STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
BAUSCH & LOMB, INC., AND AFFILIATES	:	DETERMINATION 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, One Bausch & Lomb Plaza, Rochester, New York 14604, 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 year 1995.

On May 17, 2005, petitioner, by Efrain Rivera, Vice-President and Treasurer (Patricia L. Brumbaugh, Esq., and Arthur Gelber, CPA, of counsel) and the Division of Taxation by Christopher C. O'Brien, Esq. (Clifford M. Peterson, Esq., of counsel), waived a hearing and agreed to submit the matter for determination based on documents and briefs to be submitted by September 23, 2005, which commenced the six-month period for the issuance of this determination. After review of the evidence and arguments presented, Thomas C. Sacca, Administrative Law Judge, renders the following determination.

ISSUE

Whether the Division of Taxation properly denied petitioner's claim for refund which was based upon an adjustment to the combined entire net income reported on petitioner's 1995 combined report resulting from the loss incurred on the sale of a subsidiary included in the combined group.

FINDINGS OF FACT

The parties have entered into a Stipulation of Facts, with attached exhibits, and have agreed that the stipulation and exhibits comprise the complete evidence to be submitted by the parties in this matter, and that no further evidence will be submitted to the Division of Tax Appeals for consideration or review in any further proceeding. The Stipulation of Facts and attached exhibits form the basis of the Finding of Facts herein.

1. Bausch & Lomb, Inc. ("B&L") is a New York corporation. 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.

2. 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."

3. 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.

4. 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.

5. 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.

6. 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.

7. 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.

8. 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.

9. 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.

10. 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.

11. 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.

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

13. 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.

14. 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.

15. 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.

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

17. 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.

18. 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.

19. 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.

20. 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.

21. 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.

22. 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.

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

24. 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.

25. 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.

26. 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.

27. 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.

28. 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.

29. 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.

30. 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.

31. 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)

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

33. 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.

34. 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.

35. 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.

36. 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.

37. 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.

38. 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.

39. 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."

40. 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.

41. 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.

42. 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.

43. 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.

44. 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.

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

46. 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.

47. 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.

48. 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.

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

50. 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.

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

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

53. For all field audits the Division of Taxation 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.

54. 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.

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

56. 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.

57. 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.

58. 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.

57. 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.

58. 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.

59. 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.

60. 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.

61. 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.

62. 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.

63. 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.

64. 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.

65. 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.

66. 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.

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

68. 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.

69. 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.

CONCLUSIONS OF LAW

A. Corporations subject to the New York business corporation franchise tax under Article 9-A must compute each of the five tax base classifications of Tax Law § 210(1): (a) entire net income base; (b) capital base; (c) minimum taxable income base; (d) fixed dollar minimum; and (e) subsidiary capital base, with the tax due being the highest amount of (a), (b), (c) or (d), plus the amount of (e).

B. For purposes of Article 9-A of the Tax Law, capital assets are classified as subsidiary capital, which are "investments in the stock of subsidiaries and any indebtedness from subsidiaries . . ." (Tax Law § 208[4]), investment capital, which are "investments in stocks, bonds and other securities, corporate and governmental, not held for sale to customers in the regular course of business, exclusive of subsidiary capital and stock issued by the taxpayer . . ." (Tax Law § 208[5]) and business capital, which encompasses "all assets, other than subsidiary capital, investment capital and stock issued by the taxpayer, less liabilities not deducted from subsidiary or investment capital . . ." (Tax Law § 208[7][a]).

C. Pursuant to Tax Law § 211(4), a group of affiliated corporations that meets certain ownership and operational tests may be permitted or required to file New York corporation tax returns as a combined group. Specifically, such section provides that:

> [i]n the discretion of the commissioner, any taxpayer, which owns or controls either directly or indirectly substantially all the capital stock of one or more other corporations, or substantially all the capital stock of which is owned or controlled either directly or indirectly by one or more other corporations . . . , may be required or permitted to make a report on a combined basis covering any such other corporations and setting forth such information as the commissioner may require; . . . provided, further, that no combined report covering any corporation not a taxpayer shall be required unless the commissioner deems such a report necessary, because of inter-company transactions or some agreement, understanding, arrangement or transaction referred to in subdivision five of this section, in order properly to reflect the tax liability under this article . . . .

When a combined report is filed by a group of corporations, "the tax shall be measured by the combined entire net income, combined minimum taxable income, . . . or combined capital, of all the corporations included in the report . . ." (Tax Law § 211[4][b][1]).

D. Petitioner contends that the B&L combined group amended return for 1995 was properly computed under Tax Law § 211(4)(b)(2) and 20 NYCRR 3-2.10. With regard to the tax bases of corporations included in a combined report, Tax Law § 211(4)(b)(2) provides that "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 . . . ." The business corporation franchise tax regulation, section 3-2.10(b), provides that in computing combined entire net income:

> [c]apital losses should be offset against capital gains, contributions should be deducted and intercorporate profits should be treated in computing combined entire net income as if each corporation in the group had filed its Federal income tax return on a separate basis. However, corporations may offset capital losses against capital gains, deduct contributions and defer intercorporate profits as if the corporations in the group had filed a consolidated Federal income tax return, provided the group of corporations included in the combined report consistently compute entire net income by this method. Changes in the method of computing combined entire net income under this subdivision may be made only with the approval of the Commissioner.

According to petitioner, subsidiaries included on a combined return are excluded from the calculation of subsidiary capital of the combined group. When a loss is incurred on the disposition of subsidiary assets included in the combined group, such loss is attributable to a reduction in business capital, not subsidiary capital. A loss from the sale of business capital reduces entire net income of the entire combined group. If such reduction leads to an overall loss for the year, that loss should be carried back to offset business income earned by the combined group in prior years. Petitioner concludes that as Oral Care was included in the B&L group in both 1995 and 1996, the loss incurred in 1996 on the disposition of the Oral Care stock was properly carried back to 1995, entitling petitioner to the claimed refund for the year 1995.

E. Corporations which are taxpayers in New York State must file their own corporation tax returns and pay the tax reported on such returns (Tax Law § 208[1][2]; § 209[1]). As previously discussed, taxpayer corporations are required to compute their tax liability by calculating four different tax bases and paying the tax computed on the highest tax base (Tax Law § 210[1]). One of the four tax bases is that of entire net income (Tax Law § 210[1][a]). Even though every taxpayer "is a separate taxable entity and shall file its own report," taxpayers may be permitted to file a combined report, including corporations that are not taxpayers and which inclusion is subject to certain conditions, in order to properly reflect the tax due under Article 9-A (Tax Law § 211[4]; 20 NYCRR 6-2.1, 6-2.2, 6-2.3, 6-2.5). When doing so, "the tax shall be measured by" amongst other tax bases, "the combined entire net income . . . of all the corporations in the report" (Tax Law § 211[4]).

The claim for refund filed by B&L is based on a reduction to the entire net income reported on its amended 1995 combined report. However, the statutory definition of entire net income does not include the income, profits or losses from subsidiary capital unless the loss includes figures in respect of a recovery from "any war loss, except for such amounts from a former DISC which are treated as business income under subdivision eight-A of this section" (Tax Law § 208[9][a][1]). Since B&L's stock in Oral Care was an investment in a subsidiary, B&L's loss from the sale of Oral Care is not included within its computation of entire net income unless qualified as an amount relating to a war loss, a situation that does not exist in this matter. Thus, B&L's loss from the sale of Oral Care is not properly included in the computation of combined entire net income on B&L's amended 1995 combined report.

F. Where the language of a statute is plain and unambiguous, it should be interpreted to give effect to the clear meaning of the words used (***Patrolmen's Benevolent Assn. v. City of New York***, 41 NY2d 205, 391 NYS2d 544). It is also noted that Tax Law § 211(4) is not a general statute but one that provides a specific, limited discretion to the commissioner to authorize combined reports in order to accurately reflect the tax liability due under Article 9-A, which lends further support to the decision to give only clear meanings to the words of the statute. Since Tax Law § 211(4) overlays the general tax statutes like Tax Law § 208(9)(a)(1), Tax Law § 211(4) should be construed narrowly (***Matter of H&S Holdings Limited***, Tax Appeals Tribunal, September 11, 1997).

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. Given the absence of these explicit statutory instructions, and that B&L's sale of Oral Care to a third party does not qualify as "intercorporate dividends," B&L's loss on the sale of Oral Care to a third party is properly excluded from the computation of combined entire net income on its amended 1995 combined report.

G. In the construction of statutes the basic rule of procedure and the primary consideration is to ascertain and give effect to the intention of the Legislature (McKinney's Cons Laws of NY, Book 1, Statutes § 92). In determining the Legislature's intent, it is important to construe the statute as a whole, and to read all parts together to determine the legislative intent (***Id***., §§ 97, 98; ***Matter of Amsterdam Savings Bank***, Tax Appeals Tribunal, March 11, 1993). The rules of statutory interpretation apply equally to the interpretation of regulations (***Matter of Upstate Farms Cooperatives, Inc. F/K/A Upstate Milk Cooperatives, Inc.***, Tax Appeals Tribunal, January 11, 2001; ***Matter of Genesee Brewing Company, Inc.***, Tax Appeals Tribunal, May 9, 2002; ***Matter of Sherwin-Williams Company v. Tax Appeals Tribunal***, 12 AD3d 112, 784 NYS2d 178). It is well established that the interpretation given to a statute by the agency authorized with its enforcement should generally be given weight and judicial deference if the interpretation is not irrational, unreasonable or inconsistent with the statute (***Matter of Trump-Equitable Fifth Avenue Co. v. Gliedman***, 62 NY2d 459, 478 NYS2d 846).

H. It is the position of the Division that the interplay between Tax Law §§ 208(9) and 211(4) requires the computation of the entire net incomes of the individual members of a combined group before totaling these computations when calculating combined entire net income.

The Division's regulation, at 20 NYCRR 3-2.1(c), provides that the entire net income base on a combined report is the:

> total of the amounts of the entire net income of each corporation included in the combined report with intercorporate eliminations (see section 3-2.10 of this Part) or the portion of such total allocated within New York State, subject to any modification required by sections 210(3)(d) and 210(3)(e) of the Tax Law.

By statute, the definition of entire net income requires that Federal taxable income be adjusted for various reasons when computing New York State entire net income (Tax Law § 208[9]). Therefore, under the regulatory scheme, in order for taxpayers to compute entire net income on their returns, the taxpayers are required to make the necessary adjustments to their Federal taxable income in order to insure that their computations are consistent with the statutory definition of entire net income (20 NYCRR 3-2.3[a]; 3-2.4[a]). The statutory provisions dealing with combined reports (Tax Law § 211[4]) do not contain a different definition of entire net income from that found elsewhere in the Tax Law, with the result that when those same taxpayers that had filed separately now file a combined report, they must perform the same adjustments as when they filed their individual tax returns.

Specifically, on a combined report, taxpayers would add back a loss from the sale of subsidiary capital when computing the entire net income of any of the individual members of a combined group (20 NYCRR 3-7.2). The next step would be to add the entire net incomes of the individual members of the combined group together to arrive at the combined entire net income (20 NYCRR 3-2.1[c]). When totaling the entire net incomes of the individual members of a combined group, taxpayers will have made the necessary intercorporate eliminations since an expense for one entity in an intercorporate transaction will be income to the other entity (20 NYCRR 3-2.1[c]; 20 NYCRR 3-2.10[a]).

Construing the above-cited regulations together leads to the conclusion that B&L's loss on the sale of Oral Care to Conair must be added back when computing the combined entire net income on B&L's amended combined return and that the sale would not be eliminated from the computation of combined entire net income. When performing the initial step, the computation of the entire net income of the individual members of the subject combined group, B&L's sale of Oral Care to Conair must be added back to B&L's individual entire net income since the loss incurred by that sale is a loss to B&L from the sale of subsidiary capital. When B&L's individual entire net income is totalled with the other affiliates included in the combined report, any loss generated by the sale of Oral Care would not be eliminated in the computation of combined entire net income since B&L's sale of Oral Care to Conair was not an intercorporate transaction but was to a third party.

The logical result of reading the Division's various corporate tax regulations together is that B&L's loss on the sale of Oral Care to a third party, which is a loss in subsidiary capital to B&L, should be added back in arriving at B&L's individual entire net income, a preliminary step in the calculation of the combined entire net income on B&L's 1995 amended combined report.

I. The Tax Appeals Tribunal decision in ***Matter of H&S Holdings Ltd.*** (***supra***) supports the Division's requirement that in computing combined entire net income, it is first necessary to analyze the individual entire net income of the members of the combined report. In ***H&S***

Holdings, Ltd., the taxpayer and a nontaxpayer subsidiary filed a combined report in which the taxpayer claimed an Investment Tax Credit ("ITC") while reducing its combined entire net income by the amount of the credit. The equipment subject to the claimed ITC was leased by H&S Holdings to its wholly owned subsidiary. Tax Law § 210(12)(a) provides that "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." The taxpayer took the position that its filing of a combined report with the wholly owned lessee of the equipment created a single entity which both owned and used the equipment, making it eligible for the ITC. The Tribunal concluded that the ITC "is not an item handled separately by Tax Law § 211, but is covered along with the computation of tax under Tax Law § 210." The Tribunal went on to state that "[t]here is no provision of the Tax Law that indicates that combination should grant the benefits of the ITC when petitioner alone would not qualify," effectively rejecting the taxpayer's single entity position by finding that neither the combined group nor the taxpayer itself was qualified for the ITC under Tax Law § 210(12)(a). Applying the Tribunal's rationale to the present matter, a capital loss carry back resulting from the sale of subsidiary capital is not dealt with separately by Tax Law § 211(4), but is required to be added back when computing entire net income because of the definition of entire net income under Tax Law § 208(9)(a)(1). Therefore, the Division properly denied B&L's claim for refund.

J. As previously discussed, pursuant to Tax Law 211(4), the commissioner has the discretion to permit or require any taxpayer, which owns or controls either directly or indirectly substantially all the capital stock of one or more other corporations, to make a report on a combined basis covering any such other corporations and setting forth such information as the commissioner may require. The statute further provides that no combined report covering any corporation not a taxpayer shall be required unless the commissioner deems such a report necessary, because of intercompany transactions or some agreement, understanding, arrangement or transaction referred to in subdivision five of section 211, in order properly to reflect the tax liability under article 9-A.

The regulations promulgated pursuant to section 211 provide that the Division may require or allow the filing of a combined report where three conditions are met. The first two are found in 20 NYCRR 6-2.2, where it states that the taxpayer must own or control, either directly or indirectly, substantially all of the capital stock of the corporations which are to be included in the combined filing (20 NYCRR 6-2.2[a]), and whether the activities in which the corporation engages are related to the activities of the other corporations in the group (20 NYCRR 6-2.2[b]). These conditions are commonly referred to as the capital stock and unitary business requirements.

Where, as here, the first two requirements have been met, the Division may require combined reporting if reporting on a separate basis distorts the activities, business, income or capital of the taxpayer. Distortion is presumed when the taxpayer reports on a separate basis if there are substantial intercorporate transactions among the corporations (20 NYCRR 6- 2.3[a].)

K. The Division's interpretation of Tax Law § 208(9)(a)(1) and § 211(4), as stated in 20 NYCRR 3-2.1(c); 3-2.2 and 3-7.2, furthers the legislative intent with regard to one of the purposes of Tax Law § 211(4): to address the issue of distortion (***see***, ***Matter of Sherwin-Williams Company v. Tax Appeals Tribunal***, ***supra).*** The distortion of income is avoided by the use of the Division's methodology when a combined report is filed by computing the entire net income of the individual members of a combined group and then totaling these amounts to arrive at combined entire net income. Under this methodology, the Division avoids the attribution of a loss of what was and is subsidiary capital to that of combined entire net income. For example, a possible effect of allowing the reduction of combined entire net income by an individual combined group member's loss in subsidiary capital, the situation herein, would be to take an amount that should have reduced the taxpayer's subsidiary capital for purposes of the computation of the tax on subsidiary capital in a prior year and instead assign the loss to combined entire net income reported at a later date.

As the Division correctly points out, when Oral Care was allowed to be included in the 1995 B&L combined report, B&L had already sustained large losses in Oral Care. The six years of straight-line amortization of the $119 million in goodwill recorded after Oral Care was acquired would have resulted in a write-off of approximately $18 million on B&L's financial statements by the end of 1994.[1] The additional $75 million adjustment to the goodwill recorded on B&L's financial statements, due to Oral Care's poor financial results, means that by the end of 1994, B&L had already written off from its books approximately $93 million of the original $119 million in goodwill recorded on its financial statements. The $93 million reduction in goodwill would have left approximately $26 million on B&L's books that would have been associated with its original purchase price for Oral Care. The value of Oral Care at the time of the sale to Conair in September 1996 was approximately $17 million. Consequently, the write-offs on B&L's financial statements occurred before the reorganization of Oral Care, which reorganization resulted in Oral Care's being included in the 1995 B&L combined report.

Granting B&L's request would cause distortion in the income of the taxpayer affiliates which are part of the 1995 and 1996 B&L combined groups and the B&L combined groups for

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[1]The Division arrived at the amount of $18 million as follows. Oral Care was bought in 1988. The $119 million divided by 40 years (the amortization period) equals $2,975,000.00 per year. This figure, multiplied by the six years between 1988 and 1994 equals $17,850,000.00. Said amount would not include amortization for the balance of the 1988 fiscal year after the acquisition of Oral Care.

future periods. Before 1995, Oral Care reported its New York tax liability separately from the various B&L combined groups. Previous to 1995, a value for B&L's investment in Oral Care was included in the subsidiary capital computed on the B&L combined reports. Accepting B&L's position that its loss in Oral Care should reduce its amended 1995 combined entire net income would effectively shift losses incurred before Oral Care was part of the B&L combined group to the amended 1995 combined entire net income. Such a shift would result in the distortion of the B&L taxpayer affiliates' New York taxable income in 1995 by understating those taxpayer affiliates' income. 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.

As the Division contends, the proper tax relief for the losses from Oral Care's business operations before January 1, 1995 was presumably taken by Oral Care during those years when Oral Care was a separate tax filer, resulting in lower New York taxes paid on a smaller business income. As for the proper remedy for the reduced value in B&L's investment in its stock in Oral Care, B&L should have reduced the average value that it assigned to Oral Care, when computing the subsidiary capital base on the B&L combined reports before January 1, 1995 and when Oral Care was not part of the B&L combined groups, to something more representative of the actual value of B&L's investment in its Oral Care stock. B&L's failure to have properly computed the subsidiary capital base on the earlier combined reports predating 1995 is not a sufficient reason to allow B&L's claim for refund.

L. In addition, B&L has not established that the netting of capital losses allowed under the second sentence of 20 NYCRR 3-2.10(b) should be applicable herein since the group of corporations in this combined group have not consistently computed entire net income by this method. The membership of the B&L combined group included Oral Care for the first time in 1995. Furthermore, only the members of the B&L combined group for the years 1994, 1995 and 1996 netted capital gains and losses. In addition, there is nothing in the record which establishes how much of the loss in the goodwill associated with Oral Care was attributable to B&L's business operations in the tax year ended December 31, 1994, the first year that the B&L combined group netted capital gains and losses, or the amount of such losses incurred prior to 1994. Finally, it is noted that prior to January 1, 1994, the composition of the B&L combined group consisted of only two corporations, not the nine core members of the 1994 through 1996 B&L combined group. Under these circumstances, it cannot be found that the group of corporations in the B&L combined group have consistently computed entire net income by the netting of capital losses as required by 20 NYCRR 3-2.10(b).

M. The petition of Bausch & Lomb, Inc., & Affiliates is denied, and the Division of Taxation's denial of petitioner's claim for refund is sustained.

DATED: Troy, New York
May 18, 2006

/s/ Thomas C. Sacca
ADMINISTRATIVE LAW JUDGE