

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
KELLWOOD COMPANY	:	
for Redetermination of a Deficiency or for Refund of	:	DETERMINATION
Corporation Franchise Tax under Article 9-A of the	:	ON REMAND
Tax Law for the Fiscal Years Ended January 31, 2000	:	DTA NO. 820915
through January 31, 2003.	:	
	:	

Petitioner, Kellwood Company, 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 fiscal years ended January 31, 2000 through January 31, 2003.

Following a hearing and the submission of briefs, Timothy J. Alston, Administrative Law Judge, issued a determination dated March 27, 2008, which denied the petition and sustained a Notice of Deficiency dated October 11, 2005.

Petitioner timely filed an exception to the determination and in a decision dated September 24, 2009, the Tax Appeals Tribunal remanded this matter to the administrative law judge with the following direction:

We remand this case to the Administrative Law Judge for additional findings of fact and conclusions of law with respect to KSS [Kellwood Shared Services, Inc.] based upon the existing record. As set forth above, the determination rendered below dealt solely with KFR [Kellwood Financial Resources, Inc.]. Petitioner provided testimony and documents in support of its argument that KSS had economic substance and a valid business purpose.

* * *

ACCORDINGLY, it is ORDERED, ADJUDGED and DECREED that this case be remanded so that the Administrative Law Judge can address the findings of fact and conclusions of law with respect to KSS.

ISSUE

Whether petitioner's wholly-owned subsidiary, KSS, had economic substance and a valid business purpose, and if so whether the cost markup that KSS charged Kellwood and KFR for its services was an arm's length rate.

FINDINGS OF FACT

Findings of Fact 1 through 263 in the March 27, 2008 determination are incorporated herein by reference.

Additionally, this determination makes the following Findings of Fact based on the existing record:

1. KSS was staffed with employees who performed services under contracts with Kellwood and its operating divisions and subsidiaries in payroll, accounts payable, and process improvement, in addition to assisting KFR with credit and collections prior to the movement of those employees into KFR (*see* Finding of Fact 116).

2. The Ernst and Young [E &Y] report which determined the cost plus 8 percent fee to be charged by KSS to Kellwood and KFR for its services (*see* Finding of Fact 117) was prepared consistent with IRC § 482 principles and revealed the underlying bases for its conclusions. This report was provided to the Division of Taxation (Division) during the audit and was received in evidence at the hearing in this matter.

3. KSS's taxable income represents between 0.23 percent and 2.61 percent of the Kellwood Consolidated Group's taxable income for the following years:

Kellwood Company Consolidated Group Federal Form 1120 Taxable Income			
	<i>FYE 1-31-03</i>	<i>FYE 1-31-02</i>	<i>FYE 1-31-01</i>
Consolidated Group	\$62,887,791	\$122,417,710	\$71,119,276
KSS	\$1,641,483	\$278,336	\$615,952
KSS Income as % of Consolidated Group	2.61%	0.23%	0.87%

CONCLUSIONS OF LAW

Conclusions of Law A through O in the March 27, 2008 determination are incorporated herein by reference.

Additionally, this determination makes the following Conclusions of Law based on the existing record:

A. KSS had economic substance and a valid business purpose. Furthermore, KSS's charges to Kellwood and KFR for its services had economic substance. As noted in Finding of Fact 1 herein, KSS was an active corporation employing real employees who provided real credit and collections services to Kellwood and its subsidiaries. Additionally, it is noted that the Division conceded that Kellwood had a valid business purpose in forming KSS (Division's brief p. 54). Moreover, in contrast to the Kellwood-KFR accounts receivable transactions, the Division has never claimed that KSS's charges to Kellwood and KFR for its services lacked economic substance.

B. Having prevailed on the questions of business purpose and economic substance with respect to the KSS services, Kellwood must next show that the charges for these services are arm's length and thereby establish that separate reporting with respect to Kellwood and KSS is

proper (*see Matter of Silver King Broadcasting of N.J.*, Tax Appeals Tribunal, May 9, 1996).

Regulations under IRC § 482 may be used to establish the arm's length nature of the subject intercompany transactions (*see Matter of Hallmark Marketing Corporation*, Tax Appeals Tribunal, July 19, 2007).

C. Petitioner has rebutted the presumption of distortion with respect to the KSS transactions. As noted above, the E&Y report which determined the 8 percent markup was prepared using IRC § 482 principles and revealed the underlying bases for its conclusions. I have reviewed the E & Y report which is in evidence and I find that its conclusions with respect to the use of the 8 percent markup are reasonable. I note that the Division did not challenge the 8 percent markup at the hearing, nor did its experts (*see* Finding of Fact 117). While the Division did challenge the markup in its brief, such challenge was ineffectual, consisting of an ad hominem critique of E & Y and a reference to criticism by petitioner's expert of methods used by E & Y in reports related to the KFR transactions, not the KSS transactions. The Division offered no refutation of the E & Y report itself, which determined the 8 percent markup. The substance of the report is thus uncontroverted. Under such circumstances it is clear that petitioner has met its burden of rebutting the presumption of distortion with respect to the cost plus 8 percent charges by KSS for its services and has thereby shown that the charges for these services were arm's length (*cf. Matter of Tropicana Product Sales, Inc.*, Tax Appeals Tribunal, June 12, 2000; *Matter of Medtronic, Inc.*, Tax Appeals Tribunal, September 23, 1993).

D. The Division offered no evidence or argument to show why, the absence of distortion notwithstanding, reporting on a separate basis by KSS does not properly reflect income (*see Matter of Silver King Broadcasting of N.J.*).

E. In accordance with the Tax Appeals Tribunal's direction in its September 24, 2009 decision, this matter is returned to the Tribunal for a decision on all issues raised on exception.

DATED: Troy, New York
March 18, 2010

/s/ Timothy J. Alston
ADMINISTRATIVE LAW JUDGE