977, which was not contested by agreement of the parties.

ARGUMENTS ON EXCEPTION

The Division bases its exception to the Administrative Law Judge's determination on the chief argument that Tax Law § 1083(c)(7), which it argues requires the Division to use the BAP petitioner originally reported or as found on audit in assessing petitioner based on its amended returns reporting Federal changes. The Division argues that the language of Tax Law § 1083(c)(7) does not specify the parties to which it applies, only the time period to which it applies, i.e., the additional period of limitation under Tax Law § 1083(c)(3). The Division contends that the language of Tax Law § 1082(a) (wherein it states that a report filed in response to a Federal change, conceding the accuracy thereof, shall be deemed to assess the deficiency on the date of filing) is implicitly stated in section 1083(c)(3) by the parenthetical language "(if not deemed to have been made upon the filing of the report or amended return)."

Critically, the Division then argues that the additional two-year period of limitations accorded to the Division begins with the self assessment just described in section 1083(c)(3). In support of its reading of the statutory sections, the Division cites ***Matter of International Travel Brokers*** (State Tax Commn., May 6, 1983) wherein a taxpayer filed a refund claim several years after it had filed its returns, seeking to reallocate its income. The former State Tax Commission denied the claim as untimely. The same taxpayer was audited by the Internal Revenue Service for the same period and was held liable for additional taxes for the same years. That petitioner filed another claim for refund also indicating the change in allocation. The former State Tax Commission denied this claim as well and the Division issued notices of deficiency based on the Federal change. The Division finds that the case is notable because it applies the prohibition of section 1083(c)(7) to situations where the change in BAP was made by the taxpayer's amended return reporting Federal changes.

The Division also argues that the Administrative Law Judge's interpretation would lead to "absurd" results because the Division would always be saddled with the original or BAP determined on audit and not one chosen by the petitioner. In addition, the Division argues that the Administrative Law Judge has created a "'reallocation election' which would have disastrous

consequences for the public fisc" (Division's brief in support, p. 25). The Division argues that such an election would always mean unbridled discretion in the taxpayer to choose the BAP which would yield the lowest tax without regard for the true BAP based upon the source of the income.

However, the Division also argued at oral argument that, where a taxpayer owes tax pursuant to a Federal change, it cannot alter the results of its original BAP, which could produce harsh consequences. The Division maintains that "[o]nce you reported income to us you should not be able to allocate income out of New York" (Oral Argument Tr., p. 12).

The Division maintains that the Administrative Law Judge did not reconcile Tax Law § 1083(c)(7) with Tax Law § 210(3)(a) (discussing income allocation rules) because he only gave the taxpayer the right to modify the BAP, which would only be used to the taxpayer's advantage. The Division has no right to do so given the statute of limitations. The Division believes that the Legislature intended for additional income to be reported but limited the effect of the Federal changes by prohibiting the parties from adjusting the BAP as previously reported, determined or found and that, like any other statute of limitations, the one provided for in Tax Law § 1083(c)(7) can be harsh.

The Division argues that the assessments in issue were not "self-assessments" since petitioner did not account for all of the errors it made in redetermining its income after the Federal changes. Therefore, the Division would still have had to issue a notice of deficiency and would not have been able to modify the BAP pursuant to the terms of section 1083(c)(7).

An alternative argument raised by the Division is that even if it is assumed petitioner could modify its BAP, Tax Law § 1087(c) precludes any recomputation which includes a change in allocation of income or capital upon which the taxpayer's return was based for purposes of its claim for refund (Tax Law § 1087[c][1]).

The Division also argues that the Administrative Law Judge erred in concluding that petitioner met its burden of proof with regard to the sourcing of income in its amended returns. The Division believes that the Administrative Law Judge's reliance on the testimony of

Mr. Evans was misplaced, especially in light of the missing RARs. The Division termed the testimony of Mr. Evans "simplistic" and "conclusory" and noted the inability of the parties to examine the audits for the periods 1977-1979 and 1980-1982 because they were not at issue in this matter and the accuracy of the allocation in those matters cannot be scrutinized. The Division contends that the allocations for the periods 1983-1985 were never scrutinized and, thus, cannot help petitioner to meet its burden of proof regarding the Federal changes for those years. Finally, the Division claims that petitioner did not introduce anything to prove that it accurately sourced its changes to its property allocation factor.

In response, petitioner argues that it was required to adjust its receipts factor to correctly calculate its BAP to determine its entire net income allocable to New York. In fact, petitioner maintains that Tax Law § 210(3)(a)(2) and 20 NYCRR 4-4.1 provide that all receipts which arose during the year must be included in the receipts factor for such year and that to do otherwise would result in a distortion of petitioner's tax liability.

Petitioner rejects the Division's argument that Tax Law § 1083(c)(7) prohibits modifying the BAP because its changes were not made in the period during which BAP changes are prohibited by said section. Petitioner notes support for its argument in the regulation promulgated under Tax Law §§ 211 and 1083 at 20 NYCRR 6-1.3 and 8-1.2, the former providing that an amended return be filed within 90 days after its Federal taxable income is changed or corrected and the latter providing that an assessment may be made at any time within two years after such report or amended return was filed and that no change in BAP was permissible during the additional period of limitation allowed for assessments in the case of an amended return to report Federal changes. Petitioner notes that if the Legislature had intended the self assessment by petitioner to be within the "additional period of limitation," then it would have made reference in Tax Law § 1083(c)(7) to § 1082(a)(2), which would have included the additional period for self assessment within the scope of its prohibition, as it did for other specific periods, to wit: those provided for in Tax Law §§ 1083(c)(1)(C), 1083(c)(3) and 1083(c)(4).

Petitioner directly challenges the applicability of ***Matter of International Travel Brokers*** (***supra***) commenting that no amended returns were filed in that case, that the increase in income was not the result of Federal changes and that the taxpayer never made a self assessment.

Petitioner contends that the Administrative Law Judge's determination does not lead to absurd results since the plain language of the statute prohibits the adjustment of BAP during the two-year period and the Division must use the BAP used by the taxpayer in its amended return. The Division can always challenge the adjustment to BAP made by petitioner, but the reporting requirements of Tax Law § 210(3) warrant the adjustment of the BAP to accurately reflect Federal changes.

Petitioner rejects the Division's argument that the assessments should have been sustained because they were not self assessments. Petitioner claims it filed an amended return which self assessed the tax and the Division issued assessments in response thereto.

Petitioner believes that the Division's argument with respect to the refund provision is irrelevant to petitioner's change in its BAP. Petitioner points out that Tax Law § 1087(c)(1) only prohibits the change in BAP during the two-year period following the filing of the return or report. Further, petitioner notes that section 1087(c) only applies where there has been an overpayment for Federal income tax purposes. That was not the case here, where there was a deficiency for Federal purposes and subject to section 1083(c)(3).

Finally, petitioner contends that it met its burden of proof with regard to the issue of treatment of the adjustments to BAP as entirely attributable to sources outside of New York State. In addition, petitioner maintains it amply demonstrated the changes in its property factor and that the Division has presented no evidence to challenge the adjustment.

The Division replies to petitioner's argument concerning the BAP referred to in section 1083(c)(7) by stating the source of the BAP referred to therein is the one set forth on the original return filed by the taxpayer or on any additional assessment based thereon and that the Division is not bound to the BAP set forth by petitioner on its amended return. Again, the Division asserts that the plain language of section 1083(c)(7) requires the use of the BAP from

the original or that stated in any additional assessment. The Division relies on ***People ex rel International Salt Co. v. Graves*** (267 NY 149), which applied the former section 219-d to prohibit the change of a BAP in a report filed in response to a Federal change.

The Division also contends in its reply that petitioner did not refute its argument that section 1083(c)(3) must be read to include the self assessment date pursuant to the provision of section 1082(a)(2) (deeming an amended return conceding the accuracy of a Federal change a self assessment of the deficiency).

The Division believes the Administrative Law Judge and petitioner were in error to try to read section 210 with section 1083, because the latter is a statute of limitation. Further the Division believes that the Administrative Law Judge's resolution will inevitably lead to an anomalous result.

The Division maintains that the parallel provision of Tax Law § 1087(c) supports its reading of section 1083(c)(7), especially its distinction between reports or amended returns filed in respect of a Federal change and its reference to "the taxpayer's return" for purposes of computation of a credit or refund without change in the allocation of income or capital stated therein.

OPINION

We affirm the determination of the Administrative Law Judge in this matter involving a close question of statutory construction. Clearly, the pertinent facts are not in dispute. In accordance with the provisions of Tax Law § 210(1)(a), petitioner computed its tax on the entire net income base and allocated a portion to New York by multiplying its entire net income by its BAP (Tax Law § 210[3]) and then filed franchise tax returns for the years in issue (Tax Law § 211[1]).

Upon audit by the Internal Revenue Service, petitioner was forced to recognize additional income during the years in issue. As prescribed by Tax Law § 211(3), petitioner reported the changed taxable income to New York within 90 days and conceded the accuracy of said Federal changes. However, in reporting the changes to New York on amended returns, petitioner

adjusted its receipts factor and, thus, its BAP to reflect the non-New York receipts in the additional income. Because the income was sourced outside of New York, the BAP was diminished. Indeed, to include the Federal income changes in entire net income and not to adjust the BAP would result in taxing corrected income based on an uncorrected BAP and possibly subject that income to tax without regard to its source.

Tax Law § 1082(a)(2) provides that "[i]f a report or an amended return filed pursuant to subdivision three of section two hundred eleven . . . . concedes the accuracy of a federal change . . . any deficiency in tax under article nine-a . . . resulting therefrom shall be deemed to be assessed on the date of filing such report or amended return, and such assessment shall be timely notwithstanding section one thousand eighty-three." Thus, in filing its amended returns, petitioner's statement of a deficiency thereon instantly became a timely assessment. Of critical importance is the section 1082(a)(2) requirement that there be a concession of the accuracy of the Federal changes. Without a concession, the statutory requirements would prohibit a finding that the deficiency in tax was deemed assessed on the date of filing.

Tax Law § 1083(a) sets forth the general rule that any tax under Article 9-A must be assessed within three years after the return was filed. An exception is provided for amended returns filed to report Federal changes in respect of an increase in Federal taxable income "treated in the same manner as if it were a deficiency for federal income tax purposes, [where] the assessment (if not deemed to have been made upon the filing of the report or amended return) may be made at any time within two years after such report or amended return was filed" (Tax Law § 1083[c][3]).

Petitioner self assessed the additional New York tax on its amended returns (Tax Law § 1082[a][2]). After examination of those returns, the Division had an additional period of time -- two years after the amended return was filed -- to make an additional assessment of tax (Tax Law § 1083[c][3]). That section's provisions exist to provide rules and guidance to the Division, not taxpayers. Likewise, the prohibition in Tax Law § 1083(c)(7) against changing the allocation of income or capital upon which a taxpayer's return or additional assessment (as

in this case the amended returns) is based is directed to the Division. The section explicitly states that it applies to assessments made during the additional period of limitation under section 1083(c)(1)(C) (no return filed in response to a Federal change), section 1083(c)(3) (where a report of Federal change is filed) and section 1083(c)(4) (where the deficiency is attributable to a carryback). The Division is clearly the party to which the "additional period of limitation" applies and it also is the party to which the prohibition applies.

In discussing a former section of the Tax Law, section 212(4), the Court in ***Matter of American Can Co. v. State Tax Commn***. (13 AD2d 175, 215 NYS2d 109, ***appeal dismissed*** 10 NY2d 1015, 224 NYS2d 689) said:

> "The provision of subdivision 4 upon which the Commission relies seems to us to have little or no significance beyond the simple and precise requirement that when the Commission, upon notice of a change of income by the Federal tax authorities, shall determine to undertake a reaudit, it shall not, in the course of that operation nor in the restatement resulting therefrom, proceed additionally to the matter of allocation and thereupon alter the basis thereof previously determined" ***Matter of American Can Co. v. State Tax Commn., supra***, 215 NYS2d, at 111).

In ***American Can***, the taxpayer had requested that the Commission change the allocation after the Federal taxing authority adjusted its income. The Court used the above reasoning as a basis for sustaining the Commission's decision not to change the company's allocation of income. The Court in ***American Can*** specifically rejected the lower court's reliance on ***International Salt*** saying that case involved an explicit limitation under a former section of the Tax Law which did not contain critical provisions for limitations following reaudit or restatement. We note the rejection of the ***International Salt*** case because it was cited by the Division in support of its interpretation and to point out the difficulty in using former sections of the Tax Law to support interpretations of current provisions.

In sum, we believe petitioner has exercised a right for which there exists no prohibition in the Tax Law. Further, we do not believe that its adjustment to its receipts factor creates a hardship for the Division, which was authorized to examine the return for accuracy, request substantiation for the changes and issue a notice of deficiency for any additional tax it believed

was due, subject to the rights accorded taxpayers in Tax Law § 1089. Further, the Division has not been deprived of previously held power to reallocate a taxpayer's income or capital -- it has never possessed that right.

The Division has also made much of a former State Tax Commission case, ***Matter of International Travel Brokers*** (***supra***) citing it in its Notice of Assessment Resolution, dated September 14, 1992 and again in its briefs. International Travel Brokers was the subject of a Federal audit which extended beyond the limitation on assessment period set forth in Tax Law § 1083. Ultimately, the Federal authorities increased the amount of income for the periods in issue. Instead of filing the report of Federal changes or amended returns, International Travel Brokers filed refund claims, based upon reallocation of income found to be sourced outside of New York. The Division disallowed the claims for refund since they were not filed in a timely manner. The Division then issued notices of deficiency based on the Federal changes without reallocating income. International Travel Brokers objected, saying the period for changing its allocation remained open due to its agreement with the Federal authorities and also that, in any event, it deserved the reallocation. The former State Tax Commission held that they were not bound by the agreement with the Federal authorities and that section 1083(c)(3) permitted an assessment within two years of a report of Federal changes and that section 1083(c)(7) prohibited a change in the allocation of income.

With regard to decisions of the former State Tax Commission, we have previously stated that:

> "[a]s decisions of a body of coordinate jurisdiction, the State Tax Commission decisions are not binding precedent for us, but are entitled to respectful consideration [citation omitted]" (***Matter of The Racal Corp. & Decca Elecs***., Tax Appeals Tribunal, May 13, 1993).

We respectfully disagree with the Division's reliance on this decision, given the very different facts and the former State Tax Commission's limited analysis of sections 1083(c)(3) and 1083(c)(7). International Travel Brokers did not file an amended return or a report in response to the Federal changes, thereby giving the Division an unlimited period to make an assessment and issue a notice of deficiency. The Commission correctly noted that section

1083(c)(7) precluded a change in allocation of income in an assessment issued during the additional period of assessment. However, we believe it erred in concluding that International Travel Brokers was precluded from changing the allocation. The issue was the propriety of the notices of deficiency and that was the subject of the petition filed in that case. The former State Tax Commission appears to have gratuitously offered an interpretation of Tax Law § 1083(c)(7), not based on the facts before it. We have already held that the Division is precluded from changing the allocation of income or capital during the additional period of assessment, but the central issue, not present in ***International Travel Brokers***, is whether the allocation may be changed prior to the additional period of limitation. Therefore, on all these grounds the ***International Travel Brokers*** case is distinguishable.

The Division's argument that, even if petitioner could modify its BAP, Tax Law § 1087(c)(1) precludes any recomputation where a change in allocation of income or capital upon which the taxpayer's return was based for purposes of its claim for refund is not convincing. We agree with petitioner that the prohibition in the refund provision cited by the Division uses similar language with respect to the timing of the change, to wit: "within two years from the time such report or amended return was required to be filed with the Commissioner" and would, therefore, require the same analysis as the prohibition in section 1083(c)(7). However, the prohibition on changing the allocation applies to the refund claim filed in the two-year period following the filing of the report or amended return and is not applicable to the facts herein.

In addition, section 1087(c) applies to Federal changes which are treated as overpayments for Federal income tax purposes, while the instant matter is one where the Federal changes are treated in the same manner as if it were a deficiency for Federal income tax purposes (Tax Law § 1083[c][3]) and is, therefore, not relevant to the instant facts. Further, we do not find persuasive the Division's argument that the reference to the "taxpayer's return" in section 1087(c)(1) meant that the Legislature wanted to prohibit a taxpayer from adjusting the BAP. We believe the use of that term is consistent with our interpretation of section 1083(c)(3) and

(c)(7) in that the prohibition in section 1087(c)(1) is limited to that BAP reported on the original return or the additional assessment -- in this case, the self assessment established by the amended returns.

We turn now to the issue of whether petitioner has substantiated the changes in the BAP for the periods in issue. After reviewing the record and the determination of the Administrative Law Judge, we conclude that the Administrative Law Judge thoroughly and correctly addressed this issue and that petitioner has met its burden of proof. The testimony of Mr. Evans was found to be credible and comprehensive by the Administrative Law Judge and we find no reason to disturb his conclusion. We have held that the credibility of witnesses is a determination within the domain of the trier of facts who has had an opportunity to view the witnesses first hand and evaluate the relevance and truthfulness of their testimony (***Matter of Spallina***, Tax Appeals Tribunal, February 27, 1992.) In addition, we find that the testimony of Mr. Evans and the RARs in evidence (especially those impacting the receipts factor) is "of the quality that a reasonable mind would accept as adequate to support a conclusion or ultimate fact on the record considered as a whole" and rises to that substantial level with the ability to inspire confidence (***Matter of Mobley v. Tax Appeals Tribunal***, 177 AD2d 797, 576 NYS2d 412, ***appeal dismissed*** 79 NY2d 978, 583 NYS2d 195).

We have reviewed the documentation regarding the adjustment made to the property allocation factor as set forth in the attachments to the amended returns filed for the years 1977 to 1980 and find the schedules to adequately set forth the type of adjustment made, the amount of each adjustment, and the jurisdiction to which each adjustment is properly sourced. This evidence was not met with evidence or testimony by the Division and its accuracy has not been diminished by anything else the Division has proffered. Therefore, we find that petitioner has met its burden of proof with regard to the changes in the property allocation factor for the years 1977 to 1980.

Finally, we address a statement in the Division's exception under the heading "Disagreed Findings of Fact" which takes issue with the Administrative Law Judge's "Finding of Fact in

Conclusion of Law 'J' that petitioner's [sic] proved by clear and convincing evidence that it accurately allocated the change in its BAP." We have examined the determination below and cannot locate the quoted language in conclusion of law "J." We believe the Administrative Law Judge's findings of fact and conclusions of law were well drafted and in compliance with both the State Administrative Procedure Act § 307(1) and our own Rules of Practice and Procedure at 20 NYCRR 3000.15(e)(1).

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the Division of Taxation is denied;

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

3. The petition of McDonnell Douglas Corporation is granted consistent with conclusion of law "K" of the Administrative Law Judge's amended determination; and

4. The notices of deficiency, dated April 26, 1993, are revised and reduced in accordance with conclusion of law "K" of the Administrative Law Judge's amended determination.

DATED: Troy, New York
January 8, 1998

_____
Donald C. DeWitt
President

_____
Carroll R. Jenkins
Commissioner

_____
Joseph W. Pinto, Jr.
Commissioner