These are appeals filed under the formal procedure pursuant to G.L. c. 58A, § 7 and G.L. c. 62C, § 39, from the refusal of the Commissioner of Revenue ("appellee" or "Commissioner"), to abate corporate excise, together with interest and penalties, assessed to the appellants, Staples, Inc. ("Staples") and Staples Contract & Commercial, Inc. ("SCC") (collectively "appellants") for the tax years ended January 31, 2002 through January 31, 2005 ("tax years at issue").

Commissioner Scharaffa heard these appeals and was joined by Commissioners Rose, Chmielinski, and Good in the decisions for the appellee.

These findings of fact and report are made pursuant to requests by both the appellants and the appellee under G.L. c. 58A, § 13 and 831 CMR 1.32.
FINDINGS OF FACT AND REPORT

On the basis of evidence offered at the hearing of these appeals, the Appellate Tax Board ("Board") made the following findings of fact.

I. Introduction.

These appeals concern certain intercompany balances, which the appellants contend were bona fide debt owed by Staples to its subsidiaries that were participating in its cash management system ("CMS"). Staples deducted the balances in its computation of the non-income measure of the corporate excise and Staples deducted amounts that it characterized as interest on the balances in the computation of its income measure. The Commissioner asserted that the transactions giving rise to the balances did not constitute bona fide debt for Massachusetts corporate excise purposes and therefore neither amount was deductible.

At the hearing of these appeals, the parties offered a Statement of Agreed Facts ("Agreed Statement") and seventy-four agreed-upon exhibits. Subsequent to the hearing, the parties submitted two supplements to the Agreed Statement.
The appellants also offered the testimony of Dina Courchesne, a certified public accountant who joined Staples in 2002, where she served as the manager of external reporting, the manager of international accounting, senior manager, and, at the time of the hearing of these appeals, the director of corporate accounting. Ms. Courchesne testified that she was responsible for the preparation of financial statement filings with the Securities and Exchange Commission, the oversight of corporate general and administrative expenses, and global technical accounting matters.

The Commissioner called as a witness Barrington Henry, a corporate tax supervisor for the Commissioner in the Worcester region. Mr. Henry had supervised the auditors who conducted the audit of the appellants, and he testified that in this capacity, he had reviewed Staples’ books and records and the auditors’ work product.

II. Procedural background.

For Massachusetts tax purposes, Staples was the principal reporting corporation for a combined group of affiliated entities, including SCC. For each of the tax years at issue, Staples filed a Form 355C, Combined Massachusetts Corporate Excise Return. Pursuant to valid Consents Extending the Time for Assessment of Taxes for the tax years at issue, the
Commissioner issued a Notice of Assessment ("NOA") to Staples on January 26, 2010 assessing corporate excise, together with interest and penalties, for each of the tax years at issue.\(^1\)

Pursuant to valid Consents Extending the Time for Assessment of Taxes for the tax years at issue, the Commissioner issued an NOA to SCC on January 26, 2010 assessing corporate excise, together with interest and penalties, for each of the tax years at issue.\(^2\)

On April 15, 2010, Staples and SCC each filed a separate Form CA-6 Application for Abatement ("CA-6") with the Commissioner.\(^3\) On February 8, 2011, Staples and SCC each withdrew their consent to the Commissioner’s extended consideration of its abatement application. Accordingly, pursuant to G.L. c. 58A, § 6, the CA-6s were deemed denied on that date. On March 23, 2011, Staples and SCC seasonably filed petitions with the Board. On the basis of the foregoing, the Board found that it had jurisdiction to hear and decide these appeals.

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\(^1\) The Commissioner issued another NOA to Staples on June 23, 2010 assessing corporate excise, together with interest and penalties, for tax year 2003. The parties offered no explanation for the subsequent NOA for tax year 2003, but the Board noted that the subsequent NOA assessed a penalty for that tax year.

\(^2\) The Commissioner issued another NOA to SCC on December 28, 2010 assessing corporate excise, together with interest and penalties, for tax year 2002. The parties offered no explanation for the subsequent NOA for tax year 2002, but the Board noted that the subsequent NOA assessed higher interest and penalty amounts for that tax year.

\(^3\) On July 13, 2010, Staples filed an amended and restated CA-6 with the Commissioner. The amended and restated CA-6 included Staples’ contention that penalties set out in the June 23, 2010 NOA must be abated because the NOA was issued after the time for making additional assessments for the tax year 2003 had expired. The appellants did not pursue this contention at the hearing.
The parties stipulated that if Staples’ intercompany balances under the CMS were properly characterized as debt for purposes of calculating the income measure and liabilities for purposes of calculating the non-income measure of the corporate excise for the tax years at issue, Staples would be entitled to an abatement of $10,189,899 and a refund of $1,794,304 in corporate excise, plus statutory interest. If the intercompany balances under the CMS were not properly characterized as debt for purposes of calculating the income measure and not properly characterized as liabilities for purposes of calculating the non-income measure of the corporate excise for the tax years at issue, the appellants would be required to pay $8,395,585 in corporate excise, plus statutory interest. If the intercompany balances under the CMS were properly characterized as liabilities solely for purposes of calculating the non-income measure of the corporate excise tax for the tax years at issue, Staples would be entitled to an abatement of $8,923,985 and a refund of $528,400 in corporate excise, plus statutory interest. Finally, if the intercompany balances under the CMS were properly characterized as debt solely for purposes of calculating the income measure of the corporate excise for the tax years at issue, Staples would be entitled to an abatement of $2,399,715 in corporate excise.
III. Facts pertinent to these appeals.

A. Appellants.

Staples is a Delaware corporation, headquartered in Framingham, Massachusetts. Staples, through its wholly owned subsidiaries, is a wholesale and retail distributor of office supplies, with the first of its retail stores having opened in Brighton, Massachusetts in 1986.

Staples itself does not have any business operations, but instead is a parent company of a number of wholly owned subsidiaries that operate retail stores throughout the United States and in foreign jurisdictions. At all times relevant to these appeals, Staples the Office Superstore, Inc. (“Staples West”) operated the retail stores in the western part of the United States and Staples the Office Superstore East (“Staples East”) operated the retail stores in the eastern United States.4 At all times relevant to these appeals, Staples East and Staples West together owned between 1,000 and 1,500 retail stores throughout the United States that sold office supplies and equipment to individuals and small businesses. Other members of the Staples consolidated group included: Business Depot, a Canadian retailer that also had a small catalog business that sold office supplies to companies as well as governments in

4 Staples East was owned by Staples West until a restructuring on February 1, 2004, by which Staples East became a direct subsidiary of Staples.
Canada and Europe; Quill, which predominantly sold office products to individuals and businesses through a catalog and internet delivery system in the United States; and SCC, which also operated a catalog and internet delivery system and sold products similar to those sold by Quill but at higher prices and with more customer service. SCC made most of the consolidated business group’s business-to-business sales. Staples, as the parent of this consolidated group of corporations, filed a consolidated return for federal income tax purposes and was the principal reporting corporation for the members of the combined group that were subject to tax in Massachusetts.

B. Staples’ CMS.

Staples managed the cash generated by its domestic subsidiaries on a centralized basis through its CMS, also commonly known as a “cash sweep.” Staples’ subsidiaries maintained zero-balance accounts, meaning that any cash generated by each subsidiary’s operations was “swept” on a

5 The wholly owned subsidiaries that participated in the CMS during the tax years at issue were:

1. Staples East
2. Staples West (through 1/31/04)
3. Staples the Office Superstore, LLC (“Staples LLC”) (beginning 2/1/04)
4. Staples the Office Superstore, LP (beginning 2/1/04)
5. SCC
6. Quill Corporation
7. Quill Lincolnshire, Inc. (beginning 2/1/04)
8. Medical Arts Press, Inc. (beginning 7/17/02)
9. Smilemakers, Inc. (beginning 7/17/02)
nightly basis into a common bank account maintained by Staples (the “Cash Sweep Account”). Ms. Courchesne testified that the reason Staples used the CMS was “to better manage and invest the money to earn a higher return.” Any expenses of the members of the consolidated group were paid from Staples’ Cash Sweep Account. These expenses included: invoices from vendors issued to the subsidiaries; payroll; third-party professional service providers; utilities; and rent.

Ms. Courchesne testified that amounts that the appellants treated as advanced or borrowed under the CMS depended on the amount of cash generated and/or required by each CMS participant. In other words, if expenses paid on behalf of a subsidiary exceeded that subsidiary’s contribution from its operations to the Cash Sweep Account, the subsidiary was in a “net payable” position; if it had contributed more than the expenses paid, then it remained in a “net receivable” position.

Ms. Courchesne further testified that, for the tax years at issue, the books and records that Staples used for financial reporting purposes were kept on an accrual basis and in accordance with Generally Accepted Accounting Principles (“GAAP”). As required under GAAP, Staples’ publicly available financial statements were presented on a consolidated basis and

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6 In February 2004, Staples instituted a centralized purchasing system by which Staples received reimbursement from the subsidiary making the vendor purchase. Ms. Courchesne testified that the reimbursement was processed “[t]hrough a series of intercompany accounts, from a bookkeeping standpoint.”
thus reflected transactions only with third parties. However, Staples also kept separate-company books and records of each of its subsidiaries, using them to generate separate-company financial statements for various reasons. Staples reflected any net-payable balances that it had incurred as a result of the CMS as an intercompany payable, and any receivable it had as a result of the CMS as an offset to the intercompany CMS payable.

Ms. Courchesne testified that Staples held cash on behalf of the CMS subsidiaries and credited interest as a bookkeeping entry owed to those subsidiaries that had cash on deposit. Ms. Courchesne did not know the rate of interest credited to the subsidiaries and whether the rate was competitive with what a bank would have paid on deposit.

On cross examination, Ms. Courchesne was asked about limits, if any, that existed to control the amount of cash that could be swept from the subsidiaries by means of the CMS. Her testimony on this issue was as follows:

Q: Here in the CMS system was there a ceiling on the amount that any of the subsidiaries put into the system?
A: I’m not aware – I’m not certain. Our treasury and legal department would have coordinated that. We’re just doing the accounting behind the underlying transactions.

Q: Was there a ceiling with respect to the amount of money that the subsidiaries could take out of the cash management system?
A: Again, that would be something that our treasury and legal department would handle.
C. The intercompany payable balances generated by the CMS

Staples offered into evidence individual Administrative Service Agreements ("Agreements") with CMS participants SCC, Staples East, and Staples West relating to the CMS service provided by Staples to that subsidiary. Each Agreement stated that the subsidiary would execute a Demand Note in favor of Staples for $75 million, and Staples would execute a Revolving Promissory Note ("Promissory Note") in favor of the subsidiary for the same amount. The appellants did not offer into evidence any Demand Notes from a subsidiary in favor of Staples. However, without explanation as to their varying amounts, the appellants offered the following Promissory Notes, each dated February 1, 1998, executed by Staples in favor of a CMS subsidiary: to Staples West for $75 million; to SCC for $100 million; and to Staples East for $200 million. These Promissory Notes had provisions for Staples’ payment of interest at a rate equal to the three-month London Interbank Offered Rate ("LIBOR") in effect at the beginning of the first business day of each fiscal quarter of the lender, plus 1%. The Promissory Notes recited that the principal and accrued interest was due on
February 1, 2008 or at the termination of the Agreement, whichever was earlier.

However, despite these provisions, the appellants offered no evidence of any payments on these Promissory Notes. The evidence offered — standalone balance sheets — showed bookkeeping entries of amounts generally characterized as due to or due from Staples pursuant to the CMS. If interest accrued to a subsidiary, it was merely credited as a bookkeeping entry. Moreover, not only did two of the Promissory Notes exceed the $75 million amounts in the Agreements without explanation, but the actual balances due to the subsidiaries as a result of the CMS far exceeded the stated $75 million, $100 million, and $200 million limits of the Promissory Notes, with the balances further increasing every year during the tax years at issue. Staples’ net intercompany accounts-payable balances (“net accounts-payable balances”), which reflected excess cash retained by Staples after the payment of the subsidiaries’ expenses (“excess cash”), were as follows:

<table>
<thead>
<tr>
<th>Tax year</th>
<th>Net accounts-payable balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>1/31/2002</td>
<td>$982,926,259</td>
</tr>
<tr>
<td>1/31/2003</td>
<td>$1,628,952,510</td>
</tr>
<tr>
<td>1/31/2004</td>
<td>$2,180,252,438</td>
</tr>
<tr>
<td>1/31/2005</td>
<td>$2,411,618,446</td>
</tr>
</tbody>
</table>

The appellants did not offer any evidence showing that Staples paid a subsidiary any amount from the net accounts-payable balances.
D. The appellee’s audit evidence.

Pursuant to an audit for tax year 2002, the Commissioner disallowed Staples’ interest deduction attributable to the interest that Staples credited to the operating subsidiaries as a bookkeeping entry under the CMS. Subsequently, Staples, on its returns for tax years 2003 through 2005, as originally filed, included the interest expenses in Staples’ income, pursuant to G.L. c. 63, §§ 31I and 31J (the “Addback Statutes”). Mr. Henry testified that the Commissioner’s refusal to allow the deduction of interest for tax years after 2002 was not based on the Addback Statutes and the exceptions thereunder, but instead on the audit determination that the underlying transactions did not constitute bona fide debt.

E. The Board’s ultimate findings on the validity of the CMS balances as bona fide debt.

On the basis of the evidence presented and reasonable inferences drawn therefrom, the Board made the following findings. First, the Board found no evidence of limitations on the amounts of cash swept by the CMS to the Cash Sweep Account. Ms. Courchesne admitted that she was unaware of any limits in place on how high the CMS net accounts-payable balances could

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7 G.L. c. 63, §§ 31I and 31J are applicable to tax years beginning on or after January 1, 2002. St. 2003, c. 4, § 17. Accordingly, the first tax year of those at issue to which they could be applied is the tax year ended January 31, 2003.
escalate. As evidenced by the ever-growing net payables of cash into the billions of dollars, there was no effort on the part of Staples to pay any amounts from the net-payables to its subsidiaries. The Board thus found that there was a perpetual and unlimited stream of excess cash advances made by the subsidiaries to Staples pursuant to the CMS.

Second, aside from mere bookkeeping entries of interest, Staples made no actual payments to the subsidiaries on the supposed loan amounts pursuant to the Promissory Notes. Moreover, not only did some of the Promissory Notes in evidence far exceed the $75 million amounts prescribed by the Agreements, but Staples’ failure to repay any of the excess cash led to the substantial increase in Staples’ liability to the operating companies. The amounts advanced by the subsidiaries to Staples as supposed debt were far in excess of the original $75 million, $100 million, and $200 million Promissory Notes, and yet no notes were in existence to document these excess amounts. No evidence was presented that the wholly owned subsidiaries had any control over the amounts advanced under the CMS or any mechanism to ensure payment by Staples of excess cash, indicating that the subsidiaries had no credible right to demand payment. Staples was always the net “borrower,” and the excess cash never went back to the subsidiaries. Staples did not adhere to any fixed dates of maturity or pay down any of the
accounts-payable balances, and the operating companies likewise failed to request repayment of excess cash retained by Staples.

The facts of these appeals demonstrate that Staples did not intend, nor did the CMS operating companies expect, repayment of the excess cash swept up to and retained by Staples but instead treated the net accounts-payable balances as permanent transfers of funds. Therefore, the Board found and ruled that the intercompany transfers associated with the CMS at issue during the tax years at issue did not give rise to bona fide debt, either for purposes of the net income portion or the net worth portion of the corporate excise. Accordingly, the Board issued decisions for the Commissioner in these appeals.

OPINION

1. The CMS transactions did not give rise to bona fide debt.

Pursuant to G.L. c. 63, § 30(4), a corporation’s net income generally consists of gross income less the deductions, but not credits, allowed under the Internal Revenue Code (“Code”). Code § 163(a) permits a corporation to deduct “all interest paid or accrued within the taxable year on indebtedness.” The appellants argued that intercompany transactions associated with the CMS at issue gave rise to bona fide debt and consequent interest expense deductions for Staples during the tax years at issue. For the creation of a valid interest expense, the

“Related but separate corporations can freely enter into contracts including debt transactions, like any corporations or individuals.” *Overnite Transportation Company v. Commissioner of Revenue*, Mass. ATB Findings of Fact and Reports 1999-353, 370, aff’d, 54 Mass. App. Ct. 180 (2002)(citing *Bordo Products Co. v. United States*, 476 F.2d 1312, 1323 (Cl. Ct. 1973)). However, courts examine debt transactions between related entities with greater scrutiny, particularly those between a parent borrower and its wholly owned subsidiaries, because unlike an arm’s-length relationship between an unrelated debtor and creditor, these transactions by their nature “do not result from arm’s length bargaining.” *Overnite Transportation Company*, Mass. ATB Findings of Fact and Reports at 1999-370 (citing *Kraft Foods Co. v. Commissioner*, 232 F.2d 118, 123-24 (2nd Cir. 1956));
see also, *Overnite Transportation Company v. Commissioner of Revenue*, 54 Mass. App. Ct. 180, 186 (2002) ("When ‘the same persons occupy both sides of the bargaining table, form does not necessarily correspond to the intrinsic economic nature of the transaction, for the parties may mold it at their will with no countervailing pull.’") (quoting *Fin Hay Realty Co v. United States*, 398 F.2d 694, 697 (3d Cir. 1968)).

The Board has recognized that, in reviewing the legitimacy of debt transactions between related parties, “courts have not established a bright-line rule for making such a determination but have instead employed a case-by-case analysis based on the specific facts and circumstances of a particular case.” *The TJX Companies, Inc. v. Commissioner of Revenue*, Mass. ATB Findings of Fact and Reports 2007-790, 881, aff’d in part, remanded in part on unrelated grounds, Mass. App. Ct., No. 07-P-1570, Memorandum and Order under Rule 1:28 (April 3, 2009), aff’d, Mass. App. Ct., No. 09-P-1841, Memorandum and Order under Rule 1:28 (July 23, 2010)). Consequently, “[t]he Board must review the facts and circumstances surrounding a purported intercompany loan to determine whether a true debt obligation exists.” *Id.* at 882.

In *New York Times Sales, Inc. v. Commissioner of Revenue*, 40 Mass. App. Ct. 749 (1996), the Massachusetts Appeals Court affirmed the Board’s ruling that amounts transferred from a
subsidiary to its parent in the context of a cash-management system similar to the CMS at issue here were not loans. The Appeals Court upheld the Board’s decision based on several factors that reflect true indebtedness, particularly the sixteen factors that had previously been set forth by the Third Circuit in *Fin Hay Realty Co v. United States*, 398 F.2d 694, 697 (3d Cir. 1968) and relied upon by other federal courts in *Altermann Foods, Inc. v. United States*, 505 F.2d 873, 878 (5th Cir. 1974) (“Altermann I”) and *Altermann Foods, Inc. v. U.S.*, 611 F.2d 866 (Ct. Cl. 1979) (“Altermann II”). The nine factors relied upon in *New York Times Sales* to demonstrate that the parties had intended that the transactions create dividends and not loans were that:

1. the amounts transferred were not limited in any manner;
2. there was no repayment schedule and no fixed dates of maturity;
3. the amounts ‘upstreamed’ to Times Company were intended to remain with the Times Company for use in fulfilling its various corporate purposes;
4. no interest was charged;
5. no notes or other evidences of indebtedness existed;
6. the transferred cash was not secured in any manner;
7. at no time did Times Sales request repayment;
8. there was no evidence that Times Sales had any expectations of repayment; and
9. at no time did Times Company make any effort to repay the amounts transferred to it by Times Sales.

*New York Times Sales*, 40 Mass. App. Ct. at 752. In applying the factors, the Appeals Court explained that, “[o]ur objective is not to count the factors, but rather to evaluate them.” *Id.*; see

In the present appeals, the totality of the above factors weighs heavily against the appellants. First, the amounts transferred to Staples under the CMS were not limited in any manner. As described in the parties’ Agreed Statement, the operating subsidiaries deposited all of their revenue into their zero-balance accounts, from which the deposits were swept up in their entirety to Staples’ Cash Sweep Account on a daily basis.
In cases involving similar cash-management systems, the Appeals Court and this Board have specifically found that “the amounts transferred were not limited in any manner.” *New York Times Sales*, 40 Mass. App. Ct. at 752. For example, the taxpayer in *Sysco* argued that the transfers under this type of cash-management system were somehow “limited” by the amount of the operating companies’ revenue. However, the Board found that when cash-management-system transfers to a parent are restricted only by the amount of the subsidiaries’ operating revenue, they “are, in fact, unlimited.” *Sysco*, Mass. ATB Findings of Fact and Reports at 2011-945 (citing *The New York Times Sales*, Mass. ATB Findings of Fact and Reports at 1995-148).

Second, there were no repayment schedules, no history of repayments, and no other evidence indicating that there was any actual repayment or intent to repay the excess cash retained by Staples. This perpetual and unlimited stream of cash flowing up to Staples led to the net accounts payable balances growing well beyond the original Promissory Note amounts. See *Sysco*, Mass. ATB Findings of Fact and Reports at 2011-945 (finding this factor weighed against a finding of *bona fide* debt).

The above factor dovetails into the third factor, which is that the excess cash transfers were permanent in nature and not intended to be returned. The Board in *Sysco* found that this factor was satisfied when the parent company retained cash
advances net of the subsidiaries’ expenses indefinitely. See *Sysco*, Mass. ATB Findings of Fact and Reports at 2011-945. Like the parent corporation in *Sysco*, Staples never returned any amounts above and beyond the actual expenses of the participating subsidiaries but instead retained all of the excess cash. Moreover, the Board here, as it did in *Sysco* and consistent with the holdings in *Alterman I* and *Alterman II*, “rejected the notion that ‘a parent’s payment of its subsidiary’s expenses constituted a repayment of the cash transferred to it.’” *Sysco*, Mass. ATB Findings of Fact and Reports at 2011-946 (quoting *New York Times Sales*, Mass. ATB Findings of Fact and Reports at 1995-149). In these appeals, net accounts-payable balances resulting from Staples’ CMS continued to grow into the billions of dollars, and the appellants offered no evidence to show that Staples paid or intended to repay any amounts to the subsidiaries to reduce the supposed indebtedness. The Board thus found that the wholly owned subsidiaries’ advances to Staples were permanent in nature and not ever intended to be repaid.

Fourth, while payments of interest and principal may have been referenced in the Promissory Notes, no amounts were ever actually paid to the operating subsidiaries under the CMS. They were mere bookkeeping entries of interest, which were always kept in Staples’ Cash Sweeps Account. Under similar facts in
Sysco, where “Sysco made daily calculations of interest and accounting entries for interest accrued on intercompany accounts” but never actually paid that interest, the Board found, and the Supreme Judicial Court agreed, that “interest accounting entries were just that, and amounts credited to operating companies as interest were immediately swept up to Sysco forming part of a rapidly growing net liability from Sysco to the companies during the tax years at issue.” Sysco, Mass. ATB Findings of Fact and Reports at 2011-947. The Board likewise finds that, under the facts of these appeals, Staples’ operating companies did not expect repayment of any of the net accounts-payable balances. Therefore, “interest was not ‘paid’ as it would be in a third-party lending transaction.” Id.

Fifth, even though Promissory Notes were written to reflect the supposed indebtedness, the Promissory Notes had little to do with the operation of the CMS. First, the wholly owned subsidiaries lacked control to enforce payment by the parent, and in fact, Staples made no payments on the supposed debts. Thus, while the appellants papered the CMS with Promissory Notes, “[t]he formal indicia of the arrangement and the stated intent of the parties lose probativeness because they are not the outcome of arm’s-length dealings.” Overnite, Mass. ATB Findings of Fact and Reports at 1999-374 (citing New York Times Sales, 40 Mass. App. Ct. at 753). Moreover, the actual net
accounts-payable balances far exceeded the stated $75 million, $100 million, and $200 million figures, and yet Staples and its wholly owned subsidiaries issued no new notes to document the additional balances. Accordingly, the Board found that the Promissory Notes did not reflect the substance of the transactions between the parent and subsidiaries but were merely an attempt to give the CMS the appearance of creating bona fide debt. See New York Times Sales, 40 Mass. App. Ct. at 753 and Sysco, Mass. ATB Findings of Fact and Reports at 2011-948.

Sixth, repayment of the purported debt was not secured in any way. The appellants argued that through the CMS, Staples functioned no differently than a bank, where deposits are routinely limited only by the depositors’ available cash and no collateral or security is likewise required or provided. However, as it has in the past, the Board rejected the comparison of a cash sweep into a CMS to a bank deposit. First, “a bank is legally bound to return deposits as well as accumulated interest to its customers, and absent anomalous circumstances, does so.” Sysco, Mass. ATB Findings of Fact and Reports at 2011-932, 933. Moreover, while the Promissory Notes purported to provide guidelines relating to the operation of the CMS, the Board gave little weight to these, because Staples never adhered to the Promissory Notes by repaying the sums that were “borrowed” from the CMS operating companies. Further, the
comparison to a bank “ignored that repayment of outstanding sums relating to bank overdrafts and credit lines is compelled by depository agreements and law,” which does not apply in the context of a CMS operated by a parent vis-à-vis its wholly owned subsidiaries. Id. at 2011-935.

The seventh, eighth and ninth New York Times Sales factors are interconnected and solidify the Board’s determination that the CMS did not create bona fide debt. The Board found that there was no evidence that: (1) the operating subsidiaries ever requested repayment; (2) they ever had an expectation of repayment; and (3) Staples at any time made an effort to repay the operating subsidiaries under the Promissory Notes. The net accounts-payable balances were unlimited, always growing and never repaid, and no evidence was presented that the subsidiaries had any control over the amounts advanced or any settlement procedures in place to ensure the repayment of the excess cash and accrued interest to the subsidiaries. Therefore, while the appellants attempted to paper some of the CMS transactions with Promissory Notes, “[i]ntent is more reliably gathered from the totality of the circumstances.” Overnite, Mass. ATB Findings of Fact and Reports at 1999-374 (citing Laidlaw Transp., Inc. v. Commissioner, 1998 Tax Ct. Memo Lexis 230, 74-75 (No. 9362-94, Jun. 30, 1998)). The operating companies had no actual ability to compel repayment and were
thus left without recourse should they have sought to enforce Staples’ claimed obligation to repay the outstanding net accounts-payable balances. The Board thus found and ruled that, not only did the subsidiaries never demand repayment, but they did not ever have a credible expectation of repayment. See Sysco, Mass. ATB Findings of Fact and Reports at 2011-950 (“In sum, consideration of the various factors articulated in New York Times Sales, with particular focus on those indicating that repayment of excess cash advances to Sysco was neither intended nor expected, was central to the Board’s finding that the advances did not constitute bona-fide debt.”); see also Kimberly Clark, Mass. ATB Findings of Fact and Reports 2011-11 (“[W]ith substantial emphasis placed on the factors indicating the excess cash advances made within the appellants’ cash-management system were not intended to be repaid, including the absence of requests for or effort toward repayment, or actual repayment in whole or in part, the Board found that the advances did not constitute bona-fide debt.”).

In summary, the Board found that neither Staples nor its wholly owned subsidiaries treated the net accounts-payable balances as arms’-length, unqualified, legal obligations to repay. The CMS transactions were not the result of arms’-length bargaining. There were no checks on the amounts swept up to Staples from its wholly owned subsidiaries or limits on how high
the net accounts-payable balances could reach, despite the original documented $75 million, $100 million, and $200 million contractual amounts, and there were no additional demand notes issued to account for the large amounts of excess cash retained by Staples that exceeded the original Promissory Note amounts. Moreover, no procedures existed to ensure repayment of the excess cash to the subsidiaries, and the appellants offered no evidence that any such repayment occurred. All of these factors indicated that the subsidiaries had no credible right to demand, or even an expectation of, repayment, and that Staples never intended to repay the net accounts-payable balances. Therefore, the Board here found and ruled that the transactions made under the CMS at issue were not true debt and, accordingly, interest payments made by Staples were not deductible interest payments under the income-portion of the corporate excise.

2. The transactions at issue also do not qualify as debt under the non-income portion of the corporate excise.

The Board further found that the transfers associated with the CMS at issue did not constitute *bona fide* debt under the non-income portion of the corporate excise. The appellants contended that that the non-income portion of the excise had evolved “as a result of dissatisfaction with problems of valuation in the prior tax structure” and was enacted to put in place a tax that was “more simple, equitable, and speedily
computed.” *Xtra, Inc. v. Commissioner*, 380 Mass. 277 (1980) 608. To do so, “the Legislature generally chose the ‘liberal use’ of ‘accounting or book-keeping concepts,’ concepts which corporations themselves use to measure their value on books or in paying their income taxes.” *Id.* The appellants also contended that the net-worth statute “requires that the Commissioner’s assessments be consistent with principles of accounting that are actually employed by [the] taxpayer.” *National Amusements, Inc. v. Commissioner*, Mass. ATB Findings of Fact and Reports 2001-594, 608.

However, Massachusetts courts and the Board have rejected the notion that a taxpayer’s books and records should be controlling for tax purposes. In *New York Times Sales*, the Appeals Court specifically held that the “method by which two related businesses account for cash transfers on their internal financial records is not deemed to be a controlling factor in determining the nature of the transaction” as such records are a product of the parties and therefore “do not necessarily constitute a reliable reflection of the true nature of the transaction.” *New York Times Sales*, 40 Mass. App. Ct. at 753

Then in *Overnite Transportation Company*, the Appeals Court affirmed the Board’s holding that claimed interest expenses were not properly treated as deductions for purposes of the net income component and were not properly deductible for purposes

In *National Grid USA Service Company, Inc. v. Commissioner*, Mass. ATB Findings of Fact and Reports 2014-630, the Board, addressing the same contention made by Staples in this appeal, ruled:

Nothing in either *Xtra* or *National Amusements* supports the proposition that incorrect characterization of the DSAs in the appellants’ books and records should yield the net worth tax treatment sought by the appellants. To conclude otherwise would allow a taxpayer to achieve desired tax results simply by presenting financial statements crafted to support those results.

(citing *Manning v. Boston Redevelopment Authority*, 400 Mass. 444, 453 (1987)).

The Board in the instant appeal thus found and ruled that the excess cash advances to Staples from its wholly owned subsidiaries pursuant to the CMS at issue were not *bona fide* debt for the net worth portion of the corporate excise.

3. *Neither the Addback statute nor its exceptions apply in these appeals.*

The appellants’ final argument in these appeals was that the transactions at issue satisfied the exception to § 31J, which provides that the add back of expenses accrued or incurred by a related member is not required when an expense was the result of a transaction “(1) that was primarily entered into for a valid business purpose and (2) that is supported by economic
substance,” so long as the taxpayer can demonstrate that reduction of tax was not the primary purpose for the transaction. See *Kimberly Clark*, Mass. ATB Findings of Fact and Reports at 2011-57 (quoting 830 CMR 63.31.1(4)(b)). The appellants pointed out that, not only did the CMS allow participants to receive interest from Staples that they would have earned on a standalone basis, but additionally, the pooled assets could be relied upon in entering loans and leasing arrangements with third parties. Therefore, citing these as valid business purposes for Staples to establish the CMS, and that the CMS system had economic substance, the appellants contended that the exception to § 31J applies.

However, the Commissioner was not required to consider the Addback Statutes, or any of their exceptions, in the resolution of these appeals. The Commissioner’s witness, Mr. Henry, explained that the Commissioner’s refusal to reverse the addback of the interest deduction for fiscal years 2002 through 2004 was not based on § 31J but instead, on the audit determination that the underlying transactions did not give rise to true debt and therefore, the interest expenses were not allowable in the first place. See 830 C.M.R. 63.31.1(2) (a claimed interest expense must be supported by an underlying

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8 While the appellants make this contention, their witness, Ms. Courchesne, testified that she did not know whether or not the payments made by Staples were comparable to interest payments that the subsidiaries could have earned on their standalone investments.
bona-fide debt). Without debt, there is no interest that would qualify for a deduction, and therefore, the add-back statute does not come into play.

Moreover, a purported business purpose for using the CMS to manage the consolidated group’s funds does not alter the Board’s ultimate finding that the payments at issue were not true debt. As the Board ruled in Sysco, business purpose does not affect whether payments constitute legitimate debt:

The Board does not agree that business purpose and absence of tax avoidance substantially support an assertion that intercompany transfers constitute debt. In fact, in New York Times Sales, the court explicitly described the business purpose underlying the operation of the taxpayer’s cash-management system, stating that its “primary purpose . . . was to increase the efficient use of available cash from all of the members of the Times Company group. One significant benefit of the system was that it reduced Times Company’s banking fees by consolidating banking arrangements and eliminating individual bank loans for working capital, thereby reducing interest expenses.” New York Times Sales, 40 Mass. App. Ct. at 752. Moreover, there was no assertion of tax avoidance as a motive for implementation of Times Company’s cash-management system. Consequently, the Board found Sysco’s arguments relating to the import of business purpose and absence of a tax avoidance motive unpersuasive.


Accordingly, the Board ruled that, because the CMS did not create bona fide debt for either the income or net worth components of the corporate excise, neither § 31J nor any
perceived business purpose for the CMS affects the result in these appeals.

**Conclusion**

Under the facts of the instant appeals, the Board found and ruled that the intercompany transfers under the CMS at issue did not give rise to bona-fide debt. The Board reached its determination with particular focus on facts indicating that the excess cash advances from the subsidiaries to Staples were not intended or expected to be repaid, and were not, in fact, repaid. Accordingly, the Board decided these appeals for the appellee.

**THE APPELLATE TAX BOARD**

By: ________________________________

Frank J. Scharaffa, Commissioner

A true copy,

Attest: ________________________

Clerk of the Board