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BUREAU OF LAW
MEMORANDUM

TO: Commissioners Murphy, Macduff and Conlon

FROM: E. H. Best, Counsel

SUBJECT: Application of General Instrument Corporation for Revision of Franchise Tax under Article 9A of the Tax Law for the Fiscal Period ended February 28, 1961.

The file was submitted to the Law Bureau for an opinion as to the proper recomputation of entire net income where a net operating loss was carried back to a period other than a period covered by the Federal return.

Taxpayer, a New Jersey corporation, began business in New York on September 1, 1960, and filed a franchise tax report for the period from September 1, 1960 through February 28, 1961, reporting its entire net income for the fiscal year ended February 28, 1961 as returned to the U. S. Treasury Department, computing a business allocation percentage of 12.3276% on an annual basis. Thereafter, the business allocation percentage was recomputed at 19.1963% to reflect wage, receipts and property factors for the six-month period during which the taxpayer was doing business in New York, and net income pro-rated for six months. A tax of $33,907.73 was paid.

For the fiscal year ended February 28, 1963, the taxpayer sustained a net operating loss, as returned to the U. S. Treasury Department, of $6,459,150.36 of which $2,187,435.19 was allowed as a carryback to the fiscal year ended February 28, 1961, the balance having been applied by the taxpayer to a former year. This carryback resulted in a reduction of income for the fiscal year ended February 28, 1961 from $6,063,322.25 to $3,875,887.06 and a pro-rata reduction of net income from $3,031,661.13 to $1,937,943.53. The original New York base of $581,966.76 was, as a result, reduced to $372,013.45 and the tax originally computed at $33,907.73 was recomputed at $22,360.30.

Taxpayer filed an application for revision or refund contending that the entire net operating loss as reported to the U. S. Treasury Department should be carried back and be deducted from the pro-rated income of the taxpayer, and not from the entire annual income. This would result in a tax of $10,274.81. Taxpayer

concedes that the tax has been restated in accord with the requirements of Section 208.9(g) of the Tax Law, as it then existed, but argues that such restatement does not properly reflect the taxpayer's income, and that the Tax Commission should exercise its discretion to determine the net income solely on the basis of the income during the period covered by the report, as permitted by the statute. Taxpayer does not dispute the propriety of pro-rating its total annual income to arrive at its entire net income in New York for the six-month period covered by the return, but claims that the total annual net operating loss should not be pro-rated. Taxpayer interprets the statute as permitting the full deduction of the net operating loss carryback from pro-rated annual income in order to arrive at correct entire net income for the six-month period covered by the report.

Section 208.9(g), as it then existed, required that where reports were filed for periods different from the periods covered by Federal reports, entire net income was to be determined as a fraction of Federal taxable income, of which fraction the numerator is the number of calendar months or major parts thereof covered by the New York report and the denominator the number of calendar months or major parts thereof covered by the Federal return. Section 208.9 defines "entire net income" as presumably the same as the "entire taxable income" reported or required to be reported to the U. S. Treasury Department, prior to State modifications set forth in the Tax Law. "Taxable income" as defined by Section 63(a) of the Internal Revenue Code "means gross income minus the deductions allowed by this chapter * * * ." One of the deductions allowed, at Section 172, is the net operating loss deduction. Section 208.9(g) also contained the following:

> "* * * If it shall appear that such method of determining entire net income does not properly reflect the taxpayer's income during the period covered by the report under this article, the Tax Commission shall be authorized in its discretion to determine such entire net income solely on the basis of the taxpayer's income during the period covered by its report under this article."

The portion of entire net income to be allocated to the State is determined pursuant to Section 210.3 of the Tax Law, and the Tax Commission is authorized, by Section 210.8, to exercise its discretion in adjusting the allocation by a method calculated to effect a fair and proper allocation where a statutory allocation does not properly reflect the activity, business, income or capital of the taxpayer.

The issue raised by this application is whether a net operating loss carryback deduction is to be treated differently from other deductions in computing Federal taxable income and entire net income pro-rated under Section 208.9(g). The taxpayer contends that the Tax Commission is required to allow a discretionary deduction, in full, of a net operating loss carryback, from entire net income computed pro-rata, and not in conformity with taxpayer's return to the U. S. Treasury Department.

In the Matter of Diversified Stores Corporation (see opinion of Commissioner Clark dated December 14, 1959) a request was made by the taxpayer that the Tax Commission exercise its discretion and use the taxpayer's internal accounting method to compute entire net income. Diversified sold, for cash, in January, 1959, rents receivable over a period of two years in the future, for the purpose of obtaining the maximum benefit of a Federal tax loss carryback which expired on January 31, 1959. The sale resulted in increasing the taxpayer's income for 1959 by $2,742,000. In the absence of a similar New York loss carryover, the taxpayer asked that the income from the sale of the rents be reflected as being received in the months earned, rather than in the month actually received as reported on the Federal return, claiming that such adjustment would properly match income and expenses. Commissioner Clark pointed out that such claim was not of the type that called for the Tax Commission to deviate from the statute under its discretionary powers, and should be disallowed.

The July 21, 1965 Ruling of the State Tax Commission dealing with computation of net operating loss deduction of a corporation which is part of a consolidated group for Federal income tax purposes but reports separately for New York State franchise tax purposes, requires, under such circumstances, that entire net income shall be construed to be the taxable income the taxpayer would have been required to report for Federal purposes if it were reporting separately, and contains the following final paragraph:

> "In view of the similarity between the language of the first paragraph of subdivision 9 in respect to the computation of entire net income and paragraph (f) of subdivision 9 of section 208, which provides for the net operating loss deduction, both provisions should be construed in the same manner. Thus, where a corporation reports as part of a consolidated group for federal income tax purposes but on a separate basis for New York franchise tax purposes, its net operating loss and its net operating loss deduction under article 9-A of the tax law shall be computed as if the corporation were filing on a separate basis for federal purposes."

The purpose of the provision of Section 209(f) allowing carryover of net operating losses as enacted by Chapter 713 of the Laws of 1961 was, as set forth in the legislative memorandum, to conform New York to Federal Law in granting relief to business corporations which have cyclical fluctuations in earnings, and are required to pay relatively high taxes in good years without receiving credit for losses in bad years.

The exercise of discretion requested in this application would require the Tax Commission to redetermine, year after year, whether the computation of a taxpayer's entire net income properly reflects the income for the period covered by the return, for as long as a right to a loss carryover existed, and if logically extended to Section 210.8, require further continuous recomputation of business allocation percentage not presently permitted under Section 212.2. In addition, the concept of Federal conformity would be eroded, being applied only at the option of the taxpayer. It is necessary, as well, to consider the purpose of permitting net operating loss carryover expressly enacted as a remedial device for allowing credit for bad years in which losses are sustained against good years in which high taxes are paid. In conformity with the July 21, 1965 Ruling of the Tax Commission, the entire net income and the net operating loss deduction were here computed in the same manner, and both pro-rated, for the six-month period covered by the return. To grant taxpayer's application would result in an allowance of the loss deduction for a six-month period prior to the time the taxpayer engaged in business within the state, and during which time the taxpayer earned income neither allocable nor taxable to New York. It was the intention of the Legislature to grant relief to business for loss periods in the form of credits in high tax periods, but it does not appear that it was ever intended to make gifts to taxpayers for taxes paid to other jurisdictions for periods during which no taxes were paid to New York.

The discretion vested in the Tax Commission to determine entire net income where the statutory method does not properly reflect the taxpayer's income during the period covered by the report should not be invoked merely because the taxpayer wishes to maximize a tax benefit derived from its application of a carryback on its Federal return. There is no unusual aspect or unique factual circumstance as existed in People ex rel. Sheraton v. Tax Commission, 15 App. Div. 2d 142, aff'd 13 N.Y. 2d 802, to warrant special treatment. The net operating loss deduction of this taxpayer was properly deducted from Federal gross income, prior to any pro-rata adjustment, in arriving at entire net income. The taxpayer has not objected to pro-rating of its Federal taxable income in determining its entire net income, nor is there any evidence that a discretionary determination based on the taxpayer's

actual income during the six-month period only would be of any benefit to it. In fact, the exercise of such discretion could conceivably result in a determination adverse to the taxpayer, imposing a higher tax.

Accordingly, I am of the opinion that the net operating loss deduction reported by the taxpayer to the U. S. Treasury Department for a period other than the period covered by the report is an integral element of taxpayer's entire net income; that such net operating loss deduction is properly determined in the same manner as entire net income pursuant to Section 208.9(g), and that such determination of entire net income and net operating loss deduction pursuant to Section 208.9(g) properly reflects the taxpayer's income for the period covered by the report. The proposed determination is approved.

/s/ E. H. BEST
Counsel

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July 20, 1967

7-20-67

STATE OF NEW YORK

THE STATE TAX COMMISSION

In the Matter of the Application	:
of	:
GENERAL INSTRUMENT CORPORATION	:
For revision of franchise tax under Article 9A of the Tax Law for the fiscal year ended February 28, 1961.	:

General Instrument Corporation, the taxpayer herein, having filed application for revision or refund of franchise tax under Article 9A of the Tax Law for the fiscal year ended February 28, 1961, and a hearing having been held in connection therewith at the office of the State Tax Commission in New York City, on October 21, 1965, before William F. Sullivan, Senior Tax Administrative Supervisor of the Corporation Tax Bureau of the Department of Taxation and Finance, at which hearing William C. O'Malley, C.P.A., appeared personally and testified, and the record having been duly examined and considered by the State Tax Commission,

It is hereby found:

(1) That the taxpayer was incorporated under the laws of New Jersey on or about March 1, 1937 and began business in New York State on September 1, 1960;

(2) That for the purpose of doing business in New York State a tax is imposed on foreign corporations on all or any part of each of its fiscal years; that the

first tax imposed against the taxpayer was for the period September 1, 1960 through February 28, 1961; that under Section 210, paragraph three, of the Tax Law the three factors of the business allocation percentage are determined by the period covered by the report; that the taxpayer properly reported the entire taxable net income of $5,982,403.40 which it was required to report to the United States Treasury Department; that after the adjustments required by paragraphs (a) and (b) of Section 208.9 of the Tax Law were made, the entire net income was increased to $6,063,322.25 and was then pro-rated on a 6/12ths basis as required by Section 208.9(g) of the Tax Law; that the business allocation was originally reported on the basis of the full fiscal year; that after correspondence an amended CT3-1 was filed to cover the six-month period covered by the report from September 1, 1960 to February 28, 1961;

(3) That the taxpayer sustained a Federal net operating loss in the fiscal year ended February 28, 1963 of $6,459,150.36, of which $2,187,435.19 was allowed as a carryback loss to the period ended February 28, 1961 under the provisions of Section 208.9(f) of the Tax Law, resulting in the following correction in tax:

Period September 1, 1960 to February 28, 1961

Original Income	$6,063,322.25
Less Net Operating Loss Deduction	2,187,435.19
	$3,875,887.06
Pro-rated 6/12ths	1,937,943.53
Corrected Income	$1,937,943.53
Business Allocation	19.1963%
New York Base	372,013.45
Tax at 5½%	20,460.74
Subsidiary Capital Tax	1,899.56
Total Tax	$ 22,360.30

(4) That the tax was reaudited and restated on February 12, 1965, and application for revision or refund was filed on November 15, 1965;

(5) That Section 208.9(g) of the Tax Law (prior to the 1965 amendment) read as follows:

> "(g) If the period covered by a report under this article is other than the period covered by the report to the United States treasury department, entire net income shall be determined by multiplying the taxable income reported to such department (as adjusted pursuant to the provisions of this article) by the number of calendar months or major parts thereof covered by the report under this article and dividing by the number of calendar months or major parts thereof covered by the report to such department. If it shall appear that such method of determining entire net income does not properly reflect the taxpayer's income during the period covered by the report under this article, the tax commission shall be authorized in its discretion to determine such entire net income solely on the basis of the taxpayer's income during the period covered by its report under this article."

Upon the foregoing findings and upon all the evidence presented, it is hereby

DETERMINED:

(A) That the method of determining entire net income prescribed in the first sentence of Section

208.9(g) of the Tax Law does properly reflect the taxpayer's income during the period covered by the report;

(B) That the tax for the period ended February 28, 1961 is affirmed as corrected in (3) above;

(C) That the franchise tax as corrected does not include any tax or other charges which are not legally due.

Dated: Albany, New York

this 16th day of August 1967.

THE STATE TAX COMMISSION

/s/ JOSEPH H. MURPHY
COMMISSIONER

/s/ JAMES R. MACDUFF
COMMISSIONER

/s/ WALTER MACLYN CONLON
COMMISSIONER