STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
BAUSCH & LOMB, INC., AND AFFILIATES	:	DECISION DTA NO. 819883
for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Year 1995.	:	

Petitioner, Bausch & Lomb, Inc., and Affiliates, filed an exception to the determination of the Administrative Law Judge issued on May 18, 2006. Petitioner appeared by Patricia L. Brumbaugh, Esq., and Arthur Gelber, CPA. The Division of Taxation appeared by Daniel Smirlock, Esq. (Clifford M. Peterson, Esq., of counsel).

Petitioner filed a brief in support of its exception and a reply brief. The Division filed a brief in opposition. An amicus curiae brief in support of petitioner was filed by Richard D. Pomp, Esq. and Robert D. Plattner, Esq. Oral argument at petitioner's request was heard on June 20, 2007 in Troy.

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

ISSUE

Whether the Division of Taxation properly denied petitioner's claim for refund which was based upon the carryback to 1995 of a loss on the sale in 1996 of the stock of a wholly owned subsidiary included in petitioner's combined group.

FINDINGS OF FACT

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

Bausch & Lomb, Inc. ("B&L") is a New York corporation, One Bausch & Lomb Plaza, Rochester, New York 14604. It filed a New York Federal Changes to Corporate Taxable Income Report, Form CT-3360, dated April 12, 1999, which claimed a refund of New York corporation franchise tax for the year 1995 in the amount of $306,913.00 based upon an amended New York combined franchise tax report.

The Division of Taxation ("Division") denied the claim for refund in a letter dated August 31, 2001, addressed to "BAUSCH & LOMB, INC. AND AFFILIATES." The letter stated, in part, that "[t]he refund was due to the loss on the sale of a subsidiary, which per Regulation Section 3-7.2 does not qualify for a capital loss carryback."

Petitioner, Bausch & Lomb, Inc., and Affiliates, is the group of B&L subsidiary corporations together with B&L that was included on New York business corporation franchise tax combined forms.

Petitioner timely requested a conciliation conference with the Bureau of Conciliation and Mediation Services ("BCMS") seeking a review of the denial of refund. The statutory notice was sustained by BCMS Conciliation Order No. 192077 dated November 28, 2003.

Petitioner filed a timely petition with the Division of Tax Appeals seeking review of the denial of refund. The Division filed a timely answer to the petition by letter dated May 12, 2004.

The Division served petitioner with a demand for a bill of particulars, dated May 12, 2004. Petitioner responded with a bill of particulars served by letter dated June 14, 2004.

The amount of the claimed refund has been recomputed by the Division, resulting in a corrected total refund amount of $302,706.00. The computation of the amount of the refund claimed for the year 1995 is not at issue. For purposes of this proceeding, petitioner accepts the refund amount as recomputed by the Division. If petitioner prevails on the issues of law, the refund of $302,706.00, plus interest, is due; if the Division prevails on the issues of law, the refund is denied.

The Department of Taxation and Finance form number for the reporting of business corporation franchise tax for combined groups has changed over the years from CT-3A to CT-3-A. The individual form that has been required to be filed for each corporation within a combined group has changed from a pro forma CT-3 to the current CT-3-A/C.

Bausch & Lomb, Inc. and its affiliated corporations maintain their accounting records and file State and Federal income tax returns on a fiscal year basis, with the fiscal year consisting of 52 or 53 weeks ending on the last Saturday of the calendar year.

Bausch & Lomb, Inc. and some of its subsidiaries, including the subsidiaries reported on New York State combined returns, file Federal income tax returns on a consolidated basis.

The taxpayer members of the B&L combined group have been filing their New York franchise taxes on a combined basis since at least the 1988 tax year. The composition of the member corporations of the combined group covered by the respective combined report for each tax year has varied:

a. for the tax year ended 1988, the B&L combined group consisted of B&L and Polymer Technology Corporation ("Polymer").

b. for the tax years ended 1989 and 1990, the B&L combined group consisted of B&L, Polymer and Bausch & Lomb Foreign Sales Corporation.

c. for the tax years ended 1991, 1992 and 1993, the B&L combined group consisted of B&L and Polymer.

d. for the tax year ended 1994, the B&L combined group included B&L, Polymer, Bausch & Lomb International Holdings Corporation, Bausch & Lomb Domestic Holdings Corporation, Bausch & Lomb Domestic Finance Corporation, Charles River Laboratories, Inc., Wilmington Management Corporation, Bausch & Lomb International, Inc. and Spafas, Inc.

e. for the tax year ended 1995, the B&L combined group included B&L, Polymer, Bausch & Lomb Oral Care Division, Inc., a wholly owned subsidiary of B&L, Bausch & Lomb International Holdings Corporation, Bausch & Lomb Domestic Holdings Corporation, Bausch & Lomb Domestic Finance Corporation, Charles River Laboratories, Inc., Wilmington Management Corporation, Bausch & Lomb International, Inc. and Spafas, Inc.

For the tax years ended 1988 through 1993, B&L and Polymer were the taxpayer members of the B&L combined group.

For the tax year ended 1994, B&L, Polymer, Bausch & Lomb International Holdings Corporation, Bausch & Lomb Domestic Holdings Corporation, Charles River Laboratories, Inc., Wilmington Management Corporation and Bausch & Lomb International, Inc. were the taxpayer members of the B&L combined group.

For the tax year ended 1995, B&L, Polymer, Bausch & Lomb International Holdings Corporation, Bausch & Lomb Domestic Holdings Corporation, Charles River Laboratories, Inc., Wilmington Management Corporation, Bausch & Lomb International, Inc. and Oral Care were the taxpayer members of the B&L combined group.

Petitioner's New York franchise tax combined returns, for the tax years 1994, 1995 and 1996, reported capital gains and losses on a consolidated basis. For these years, capital gains incurred by one member of the combined group were consistently netted against losses incurred by other members of the combined group. The 1994 and 1995 capital gains and losses were summarized in the requests to include corporations in the combined report.

Bausch & Lomb, Inc. was a New York taxpayer in 1995 and 1996.

The parent company identified on the 1995 and 1996 General Business Corporation Combined Franchise Tax Return, Form CT-3-A, for the B&L combined groups was Bausch & Lomb, Inc.

Before 1995, Oral Care, or its predecessor corporation, had been a New York tax filer, filing a separate business corporation franchise tax return since at least 1988.

For the tax years before 1995, the value of the stock in Oral Care owned by B&L was included in the computation of subsidiary capital on the Form CT-3-A combined group returns and on the B&L pro forma CT-3 or CT-3-A/ATT reports that accompanied the combined group Form CT-3-A returns.

For some of the tax years previous to 1995, the total tax liability reported by the taxpayer members of the B&L combined groups, resulting from their filing of combined returns in New York State, included a tax computed on subsidiary capital.

The average value for Oral Care used by petitioner in the computation of subsidiary capital on the B&L combined reports for the tax years ended 1989 through 1994 varied between $130,000,000.00 and $134,000,000.00. Specifically, for the 1993 and 1994 tax years, the average value was $133,893,881.00 and $133,463,283.00, respectively.

By letter dated January 24, 1996, petitioner requested permission to include Oral Care in the 1995 B&L combined group, since the nature of the Oral Care business had changed.

By letter dated March 15, 1996, the Division granted tentative permission to include Oral Care in the 1995 B&L combined group.

Oral Care was included in the B&L combined group for the first time when the 1995 combined report was timely filed on September 13, 1996. B&L paid the total tax liability reported on the 1995 combined report filed by taxpayer members of the B&L combined group.

The original 1995 B&L combined report filings included the following:

a. Bausch & Lomb Inc., and Affiliates Form CT-3-A.

b. Form CT-3-A/B Subsidiary Detail spreadsheet.

c. Form CT-3-A/ATT Investment Capital and Subsidiary Capital schedules for Bausch & Lomb, Inc., Bausch & Lomb International, Inc. and Bausch & Lomb Oral Care Division, Inc.

d. Form CT-399 Depreciation Adjustment schedule for Bausch & Lomb, Inc.

e. Form CT-5.3, Request for Six-Month Extension to File for Bausch & Lomb, Inc., and Affiliates combined group.

f. Statements 1 through 13.

g. Two sets of Federal Form 1118 Foreign Tax Credit for Bausch & Lomb, Inc.

h. Federal Form 1120 Schedule D - Capital Gains and Losses.

i. Table of Contents to Federal filings.

j. First four pages of the Federal Form 1120 for B&L, plus additional Federal forms, schedules and statements.

k. B&L Claim for Investment Tax Credit and Employment Incentive Credit, Form CT-46.

l. B&L Request for Permission to File a Combined Return or to Change an Existing Combined Group, Form AU-2.1, so as to include Oral Care, Division of Taxation's tentative permission to include Oral Care and letter of September 10, 1996 transmitting CT-3-A.

m. Federal Form 1120 for Bausch & Lomb, Inc. and Consolidated Subsidiaries plus additional Federal forms, schedules and statements.

n. Bausch & Lomb combined group CT-3M/4M, CT-5.3 request for extension and letter dated September 10, 1996 transmitting CT-3M/4M.

o. Reports by a Corporation Included in a Combined Franchise Tax Return, Form CT-3-A/C, Depreciation Adjustment Schedules, Form CT-399 and pro forma Federal Form 1120s for Oral Care, Bausch & Lomb International, Inc., Bausch & Lomb International Holdings Corporation, Wilimington Management Corporation, Polymer, Bausch & Lomb Domestic Holdings Corporation, Spafas, Inc., Bausch & Lomb Domestic Finance Corporation and Charles River Laboratories, Inc.

Instructions for the 1995 General Business Corporation Combined Franchise Tax Return, Form CT-3-A, were published by the Division to provide guidance for taxpayers in preparing their returns.

The taxpayer members of the B&L combined group filed a 1996 combined report including Oral Care. The 1996 B&L combined report filing included the following:

a. Bausch & Lomb, Inc., and Affiliates Form CT-3-A.

b. B&L combined group Form CT-3-A/B, Subsidiary Detail spreadsheet.

c. Form CT-3-A/ATT Investment Capital and Subsidiary Capital schedules for Bausch & Lomb, Inc., Bausch & Lomb International, Inc., Bausch & Lomb Oral Care Division, Inc., Charles River Laboratories, Inc., Bausch & Lomb International Holding Corporation and Spafas, Inc.

d. B&L Claim for Investment Tax Credit and Employment Incentive Credit, Form CT-46.

e. Form CT-5.3, Request for Six-Month Extension to File for Bausch & Lomb, Inc., and Affiliates combined group.

f. Bausch & Lomb, Inc. and Combined Subsidiaries General Business Corporation MTA Surcharge Return, Form CT-3M/4M.

g. Federal Form 1120 for Bausch & Lomb, Inc. plus additional Federal forms, schedules and statements.

h. Reports by a Corporation Included in a Combined Franchise Tax Return, Form CT-3-A/C, Depreciation Adjustment Schedules, Form CT-399 and pro forma Federal Form 1120s for Oral Care, Bausch & Lomb International, Inc., Bausch & Lomb International Holdings Corporation, Wilimington Management Corporation, Polymer, Bausch & Lomb Domestic Holdings Corporation, Spafas, Inc., Bausch & Lomb Domestic Finance Corporation and Charles River Laboratories, Inc.

Instructions for the 1996 General Business Corporation Combined Franchise Tax Return, Form CT-3-A, were published by the Division to provide guidance for taxpayers in preparing their returns.

The Division, after conducting an inquiry in conjunction with an audit, confirmed the tentative permission granted pursuant to petitioner's request and permitted the inclusion of Oral Care in the 1995 B&L combined group.

In conjunction with the CT-3360 reporting Federal changes for 1996, an amended CT-3-A return for the year 1995 was filed by the taxpayer members of the B&L group based on the carryback of a capital loss from the year 1996 as reported on the Federal consolidated tax return filed by B&L and subsidiaries for the year 1996 and an amended Federal consolidated return for the year 1995.

Attached to the Federal Changes to Corporate Taxable Income, Form CT-3360, filed by Bausch & Lomb, Inc. was a document entitled "New York Capital Loss Carryforward" which provided as follows:

	Fiscal Year Ended	New York Capital Loss
Generated	12/28/96	(91,671,265)
Carryback	12/25/93	1,619,502
Carryback	12/31/94	308,417
Carryback	12/30/95	29,438,191
Carryforward Available for 1997		(60,305,155)

Bausch & Lomb, Inc. is a New York corporation with its headquarters located in Rochester, New York.

B&L was incorporated in the State of New York in 1908 to carry on a business which was established in 1853 as an optical goods shop founded by John Jacob Bausch, a German immigrant.

B&L has numerous subsidiaries, some of which file separate New York corporation tax returns, and some of which are included with B&L on a combined return as part of the B&L combined group.

In 1988 B&L acquired Dental Research Corporation, manufacturer of the Interplak battery powered toothbrushes for plaque removal. Dental Research Corporation was renamed Bausch & Lomb Oral Care Division, Inc. After its acquisition, Oral Care retained its form as a business corporation and was a wholly owned subsidiary of Bausch & Lomb, Inc.

Dental Research Corporation was acquired by a Bausch & Lomb payment of $133,000,000.00 in promissory notes and cash. The acquisition included tangible and intangible assets and goodwill. The acquisition cost exceeded the fair market value of the acquired assets by approximately $119,000,000.00, which amount represented the goodwill associated with the Interplak name and product. For the purpose of financial reporting, and not for tax purposes, the $119,000,000.00 was amortized using the straight-line method over 40 years.

During the period January 1, 1992 through December 31, 1995, the Oral Care business was subjected to considerable competition from products newly developed by other companies, concerns about quality control, considerable market value decline and repetitive operating losses that reduced the goodwill value of the Interplak product line manufactured and marketed by Oral Care. Bausch & Lomb recorded a one-time goodwill impairment charge of $75 million on its 1994 financial statements in order to recognize the weak performance of Oral Care.

By the early 1990s the B&L business included development, manufacture and marketing of products and services for the personal health, medical, biomedical and optic fields.

After a decade of expansion of its business segments Bausch & Lomb began to restructure and focus on its core healthcare and optics business. The 1993 10-K business description for the

Bausch & Lomb consolidated businesses reflected the decade of expansion of lines of business: “Bausch & Lomb Incorporated is a world leader in the development, manufacture and marketing of products and services for the personal health, medical, biomedical and optical fields.” However, the 1994 10-K provided a more succinct description: “Bausch & Lomb’s operations have been classified into two industry segments: Healthcare and Optics.”

In January 1995, Bausch & Lomb decided to relocate Oral Care from its independent location in Georgia to B&L facilities in Rochester, New York and combine the Oral Care warehouse and distribution operations at a B&L facility in Greenville, South Carolina. A few Oral Care employees were transferred to the B&L offices in Rochester, New York, but most activities previously performed by Oral Care employees were transferred to employees of B&L. The transfer of Oral Care functions was completed in June 1995.

In May 1995, B&L sold its Sports Optics Division which consisted of a full line of binoculars, riflescopes, telescopes, spotting scopes and sporting glasses under well-known brand names including Bushnell, Jason and Bausch & Lomb.

The Sports Optics Division was an operational unit within B&L. It was not incorporated as a separate business corporation and was not reported as a subsidiary on the B&L consolidated group Federal Form 851.

The Sports Optic Division never filed a separate CT-3 return in New York, nor was a pro forma CT-3 or a CT-3-A/C in the name of the Sports Optics Division attached to any of petitioner’s New York CT-3-A filings since 1988.

A separate value for the ownership of the Sports Optics Division was not included in the computation of subsidiary capital on the B&L combined group CT-3-A returns filed since 1988.

The sale of the Sports Optics Division appears on the Federal 1995 consolidated group Form 1120, Schedule D, as a sale of assets.

The gain on the sale of the Sports Optics Division was included in Federal taxable income and, therefore, in entire net income reported to New York for the year 1995 for the B&L combined group.

In December 1995, the Bausch & Lomb board of directors approved restructuring actions, including employee severance and plant closures associated with a reconfiguration of manufacturing processes, some consolidation of administrative functions, the elimination of corporate staff positions and the sale of a company airplane.

In June 1996, the Bausch & Lomb board of directors approved plans to resructure portions of the eyewear and vision care segments, as well as certain corporate administrative functions.

On September 20, 1996, Bausch & Lomb completed the sale of Oral Care to Conair Corporation. Bausch & Lomb recorded a loss on the sale.

The Bausch & Lomb tax loss from the sale of Oral Care was $93,126,403.00. On the 1996 Federal Form 1120, Schedule D, for Bausch & Lomb, the cost basis in the stock in Oral Care was $110,175,297.00 and the selling price for Oral Care was $17,048,894.00.

The Division conducted a field audit of the New York corporation franchise tax returns of petitioner filed for the years 1992 through 1995.

The Division audit staff are provided training and standard procedures for conducting audits of taxpayers.

For all field audits the Division audit staff are required to keep a record on "Tax Field Audit Record," Form DO-220.5, of their audit activities and contacts with taxpayers. Included in the Tax Field Audit Record relating to the audit of petitioner are most of the contacts between the Division and petitioner.

The audit of petitioner for the years 1992 through 1995 was initially assigned to Erich J. Fuerter, with the first entry on the DO-220.5 being May 22, 1996. Mr. Fuerter left New York State service in 1998. The audit of petitioner was reassigned to Amy E. DiPirro on June 25, 1998.

In general, the Division's auditors identify their workpapers, both handwritten and computer generated, by placing their initials on the pages they have prepared.

It is the policy of the Division to include in the audit file everything given by the taxpayer to an auditor. The Division's auditors may make handwritten notes or comments on documents and records provided to them by a taxpayer, but do not necessarily include their initials with those entries. Taxpayers may make handwritten notes or comments, without identification of the maker of the notes or comments, on documents and records that they provide to the Division's auditors and which are included in the audit file.

The initials of "MAK" are those for Margaret Knauf, a/k/a Peggy Knauf, an employee of the B&L Tax Department whose responsibilities included preparing tax returns and providing documents during audits.

For general business corporation franchise tax audits, the Division's auditors use a standard form "AUDIT WORKPAPERS INDEX" as a guide in organizing workpapers. This index form does not provide specific page references to the workpapers of a particular audit and includes standard section headings, some of which may not apply to the workpapers for a particular audit.

The Field Audit Report section of the audit workpapers chronicles the Division's findings and adjustments for the audit period. The report includes a narrative describing the scope, process and findings of the audit.

The "Schedules" section of the Audit workpapers includes a worksheet showing the computation of additional tax or refund due and other worksheets showing secondary computation materials supporting that computation.

The "Informal Conference Notes" cover meetings with the taxpayer by the Division's auditors and audit supervisors. The "Internal Conference Notes" section in the audit workpapers includes a letter from petitioner to the Division responding to the Division's initial proposed audit findings, notes from meetings with taxpayer personnel in 2000 and 2001, notes of the auditor concerning her review of the taxpayer's claim for refund, documents received from the taxpayer relating to those meetings and a team leader review regarding an audit for the period 1996 through 1998.

The audit of petitioner was conducted in conjunction with separate audits for two other corporations related to B&L but not included in the B&L combined group. The audit addressed numerous issues including combined reporting, entire net income, investment capital, income and allocation, total capital, subsidiary capital and allocation, business allocation percentage, Federal changes, tax credits, license fees, minimum taxable income tax base, Metropolitan Transportation District surcharge and the claim for refund based upon the capital loss carryback from 1996.

The audit had the following results:

a. Changes to Federal corporation taxes for the years 1988 and 1989 which resulted in changes to New York corporation taxes for those years.

b. No adjustment to the composition of the B&L combined group for any of the years 1992, 1993, 1994 or 1995 after specifically considering the addition of Oral Care.

c. Petitioner correctly reported total capital, subsidiary capital and allocation and business allocation percentages for the years 1992, 1993, 1994 and 1995.

d. The recomputation of the entire net income component for interest indirectly attributable to subsidiary capital for the years 1992 through 1995 to adjust the value for some subsidiaries at net worth.

e. For the year 1995, the exclusion of a corporation that was less than 50% owned from the computation of income from subsidiary capital reported for purposes of the computation of combined entire net income.

f. The claim for refund for the year 1995 resulted from petitioner's carryback from a 1996 net capital loss which represented a loss from Bausch & Lomb's sale of its stock in Oral Care.

g. Denial of petitioner's claim for refund based on the conclusion that 20 NYCRR 3-7.2 required that Bausch & Lomb's loss from its subsidiary capital, the sale of its Oral Care stock, be added to Bausch & Lomb's recomputed 1995 Federal taxable income when calculating the combined entire net income on the 1995 amended combined return for the B&L combined group.

The audit was concluded on September 6, 2001 when petitioner signed and submitted a Revised Consent to Field Audit Adjustment and a check in the amount of $184,676.00 in full payment of adjusted taxes, plus interest, for the years 1988 through 1995. In addition, the Division issued a letter of refund denial for the claimed refund based on the refusal to recognize the carryback to 1995 of the 1996 loss resulting from the September 1996 sale of Oral Care.

In denying petitioner's refund claim, the audit considered the information contained on petitioner's 1995 and 1996 tax returns, specifically the amended CT-3-A for 1995, dated April 13, 1999, the Federal Form 1120, Schedule D, for 1996 and a supporting statement computing available New York capital loss carryforward.

Petitioner's original General Business Corporation Combined Franchise Tax Return, Form CT-3-A, for the year 1995 reported a capital gain of $29,438,191.00. In 1996, petitioner's New York capital loss reported was $91,671,265.00. This capital loss was a net amount, as petitioner's loss from the sale of Oral Care was $93,126,403.00. On the Federal Form 1120, Schedule D, for 1996, petitioner reported a cost basis of $110,175,297.00 for its stock in Oral Care and a sales price for that stock of $17,048,894.00.

The amended CT-3-A for 1995 reduced the reported amount of entire net income in 1995 by $29,438.191.00. For Bausch & Lomb, Inc., the parent in the combined group, the amount of $177,742,724.00 reported on the amended 1995 CT-3-A return in Column 1, entitled "Parent," at Line 1, reporting Federal taxable income, reflects a reduction by $29,438,191.00 from the amount reported on the original CT-3-A for 1995. The amount of $131,214,060.00 reported on the amended 1995 CT-3-A return on Line 1 at Column E, entitled "Combined Total" reflects a reduction of $29,438,191.00 from the amount reported on the original CT-3-A for 1995. The reduction of $29,438,191.00 on Line 1 of the amended 1995 CT-3-A return to the amount of $131,214,060.00 shown in Column E flows through all the other totals in Column E on the lines subsequent to Line 1, resulting on Line 24 in a reduced reported combined entire net income base of $23,980,192.00.

In computing the value of subsidiary capital for 1995 for purposes of computing interest and expenses indirectly attributable to subsidiary capital, the audit included the value of Oral

Care in the B&L combined group average assets. The value of Oral Care, in the computation of subsidiary capital on the B&L combined group's report, was eliminated.

The 1996 New York return for petitioner, dated September 11, 1997, reported the sale of Oral Care on September 20, 1996.

The filing of petitioner's CT-3360 was the first notice to the Division of petitioner's proposed carryback to 1995 of the 1996 net capital loss which was a loss from B&L's 1996 sale of the Oral Care stock. The initial review by the auditor of the CT-3360 claim for refund in June 1999 determined that Oral Care was subsidiary capital and resulted in the conclusion that the refund should be denied. The auditor concluded that the B&L ownership of stock in Oral Care was an investment in subsidiary capital for New York State purposes whether or not Oral Care filed its tax reports in the State on a combined or separate basis.

In 2000, the Division made a determination to remove Oral Care from the B&L combined group. In 2001, after receiving additional information from petitioner, the Division allowed the inclusion of Oral Care in the B&L combined group for 1995.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge concluded that B&L's loss on the sale of stock of Oral Care was excluded from the calculation of entire net income by section 208.9(a)(1) of the Tax Law because it constituted "income, gains and losses from subsidiary capital" and that result was not changed by section 211.4(b)(2). The determination states in this regard as follows:

> The wording of Tax Law § 211(4) does not provide the interpretation that B&L seeks. The only instructions provided by the Legislature within Tax Law § 211(4) regarding the computation of combined entire net income is that "intercorporate dividends shall be eliminated." Thus, when enacting Tax Law § 211(4), the Legislature did not explicitly state that Tax Law § 208(9)(a)(1) was superseded by Tax Law § 211(4) such that the computation of combined entire net income on a combined report should

> include, rather than exclude, the income, losses and profits from the sale of an investment in a subsidiary even when the subsidiary is part of the combined group.

The Administrative Law Judge found support for this conclusion in our decision in ***Matter of H&S Holdings Ltd., infra,*** and from his finding that the result sought by petitioner would result in distortion of income. The decline in value of the stock of Oral Care appears to have occurred largely during years when that corporation was not included in the combined return of petitioner and would accordingly have reduced the tax on subsidiary capital for those years. Permitting this decline in value to be applied a second time in the form of a deduction in determining entire net income for the year of sale would in his view result in distortion. Additional distortion would result for the following reason:

> Further distortion would result, in accepting petitioner's position, because it would be allowed to carry forward the balance of its capital loss to years after 1996, which is a period when Oral Care would no longer be a part of the B&L combined group as it was sold in September 1996. Such a carry forward could result in the reduction of the combined entire net income on a combined report encompassing a combined group of a different member composition, and without the corporation whose sale resulted in the loss at issue.

ARGUMENTS ON EXCEPTION

Petitioner argues in support of its exception that principles of statutory construction require that the specific direction in section 211.4(b)(2) to eliminate intercorporate stock holdings in computing combined subsidiary capital should have controlling significance in interpreting the more general definition of subsidiary capital in section 208.4 for purposes of applying section 208.9(a)(1) (See, exception, Attachment, p. 2; See also, brief in support, pp. 13-14). Petitioner also rejects the conclusion that its position results in distortion of income (Se, brief in support, pp. 17-21).

The Division argues in opposition that B&L's stock in Oral Care did not lose its character as subsidiary capital upon that corporation's joining in petitioner's combined return because section 211.4 does not redefine terms defined elsewhere and only modifies the computation of tax within section 210 to eliminate intercorporate transactions (See, brief in opposition, pp. 7-10). The Division also draws support for its position in various historical materials describing the adoption in 1944 of the current tax structure of the corporation franchise tax (See, brief in opposition, pp. 13-15).

OPINION

The issue in this case is whether the words "in computing combined subsidiary capital intercorporate stockholdings shall be eliminated," which appear in Tax Law § 211.4(b)(2), apply in determining what constitutes "[i]ncome, gains and losses from subsidiary capital" within the meaning of Tax Law § 208.9(a)(1). For the reasons discussed below, we have concluded that they do. As a result, we hold that the add-back of losses from subsidiary capital provided for in section 208.9(a) does not apply to the loss incurred by B&L on the sale of stock of Oral Care.

Corporations subject to the corporation franchise tax under Article 9-A of the Tax Law are required to calculate tax under various tax bases, two of which are involved in this case–*viz*. the tax on the entire net income base and the tax on subsidiary capital. The determination of entire net income generally begins with Federal taxable income which is then subject to various adjustments in arriving at the base subject to tax (***see,*** Tax Law § 208.9). One such adjustment is that "income, gains and losses from subsidiary capital" are not included in entire net income (***see,*** Tax Law § 208.9[a][1]). Similarly, entire net income is determined, in the discretion of the Division, without deduction for "interest directly or indirectly and any other amount directly or indirectly attributable as a carrying charge or otherwise to subsidiary capital or to income, gains or losses from subsidiary capital"(Tax Law § 208.9[b][6]). Subsidiary capital is instead subject to a separate tax of nine-tenths of a mill for each dollar of subsidiary capital allocated to New York (***see,*** Tax Law § 210.1[e]). The tax on subsidiary capital is essentially an annual *ad valorem* property tax with real property and marketable securities valued at fair market value and other personal property valued at book value (***see,*** Tax Law § 210.2). In general, subsidiary capital includes stock and indebtedness of corporations of which the parent corporation owns over 50% of the voting stock (***see,*** Tax Law § § 208.3, 208 .4).

In the case of corporations joining in combined reports, the computation of the tax bases described above are adjusted by Tax Law § 211.4(b)(2) which reads as follows:

> In computing combined entire net income, combined minimum taxable income or combined pre-nineteen hundred ninety minimum taxable income intercorporate dividends shall be eliminated, in computing combined business and investment capital intercorporate stockholdings and intercorporate bills, notes and accounts receivable and payable and other intercorporate indebtedness shall be eliminated and *in computing combined subsidiary capital intercorporate stockholdings shall be eliminated*, provided, however, that intercorporate dividends from a DISC or a former DISC not exempt from tax under paragraph (i) of subdivision nine of section two hundred eight of this article which are taxable as business income under this article shall not be eliminated [italics added].

The position of petitioner is that the italicized quoted words apply in determining what is comprised by the words "Entire net income shall not include . . . income, gains and losses from subsidiary capital" which appear in section 208.9(a). The Division's position is that they do not.

The Division makes the argument, which was embraced by the Administrative Law Judge, that section 211.4(b)(2), although *eliminating* intercorporate stockholdings from the computation of subsidiary capital, does not affect what items are *included* in entire net income. The Division seems to be saying that because section 208 defines various terms used in other provisions and section 208.9 begins with the words "The term 'entire net income' means . . . ," the scope of section 208.9 can be altered only by provisions that are themselves definitions, as would be the case if they used “means” or “is defined as” or words of similar import, rather than “eliminated.” This is a highly semantic and unconvincing argument--particularly since the very provision at issue, subsection (a) of section 208.9, uses the words “shall not include,” rather than “shall not mean,” to alter the scope of the definition of entire net income. It is hard to understand why the word “include” is somehow more definitional than the word “eliminate” or why we should conclude in any event that section 211.4(b)(2) would need to be phrased as a definition in order to limit the scope of section 208.9(a)(1).

The Division asserts that its position reflects the intention of the legislature in creating the current structure of the franchise tax in 1944. Among the materials attached to its brief is an article authored by Ellis J. Staley, Jr., Legal Assistant to the Commissioner of the New York State Department of Taxation and Finance and published in the proceedings of the 1945 New York University Conference on the New York State Franchise Tax on Business Corporations (Staley, “The New Problems of Consolidated Returns”) which includes the following:

> In computing the tax of the taxpayer or taxpayers reporting on a consolidated basis the consolidated entire net income and capital of all the corporations covered by such report will be regarded by the Tax Commission as the entire net income and capital of one corporation.
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> * * *
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> In the case of corporations reporting on a consolidated basis, there is eliminated in computing the amount of subsidiary capital all investments of any corporation included in the consolidated report in the stocks of any subsidiary corporation included in such report and the amount of indebtedness owed to any corporation included in the consolidated report by any subsidiary included in such report. Thus, on a consolidated basis the amount of subsidiary capital is only the amount of the investments of the consolidated corporations’ subsidiaries which are not included in the consolidation.

*   *   *

> The result obtained by reporting on a consolidated basis under old Article 9-A was two-fold. First, the corporation, so reporting, received a benefit to the extent of the elimination from net income of any intercorporate dividends, and second, the allocation percentage for apportioning the amount of income and capital, within and without the State, was altered by the inclusion of the allocating factors of all the corporations in the consolidation. Under new Article 9-A the first result has been eliminated by the provisions of the law which now exclude from entire net income for all taxpayers, whether or not reporting on a consolidated basis, all income, gains and losses from subsidiary capital which automatically eliminates any dividends received from a subsidiary (Id. pp. 49-51).

The Division cites the final quoted sentence as supportive of its argument since it implies that the exclusion now set forth in section 208.9(a)(1) applies to corporations "whether or not reporting on a consolidated basis" and therefore subject to section 211.4(b)(2) (Brief in opposition, p. 14). On the other hand, the first quoted sentence indicates that the combined group should be treated as a single corporation. If this hypothesis were followed in the present case, it would seem appropriate to treat the sale of a combined subsidiary as if it were the sale of an unincorporated division–a transaction that would certainly be taken into account in computing tax on entire net income. It is inconsistent with this theory to treat the sale as exempt from that tax. While these contemporaneous comments of the Division's representative are of interest, they are not legislative history of the statute and are of limited value in resolving the issue before us.

The Division's position in this case is inconsistent with the reading of the statute that it adopted in an Advisory Opinion (TSB-A-94[13][C], August 29, 1994). There the Division relied on 20 NYCRR 3-6.6 which applies Tax Law § 211.4(b)(2) and provides, "In computing combined subsidiary capital, all investments in the stock of subsidiaries included in the combined report and any indebtedness from subsidiaries included in the combined report must be eliminated." The Division held that a deduction for interest on debt incurred to acquire a combined subsidiary was not eliminated from the calculation of entire net income by section 208.9(b)(6). The Advisory Opinion concluded, "This is proper because there is no subsidiary capital on the combined report to which to attribute the interest expense."

The Division's brief in opposition observes that advisory opinions are not binding and states that TSB-A-94(13)(C) is "not on point, since . . . the Division was not interpreting Tax Law § 208.9(a)(1) but rather section 208.9(b)(6) which is a discretionary statute" (Brief in opposition, p. 20). While it is true that advisory opinions are not binding and that the provision addressed was a different paragraph of section 208.9, the Advisory Opinion applied section 211.4(b)(2) of the Tax Law and section 3-6.6 of the regulations in determining the scope of "subsidiary capital" for purposes of the definition of entire net income in section 208.9, which is exactly the interpretation on which petitioner relies. In its arguments in this case the Division has not recanted the position taken in the Advisory Opinion. This leaves us with the understanding that in the Division's view, (A) a parent corporation's investment in a combined subsidiary is exempt from the tax based on entire net income as a result of the application of section 208.9(a)(1) and (B) is exempt from the tax based on subsidiary capital as a result of the application of section 211.4(b)(2), but (C) interest on debt incurred to carry the investment in a combined subsidiary is nevertheless deductible in determining entire net income.

The Division argues that its position avoids distortion of income of the corporations involved. The Administrative Law Judge adopted this theory in his determination. The Division advances several interpretations of the avoided distortion, none of which is convincing. First, it appears that the decline in the fortunes of Oral Care occurred over a period of years beginning when it was an uncombined subsidiary of B&L and therefore subject to the tax on subsidiary capital. The Division seems to be saying that this results in a double counting of the depreciation in value of the company because it first reduced the value of subsidiary capital and then reduced entire net income upon sale. This result is not surprising or anomalous but is rather a logical consequence of the different nature of the two taxes and the legislative decision to apply the corporation franchise tax on more than one base. If Oral Care had prospered, its profits would have borne the tax on entire net income and its retained earnings would then have increased the company's value to B&L for purposes of the tax on subsidiary capital. If B&L had sold Oral Care at a gain, the tax on entire net income would again apply to that increased value under the interpretation advanced by petitioner.

A second theory of distortion seems to be based on the idea that built-in losses which economically accrued before a corporation joined in the combined report or at a time when the members of the combined group were different should not be allowed (***see,*** Brief in opposition, p. 22-23). No legal basis on which we could impose such limitations on the use of losses under the current Tax Law and regulations has been suggested by the Division. We also note that there was apparently no shift in the ownership of the corporations involved between the period over which the values declined and when the loss was realized on sale of Oral Care and accordingly no trafficking in the losses. To the extent that there is a concern about changes in the membership of a combined return group between the year when a loss was recognized and the years to which the loss was carried, it should not bear on the question of whether the loss was recognized.

Finally, we find that our decision in ***Matter of H & S Holdings Limited*** (Tax Appeals Tribunal, September 11, 1997), does not support the Division's position in this case. In that case we interpreted the following specific language of Tax Law § 210.12(a): "In the case of a combined report the term investment credit base shall mean the sum of the investment credit base of each corporation included on such report." We concluded that this language requires that each of the combined corporations must meet the conditions for the investment credit independently. At most this case stands for the proposition that the combined group is not treated as a single corporation in the face of a statutory provision that unambiguously provides otherwise. It does not help us to determine the relationship between the two sections here at issue–section 208.9(a)(1) and section 211.4(b)(2). Also, our decision in ***Matter of Amsterdam Sav. Bank*** (Tax Appeals Tribunal, March 11, 1993), which allowed a loss on sale of a combined subsidiary, is inapposite since it turned on the different wording of the provisions of the franchise tax on banking corporations under Article 32 of the Tax Law. Accordingly, it is ORDERED, ADJUDGED, and DECREED that:

1. The exception of Bausch & Lomb Inc., and Affiliates is granted;

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

3. The petition of Bausch & Lomb Inc., and Affiliates is granted; and

4. The claim for refund dated April 12, 1999 of Bausch & Lomb and Affiliates is modified as set forth in the finding of facts above and the Division's denial dated August 31, 2001 of the claim for refund as so modified is cancelled.

DATED:Troy, New York
December 20, 2007

/s/ Charles H. Nesbitt
Charles H. Nesbitt
President

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

/s/ Robert J. McDermott
Robert J. McDermott
Commissioner