

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition
of

EMPIRE MUTUAL INSURANCE COMPANY

DECISION

for Redetermination of a Deficiency or for
Refund of Corporation Franchise Tax under
Articles 27 and 33 of the Tax Law for the Years
1978 and 1980.

Petitioner, Empire Mutual Insurance Company, 122 Fifth Avenue, New York,
New York 10011, filed a petition for redetermination of a deficiency or for
refund of corporation franchise tax under Articles 27 and 33 **of** the Tax Law for
the years 1978 and 1980 (File Nos. 38226 and 50920).

A hearing was held before Arthur Bray, Hearing Officer, at the offices of
the State Tax Commission, Two World Trade Center, New York, New York, on
August 23, 1984 at 9:15 A.M., with all briefs to be submitted by June 10, 1985.
Petitioner appeared by Ernst & Whinney (Kenneth Zemsky, Esq., of counsel and
Pasquale Ciccodicola, C.P.A.). The Audit Division appeared by John P. Dugan,
Esq. (Paul Lefebvre, Esq., of counsel).

ISSUE

Whether petitioner was entitled to claim net operating loss carryforwards
to a particular year for New York State purposes which in their aggregate
amounts equaled the net operating losses claimed on the Federal return for the
same carryforward year, but which were comprised of different loss years for
New York State and Federal purposes.

FINDINGS OF FACT

1. On January 1, 1975, Security Mutual Insurance Company ("Security Mutual") merged with Empire Mutual Insurance Company ("Empire Mutual"). Empire Mutual was the surviving corporation.

2. For the year 1973, Empire Mutual reported a Federal net operating loss of \$1,068,732.00. For the same year, Security Mutual reported a Federal net operating loss of \$1,054,664.00. Since the New York State Franchise Tax on Insurance Corporations was not imposed until January 1, 1974, neither corporation had a New York State net operating loss for the year 1973.

3. For the year 1974, Empire Mutual reported a Federal net operating **loss** of \$7,024,583.00 and Security Mutual reported a Federal net operating loss of \$8,027,709.00. During the same period, Empire Mutual had a New York State net operating **loss** of \$1,725,112.00 and Security Mutual reported a New York State net operating loss of \$7,778,012.00.

4. In 1978, the post-merger Empire Mutual reported a net profit.

5. On its U.S. Mutual Insurance Company Income Tax Return for 1978, Empire Mutual claimed a net operating loss of \$6,028,264.00, which was comprised of the reported Federal net operating losses for the year 1973 of Empire Mutual of \$1,068,732.00 and of Security Mutual of \$1,054,664.00; and the amount of \$3,904,868.00, which petitioner's representative explained, was from the combined losses of Empire Mutual and Security Mutual for 1974.

6. On its 1978 State of New York Franchise Tax Return for Insurance Corporations, petitioner claimed the same amount of net operating loss, \$6,028,264.00, based upon losses carried forward from the year 1974.

7. On its U.S. Mutual Insurance Company Income Tax Return for 1980, petitioner utilized a 1975 net operating loss carry forward from the year 1974.

taxable income to zero. However, on its State of New York Franchise Tax Return for Insurance Corporations for the same period, petitioner reported net operating loss carryforwards arising from net operating losses incurred during the years 1975 and 1976. The total amount of the New York State net operating losses utilized on its 1980 New York State return did not exceed the total amount of net operating losses utilized for Federal purposes.

8. On February 26, 1982, the Audit Division issued a Notice of Deficiency to Empire Mutual Insurance Company asserting a deficiency of corporation franchise tax for the period ended December 31, 1978 in the amount of \$692,859.00, plus interest of \$205,883.00, for a total of \$898,742.00. The Statement of Audit Adjustment which accompanied the Notice of Deficiency stated that:

"A New York net operating **loss** deduction must be applied in the same manner as for federal tax purposes. Since only \$1,725,112 of the federal net operating loss was applied from 1974, the balance being carried forward from periods prior to 1974, the New York net operating loss deduction is limited to that amount."

9. After the hearing, the Audit Division acknowledged that it erroneously concluded that only \$1,725,112.00 of the \$6,028,264.00 Federal net operating loss deduction taken by petitioner in 1978 was allowable **as** 1974 losses. In fact, \$2,123,396.00 represented the net operating loss carryforward from the year 1973 and \$3,904,868.00 represented the net operating loss carryforward from the year 1974. Therefore, the Audit Division has requested that the Notice of Deficiency be revised to reflect a tax due of \$603,511.00 for the year 1978 based upon an allowed net operating loss carryforward of \$3,904,868.00.

10. On December 7, 1983, the Audit Division issued a Statement of Audit Adjustment to petitioner explaining that petitioner had a deficiency of franchise tax for the period ended December 31, 1980 in the amount of \$677,227.00, plus interest of \$272,956.00 for a total of \$950,183.00.

Audit Adjustment explained that since petitioner utilized only its net operating loss carryforward from the period ended December 31, 1975 for Federal purposes, only the New York net operating **loss** from the period ended December 31, 1975 may be carried forward to reduce New York entire net income in 1980. After the modifications required by Article **33** of the Tax Law, the net operating loss permitted was \$6,439,461.00.

11. Following the issuance of the Statement of Audit Adjustment for the year 1980, petitioner advised the Audit Division, by letter dated February 1, 1984, that its computation was in error and that the amount which should have been assessed by the Audit Division was \$547,171.00. Petitioner also stated in this letter that it agreed that tax **of** \$373,469.00 was due. In conjunction with this letter, petitioner enclosed payment of \$697,780.00, representing tax of \$547,171.00 and interest of \$150,609.00. The Audit Division has accepted petitioner's computation of tax.

12. Petitioner's letter of February 28, 1984 has been accepted as a claim for refund **of** \$173,702.00 based upon the \$547,171.00 which should have been asserted by the Audit Division and the agreed upon amount of \$373,469.00.

CONCLUSIONS OF LAW

A. That for taxable years commencing before January 1, 1974, insurance corporations such **as** petitioner were subject to the tax imposed by section 187 of Article 9 of the Tax Law. The tax was measured by the insurance corporation's premiums written **on** risks located or resident **in** this state.

B. That for taxable years commencing on or after January 1, 1974, insurance corporations are subject to franchise taxes imposed by Article 33 **of** the Tax Law.

C. That section 1503 sets forth the rules by which entire net income is calculated. A net operating loss deduction is permitted by paragraph (4) of subdivision (b) as follows:

"Any 'net operating loss deduction'...allowable under section... one hundred seventy-two...of the internal revenue code...which is allowable to the taxpayer for federal income tax purposes:

- (A) shall be adjusted to reflect the modifications required by the other paragraphs of this subdivision;
- (B) shall not, however, exceed any such deduction allowable to the taxpayer for the taxable year for federal income tax purposes; and
- (C) shall not include any such loss incurred in a taxable year beginning prior to January first, nineteen hundred seventy four or during any taxable year in which the taxpayer was not subject to the tax imposed under section fifteen hundred one."

D. That in view of Finding of Fact "9", petitioner has been allowed to carry forward from the year 1974 a net operating loss deduction equal to the full amount of the federal net operating loss deduction arising from the year 1974.

E. That section 1503(b)(4) of Article 33 of the Tax Law and section 208.9(f) of Article 9-A of the Tax Law, which allow corporate taxpayers subject to taxation under the respective articles' net operating loss deductions, are substantially similar and are to be construed in a like manner (L. 1974, Ch. 649, section 12).

F. That in Matter of Employers' Fire Insurance Company, State Tax Commission, April 3, 1981, determination confirmed, Matter of The Employers' Fire Insurance Company v. State Tax Comm., Cal. No. 3 (Sup. Ct., Albany Co., November 12, 1981), the Commission noted, with regard to Tax Law sections 1503(b)(4) and 208.9(f):

"That the allowance, by the aforementioned statutes, of net operating loss carryback and carryforward is intended to conform New

and those with fluctuating incomes. See Telmar Communications Corp. v. Procaccino, 48 A.D.2d 189 (3d Dept. 1975); American Can Co. v. State Tax Commission, 37 A.D.2d 649 (3d Dept. 1971); Governor's Memorandum, N.Y.S. Legislative Annual 1961, 461; Dept. of Taxation and Finance Memorandum to the Governor, S. Int. No. 2842, Pr. No. 4441, April 6, 1961 (L. 1961, Ch. 713 Bill Jacket)."

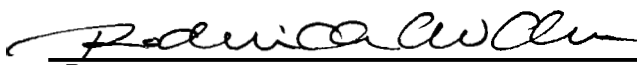
G. That in view of the foregoing policy, it is clear that "[t]here can be no carryforward of a net operating loss to years in which there was no Federal net operating **loss** carryforward stemming from the same loss." (Matter of Employer Fire Insurance Company, supra at State Tax Commission, April 3, 1981; ~~see also~~ Matter of American Employers' Insurance Company v. State Tax Comm., Cal. No. 10 (SUP. Co., Albany County, October 29, 1984). Accordingly, the Audit Division properly limited the amount of the net operating loss carryforward to 1978 to the amount of the 1974 net operating loss utilized on its Federal return in 1978. Similarly, The Audit Division properly disallowed the net operating loss carryforward to 1980 from the year 1976 since there was no corresponding Federal net operating loss carryforward from 1976 to 1980.


H. That the petition of Empire Mutual Insurance Company is denied and the Notice of Deficiency issued February 26, 1982, as modified by Finding of Fact "9", is sustained; the claim for refund, per Finding of Fact "12", is denied.


DATED: Albany, New York

STATE TAX COMMISSION

JAN 17 1980


PRESIDENT


COMMISSIONER


COMMISSIONER