STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition of Federated Department Stores, Inc.	:	
	:	AFFIDAVIT OF MAILING
for Redetermination of a Deficiency or a Revision of a Determination or a Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the F.Y.E. 2/3/73 & 2/2/74.	:	

State of New York
County of Albany

Jay Vredenburg, being duly sworn, deposes and says that he is an employee of the Department of Taxation and Finance, over 18 years of age, and that on the 14th day of August, 1981, he served the within notice of Decision by certified mail upon Federated Department Stores, Inc., the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Federated Department Stores, Inc.
ATTN: Paul P. Thiemann
222 West Seventh St.
Cincinnati, OH 45202

and by depositing same enclosed in a postpaid properly addressed wrapper in a (post office or official depository) under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the petitioner herein and that the address set forth on said wrapper is the last known address of the petitioner.

Sworn to before me this
14th day of August, 1981.

Connie A. Hazelton

STATE OF NEW YORK
STATE TAX COMMISSION
ALBANY, NEW YORK 12227

August 14, 1981

Federated Department Stores, Inc.
ATTN: Paul P. Thiemann
222 West Seventh St.
Cincinnati, OH 45202

Gentlemen:

Please take notice of the Decision of the State Tax Commission enclosed herewith.

You have now exhausted your right of review at the administrative level. Pursuant to section(s) 1090 of the Tax Law, any proceeding in court to review an adverse decision by the State Tax Commission can only be instituted under Article 78 of the Civil Practice Laws and Rules, and must be commenced in the Supreme Court of the State of New York, Albany County, within 4 months from the date of this notice.

Inquiries concerning the computation of tax due or refund allowed in accordance with this decision may be addressed to:

NYS Dept. Taxation and Finance
Deputy Commissioner and Counsel
Albany, New York 12227
Phone # (518) 457-6240

Very truly yours,

STATE TAX COMMISSION

cc: Petitioner's Representative
Paul P. Thiemann
222 West 7th St.
Cincinnati, OH 45202
Taxing Bureau's Representative

STATE OF NEW YORK
STATE TAX COMMISSION

In the Matter of the Petition of Federated Department Stores, Inc.	
	AFFIDAVIT OF MAILING
for Redetermination of a Deficiency or a Revision of a Determination or a Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the F.Y.E. 2/3/73 & 2/2/74.	

State of New York
County of Albany

Jay Vredenburg, being duly sworn, deposes and says that he is an employee of the Department of Taxation and Finance, over 18 years of age, and that on the 14th day of August, 1981, he served the within notice of Decision by certified mail upon Paul P. Thiemann the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Paul P. Thiemann
222 West 7th St.
Cincinnati, OH 45202

and by depositing same enclosed in a postpaid properly addressed wrapper in a (post office or official depository) under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the representative of the petitioner herein and that the address set forth on said wrapper is the last known address of the representative of the petitioner.

Sworn to before me this
14th day of August, 1981.

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition of FEDERATED DEPARTMENT STORES, INC. for Redetermination of a Deficiency or for Refund of Franchise Tax on Business Corporations under Article 9-A of the Tax Law for the Fiscal Years Ended February 3, 1973 and February 2, 1974.	DECISION

Petitioner, Federated Department Stores, Inc., 222 West Seventh Street, Cincinnati, Ohio 45202, filed a petition for redetermination of a deficiency or for refund of franchise tax on business corporations under Article 9-A of the Tax Law for the fiscal years ended February 3, 1973 and February 2, 1974 (File No. 14399).

A formal hearing was held before Edward L. Johnson, Hearing Officer, at the offices of the State Tax Commission, Building #9, State Campus, Albany, New York on June 15, 1977 at 9:15 A.M. Petitioner appeared by Paul P. Thiemann, Esq. The Audit Division appeared by Peter Crotty, Esq. (Laurence E. Stevens, Esq., of counsel).

ISSUES

I. Whether the Audit Division properly required petitioner Federated Department Stores, Inc. and its subsidiary Federated Acceptance Corporation to file combined franchise tax reports for the years at issue.

II. Whether petitioner Federated Department Stores, Inc. and its subsidiary Lo-Ray's Center, Inc. should be permitted to retroactively file combined franchise tax reports for the years at issue.

III. Whether the Audit Division properly disallowed a portion of the interest expense of petitioner Federated Department Stores, Inc. and of its subsidiary Federated Acceptance Corporation as indirectly attributable to subsidiary capital.

FINDINGS OF FACT

1. For the fiscal years at issue, petitioner filed separate New York State franchise tax reports: it did not include therein Federated Acceptance Corporation ("FAC") or Lo-Ray's Center, Inc. ("Lo-Ray's").

2. On November 28, 1975, as the result of a field audit conducted, the Audit Division issued to petitioner, Federated Department Stores, Inc., two notices of deficiency, asserting additional franchise taxes due under Article 9-A of the Tax Law for the fiscal years ended February 3, 1973 and February 2, 1974 in the amounts $5,102.02 and $41,335.98, respectively, with interest thereon. The bases of the deficiencies were as follows: the Audit Division's requirement that petitioner file combined reports with FAC for the fiscal years at issue; denial of petitioner's request to include Lo-Ray's in such combined reports; and disallowance of a portion of the interest expense of petitioner and of FAC for each of the fiscal years, as indirectly attributable to subsidiary capital.

3. During the periods in question, petitioner, a Delaware corporation, maintained over ten department store chains in eighteen states, including New York, and discount store chains in Florida, California and Ohio. Its Ralphs Grocery Division ("Ralphs") operated approximately sixty supermarkets in the greater Los Angeles area of southern California.

4. On May 22, 1972, petitioner acquired all of the capital stock of Lo-Ray's, which owned eight supermarkets in northern California in the San

Francisco area. The following month, $21,000.00 of merchandise was transferred to Lo-Ray's stores from Ralphs' warehouses and plants. For 1972, such transfers constituted approximately 26 percent of total purchases for Lo-Ray's; for 1973, they comprised approximately 41 percent of Lo-Ray's total purchases. Merchandise shipped from Ralphs' manufacturing plants was billed to Lo-Ray's at cost. The warehousing charges to Lo-Ray's were calculated to reflect a net income above expense to provide a return on investment in furniture and fixtures.

5. Commencing in June, 1972, four-week closing statements were prepared, consolidating figures from Lo-Ray's and Ralphs; in addition, Lo-Ray's adopted Ralphs' receiving procedures. In July, Lo-Ray's adopted Ralphs' "ad markdown and price changes" procedures and inaugurated Ralphs' training program for key personnel. In October, Lo-Ray's stores began operations under the name of Ralphs and thereafter, Ralphs' advertising department directed all advertising programs for Lo-Ray's. In November, Lo-Ray's accounts and general ledger were incorporated into Ralphs' electronic data processing system. And in January, 1973, Lo-Ray's fiscal year was changed from March 1 through February 28, to January 30 through January 29, in order to conform with Ralphs' fiscal year.

6. During the periods at issue, two Lo-Ray's stores were refurbished and one new store erected, under the supervision of the vice-president of construction for Ralphs.

7. On February 2, 1974, Lo-Ray's was liquidated into Federated Department Stores, Inc. and became the Northern Division of Ralphs.

8. FAC, a wholly-owned subsidiary of petitioner, shares space with petitioner at petitioner's executive offices in Cincinnati. Its exclusive activity is the purchasing of thirty-day customer obligations as generated by petitioner's

retail merchandising operations. FAC has no employees of its own, but rather, utilizes petitioner's personnel to perform its functions.

9. On its consolidated Federal returns for the years at issue, petitioner took deductions for interest expense in the following amounts:

	FYE 2/3/73	FYE 2/2/74
Petitioner	$10,162,426.00	$11,834,249.00
FAC	50,722.00	3,860,837.00
Total	$10,213,148.00	$15,695,086.00

Pursuant to the field audit, the corporation tax examiner disallowed $60,074.00 of the total interest deduction for the fiscal year ended February 3, 1973, and $46,834.00 of said deduction for the fiscal year ended February 2, 1974.

CONCLUSIONS OF LAW

A. That subdivision 4 of section 211 of the Tax Law authorizes the Tax Commission, in its discretion, to require or permit a domestic parent corporation and its wholly-owned domestic subsidiary to make a report on a combined basis. This authorization also applies to foreign corporations doing business in New York. However, no combined report covering a foreign corporation not doing business in New York may be required, unless the Tax Commission deems such a report necessary, because of intercompany transactions or some agreement, understanding, arrangement or transaction which distorts income or capital, in order to properly reflect tax liabilities.

B. That during the periods at issue, the State Tax Commission provided, by regulation, that in determining whether the tax would be computed on a combined basis, it would consider various factors, including the following:

(1) Whether the corporations were engaged in the same or related lines of business;
(2) Whether any of the corporations were in substance merely departments of a unitary business conducted by the entire group;
(3) Whether the products of any of the corporations were sold to or used by any of the other corporations;

(4) Whether any of the corporations performed services for, or loaned money to, or otherwise financed or assisted in the operations of any of the other corporations;
(5) Whether there were other substantial intercompany transactions among the constituent corporations.
Former 20 NYCRR 5.28(b).

The essential elements of these factors have been carried over into the current regulations which were effective for taxable years beginning on or after January 1, 1976, and which provide, in pertinent part:

"In deciding whether to permit or require combined reports the following two (2) broad factors must be met:
(1) the corporations are in substance parts of a unitary business conducted by the entire group of corporations, and
(2) there are substantial intercorporate transactions among the corporations."
20 NYCRR 6-2.3(a).

The mandatory language of the current regulations takes cognizance of those elements which the Tax Commission has consistently deemed to be the key factors in determining whether combination should be permitted or required, i.e., the unitary nature of the business conducted by the corporations, and whether there were substantial intercorporate transactions among the corporations. Matter of Annel Holding Corp. et al., State Tax Commission, August 2, 1973, determination confirmed, Annel Holding Corp. v. Procaccino, 77 Misc. 2d 886 (Sup. Ct. Albany Co. 1974); Matter of N. K. Winston Corp. et al., State Tax Commission, August 21, 1974; Matter of Alpha Computer Service Corporation et al., State Tax Commission, September 28, 1979; Matter of Montauk Improvement, Inc. and Montauk Country Club, Inc., State Tax Commission, September 28, 1979. These factors must be given particular emphasis, although all five factors of former 20 NYCRR 5.28(b) must be considered.

C. That the Audit Division properly required petitioner to file combined reports with its wholly-owned subsidiary FAC during the fiscal years at issue.

FAC functioned as a mere department of the parent corporation; its sole business was the financing of petitioner's customer obligations. Wurlitzer Co. v. State Tax Commission, 35 N.Y. 2d 100 (1974).

D. That the Audit Division properly denied petitioner permission to retroactively file combined reports with its subsidiary Lo-Ray's. As the State Tax Commission explained in the Matter of Walker Engraving Corporation (June 6, 1971), the filing of combined returns is not a statutory right on the part of the taxpayer. The detailed facts necessary to determine whether permission for combined filing should be sought from the Commission are available to the taxpayer at the time annual franchise tax reports are due; and, except under unusual circumstances, the taxpayer has no need of an extended period to determine whether permission should be requested. Petitioner has not shown such extraordinary circumstances as would entitle it to file retroactive combined reports with Lo-Ray's.

Furthermore, Lo-Ray's is a foreign corporation not doing business in this state. Its income was not generated, in whole or in part, by intercompany transactions with the parent taxpayer corporation; Wurlitzer (supra), therefore, is inapposite. (In Wurlitzer, the subsidiary financing corporation, notwithstanding that it was a foreign corporation not doing business in New York, was nonetheless required to file franchise tax reports on a combined basis with its parent; the subsidiary's income was wholly generated by intercompany transactions with the parent corporation, a New York taxpayer.)

Finally, petitioner's contention that Lo-Ray's and Ralphs met the criteria enumerated in former 20 NYCRR 5.28(b) for combined filing misses the point. The entities which must be compared are Federated Department Stores, Inc. and Lo-Ray's. Petitioner, a corporation which operates numerous department store

chains in eighteen states, has not demonstrated that it was entitled to file reports on a combined basis with a corporation which owned and operated eight supermarkets in the San Francisco area.

E. That section 208.9(b)(6) of the Tax Law provides that entire net income of the corporate taxpayer shall be determined without deduction or exclusion of:

> "in the discretion of the tax commission, any amount of interest directly or indirectly and any other amount directly attributable as a carrying charge or otherwise to subsidiary capital or to income, gains or losses from subsidiary capital."

This disallowance prevents the taxpayer from reaping a double benefit, since section 209.9(a)(1) allows the corporation to exclude income from subsidiary capital.

F. That since a portion of petitioner's borrowings was used to make investments in and advances to its subsidiaries, a portion of petitioner's interest expense was indirectly attributable to subsidiary capital, in the proportion that its investments in and advances to subsidiaries bears to its total assets. Matter of World Wide Volkswagen Corp., State Tax Commission, April 30, 1974; Matter of Norton Co., State Tax Commission, May 18, 1973; Matter of Texaco, Inc., State Tax Commission, December 22, 1971. This rationale is obviously inapplicable to FAC which has no subsidiaries; thus no portion of FAC's interest expense deduction should have been disallowed pursuant to section 208.9(b)(6). In computing the interest expense indirectly attributable to subsidiary capital, the proportion (investments in and advances to subsidiaries/total assets) must be applied only to petitioner's interest expense deduction.

G. That the petition of Federated Department Stores, Inc. is granted to the extent indicated in Conclusion of Law "F"; that the notices of deficiency

issued November 28, 1975 are to be modified accordingly; and that except as so modified, the deficiencies are in all other respects sustained.

DATED: Albany, New York

AUG 14 1981

STATE TAX COMMISSION

PRESIDENT

COMMISSIONER

COMMISSIONER