STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
CHRISTIAN SALVESEN, INC.	:	DECISION DTA NO. 813434
for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Fiscal Years Ended March 31, 1991 and March 31, 1992.	:	

Petitioner Christian Salvesen, Inc., One Enterprise Avenue, Secaucus, New Jersey 07094, filed an exception to the determination of the Administrative Law Judge issued on October 31, 1996. Petitioner appeared by Price Waterhouse, LLP (John J. Fielding, CPA and Messiha F. Shafik, CPA). The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Kevin R. Law, Esq. and Laura J. Witkowski, Esq., of counsel).

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

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

ISSUE

Whether the inclusion of certain receipts and property in the calculation of petitioner's business allocation percentage resulted in the taxation of extraterritorial values and, if so, whether the Division of Taxation (hereinafter the "Division") should have exercised its

discretionary adjustment authority under Tax Law § 210(8) to properly reflect petitioner's business activity within New York State and effect a fair and proper allocation of the income and capital reasonably attributable to the State.

FINDINGS OF FACT

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

Petitioner, Christian Salvesen, Inc. ("CSI"), was a Delaware corporation which maintained its headquarters in New Jersey. CSI provided refrigeration, cold storage and related services for the food industry. The majority of CSI's business was conducted outside of New York.

Historically, CSI's business activities in New York included providing refrigeration, storage and related services to one retail supermarket store ("Company A") at its Chester, New York warehouse. Company A began experiencing financial difficulties and, as a result, CSI entered into a contract, dated February 5, 1991, which effectively provided for the financing of the Company A's inventory in addition to CSI's providing of refrigeration storage services. It was CSI's opinion that in order to retain certain legal rights in the event of a default, CSI was required to structure the "inventory financing" agreement as a sales contract. CSI interpreted the agreement as requiring Company A to purchase inventory which was immediately sold to CSI. CSI refrigerated and stored the inventory. As the need arose, CSI sold the same inventory back to Company A. CSI charged Company A the cost of the inventory (which was the same cost charged by the corporation to CSI) plus an amount equal to the prime rate plus 2.5 percentage points. Additionally, there were charges for refrigerated storage and handling. The transactions between CSI and the Company A were netted on a daily basis.

The agreement between CSI and Company A provided, in part, as follows:

> 1. CSI'S Initial Purchase
>
> As of today, CSI hereby purchases and [Company A] hereby sells the frozen food and ice cream inventory currently located at the CSI Chester, New York warehouse facility and more particularly described in schedule A attached hereto exclusive of products bearing any [Company A] tradename [sic] or trademark ("[Company A] Brand Products") (the "Inventory"). The purchase price paid by CSI for the Inventory is $3,560,212.52, which amount represents the fair market value of such Inventory to [Company A] as also shown on Schedule A. Receipt of the purchase price is hereby acknowledged by [Company A]. This Agreement shall constitute a bill of sale of the Inventory from [Company A] to CSI . . . .
>
> * * *
>
> 3. [Company A] Purchasing Assistance and Inventory Control
>
> [Company A] agrees to purchase products at the request of CSI and immediately to resell to CSI at invoiced cost such products; provided the products are to be purchased from companies with which [Company A] will be placing an order within three months following CSI's request. . . . [Company A] agrees to provide, without any additional charge, inventory control assistance in the same manner and kind as has historically been provided by [Company A] at CSI's Chester, New York facility. . . .
>
> * * *
>
> 4. CSI Agreement to Accommodate [Company A] Stocking Requirements
>
> Subject to the provisions of this paragraph, CSI shall stock products in its inventory in accordance with advice and requests from [Company A] delivered from time to time. CSI will not be obligated to honor [Company A's] advice and requests to the extent that:
>
> (a) the aggregate cost of the inventory (inclusive of the initial purchase pursuant to paragraph 1 of this Agreement plus additional purchases for that facility less amounts sold from that facility by CSI) would exceed CSI's then current

budget levels. (CSI's current maximum inventory-carrying amount is $4.5 million);

* * *

8. Miscellaneous

A. Nothing in this Agreement shall be deemed to restrict the ability of CSI to sell any of the inventory or other products purchased from [Company A] to parties other than [Company A]. It is understood, however that [Company A] shall have priority as to availability of the Distribution Inventory.

* * *

C. [Company A] agrees to indemnify CSI for any liability (other than liability arising as a direct result of the negligence or willful misconduct of CSI) and for any and all liability or expenses, including without limitation expenses incurred in defending actual or threatened claims and litigation, in connection with the sale of defective or allegedly defective products [Division's exhibit "N"].

The foregoing agreement provided that it would expire upon the earlier of June 13, 1994, the date that either party "may so choose upon the material default of the non-terminating party in any of its material obligations . . . or . . . the expiration of six months after notice of termination is given by either party to the other." (Division's exhibit "N").

CSI's contractual arrangement with the Company A is the only contract of this type CSI has entered into. Petitioner does not finance the inventory of any other customer.

CSI filed a General Business Corporation Franchise Tax Return for the fiscal years ended March 31, 1991 and March 31, 1992. Each of the returns stated that CSI's business activity was refrigeration and storage. For the fiscal year ended March 31, 1991, CSI included in its receipts and property factors, respectively, the gross sales and inventory values arising from the contract with Company A for the approximately two months of the fiscal year that the contract was in

existence. For the fiscal year ended March 31, 1992, as a result of including the gross receipts from the sale of inventory to Company A in the receipts factor, CSI's New York receipts factor increased from approximately 5 percent to approximately 46 percent. For the same fiscal year, as a result of including the value of inventory in both the numerator and denominator of the property factor, the property factor increased from approximately 7 percent to 12 percent.

The schedule on the franchise tax returns showing the computation of CSI's business allocation percentage reported the following amounts with respect to inventories owned:

Fiscal year ended	1/31/91	1/31/92
New York State	$1,859,091.00	$4,105,649.00
Everywhere	$1,859,091.00	$4,105,649.00

The schedule on the franchise tax returns showing the computation of CSI's business allocation percentage reported, among other things, the following with respect to the receipts for the fiscal year ended December 31, 1991:

	New York State	Everywhere
Sales of tangible personal property shipped to points within New York State	$11,305,541.00	
All sales of tangible personal property		$58,513,315.00

The schedule on the franchise tax return showing the computation of CSI's business allocation percentage reported, among other things, the following with respect to receipts for the fiscal year ended December 31, 1992:

	New York State	Everywhere
Sales of tangible personal property shipped to points within New York State	$55,454,864.00	
All sales of tangible personal property		$100,715,220.00

CSI was audited by the Division for the fiscal years ended March 31, 1990 and March 31, 1991. Upon the conclusion of the audit, petitioner paid the tax due which pertained to adjustments not at issue here.

In a letter dated March 27, 1992, petitioner's representative requested that an interpretation letter be issued allowing CSI to adjust its business allocation percentage to:

> (1) [r]eflect the receipts related to CSI's refrigeration and cold storage business activities conducted in New York State and only the "inventory financing" element of its contractual arrangement with [Company A]; and
>
> (2) [e]xclude from its property factor the value related to the inventory on behalf of [Company A].

The letter explained that the basis for its request was, in part, as follows:

> Based upon the statutes and regulations cited above [Tax Law §§ 210(3), 210(8); 20 NYCRR 4-4.6(b),(c)], CSI should be allowed to adjust its BAP to exclude its activity of buying and selling inventory which is limited to its contractual arrangement with . . . [Company A], since such activity distorts CSI's receipts and property factors.
>
> CSI is engaged in the business of providing refrigeration, cold storage and related services to the food industry. CSI is not in the business of buying and selling inventory or inventory financing. However, since income is realized from the inventory financing agreement, the related amounts will be included in the receipts factor. This activity is provided to accommodate . . . [Company A] during a period of financial distress and is not an activity CSI is involved in anywhere else or plans to be involved in the future.

In a letter dated June 23, 1992, the Division advised petitioner's representative that the Corporation Tax Policy Committee had decided that section 4-6.1(c) of the Commissioner's regulations required CSI to file its March 31, 1992 report and compute the tax due by following the statutory formula. CSI was also told that it should file a claim for Credit or Refund of Corporation Tax Paid. The letter directed that the refund claim should show a recomputed business allocation percentage which excluded the inventory and receipts associated with the contract between CSI and the Company A. It was explained that upon receipt of the claim for refund, the Corporation Tax Policy Committee would decide if a discretionary adjustment to the business allocation percentage was warranted.

On June 7, 1993, the Division received CSI's Claims for Credit or Refund of Corporation Tax Paid for the fiscal years ended March 31, 1991 and March 31, 1992. The basis for the refund claims was the same as that set forth in the request for an interpretation letter.

In a letter dated September 3, 1993, petitioner's representative was advised that his request for permission to vary from the statutory method of computing petitioner's New York State tax liability was denied. The Policy Committee felt that the statutory formula properly reflected CSI's activities in New York.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge preliminarily determined that certain factual statements made by petitioner in its brief and objected to by the Division were supported by the record and/or admissible as hearsay, citing ***Matter of Flanagan v. New York State Tax Commn.*** (154 AD2d 758, 546 NYS2d 205).

The second issue addressed by the Administrative Law Judge was whether there had been a taxation of extraterritorial value in the Division’s assessment of tax. After explaining the three-

factor formula used in determining petitioner's business allocation percentage ("BAP") as set forth in Tax Law § 210(3), the Administrative Law Judge noted that the tax assessed must be attributable to activities within New York and if found to distort the amount of petitioner's business activities in New York, could be adjusted by the Commissioner of Taxation and Finance pursuant to the authority vested in him by Tax Law § 210(8).

The Administrative Law Judge noted that the "taxing State need not identify and select out its specific intrastate income-producing activities so long as the corporation is operating a unitary business enterprise and the income is derived from the unitary business" (***Matter of British Land [Maryland] v. Tax Appeals Tribunal,*** 85 NY2d 139, 623 NYS2d 772, 775). After analyzing the record before him, he concluded that petitioner was operating a unified business enterprise and that the financing scheme it had devised with its customer in New York was created to facilitate the continuation of petitioner's business operations in New York, to wit: to provide refrigeration, storage and related services to its customers.

Finally, the Administrative Law Judge concluded that petitioner had not demonstrated that the statutory formula attributed its income in a manner which was out of all proportion to the amount of business transacted in New York. Therefore, petitioner had not established that it was an abuse of discretion for the Division to decline to exercise its authority under Tax Law § 210(8).

ARGUMENTS ON EXCEPTION

On exception, petitioner argues that for the period in issue the BAP attributed a disproportionate amount of income to New York. It contends that its "true" business is providing refrigeration, cold storage and related services and that its "financing" agreement was separate and unique, therefore supporting its request for a discretionary adjustment.

Petitioner maintains that the Commissioner's failure to adjust its BAP was an abuse of discretion which resulted in an inaccurate apportionment of income to New York.

The Division continues to argue that the burden of proof is on petitioner to show by clear and cogent evidence that the apportionment formula reaches extraterritorial value and that petitioner has failed to demonstrate such improper taxation herein.

The Division contends that all of petitioner's activities in New York were related to its "true" business of refrigeration, cold storage and related services, including its arrangement with its New York customer. The Division believes that the services provided were inextricably intertwined and, therefore, unitary.

Finally, the Division argues that petitioner has not established distortion due to the application of the apportionment formula. The additional receipts and property are the direct result of the sales of goods to its customer in New York and the inventory it retained in New York. Therefore, the increase in the BAP is the consequence of accounting for the increased business activity in New York undertaken by petitioner to continue its valuable relationship with its customer.

OPINION

Each of the arguments raised by petitioner on exception was raised before the Administrative Law Judge as well. We find that the Administrative Law Judge completely and adequately considered and addressed those arguments and we affirm his determination in its entirety based upon the reasoning and conclusions set forth therein.

Additionally, we conclude that.the scheme created by petitioner to insure its financial stake in its New York operations was a direct response to the fiscal condition of its chief customer, Company A. In order to maintain its refrigeration, storage and related services operations in New

York and preserve the profits it took therefrom, it chose to purchase Company A's inventory and then sell it back to Company A at a profit, characterized by petitioner as a finance charge. By purchasing the inventory, petitioner avoided the claims of any other creditor, which might have been raised if Company A had become insolvent or adjudicated a bankrupt. It appears petitioner was reaping even more profits from its New York operations under the new arrangement, an advantage which cannot be overlooked. The fact that it also incurred more franchise tax was merely a by-product of its choice to structure its arrangement with Company A as it did. It is well established that: "[i]t is the form chosen by the taxpayer which is controlling and the fact that a taxpayer could have chosen a different form which would have had different tax consequences does not convert a taxable transaction into a nontaxable one" (***Matter of Chanry Communications, Ltd.,*** Tax Appeals Tribunal, March 7, 1991, ***confirmed Matter of Henry v. Wetzler,*** 183 AD2d 57, 588 NYS2d 924, ***affd*** 82 NY2d 859, 609 NYS2d 160, ***cert denied*** 511 US 1126, ***citing Sverdlow v. Bates,*** 283 App Div 487, 129 NYS2d 88, 91).

Likewise, in ***Matter of 107 Delaware Assocs. v. New York State Tax Commn. (***64 NY2d 935, 488 NYS2d 634, ***revg*** 99 AD2d 29, 472 NYS2d 467), the Court of Appeals reversed the Appellate Division and reinstated the determination of the Tax Commission and the dissenting opinion of Justice Casey of the Appellate Division. In his dissenting opinion, Justice Casey stated:

> [h]aving elected to conduct their businesses under this format, and having reaped the benefits thereof, the individual petitioners now seek to avoid any disadvantage arising out of the selected format. There is nothing irrational about the Tax Commission's determination which has the effect of binding the taxpayers to the form of business chosen by them (***see, e.g., Matter of Ormsby Haulers v. Tully,*** 72 AD2d 845, 421 NYS2d 701) [***Matter of 107 Delaware Assocs. v. New York State Tax Commn***., 99 AD2d 29, 472 NYS2d 467, 470].

By freely choosing the structure of its transactions with Company A, petitioner reaped certain benefits but also incurred disadvantages, and it is that form which is controlling.

Petitioner's business operations in New York included its refrigeration, storage and related services and a support operation for Company A. The operations were not distinct, but the business activities of the same entity serving the same purpose and goal. The standard unified business analyses of functional integration, centralization of management and economies of scale simply do not obtain herein (***see, Matter of British Land [Maryland] v. Tax Appeals Tribunal, supra***). To the extent that there was ever a question as to the unitary nature of petitioner's business operations, petitioner has introduced nothing to prove the contrary.

Petitioner believes that the apportionment formula utilized by the Division, and set forth in Tax Law § 210(3), taxes income which is not fairly attributable to New York activities, even though the increases were reflective of increased receipts and inventory directly related to its arrangement with Company A. Petitioner argues that the apportionment formula caused great distortion when it included the receipts from the sale of inventory and the value of the inventory itself. However, as the Administrative Law Judge concluded, ***British Land (Maryland)*** specifically rejected the argument that "a tax on extraterritorial values can be established simply by showing that the taxpayer's formula-based intrastate income is many times greater than the income reflected in a separate geographical accounting" (***Matter of British Land [Maryland] v. Tax Appeals Tribunal, supra***, 623 NYS2d, at 777).

On exception, petitioner has once again argued the applicability of ***People ex rel. Sheraton Bldgs. v. Tax Commn.*** (15 AD2d 142, 222 NYS2d 192, ***affd*** 13 NY2d 802, 242 NYS2d 226), ***Matter of Bonner Props.*** (State Tax Commn., April 6, 1984) and ***Matter of A.E. Bruggemann & Co. v. State Tax Commn.*** (42 AD2d 459, 349 NYS2d 28, ***lv denied*** 33 NY2d 520, 352

NYS2d 1025). However, as noted by the Administrative Law Judge, in each of those cases the critical difference supporting the exercise of the discretionary adjustment authorized by Tax Law § 210(8) was that the business operations of those taxpayers in New York was held to be distinct from their operations outside the State. As noted above, that was not the conclusion reached herein and we conclude that the Division did not err in refusing to exercise their discretionary authority pursuant to Tax Law § 210(8).

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Christian Salvesen, Inc. is denied;

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

3. The petition of Christian Salvesen, Inc. is denied; and

4. The Division of Taxation's denial of petitioner's two claims for credit or refund for the fiscal years ended March 31, 1991 and March 31, 1992 is sustained.

DATED: Troy, New York
April 2, 1998

/s/Donald C. DeWitt
Donald C. DeWitt
President

/s/Carroll R. Jenkins
Carroll R. Jenkins
Commissioner

/s/Joseph W. Pinto, Jr.
Joseph W. Pinto, Jr.
Commissioner