New York Tax Highlights

Featuring digests of all State and New York City Tribunal and ALJ decisions

Volume 15, No. 3 April 15, 2008

Developments of Interest

Nontaxpayer's Sales Included in Numerator of Combined Receipts Factor

The New York Court of Appeals has ruled that receipts from New York sales made by a nontaxpayer subsidiary which was included in a combined report with its parent must be reflected in the numerator of the combined group's receipts factor in calculating the group's business allocation percentage. The court further found that inclusion of the nontaxpayer's New York sales in the numerator of the business allocation formula did not amount to an unlawful tax on the income of the subsidiary. Moreover, the court held that the inclusion of these sales in the combined group's numerator did not violate federal Public Law 86-272, which bars a state from imposing income tax on a company whose activity in the state does not exceed the solicitation of orders for tangible personal property that are approved and shipped or delivered from outside the state.

Indeed, the court went so far as to conclude that the tax immunity afforded by Public Law 86-272 was not available to the subsidiary since the activities of the unitary group of which it was a member extended beyond the mere solicitation of orders, *i.e.*, the ''person'' that could have immunity from tax under Public Law 86-272 is the unitary group and not each member standing alone. (*Matter of Disney Enterprises, Inc. et al. v. Tax Appeals Tribunal*, March 25, 2008)

No Further Publication of Small Claims Determinations

The State Tax Appeals Tribunal recently adopted a policy that determinations issued by the Small Claims Unit of the Division of Taxation will no longer be published. According to the Tribunal, this policy was adopted in response to privacy concerns brought to the Tribunal's attention. The Tribunal notes that Tax Law Sec. 2012 expressly provides that the Division of Tax Appeals is not required to publish determinations issued by the Small Claims Unit.

Digests of Decisions

(*A ✔ indicates that the editors consider the digested item to be of special importance*.)

Corporation Franchise Tax — Article 9-A

Kellwood Company, DTA No. 820915, March 27, 2008 (Timothy J. Alston, NYS ALJ)

The Division of Taxation properly required a supplier of fashion apparel and recreational products to report its corporation franchise tax on a combined basis with its nontaxpayer subsidiary that was formed to provide factoring services for the taxpayer. The taxpayer failed to rebut the presumption that reporting on a separate basis distorted its New York income which arose as a result of the substantial intercorporate transactions between the two unitary entities. The Division's assertion

Editors:
Arthur R. Rosen, McDermott, Will & Emery (New York City)
Mark S. Klein, Hodgson Russ LLP

Contributing Editors:
Hodgson Russ LLP: **Paul R. Comeau** and **Christopher L. Doyle**

that the transactions between the taxpayer and its factoring subsidiary – *i.e.*, the transfer of accounts receivable from the taxpayer to the factoring subsidiary in exchange for the servicing of those receivables and the advancement of 100 percent of the face value of the receivables, less a three-percent discount rate – lacked economic substance and were not accomplished for a substantial business purpose was upheld. (This arrangement reduced the taxpayer's taxable income and, therefore, its state tax liability.)

The taxpayer failed to show that it reasonably anticipated any economic benefit from the financing component of the transaction with its subsidiary, *i.e.*, the financing arrangement appeared to be designed solely to provide tax benefits to the taxpayer. The taxpayer had access to less costly means of financing than its transactions with the factoring subsidiary. Indeed, when the taxpayer's receivables were first transferred to the subsidiary, the subsidiary did not have funds to purchase the receivables and make advances to the taxpayer. Instead, the taxpayer loaned the money to the subsidiary to make the purchases. This circular flow of money had little effect on the taxpayer's net economic position and the advances were not a source of financing for the taxpayer. Even after the subsidiary became a net lender to the taxpayer, the advances to the taxpayer were not a true source of financing because the source of the advanced funds was the taxpayer's receivables, a financing source it would have had without the factoring arrangement.

The primacy of state tax savings as the rationale for entering into the factoring transactions was also reflected in the structure of the compensation the taxpayer paid to the accounting firm that planned and implemented this arrangement. (The accounting firm received compensation equal to 40 percent of the taxpayer's tax savings for the first full year of the factoring arrangement.)

Because it was found that the financing transactions at issue lacked economic substance and a non-tax business purpose, it was not necessary to consider another basis for requiring combination – whether the consideration paid by the taxpayer under the financing arrangement reflected arm's length prices.

A penalty for substantial underpayment of tax was sustained despite the taxpayer's contention that it had relied in good faith on the accounting firm's professional advice in entering into the financing transactions. Reports prepared by the accounting firm listed various business reasons for entering into the factoring arrangement, which did not include a need for financing via advances from the subsidiary. Nevertheless, the report set a discount rate as consideration for the transfer of the accounts receivable which allocated about 60 percent to the cost of the financing. The taxpayer should have been aware of the disconnect between the stated reasons for entering into the transactions and the consideration paid under the transactions.

General Practice and Procedure

Inam U. Satti, DTA No. 821388, March 27, 2008 (Per Curiam, NYS TAT)

The Division of Tax Appeals lacked jurisdiction to hear this matter because an incorrect conciliation order was attached to the petition. The petitioner's representative was twice given 30 days to provide a corrected petition, but did not respond with the requested copy of the conciliation order that would enable the Division of Tax Appeals to determine the timeliness of the petition.

Lake Grove Entertainment, LLC, DTA No. 821297, March 27, 2008 (Dennis M. Galliher, NYS ALJ)

A consent to the extension of the statute of limitations for assessing sales and use taxes was valid since it was signed by the taxpayer's chief financial officer prior to the expiration of the limitation period. The conclusion with regard to the signature date was supported by the date on which the consent form was accepted back by the Division of Taxation. Accordingly, the Notice of Determination in this matter was issued within the limitation period, as validly extended.

Other aspects of this determination are digested under ''Sales and Use Taxes – Articles 28 and 29.''

Hugo Pacori, DTA No. 821943, April 3, 2008 (Brian L. Friedman, NYS ALJ)(Order)

The Division of Tax Appeals lacked jurisdiction to consider a petition in a personal income tax matter

New York Tax Highlights is published bi-weekly (except during periods in which the New York State or City Tribunals and ALJs release no decisions or determinations) by Corporate Tax Publishers, Inc., P.O. Box 261, Leonia, NJ 07605. Telephone: 201-461-6619. © 2008, **Corporate Tax Publishers, Inc**. All rights reserved. Annual Subscription: $265.

Subscribers may obtain from the publisher a copy of any digested determination, decision or order by fax or mail. The charge for fax or mail delivery is 75 cents per page plus a single order billing and service charge of $15 (subscribers may include as many documents in a single order as they wish).

since the Notice of Deficiency was not attached to the petition. The Tax Appeals Tribunal's rules require that a copy of the statutory notice being protested be attached to the petition for purposes of determining whether the petition is timely.

Personal Income Taxes (Including Nonresident Taxes)

✔ ***PricewaterhouseCoopers, LLP,*** DTA No. 821300, April 3, 2008 (Thomas C. Sacca, NYS ALJ)

As a result of the repeal of the New York City nonresident earnings tax (the ''commuter tax''), which was effective July 1, 1999, *no* commuter tax was owed by nonresident partners of a partnership whose taxable year did not end before July 1, 1999. The repeal legislation provided that for taxable years beginning on or before June 30, 1999, which include that date, a nonresident no longer subject to the commuter tax computes his or her liability for that year as if that individual's taxable year for federal income tax purposes ended on June 30, 1999. Giving effect to this statutory mandate and Internal Revenue Code Section 706(a), which requires a partner to include in income his or her distributive share of partnership income ''for any taxable year of the partnership ending within or with the taxable year of the partner,'' when a partnership's taxable year ended after June 30, 1999, the partner's entire share of net earnings was exempt from the City nonresident earnings tax.

Sales and Use Taxes — Articles 28 and 29

Lake Grove Entertainment, LLC, DTA No. 821297, March 27, 2008 (Dennis M. Galliher, NYS ALJ)

Sales tax was properly assessed on the total receipts of an operator of a large entertainment complex generated from the sales of party packages. The operator offered party attendees bowling, ice skating, rock climbing, a roller coaster and other rides plus pizza, hot dogs, soda, and ice cream. The assertion by the operator that it could charge a single price for a party package and remit tax only on the amounts charged for the taxable items (food, beverages, bowling shoe rentals) included in the package was rejected.

The operator was not engaged in making distinct nontaxable transactions with party package customers, but rather offered a single transaction, *i.e.*, the party package, for which it provided an invoice setting forth a single charge that did not separately state the amount of sales tax charged or otherwise distinguish between the taxable and nontaxable components of the charge. The settled law is that when a single invoice charge includes both taxable and nontaxable components, the entire charge is subject to tax. Signs advertising that all applicable sales taxes are included in the party package charge were insufficient to constitute the separate statement of tax on a receipt. Accordingly, the Division of Taxation properly assessed sales tax on the full amount of the operator's receipts from party package sales, including on the sales tax included by the operator in the total price of the party package.

Other aspects of this determination are digested under ''General Practice and Procedure.''

Subscribers may obtain from the publisher a copy of any digested determination, decision or order by fax or mail. The charge for fax or mail delivery is 75 cents per page plus a single order billing and service charge of $15 (subscribers may include as many documents in a single order as they wish). Call: (201)-461-6619.