STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
ROYAL INDEMNITY COMPANY	:	DECISION
for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 33 of the Tax Law for the Years 1976 and 1977.	:	

Petitioner[1] Royal Indemnity Company, 150 William Street, New York, New York 10038, filed an exception to the determination of the Administrative Law Judge issued on September 11, 1987 with respect to its petition for a redetermination of a deficiency of corporation franchise tax under Article 33 of the Tax Law for the years 1976 and 1977 (File No. 800118). Petitioner challenges conclusion of law B of such determination. Petitioner appeared by Everett, Johnson & Breckinridge, Esqs. (Eugene Chester, Esq., of Counsel). The Division of Taxation appeared by William Collins, Esq. (Paul A. Lefebvre, Esq., of Counsel).

Neither the petitioner nor the Division of Taxation requested oral argument and only the Division submitted a brief in support of its position. After reviewing the hearing record, the determination, the exception and the Division of Taxation's brief, the Tax Appeals Tribunal renders the following decision.

ISSUE

[1]In addition to petitioner, thirteen other taxpayers have petitions pending which raise issues identical to those presented herein. Each of these thirteen taxpayers (see Appendix "A"), has joined with the Audit Division in executing a stipulation agreeing to be bound by the final judicial decision reached in the instant matter.

The issue raised on this appeal is whether the Division of Taxation properly limited the net operating loss deduction on petitioner's 1976 and 1977 New York State corporation franchise tax return to the amount of the net operating loss actually absorbed on petitioner's Federal tax returns for the corresponding years. Petitioner argues that Federal rules apply only to determine the computational procedure applicable to the State deduction, not the amount.

FINDINGS OF FACT

The facts set forth in the Administrative Law Judge determination were stipulated to by the parties, the petitioner having waived its right to a hearing. Accordingly, the findings of fact for the purposes of this review are as stated in the Administrative Law Judge determination and are incorporated herein by this reference.

To summarize these facts as they apply to the net operating loss deduction issue, the petitioner sought to carry forward 1974 and 1975 net operating losses and claim them as deductions on its State franchise tax returns for 1976 and 1977 in amounts greater than those deducted on the corresponding Federal returns. The Federal deductions claimed were smaller than the State deductions because petitioner had already utilized all of the 1974 and a portion of the 1975 net operating losses in years prior to 1974 for Federal purposes. The Division of Taxation reduced the net operating loss deduction of petitioner on its State return for the year 1976 to the amount necessary to reduce Federal taxable income to zero, and for the year 1977 to an amount equal to the Federal net operating loss deduction claimed by petitioner. Each of these adjustments was premised on the Division's position that petitioner's 1976 and 1977 New York State net operating loss deductions could not exceed the amount of the 1974 and 1975 losses carried forward and deducted on the Federal returns for the corresponding years. The

Division's adjustment for 1976 was based on the additional premise that the amount of the State net operating loss deduction is limited to the amount of the Federal net operating loss deduction actually absorbed on the Federal return for that year, i.e., the amount necessary to reduce federal taxable income to zero for that year. Although the petitioner does not specifically address this issue, it is raised on the facts presented so we will address it as a subsidiary issue.

OPINION

The resolution of the primary issue of whether the State net operating loss deduction is determined by the Federal amount or only by Federal computational rules depends on the application of the provisions of section 1503 of the Tax Law which set forth the computation of entire net income. Basically, this computation begins with the taxpayer's taxable income for Federal purposes for the taxable year (Tax Law §1503[a]). The Federal amount is then modified for State tax purposes by the provisions of section 1503(b) . Among these modifications is that required by section 1503(b)(4) which provides, in pertinent part, that:

> "Any 'net operating loss deduction'...allowable under [section] ... one hundred seventy-two ... of the internal revenue code ... which is allowable to the taxpayer for federal income tax purposes:
>
> "(A) shall be adjusted to reflect the modifications required by the other paragraphs of this subdivision;
>
> "(B) shall not, however, exceed any such deduction allowable to the taxpayer for the taxable year for federal income tax purposes; and
>
> "(C) shall not include any such loss incurred in a taxable year beginning prior to January first, nineteen hundred seventy-four or during any year in which the taxpayer was not subject to the tax imposed under section fifteen hundred one." (Tax Law §1503[b][4])

The plain words of this statute support the position of the Division of Taxation. On its face, this statute begins with the allowable Federal deduction, requires its adjustment for New

York purposes, but then explicitly limits the adjusted amount to no more than the deduction allowable for the taxable year for Federal purposes. Clearly, this statutory computation indicates an intent to conform the amount of State deduction to the amount of the Federal deduction for the corresponding year and is in accord with the Division's position. In contrast, it is unclear what meaning petitioner could give to the statutory language to support its interpretation.

Further, the legislative history of section 1503(b)(4) of the Tax Law supports the Division's interpretation. Section 1503(b)(4), included in Article 33 of the Tax Law, is substantially similar to section 208.9(f) contained in Article 9-A of the Tax Law, which allows a taxpayer subject to tax under Article 9-A a net operating loss deduction (Tax Law § 208.9[f]). The Legislature enacted Article 33 with the statement "That the provisions of such article which are the same as or are substantially identical with those in article nine-a of the tax law shall be regarded as being in pari materia and shall be construed in a like manner." (L 1974, ch 649, § 12) When section 1503(b)(4) was enacted, section 208.9(f) had been in effect since 1961 and been given the interpretation at issue here, that is, that the State net operating loss deduction could not exceed the amount deducted on the Federal return for the corresponding year (see, 1962 Ruling of New York State Tax Commn. with respect to Corporation Franchise Tax, at 15; Matter of Savin Business Machine Corp., State Tax Commn., March 24, 1970; Matter of Vision Associates, State Tax Commn., March 9, 1970). The clear statement of the Legislature indicates that section 1503(b)(4) was to have the meaning then given to section 208.9, which was that the State net-operating loss deduction for any year could not exceed the amount of the Federal deduction for the same year.

Finally, the Division's interpretation of section 1503(b)(4) of the Tax Law has already been reviewed by New York courts and the Division's interpretation has been upheld (Matter of American Employer's Insurance Co. v. State Tax Commn., 114 AD2d 736; Matter of Employer's Fire Insurance Co. v. State Tax Commn., Sup. Ct., Spec. Term, Albany County, November 12, 1981, Pitt, J.). These decisions considered arguments similar to those advanced by this petitioner.

In support for its position that section 1503(b)(4) of the Tax Law only requires that the State franchise taxpayer use the computational procedure required for Federal tax purposes, petitioner counters the plain language of the statute, the New York court decisions and the legislative intent with the decision In the Matter of Avien, Inc. v. City of New York (532 F2d 273 [2nd Cir]). Petitioner seeks to apply the rationale of Avien, overriding the New York court rule set forth in American Employer's Insurance, by arguing that the American Employer's Insurance decision was incorrect when interpreting a franchise tax provision to rely on the decisions in Matter of Sheils v. State Tax Commn. (52 NY2d 954) and Matter of Gurney v. Tully (51 NY2d 818) which involved the State's personal income tax.

We find the petitioner's analysis unpersuasive. The Sheils and Gurney decisions, though dealing with the calculation of adjusted gross income under the State's income tax, dealt with essentially the same problem as at issue here, that is, when a State tax computation begins with a Federal tax calculation, is such a provision to be literally applied to mean the amount of the Federal tax calculation or only to mean that Federal computational procedures are required. Sheils and Gurney held that a literal interpretation by the Division of Taxation of such a State tax provision was reasonable. This analysis is clearly relevant to the interpretation of section

1503(b)(4) of the Tax Law and supports the conclusion that the Division of Taxation's interpretation of this provision is reasonable and must be upheld. The precedential value of the Avien decision in New York has been further impaired by the recent decision in Eveready Insurance Co. v. State Tax Commn. (129 AD2d 958, lv denied 70 NY2d 604) which held contrary to Avien on.substantially similar facts.

With respect to the subsidiary issue, not specifically addressed by the petitioner, we also found that the Division's position that the State net operating loss deduction is limited to the amount of such deduction actually absorbed on the Federal return for the same year to be in accord with the statutory language, the legislative history and the case law.

As set forth above, section 1503(b)(4) of the Tax Law limits the State deduction to the deduction allowable for Federal purposes. It is a reasonable interpretation that "allowable" means the amount of the Federal deduction required to reduce Federal taxable income to zero (see, Matter of Telmar Communication Corp., State Tax Commn., June 20, 1974, aff'd, Telmar Communication v. Procaccino, 48 AD2d 189).

Further, this interpretation had been given to the term "allowable" as used in section 208.9 of the Tax Law at the time section 1503(b)(4) of the Tax Law was enacted (Matter of Savin Business Machines Corp., supra, State Tax Commn., March 24, 1970; Matter of Vision Associates, Inc., supra, State Tax Commn., March 9, 1970). Again, the Legislature's direction that the provisions of Article 33 of the Tax Law be construed in a like manner as the provisions of Article 9-A of the Tax Law (L 1974, ch 649, § 12) requires the conclusion that “allowable" in section 1503(b)(4) means the amount of the Federal deduction necessary to reduce Federal taxable income to zero.

Finally, one rationale underlying Sheils, that the taxpayer not benefit from a double deduction, supports this interpretation of "allowable." If the petitioner's State net operating loss deduction was not limited to the amount actually absorbed on the corresponding Federal return, the petitioner would potentially benefit from the same deduction twice on its State return. This could occur since the excess would be deducted on the State return in one year, but could be carried forward or backward for Federal purposes to another year. This carryover to another year for Federal purposes would result in the same amount appearing as a Federal net operating loss deduction apparently qualifying as a State deduction for a second time. Since the Division's interpretation of allowable prevents such double deductions, it is neither irrational nor unreasonable and should be upheld (Berg v. Tully, 92 AD2d 436, lv denied 60 NY2d 552).

Accordingly, based on the above analysis, we affirm the Administrative Law Judge's determination that the Division of Taxation's interpretation of section 1503(b)(4) of the Tax Law with respect to the petitioner's 1976 and 1977 State net operating loss deduction was reasonable and must be upheld.

Accordingly, it is ORDERED, ADJUDGED AND DECREED.

1. That each and every exception of the petitioner, Royal Indemnity Company, to the determination of the Administrative Law Judge be and the same is hereby overruled.

2. That said determination is confirmed in all respects.

3. That the petition of Royal Indemnity Company is granted to the extent indicated by conclusion of law "C" of the Administrative Law Judge's determination and except as so granted is in all other respects denied and the notices of deficiency dated May 8, 1980 as modified are sustained.

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John P. Dugan
President

Francis R. Koenig
Commissioner

APPENDIX "A"

The following taxpayers having executed stipulations to be bound by the ultimate judicial decision rendered in the Matter of Royal Indemnity Co. (DTA No. 800118):

Taxpayer	DTA Nos.
AMICA Mutual Ins. Co.	800170
American Manufacturers Mutual Ins. Co.	800110

American Motorists Ins. Co.	800111
Atlantic Mutual Ins. Co.	800114
Centennial Ins. Co.	800130
Globe Indemnity Co.	800117
Hartford Accidents Indemnity Co.	800266
Hartford Fire Ins. Co.	800179
Pacific Indemnity Co.	800134, 800142
Statewide Ins. Co.	800500, 800895, 800125
Unigard Mutual Ins. Co.	800126
Vigilant Ins. Co.	800119