STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
MOD MAID IMPORTS, INC.	:	DETERMINATION DTA NO. 809148
for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Fiscal Year Ended April 30, 1985.	:	

Petitioner, Mod Maid Imports, Inc., 500 Seventh Avenue, New York, New York 10018, 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 year ended April 30, 1985.

A hearing was held before Joseph W. Pinto, Jr., Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on June 22, 1992 at 1:15 P.M. All documents, submissions and briefs were to have been served and filed by August 24, 1992. Petitioner appeared by William I. Abramson, C.P.A. The Division of Taxation appeared by William F. Collins, Esq. (Robert J. Jarvis, Esq., of counsel).

ISSUE

Whether the Division of Taxation properly required petitioner to add back certain interest payments made to brother/sister corporations pursuant to Tax Law former § 208.9(b)(5).

FINDINGS OF FACT

On or about September 29, 1989, the Division of Taxation ("Division") issued two statements of audit adjustment and two notices of deficiency to petitioner, Mod Maid Imports, Inc. ("Mod Maid"). The first Statement of Audit Adjustment covered the fiscal year ended April 30, 1985and indicated a tax deficiency of $38,211.00, interest of $18,349.00 and penalty of $3,821.00, for a total balance due of $60,381.00. The statement indicated that this balance was as a result of a "recent field audit." Based upon this Statement of Audit Adjustment, a Notice of Deficiency was issued to Mod Maid for the same period indicating the same amount

of tax, interest and penalty due. The second Statement of Audit Adjustment for the fiscal year ended April 30, 1985 indicated a tax deficiency of $6,207.00, interest of $2,981.00 and penalty of $621.00, for a total balance due of $9,809.00. Once again, the statement indicated that the balance due was as a result of a "recent field audit." A second Notice of Deficiency was issued which set forth the same amount of tax, interest and penalty for the same period as set forth on the second Statement of Audit Adjustment.

The audit conducted in this matter began as a general field verification of the fiscal years ended April 30, 1985 through April 30, 1987. It was discovered that Mod Maid failed to include wages in its allocation percentages for the years audited and corrections were made to include the wage factor in the allocation percentage. Mod Maid did not contest this issue or the additional taxes resulting therefrom at hearing. However, it was discovered that Mod Maid failed to add back interest paid to what the Division categorized as stockholders of Mod Maid. This addback occurred only in the fiscal year ended April 30, 1985 and resulted in the addback of $698,293.00 to entire net income.

The second Notice of Deficiency issued in this matter reflects the additional taxes due pursuant to Tax Law § 209-B, the Temporary Metropolitan Transportation Business Tax Surcharge on additional taxes due.

Mod Maid was one of a group of related corporations referred to by petitioner's representative as the "Lou Levy" group, allegedly the largest manufacturer of women's coats in the country. During the period in issue, there were approximately six or seven corporations in this group and the stock of each of the corporations was owned by the same individuals. The exact number of corporations in the "Lou Levy" group during the period in issue was not divulged in the record nor was the exact number or identity of the shareholders. Several of the corporations made retail sales, while others performed administrative functions and purchasing functions.

During the period in issue, Mod Maid paid interest to these other corporations.

Although Mod Maid's representative, William I. Abramson, CPA, testified as to the

relationship among the corporations in the Lou Levy group, to the extent that he was aware of said corporations, none of the shareholders testified nor was any documentary evidence produced which would have established the corporate structure of the group and the specific relationships among the corporations in the group. Further, there was no evidence with regard to the exact nature or amount of interest paid to specific creditors.

SUMMARY OF PETITIONER'S POSITION

Mod Maid argues that the intent of the statute at issue herein, Tax Law former § 208.9(b)(5), was to prevent a corporation from improperly characterizing otherwise nondeductible payment of dividends as a deductible payment of interest, thus lowering its tax liability. Mod Maid argues that the interest incurred by it was with respect to real corporate debt. Mod Maid argues that since the debt was incurred with respect to ordinary business expenses, the interest paid with respect to the debt should be fully deductible.

CONCLUSIONS OF LAW

A. During the period in issue, Tax Law former § 208.9(b)(5) provided as follows:

"(b) Entire net income shall be determined without the exclusion, deduction or credit of:

* * *

"(5) Ninety per centum of interest on indebtedness directly or indirectly owed to any stockholder or shareholder (including subsidiaries of a corporate stockholder or shareholder), or members of the immediate family of an individual stockholder or shareholder, owning in the aggregate in excess of five per centum of the issued capital stock of the taxpayer . . . ."

Mod Maid argues that it should not be subject to the terms and provisions of Tax Law former § 208.9(b)(5) because the interest paid by Mod Maid was incurred with respect to an ordinary business expense and the amount paid with respect to the debt should be allowed to retain its true character as fully deductible interest. However, it is settled that a taxpayer bears the burden of establishing an entitlement to a deduction (see, Matter of Marriott Family Rest. v. Tax Appeals Tribunal of State of New York, 174 AD2d 805, 806, 570 NYS2d 741, lv denied 78 NY2d 863, 578 NYS2d 877). Further, the taxpayer seeking the deduction must be able to point to an applicable statute and show that it comes within its terms and only where there is a clear

statutory provision can any particular deduction be allowed (see, Matter of Grace v. New York State Tax Commn., 37 NY2d 193, 197, 371 NYS2d 715).

Mod Maid relies on the New York State Legislative Commission on the Modernization and Simplification of Tax Administration and the Tax Law, The Article 9-A Franchise Tax: The Interest Addback Rule (Staff Report, January 20, 1984), which, in the first 21 pages of the 47-page report, dealt with the so-called debt/equity issue, i.e., problems arising from transactions relating to stock being taxed differently from transactions relating to debt. Petitioner would have this forum believe that it should look to the substance and not the form of its transactions to ascertain their true nature based on the legislative history. But such reliance on legislative history to support its position on this issue has already been passed upon by the court in Friesch-Groningsche Hypotheekbank Realty Credit Corp. v. Tax Appeals Tribunal (___ AD2d ___, 585 NYS2d 867, lv denied 80 NY2d 761):

> "Petitioner urges that legislative history indicates that the substance rather than the form of the transaction should be considered. Where the interpretation is based upon the plain language of the statute and in the absence of ambiguity on its face, resort to legislative history would be inappropriate (Matter of Allen v. State Tax Commn., 126 AD2d 51, 54, 512 NYS2d 916). We find petitioner's legislative historical references to no avail." (Matter of Friesch-Groningsche Hypotheekbank Realty Credit Corp. v. Tax Appeals Tribunal of State of New York, supra, 585 NYS2d at 869.)

The Appellate Division in Freisch-Groningsche was referring to that petitioner's argument that the "conduit principle", effective in tax years prior to the one in issue, was an integral part of the substance-over-form approach commonly invoked by courts to characterize transactions for tax purposes. However, the Tax Appeals Tribunal pointed out in its decision in Freisch-Groningsche that "in enacting the specific provisions, the Legislature intended that the form rather than the substance of a transaction should govern its tax consequences", citing the same New York State Legislative Commission Report on Modernization and Simplification of Tax Administration and the Tax Law (see, Matter of Freisch-Groningsche Hypotheekbank Realty Credit Corp., Tax Appeals Tribunal, December 28, 1990). For the same reasons cited in the Appellate Division decision in Freisch-Groningsche, and the rationale cited by the Tribunal in the case below, petitioner's "form over substance" argument must fail herein.

B. The second issue which arises in this matter is the application of Tax Law former § 208.9(b)(5) to the corporate structure herein. Because the only evidence was the nebulous testimony of Mr. Abramson it was impossible to determine whether this statute was simply not applicable to petitioner, as asserted by the Division, on the very terms set forth therein.

Although Mr. Abramson insisted on the use of the terms "brother/sister" corporations to define those corporations in the "Lou Levy" group, of which petitioner was a member, he could not state with any certainty how many corporations comprised that group or the number and identity of the shareholders of those corporations. Perhaps petitioner was contending that the "Lou Levy" group was a "brother-sister" controlled group as used in Internal Revenue Code § 1563(a)(2). Such a group has been defined as connoting a close horizontal relationship between two or more corporations, suggesting that the same indivisible group of five or fewer persons must represent 80% of the ownership of each corporation. But petitioner did not establish these facts (U.S. v. Vogel Fertilizer Co., 455 US 16, 70 L Ed 2d 792, 800).

Hence, payment of interest by Mod Maid to one of these other legal entities or companies in the "Lou Levy" group might not have been interest paid to a stockholder or shareholder or subsidiary of a corporate stockholder or shareholder or members of the immediate family of an individual stockholder or shareholder owning in the aggregate in excess of 5% of the issued capital stock of Mod Maid (cf., Norcliff Thayer, Inc. v. Chu, 123 Misc 2d 16, 472 NYS2d 537 [wherein payments of interest to a "sister" corporation which was wholly owned by the common parent was found to be subject to the terms of Tax Law former § 208.9(b)(5)]).

However, petitioner has the burden of proof in cases before the Division of Tax Appeals, and it was incumbent upon it to come forward with evidence which clearly established the facts upon which it based its petition for relief (Tax Law § 1089[e]; 20 NYCRR 3000.10[d][4]). Further, uncertainty, inconsistencies and ambiguities arising from petitioner's failure to meet its burden will be resolved against the taxpayer, regardless of the maxim that "a statute which levies a tax is to be construed most strongly against the government and in favor of the citizen" (Grace v. New York State Tax Commn. 37 NY2d 193, 371 NYS2d 715, lv denied 37 NY2d

708, 315 NYS2d 1027 [where, as here, when a petitioner seeks a deduction (or exemption from the add-back provision), it must be able to point to an applicable statute and show that it comes within its terms]).

Since petitioner failed to submit New York franchise tax reports, Federal income tax returns or any other evidence substantiating petitioner's relationship with the other corporations in the "Lou Levy" group and their existence as independent entities as opposed to "brother-sister" corporations, it has not demonstrated an entitlement to an interest deduction herein, or an exemption from Tax Law former § 208.9(b)(5).

Therefore, for all the reasons stated herein, it is determined that petitioner is subject to the terms of Tax Law former § 208.9(b)(5).

C. The petition of Mod Maid Imports, Inc. is denied and the two notices of deficiency dated September 29, 1989 are sustained.

DATED: Troy, New York
March 18, 1993

/s/ Joseph W. Pinto, Jr.
ADMINISTRATIVE LAW JUDGE