STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
THE UNITED STATES LIFE INSURANCE COMPANY IN THE CITY OF NEW YORK	:	DECISION DTA No. 807011
for Redetermination of a Deficiency or for Refund of Franchise Tax on Insurance Corporations under Article 33 of the Tax Law for the Years 1984 and 1985.	:	

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on February 7, 1991 with respect to the petition of The United States Life Insurance Company in the City of New York, 125 Maiden Lane, New York, New York 10038-4985 for redetermination of a deficiency or for refund of franchise tax on insurance corporations under Article 33 of the Tax Law for the years 1984 and 1985. Petitioner appeared by Thomas D. Hogan, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Kenneth J. Schultz, Esq., of counsel).

The Division of Taxation filed a brief in support of its exception. Petitioner filed a brief in response. Oral argument, at the request of the the Division of Taxation, was heard on October 10, 1991.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUE

Whether, in computing entire net income for purposes of the franchise tax on insurance corporations, the modifications to Federal life insurance company taxable income under Tax Law § 1503(b) should be reduced by 20% where petitioner, in computing Federal life insurance

company taxable income, took the 20% special life insurance company deduction provided by Internal Revenue Code former § 806.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

Petitioner, The United States Life Insurance Company in the City of New York ("USLIC"), is a life insurance company incorporated in New York State with its principal place of business in New York, New York. USLIC carried on an insurance business in New York and was classified for Federal incometax purposes as a life insurance company under Subchapter L of the United States Internal Revenue Code.

During the years in issue, life insurance companies received a special life insurance company deduction under Internal Revenue Code former § 806(a). Section 806(a) provided as follows:

> "Special life insurance company deduction. For purposes of section 804 [defining life insurance deductions], the special life insurance company deduction for any taxable year is 20 percent of the excess of the tentative LICTI [life insurance company taxable income] for such taxable year over the small life insurance company deduction (if any)."

Internal Revenue Code § 806(a) was added by P.L. 98-369, section 211(a), effective for tax years beginning after December 31, 1983. The purpose of section 806(a) was stated as follows:

> "some adjustment is necessary to avoid suddenly imposing a substantially increased tax burden on life insurance companies. Under present law, a life insurance company is able to defer or avoid taxation on a substantial portion of its current income, and thus this provision ameliorates the hardship that might otherwise result from a sudden, substantial increase in a company's tax base." (See, S Rep No. 169, 98th Cong, 2d Sess 1984; HR Rep No. 432, 98th Cong, 2d Sess 1984.)

The Tax Reform Act of 1986, P.L. 99-514, repealed section 806(a). The Senate Finance Committee Report of May 29, 1986 explained the basis for the repeal of the deduction as follows:

> "The 20 percent special life insurance company deduction was enacted in 1984 because it was believed necessary to ameliorate the sudden, substantial increase in the tax liability of life insurance companies. This increase occurred as a result of the change from the three-phase taxable income computation that was in effect previously to a single phase system consistent with generally applicable corporate tax law. The provision was not intended to tax life insurance companies at generally lower tax rates than other corporations.
>
> In light of the overall reduction of corporate tax rates contained in other provisions of the bill, the committee believes that the 20 percent special life insurance company deduction is no longer necessary. Despite the elimination of this special deduction, the maximum marginal tax rate applicable to life insurance companies will decline under the bill."

During the years in issue, USLIC filed consolidated U.S. Life Insurance Company Income Tax Returns, Federal Form 1120L, with other life insurance subsidiaries of USLIFE Corporation, its parent corporation. In calculating its LICTI for the years in issue, petitioner began with its gross income, which was the sum of premiums, investment income, net capital gains and other amounts generally includible in gross income. From this amount, petitioner took several deductions, including deductions for dividends received, interest to stockholders, New York State franchise taxes paid and depreciation under the Accelerated Cost Recovery System ("ACRS"). Finally, petitioner, in computing its LICTI, took the special life insurance company deduction by eliminating 20% of its gain from operations. Although each item of income and each deduction was not reduced by 20%, the overall effect of subtracting the special life insurance company deduction was to reduce the individual components of the gains from operations by 20%.

During the years in issue, petitioner filed Franchise Tax Returns for Insurance Corporations, New York State Form CT-33. In arriving at entire net income on Schedule B of the New York State return, USLIC reported as federal taxable income the amount of life insurance company taxable income shown on Federal Form 1120L for the corresponding years. The LICTI included the special life insurance company deduction. To federal life insurance company taxable income petitioner added back the dividend received deduction, the interest to stockholders, the New York State franchise tax deduction and the ACRS depreciation

deduction. In addition, petitioner subtracted from federal life insurance company taxable income 50% of dividends from nonsubsidiary corporations. It is these five modifications to federal life insurance taxable income that are at issue in this matter.

In preparing the New York State return for 1984, petitioner, in making the modifications to federal life insurance company taxable income described above, took the full amount as reflected on the Federal return for such year. Subsequently, on May 27, 1986, petitioner filed with the Division of Taxation an amended Form CT-33 and two claims for credit or refund of corporation tax paid, New York State Form CT-8, for the year 1984. The basis for the amended return and the claims for credit or refund was, in part, the reduction by petitioner of each of the modifications by 20%. This resulted in a net reduction of $925,851.00 in entire net income. Petitioner multiplied the net reduction by the business allocation percentage of 53.7881 to arrive at allocated entire net income of $497,998.00. The allocated entire net income was multiplied by the tax rate of 9% to arrive at a franchise tax reduction of $44,820.00. Taken together with the tax reduction of the related Metropolitan Transportation Business Tax Surcharge of $4,758.00 it resulted in a total claim for refund of $49,578.00 for the year 1984.

On or about November 6, 1987, the Division of Taxation issued to petitioner a denial of the refund claim for the year 1984. On April 29, 1988, the Division of Taxation issued to petitioner two notices of deficiency for the year 1984, showing a total amount of tax due of $10,344.00. In a letter dated April 22, 1988 and two statements of audit adjustment dated April 29, 1988, the Division of Taxation explained that the refund denial and the notices of deficiency were based on the Division's position that the modifications were to be added back at 100%.

The amount of tax claimed by petitioner as a credit or refund for the year 1984 is $49,578.00 and is computed as follows:

Modification Adjustments - Additions per Tax Report

Dividends received deduction	$1,767,935
Interest to stockholders	329,854
New York State franchise tax	2,317,584
ACRS deduction	1,623,377
Total	$6,038,750

Subtractions per Tax Report	
50% of dividends from nonsubsidiary corporations	(1,409,494)
Net Additions	$4,629,256

Reduction of modifications of Federal taxable income items by 20% to agree with the 20% modification of Federal taxable income	$925,851
Business allocation percentage	53.7881%
Reduction in allocated entire net income	497,998
Tax rate	9%
Claim for reduction in franchise tax	$ 44,820
Claim for reduction in MTA tax	4,758
Total tax reduction	$ 49,578

On the New York State Franchise Tax Return for Insurance Corporations for the year 1985, petitioner reported the modifications at 80% of the amounts shown on its U.S. Insurance Company Income Tax Return for the same year. In response, the Division, on April 7, 1989, issued two notices of deficiency to petitioner for the year 1985 assessing, in the aggregate, $49,584.00 in tax, plus penalty and interest. The amount contested by petitioner is $43,131.00 and is computed as follows:

Modification Adjustments - Additions per Tax Report

Dividends received deduction	$1,199,843
Interest to stockholders	168,668
New York State franchise tax	1,700,908
ACRS deduction	1,142,318
Total	$4,211,737
Subtractions per Tax Report	
50% of dividends from nonsubsidiary corporations	(1,008,742)
Net Additions	$3,202,995

Audit adjustment to increase modifications by 20%	4,003,744
Audit increase in entire net income	800,749
Business allocation percentage	53.9070%
Audit increase in allocated entire net income	431,660
Tax rate	9%
Audit increase in franchise tax	$ 38,849
Audit increase in MTA tax	4,282
Total tax increase	$ 43,131

OPINION

The Administrative Law Judge determined that since the Division of Taxation (hereinafter the "Division") accepted petitioner's Federal life insurance company taxable income (LICTI) (which had been reduced by 20% due to the special life insurance company deduction under Internal Revenue Code former § 806[a]) as the starting point in computing entire net income pursuant to Tax Law § 1503(a), it followed that in making the modifications required by Tax Law § 1503(b), the individual items should also be reduced by 20% in calculating petitioner's franchise tax on insurance corporations pursuant to Article 33 of the Tax Law. Moreover, the Administrative Law Judge found that it would be inequitable and unreasonable to require petitioner to add back the modification items at 100% when calculating New York State entire net income, where the same items were utilized at 80% in computing Federal LICTI.

On exception, the Division alleges that since the Federal income tax imposed by the Internal Revenue Code is separate and distinct from the franchise tax imposed by Tax Law § 1501, consistency between the calculation of income for Federal income tax purposes and New York State franchise tax purposes is neither required nor appropriate. The Division argues that consistency with the Federal income tax applies only to the starting point of the calculation of entire net income. Moreover, the Division claims that there is no statutory authority for petitioner's use of the particular modification items at 80% since the New York State modifications of income and expense are not keyed to the taxpayer's Federal income tax return, but are derived directly from the taxpayer's books and records. Therefore, the Division asserts that the literal construction and application of Tax Law § 1503(b) requires inclusion of petitioner's modifications at 100% since no specific statutory authority provides otherwise, and that such accounting is neither unreasonable nor inequitable. The Division also claims (by

examples set forth in its brief) that if it were to reduce specific items of income and expense by 20% in the computation of entire net income, such approach would produce disparate results with respect to other life insurance companies (depending upon whether a particular life insurance company generated a profit or loss at the Federal level).

Petitioner asserts that the former State Tax Commission's decision in Matter of the Prudential Ins. Co. of Am. (State Tax Commn., May 8, 1985) supports the practice of using amounts in the same percentage as they were used to modify Federal LICTI to calculate the amount of modifications used to compute entire net income under Tax Law § 1503(b). Therefore, petitioner claims that it should be entitled to use the same modification amounts as effectively used for Federal tax purposes in calculating its New York State tax. Petitioner argues that the Administrative Law Judge correctly concluded that since each item of income and expense making up Federal LICTI is effectively reduced by 20% when the special life insurance company deduction under Internal Revenue Code former § 806(a) is applied, and that since the Division accepts Federal LICTI as the starting point in computing entire net income pursuant to Tax Law § 1503(a), it logically follows that items added back pursuant to Tax Law § 1503(b) should be reduced by 20%. Petitioner maintains that this parallel reduction to the modification items is necessary in order to: (1) maintain internal mathematical consistency, (2) comply with recognized accounting principles of double-entry bookkeeping that use equal and offsetting debits and credits, (3) satisfy established rules of statutory construction, and (4) implement the basic statutory presumption in Tax Law § 1503 that entire net income is presumably the same as LICTI. Finally, petitioner asserts that the supplemental examples set forth in the Division's brief demonstrate that petitioner's approach to computing modifications to entire net income achieves reasonable, fair, and even-handed results.

We reverse the determination of the Administrative Law Judge.

The franchise tax on insurance corporations conducting business in New York is imposed and administered in accordance with Article 33 of the Tax Law. That law became effective with the 1974 taxable year (L 1974, ch 649, § 13), and provides that the franchise tax is

calculated on the basis of a taxpayer's "entire net income" (Tax Law § 1502). Tax Law § 1503(a) provides that the "starting point" for computing entire net income shall presumably be the same as the "life insurance company taxable income" (LICTI) that the taxpayer is required to report to the Federal government.

Tax Law § 1503(a) provides, in pertinent part, that:

> "[t]he entire net income of a taxpayer shall be its total net income from all sources which shall be presumably the same as the life insurance company taxable income . . . which the taxpayer is required to report to the United States treasury department, for the taxable year . . . except as hereinafter provided" (emphasis supplied).

Entire net income is then determined by adjusting Federal LICTI for certain individual modifications articulated in Tax Law § 1503(b).

For the tax years at issue herein, petitioner made a series of modifications to LICTI in order to adjust its Federal taxable income for New York State franchise tax purposes. These modifications included the 50% of dividends from non-subsidiary corporations (Tax Law § 1503[b][1][B]), the dividends received deduction (Tax Law § 1503[b][2][A]), the deduction for New York State franchise tax (Tax Law § 1503[b][2][D]), interest to stockholders (Tax Law § 1503[b][2][G]), and the deduction for ACRS depreciation (Tax Law § 1503[b][2][M]). In calculating entire net income, petitioner reduced each individual item by 20% because these items had been effectively reduced by 20% under the special life insurance company deduction of Internal Revenue Code former § 806(a). The Division recomputed the modifications at 100% based upon the position that unless the particular subsection of Tax Law § 1503(b) provides otherwise, the modifications to entire net income must be made at 100%.

The issue before us now is whether, in computing entire net income for purposes of the franchise tax on insurance corporations, the modifications to Federal LICTI required by Tax Law § 1503(b) must be made at 100% where the particular modification provisions do not provide otherwise, or reduced by 20% where petitioner took the 20% special life insurance company deduction pursuant to Internal Revenue Code former § 806(a) in computing Federal taxable income. The issue is one of statutory construction and interpretation.

The focus of jurisprudential inquiry in such cases is to determine the legislative intent as expressed in the statute, taking into consideration the nature of the subject matter, the policy behind the statute, and statutes in pari materia (see, United States v. National Mar. Engrs.' Beneficial Assn., 294 F2d 385, 391 [2nd Cir 1961] citing Church of the Holy Trinity v. United States, 143 US 457; Rankin on Behalf of Bd. of Ed. City of New York v. Shanker, 23 NY2d 111, 295 NYS2d 625, 628; see also, McKinney's Cons Laws of NY, Book 1, Statutes, §§ 92, 95-98, 111). It is an axiom of statutory construction that where statutory language is clear and unambiguous, a court shall construe it so as to give effect to the plain and ordinary meaning of the words used (State by Abrams v. Ford Motor Co., 74 NY2d 495, 549 NYS2d 368, 370). Therefore, it is not within the province of the court (or this Tribunal) to give a statute any greater effect than its language allows (People v. Abrams, 82 Misc 2d 979, 372 NYS2d 138, 141) unless necessary to effectuate a demonstrated legislative intention (Matter of Federal Ins. Co. v. State Tax Commn., 146 AD2d 888, 536 NYS2d 595). Further, where the taxpayer seeks a deduction urging exclusion or variance from the scope of the taxing statute, there is a presumption in favor of the State's taxing power (Mobil Oil Corp. v. Finance Adm'r. of City of New York, 58 NY2d 95, 459 NYS2d 566, 568).

Petitioner asserts that since Tax Law § 1503(b) is "so intimately entwined" with the definition of Federal LICTI, the franchise tax on insurance corporations and the Internal Revenue Code are in pari materia so that the Federal and State statutes must necessarily "be read together as an integrated whole" (petitioner's brief, p. 14). Moreover, petitioner argues that it was the Legislature's "obvious" intent that the franchise tax pursuant to Tax Law § 1503 be construed as a whole, with adjustments as originally included in Federal LICTI under § 1503(a) flowing through to modifications of entire net income under § 1503(b), in order to achieve a fair, equitable, and even-handed result. Petitioner's argument is premised on the assumption that the Federal and State statutory provisions at issue operate in tandem or on parallel tracks and, therefore, consistency between modifications to Federal LICTI and New York State entire net income is required. There is a strong legislative intent indicating uniformity in

interpretation where a State statute is copied verbatim from a Federal statute or contains substantially similar tax provisions (Matter of Mosbacher v. Graves, 254 App Div 438, 5 NYS2d 553, 555, affd 279 NY 793; see, Matter of Marx v. Bragalini, 6 NY2d 322, 189 NYS2d 846, 854). However, it is a settled principle that "[f]ranchise taxes are separate and distinct from income taxes" and are "imposed on the privilege a state grants a corporation to conduct business within its territory" (Matter of Zurich Ins. Co. v. State Tax Commn., 144 AD2d 202, 534 NYS2d 515, 517, lv denied 74 NY2d 602, 541 NYS2d 985; see also, Tax Law § 1501[a]). Thus, the Federal income tax imposed on insurance corporations by the Internal Revenue Code is separate and distinct from the franchise tax imposed by Tax Law § 1501. Notwithstanding petitioner's argument that inequitable treatment may result from the failure to make modifications to entire net income under § 1503(b) in the same percentage as adjustments made to Federal LICTI, the tax levied by New York State remains a franchise tax calculated by entire net income as defined by the Legislature. Because the Legislature's authority to impose a corporate franchise tax arises under the term "privilege," the Legislature has wide discretion in selecting the subject and the parameters of said tax (see, Association of the Bar of City of New York v. Lewisohn, 34 NY2d 143, 356 NYS2d 555, 564).

Here the statutory provision is clear and of ascertainable meaning. While the starting point for determining entire net income under Tax Law § 1503 is the taxable income which the taxpayer is required to report for Federal income tax purposes, the tax then deviates from the Federal tax by providing its own inclusions and exclusions from the tax base (Tax Law § 1503[b]). The specific statutory language "except as hereinafter provided," in Tax Law § 1503(a) clearly indicates that the Legislature intended that the Federal number was to be only the starting point in computing entire net income for State tax purposes. Thus, Tax Law § 1503 requires that consistency with Federal income taxation apply with respect to the preliminary computation of entire net income in § 1503(a) and not to the modifications in § 1503(b) unless specifically indicated. Therefore, while the special life insurance company deduction under Internal Revenue Code former § 806 reduces a life insurance company's Federal tentative LICTI

by 20%, its carryover into Tax Law § 1503(a) is limited to this reduced Federal LICTI being the starting point for the calculation of entire net income.

In calculating entire net income, the statutory framework provides for specific adjustments to the Federal LICTI starting point. There is no generally applicable provision in the statute that allows for these adjustments to be computed at anything other than full value. When calculations are to be made at other than full value, the statute specifically so provides (see, e.g., Tax Law § 1503[b][1][B] [which requires that dividends from non-subsidiary corporations be added back at 50%]). In addition, there is no general statutory mandate that the modifications at issue be treated similarly with respect to both the State and Federal tax computations. Moreover, "any inequity which may result from the dissimilarity between the Federal and State statutes is a consequence of the . . . statutory scheme and is not a matter within the authority of the judiciary to correct" (Matter of Kreiss v. New York State Tax Commn., 61 NY2d 916, 474 NYS2d 717, 718).

Support for our conclusion that the statutory language should be read literally in this instance can be found in Matter of Federal Ins. Co. v. State Tax Commn. (supra) which also involved modifications to Federal taxable income for purposes of calculating the franchise tax on insurance corporations pursuant to Article 33. In that case, the petitioner, in calculating its entire net income for purposes of the franchise tax, sought to deduct certain investment expenses from its starting point of Federal taxable income even though in calculating its Federal taxable income, it had already deducted those expenses pursuant to provisions of the Internal Revenue Code. Thus, for State tax purposes, the expenses were deducted twice, once in calculating Federal taxable income and again in calculating franchise tax entire net income. The former State Tax Commission argued that, in spite of the specific language of Tax Law § 1503(b)(3) which permitted a taxpayer insurance corporation to deduct expenses of this type when calculating its entire net income, the Legislature could not have intended to give taxpayers a double benefit. The petitioner argued that the literal language of the statute should be controlling. The Appellate Division, in reversing a decision of the Supreme Court in favor of

the State Tax Commission, held that in the absence of a demonstrated legislative intention to prohibit the deduction when the expenses had already been deducted for Federal purposes, the plain language of Tax Law § 1503(b)(3) allowing the deduction should apply.

In the matter before us, petitioner argues that, in the absence of legislative materials supporting its view of the Legislature's intention, we should infer from the many references to the Internal Revenue Code in the Tax Law, a legislative intention to adjust the modifications to entire net income as those items were adjusted for Federal purposes. We agree with the conclusion of the court in Federal Ins. Co. that in the absence of a demonstrated legislative intent to the contrary, a deviation from the plain language of the statute is not justified.

We turn next to petitioner's claim that Tax Law § 1503 contains an unexpressed presumption which requires that the same amounts used to modify Federal LICTI must also be used in calculating modifications to New York State entire net income. Petitioner claims that this interpretation of Tax Law § 1503(b) is supported by the decision in Prudential (supra). Prudential was a mutual insurance company which carried on business in New York and elsewhere and was classified as a life insurance company for Federal income tax purposes. During each of the years at issue, Prudential filed a U.S. Life Insurance Company Income Tax return (Federal Form 1120L) in which its gain from operations before its deduction for dividends to policyholders (Schedule E) exceeded its taxable investment income (Schedule C). However, its dividends to policyholders exceeded this excess by more than the $250,000.00 maximum amount allowable under Internal Revenue Code § 809(f),[1] so that in computing gains from operations, the limitation on the deduction for dividends to policyholders applied in determining Federal LICTI. As a result, Prudential's Federal LICTI under Internal Revenue Code § 802(b)(1) was equal to its taxable investment income under Internal Revenue Code § 804 minus $250,000.00.

[1]Internal Revenue Code § 809(f) provides that, in computing gain from operations, the maximum deduction allowable for dividends to policyholders is an amount which, when subtracted from gain from operations computed without regard to this deduction, will produce a tax base that is $250,000.00 less than taxable investment income.

For each of the years at issue, Prudential filed New York Franchise Tax Returns for Insurance Corporations in which it calculated its entire net income utilizing as a starting point its Federal LICTI as reported on its Federal Form 1120L for the corresponding year. Prudential calculated its entire net income by making modifications to Federal LICTI utilizing the Internal Revenue Code § 804 figures for such items which had been used in computing its taxable investment income (see, Schedule C of its Federal return). On audit, the Department of Taxation and Finance determined deficiencies for each of the years at issue on the ground that, in arriving at entire net income, the modifications to Federal LICTI must be made using the Internal Revenue Code § 809 (gains from operations) figures rather than the Internal Revenue Code § 804 (taxable investment income) figures. It was the Audit Division's policy that "[s]ince NY income is computed based upon gain from operations, all NY modifications used in arriving at entire net income must also be those amounts used in computing Federal gain from operations (Statement of Audit Adjustment for years 1975 through 1977)."[2]

The issue presented to the former State Tax Commission in Prudential concerned whether the modifications required to be made to the taxpayer's Federal taxable income by Tax Law § 1503(b) should be made with reference to the computation of its taxable investment income under Internal Revenue Code § 804 or with reference to the computation of its gain from operations before deduction of dividends to policyholders under Internal Revenue Code § 809. The State Tax Commission held that since the taxpayer's Federal LICTI was based upon the taxable investment income figures, and not the gains from operations figures, the petitioner properly computed modifications to entire net income using the Internal Revenue Code § 804 figures pertaining to taxable investment income.

The focus of the Prudential decision was on determining the accounting base from which the requisite modification amounts would be derived; that is, whether the modification amounts should be derived from the base used by the taxpayer to calculate Federal LICTI or an alternative base. The State Tax Commission found that Prudential correctly calculated its Tax

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[2]It is noted that there is no statutory requirement that New York income be based on gain from operations.

Law § 1503(b) modifications using the Internal Revenue Code § 804 figures since its Federal LICTI (the statutorily mandated starting point) consisted of its taxable investment income under Internal Revenue Code § 804 (less $250,000.00) rather than its gains from operations under Internal Revenue Code § 809. However, these modification amounts were then applied to entire net income according to the specific language of Tax Law § 1503(b) for each type of modification, that is, at full value unless otherwise provided in the statute. Thus, the Prudential decision is distinguished by its facts and the focus of its inquiry from the case before us and does not, as urged by petitioner, support the conclusion that petitioner's modifications to entire net income should be reduced by 20% because its Federal LICTI had been so reduced.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the Division of Taxation is granted;

2. The determination of the Administrative Law Judge is reversed;

3. The petition of The United States Life Insurance Company in the City of New York is denied;

4. The Division of Taxation's denial of petitioner's refund claim for the year 1984, issued on or about November 6, 1987, is sustained; and

5. The notices of deficiency dated April 29, 1988 and April 7, 1989 respectively, issued to petitioner The United States Life Insurance Company in the City of New York are sustained.

DATED: Troy, New York
April 2, 1992

/s/John P. Dugan
John P. Dugan
President
Commissioner

/s/Maria T. Jones
Maria T. Jones
Commissioner