

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of

Anchor Savings Bank FSB : AFFIDAVIT OF MAILING

for Redetermination of a Deficiency or Revision :
of a Determination or Refund of Corporation :
Franchise Tax under Article 32 of the Tax Law for :
the Year 1979. _____

State of New York }

ss.:

County of Albany }

David Parchuck, being duly sworn, deposes and says that he is an employee of the State Tax Commission, that he is over 18 years of age, and that on the 9th day of August, 1984, he served the within notice of Decision by certified mail upon Anchor Savings Bank FSB, the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

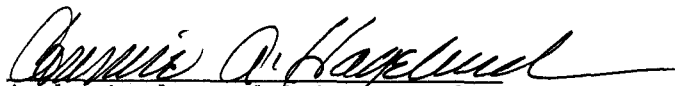
Anchor Savings Bank FSB
5323 Fifth Ave.
Brooklyn, NY 11201

and by depositing same enclosed in a postpaid properly addressed wrapper in a post office under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the petitioner herein and that the address set forth on said wrapper is the last known address of the petitioner.

Sworn to before me this
9th day of August, 1984.





Authorized to administer oaths
pursuant to Tax Law section 174

STATE OF NEW YORK
STATE TAX COMMISSION
ALBANY, NEW YORK 12227

August 9, 1984

Anchor Savings Bank FSB
5323 Fifth Ave.
Brooklyn, NY 11201

Gentlemen:

Please take notice of the Decision of the State Tax Commission enclosed herewith.

You have now exhausted your right of review at the administrative level. Pursuant to section(s) 1090 & 1468 of the Tax Law, a proceeding in court to review an adverse decision by the State Tax Commission may be instituted only under Article 78 of the Civil Practice Law and Rules, and must be commenced in the Supreme Court of the State of New York, Albany County, within 4 months from the date of this notice.

Inquiries concerning the computation of tax due or refund allowed in accordance with this decision may be addressed to:

NYS Dept. Taxation and Finance
Law Bureau - Litigation Unit
Building #9, State Campus
Albany, New York 12227
Phone # (518) 457-2070

Very truly yours,

STATE TAX COMMISSION

cc: Petitioner's Representative
Rand D. Johnson
Cullen & Dykman
177 Montague St.
Brooklyn, NY 11201
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition
of
ANCHOR SAVINGS BANK, FSB
for Redetermination of a Deficiency or for
Refund of Corporation Franchise Tax under
Article 32 of the Tax Law for the Year 1979.

DECISION

Petitioner, Anchor Savings Bank, FSB, 5323 Fifth Avenue, Brooklyn, New York 11201, filed a petition for redetermination of a deficiency or for refund of corporation franchise tax under Article 32 of the Tax Law for the year 1979 (File No. 42083).

On February 9, 1984, petitioner, by Cullen and Dykman, Esqs. (Rand D. Johnson, Esq., of counsel), filed a waiver of formal hearing and requested that this matter be decided by the State Tax Commission on the basis of the existing record with all briefs to be submitted by March 8, 1984. After due consideration, the Tax Commission renders the following decision.

ISSUE

Whether interest income from tax-exempt bonds must be included in entire net income for purposes of determining corporation franchise tax pursuant to section 1453(b)(1) of the Tax Law.

FINDINGS OF FACT

1. On June 3, 1982, the Audit Division issued a Notice and Demand for Payment of Corporation Tax Due against petitioner, Anchor Savings Bank, FSB in the amount of \$244,198.87, plus interest of \$66,811.54, for a total due of \$311,010.41 for the taxable year ended December 31, 1979. A Statement of Audit Adjustment issued February 25, 1982 explained that, under section 1453(b)(1) of

the Tax Law, any income from interest or dividends must be included in computing entire net income. The statement further explained that tax-exempt interest was includible in entire net income because "Article 32 is a franchise tax rather than a tax on income".

2. Petitioner paid the tax under protest by check dated June 14, 1982 in the amount of \$311,010.41. On or about August 11, 1982, petitioner filed a Claim for Credit or Refund of Corporation Tax Paid in the amount of \$324,409.51 plus interest from date of payment.¹ The Audit Division denied petitioner's claim by letter dated September 23, 1982.

3. Petitioner is a banking corporation subject to the tax imposed by Article 32 of the Tax Law. Petitioner received interest income during its tax year ended December 31, 1979 in the amount of \$2,146,649.73 from several different issues of New York State Housing Finance Agency bonds ("HFA bonds") and bonds issued by various municipal housing authorities pursuant to Article 3 of the Public Housing Law ("MHA bonds"). Petitioner's interest income was comprised of \$1,389,554.13 from HFA bonds and \$757,095.60 from MHA bonds. Petitioner did not include such income in its entire net income for purposes of calculating the tax due under Article 32 of the Tax Law.

4. In failing to include the aforesaid interest income in its entire net income, petitioner relied on provisions of the Private Housing Finance Law and the Public Housing Law. Section 54 of the Private Housing Finance Law provides, in part, that "...the notes and bonds of the [Housing Finance Agency], issued

¹ Petitioner erroneously overstated the amount of tax and interest it had actually paid in computing its refund claim. Petitioner reported \$1,264,381.32 in tax on its return and paid tax of \$244,198.87, plus interest of \$66,811.54, by its June 14, 1982 check for a total of \$1,575,391.73 rather than the \$1,588,790.83 as claimed. The difference is a \$13,399.10 credit by which the Audit Division had reduced the original deficiency and which petitioner mistakenly presumed it had paid.

pursuant to this article and the income therefrom...shall at all times be free from taxation, except for estate and gift taxes and taxes on transfers".

Section 52.2 of the Public Housing Law provides that bonds, mortgages, notes and other obligations of an authority, together with interest thereon, shall be exempt from tax.

5. The Audit Division's position is that Article 32 imposes a franchise tax which taxes the privilege of doing business, which privilege uses income as a measure of the value of the privilege; therefore, the income itself is not subject to direct taxation.

6. Petitioner argues that there is no merit to the argument that there is a distinction between direct and indirect taxes. The exemptions apply equally to direct and indirect taxes, petitioner maintains, and such an interpretation is consistent with trends in Federal and state courts. Petitioner also points out that section 61 of the Private Housing Finance Law provides, "[i]nsofar as the provisions of this article are inconsistent with the provisions of any other law, general, special or local, the provisions of this article shall be controlling". Petitioner argues, therefore, that any conflict between Article 32 and the Private Housing Finance Law must be resolved in favor of the latter.

CONCLUSIONS OF LAW

A. That section 1451(a) of the Tax Law imposes a tax on banking corporations for the privilege of doing business or exercising the corporate franchise for the taxable year. The basic tax is measured by the taxpayer's entire net income; however, an alternative tax based on interest and dividends credited to depositors or shareholders in the case of savings banks or based on issued capital stock in the case of other financial companies is imposed if a greater tax results (Tax Law §1455).

B. That section 1453(a) provides that entire net income means entire Federal taxable income for the taxable year with certain exceptions. Entire net income is computed without the deduction or exclusion of "any part of any income from dividends or interest on any kind of stock, securities or indebtedness" other than amounts treated as dividends pursuant to section 78 of the Internal Revenue Code (Tax Law §1453(b)(1)).

C. That the United States Supreme Court "has consistently upheld franchise taxes measured by a yardstick which includes tax-exempt income or property, even though a part of the economic impact of the tax may be said to bear indirectly upon such income or property" (Werner Machine Co. v. Director of Division of Taxation, 350 U.S. 492, 494. See also Pacific Company, Ltd. v. Johnson, 285 U.S. 480). In Werner, supra, the Court was interpreting 31 U.S.C. §742 which, until 1959, provided that "[a]ll stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority". Such language is similar to that contained in section 54 of the Private Housing Finance Law and section 52.2 of the Public Housing Law.

In 1959, Congress amended 31 U.S.C. §742 by adding a second sentence which provides that "[t]his exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly in the computation of the tax", with exceptions for nondiscriminatory franchise taxes or other nonproperty taxes, and for estate or inheritance taxes. The Supreme Court, in interpreting the revised version of 31 U.S.C. §742, has held that a state property tax on bank shares, computed on the basis of the bank's net assets without any deduction for tax-exempt United States obligations held by the bank, violated revised 31

U.S.C. §742 (American Bank & Trust Company v. Dallas County, ___ U.S. ___, 77 L.Ed.2d 1072). In similar fashion, the Supreme Court of Montana found that that state's corporation license tax, which required inclusion of tax-exempt interest income from Federal obligations, was in violation of 31 U.S.C §742 (First Federal Savings and Loan Association v. Department of Revenue, 654 P.2d 496 [Sup. Ct. Montana], cert. denied, ___ U.S. ___, 77 L.Ed.2d 1378; accord, Federal Products Corp. v. Norberg, 429 A.2d 447 [Sup. Ct. R.I.]. Contra, Memphis Bank and Trust Co. v. Garner, 624 S.W.2d 551 [Sup. Ct. Tenn.]).

Petitioner's reliance, however, on American Bank, supra and First Federal Savings, supra is misplaced. Both of those cases dealt with 31 U.S.C. §742 in its revised form which clearly provides that the exemption extends to any form of taxation which even considers interest, directly or indirectly, in the computation of the tax. The language of the relevant sections of the Private Housing Finance Law and the Public Housing Law does not approach the 31 U.S.C. §742 exemption in breadth. As discussed supra, the New York statutes are more similar to the prior version of 31 U.S.C. §742, and the Court in American Bank, supra, was careful to point out that the prior version did not prohibit franchise taxes measured by tax-exempt obligations (77 L.Ed. at 1076). The interest income from the HFA and MHA bonds was, therefore, properly includible in petitioner's entire net income.

D. That, inasmuch as Article 32 is a franchise tax which taxes interest income indirectly and section 54 of the Private Housing Finance Law applies to direct taxation, there is no conflict between the two statutes and petitioner's argument that any conflicts must be resolved in favor of the Private Housing Finance Law (Priv. Hous. Fin. Law §61) is without merit.


E. That the petition of Anchor Savings Bank, FSB is denied and the denial of refund issued September 23, 1982 is sustained.

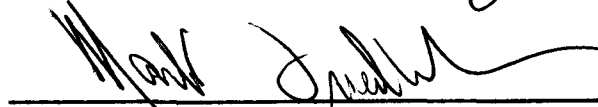
DATED: Albany, New York

STATE TAX COMMISSION

AUG 09 1984


PRESIDENT


COMMISSIONER


COMMISSIONER