

STATE OF NEW YORK  
TAX APPEALS TRIBUNAL

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|--|---|-----------------------------|
| In the Matter of the Petition                | : |                             |
| of   | : |                             |
| <b>NEW YORK LIFE INSURANCE COMPANY</b>       | : | DECISION                    |
| <b>AND SUBSIDIARY</b>                        | : | DTA No. 810612 <sup>1</sup> |
|  | : |                             |
| for Redetermination of a Deficiency or for   | : |                             |
| Refund of Corporation Franchise Tax under    | : |                             |
| Article 33 of the Tax Law for the year 1984. | : |                             |

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Petitioner New York Life Insurance Company and Subsidiary, 51 Madison Avenue, Room 604, New York, New York 10010, filed an exception to the determination of the Administrative Law Judge issued on October 21, 1993. Petitioner appeared pro se by Michael M. Oleske, Esq., officer and associate tax counsel. The Division of Taxation appeared by William F. Collins, Esq. (Kenneth J. Schultz, Esq., of counsel).

Petitioner filed a brief in support of its exception. The Division of Taxation filed a letter in lieu of a brief. Petitioner's reply brief was received on February 14, 1994, which date began the sixth-month period to issue this decision. Neither party requested oral argument.

The Tax Appeals Tribunal renders the following decision per curiam.

***ISSUE***

Whether petitioner properly calculated its 50% dividends received deduction pursuant to Tax Law former § 1503(b)(1)(B) by including all dividends received (other than from subsidiaries) in its calculation base rather than limiting the calculation base to just the company's share of such dividends.

***FINDINGS OF FACT***

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

On January 11, 1993 the parties, by their respective representatives, submitted an executed stipulation of facts dated November 24, 1992. This stipulation is reproduced here in its entirety as Findings of Fact "1" through "12." Said stipulation has been modified only to change references to "the taxpayer" and "the company" to "petitioner" and "Department of Taxation and Finance" to "Division of Taxation."

Petitioner, New York Life Insurance Company, is a New York life insurance company engaged in the sale of life, health and annuity products.

For the year 1984, petitioner filed a combined report with its wholly-owned subsidiary, New York Life Insurance and Annuity Corporation, a Delaware corporation.

On December 7, 1989, a Notice of Deficiency (Assessment No. C891207000F) was issued to petitioner assessing additional franchise taxes and interest for the year 1984 in the amounts of \$63,704.00 and \$36,590.00, respectively.

On December 7, 1989, a Notice of Deficiency (Assessment No. C891207001S) was issued to petitioner assessing additional MTA [Metropolitan Transportation Business Tax Surcharge] taxes and interest for the year 1984 in the amounts of \$8,046.00 and \$4,621.00, respectively.

The tax increases in the notices are attributable to an adjustment to petitioner's deduction for dividends received from non-subsiary corporations.

On January 17, 1990, petitioner filed a Request for Conciliation Conference with the Bureau of Conciliation and Mediation Services.

On January 17, 1992, a Conciliation Order (CMS No. 102445) was issued, sustaining the statutory notices.

On its Federal income tax return (Form 1120-L), petitioner reported that it had received dividends on stock of non-subsidiary corporations in 1984 in the amount of \$39,199,047.00.

For Federal income tax purposes, petitioner claimed a dividends- received deduction on its original Federal income tax return for the year 1984 in the amount of \$12,664,739.00. Subsequently, petitioner submitted to the Internal Revenue Service an amended Federal income tax return for the year 1984 (amended form 1120-L) claiming a dividends-received deduction in the amount of \$13,015,073.00. In each case, the amount represented a deduction for the "company's share" of dividends received, in accordance with Internal Revenue Code § 805(a)(4).

In computing its entire net income, petitioner determined its deduction for dividends received as an amount equal to 50 percent of the dividends received from corporations other than subsidiaries, pursuant to Tax Law § 1503(b)(1)(B). The amount of said deduction claimed on Form CT-33 was \$19,599,524.00.

Upon audit of petitioner's return, the Division of Taxation ("Division") determined that petitioner's deduction for dividends received should be limited to 50 percent of the "company's share" of dividends received, i.e., \$7,501,683.00 (50 percent times \$15,003,366.00).<sup>2</sup>

The net effect of the proposed adjustment is to increase petitioner's entire net income in the amount of \$12,097,841.00.

### ***OPINION***

The Administrative Law Judge concluded that prior to 1984 the policyholders' share of investment income was excluded from life insurance company taxable income and, therefore, that during the same time period, the dividends received deduction pursuant to Tax Law former § 1503(b)(1)(B) could only apply to the company's share of such dividends. Second, the Administrative Law Judge concluded that because of the changes in computing life insurance company taxable income for Federal purposes under the Tax Reform Act of 1984, the policyholders' share was now included in the calculation of life insurance company taxable

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<sup>2</sup>The difference between this \$15,003,366.00 amount for the company's share of dividends received and the amount listed in finding of fact "9" is not explained in the record.

income. The Administrative Law Judge rejected the Division's contention that the deduction for increases in reserves pursuant to IRC § 807(b) resulted in the post 1983 deduction of the policyholder's share of dividends from life insurance company taxable income, holding that the deduction for increases in reserves is unrelated to the policyholders' share of dividends. Next, the Administrative Law Judge, reading the provisions of Tax Law former §§ 1503(b)(1)(B), 1503(b)(2)(B) and 1503(b)(2)(I) as an integrated whole, held that the 50 percent dividends received deduction pursuant to Tax Law former § 1503(b)(1)(B) was properly limited to the company's share of such dividends even after the 1984 changes made to Federal life insurance company taxable income. Finally, the Administrative Law Judge held the 1987 amendment to Tax Law § 1503(b)(1)(B) was a clarification of the Legislature's intent of providing a dividends received deduction for only the company's share of dividends received because the statute prior to its amendment is properly interpreted as also allowing a deduction for only the company's share of dividends received.

On exception, petitioner asserts that since the full amount of dividend income is includible in life insurance company taxable income in 1984 and the 50% dividends received deduction under Article 33 of the Tax Law is applied to the amount of dividends included in life insurance company taxable income, it was proper to compute the deduction with respect to all dividends received. Furthermore, petitioner asserts that the 1987 amendment to Tax Law § 1503(b)(1)(B) was more than a mere clarification of the statute but a substantive change because the statute as it existed in 1984 cannot be interpreted to limit the 50% dividends received deduction to the company's share of dividends.

In response, the Division relies on the reasoning of the Administrative Law Judge contained in the determination below except for conclusion of law "F" of the determination. Here, the Division contends that since IRC § 805(a)(2) does not exclude the policyholders' share of investment yield from the calculation of the deduction for increases in reserves (unlike IRC former § 810[b]), the effect of this deduction is to exclude the policyholders' share of dividends received from life insurance company taxable income. Thus, the Division argues that the

modifications to life insurance company taxable income under Article 33 of the Tax Law can logically be applied to limit the 50% dividends received deduction to the company's share.

We reverse the determination of the Administrative Law Judge.

Article 33 of the Tax Law imposes a franchise tax on life insurance companies. The tax is imposed on the entire net income of the insurance company (Tax Law § 1502). Entire net income is calculated using life insurance company taxable income as defined under the Internal Revenue Code as a starting point (Tax Law § 1503[a]), and making certain modifications pursuant to Tax Law § 1503(b). The controversy between the Division and petitioner arises over the interpretation of the modification set forth under Tax Law former § 1503(b)(1)(B). Tax Law former § 1503(b)(1)(B) provided that "entire net income shall not include fifty percent of dividends other than from subsidiaries." The differing interpretations are a result of the changes in the computation of life insurance company taxable income under the Tax Reform Act of 1984.

#### ***PRIOR LAW***

As the Administrative Law Judge noted, prior to the Tax Reform Act of 1984, life insurance companies were taxed for Federal purposes under a three phase system. The life insurance company was taxed on the lesser of its gain from operations or its taxable investment income and, if its gain from operations exceeded its taxable investment income, then 50% of such excess was taxed (IRC former § 802[b]). The other 50% of such excess was taxed when distributed to stockholders or upon corporate dissolution (IRC former § 802[b]). The sum of these three components determined life insurance company taxable income (IRC former § 802[b]).

#### ***TAXABLE INVESTMENT INCOME***

Taxable investment income consisted of the company's share of investment yield less the company's share of tax-exempt interest and of the deduction for dividends received (IRC former § 804). The policyholders' share of investment yield was excluded in determining taxable investment income by obtaining a percentage equal to the policy and other contract liability

requirements divided by the investment yield (IRC former § 804[a][1]). "In general, the effect of this computation is to allocate to the policyholder an amount at least equal to the reserves required under State law . . ." (Staff of the Joint Committee on Taxation, 98th Cong., 2d Sess., General Explanation of the Revenue Provisions of the Tax Reform Act of 1984, 573, fn 4).

### ***GAIN FROM OPERATIONS***

Gain from operations was the sum of the life insurance company's share of investment yield, net capital gain, premiums, decreases in reserves and other amounts generally includible in the gross income of a taxpayer less deductions (IRC former § 809[b],[c]). Deductions allowed, among others, included deductions for business and investment expenses, increases in reserves, the company's share of tax-exempt interest, and the dividends received deduction on the company's share (IRC former § 809[d]).

Based on this analysis of the computation of life insurance company taxable income under prior law, we agree with the Administrative Law Judge's conclusion that the policyholders' share of dividends was excluded in computing life insurance company taxable income prior to the 1984 changes.

### ***TAX REFORM ACT OF 1984***

As the Administrative Law Judge also noted, the Tax Reform Act of 1984 brought about substantial changes in the provisions of the Internal Revenue Code dealing with life insurance companies. The three phase system of taxation on life insurance companies was replaced with a single phase system. The tax is still imposed on life insurance company taxable income (IRC § 801[a]), but life insurance company taxable income is now defined as life insurance gross income minus life insurance deductions (IRC § 801[b]). Life insurance gross income consists of premiums, decreases in certain reserves and certain other amounts (IRC § 803[a]). All dividends are included in life insurance gross income without allocation between the company's share and the policyholders' share pursuant to IRC § 803. Life insurance deductions are those deductions generally available to corporate taxpayers (IRC § 805[a][8]) with modifications pursuant to IRC § 805(b), and those deductions pursuant to IRC §§ 805(a) and 806 available

only to life insurance companies. As can be seen, there is no longer a distinction drawn between taxable investment income and gain or loss from operations when computing life insurance company taxable income.

The Division acknowledges that after the 1984 changes, the policyholders' share of dividend income is included in life insurance gross income but contends that the policyholders' share of dividends is deducted from gross income to compute life insurance company taxable income by operation of IRC § 805(a)(2). The Division's theory is based on the fact that the deduction for increases in reserves allowed by IRC § 805(a)(2) does not require an adjustment for the policyholders' share of investment yield, i.e., the policyholders' share of investment yield is not excluded from the calculation of this deduction. The Division argues that the effect of the 805(a)(2) deduction for increases for reserves is to deduct all the policyholders' share of dividend income from life insurance gross income. We do not accept the Division's theory because it appears to be based on the faulty premise that the deduction for increases for reserves always results in the exclusion of the entire amount of the policyholders' share of dividends from life insurance company taxable income.

Generally, under IRC §§ 805(a)(2) and 807(b), if the amount of reserves at the end of the taxable year is greater than the amount of reserves at the beginning of the year, then the difference results in a deduction for increases in reserves. As the Division notes, the policyholders' share of investment yield is not excluded from the calculation of this deduction, as it was under prior law.<sup>3</sup> Nonetheless, our understanding of this deduction is that there is no direct, necessary correlation between it and the policyholders' share of dividends and that amounts which would be attributable to the policyholders' share of dividends could only be excluded from life insurance company taxable income if there was an increase in reserves for that taxable year in an amount at least equal to the policyholders' share of dividends. Thus, if the policyholders' share of dividend income was an amount exceeding the deduction for

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<sup>3</sup>Under prior law, the reserves at the end of the year had to be adjusted to exclude the policyholders' share of investment yield (IRC former § 810[b]). The policyholders' share of investment yield was excluded from the increase in reserves deduction so as to prevent a double deduction of such amount because the policyholders' share of investment yield was already excluded when determining gain from operations (IRC former § 809[b]).

increases in reserves, only a portion of the policyholders' share could possibly be excluded from life insurance company taxable income. Further, IRC § 807(a) requires that any decrease in reserves be included in gross income. In such an instance, there would be no possible deduction of the policyholders' share of dividends. In sum, the Division has not shown us that the deduction for increases in reserves results in a dollar for dollar deduction of the policyholders' share of dividends when computing life insurance company taxable income. As a result, we agree with the Administrative Law Judge's conclusion that as a result of the Federal changes in 1984, Federal life insurance company taxable income includes the policyholders' share of dividends.

### ***ARTICLE 33 FRANCHISE TAX***

New York State imposes a franchise tax on insurance companies doing business in the state (Tax Law § 1501). As stated above, the tax is imposed on the entire net income of the taxpayer (Tax Law § 1502), which is presumably the same as the life insurance company taxable income with some modifications (Tax Law § 1503). The provisions relevant to the issue at hand of Tax Law former § 1503 read as follows:

"(b) Modifications. In computing entire net income, the following modifications shall be made:

"(1) Entire net income shall not include:

\* \* \*

"(B) fifty percent of dividends other than from subsidiaries;

\* \* \*

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

\* \* \*

"(B) any part of any income from dividends or interest on any kind of stock, securities or indebtedness, except as provided in subparagraphs (A) and (B) of paragraph one hereof;

\* \* \*

"(I) in the case of a life insurance company, the provisions of subparagraph (B) of this paragraph shall not apply to the policyholder's share of the items described in such subparagraph. For purposes of this subparagraph, the policyholder's share of such items means the amount, if any, of each such item excludable in determining taxable investment income or gain or loss from operations under sections eight hundred four or eight hundred nine, respectively, of the internal revenue code."

Reading the provisions of Tax Law former § 1503 together as an integrated whole reveals that Tax Law § 1503(b)(2)(B) required that any deductions, exclusions or credits taken with respect to income from dividends at the Federal level be added to life insurance company taxable income. However, deductions, exclusions or credits taken with respect to policyholders' share of dividends were not to be added back when applying Tax Law § 1503(b)(2)(B) pursuant to Tax Law § 1503(b)(2)(I). It is undisputed that the net effect of this scheme prior to 1984 was that the policyholders' share of dividends was not included in entire net income and that the 50% dividends received deduction of section 1503(b)(1)(B) was limited to the company's share of dividends. This scheme was logical because the scope of the deduction matched the source of the income. Because of the changes in computing life insurance company taxable income under the Tax Reform Act of 1984, we conclude that the application of these provisions yielded a different result for the year in issue.

As concluded earlier, after the 1984 changes, Federal life insurance taxable income included the policyholders' share of dividends. Section 1503(b)(2)(B) had no effect on this result because the policyholders' share of dividends had not been excluded, deducted or credited for Federal purposes and, thus, was not required to be added back. Therefore, after the 1984 Federal changes the entire net income that was subject to modification by section 1503(b)(1)(B) included the policyholders' share of dividends. On its face, the modification made by section 1503(b)(1)(B) simply allowed a deduction from entire net income for nonsubsidiary dividends: there was no explicit limitation to the company's share. Further, the logic that supported limiting section 1503(b)(1)(B) to the company share of dividends prior to the 1984 changes does not apply after the 1984 changes, i.e., the sources of income were no longer limited to the company share. Because the literal words of the statute do not exclude the policyholders' share

of dividends from the 1503(b)(1)(B) deduction and because this interpretation does not lead to an even arguably absurd result for the year at issue (see, Matter of United States Life Ins. Co. v. Tax Appeals Tribunal, 194 AD2d 952, 599 NYS2d 168, lv denied 82 NY2d 657, 604 NYS2d 556), we conclude that petitioner properly calculated this deduction.

It follows from the previous conclusion that we do not agree with the Administrative Law Judge that the 1987 amendment to section 1503(b)(1)(B) was merely clarifying. As a result of this amendment, section 1503(b)(1)(B) now provides that:

"fifty percent of dividends other than from subsidiaries except that in the case of a life insurance company, such modification shall apply only with respect to the company's share of such dividends, which share means the percentage determined under paragraph one of subsection (a) of section eight hundred twelve of the internal revenue code."

First, as discussed above, we cannot read the statute as it existed in 1984 as applying only to the company's share of dividends. Second, we do not find the legislative history relied on by the Division persuasive. The only evidence we could find in the legislative history of Chapter 817 about the amendment of section 1503(b)(1)(B) was set forth in a chart attached to a letter from Roderick G.W. Chu, Commissioner of Taxation and Finance to Honorable Mario M. Cuomo. The letter recommended approval of Senate Bill No. 6494. The attached chart states that the amendment to section 1503(b)(1)(B) "clarifies that only 50% of company's share of dividends from nonsubs. are excluded" (Governor's Bill Jacket, L 1987, ch 817, p. 000031).<sup>4</sup> The same chart also indicates that the amendment of section 1503(b)(1)(B) applied only to taxable years beginning after December 31, 1986 (L 1987, ch 817 was effective on August 7, 1987; see L 1987, ch 817, § 110[a]). In our view, the limited application of the amendment to taxable years after 1986 is inconsistent with the contention that the amendment was merely clarifying, i.e., merely stating what the law had always been. In contrast, the amendment found

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<sup>4</sup>The Division, in its post hearing brief, and the Administrative Law Judge both state that the Executive Department Memorandum accompanying the bill stated that the amendment was intended to be clarifying. They are referring to the chart attached to the July 20, 1987 Chu letter. The only memorandum issued by the Governor with respect to Chapter 817 of the Laws of 1987 was the Governor's approval memorandum (McKinney's 1987 Session Laws, vol. 2, p. 2730) which does not specifically mention the amendment to section 1503(b)(1)(B), much less state that it is intended to be clarifying.

by the Court of Appeals in Mayblum v. Chu (67 NY2d 1008, 503 NYS2d 316) to be clarifying had been explained as such in a memorandum issued by the Executive Department (1984 McKinney's Session Laws of NY at 3457) and the amendment was not limited in its application to a specific time period, but took effect, as did the entire bill of which it was a part, 30 days after it became a law (L 84, ch 900, § 25). For these reasons, we find the legislative history relied on by the Division insufficient to establish that the amendment was not a substantive change.

Accordingly, it is ORDERED, ADJUDGED, and DECREED that:

1. The exception of New York Life Insurance Company and Subsidiary is granted;
2. The determination of the Administrative Law Judge is reversed;
3. The petition of New York Life Insurance Company and Subsidiary is granted; and
4. The Division of Taxation is directed to cancel the notices of deficiency dated

December 7, 1989 in accordance with this decision.

DATED: Troy, New York  
August 4, 1994

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

/s/Francis R. Koenig  
Francis R. Koenig  
Commissioner