New York City Tax Appeals Tribunal

In the Matter of	:	
	:	DECISION
BANKERS TRUST CORPORATION (f/k/a BANKERS TRUST NEW YORK CORPORATION) AND ITS AFFILIATED ENTITIES	:	TAT (E) 04-36 (BT)
Petitioners.	:	

Bankers Trust Corporation (formerly known as Bankers Trust New York Corporation) ("BTNY") and several affiliated corporations ("Petitioners") filed an Exception to a Determination of the Chief Administrative Law Judge (the "CALJ") dated December 23, 2008 (the "CALJ Determination"). The CALJ Determination denied Petitioners' requested refunds of New York City Banking Corporation Tax (the "City Bank Tax") for the calendar years 1986, 1987 and 1993 (the "Tax Years") except to the extent agreed to by the Parties in ¶59 of a Stipulation of Facts dated June 19, 2007, and amended September 6, 2007, Tribunal's Exhibit 1 (the "Stipulation").

Petitioners appeared by Stephen L. Solomon, Esq., and Kenneth I. Moore, Esq., of Hutton & Solomon LLP. The Commissioner of Finance of the City of New York ("Respondent") appeared by Martin Nussbaum, Esq., Assistant Corporation Counsel, New York City Law Department. The Parties filed briefs and oral argument was held before this Tribunal. Commissioner Robert J. Firestone did not participate in this Decision.

During the Tax Years, BTNY was a bank holding company organized under Article 3A of the New York State Banking Law.[1] During the Tax Years, BTNY owned 100% of the stock of Bankers Trust Company ("BT"), a New York State (the "State") chartered banking corporation.

To enable it to operate in foreign countries, BT formed Bankers International Corporation ("BIC") as an Edge Act[2] corporation. During the Tax Years: (1) BT owned 100% of the stock of BIC; (2) BIC was the record title holder of 100% of the stock of BT Holdings (Europe) Limited ("BTE") and BT International (Delaware) Inc. ("BTI"); (3) BTE was the record title holder of 100% of the stock of Bankers Trust Holdings (U.K.) Ltd. ("BTUK"); (4) BTI was the record title holder of 100% of the stock of BT Foreign Investment Corporation ("BTFIC"); and (5) BTFIC was the holder of 100% of the stock of Bankers Trust GmbH ("BT GmbH"). In this Decision, BTUK and BT GmbH are referred to as the "Indirect Subsidiaries", BTE and BTFIC are collectively referred to as the "Immediate Parents" and BIC, BTI, BTE and BTFIC are collectively referred to as the "Intermediate Corporations." This corporate structure had a business purpose because it was dictated by the complex laws and regulations of the various jurisdictions in which these corporations did business, as well as by the Edge Act, and was created for the purpose of insulating and protecting BT's assets.

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[1] Except as otherwise noted, the CALJ's Findings of Fact, although paraphrased and amplified herein, generally are adopted for purposes of this Decision. Certain Findings of Fact not necessary to this Decision have not been restated and can be found in the CALJ Determination. We reject the following Findings of Fact: "The business of BT and all of its directly and indirectly owned subsidiaries was managed and controlled . . . by the Management and Network Committees. . . ." and "Through the Management Committee, BT possessed and exercised effective control over the business operations of the Indirect Subsidiaries, including the movement of assets, even though there was no trust or contractual agreement relating to the control of those corporations." CALJ Determination at 8, 11. We find that these Findings of Fact are not supported by the Record.

[2] Section 25A of the Federal Reserve Act (12 U.S.C. ch. 6, subch. II).

The case before this Tribunal has a lengthy history, which we will not recite in detail, rather, we will summarize the relevant events.[3] Petitioners filed combined City Bank Tax returns (Forms NYC 1A) for the Tax Years. On those combined returns, Petitioners reported interest income that BT received from affiliated corporations not included in those returns, including the Indirect Subsidiaries. Petitioners deducted 17% of that interest income under §11-641(e)(11)(i) of the Administrative Code of the City of New York (the "Code") as interest income from subsidiary capital (the "17% Interest Deduction"). On audit, the New York City Department of Finance (the "Department") allowed the 17% Interest Deduction for that interest income to the extent it was paid by first-tier subsidiaries, *i.e.,* corporations in which BT was the record title owner of more than 50% of the voting stock, but disallowed the deduction for the portion of that interest income not paid to BT by first-tier subsidiaries. Petitioners agreed to those audit adjustments and paid the resulting City Bank Tax deficiencies.

The State Department of Taxation and Finance (the "State Tax Department") similarly disallowed Petitioners' deduction of 17% of interest income paid to BT by second-tier and more remote subsidiaries on Petitioners' State Banking Corporation Tax (the "State Bank Tax") returns for certain years, including the Tax Years, under Tax Law §1453(e)(11)(i) (the "State 17% Interest Deduction"). However, in 1997, as part of a settlement of Petitioners' State Bank Tax liabilities for the years 1985 through 1994, the State Tax Department allowed Petitioners a State 17% Interest Deduction for a portion of the interest income paid to BT by second-tier and more remote subsidiaries for those years (the "State Settlement Adjustment"). Petitioners filed Forms NYC 3360B to report that settlement to the Department and to request City Bank Tax refunds for the Tax Years. Petitioners' refund requests were based on a 17% Interest Deduction for a portion of the interest income received by BT from second-tier or

[3] A more detailed description of the history of the present case appears in the CALJ Determination at 2-6.

more remote subsidiaries not included in Petitioners' combined City Bank Tax returns for the Tax Years as allowed under the State Settlement Adjustment. The Department audited Petitioners' Forms NYC 3360B and disallowed those refund requests. In response, Petitioners brought a declaratory judgment action arguing that the Department exceeded its authority in auditing those refund claims. Without addressing the merits of the underlying substantive issues, the New York Court of Appeals ruled that Petitioners had failed to exhaust their administrative remedies in the matter. Bankers Trust Corp. v. NYC Dept. of Finance, 1 N.Y. 3d 315 (2003). Thereafter, Petitioners initiated the present case.

Petitioners have agreed to limit their City Bank Tax refund requests to stipulated amounts of City Bank Tax attributable to the 17% Interest Deduction for interest income received by BT from its first-tier subsidiaries[4] and from the Indirect Subsidiaries in the Tax Years. The Parties have stipulated that if Petitioners are entitled to the 17% Interest Deduction for interest income received by BT from the Indirect Subsidiaries during the Tax Years based on the State Settlement Adjustment, the principal tax amounts of the refunds due Petitioners are $1,272,475 for 1986; $1,294,193 for 1987; and $3,824,106 for 1993. The Parties further agree that if Petitioners are entitled only to the 17% Interest Deduction for interest income received by BT from first-tier subsidiaries during the Tax Years, the principal tax amounts of the refunds due Petitioners are $2,507 for 1986; $711 for 1987; and $258 for 1993. The only issue before this Tribunal is whether the Indirect Subsidiaries qualified as subsidiaries of BT entitling Petitioners to claim the 17% Interest Deduction for interest income BT received from the Indirect Subsidiaries during the Tax Years. The Parties resolved all other issues in this matter before the CALJ Determination was issued. *See* CALJ Determination at 6-7.

[4] Respondent does not dispute Petitioners' entitlement to the 17% Interest Deduction for interest income paid by first-tier subsidiaries. Stipulation ¶38.

Petitioners' first witness, Martin Linzer, was an officer of BT in its tax department during the Tax Years but was not an officer or director of any of the Intermediate Corporations or Indirect Subsidiaries. Mr. Linzer testified that he was responsible for the tax returns of Petitioners and their uncombined affiliates although he did not personally prepare the tax returns for the Tax Years. Mr. Linzer testified that the Intermediate Corporations each filed separate New York City General Corporation Tax ("GCT") returns for the Tax Years and were not included in Petitioners' combined City Bank Tax returns for the Tax Years. Except for the 1993 GCT returns of BTI and BTFIC, those GCT returns are included in the Record. None of the Intermediate Corporations listed any subsidiaries on their 1986 GCT returns. T. Ex. C8, D7, E7 and F7. BIC listed BTE and BTI as subsidiaries on its 1987 and 1993 GCT returns. T. Ex. C9, C10. BTE listed BTUK as a subsidiary on its 1987 and 1993 GCT returns. T. Ex. D8, D9. BTI listed BTFIC as a subsidiary on its 1987 GCT return. T. Ex. E8. BTFIC listed BT GmbH as a subsidiary on its 1987 GCT return. T. Ex. F8. With one exception, while BTE, BTI and BTFIC excluded income from subsidiary capital under Code §11-602.8(a)(1) on their GCT returns for 1987 and BIC and BTE excluded such income from their 1993 GCT returns, it is not possible to determine whether any of those excluded amounts came from the Indirect Subsidiaries. The one exception is that, on its 1993 GCT return, BTE excluded interest income it received from BTUK as income from subsidiary capital.

Mr. Linzer testified that BT had a management team (the "Management Committee")[5] that:

> would get together and decide . . . the policies and procedures for the global bank – they would make the big decisions on where

[5] The management team is referred to as the Management Committee in the Annual Reports of BTNY included in the Record. T. Ex. A1, A2 & A3. The Management Committee comprised individuals who were officers of BT, BTNY or both during the Tax Years and some of whom also were directors of BT and BTNY during the Tax Years. T. Ex. A1, A2 & A3.

> we want to operate, how we wanted to operate for the total operations of [BT].

Tr. 26. He also testified that there was a separate body, the Network Committee, composed of "top people in" BT who were responsible for "doing the corporate housekeeping [that] needed to be done when decisions were to be made." Tr. 26-27.[6] Mr. Linzer was not a member of the Management Committee or the Network Committee during the Tax Years.

The Intermediate Corporations' activities and functions generally were those of holding companies. They had no direct employees and their business was conducted by their officers and directors virtually all of whom also were officers of BT. During the Tax Years, one or two of the directors of BIC, BTE and BTFIC also were directors of BT. Some of the directors of BIC, BTI and BTFIC also were members of the Management Committee during the Tax Years, and, in 1993, some were members of the Network Committee. None of the directors of BTE was a director of BT or a member of the Management Committee or Network Committee during the Tax Years.[7]

The Parties stipulated that during the Tax Years, the Intermediate Corporations were "separate corporate entities that were respected and treated as separate corporate entities under Federal, New York State and New York City income tax laws. They observed all required corporate formalities and procedures." Stipulation ¶52.

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[6] The Bankers Trust Network Committee Policies and Procedures, dated July 1, 1995, states that the Network Committee was created in 1988. Therefore, the Network Committee existed only during the last Tax Year, 1993. T. Ex. B20 at 1.

[7] The CALJ's Findings of Fact are amplified and modified to more accurately reflect the Record.

The Indirect Subsidiaries were foreign corporations. BT GmbH conducted an active banking business while BTUK was a holding company.[8] The Indirect Subsidiaries observed all required corporate formalities and procedures of the respective local laws in the U.K. and Germany where they were formed and were respected and treated as separate corporate entities under the laws of those countries. They were not required to file Federal, State or New York City (the "City") income tax returns.

In 1986, only one of the directors of BTUK was an officer of BT. In 1987 and 1993, a majority of the directors of BTUK were officers of BT. In 1986 and 1987, a majority of the general managers of BT GmbH were officers of BT. The Record does not contain sufficient information to verify whether any of the general managers of BT GmbH in 1993 also were officers of BT. None of the directors or general managers of the Indirect Subsidiaries was a director of BT or a member of the Management Committee or Network Committee during the Tax Years.

Petitioners' second witness, James T. Byrne, Jr., joined BT in 1967. Effective December 31, 2001, Mr. Byrne retired as a senior vice president and corporate secretary of Bankers Trust Corporation and as a managing director and corporate secretary of the successor to BT but remained a director of both entities. T. Ex. N. Mr. Byrne was not a director of BT or BTNY, or a member of the Management Committee or Network Committee during the Tax Years. During his career with BT, he headed its Compliance, Government Relations, Public Affairs and Corporate Affairs Departments. Mr. Byrne testified generally about the corporate structure of Petitioners and their uncombined affiliates and the reasons behind that structure. He also testified that the senior management of BT established the global policies and practices for foreign subsidiaries but the "day-to-day operations of the

[8] The CALJ's Findings of Fact regarding the activities of the Indirect Subsidiaries are modified to more accurately reflect the Record.

subsidiaries were conducted locally." Tr. 210. He further testified that proposals to create or acquire a subsidiary in another country usually originated in that country. Tr. 212. Whether a decision on such a proposal would be made locally or by the Management Committee depended on its "materiality" but the Management Committee would be advised of the decision and could "block" any acquisition. Tr. 213-15.

Mr. Byrne testified that the Network Committee "looked at operations globally" and handled the "nuts and bolts" of creating a new business. Tr. 225. He further testified that there were senior people in BT responsible for various aspects of global operations but the operating companies each had a credit officer, chief accounting officer or chief financial officer and, in some larger companies, a legal and auditing person as well. Tr. 226. These local "people reported up through the various entities" to their counterparts at BT. Tr. 226-27. BT provided indemnification, through insurance and otherwise, for all officers and directors of BT, including those who also served as officers or directors of its subsidiaries at the direction of BT if they requested such indemnification, to the extent permitted by State law. Tr. 233-36.[9]

Mr. Byrne also testified that, at the direction of Charles Sanford, Jr., the Chairman of the Board of BTNY and BT, he and other staff created a book of Rules for Business Conduct, generally a code of ethical business standards, under which all employees of Petitioners and their affiliates worldwide had to agree to operate regardless of accepted practices elsewhere. Tr. 227-230.[10] However, when asked if the Management Committee would dictate changes

[9] The CALJ's Findings of Fact are modified to more accurately reflect the Record.

[10] A copy of the Rules for Business Conduct, U.S. Edition, dated June 1990, is included in the Record as T. Ex. A9. The Rules of Business Conduct required approval by a member of the Management Committee if an employee wanted to accept appointment to a directorship or fiduciary position with an entity outside the BTNY affiliated group. T. Ex. A9 at 8 (Conflict of Interest Rule #7), Petitioner's Brief at 20. The Rules of Business Conduct were silent on the subject of Management Committee approval of directorships or

in operations or personnel to address a problem under those standards, Mr. Byrne testified that: "It wouldn't dictate. . . . if there was a problem in connection with the rules . . . if the Management Committee became aware of it, it would instruct the senior officer responsible for that business to straighten it out and report back to the Management Committee." Tr. 230-31 (emphasis added.)

Mr. Byrne testified generally about the importance of corporate housekeeping, the maintenance of the corporate books including the certificate of incorporation, corporate resolutions, board meeting minutes, etc. necessary to memorialize the existence and operation of a corporation. Tr. 238-39. He described those records as "critical – to the existence of a corporation." Tr. 239. Both Mr. Byrne and Petitioners' third witness, Robert K. Lem, who joined BT as an attorney in its international legal department in 1981 (Tr. 279), testified to the care taken in executing the corporate minutes and resolutions of the various entities whose action was necessary for a transaction. Tr. 240-43, 284-289. Mr. Lem testified that corporate housekeeping was necessary to "keep the separation of liability from getting up to the bank. . . . You are worried always about piercing the corporate veil if there is no corporate housekeeping and it looks like a sham company." Tr. 287, 290.

Mr. Linzer and, to a lesser extent, Mr. Lem testified about four specific transactions involving BT. The first transaction involved the creation of a new Australian subsidiary to acquire a commercial banking license in Australia where Petitioners previously had operated only a merchant bank. Mr. Lem testified that the recommendation to acquire the commercial banking license in Australia came from "our business people in Australia" who presented the proposal to the Management Committee for approval. Tr. 282. The corporate structure was dictated by the Australian bank regulators. Mr. Linzer testified that at a September 17, 1985,

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fiduciary appointments within the BTNY affiliated group. The CALJ's Findings of Fact are modified to more accurately reflect the Record.

meeting of the Board of Directors of BT, the transaction was approved "based on the conditions that were put forth by the Australian authorities." Tr. 43.

The second transaction took place in 1986 and involved a $200 million increase in the capitalization of Petitioners' bank affiliate in the U.K. required by the British bank regulatory authority. Tr. 63. Mr. Linzer testified that the Management Committee would have had to approve this transaction but the Record includes only minutes of a meeting of the Board of Directors of BIC approving the transaction. Tr. 69-70, T. Ex. C31. Part of the required funds came from a securities offering by BTUK guaranteed by BTNY, $75 million of the funds came from BIC and the remainder came from BTE. Tr. 64-71, T. Ex. G38.

The third transaction took place in 1983, not during the Tax Years, and was initiated by staff in the Paris branch of BT, which presented it to the Management Committee. Tr. 98. This transaction resulted in the creation of the structure of the Intermediate Corporations and the Indirect Subsidiaries as it existed during the Tax Years. Apart from a BT memorandum dated December 28, 1983, and prepared by Mr. Salvator Sodano[11] describing the necessary steps, no contemporaneous documents relating to this transaction were submitted into evidence. Tr. 103, T. Ex. D62.

The fourth transaction involved a reorganization of BT GmbH to shift most of its assets to the U.K. This transaction was effected through a sale of most of the assets of BT GmbH to an affiliate of Petitioners in the U.K. This reorganization was initiated by staff in the London Treasury unit of BT and structured to satisfy various tax and regulatory requirements.

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[11] Mr. Linzer testified that Mr. Sodano was an officer of BT at the time of this transaction. The Record does not contain any documentation about the officers or directors of BT or BTNY in 1983. During the Tax Years, Mr. Sodano was an officer of BT only in 1987. T. Ex. I3. He was an officer of BIC and BTFIC during all three Tax Years. T. Ex. I2, I3 & I4.

Tr. 113-14, T. Ex. B18. The transaction was on the agenda of an August, 26, 1993, meeting of the Network Committee for approval. T. Ex. B18. Although initiated in 1993, this transaction did not take place until 1994. Tr. 118.

Mr. Linzer testified that, to his knowledge, there were no agreements under which any of the upper-tier entities had rights with respect to the lower-tier entities other than "control through the voting stock of each and every corporation." Tr. 107. *See also* Tr. 93-94. Mr. Byrne gave similar testimony. Tr. 274.

Petitioners take exception to the CALJ's conclusion that Petitioners did not prove that BT was the actual beneficial owner of the Indirect Subsidiaries and that, therefore, Petitioners were not entitled to the 17% Interest Deduction for the interest income received by BT from the Indirect Subsidiaries during the Tax Years.

Code §11-641(e) allows a deduction for various items in computing entire net income under the City Bank Tax including "seventeen percent of interest income from subsidiary capital. . . ." Code §11-641(e)(11)(i). Code §11-638(e) defines "subsidiary capital" as "investments in the stock of subsidiaries and any indebtedness from subsidiaries. . . ." Code §11-638(d) defines a "subsidiary" as "a corporation or association of which over fifty percent of the number of shares of stock entitling the holders thereof to vote for the election of directors or trustees is owned by the taxpayer."

Principles of statutory construction call for taxing statutes generally to be construed against the government and in favor of taxpayers where there is "doubt as to the construction" of the statute. McKinney's Statutes §313.c. However, "deduction provisions are to be construed in favor of the taxing authority and the extent to which a deduction shall be allowed is a matter of legislative grace to which a taxpayer must prove entitlement." Citrin

Cooperman & Co., LLP v. Tax Appeals Tribunal of the City of NY, 52 A.D.3d 228, 228 (1st Dept. 2008) (citations omitted.) Thus, Petitioners bear the burden of proving their entitlement to the 17% Interest Deduction.

Code §11-638, subdivisions (d) and (e) relating to subsidiary capital, and Code §11-641(e)(11)(i), authorizing the 17% Interest Deduction, were enacted by the State Legislature in 1985 as part of a major overhaul of the taxation of banks by the City and State. Laws of New York 1985, ch. 298 (the "1985 Legislation") §§32 and 38.[12] The corresponding provisions of the State Bank Tax law, Tax Law §§1450(d) and (e) and 1453(e)(11)(i), were enacted at the same time. 1985 Legislation, §§12 and 18.

It is notable that while the definition of "subsidiary" enacted by the 1985 Legislation refers to voting stock "owned by the taxpayer", elsewhere in the 1985 Legislation the State Legislature used different language in establishing stock ownership requirements. For example, the definition of a banking corporation subject to the State Bank Tax and the City Bank Tax, as amended by §§13 and 33 of the 1985 Legislation, includes "any corporation sixty-five percent or more of whose voting stock is owned or controlled, directly or indirectly", by certain other types of banking entities (emphasis added.) Code §11-640(a)(9); Tax Law §1452(a)(9).[13] Similarly, §§27 and 45 of the 1985 Legislation amended the State Bank Tax and the City Bank Tax to permit a banking corporation or bank holding company to file a combined return with one or more other banking corporations or bank holding companies under certain circumstances if the first corporation "owns or controls, directly or

[12] Code §11-641(e)(11)(i) was enacted as Code §R46-37.3(e)(11)(i) and Code §11-638 subdivisions (d) and (e) were enacted as Code §R46-37.0(d) and (e). The Code was recodified and renumbered by Laws of New York 1985, ch. 907, §1.

[13] Prior to the recodification of the Code in 1985, *see supra* note 12, Code §11-640(a)(9) was numbered Code §R46-37.2(a)(9). For a discussion of Code §R46-37.2(a)(9) prior to its renumbering and amendment by the 1985 Legislation, *see infra* notes 24 & 25 and the accompanying text.

indirectly" 80% or more of the voting stock of the other corporations (emphasis added.) Code §11-646(f)(2);[14] Tax Law §1462(f)(2).

The GCT and the State Business Corporation Tax (the "State Corporation Tax") make similar distinctions referring to voting stock "owned" in the definition of subsidiary but to capital stock "owned or controlled either directly or indirectly" in describing corporations eligible for combined filing (emphasis added.) *Compare* Code §11-602.2 and Tax Law §208.3 *with* Code §11-605.4 and Tax Law §211.4(a), respectively.

The New York Court of Appeals has held that "where . . . the Legislature uses different terms in various parts of a statute, courts may reasonably infer that different concepts are intended. Matter of Albano v Kirby, 36 NY2d 526, 530 [1975]; [McKinney's Statutes] § 236 at 403." Rangolan v. County of Nassau, 96 N.Y. 2d 42, 47 (2001). Under this principle, we can conclude that the State Legislature intended the word "owned" in the definition of subsidiary for purposes of the City Bank Tax, the State Bank Tax, the GCT and the State Corporation Tax to mean something different from "owned or controlled . . . directly or indirectly."

As in effect during the Tax Years, the relevant section of the rules governing the definition of a "subsidiary" for purposes of the City Bank Tax read:

> (i) The term "subsidiary" means a corporation which is controlled by the taxpayer, by reason of the taxpayer's ownership of more than 50 percent of the voting stock of such corporation.
>
> (ii) The test of ownership is actual beneficial ownership, rather than mere record title as shown by the stock books of the issuing corporation. A corporation will not be considered to be a

[14] Code §11-646(f)(2) was enacted by §45 of the 1985 Legislation as Code §R46-37.8(f)(2).

subsidiary because more than 50 percent of the shares of its voting stock is registered in the taxpayer's name, unless the taxpayer is the actual beneficial owner of such stock. However, a corporation will not be considered a subsidiary if more than 50 percent of the shares of its voting stock is not registered in the taxpayer's name, unless the taxpayer submits proof that it is the actual beneficial owner of such stock.

(iii) A corporation is a subsidiary for purposes of the banking corporation tax law if the taxpayer is the actual beneficial owner of more than 50 percent of the shares of such corporation's voting stock, even though the taxpayer has conferred the right to vote such stock on others, by means of a proxy, voting trust agreement or otherwise.

(iv) In any case where the record holder of shares of voting stock of a corporation is not the actual beneficial owner of the stock, or where the right to vote such stock is not possessed by the record holder or by the actual beneficial owner of the stock, a full and complete statement of all relevant facts must be submitted with the return.

(v) A corporation will be treated as a subsidiary of a taxpayer only for that part of the taxable year during which the taxpayer is the owner of more than 50 percent of the shares of stock of such corporation which, during that period, entitle the holders to vote for the election of directors or trustees.[15]

[15] In 1986 and 1987, the language quoted was contained in §1-2.22 of the Department's Regulations Relating to the New York City Tax on Banking Corporations as promulgated December 6, 1985. All of the Department's rules, including the rules under the City Bank Tax, were reorganized and renumbered as part of the compilation of all City rules under §1045 of the New York City Charter (the "City Charter"). The Department's Regulations Relating to the New York City Tax on Banking Corporations were renumbered as 19 RCNY Chapter 3 (the "City Bank Tax Rules"). The quoted rule was renumbered as City Bank Tax Rule 19 RCNY §3-01(b) "Subsidiary".

The above rule, as in effect during the Tax Years, is referred to in this Decision as the "Former City Bank Tax Rule."[16] The Former City Bank Tax Rule was virtually identical to the Department's rule relating to the definition of "subsidiary" under the GCT as in effect during the Tax Years.[17] The corresponding regulations of the State Tax Department under the State Bank Tax and the State Corporation Tax as in effect during the Tax Years were virtually identical in all relevant respects to the Former City Bank Tax Rule and the corresponding rule under the GCT.[18]

The City and State rules and regulations governing the GCT, the State Corporation Tax, the City Bank Tax and the State Bank Tax distinguish ownership of a corporation from direct or indirect ownership or control of a corporation in the same way those terms are distinguished in the related statutes.

The City Bank Tax Rule relating to the definition of a "banking corporation", which was in effect during the Tax Years, reads as follows:

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[16] The Former City Bank Tax Rule was amended in 1997. In part, that amendment added the following sentence to subparagraph (ii) of the Former City Bank Tax Rule: "Actual beneficial ownership of stock does not mean indirect ownership or control of a corporation through a corporate structure consisting of several tiers and/or chains of corporations." (Emphasis added.)

[17] The Department's rules relating to the GCT were reorganized and renumbered as 19 RCNY (Chapter 11) (the "GCT Rules") as part of the compilation of all City rules under City Charter §1045. The Department's GCT rule relating to the definition of "subsidiary" for purposes of the GCT as in effect in 1986 and 1987 was §3-51 of the Department's Regulations Relating to the New York City General Corporation Tax and was renumbered under City Charter §1045 as GCT Rule 19 RCNY §11-46 "Subsidiary". GCT Rule 19 RCNY §11-46 "Subsidiary" also was amended in 1997 in part to add the following sentence: "Actual beneficial ownership of stock does not mean indirect ownership or control of a corporation through a corporate structure consisting of several tiers and/or chains of corporations." (Emphasis added.)

[18] The corresponding State regulations are 20 NYCRR §16-2.22 and §3-6.2, respectively. The State Bank Tax regulation and the State Corporation Tax regulation were amended in 1994 to add a sentence comparable to that added to the City Bank Tax Rules and GCT Rules. *See supra* notes 16 and 17.

> (x)(A)(*a*) Any corporation whose voting stock is 65 percent or more owned or controlled, directly or indirectly, by a bank holding company or by a corporation described in any of the foregoing subparagraphs of this definition is a banking corporation if the requirements set forth in this subparagraph (x)(A)(*a*) are met. . . .
>
> *(c)* The test of ownership . . . is actual beneficial ownership rather than mere record title as shown by the stock books of the issuing corporation. A corporation may be the actual beneficial owner of voting stock of another corporation even though it has conferred the right to vote such stock on others, by means of a proxy, voting trust or otherwise. The term "control" for purposes of this subparagraph (x)(A) refers to all cases where one corporation directly or indirectly possesses the power to dictate or influence the management and policies of another corporation, whether through the ownership of the voting stock of such corporation or the ownership of the voting stock of another corporation which possesses that power. The decision as to whether or not a corporation is controlled by another corporation will be determined by the facts in each case.

City Bank Tax Rule 19 RCNY §3-01(b) "Banking corporation" (x)(A).[19] That rule distinguishes actual beneficial ownership from control. Consistent with the statutory language, which includes indirect control, that rule defines control as including control derived from direct or indirect ownership. Petitioners would have us read this definition of "control" into the concept of actual beneficial ownership in the Former City Bank Tax Rule. Although both provisions of the rules governing the City Bank Tax were adopted at the same time in 1985, the definition of control included in City Bank Tax Rule 19 RCNY §3-01(b)

[19] City Bank Tax Rule 19 RCNY §3-01(b) "Banking corporation" (x)(A) was numbered §1-2.5(j)(1) when adopted in 1985. The corresponding State Bank Tax regulation is 20 NYCRR §16-2.5(j)(1).

"Banking corporation" (x)(A) quoted above was not included in the Former City Bank Tax Rule. The same is true of the corresponding State Bank Tax regulations.[20]

Subparagraph (i) of the Former City Bank Tax Rule refers to a subsidiary as a corporation "controlled by the taxpayer, by reason of the taxpayer's ownership of more than" 50% of the subsidiary's voting stock. To be consistent with the statutory definition of subsidiary in Code §11-638(d), which does not refer either to "control" or "indirect" ownership, the reference to "control" in the Former City Bank Tax Rule cannot be read to include control derived from indirect ownership.

Despite the statutory language, Petitioners assert that ownership of a subsidiary under Code §11-638(d) and the Former City Bank Tax Rule includes indirect ownership. Petitioners primarily rely on the interpretation of State Corporation Tax regulations in Matter of The Racal Corp. and Decca Electronics, Inc., New York State Tax Appeals Tribunal (May 13, 1993)("Racal") and State Bank Tax regulations in Matter of Bankers Trust NY Corp., New York State Tax Appeals Tribunal (March 14, 1996) ("Bankers Trust"). In Racal, the New York State Tax Appeals Tribunal (the "State Tribunal") stated that the State Corporation Tax regulation corresponding to the Former City Bank Tax Rule:

> [introduces] a concept not apparent on the face of the statute, i.e., that the taxpayer controls the corporation through the beneficial ownership of the stock.
> Thus, the question we are presented with is not one of simply interpreting and applying the statutory definition of subsidiary,

[20] The City Bank Tax Rules and GCT Rules relating to the requirements for filing combined reports, which were in effect during the Tax Years, similarly refer to direct or indirect ownership or control reflecting the related statutory provisions. *See* City Bank Tax Rule 19 RCNY§3-05(b), which refers to the definitions of ownership and control in City Bank Tax Rule 19 RCNY §3-01(b) "Banking corporation" (x)(A)*(c)* and *(d)*, and GCT Rule 19 RCNY §11-91(e)(1).

> but instead, of applying the regulation promulgated by the [State Tax Department]. . . .

Racal, at 8 (emphasis added.)

The Racal case addressed 20 NYCRR §3-6.2, relating to the definition of subsidiary under the State Corporation Tax, as applied to stipulated facts. Briefly, the stipulated facts of Racal were that The Racal Corporation ("TRC") was 100% owned by an affiliated group of companies identified as the Racal Electronics, Inc., U.S. affiliated group ("REI") and functioned as REI's principal holding company. TRC owned 100% of the issued and outstanding capital stock of Decca Electronics, Inc. ("DEI"). DEI owned 100% of the issued and outstanding voting stock of Decca Navigator Systems, Inc. ("DNSI"). DNSI owned 100% of the issued and outstanding voting stock of Racal Decca Survey, Inc. ("RDSI"). DEI and DNSI were inactive shell corporations during the tax years in question. Racal, at 2-3. TRC, DEI, DNSI and RDSI had common officers and directors during the tax years. Racal, at 4. TRC filed State tax returns for the tax years in question and DEI filed State Corporation Tax returns for the fiscal years 1985 through 1987.[21] The parties also stipulated that, during the tax years:

- "TRC/DEI had absolute control over" the election and removal of DNSI and RDSI officers and directors and over all DNSI and RDSI operations.
- The officers and directors of DNSI and RDSI "did not have the power or authority to act independently of TRC/DEI. . . ."

[21] It appears that TRC and DEI filed separate, not combined, State Corporation Tax returns. Racal, at 2-3. *See also* Petitioner's Brief at 35-36. However, TRC and DEI filed a single petition in Racal.

- "TRC/DEI had the absolute power to" cause DNSI and RDSI to declare and pay dividends, to "dictate the management and policies of DNSI and RDSI" and "to maintain a shareholder derivative action"; and
- "TRC/DEI had the absolute right" to sell or pledge all of the stock of DNSI and RDSI.

Racal, at 4. Both RDSI and DNSI paid interest to DEI during the tax years. TRC, DEI, DNSI and RDSI filed consolidated Federal tax returns with REI. Neither DNSI nor RDSI was required to file State Corporation Tax returns. Racal, at 3-4.

In determining entire net income under the State Corporation Tax, a corporation is allowed to exclude 100% of income from subsidiary capital. Tax Law §208.9(a)(1). The State Tax Department disallowed the claimed exclusion of the interest income received by DEI from RDSI as income from subsidiary capital. The State Tribunal affirmed the administrative law judge's determination that DNSI and RDSI were subsidiaries of the petitioners, TRC and DEI, and cancelled the notices of deficiency stating:

> The Administrative Law Judge's determination and our affirmance only hold that where a corporation controls all aspects of a second tier subsidiary's operation and management that this is beneficial ownership within the meaning of the regulation.

Racal, at 13 (emphasis added.) Petitioners argue that Racal requires us to find that the Indirect Subsidiaries were subsidiaries of BT during the Tax Years.

Under the Former City Bank Tax Rule, because BT is not the record title owner of the stock of the Indirect Subsidiaries, BT must submit proof that it is the actual beneficial owner of those corporations to claim them as subsidiaries. Petitioners have argued that BT is the

actual beneficial owner of the Indirect Subsidiaries based on the control over those corporations exercised by the Management Committee and Network Committee and that the record title owners, the Immediate Parents, merely act at the direction of BT. Petitioner's Brief at 44, 47. To support that claim at the hearing before the CALJ, Petitioners submitted documentary evidence and testimony regarding the activities and corporate structure of Petitioners, the Intermediate Corporations and the Indirect Subsidiaries.[22]

Petitioners introduced evidence of four specific transactions. The Record shows that each transaction was initiated not by the Management Committee or Network Committee, but by local personnel to address local regulatory conditions in some cases. Documentary evidence of approval by BT of those transactions was provided for only two of the four transactions. The manner in which the transactions were implemented was often dictated by regulatory requirements in the local jurisdiction rather than by management. Mr. Linzer's testimony regarding the four transactions was based solely on his examination of available documents, not personal knowledge. Tr. 30, 32-33, 66-67, 70, 72. Mr. Byrne did not give any testimony regarding the four transactions. Mr. Lem testified from first-hand knowledge about only the creation of a new Australian subsidiary to acquire a commercial banking license and none of the other transactions. However, Mr. Lem's involvement in that transaction was limited to ensuring the execution of the necessary corporate resolutions. Tr. 284-85.

While the Record establishes that BT and BTNY provided centralized management of global business policies and strategies and had final decision-making authority, Petitioners did not introduce any evidence of any specific transactions initiated by the Management

[22] We note, however, that while much of the documentary evidence relates to the Tax Years, a significant portion of that evidence does not. *See*, *e.g.,* T. Ex. A5, A11 & B2, excerpts from Network books from 1990; T. Ex. A9, Rules for Business Conduct dated June 1990; T. Ex. B6, Memorandum re: BIC Board dated 12/17/79; T. Ex. B16 & B17 relating to officers' and directors' indemnification; and T. Ex. B20 Network Committee Policies and Procedures manual dated 7/01/1995.

Committee or Network Committee during the Tax Years. Mr. Byrne testified that proposals to open or acquire a new foreign subsidiary usually originated in that country and that final decisions on any such acquisition would be made locally or by the Management Committee depending on its materiality. Tr. 212-13. Mr. Linzer testified that: "[I]t is very hard in the [Tax Years] we are talking about to find transactions. You know, during this period, maybe things didn't happen that show that control and that management movement." Tr. 90-91.

All of Petitioners' witnesses testified to the importance of corporate housekeeping and made clear that each step in transactions undertaken by Petitioners and their uncombined affiliates was meticulously documented to maintain the integrity of the corporate structure. Nothing in the Record establishes that BT exerted control over the Indirect Subsidiaries beyond that of a 100% indirect shareholder through its power to elect directors who, in turn, appointed officers who performed those same functions for the next lower-tier of entities and so on down the chain. There is no evidence in the Record that BT ever bypassed the corporate structure to conduct activities in the Indirect Subsidiaries directly.

Mr. Byrne, testified that while the officers and directors of lower-tier affiliates of BT who also were officers or directors of BT followed its objectives in their actions on behalf of those lower-tier subsidiaries, nevertheless, they would have to "vote in accordance with what they believe to be in the best interest of [the subsidiary]." Tr. 251-52. Mr. Byrne's testimony is confirmed by minutes of directors' meetings of BTE, the Immediate Parent of BTUK, included in the Record. Those minutes contain declarations of directors of BTE stating that, notwithstanding their dual positions as directors of BTE and as officers or directors of BT or one of the Intermediate Corporations and the resulting potential for conflicts of interest, the matter under consideration "was fair as to [BTE]. . . ." T. Ex. D51, D52, D54, D55, D56, D57 and D59.

Based on the foregoing, we find that Petitioners have not proven that BT possessed or exercised the necessary level of control over "all aspects of [the] operation and management" of the Indirect Subsidiaries to be considered the actual beneficial owner of those corporations during the Tax Years under Racal. Racal, at 13.

In addition to Racal, Petitioners cite TSB-M-79(1)C(Rev) (October 19, 1979) (the "1979 TSB Memorandum") in support of their position that a second-tier subsidiary can qualify as a subsidiary. The 1979 TSB Memorandum is not compelling authority for that position. Memoranda of the State Tax Department Technical Service Bureau ("TSB") have no legal effect and are not binding authority on the State Tribunal, this Tribunal or the Department.[23] Moreover, the 1979 TSB Memorandum was issued under Tax Law §1452(a)(8) prior to its amendment by the 1985 Legislation, not Tax Law §1450(d) defining "subsidiary", which did not exist in the State Bank Tax law in 1979.

When the 1979 TSB Memorandum was issued, Tax Law §1452(a)(8) included in the definition of a "banking corporation" subject to the State Bank Tax, a corporation "eighty percent or more of whose voting stock is beneficially owned" by one of several types of banking institutions.[24] In the 1979 TSB Memorandum, the State Tax Department stated that:

> Voting stock is beneficially owned when a corporation has actual or beneficial ownership of the voting stock of another corporation. The stockholder has actual ownership when it has the right to vote for the election of directors and the right to receive dividends. The stockholder has beneficial ownership

[23] 20 NYCRR §2375.6(c). *See also* Matter of Garden Way Inc., New York State Tax Appeals Tribunal (February 24, 1994).

[24] The corresponding provision of the pre-1985 City Bank Tax law was former Code §R46-37.2(a)(8).

when it owns indirectly and controls the voting stock of another corporation. [Emphasis added.]

The 1985 Legislation changed the language in Tax Law §1452(a)(8) from "beneficially owned" to "owned or controlled, directly or indirectly",[25] which was the applicable language during the Tax Years. Moreover, the 1979 TSB Memorandum referred to "actual or beneficial ownership" (emphasis added) while the Former City Bank Tax Rule and the corresponding State regulation refer to "actual beneficial" ownership. In the 1979 TSB Memorandum, the State Tax Department defined "actual" ownership as requiring the right to vote and receive dividends. In sum, the 1979 TSB Memorandum interpreted a statute that was subsequently amended by the 1985 Legislation to expressly provide for indirect ownership or control. The present case involves a different statutory provision; one that was enacted by the 1985 Legislation but contains no reference to indirect ownership or control. Consequently we are not persuaded that we must apply the definition of "beneficial ownership" in the 1979 TSB Memorandum to the phrase "actual beneficial ownership" in the Former City Bank Tax Rule in the absence of any support for that interpretation in the statute.[26]

Petitioners also cite a State Tax Department advisory opinion, TSB-A-87(23.1)C/TSB-A-88(7.1)C (November 2, 1992), in support of its position that a second-tier subsidiary can qualify as a subsidiary under the State Corporation Tax. Petitioner's Brief at 32. TSB-A-87(23.1)C/TSB-A-88(7.1)C does not stand for that proposition. That advisory opinion

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[25] The 1985 Legislation also renumbered paragraph (8) of Tax Law §1452(a) as paragraph (9).

[26] While City Charter §170.d requires us to "follow as precedent the prior precedential decisions of the" State Tribunal, the State Tribunal's discussion of the 1979 TSB Memorandum in Bankers Trust and Racal cannot require this Tribunal to follow as precedent otherwise nonprecedential TSB memoranda or opinions. We also note that the State Tax Department declared TSB-M-79(1)C(Rev) obsolete in TSB-M-79(1.1)C (Rev) (May 1, 1995) after the Racal decision was issued but before the Bankers Trust decision was issued.

represents a step in the evolution of the State Tax Department's treatment of Subpart F[27] income for State Corporation Tax purposes. For Federal tax purposes, a U.S. corporation that owns a controlled foreign corporation ("CFC") is required to report as dividend income, its share of the earnings of that CFC even if there are no distributions from the CFC. Where a U.S. corporation owns a chain of CFCs, Subpart F requires the U.S. shareholder to report as dividend income the earnings of all of the CFCs in the chain. In an earlier TSB advisory opinion, TSB-A-87(23)C (September 9, 1987), the State Tax Department concluded that Subpart F income should be treated as dividend income for State tax purposes consistent with the Federal treatment, but that Subpart F income attributable to a second-tier or more remote CFC could not be treated as income from subsidiary capital.

In 1992, the State Tax Department modified that advisory opinion in TSB-A-87(23.1)C/TSB-A-88(7.1)C, cited by Petitioners. In concluding that Subpart F income from a more than 50% indirectly owned CFC could be treated as income from subsidiary capital, the State Tax Department stated:

> For [State Corporation Tax] purposes, a dividend may only be paid to a shareholder. That is, the Subpart F income of the lowest tier CFC is deemed paid to the next higher tier CFC. That CFC, in turn, is deemed to have paid a Subpart F deemed dividend to the next higher tier CFC and so on, until such Subpart F deemed dividend is deemed paid by the first tier CFC which is directly owned by the taxpayer. The taxpayer's directly owned CFC is deemed to have paid a dividend to the taxpayer consisting of the Subpart F income from such CFC as well as the Subpart F income of the lower tier CFCs.

Contrary to Petitioners' reading of that Advisory Opinion, the State Tax Department did not treat the lower-tier CFCs as subsidiaries of the U.S. corporate shareholder. Instead, it deemed

[27] "Subpart F" refers to Internal Revenue Code §§951-965.

each CFC in the chain to have paid a dividend to its direct shareholder up the chain to the U.S. corporation required to report the Subpart F income.

Finally, Petitioners assert that under Bankers Trust, we must conclude that BT was the actual beneficial owner of the Indirect Subsidiaries. BTNY was the petitioner in Bankers Trust although it filed combined State Bank Tax returns for the years in question with more than 60 affiliated corporations, including BT. Among the issues in that case was whether uncombined second-tier and more remote subsidiaries were subsidiaries of BTNY[28] under Tax Law §1450(d) entitling the petitioner, BTNY, to claim the State 17% Interest Deduction on those combined returns for interest income those second-tier and more remote subsidiaries paid to BT.

In Bankers Trust, noting the close similarity between the definition of "subsidiary" in the regulations under the State Bank Tax and the State Corporation Tax, the State Tribunal relied on its analysis of 20 NYCRR §3-6.2 in Racal and similarly limited its analysis to the language of the State Bank Tax regulation corresponding to the Former City Bank Tax Rule.[29] However, the State Tribunal distinguished Racal noting that, while in Racal the parties had stipulated that the taxpayer had "absolute control of all aspects of the second-tier subsidiary's operation", no such stipulation had been made by BTNY. Bankers Trust, at 27. The State Tribunal ruled that, without a comparable stipulation, because the stock of the second-tier and

[28] Although the State Tribunal in Bankers Trust addressed the issue before it in terms of whether the uncombined second-tier and more remote subsidiaries were subsidiaries of the petitioner, BTNY, BTNY's witness described BT, and not BTNY, as the owner of those second-tier and more remote subsidiaries. Bankers Trust, at 27-28.

[29] "As we stated in [Racal]: '[T]he question we are presented with is not one of simply interpreting and applying the statutory definition of subsidiary, but instead, of applying the regulation promulgated by the [State Tax Department]. . . .'" Bankers Trust, at 26 (emphasis added.)

more remote subsidiaries was not registered in BTNY's name, BTNY had to submit proof that it was the actual beneficial owner of those subsidiaries.

The State Tribunal, disagreed with the administrative law judge and held that it did not have to determine whether the petitioner, BTNY, "'controlled all aspects of the operations and management of the indirect subsidiaries'", Bankers Trust, at 27 (citation omitted.) The State Tribunal concluded that to establish that BTNY was the actual beneficial owner of the lower-tier corporations claimed as subsidiaries, BTNY had to prove that it "had 'command over property or enjoyment of its economic benefits'; '[owned] indirectly and [controlled] the voting stock of another corporation'; or had the 'absolute right to sell or pledge the stock, receive dividends from the stock and vote and maintain a shareholder derivative action. . . .'" Bankers Trust, at 27. Having articulated those standards, the State Tribunal did not explain what BTNY might have shown to satisfy them, holding only that BTNY had not met its burden of proof and, consequently, disallowing the State 17% Interest Deduction for interest income received from second-tier and more remote subsidiaries. However, the State Tribunal rejected BTNY's argument that:

> any time a corporation has "actual beneficial ownership" of 100% of the stock of a subsidiary, it has the power to "control all aspects" of its management and operations, since through its chain of ownership, it has the power to control stockholder voting, control membership on the board of directors and the personnel employed by such subsidiaries. There is no greater degree of control than that exemplified by 100% stock ownership.

Bankers Trust, at 28 (citation omitted.) The State Tribunal was forceful in stating that proof of actual beneficial ownership of a second-tier corporation in a chain required more than proof of indirect stock ownership:

> [N]either Tax Law §1450 nor the regulation interpreting it provide that indirect ownership of 100% of the stock of a second-tier subsidiary corporation conclusively demonstrates actual control of such corporation or actual beneficial ownership of its stock. If the only issue is ownership of 100% of the stock of a corporation claimed to be a subsidiary, then the holding in Racal is superfluous. In Racal, the taxpayer was the indirect owner of 100% of the shares of each of the corporations claimed by it to be subsidiaries. However, it was the indicia of control over those corporations and of their beneficial ownership that formed the basis of the [State] Tribunal's decision and not the 100% indirect ownership of their stock.

Bankers Trust, at 28 (emphasis added.)

Thus, under Bankers Trust, to establish that it is the actual beneficial owner of a second-tier or more remote subsidiary, a 100% indirect shareholder must prove a degree of control over that subsidiary beyond the indirect shareholder's power to control the voting of the shares, board membership and personnel of the lower-tier subsidiary through a chain of ownership.

Petitioners assert that we must conclude that the Indirect Subsidiaries were subsidiaries of BT if BT satisfies any one of the three standards articulated in Bankers Trust.[30] Petitioner's

[30] While Petitioners assert that we are bound by the decision in Bankers Trust under City Charter §170.d, which requires us to "follow as precedent the prior precedential decisions of the" State Tribunal, Petitioners do not suggest that the State Tribunal's conclusion that BTNY did not meet its burden of proof is binding on this Tribunal.

The Bankers Trust decision involved only interest paid in 1985, not the Tax Years. Bankers Trust involved several issues in addition to the State 17% Interest Deduction. Despite the State Tribunal's ruling in Bankers Trust that BTNY had not met its burden of proving that it was the actual beneficial owner of the second-tier and more remote subsidiaries, the State Tax Department subsequently allowed a portion of the State 17% Interest Deduction for interest income paid to BT by second-tier and more remote subsidiaries as part of a settlement of Petitioners' State Bank Tax liabilities for the tax years 1985 through 1994.

Brief at 44. Because the State Tribunal did not explain what facts BTNY might have presented to satisfy the three standards, we will examine the State Tribunal's sources for those standards to determine what might be required.

The State Tribunal based the first standard, "command over property or enjoyment of its economic benefits" on Yelencsics v. Commissioner, 74 T.C. 1513, 1527 (1980) ("Yelencsics"). In Yelencsics, which involved a sale of stock between unrelated parties, the United States Tax Court (the "Tax Court") addressed the question of whether sufficient incidents of ownership had been transferred to the purchaser of the stock so as to cause the purchaser, rather than the seller, to be considered the owner of the stock and taxed on payments made by the corporation as constructive dividends. That case did not involve a chain of wholly-owned corporations where no transfer of stock occurred, as in the case before this Tribunal. The Tax Court found the purchaser to be the owner of the stock, and not the seller who retained record title to the stock, because the purchaser, and not the seller, had unqualified voting proxies, elected a majority of the directors and officers, was entitled to "all profits, dividends and bonuses" from operations and bore the risk of loss on the stock. Yelencsics, at 1528. In the present case, to the extent that BT enjoyed any of those rights with respect to the Indirect Subsidiaries, it did so only through its power indirectly to vote the shares and control membership on the board of directors of the Indirect Subsidiaries. The State Tribunal in Bankers Trust rejected BTNY's argument that those powers constituted the degree of control required by Racal. Moreover, BT shared with the Intermediate Corporations whatever risks and benefits of ownership of the Indirect Subsidiaries it possessed. By contrast, the Tax Court's decision in Yelencsics was based on the fact that only the purchaser possessed the risks and benefits of ownership. Therefore, we find that Petitioners have not satisfied the first standard.

The State Tribunal derived its second standard, whether the taxpayer "'owns indirectly and controls the voting stock of another corporation'" from the 1979 TSB Memorandum. Having rejected BTNY's assertion that the "power to control stockholder voting, control membership on the board of directors and the personnel employed by" a corporation was equivalent to the "power to 'control all aspects' of [the] management and operations" of that corporation,[31] the State Tribunal did not explain what degree of control over the voting stock of another corporation would have been sufficient to satisfy this standard. Petitioners do not contend that BT controls the Indirect Subsidiaries other than through ownership of the Intermediate Corporations. In response to the CALJ's question as to whether "there were any contracts or trust agreements or other agreements whereby [BT] was authorized to control its subsidiaries," Petitioners' witness, Mr. Linzer, testified "The way that they control is they control through the voting stock of each and every corporation." Tr. 107. *See also* Petitioner's Brief at 44-45. The State Tribunal in Bankers Trust rejected a comparable argument by BTNY. We have already concluded that, while BT was an indirect owner of the Indirect Subsidiaries, Petitioners have not proven that BT possessed or exercised sufficient control over the Indirect Subsidiaries to be considered the actual beneficial owner of those entities.[32]

The State Tribunal based the third standard, whether the purported actual beneficial owner possessed the "absolute right to sell or pledge the stock, receive dividends from the stock and vote and maintain a shareholder derivative action", on another State Corporation Tax case, Xerox Corp. v. Dept. of Taxation and Finance, 140 A.D.2d 945 (4th Dept. 1988).[33]

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[31] Bankers Trust, at 28.

[32] *See supra* at 19-22. *See also supra* notes 24-26 and the accompanying text regarding the 1979 TSB Memorandum.

[33] The relevant language appears in an unreported order by a lower court in that case in which the judge rejected the State Tax Department's cross motion for summary determination and issued an order

Petitioners assert that BT had the right to vote for the election of directors and the right to "cause dividends to be paid", rather than the right to receive dividends, but Petitioners concede that those rights were derived indirectly through BT's control and ownership of intervening entities. Petitioner's Brief at 44-45. BT shared those rights with the Intermediate Corporations, specifically the Immediate Parents, which, as the record title owners of the Indirect Subsidiaries, had the right to receive dividend distributions. An indirect, nonexclusive right to sell or pledge stock, receive dividends or bring a derivative action is not equivalent to the absolute right to take those actions under the third standard of Bankers Trust.

Because Petitioners have not shown that they satisfied any of the standards of Bankers Trust necessary to establish that BT was the actual beneficial owner of the Indirect Subsidiaries during the Tax Years, we conclude that Petitioners are not entitled to the 17% Interest Deduction for the interest income paid to BT by the Indirect Subsidiaries during the Tax Years.

As noted above, the Immediate Parents as well as BT claimed the Indirect Subsidiaries as subsidiaries on several of their City tax returns included in the Record. Petitioners contend that a corporation can be the subsidiary of more than one corporation at the same time and dispute the CALJ's contrary conclusion. Petitioner's Brief at 2, 22, 33.

A subsidiary is defined in Code §11-638(d) as "a corporation or association of which over fifty percent of the number of shares of stock entitling the holders thereof to vote for the election of directors or trustees is owned by the taxpayer." (Emphasis added.) The New York Court of Appeals has stated that:

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granting summary judgment for the taxpayer. TSB-H-87(25)C. That order was subsequently reversed on appeal in the cited decision.

> As the clearest indicator of legislative intent is the statutory text, the starting point in any case of interpretation must always be the language itself, giving effect to the plain meaning thereof. As we have stated:
>
> > "In construing statutes, it is a well-established rule that resort must be had to the natural signification of the words employed, and if they have a definite meaning, which involves no absurdity or contradiction, there is no room for construction and courts have no right to add or take away from that meaning."

Majewski v. Broadalbin-Perth Central Sch. Dist., 91 N.Y.2d 577, 583 (1998) (citations omitted). *See also* McKinney's Statutes §94. The natural and obvious meaning of the language of Code §11-638(d) is that a corporation will qualify as a subsidiary of the taxpayer owning a majority of the voting stock of that corporation. Nothing in the plain language of that statute indicates that the State Legislature intended or expected more than one taxpayer to meet that requirement at the same time.[34] Nevertheless, Petitioners would have us conclude otherwise in the case of a chain of wholly-owned corporations.

The Former City Bank Tax Rule provides that the record title owner of more than 50% of the voting stock of a corporation cannot claim it as a subsidiary unless it also is the actual beneficial owner of the stock and, conversely, that an entity that is not the record title owner of more than 50% of the voting stock of a corporation can only claim it as a subsidiary if it submits proof that it is the actual beneficial owner.[35] Consistent with the use of the singular

[34] The singular "taxpayer" cannot be read to include the plural "taxpayers" because that would render the "over fifty percent" stock ownership requirement meaningless. Such a reading would permit multiple taxpayers collectively owning more than 50% of the voting stock of a corporation each to claim that corporation as a subsidiary regardless of the amount of voting stock owned by any one of those taxpayers.

[35] The Former City Bank Tax Rule at subparagraph (ii) reads in part: "A corporation will not be considered to be a subsidiary because more than 50 percent of the shares of its voting stock is registered in

"taxpayer" in Code §11-638(d), the Former City Bank Tax Rule refers to "the actual beneficial owner" (emphasis added) rather than an "actual beneficial owner" and only uses the singular form "owner." Thus, we question whether under the Code and the Former City Bank Tax Rule, which is identical in this respect to the corresponding GCT rule, there can be multiple actual beneficial owners of more than 50% of the voting stock of the same corporation at the same time.

To support their position, Petitioners rely on the holding in Racal that, under the facts as stipulated, DNSI and RDSI were subsidiaries of the petitioners in that case, TRC and DEI. In Racal, the State Tax Department argued that a finding that a corporation could be a subsidiary of more than one corporation would lead to the "absurd result" that more than one corporation could be subject to the tax on subsidiary capital under the State Corporation Tax on the same corporate subsidiary.[36] The State Tribunal disagreed but did not explain how that result could be avoided, stating only that its holding "does not mean that all corporations with an indirect interest in other corporations would be subject to the tax on subsidiary capital." Racal, at 13.

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the taxpayer's name, unless the taxpayer is the actual beneficial owner of such stock. However, a corporation will not be considered a subsidiary if more than 50 percent of the shares of its voting stock is not registered in the taxpayer's name, unless the taxpayer submits proof that it is the actual beneficial owner of such stock."

[36] The City Bank Tax, under which Petitioners filed their returns, does not include a tax on subsidiary capital. On the separate GCT returns of the Intermediate Corporations included in the Record, they allocated 0% of their subsidiary capital to the City resulting in no tax on subsidiary capital so the issue of multiple taxation did not arise in the present case. Under the GCT, income from a subsidiary is not taxed to its corporate parent. As a consequence, permitting a corporation to qualify as a "subsidiary" of more than one corporation in a controlled group would create opportunities for manipulation in addition to the risk of multiple taxation of subsidiary capital. *See* CALJ Determination at note 17. While the opportunities for abuse are more limited under the City Bank Tax, the definition of subsidiary is effectively the same under both taxes and should be interpreted consistently. *See* Racal, at 11.

In Racal the State Tribunal adopted the administrative law judge's additional finding of fact that "[t]he [State Tax Department] adjusted the entire net income of petitioners by adding back to entire net income the interest payments received by DEI from RDSI, which had been deducted by DEI as interest income from subsidiary capital." Racal, at 5. If, as Petitioners in the present case assert, TRC and DEI filed separate State Business Corporation Tax returns, the State Tax Department could only have added the interest income received by DEI from RDSI to DEI's separate entire net income. Consequently, the only relevant inquiry should have been whether RDSI qualified as a subsidiary of DEI. The State Tribunal did not address any other audit adjustment in its decision in Racal. Therefore, it is arguable that the State Tribunal's conclusion that RDSI and DNSI also were subsidiaries of TRC is not binding precedent.[37] Petitioners have offered no other support for their argument that the Indirect Subsidiaries can be subsidiaries of BT and the Immediate Parents at the same time[38] nor have they addressed the issue of multiple taxation of subsidiary capital.

[37] While the facts as stipulated in Racal refer to deficiencies asserted against TRC, the nature of the adjustments underlying those deficiencies is not explained or addressed in the decision. Petitioners assert various facts in the history of the Racal case as support for their argument that Racal is precedent for the proposition that a corporation can be a subsidiary of more than one entity at a time. Petitioner's Brief at 37-38. However, none of these facts is mentioned in the Racal decision or supported by evidence submitted by Petitioners in the present case. Over Respondent's objection and noting that the probative value was likely to be "minimal", the CALJ admitted, for what they were worth, T. Ex. T and U, purporting to be copies of the Petition and Answer, respectively, in Racal. Tr. 304. Petitioners offered those Exhibits to "help clarify some of the facts when we review the legal issues and holding of . . . the Racal decision." Tr. 305. We find nothing in those Exhibits to support the facts asserted in Petitioner's Brief at 37-38. Moreover, Petitioners laid no foundation as to how those documents were obtained or from whom, whether there were any subsequent amendments to those pleadings or whether Petitioners' introduction of those Exhibits in this case was permissible under applicable tax secrecy laws. Therefore, we conclude that T. Ex. T and U have no probative value in the present case. In any event, it is only the written decision of the State Tribunal in Racal based on the facts as described in that decision that can be considered binding precedent.

[38] Because BTNY and BT had virtually identical boards of directors and many members of the Management Committee also were officers or directors of BTNY as well as BT during the Tax Years, Petitioners also have not established that BT and not BTNY was the actual beneficial owner of the Indirect Subsidiaries.

As we find that Petitioners did not prove that BT was the actual beneficial owner of the voting stock of the Indirect Subsidiaries during the Tax Years, we affirm the determination of the CALJ that Petitioners were not entitled to the 17% Interest Deduction for the interest income paid by the Indirect Subsidiaries to BT in the Tax Years.[39] As a consequence, Petitioners' refund requests are denied except to the extent agreed to by the Parties in ¶59 of the Stipulation.

Dated: April 8, 2010
New York, New York

_____
GLENN NEWMAN
President and Commissioner

_____
ELLEN E. HOFFMAN
Commissioner

[39] We have considered all other arguments raised by Petitioners and find them to be unpersuasive.