Corp. Tax Determinations
A - Z

STATE OF NEW YORK Freeport Sulphur Company

DEPARTMENT OF TAXATION AND FINANCE

BOARD OF CONFEREES - CORPORATION TAX BUREAU

In the Matter of the Application of FREEPORT SULPHUR COMPANY for refund of franchise tax under Article 9A of the Tax Law for the privilege year begun January 1, 1958	Hearing Case No. 2941

The tax was audited and stated February 11, 1960 as follows:

Net income	Business Allocation	Income Allocable to N.Y.	Tax on Income at 5½%
$95,166,302.80	3.6482%	$3,471,857.06	$190,952.14
		Subsidiary capital tax	1,498.79
		Total tax	$192,450.93

Application for revision was timely filed February 13, 1962.

Two questions are involved, namely,

(1) Whether the taxpayer was doing business in New York State so as to be subject to franchise tax under Article 9A.

(2) Whether a capital gain of $95,392,637.35 from the sale of oil and gas properties located entirely within the State of Louisiana should be included in entire net income subject to allocation by the business allocation percentage.

Formal hearing was held August 12, 1965 in Albany before W. F. Sullivan and D. H. Gilhooly. The taxpayer was represented by Robert Mc Arthur, Jr. Treasurer, William J. Byrne, Jr. Assistant Treasurer and H. John Brundage, CPA of Lybrand, Ross Bros. and Montgomery, 2 Broadway, New York City.

The taxpayer corporation, A Delaware Corporation, whose head office is located at 161 East 42nd Street, New York, which began business in New York State January 1, 1937, was engaged for the year in question in the mining of crude sulphur and the production of crude oil and gas none of which took place within New York State. The operations of the taxpayer are separated into two divisions, the Sulphur Division, which sold sulphur produced at and delivered from its mines located in Louisiana and Texas, and the Oil Division which sold oil and gas produced at, and delivered from its fields located in Louisiana, Texas, Oklahoma and New Orleans.

With respect to the Oil Division, its orders for sales were received and accepted, billed and collected at its New Orleans office where all policy matters with respect to such division were usually determined except that for over-all company tax policy, depreciation and amortization rates, and approvals for drilling and development programs were determined in New York. Requests for approval for expenditures of a capital nature for such division were, with one exception, prepared and approved at the New Orleans office, the one exception being that if an approval was sought for an expenditure over $25,000 in excess of the budgeted figure such expenditure required the approval of the executive officer in New York.

Approved [illegible] 12/28/65

There was only one such instance during 1958. While the Oil Division had in New Orleans, its own cost ledgers and separate accounts by property it did not have a complete set of books since the complete set of books for all the divisions were maintained in the New York office. All of the assets of the Oil and Gas division were located outside of New York. The operational vice presidents of the Oil and Gas division were all located in New Orleans and reported either to the executive vice president or president both of whom were located in the New York office.

With respect to the Sulphur Division, all sulphur was delivered to the customer from its mines located in Louisiana and Texas on the basis of orders, received both in and outside New York, all of which are subject to final approval at the New York office. During the year 1958, the corporation, out of a total average inventory of 1 1/2 million tons of sulphur, had approximately 6,000 tons thereof located on consignment at the plant of a customer in Mechanicville, New York.

The head office located at 161 East 42nd Street, New York City to which its general executive officers were attached and where the Board of Directors meetings were held was staffed by 160 employees out of a total company payroll of 1,760. As previously stated, all orders of the Sulphur Division were approved, billed and collected from such office, the general accountings records of the corporation were maintained there as well as the corporate, financial and legal departments. During the month of November and December of 1958, the purchase of approximately 90 million dollars of United States Bills, Notes and Bonds was directed from such office. This investment was made from the proceeds of the capital gain from the sale of the oil and gas properties located in Louisiana. During December of 1958 the sale of 4 million dollars of United States Treasury Notes and Bonds were directed from such office. In such month, United States Treasury Bills of approximately 35 million matured. The proceeds thereof were immediately reinvested at the direction of the New York office. During 1958, the corporation owned three residential properties, two being apartments in New York City and one a private house in Westchester County. Each of these residences were occupied pursuant to a contract of purchase by an employee of the New York office, one of which was an assistant vice president. The average depreciated book value of such New York real estate was $42,388.81 for the year 1958. There were no charges made to the Oil Division for services of the New York office except for an insignificant New York administration charge that was made against the Oil Division for the expenditure of time of supervisory people in the Head Office in New York who were engaged in the consolidation of monthly reports and preparation of projections and budgets for the Oil Division.

Based on the foregoing assets and activities in New York State, the Board has concluded that the corporation was doing business in New York State so as to be subject to franchise tax under Article 9A.

With respect to the remaining question, it is noted that the capital gain of $95,392,637.35 from the sale of its oil and gas field located entirely in Louisiana was an unusual transaction of the Oil Division and not one in the ordinary course of business. Other than the facts that the operating vice presidents of the Oil Division, who were located in Louisiana did report to and come under the direction of either the President or Executive Vice Presidents in New York, that the final decision for any oil drilling or development was made in New York and that the general accounting records of the corporation were maintained in the New York office, the Oil Division operated autonomously, completely outside New York, all of its oil being produced, sold and delivered outside New York. (No gas was sold during 1958). There was no interdivisional

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sales or services between the Oil Division and the Sulphur Division. It should also be noted that the State of Louisiana allocated all of the capital gain to such state and taxed it in its entirety.

Considering all of these facts the Board believes that the inclusion of the capital gain in income allocable to New York by the three factor formula produces an inequitable result. The Board does not however agree with the taxpayer that the full gain from the sale of the property should be completely eliminated from taxable income without any adjustment. The Board, subject to Commission approval, proposes to offer to the taxpayer the elimination from income of the capital gain of $95,392,637.35 less $19,670,669.48 representing the sum of the depreciation, depletion and intangible drilling costs applicable to the property sold which were allowed as a deduction in arriving at taxable income during the years the property was held, namely from 1952 to 1958 year of sale. It is believed that in view of the Sheraton decision this adjustment is proper and produces a fair and equitable result. The following corrected tax will result:

Net income for New York franchise tax purposes as reported and taxed		$95,166,302.80
Less: capital gain from sale of oil and gas properties located entirely in Louisiana adjusted as follows:		
Capital gain included in above income	$95,392,637.35	
Less: deductions applicable to such property allowed in computing taxable income from date of acquisition to date of sale:		
Intangible drilling and division cost	(14,962,287.20)	
Cost and percentage depletion	(4,037,642.25)	
Depreciation	(670,740.03)	
Capital gain as adjusted		75,721,967.87
New York income as corrected		19,444,334.93
Business allocation percentage		3.6482
Corrected income allocable to New York		709.368.23
Corrected tax on income at 5½%		39,015.25
Plus subsidiary capital tax (no charge)		1,498.79
Total corrected tax		40,514.04
Tax as originally computed		192,450.93
Proposed reduction in tax		(151,936.89)

William F. Sullivan

Chairman

Approved
E. L. Dreany

approve Gwandoff

Donald H. Gilhooly

DHG:MB
September 27, 1965

9/28/65