STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition of TURBODYNE CORPORATION for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Periods Ended December 31, 1973 through December 31, 1979 and October 31, 1984.	: : : : : :	DETERMINATION DTA NO. 812134

Petitioner, Turbodyne Corporation, c/o Cooper Industries, P.O. Box 4446, Houston, Texas 77210, filed a petition for redetermination of a deficiency or for refund of corporation franchise tax under Article 9-A of the Tax Law for the periods ended December 31, 1973 through December 31, 1979 and October 31, 1984.

A hearing was held before Dennis M. Galliher, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on June 14, 1994 at 9:15 A.M., with all briefs to be filed by December 14, 1994. Petitioner, appearing by Morrison & Foerster, Esqs. (Paul H. Frankel and Hollis L. Hyans, Esqs., of counsel), submitted a brief on October 11, 1994. The Division of Taxation, appearing by William F. Collins, Esq. (Robert Tompkins, Esq., of counsel), submitted its brief on November 15, 1994. Petitioner's reply brief was submitted on December 14, 1994.

ISSUES

I. Whether the Division of Taxation properly denied petitioner's request to file a combined report covering its parent and its brother/sister corporations because (a) the statute of limitations for assessment or refundhad expired with respect to those other entities proposed to be combined with petitioner, and/or (b) that petitioner's accounting period differed from that of the other corporations proposed to be combined with petitioner.[1]

II. Whether penalties imposed against petitioner based on its failure to timely report Federal audit changes, as required per Tax Law § 211(3), should be abated.

FINDINGS OF FACT[2]

Combined Filing

During the years in issue, petitioner, Turbodyne Corporation ("Turbodyne"), was a wholly-owned subsidiary of Edison International, Inc. ("Edison"). Edison also owned 100% of the stock of Campbell Chain Company ("Campbell") and Worthington Compressors, Inc. ("Worthington").

Effective November 1, 1984, petitioner was sold by Edison.

Turbodyne, Edison, Campbell and Worthington were each subject to New York State corporation franchise tax, and filed separate New York State corporation franchise tax reports ("State reports"). More specifically, on October 15, 1985, petitioner filed a State report for the short period

spanning January 1, 1984 through October 31, 1984. Although petitioner was a calendar year taxpayer and maintained its books and records on a calendar year basis (as did Edison, Campbell and Worthington), both its Federal pro forma income tax return included in the Federal consolidated return of petitioner and its affiliates, and its State report, included income from its operations only through the October 31, 1984 date of the sale of petitioner's stock by

[1]The parties have agreed that, in the event petitioner is permitted to file a combined report covering its parent and its brother/sister corporations, the Division of Taxation will have a period of one year from the date of final determination granting such permission in order to conduct an audit of the respective State reports included in the combined report (other than to redetermine whether petitioner may file a combined report). Petitioner, in turn, will have an opportunity to contest any proposed adjustments which may result from such audit as prescribed by the Tax Law.

[2]Petitioner submitted proposed findings of fact numbered "1" through "18". These proposed facts have been accepted and are incorporated in the Findings of Fact herein.

Edison. Petitioner was required to file a separate State report for the remainder of its taxable year, i.e., November 1, 1984 through December 31, 1984. Also on October 15, 1985, Edison, Campbell and Worthington filed their respective State reports for the 1984 calendar year.

In May 1988, the Division of Taxation ("Division") commenced a field audit of petitioner's State report for the short period ended October 31, 1984. During the course of the audit, petitioner requested that it be permitted to file a combined franchise tax report ("combined report") including Edison, Campbell and Worthington.[3]

On January 31, 1990, a Notice of Deficiency was issued to petitioner asserting additional tax due for the short period ended October 31, 1984 in the amount of $67,818.00, plus interest. In addition, the Division did not permit petitioner to file a combined report with Edison, Campbell and Worthington.

Petitioner timely filed a protest to the Notice of Deficiency and requested that a conciliation conference be held. Petitioner asserted that its State report for the period ended October 31, 1984 should be filed on a combined basis covering Edison, Campbell and Worthington in order to properly reflect its income.

On April 27, 1990, while the statute of limitations for refunds was still open for petitioner with respect to its short period ended October 31, 1984, a combined report was filed, including petitioner, Edison, Campbell, Worthington and McGraw-Edison International Sales Corporation ("McGraw-Edison") and a refund was requested.[4]

[3]It would appear that petitioner's request during the audit for combined filing was an oral request. In this regard, the Division's brief notes that petitioner's first formal request for combined filing was not made until after the Division's Notice of Deficiency had been issued and after the Tax Appeals Tribunal had issued its decision in Matter of Autotote, Ltd. (April 12, 1990). However, the Division does not dispute that, upon audit, petitioner requested permission to file a combined report, and does not argue that petitioner's request was not timely in light of Autotote.

[4]Edison had previously filed an amended State report for 1984, as a result of State audit adjustments, together with McGraw-Edison, a wholly-owned domestic international sales

A conciliation conference was held on November 19, 1991 and thereafter, on May 7, 1993, a Conciliation Order was issued sustaining the Division's Notice of Deficiency. As sustained, the Division's position was (i) that the statute of limitations barred combined filing (i.e., corporations whose tax years were closed could not be included in the combined group), and (ii) that combined filing was barred because not all members of the proposed combined group used the same accounting period.

On July 27, 1993, petitioner timely filed a petition contesting the Conciliation Order and objecting to the Division's denial of a claimed $1,043,027.00 refund. This refund amount was determined via a formula whereunder petitioner multiplied the total refund which would have been due if the statute of limitations had been open for Edison, Campbell, Worthington and McGraw-Edison by a fraction, the numerator of which was

petitioner's 1984 corporation franchise tax liability as reported on its separate State report (plus the additional tax set forth in the Notice of Deficiency for that period) and the denominator of which was the total corporation franchise tax liability, on a separate basis, of all members of the proposed combined group. This calculation may be set out as follows:

$$\frac{\text{petitioner's separate report tax liability}}{\text{total tax liability, on a separate basis, of all group members}} \times \text{total refund for group}$$

- OR -

$$\frac{\$1,102,455.00}{\$1,202,793.00} \times \$1,133,725.00 = \$1,043,027.00$$ [5]

The Division does not contest that petitioner, together with Edison, Campbell, Worthington and McGraw-Edison, meet the stock ownership, unitary business and distortion

corporation.

[5] The ratio used to determine the portion of the total refund attributable to petitioner was rounded to 92%.

requirements for combination which are set forth in corporation franchise tax regulations sections 20 NYCRR 6-2.1, 6-2.2 and 6-2.3. Furthermore, the Division does not assert that petitioner's request to file a combined report with its affiliates is untimely in that it was made more than 30 days after the close of petitioner's taxable year ended October 31, 1984. Finally, the Division concedes that the statute of limitations for assessment or refund with respect to petitioner remains open. In contrast, petitioner acknowledges that the statute of limitations for assessment or refund has expired with respect to Edison, Campbell and Worthington.

Penalties

On January 15, 1988, the Internal Revenue Service ("IRS") finalized Federal audit changes pertaining to petitioner for the years 1973 through 1976. Thereafter, in April 1988, the IRS finalized Federal audit changes pertaining to petitioner for the years 1977 through September 30, 1979.

On or about March 9, 1988, the Division contacted petitioner and scheduled an audit appointment for May 9, 1988 covering these Federal audit change years (it would appear that such audit was a part of the audit covering petitioner's taxable period ended October 31, 1984 [see, Finding of Fact "4"]). Although petitioner was aware of the statutory requirement to report the Federal audit changes to the Division within 90 days of finalization, petitioner did not formally do so.

On January 31, 1990, notices of deficiency for additional tax, interest and penalty totalling $420,177.00 were issued to petitioner as the result of Federal audit changes for the taxable years 1973, 1977, 1978 and for the taxable year ended September 30, 1979. Petitioner timely filed a protest against these notices of deficiency seeking a waiver of penalties and requesting that a conciliation conference be held. On May 7, 1993, a Conciliation Order was issued sustaining the imposition of penalties.

Petitioner's main argument against the imposition of penalties centers on the claim that at the time the Federal audit changes were finalized, petitioner knew that the Division's audit covering the same years was imminent and thus determined that it was unnecessary to formally file a report of the Federal changes.

CONCLUSIONS OF LAW

- Combined Filing -

A. The first issue in this case presents a narrow question, to wit, whether the statute of limitations on assessment or refund must be open for each individual corporation being required or seeking permission to be included in a combined franchise tax report. There is no dispute that the corporations here involved meet the requirements for combined filing (i.e., the stock ownership, unitary business and distortion standards), that the statute of limitations on assessment or refund remains open for petitioner but is closed with respect to the other corporations involved, and that petitioner's request for permission to file on a combined basis, though made more than 30 days after the close of its taxable year, was not untimely in light of the Tax Appeals Tribunal's decision in Matter of Autotote, Ltd. (supra). Thus, the only real question is whether petitioner's request to file on a combined basis with the other named corporations was properly denied because the statute of limitations on assessment (Tax Law § 1083[a]) and for claiming refunds (Tax Law § 1087[a]) was closed with respect to such other corporations.

B. Petitioner argues that a combined report is merely a device to reflect the accounting by which the appropriate amount of entire net income for each corporation in the combined group is attributed to New York. Petitioner maintains that the combined group is not a taxpayer or separate entity, but rather is a reflection of the income of each of the corporations joining as a part of the combined group. Petitioner goes on to argue that the statute of limitations should not serve to limit one's right to be included in a combined group, but rather should only serve as a limitation on which members of a combined group may be subject to an assessment of liability or be allowed to claim a refund. By contrast, the Division does not dispute that the purpose for permitting or requiring combined filing is to reflect each corporation's appropriate amount of entire net income allocable to New York. However, the Division maintains that a combined report itself is more than an accounting device or method, to wit, that it is a tax return. The Division argues that taxpayers and the Division should be able to rely on the statute of limitations as a means of assuring finality. In this regard, the Division maintains that it cannot (or at least should not) be allowed to include closed-year corporations in a combined report to result in an increased assessment collectible against an open-year corporation included in such report. In turn, the Division points out that under the same standard a taxpayer cannot (or at least should not) be able to include closed-year corporations in a combined report to result in a refund (as here) for an open-year corporation included in such report. In sum, the Division argues that a combined report is a tax return for all group members, and that in order to be included within the combined filing group (and thus be able to claim a refund or be subject to an assessment), all group members' years must be open.

C. There is no direct precedent addressing the particular question presented herein. In fact, this issue would seem to occur only infrequently because a corporation's filing status is generally known and set within 30 days after the close of its taxable year, a point in time at which the statute of limitations on assessment or refund would be open for affiliates of a taxpayer which might be included in a combined report. In this case, each of the corporations filed on a separate report basis, and petitioner admittedly did not request permission to file on a combined basis until after the audit had been undertaken. As noted above, failure to request permission to file on a combined basis within 30 days of the close of the taxable year (the "30-day rule") will not bar a taxpayer from being permitted to combine when, under audit, that taxpayer is found to meet the bases upon which combined filing would otherwise be required or permitted (Matter of Autotote, Ltd., supra). Here, however, because of the passage of time, the statute of limitations had closed for all of petitioner's affiliates, with petitioner remaining an open-year corporation only because of consents it had executed extending the period of limitations.

D. Notwithstanding petitioner's arguments to the contrary, expiration of the statute of limitations on assessment or refund does serve as a bar to being included in a combined report.

First, both the Division and taxpayers should be able to rely on the finality provided by expiration of the statute of limitations. In this case, there was no request for combination within the 30-day rule period, or thereafter when each company filed its separate reports, or during the time when petitioner's affiliates' years remained open. The result sought herein, permission to file on a combined basis including closed-year corporations thus leading to a refund to petitioner, is no different in theory than allowing the Division to require combination upon audit of an open-year taxpayer and include closed-year affiliate corporations in the newly-combined group resulting in a deficiency assessable against the open-year corporation. In neither instance does the opposing party find itself able to rely upon the closure ordinarily provided by the statute of limitations. Stated simply, a taxpayer ought to be able to rely upon the proposition that its results or those of its affiliates will not be disturbed or changed by after-the-fact inclusion of closed-year entities. It is equally unfair for the Division to be able to revive and include a "dead-year" corporation as the springboard from which to generate an assessment as it is for a taxpayer to revive and use a "dead-year" corporation to generate a refund.

E. Additional direct support for limiting combined filing to groups which include only corporations with open years may be found in 20 NYCRR 8-1.3(a), which provides as follows:

> "Where the tax is computed on the basis of a combined report, the [Commissioner of Taxation] may <u>assess</u> the entire amount of the tax and all additional taxes computed on the basis of such report <u>against any one or more of the taxpayers covered by the combined report</u>, in such proportions as [he] determines, <u>but every such taxpayer</u> is liable for the entire amount" (emphasis added).

This language leads directly to a conclusion that all members of the combined group must have open tax years. That is, the regulation plainly states that the Division can <u>assess</u> any of the taxpayers in the combined group. In turn, it is clear that the statute of limitations on assessment must be open in order for the Division to <u>assess</u> liability. The regulation does not limit this right to assess <u>any</u> combined group taxpayer by stating that "the Commissioner may assess any combined group taxpayer unless such an assessment is precluded by the statute of limitations on assessment." Rather, the regulation simply provides that <u>all</u> taxpayers covered by the combined report <u>are</u> <u>liable</u> for tax and may be <u>assessed</u>. It follows then that all of such group member taxpayers must have open years in order to be included in the group.

F. In this case, petitioner employed a formula to determine its "share" of the refund (see, Finding of Fact "9") which would be due the group if combination were permitted. The Division did not challenge the use of such a formula, as borne out by its admission thereto in its answer to the petition (see, Ex. "B" at ¶ 2).[6] However, it seems obvious that the need to use a formula only arises if closed-year corporations are included in combined reports, and such "need" appears to conflict with the direct words of 20 NYCRR 8-1.3. As set out above, said regulation allows assessment against any of the taxpayers in the group. Since the statute of limitations must be open in order to permit assessment, it follows that all group members must be open-year corporations. In turn, where all group members' years are open, there is no apparent need to employ a formula to allocate shares of either an assessment or a refund to the open-year group member(s). In fact, assuming acceptance of petitioner's position (i.e., that the statute of limitations only serves to limit which group members may be assessed or claim refunds [notwithstanding 20 NYCRR 8-1.3]), then the entire assessment or refund would flow to the open-year corporation with no reason that any limiting formula would be needed. Thus, a conclusion that all group members must have open years eliminates any need to formula apportion and remains consistent with the regulation by allowing any one or all of the taxpayers in the group to receive a refund or be assessed. Finally, any argument that petitioner's ability to claim and receive a refund is being controlled by whether the statute of limitations has expired with respect to other separate entities must be viewed in light of the fact

that the very basis upon which petitioner may claim a refund is driven by other separate entities

[6]Subsequent to the hearing, the Division raised a question as to its right to challenge the formula. However, the record does not bear out a claim that the Division, at hearing, clearly sought to amend its answer or otherwise challenge the specific formula employed by petitioner, nor did the Division propose any alternative formula. Thus, acceptability and use of the specific formula is not an issue in this case. However, the need to employ a formula and arrive at an allocation of a refund (or of an assessment) is a matter meriting discussion.

(i.e., there is no refund but for the filing of a combined return including such other companies).

G. Petitioner's position leads to situations where only one open-year taxpayer in a combined group would be subject to an assessment or receive a refund notwithstanding that it is the inclusion of closed-year corporations which is entirely responsible for causing the assessment or refund. Thus, it becomes apparent that what could not be done directly by either party (issue an assessment or obtain a refund) due to statute of limitations closure can be achieved indirectly by disregarding the statute of limitations in the combined filing setting. Accordingly, and in sum, closed-year corporations may not be included in a combined report, either when the Division seeks to require combination upon audit or when a taxpayer seeks permission to combine during the course of an audit.[7]

H. The Division initially also raised a second basis for denying permission to file a combined report, to wit, by virtue of having been sold and thus being required to file two short-period tax returns, petitioner had a different accounting period from the other corporations in the proposed combined group. This argument was mentioned briefly by both parties in their opening statements, was addressed by petitioner on direct examination and by the Division by two questions on cross examination, and was discussed in more detail in petitioner's brief. The Division, however, did not further address this issue in its brief or otherwise. In fact, the Division's brief only identifies and addresses as an issue the statute of limitations basis for denying combination and does not identify as an issue, mention or otherwise discuss the "different accounting period" basis for denial. Thus, it would appear that the Division has

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[7]Certain arguments are mentioned in the briefs regarding the possibility that (a) an open-year taxpayer facing assessment under required combination would receive contribution from its closed-year affiliates rather than collapse under the liability (thereby in practical effect constituting an assessment against a closed-year corporation) or (b) that such an open-year corporation facing assessment would be stripped of its assets thereby limiting or precluding collection by the Division (whereas a taxpayer seeking a refund from the Division would not face such a collection problem). These arguments are not encompassed within the facts of this case, are thus speculative and, while interesting, are essentially academic.

abandoned such issue as a basis for denying combined filing. However, assuming such basis for denial remains in dispute, it should be resolved in petitioner's favor. First, the Division's regulations clearly distinguish between a "taxable year" (including part or short taxable years) and an "accounting period" (compare, 20 NYCRR 1-2.7 with 20 NYCRR 2-1.1). Furthermore, the Division's regulations also distinguish "becoming or ceasing to be a part of a Federal consolidated group" from a "change of accounting period" by listing such items separately as events requiring the filing of a short-period tax report (see, 20 NYCRR 6-1.2[d], [e]). It is true that 20 NYCRR 6-3.2(b) provides that all corporations in the combined group must use the same "accounting period". The Division's position seems to be that because petitioner was acquired by a new parent corporation effective October 31, 1984 and thus was no longer part of Edison's consolidated Federal group after such date, it was thus precluded from filing on a combined basis as proposed for State purposes. However, the filing of a short-period return, whereby the income of a corporation leaving a Federal consolidated group is included in the group's income for the period of time it was a member of such group (see, Treas Reg § 1.1502-76), does not mean that petitioner changed its accounting period. In fact, there is no evidence that petitioner changed its accounting period from a calendar year to some other period when or because it was sold. Rather, petitioner's operating results for the year in question were simply allocated to the respective periods when petitioner was a part of the group (through October 31, 1984) and the balance of the year. Each of the members of the proposed combined group had calendar year accounting periods, and petitioner's short-period return covers the period of time when petitioner was affiliated with the other corporations. In sum, petitioner and its affiliates all had calendar year accounting periods and petitioner's short-period return, which included its income from operations for the period during which it was a member of the affiliated group, falls entirely within such calendar year accounting period. Finally, the Division has, in the context of Internal Revenue Code § 338(h)(10) elections, accepted the position that short-period reports may be included in a combined report with no indication that such circumstance (the filing of a short-period report) causes a change of accounting period for a short-period filer (see, TSB-M-91[4]C).

- Penalties -

I. In addition to the foregoing, there remains the separate issue of penalties imposed for petitioner's failure to have timely reported Federal audit changes, i.e., within 90 days of their finalization as required by Tax Law § 211(3). Petitioner seeks waiver of these penalties, arguing that its failure was due to reasonable cause and not due to willful neglect. Petitioner admits it was aware of the statutory requirement to report the Federal changes to the Division and did not do so. However, petitioner claims its failure to report as required was reasonable, arguing that since an audit of the same years was imminent, filing a formal report of changes would be unnecessary and inefficient. Petitioner goes on to note that when the audit commenced, petitioner fully cooperated with the auditor(s), including advising the auditor(s) of the details of the Federal adjustments. Finally, petitioner maintains that it has filed all other State reports and paid tax on a timely basis and that, by the time of the audit, petitioner was owned by a new parent corporation, thus making technical compliance with the reporting requirements more difficult.

J. Petitioner's request for abatement of penalties is denied. First, petitioner argues that, in terms of efficiency, it was reasonable not to formally file a report of changes given that an audit was imminent (here scheduled). However, it remains that petitioner was admittedly aware of the statutory duty to file such report and, apparently after consideration, consciously decided not to do so. Under very similar circumstances, the Tax Appeals Tribunal, in Matter of Paramount Pictures Corporation and Subsidiaries (March 14, 1991), upheld the imposition of penalties, holding that:

> "Petitioner's view of administrative efficiency fails to justify such a deliberate violation of its reporting responsibilities under the Tax Law. To allow returns to be filed and tax paid according to the discretion of the taxpayer would frustrate the goal of timely reporting that section 211 seeks to achieve.
>
> "Based upon all the evidence presented, we conclude that petitioner made a conscious decision not to comply with the clear language of Tax Law § 211(3). We agree . . . that to allow such a blatant disregard for the statutory time requirement set forth in Tax Law § 211(3) would render this provision meaningless."

Petitioner's attempt to distinguish its case from Paramount by comparing the relative periods of delay and describing those herein as "not inordinate" and "brief"[8] does not address the issue of petitioner's conscious decision not to file the required report notwithstanding its awareness of the obligation to do so. So too, petitioner's other arguments for abatement are not persuasive. Extending cooperation to the auditor(s) in conducting an audit is no more than what should be the expected (and accepted) norm. Finally, it is unclear why the 1984 acquisition of petitioner by a new parent corporation would make petitioner's technical compliance with the reporting requirements (of which it was admittedly aware) more difficult four years later in 1988. In sum, petitioner's request for abatement of penalties is denied.

K. The petition of Turbodyne Corporation is hereby denied, as is its claim for refund, and the Division's notices of deficiency dated January 31, 1990 (see, Findings of Fact "5" and "13") are sustained.

DATED: Troy, New York
May 25, 1995

/s/ Dennis M. Galliher
ADMINISTRATIVE LAW JUDGE

[8]In Matter of Paramount the periods of delay between finalization and reporting were 22 months in one instance and 12 months in the other, while the periods of delay herein were 10 months in one instance and 7 months in the other.