STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
EMIGRANT BANCORP, INC.	:	DECISION DTA NO. 820059
for Redetermination of a Deficiency or for Refund of Franchise Tax on Banking Corporations under Article 32 of the Tax Law for the Years 1998 and 1999.	:	

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on March 30, 2006 with respect to the petition of Emigrant Bancorp, Inc., 5 East 42nd Street, New York, New York 10017. Petitioner appeared by Thacher Proffitt & Wood, LLP (Patrick J. Boyle and Jonathan D. Forstot, Esqs., of counsel). The Division of Taxation appeared by Daniel Smirlock, Esq. (Nicholas A. Behuniak, Esq., of counsel).

The Division of Taxation filed a brief in support of its exception. Petitioner filed a brief in opposition and the Division of Taxation filed a reply brief. Oral argument, at the Division of Taxation's request, was heard on January 22, 2007 in New York, New York.

ISSUES

I. Whether the Division of Taxation properly computed the balance of the reserve for losses on qualifying real property loans maintained by a wholly-owned subsidiary of petitioner as of December 31, 1995, thereby resulting in a modification to petitioner's taxable income and a resulting tax deficiency for the years at issue.

II. Whether a Consent to Field Audit Adjustment signed by the controller of petitioner, wherein petitioner purportedly agreed to reserve balances for years 1991 through 1995, renders moot the matter at issue.

FINDINGS OF FACT

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

Emigrant Bancorp, Inc. ("petitioner") is a banking corporation which files New York State franchise tax returns under Article 32 of the Tax Law on a combined basis with its wholly owned subsidiary, Emigrant Savings Bank (the "Bank") and with other first-tier and lower-tier subsidiaries.

The Bank is a "thrift institution" within the meaning of Tax Law § 1453(h). As such, the Bank is required to maintain reserves including a reserve for losses on qualifying real property loans (Tax Law § 1453[h][6][A]) and is allowed a deduction in computing entire net income for the amount of a reasonable addition to its reserve for bad debts (Tax Law § 1453[h][3]).

In July 2001, the Division of Taxation ("Division") commenced an audit of petitioner. On October 30, 2001, April 29, 2002 and September 29, 2002, petitioner, by its Senior Vice President and Controller, Francis R. May, executed a series of consents extending the period of limitation for assessment of corporation franchise tax under Article 32 of the Tax Law whereby the amount of tax due for the year 1998 could be determined or assessed at any time on or before June 30, 2003.[1]

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[1] The consents also extended the period of limitation for assessment of tax due for the year 1997 as well; however, the issues pertaining to the year 1997 are not the subject of this proceeding.

Pursuant to the audit, the Division, on March 17, 2003, issued a Notice of Deficiency to petitioner which asserted total tax due in the amount of $3,428,474.00, plus interest of $779,896.55, less payments or credits of $279,856.00, for a total amount due of $3,928,514.55 for the years 1998 and 1999. The tax due consisted of $779,166.00 in franchise tax on banking corporations pursuant to Tax Law § 1451(a) and $132,458.00 in temporary metropolitan transportation business tax surcharge ("MTBTS") pursuant to Tax Law § 1455-B for the year 1998 and $2,151,154.00 in franchise tax and $365,696.00 in MTBTS for the year 1999.

The basis for the issuance of the Notice of Deficiency was the determination by the Division that petitioner incorrectly computed the amount allowable as a deduction pursuant to Tax Law § 1453(h)(3) in computing its entire net income. The Division determined that petitioner overreported its allowable deduction under Tax Law § 1453(h)(3) which resulted in the deficiencies of tax asserted in the Notice of Deficiency.

Based upon an adjustment which related to section 481 of the Internal Revenue Code ("IRC"), the Division, on or about April 7, 2005, provided amended schedules[2] to petitioner which reflected an amended amount of tax due of $2,372,754.00 rather than the amount of $3,428,474.00 as asserted in the Notice of Deficiency.

At the hearing, the Division introduced further amended schedules dated April 19, 2005 (Division of Taxation's Exhibit "J") which on page 4 thereof reflect a "charge off" of $1,826,216.00 for 1999 rather than $2,336,522.00 as indicated in the amended schedules provided on April 7, 2005. Petitioner's representatives indicated that they would indicate, in writing, if they agreed with this latest adjustment which would increase total tax due from

[2] These schedules are contained in petitioner's hearing memorandum (Division of Taxation's Exhibit "G" as Exhibit "11" therein).

$2,372,754.00 (as provided in the amended schedules of April 7, 2005) to $2,423,246.00. In footnote "1" of petitioner's brief submitted June 27, 2005, petitioners agreed with the April 19, 2005 schedules and accordingly, the total amount of tax at issue in this proceeding is $2,423,246.00, plus interest.

At the hearing, it was agreed by the parties that if the Division prevails in this proceeding, the amount of tax due from petitioner will be the revised amount, i.e., $2,423,246.00, plus interest, and if petitioner prevails in this proceeding, there shall be no tax deficiency for the audit period.

At the hearing, the Division introduced into evidence a Consent to Field Audit Adjustment dated September 4, 2001. In addition to the consent which was signed by petitioner's Senior Vice President and Controller, Francis R. May, on September 10, 2001, there were eight additional pages of schedules prepared on various dates by the Division's auditors. The last page (page 9) sets forth a schedule, dated July 11, 2001, which purports to be petitioner's bad debt deductions for the years 1991 through 1996 as computed by the auditors.

On page 1, the actual consent signed by Mr. May, the summary of taxes for the years 1993 through 1996 indicates that for these years a refund in the amount of $206,183.00 was due. There was no evidence that any of the other pages of schedules were attached to the consent at the time it was signed by Mr. May or that he consented to the calculations of the bad debt deductions made by the Division.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

After a review of the relevant statute, the Administrative Law Judge found that petitioner's analysis of the statute was "correct." The Administrative Law Judge accepted

petitioner's arguments and found the Division's increase of the Bank's reserve balance in an amount equal to 40 percent of the Bank's entire net income ("ENI") (minus charge offs) was excessive since the Division's use of the 40 percent deduction from the Bank's ENI, resulted in an increase in the bad debt reserve balance and, in turn, decreased the amount permitted to be deducted under the statute by reason of the annual six percent limitation. The Administrative Law Judge found that the Bank, on its returns, properly reduced its New York bad debt deduction below 40 percent of its ENI based upon the provisions of Tax Law former § 1453(h)(1), which was the amount, the Administrative Law Judge determined, that should have been used by the Division in calculating the Bank's bad debt reserve.

The Administrative Law Judge also agreed with petitioner's argument that post-1996 Tax Law section 1453(h) permits a taxpayer to take a bad debt deduction of approximately 32 percent and, if the provisions of pre-1996 section 1453(h)(1) are factored into the computation of the bad debt deduction under pre-1996 section 1453(h)(2), the bad debt deduction pre-1996 was also approximately 32 percent.

The Administrative Law Judge stated that petitioner's position was supported by the Division's TSB-M-96(1)C where it is stated that the 1996 amendments to the Tax Law would essentially maintain the level of deduction provided to thrifts under state law. Moreover, the Administrative Law Judge stated, the Memorandum in Support of the 1996 amendments[3] stated that the bill was intended to provide "consistent tax treatment for thrifts and revenue neutrality for the State."

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[3] Chapter 411 of the Laws of 1996

Accordingly, the Administrative Law Judge canceled the deficiency of tax asserted by the Division to be due from petitioner.[4]

ARGUMENTS ON EXCEPTION

The Division, on exception, challenges four conclusion of law of the Administrative Law Judge.[5] The Division argues that pre-1996 Tax Law § 1453(h)(1) is a separate limitation from that contained in paragraph 2 of Tax Law § 1453(h). The Division states that the central issue to this controversy is whether the pre-1996 reserve account should have been annually increased by 32 percent (the total amount which was permitted as an expense for bad debts) or 40 percent (only one portion of the bad debt expense). The Division explains that the 32 percent total expense is comprised of the combined components of Tax Law §§ 1453(h)(1) and 1453(h)(2), whereas the 40 percent is ascertained from application of just section 1453(h)(2). By statute, the Division points out, the pre-1996 reserve account balance is increased pursuant to Tax Law § 1453(h)(3)(C) which in turn notes that the annual increase to the reserve balance is pursuant to Tax Law § 1453(h)(2) only. The Division points out that there is no reference in the statute to the reserve balance being increased by the total annual bad debt expense of 32 percent, but rather just the portion which related to section 1453(h)(2) or 40 percent.[6]

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[4]The Administrative Law Judge also found that the Division did not refute petitioner's claim that it never consented to the Division's bad debt reserve balances for the audit period and for those years prior thereto. Since there was no evidence presented by the Division to show that an officer of petitioner actually saw and consented to the Division's computations of the bad debt reserve balances for the years 1991 through 1996, the Administrative Law Judge found that petitioner was not precluded from contesting the tax deficiency asserted here. The Division has not taken an exception to this portion of the determination.

[5]Specifically, Conclusions of Law "B," "H," "K," and "M."

[6]The Division recognizes this may appear to be an anomaly, but it is not. Although it would appear that a "portion" of the total deduction should be less than the total deduction which is permitted, i.e., if 40 percent is only a portion of the total deduction, one would expect that the total deduction would be more than 40 percent. That is not so, since the second "portion" of the deduction actually requires an add back or reduction of the total deduction. Thus, a combination of the two portions results in a total which is less than only one part of the deduction on its

Petitioner argues that requiring it to maintain a bad debt reserve balance of 40 percent while only permitting it to take a bad debt deduction of only 32 percent would result in a collapse of the statutory framework. Petitioner urges that the point of the reserve balance is to ensure that an amount deducted in year one is reserved for future losses and then accounted for. The Division counters that this may be true for financial reporting or book purposes, but nothing is in the record to establish the Legislature intended that for purposes of this statute. The Division points out that there are frequently differences between values set forth for financial reporting purposes and the values for tax purposes, e.g., depreciation permitted for assets for financial reporting purposes often differ from amounts permitted as depreciation for tax purposes.

In part, petitioner argues that since the post-1996 reserve balance now works that way (i.e., the reserve balance is increased annually by the full amount of the entire annual bad debt expense), the Legislature could not have intended for the pre-1996 statute to work as it is actually written.

Petitioner argues that since the subsections of Tax Law § 1453(h), at various times refer to each other, then the Legislature plainly intended to link the bad debt deduction allowed with the required increase in the reserve balance. The Division agrees there was a link but asserts that the tax preference item was limited to just one portion of the annual bad debt deduction.

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OPINION

BACKGROUND

Petitioner filed its New York State franchise tax returns under Article 32 of the Tax Law for 1998 and 1999 on a combined basis with its subsidiary, the Bank.

The Bank is a "thrift institution" and is required for New York State tax purposes to maintain, as relevant here, a reserve for losses on qualifying real property loans, and to deduct additions to such reserves in computing its ENI for each taxable year[7] (Tax Law §§1453[b][1], 1453[h][3], 1453[h][6][A]).

Tax Law § 1453(h)(6)(A)(iii), as amended in 1996, sets forth the method for determining the opening balance of a thrift institution's bad debt reserve balance as of January 1, 1996 which, in the case of petitioner, is the balance of its bad debt reserve account as of December 31, 1995.

Petitioner argues that the central issue in this case is whether the Commissioner is correct in arguing that the six percent limitation restricts the extent to which the Bank was allowed to deduct from its ENI the amount that would otherwise be permitted by Tax Law § 1453(h). Petitioner claims that the six percent limitation was incorrectly applied and that the Division incorrectly calculated the reserve balance as of December 31, 1995 (the balance that should have been carried over to 1996).

THE PRE-1996 STATUTE

Chapter 817 of the Laws of 1987 amended Tax Law § 1453 by, as relevant here, adding a new subsection (h).

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[7]Subject to certain limitations.

The changes in the 1987 statute were explained by the Division in a Technical Services Bureau memorandum (TSB-M-87[17]C). The memorandum noted that the provisions of Chapter 817 of the Laws of 1987 known as the Business Tax Reform and Rate Reduction Act of 1987, amended Article 32 of the Tax Law pertaining to the franchise tax on banking corporations. With respect to thrift institutions, the memorandum stated, in relevant part, as follows:

> New subsection (h) of Section 1453 allows a thrift institution (one subject to IRC Section 593) which computes all or a portion of its bad debt deduction using the percentage of taxable income method for federal income tax purposes to subtract from federal taxable income a New York State bad debt deduction. This bad debt deduction is nearly equal to the amount which was allowed as a deduction for federal income tax purposes prior to 1987. A taxpayer which subtracts a New York State bad debt deduction from federal taxable income must add to such income the following:
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> 1. Any amount allowed as a deduction for federal income tax purposes pursuant to IRC Section 593(b)(1)(B) plus
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> 2. 20 percent of the amount by which (i) the sum of the amount allowed a New York State bad debt deduction plus the amount allowed as a deduction for federal income tax purposes pursuant to IRC Section 593(b)(1)(A) exceeds (ii) the amount which would have been allowable as a deduction had the thrift institution maintained its bad debt reserve for all taxable years on the basis of actual experience.

Therefore, TSB-M-87(17)C explained pre-1996 Tax Law § 1453(h) by stating that a taxpayer which claims a New York State bad debt deduction must first add back the amount calculated in paragraph (1) of pre-1996 Tax Law § 1453(h), i.e., it must add back to its Federal taxable income, its Federal bad debt deduction for losses on qualifying real property loans plus 20 percent of the amount by which its New York State bad debt deduction plus its Federal bad debt deduction for losses on nonqualifying loans exceeds the deduction that would have been allowed if the actual experience method had been used. This provision in pre-1996 Tax Law

§ 1453(h)(1) provides for a reduction or limitation on the amount that can be claimed as a New York State bad debt deduction computed under pre-1996 Tax Law § 1453(h)(2).

Pursuant to IRC § 593(b)(2)(A), the "percentage of taxable income method," or PTI method, is defined as an amount equal to eight percent of the taxable income for the year, subject to certain reductions or limitations.[8] The PTI method is the method used by this taxpayer.[9]

In 1996, it was anticipated by those in the New York State Legislature that Congress would pass legislation to limit the historically favorable tax treatment given to thrift institutions, such as the Bank. That in fact happened when, in 1996, IRC § 593(f) was added by Public Law 104-188 for tax years beginning after December 31, 1995. This provision repealed the reserve method of accounting for bad debts of qualified thrift institutions, thereby eliminating the bad debt deduction provided to thrift institutions by IRC § 593. At that time, Article 32 of the Tax Law used the Federal calculation of the bad debt reserve as the starting point for determining the allowable New York State deduction for additions to the bad debt reserve by these thrift institutions. Since elimination of the Federal starting point would cause New York State thrifts to lose their State tax benefits, the New York State Tax Law was amended on July 30, 1996 to maintain the historical tax preference granted these institutions. This was accomplished by taking provisions previously in Federal Law and placing them into the Tax Law.

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[8] The eight percent of taxable income must be reduced (but not below zero) by the amount determined to be a reasonable addition to the bad debt reserve on nonqualifying loans (IRC § 593[b][2][B]) and the eight percent of taxable income shall not exceed the amount necessary to increase the bad debt reserve on qualifying real property loans to six percent of such loans outstanding (IRC § 593[b][2][C]).

[9] The "experience method" is defined in IRC § 593(b)(3) as the amount computed in the same manner as is provided with respect to additions to the reserves for losses on loans of banks under IRC § 585(b)(2).

FEDERAL CHANGES

On November 6, 1996, the Technical Services Bureau issued a memorandum (TSB-M-96[1]C) to explain the changes to thrift institutions. The memorandum stated, in relevant part, as follows:

> Federal law, Public Law 104-188, enacted on August 20, 1996, repealed the bad debt deduction provided to thrift institutions by section 593 of the Internal Revenue Code (IRC) for periods beginning after December 31, 1995. Accordingly, thrift institutions will now be required for federal income tax purposes to account for their losses from loans in the same manner as commercial banks. . . .Thrift institutions that qualify as small banks will be able to continue to use the reserve method but their allowable deduction must be computed using the experience method.
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> The New York State Tax Law was amended on July 30, 1996 to essentially maintain the level of deduction provided to thrifts under state law by, in general, replicating in section 1453(h) the provisions of section 593 of the IRC. Section 593 of the IRC allowed thrift institutions a bad debt deduction in computing federal taxable income which was based, in general, on the larger of the percentage of taxable income method or the experience method. Before the New York State amendment was enacted, the calculation of the New York State bad debt deduction for thrifts was tied to the deduction provided under section 593 of the IRC.
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> In addition the amendment provides that any amount a thrift institution is required to include in federal taxable income as a recapture of a portion of its bad debt reserve, either because of certain distributions of property to shareholders or because of the recovery of the bad debt reserve required by the aforementioned federal legislation, will not be included in entire net income.

So while the IRC was amended to repeal the percentage of taxable income ("PTI") method, New York State preserved the PTI method for thrift institutions by means of amendments to Tax Law § 1453 made by Chapter 411 of the Laws of 1996.

CHANGES MADE BY CHAPTER 411, LAWS OF 1996

Tax Law § 1453(h) was amended to eliminate the provisions of pre-1996 Tax Law § 1453(h)(1) which required a 20 percent add back to ENI and renumbered the provisions for calculations of adjustments to ENI and for the calculation of the bad debt reserve balance additions.

Tax Law § 1453(h)(6)(A) provides that a thrift institution (such as petitioner) shall maintain a New York bad debt reserve for losses on various types of loans.

Tax Law § 1453(h)(3) states that a thrift institution shall be allowed as a deduction in computing ENI the amount of a reasonable addition to its bad debt reserve.

Tax Law § 1453(h)(4)(A) provides that the deduction allowed in computing ENI "shall be an amount equal to thirty-two percent of the entire net income for such year" subject to certain limitations, one of which is set forth in Tax Law § 1453(h)(4)(C) which states that the "amount determined under this paragraph shall not exceed the amount necessary to increase the balance at the close of the taxable year of the reserve for losses on qualifying real property loans to six percent of such loans outstanding at such time" (hereinafter, the "six percent limitation").

Tax Law § 1453(h)(6)(A)(iii) prescribes the method for determining the opening balance of a thrift institution's bad debt reserve balance as of January 1, 1996 which, in the case of petitioner, is the balance of its bad debt reserve account as of December 31, 1995.

The limited legislative history for 1996 is reflected in the Memorandum in Support of Chapter 411 of the Laws of 1996, which stated the purpose of the law was to

> decouple from federal tax law the current provisions in the State bank tax law that prescribe the treatment of reserves for loan losses by qualifying thrift institutions. The bill incorporates and assimilates relevant current federal provisions, which are anticipated to be repealed, while maintaining the preferential current State tax

> law treatment of loss reserves for real property loans afforded to thrifts. As such, the bill achieves consistent tax treatment for thrifts and revenue neutrality for the State (Mem of NY Senate, 1996 McKinney's Session Laws of NY, at 2356).

It is apparent that the bad debt reserve balance carried forward from years prior to the 1996 year directly impacts the balance in the bad debt reserve account for 1996 and thereafter and the balance of this account also affects the amount of the bad debt deduction permitted in any given year (Tax Law § 1453[h][6][A][iii]).

In this regard, petitioner argues that the Division incorrectly calculated the bad debt reserve account of the Bank as of December 31, 1995, and that this caused the Bank's bad debt reserve account balances for succeeding years to be overstated. This has, petitioner claims, erroneously limited its claimed bad debt deductions for the years at issue, i.e., 1998 and 1999.[10] There is no dispute between the parties concerning the statutory interpretation of post-1996 Tax Law § 1453(h).

The title of pre-1996 Tax Law § 1453 is "Computations of entire net income." Paragraph (1) of subsection (h) requires a taxpayer which computes all or a portion of its bad debt deduction pursuant to IRC § 593(b)[11] using the PTI method in IRC § 593(b)(2) to exclude (i.e., make a subtraction) from its ENI: (A) any amount allowed as a deduction for Federal income

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[10]The parties have agreed that if the Division is correct in its interpretation and application of pre-1996 Tax Law § 1453(h), the amounts of the deficiencies asserted in the Notice of Deficiency, as later revised by schedules provided by the Division on April 7, 2005 and on April 19, 2005, are corrected; and, if on the other hand, petitioner is correct in its interpretation and application of that section of the Tax Law, there are no deficiencies of tax for the years at issue.

[11] As noted in conclusion of law "C" of the Administrative Law Judge's determination, Public Law 104-188 added a new subsection (f) to IRC § 593 which provided that subsections (a), (b), (c) and (d) shall not apply to any taxable year beginning after December 31, 1995. Since those subsections were not repealed but were made inapplicable only to taxable years beginning after December 31, 1995, the subsections shall not be referred to as "former subsections."

tax purposes pursuant to IRC § 593(b)(1)(B);[12] plus (B) 20% of the amount by which (i) the sum of the amount determined in Tax Law former § 1453(h)(2) *plus* the amount allowed as a deduction for Federal income tax purposes pursuant to IRC § 593(b)(1)(A) (which refers to amounts determined to be a reasonable addition to its reserve for losses on nonqualifying loans) exceeds (ii) the amount which would have been allowable as a deduction had the thrift institution maintained its bad debt reserve for all taxable years on the basis of actual experience.

Before the calculation required by Tax Law § 1453 former (h)(1) is made, a separate calculation must first be made pursuant to former subsection (h)(2).

Tax Law former § 1453(h)(2) makes provision for a deduction in computing ENI and applies to taxpayers described in former paragraph (1), i.e., taxpayers who compute all or a portion of their bad debt deduction pursuant to the PTI method. Former paragraph (2)(A) then sets forth the method for calculating the New York bad debt deduction as follows: (i) ascertain the amount deducted for Federal income tax purposes pursuant to IRC § 593(b)(1)(B) for amounts determined to be a reasonable addition to the reserve for losses on nonqualifying loans and add it to the amount, if any, deducted for Federal income tax purposes for amounts determined to be a reasonable addition to the reserve for losses on qualifying real property loans, then

(ii) Multiply the amount determined in (i) by five, then

(iii) Subtract from the amount determined in (ii) the amount deducted for Federal income tax purposes for amounts determined to be a reasonable addition to the reserve for losses on nonqualifying loans.

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[12]Section 593 refers to bad debt reserve and deduction for losses on qualifying and nonqualifying real property loans for Federal purposes.

However, the deduction calculated under former subparagraph (A) cannot exceed the amount necessary to increase the balance at the close of the taxable year of the New York reserve for losses on qualifying real property to six percent of such loans outstanding at that time (the six percent limitation) (Tax Law former § 1453[h][2][B]).[13]

Tax Law former § 1453(h)(3)(A) requires that each taxpayer described in paragraph (h)(1), i.e., a taxpayer like petitioner which computes its bad debt deduction pursuant to the PTI method, must establish and maintain a bad debt reserve and that the balance of the bad debt reserve must, in essence, be the same as the balance maintained for Federal income tax purposes.

Former subparagraph (3)(B) states that all debts charged or credited to the bad debt reserve for losses on qualifying real property loans for Federal purposes must also be charged or credited to the New York bad debt reserve for losses on such loans.

As relevant here, former Tax Law § 1453(h)(3)(C) provides that the New York bad debt reserve for losses on qualifying real property loans *shall be increased by the amount of the New York bad debt deduction determined under paragraph (2)* of Tax Law former § 1453(h).[14]

We now examine whether the Division's interpretation of the relevant provisions, including pre-1996 Tax Law § 1453(h), was reasonable and properly calculated petitioner's bad debt reserve balance for the years immediately prior to the years at issue.

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[13]Former subparagraph (C) of Tax Law § 1453(h) adds a further limitation to the New York bad debt deduction, but for purposes of our discussion here we need not include them.

[14]Or the amount of the addition to the bad debt reserve determined for Federal purposes under IRC § 593(b)(1)(B) if that amount was determined using the experience method set forth in IRC § 594(b)(3). This provision does not apply to this taxpayer since it uses the PTI method.

A thrift institution which subtracts a New York State bad debt deduction from its Federal taxable income is first required to exclude from its computation of entire net income (and, therefore, add back) to its Federal taxable income, the amount of its Federal bad debt deduction (Tax Law former § 1453[h][1][A]), and then it may compute the New York State bad debt deduction using, in the case of this taxpayer, the PTI method. The bad debt deduction, using the PTI method (which is the method at issue in this proceeding), is computed at 40 percent of taxable income subject to the adjustments, i.e., the six percent limitation and the Federal addition to the bad debt reserve.[15]

The calculations set forth in Tax Law former § 1453(h)(1), while not part of the actual calculation of the bad debt deduction computed pursuant to Tax Law former § 1453(h)(2), are still impacted by the former paragraph (1) calculation, since it imposes a limit on the amount that can be claimed as a New York State bad debt deduction.

Since Tax Law former § 1453(h)(3)(C), i.e., pre-1996 section 1453(h)(3)(C), provides that the New York bad debt reserve shall be increased by the amount of the New York bad debt deduction determined under Tax Law former § 1453(h)(2), which deduction is also impacted by the computations contained in pre-1996 section 1453(h)(1), the Administrative Law Judge concluded that petitioner's interpretation of the statute was "correct."

The Administrative Law Judge found the Division's increasing of the reserve balance in an amount equal to 40 percent of the Bank's ENI (minus charge offs) was excessive, since the Division's use of the 40 percent deduction from the Bank's ENI resulted in an increase in the

[15]Set forth in Tax Law former § 1453[h][2][B], [C] and Tax Law former § 1453(h)(1)(B).

bad debt reserve balance and, in turn, a decrease in the amount permitted to be deducted by reason of the annual six percent limitation.

In addition, the Administrative Law Judge accepted petitioner's claim that since the post-1996 section 1453(h) permits a taxpayer to take a bad debt deduction of approximately 32 percent and, if the provisions of pre-1996 section 1453(h)(1) were factored into the computation of the bad debt deduction under pre-1996 section 1453(h)(2), the bad debt deduction pre-1996 was also approximately 32 percent.[16]

The Administrative Law Judge relied on the Memorandum in Support of the 1996 amendments[17] and stated that the bill intended "consistent tax treatment for thrifts and revenue neutrality for the State."

We reverse the determination of the Administrative Law Judge.

In the construction of statutes, courts must give effect to the intention of the Legislature (***see***, Majewski ***v. Broadalbin-Perth Cent. School Dist.***, 91 NY2d 577, 673 NYS2d 966). To determine legislative intent, courts must first look at the literal reading of the act itself (***see***, McKinney's Cons Laws of NY, Book 1, Statutes § 92). A statute must be read according to the language used by the Legislature. Where the language of the statute is clear and unambiguous, the court should construe it so as to give effect to the plain meaning of the words used (***see***, ***Matter of Raritan Dev. Corp. v. Silva***, 91 NY2d 98, 667 NYS2d 327). If the language has no

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[16]While the post-1996 statute omits the add back contained in pre-1996 section 1453(h)(1), the 32 percent deduction is now an up-front deduction without the necessity of the two-step computation contained in the pre-1996 statute.

[17] Chapter 411 of the Laws of 1996

ambiguity, the courts may not resort to rules of construction to broaden the scope and application of a statute (***see***, ***Majewski v. Broadalbin-Perth Cent. School Dist.***, ***supra***).

The central question presented is whether the pre-1996 reserve account should have been annually increased by 32 percent (the total amount which was permitted as an expense for bad debts) or 40 percent (only a portion of the expense for bad debts). As has been explained earlier, the 32 percent total expense is comprised of the components of both Tax Law § 1453(h)(1) and § 1453(h)(2), whereas the 40 percent is ascertained from application of Tax Law § 1453(h)(2) only. By statute, the pre-1996 reserve account is increased annually pursuant to Tax Law former § 1453(h)(3)(C), which plainly states that the New York bad debt reserve account for losses on qualifying real property loans shall be increased by the amount of the New York bad debt deduction determined pursuant to paragraph (2) of Tax Law § 1453(h).[18] The Administrative Law Judge stated that the computation of the bad debt deduction would be the same (approximately 32 percent) under the pre-1996 law as it is under the post-1996 law if the provisions of pre-1996 section 1453(h)(1) were factored into the computation of the bad debt deduction along with section 1453(h)(2). That may be true but the statute does not provide that pre-1996 section 1453(h)(1) be "factored into the computation." The Legislature could have provided in former section 1453(h)(3)(C) that the bad debt reserve account for losses on qualifying real property loans shall be increased by the amount of the New York bad debt deduction determined pursuant to **both** paragraphs (1) and (2) of Tax Law § 1453(h). The fact that it did not do so is a strong indication to this Tribunal that the Legislature did not have that

[18]In the alternative, for taxpayer's using the experience method set forth in IRC § 494(b)(3), it can also be the amount of the addition to the bad debt reserve determined for Federal purposes under IRC § 593(b)(1)(B). This petitioner does not use the experience method.

intent. The Administrative Law Judge made much of the fact that the supporting memorandum for the 1996 amendments to the statute made the general statement that the amendments were revenue neutral as a justification for modifying the express terms of the statute. As noted earlier, such an inquiry into legislative intent only comes into play where the statute is vague or unclear as to its meaning (***Majewski v. Broadalbin-Perth Cent. School Dist.*, *supra***). The wording of pre-1996 Tax Law § 1453(h)(3)(C) is clear and unambiguous, and under these circumstances, it is the statute that must be given effect, not the supporting memorandum.

Petitioner seeks to construe the statute in such a way as to increase its bad debt deduction for amounts placed in its required bad debt reserve account. Petitioner's brief states that "the Legislature did not and could not have intended that bad debt reserves should be increased annually at higher levels than the annual bad debt deduction itself . . ." (Petitioner's brief in opposition, p. 2). A deduction has been found to be "functionally a particularized species of exemption from taxation . . . [a] taxpayer seeking a deduction must be able to point to an applicable statute and show that he comes within its terms" (***Matter of Grace v. New York State Tax Commn.***, 37 NY2d 193, 371 NYS2d 715, 719, ***lv denied*** 37 NY2d 708, 375 NYS2d 1027). As set forth above, Tax Law § 1453(h)(3) specifically requires that the pre-1996 annual adjustment to a taxpayer's bad debt reserve account balance is affected by only that calculation performed under Tax Law § 1453(h)(2). The Division interprets the statute such that pre-1996 Tax Law § 1453(h)(1) is a separate limitation from the amount calculated under pre-1996 Tax Law § 1453(h)(2), and that the calculations under each impacts ENI and the reserve for bad debt account balance separately and for differing amounts. We find that the Division's interpretation is reasonable and consistent with the statute as written.

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 Emigrant Bancorp, Inc. is denied; and

4. The Notice of Deficiency dated February 17, 2003, as adjusted, is sustained.

DATED: Troy, New York
July 19, 2007

/s/ Charles H. Nesbitt
Charles H. Nesbitt
President

/s/ Carroll R. Jenkins
Carroll R. Jenkins
Commissioner

/s/ Robert J. McDermott
Robert J. McDermott
Commissioner