

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition

of

FEDERAL INSURANCE CO.

DECISION

for Redetermination of a Deficiency or for
Refund of Corporation Tax under Article 33
of the Tax Law for the Year 1979.

Petitioner, Federal Insurance Co., 51 John F. Kennedy Parkway, Short Hills, New Jersey 07478, filed a petition for redetermination of a deficiency or for refund of corporation tax under Article 33 of the Tax Law for the year 1979 (File No. 51730).

On March 26, 1986, petitioner, by its duly authorized representatives, Everett, Johnson & Breckinridge, Esqs. (Eugene Chester, Esq., of counsel), waived a hearing and submitted its case for decision based upon the entire file, including a stipulation of facts, and briefs to be filed by April 15, 1986. After due consideration of the file the Commission renders the following decision.

ISSUE

Whether in computing its entire net income for 1979, petitioner may properly deduct \$599,371.00 representing investment expenses incurred in earning federally tax-exempt income.

FINDINGS OF FACT

1. Petitioner, Federal Insurance Company ("Federal"), is an insurance corporation organized under the laws of the State of New Jersey. Federal is engaged in the insurance business in New York State as a property and casualty insurer.

2. Federal timely filed a New York State franchise tax return under Article 33 (Form CT-33) for the taxable year 1979.

3. Federal is a member of an affiliated group of corporations whose parent is The Chubb Corporation, and Federal's income and deductions are included in the consolidated federal income tax return filed by The Chubb Corporation. For purposes of Tax Law Article 33, Federal's income and deductions were computed as if it were filing on a separate basis for federal income tax purposes.

4. In computing its entire net income for the year 1979, Federal deducted \$599,371.00 representing investment expenses incurred on federally tax-exempt income (~~see~~ Finding of Fact "10", infra.).

5. On August 16, 1982, the Audit Division issued to Federal a "Statement of Audit Adjustment" which increased the amount of tax-exempt interest included in Federal's entire net income by \$599,371.00. In turn, Federal's franchise tax liability for 1979 was increased by \$11,555.00.

6. On August 16, 1982, the Audit Division issued to Federal a Notice of Deficiency asserting tax due in the amount of \$11,555.00, plus interest of \$1,102.31. Such amounts were, however, offset by other adjustments and by a credit due Federal for its 1980 taxable year.

7. The adjustment of \$599,371.00 eliminated petitioner's claimed deduction for expenses attributable to income subject to tax under Article 33 but exempt from federal income tax. The Audit Division's disallowance is based on the assertion that the same expenses had already been deducted for federal income tax purposes, and, therefore, could not be deducted again under Article 33.

8. This identical issue, regarding the deduction of certain investment expenses, had been raised previously upon audit of Federal's 1977 and 1978 New

York State Franchise Tax Returns under Article 33. For both 1977 and 1978, this issue was resolved in favor of Federal at a pre-hearing conference held on November 19, 1981.

9. On September 29, 1983, Federal filed a claim for refund (Form CT-8), requesting a refund of \$11,555.00 in tax and \$1,102.00 in interest. This claim was denied by the Audit Division in a letter dated February 3, 1984.

10. The parties have, by a duly executed stipulation, agreed that the \$599,371.00 which petitioner deducted in computing its entire net income for the calendar year 1979 represented the investment expense petitioner incurred which was allocable to interest wholly exempt from tax under the Internal Revenue Code.

11. In effect, the Audit Division has increased petitioner's tax exempt interest amount for 1979 from \$25,828,314.00 to \$26,427,685.00, by adding back \$599,371.00 of investment expenses attributable to such tax exempt interest. Petitioner admits that such investment expenses were deducted in arriving at Federal taxable income, but maintains that such expenses are properly again deductible in computing entire net income under Tax Law Article 33.

CONCLUSIONS OF LAW

A. That Tax Law Article 33 provides for a franchise tax upon insurance corporations, such as petitioner, based upon a portion of their "entire net income". Tax Law Section 1503(a) defines "entire net income" as

"total net income from all sources which **shall** be presumably the same as the ... taxable income ... which the taxpayer is required to report to the United States treasury department, for the taxable year ... except as hereinafter provided."

B. That Tax Law section 1503(b) sets forth various modifications required to be made to convert federal "taxable income" (as above) to "entire net

its federal taxable income all of the tax exempt interest it earned and excluded from federal taxable income. Tax Law Section 1503(b)(3) in turn provides, in part, as follows:

"In determining entire net income, there shall be subtracted interest on indebtedness incurred or continued to purchase or carry obligations or securities the income from which is subject to tax under this article but exempt from federal income tax and ordinary and necessary expenses paid or incurred during the taxable year attributable to income which is subject to tax under this article but exempt from federal income tax...", (Emphasis added.)

The evident purpose *of* the quoted paragraph is to permit the deduction of expenses associated with income taxable under Article 33, where the income is exempt from federal taxation and the associated expenses accordingly disallowed.

C. That in computing federal taxable income petitioner properly deducted from its gross income the (tax exempt) interest income it earned from the **sources specified in Internal Revenue Code ("I.R.C.") section 103 (I.R.C. § 832[c][7])**. In addition, petitioner properly deducted as ordinary and necessary expenses those investment expenses attributable to the above tax exempt interest income (I.R.C. §§ 832[c], 265[1]).¹ Thus, in sum, petitioner's federal taxable income as properly reported to New York State (Form CT-33, Schedule B, line 23) did not include any tax exempt interest income earned by petitioner and did include a deduction for \$599,371.00 representing investment expense incurred by petitioner in connection with such tax exempt interest income.

1 I.R.C. § 265(1) bars deduction of expenses allocable to tax exempt income, ~~except~~ tax exempt interest income against which expenses are deductible ~~except~~ I.R.C. § 212 expenses), **Also**, I.R.C. § 265(2) bars deduction of interest expense on borrowings incurred or continued to earn tax exempt interest income. Petitioner had, in any event, no interest expense on


D. That in computing entire net income, petitioner **was** not entitled to again deduct the investment expenses related to tax exempt interest. "[T]ax deductions and exemptions depend upon clear statutory provisions and the burden is on the taxpayer to establish a right to them (citation omitted)." (Matter of Scholastic Bus Service, Inc. v. State Tax Comm., 498 N.Y.S.2d 278, 280 [3rd Dept., 1986].) Here petitioner failed to establish its right to a double deduction.

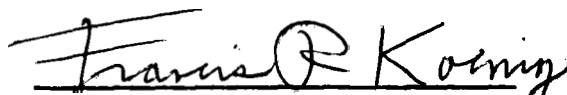
E. That the petition of Federal Insurance Co. is hereby denied.


DATED: Albany, New York

STATE TAX COMMISSION

OCT 15 1986


PRESIDENT


COMMISSIONER


COMMISSIONER