STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
AMSTERDAM SAVINGS BANK	:	DETERMINATION DTA NO. 808445
for Redetermination of a Deficiency or for Refund of Franchise Tax on Banking Corporations under Article 32 of the Tax Law for the Year 1988.	:	

Petitioner, Amsterdam Savings Bank, 11 Division Street, Amsterdam, New York 12010, filed a petition for redetermination of a deficiency or for refund of franchise tax on banking corporations under Article 32 of the Tax Law for the year 1988.

A hearing was held before Robert F. Mulligan, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on May 15, 1991 at 9:30 A.M., with final briefs submitted on March 19, 1992. Petitioner appeared by KPMG Peat Marwick (Brian C. Flynn, C.P.A. and Daniel J. McCarty, C.P.A.). The Division of Taxation appeared by William F. Collins, Esq. (Kenneth J. Schultz, Esq., of counsel).

ISSUE

Whether petitioner may properly be required to add back to Federal taxable income 60% of a loss sustained on the sale of stock in a corporate subsidiary.

FINDINGS OF FACT

Petitioner, Amsterdam Savings Bank, provides commercial and retail banking services in the Albany area and west, to Syracuse, New York.

During 1988, petitioner owned three subsidiaries:

(a) F.H. Doherty Associates Inc. ("Doherty") of Syracuse, New York, the principal business activity of which was real estate;

(b) 19 Front Street, Inc., of Binghamton, New York, the principal business activity of which was real estate; and

(c) ASB Insurance Agency, Inc., of Amsterdam, New York, the principal business activity of which was brokerage.

Petitioner filed a Combined New York State Franchise Tax Return for Banking Corporations with its above-mentioned subsidiaries for 1988. On Schedule D of petitioner's United States Corporation Income Tax Return for said year, petitioner had deducted a long-term capital loss of $418,495.00 on the sale of its Doherty stock. The capital loss more than offset two long-term capital gains of $287,240.00 and $115,493.00 attributable to non-subsidiary investments, resulting in a net long-term capital loss of $15,762.00.

Upon audit, it was determined that petitioner was required to add back to Federal taxable income the loss incurred on the sale of the Doherty stock. The auditor explained the addback as follows:

> "Taxpayer sold stock of its subsidiary F.H. Doherty on 8/2/88. Taxpayer incurred a loss in the amount of ($418,495). NYS Tax Law Reg. [sic] Sec. 1453(e)(11)(2) requires that a loss on the sale of subsidiary stock must be added back to entire net income at a rate of 60% of the loss deducted on the Federal return.
>
> Loss on sale of F.H. Doherty (402733)
> 60% addback % 60%
> Subsidiary loss required to be added back ~~241640~~"[1]

On May 1, 1990, the Division of Taxation issued a Statement of Audit Adjustment and Notice of Deficiency to petitioner for 1988 asserting a deficiency of $12,329.00 in tax and $1,589.00 in interest, for a total of $13,918.00, based on the adjustment for the Doherty stock.[2] It is noted that the caption of the Notice of Deficiency states: "NOTICE OF DEFICIENCY - ARTICLE 9-A, TAX LAW". The Statement of Audit

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[1] Worksheet attached to Exhibit E, Field Audit Report.

[2] The tax was actually computed on a net increase to Federal taxable income of $136,985.00. This net increase was comprised of the $241,640.00 addback for the Doherty loss and $36,901.00 for nontaxable municipal interest required to be added back, less $141,556.00 for a special dividend deduction per the Federal return which was not required to be added back to income. The latter two items were not discussed at the hearing or addressed in the briefs.

Adjustment, however, does not refer to Article 9-A, but indicates that the applicable tax article is Article 32.

The 1988 Corporation Franchise Tax packet CT-32-P, containing the returns and instructions for Article 32 of the Tax Law, states the following with respect to dividend income, gains, or losses from subsidiary capital which are to be reported as subtractions on Line 41 of Form CT-32:

> "Attach a list showing the names of the subsidiaries and the amount of dividend income, gains and losses from each.... Deduct from subsidiary dividends any Section 78 dividends deducted at line 36 which are attributable to dividends from subsidiary capital. If losses from subsidiary capital exceed dividends and gains from subsidiary capital, the net loss is multiplied by 60% and the result is shown in brackets as a negative deduction."

CONCLUSIONS OF LAW

A. Tax Law § 1451(a) imposes a tax on every banking corporation for the privilege of exercising its franchise or doing business in New York in a corporate or organized capacity. The tax is to be computed under Tax Law § 1455.

B. Tax Law § 1455 provides that the tax imposed under Tax Law § 1451 is to be the greater of:

(a) a basic tax, calculated at 9% of a taxpayer's entire net income allocated to New York; or

(b) an alternative minimum tax, which itself is the greater of:

(i) a tax based on allocated assets;

(ii) a tax computed at 3% of allocated alternative entire net income; or

(iii) two hundred and fifty dollars.

In this case, petitioner computed its tax based on allocated combined entire net income (i.e., the basic tax). The deficiency issued by the Division of Taxation also utilized said method.

C. The term "entire net income" (except for certain corporations exempt from Federal

income tax or certain corporations organized outside the United States) means total net income from all sources. This income is to be the same as the taxable income which the taxpayer is required to report to the United States Department of the Treasury for purposes of the Federal income tax, with certain adjustments for items to either be added or subtracted from Federal taxable income (Tax Law § 1453[a]; 20 NYCRR 18-2.2).

D. Tax Law § 1453(b)(1) provides that except in cases of corporations organized under the laws of countries other than the United States, entire net income is to be computed without the deduction or exclusion of any part of any income from dividends or interest on any kind of stock, securities or indebtedness, except that for purposes of said provision there shall be excluded any amounts treated as dividends pursuant to section 78 of the Internal Revenue Code[3] and any amounts described in Tax Law § 1453(e)(11) and (12).

E. Tax Law § 1453(e)(11) and (12) provide as follows:

> "(e) There shall be allowed as a deduction in determining entire net income, to the extent not deductible in determining federal taxable income:
>
> * * *
>
> (11) (i) seventeen percent of interest income from subsidiary capital, and
>
> (ii) sixty percent of dividend income, gains and losses from subsidiary capital,
>
> (12) twenty-two and one-half percent of interest income on obligations of New York state, or of any political subdivision thereof, or of the United States, other than obligations held for resale in connection with regular trading activities...."

The regulations promulgated for Article 32 use similar language (20 NYCRR 18-2.4 [b][11], [12]).

F. Tax Law § 1450(e) defines the term "subsidiary capital", in pertinent part, as follows:

> "The term 'subsidiary capital' means investments in the stock of subsidiaries and any indebtedness from subsidiaries, exclusive of accounts receivable acquired in the ordinary course of trade or business for services rendered or for sales of property held primarily for sale to customers...."

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[3]Section 78 of the Internal Revenue Code, which is not pertinent here, applies to "Dividends Received from Certain Foreign Corporations by Domestic Corporations Choosing Foreign Tax Credit".

G. It is clear that the computation of petitioner's entire net income is to start with petitioner's Federal taxable income for 1988 (Tax Law § 1453[a][1]). Also, there is no question that income from dividends or interest on stock, securities or indebtedness is not to be deducted or excluded (Tax Law § 1453[b][1]). Where the parties disagree is with respect

to the interpretation of Tax Law § 1453 (e)(11)(ii), i.e., whether 60% of a loss from subsidiary capital must be added back.

H. The problem stems from the words "to the extent not deductible in determining federal taxable income" in Tax Law § 1453(e), as applied to a loss attributable to subsidiary capital. If petitioner had dividend income or gain from subsidiary capital which was not deductible in determining Federal taxable income, clearly 60% of such income or gain would be allowed as a deduction. However, since petitioner had a loss attributable to subsidiary capital and such loss was deductible in the calculation of Federal taxable income, a literal reading of Tax Law § 1453(e) and paragraph (11)(ii) thereof, raises a question as to what purpose, if any, is served by the term "losses" in said paragraph (11)(ii).

I. With respect to the construction of statutes, the primary consideration is to ascertain the intention of the Legislature.

> "In interpreting a statute, the intent of the legislature is the controlling or most important factor. Accordingly, the primary rule of construction of statutes is to ascertain and declare the intention of the legislature, and carry such intention into effect. The courts may not speculate as to the probable intent of the legislature." (97 NY Jur 2d, Statutes, § 101)

The first step in determining legislative intent is to examine the words and language used in the statute. If the language "is unambiguous and the words plain and clear, there is no occasion to resort to other means of interpretation." (McKinney's Cons Laws of NY, Book 1, Statutes § 92.) If, after a reading of the statute, its meaning is still not clear, the search for legislative intent must extend to the purpose of the enactment (id.).

Where the language of a statute is of doubtful or ambiguous import, resort may be had to legislative reports and recommendations leading to the enactment thereof (97 NY Jur 2d, Statutes § 161 et seq.). Subsequent legislative action is also entitled to great weight in determining what was intended by the earlier act (97 NY Jur 2d, Statutes, § 170). The interpretation accorded to the statute by the agency charged with its administration should also be considered (97 NY Jur 2d, Statutes, § 159).

J. Upon first reading, it would appear that there is at least a practical inconsistency between the phrase "to the extent not deductible in determining federal taxable income" in Tax Law § 1453(e) and the inclusion of the term "losses" in the phrase "sixty percent of dividend income, gains and losses from subsidiary capital" in paragraph (11)(ii) thereof. This is because such a loss would ordinarily have been deducted on the Federal return and the deduction of an additional 60% of such loss thus would not take place. Accordingly, this is a case where the purpose of the statutory enactment should be examined.

K. The Division of Taxation has correctly pointed out that one of the aims of the modifications included in the enactment of Tax Law § 1453 by Laws of 1972 (ch 167), was to prevent a taxpayer from reaping a double deduction.

> "The modifications are substantially the same as the variations from Federal law which existed under Articles 9-B and 9-C.[4] Provision is also made to prevent the double taxation and double deduction of items of income, gain or loss which were included in computing the tax under Article 9-B or 9-C and to allow certain deductions which might otherwise be denied in the transition to a tax computed on the basis of Federal taxable income under Article 32." (1972 NY Legis Ann, at 262.)

(It is noted from the foregoing that another aim of the modifications was to prevent double taxation.)

The significance of the phrase "to the extent not deductible in determining federal taxable

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[4] Articles 9-B and 9-C, applying to State and Federal financial institutions, respectively, were replaced by Article 32 effective January 1, 1973. (L 1972, ch 167, § 1.)

income" as a deterrent to double deductions is more readily apparent when viewed in the context of other section 1453(e) modifications, e.g., subdivisions (1) and (2), which provide deductions for interest and expenses attributable to income which is subject to tax under Article 32, but is exempt from Federal income tax. In Federal Insurance Company v. State Tax Commn. (146 AD2d 888, 536 NYS 2d 595), the Appellate Division, Third Department, observed that the aforementioned phrase had, in fact, been intended to prevent double deductions and held that an insurance corporation taxable under Article 33 was entitled to deduct investment expenses incurred in the production of Federally exempt interest income, although it had already deducted such expenses on its Federal return. The Court pointed out that Tax Law § 1503(b)(3) did not contain the limitation "to the extent not deductible in determining federal taxable income" which had been included in its Article 32 counterpart. As Article 32 predated Article 33 by two years, the Court reasoned that the Legislature had knowledge of the difference and had deliberately not included the limitation in Article 33. As a result of the Federal Insurance decision, Tax Law § 1503(b)(3) was amended by Laws of 1989 (ch 61, § 288), which limited the subtraction modifications by adding to the statute the words "to the extent not deductible in determining federal taxable income." The purpose of the amendment was clearly to "limit taxpayers to only one deduction." (Attachment 'O' to Assembly Bill 3608-A, Statement in Support, page 09, Governor's Bill Jacket, L 1989, ch 61.)

L. Tax Law § 1453(e)(11) was added by Laws of 1985 (ch 298, § 18). Review of the Governor's Bill Jacket material does not shed light on the purpose of this specific provision, but does explain the basis for the numerous changes made to Article 32 by chapter 298. The Memorandum in Support of the legislation stated, in pertinent part, as follows:

> "Purpose: The bill revises the franchise tax on banking corporations to make the tax analogous to the franchise tax on general business corporations." (Bill Jacket at page 000029)

The Statement in Support of the bill traced the changes in the banking industry since the enactment of Article 32 in 1972 and concluded:

> "In light of these developments, it is appropriate to tax banking corporations more like general business corporations and to cease treating

savings banks and savings and loan associations differently from commercial banks.

It should be noted that while the changes made by this bill will tax banking corporations in a manner similar to general business corporations in many respects, many differences remain between the taxation of these two types of corporations. This is appropriate because banking corporations are still subject to regulatory restrictions and are not yet indistinguishable from general business corporations." (Bill Jacket at page 000037).

Thus, while the Division of Taxation's reliance on the analogy between Article 32 and Article 9-A is well founded, it is noted that numerous differences remain and the analogy is not without exception.

M. In its Memorandum of Law dated August 8, 1991, petitioner points out the following:

"There are similarities in the taxation of banking corporations under Article 32 and general business corporations under Article 9-A, however, there are abundant important differences between the two tax law sections as well. For example, in computing entire net income Article 9-A provides for the following:

1. it excludes all income and expenses attributable to subsidiary capital,

2. it allows a fifty percent dividend deduction of dividends received from non-subsidiary corporations, and

3. it allows a net operating loss deduction.

There are no similar provisions contained in Article 32.

Also, in computing entire net income Article 32 provides for the following:

1. allows for the special bad debt deduction based upon forty percent of taxable income with certain modifications, and

2. it excludes twenty-two and one-half percent of interest income on obligations of New York State and the United States.

There are no similar provisions contained in Article 9-A."

It is also noted that Article 9-A provides for a tax on subsidiary capital, while Article 32 does not.

N. While the statutory language at issue is somewhat ambiguous, and it is possible that the Legislature had intended that 60% of losses attributable to subsidiary capital were to be

added back, the statute does not specifically so provide, and there is nothing in the legislative history to indicate that such action was to be implied. The Division of Taxation's main objections are readily disposed of: First, while the Legislature clearly intended to prevent double deductions, there was no second deduction here. The loss on subsidiary capital was deducted only in the calculation of petitioner's Federal taxable income. Secondly, while the intention of the Legislature in enacting Laws of 1985 (ch 298) was to tax banking corporations more like general business corporations, the legislative history shows that it was also understood that "many differences remain between the taxation of these two types of corporations". Some of these differences have been set forth in Conclusion of Law "M". It is noted that not only is the addback provision not specified in the Tax Law, it also does not appear in the regulations or even in the Division's Technical Services Bureau Memorandum TSB-M-85(16)C issued February 10, 1986. From the record herein, the addback is apparently found only in the instructions to Form CT-32 (Finding of Fact "6"), raising a question as to the Division's own interpretation of the provision. To assume that the Legislature had intended the addback of a loss on subsidiary capital would be "speculative and conjectural" (Federal Insurance Company v. State Tax Commn., 146 AD2d at 890, 536 NYS 2d at 597). Accordingly, there is no demonstrated legislative intent which would justify a deviation from the plain language of Tax Law § 1453(e)(11)(ii) and the addback may not be required by the Division of Taxation.

O. The petition of Amsterdam Savings Bank is granted and the Notice of Deficiency issued May 1, 1990 is cancelled.

DATED: Troy, New York
June 25, 1992

/s/ Robert F. Mulligan

ADMINISTRATIVE LAW JUDGE