

STATE OF NEW YORK

STATE TAX COMMISSION

\_\_\_\_\_ :  
In the Matter of the Petition :  
of :  
The Prudential Insurance Company of America :  
for Redetermination of a Deficiency or Revision :  
of a Determination or Refund of Corporation :  
Franchise Tax under Article 33 of the Tax Law for :  
the Years 1975 - 1979. :  
\_\_\_\_\_ :

AFFIDAVIT OF MAILING

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 8th day of May, 1985, he served the within notice of Decision by certified mail upon The Prudential Insurance Company of America, the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

The Prudential Insurance Company of America  
Attn: Charles H. Richardson, Vice President  
Prudential Plaza  
Newark, NJ 07101

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  
8th day of May, 1985.

David Parchuck

James A. Hagelind  
Authorized to administer oaths  
pursuant to Tax Law section 174



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

May 8, 1985

The Prudential Insurance Company of America  
Attn: Charles H. Richardson, Vice President  
Prudential Plaza  
Newark, NJ 07101

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 & 1519 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  
Francis A. Goodhue, Jr.  
Dewey, Ballantine, Bushby, Palmer and Wood  
140 Broadway  
New York, NY 10005  
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

---

In the Matter of the Petition  
of  
THE PRUDENTIAL INSURANCE COMPANY OF AMERICA  
for Redetermination of a Deficiency or for  
Refund of Franchise Tax on Insurance Corporations under Article 33 of the Tax Law for the Years 1975 through 1979.

DECISION

---

Petitioner, Prudential Insurance Company of America, Prudential Plaza, Newark, New Jersey 07101 filed a petition for redetermination of a deficiency or for refund of Franchise Tax on Insurance Corporations under Article 33 of the Tax Law for the years 1975 through 1979 (File Nos. 28046 and 39076).

A formal 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 April 25, 1984 at 9:15 A.M. with all briefs to be submitted on or before August 22, 1984. Petitioner appeared by Dewey, Ballantine, Bushby, Palmer & Wood (Francis A. Goodhue, Jr., Esq., of counsel). The Audit Division appeared by John P. Dugan, Esq. (William Fox, Esq., of counsel).

ISSUE

Whether, in determining Prudential's "entire net income" under Article 33 of the Tax Law, the modifications required to be made to Prudential's federal taxable income by §1503(b) of the Tax Law are to be made with reference to the definitions set forth in the taxable investment income computation in §804 of the Internal Revenue Code, or whether such modifications are to be made with reference to the definitions in the gain from operations computation in §809 of the Internal Revenue Code.

FINDINGS OF FACT

1. During each of the years in issue, The Prudential Insurance Company of America ("Prudential") was a mutual insurance company incorporated in New Jersey with its principal place of business in Newark, New Jersey. Prudential carried on an insurance business in New York and elsewhere and was classified for Federal income tax purposes as a life insurance company under Subchapter L of the United States Internal Revenue Code of 1954.

2. During each of the years in issue, Prudential filed a U.S. Life Insurance Company Income Tax Return ("Federal Form 1120L").

3. During each of the years in issue, Prudential's gain from operations before its deduction for dividends to policyholders exceeded its taxable investment income. However, its dividends to policyholders exceeded this excess by more than \$250,000.00, so that the limitation on the deduction for dividends to policyholders applied. As a result, Prudential's gains from operations and consequently its life insurance company taxable income was its taxable investment income minus \$250,000.00.

4. In the computation on the U.S. Life Insurance Company Income Tax Return ("Federal Return") of both taxable investment income and gain from operations, the total amounts of tax-exempt interest and dividends received from other corporations are set forth first. There is next excluded the amounts shown as being the policyholders' share of such items. Finally, the balance, which is the company's share of tax exempt interest and corporate dividends, is set forth and included as items of income.

5. Thereafter, in arriving at taxable investment income and gain from operations, a deduction is taken for the company's share of tax exempt interest

and a dividends received deduction equal to 85 percent of the company's share of dividends received is taken.

6. Although the computations of taxable investment income and gain from operations before dividends to policyholders both exclude the policyholders' share of tax exempt interest and the policyholders' share of dividends received and although both computations allow deductions for the company's share of tax exempt interest and 85 percent of the company's share of dividends received, the policyholders' share and the company's share of each of the respective items are not the same for purposes of computing taxable investment income, as they are for purposes of computing gain from operations before dividends to policyholders.

7. The percentages representing the company's share, for purposes of computing taxable investment income under Internal Revenue Code section 804, and the company's share utilized for computing gains from operations under section 809 of the Internal Revenue Code during each of the years in issue are as follows:

<u>Year</u>	<u>Section 804 Percentage</u>	<u>Section 809 Percentage</u>
1975	27.67607895%	53.60207373%
1976	27.18040899%	54.09018683%
1977	26.38718581%	52.22297575%
1978	27.43704116%	52.40429140%
1979	26.07294709%	50.94215020%

8. During each of the years in issue, Prudential deducted, as an investment expense in arriving at investment yield, the entire portion of the New York State franchise tax that was measured by income. In addition, Prudential deducted, in computing gains from operations before dividends to policyholders, the entire portion of the New York State franchise tax that was measured by premiums.

9. For each of the years in issue, Prudential filed tax returns under Article 33 of the New York State Tax Law on a State of New York Franchise Tax Return for Insurance Corporations and timely paid the taxes shown thereon to be due in the following amounts:<sup>1</sup>

<u>Year</u>	<u>Amount of Tax</u>
1975	\$ 9,810,080.46
1976	10,125,521.00
1977	10,963,126.00
1978	12,493,896.00
1979	11,952,514.00

10. During each of the years in issue, in arriving at entire net income on Schedule B of the New York State return, Prudential reported as federal taxable income the amount of life insurance company taxable income shown on Federal Form 1120L for the corresponding year. To federal life insurance company taxable income Prudential added back as the "Dividend received deduction taken in computing line 23" and the "interest income not included in line 23", the section 804 percentage of such items which it had deducted in computing its taxable investment income on Schedule C of its federal returns.<sup>2</sup>

11. On Schedule B of the New York State return during each of the years in issue Prudential added back the section 804 percentage of that portion of the New York State franchise tax measured by income which it had deducted in computing its taxable investment income on schedule C of its federal return.

12. Prudential also subtracted on schedule B of the New York State returns the section 804 percentage of (a) dividends from subsidiaries (1975 and 1977

---

<sup>1</sup> The title of the return was slightly different in 1975.

<sup>2</sup> References are to the New York State franchise tax returns for insurance corporations for 1979. The numbering of the forms for earlier years is different.

only), (b) 50 percent of other dividends, (c) gains from installment sales made prior to 1974 and (d) foreign taxes taken as a credit on petitioner's federal return (1975 - 1977).<sup>3</sup>

13. The Audit Division issued notices of deficiency to Prudential as follows:

<u>Date Issued</u>	<u>Year In Issue</u>	<u>Asserted Deficiency Of Tax</u>	<u>Interest</u>	<u>Total</u>
August 2, 1979	1975	\$ 73,344.00	\$21,087.87	\$ 94,431.87
September 10, 1979	1976	\$116,351.00	\$24,891.07	\$141,242.07
September 10, 1979	1977	\$120,506.00	\$15,536.96	\$136,042.96
May 19, 1982	1978	\$285,185.00	\$96,963.03	\$382,148.03
May 19, 1982	1979	\$227,332.00	\$57,969.24	\$285,301.24

14. Each Statement of Audit Adjustment for the years 1975 through 1977 explained, in relevant part, that the Audit Division determined deficiencies on the ground that "[s]ince NY income is computed based upon the gain from operations, all NY modifications used in arriving at entire net income must also be those amounts used in computing federal gain from operations". The Statement of Audit Adjustment for each of the years 1978 and 1979 explained that "[w]hen federal taxable income is based upon gain from operations, all adjustments in arriving at New York entire net income must be from Schedule E--Gain from Operations...[t]he dividend received deduction, the federal tax exempt income, [the] New York State franchise tax deduction, and the 50% dividend deduction have been adjusted accordingly".

15. In computing the deficiencies referred to in the last paragraph, the Audit Division (i) added back to and subtracted from federal taxable income as shown on Schedule B of the state returns the section 809 percentages of the

---

<sup>3</sup> Petitioner has conceded that the deductions for foreign taxes for 1976 and 1977 were not allowable.



items referred to in paragraphs 10, 11, and 12 above, rather than the section 804 percentages of such items as Prudential had done; and (ii) added back to federal taxable income the entire portion of the New York franchise tax measured by premiums that was included in the deductions from total income shown on line 19 of Schedule E of Prudential's federal return.

16. The instructions issued by the Department of Taxation and Finance with respect to the state return provided that a taxpayer whose federal taxable income was measured only by gain from operations should use the section 809 percentage shown on Schedule E of the Federal return in determining the company's share of tax exempt income and dividends received deductions to be added back in arriving at entire net income for purposes of the Article 33 tax. The instructions also provided that in the case of life insurance companies whose federal taxable income is computed on the basis of taxable investment income plus one-half of the excess of gains from operations over taxable investment should utilize both the section 804 percentage shown on Schedule C of the federal return and the section 809 percentage shown on Schedule E of the federal return.

17. The parties have agreed to changes in the figures reflected in the Notices of Deficiency and accompanying Statements of Audit Adjustment and, as a result, have stipulated that the correct amounts of deficiencies are as follows:

<u>Year</u>	<u>If Prudential's Position Is Sustained</u>	<u>If Prudential's Position Is Determined To Be Erroneous</u>
1975	-0-	\$ 70,766
1976	\$13,514	\$114,109
1977	\$11,932	\$121,883
1978	-0-	\$260,951
1979	-0-	\$209,339

18. That in accordance with section 307(1) of the New York State Administrative Procedure Act, Prudential's proposed findings of fact have been

substantially adopted and incorporated herein. It is noted, however, that proposed finding of fact "16" is rejected because it is in the nature of a legal conclusion. In addition, proposed finding of fact "19" is rejected as unnecessary to the determination.

CONCLUSIONS OF LAW

A. That, in general, sections 1501 and 1502 of the Tax Law impose a franchise tax on insurance corporations computed upon the greatest of one of four bases: (1) allocated entire net income; (2) allocated business and investment capital; (3) allocated entire net income plus compensation paid to officers and certain shareholders; or (4) \$125.00 plus a specified fractional amount per dollar of allocated subsidiary capital. In this instance, only the computation of entire net income is in issue.

B. That during the period in issue section 1503(a) of the Tax Law provided:<sup>4</sup>  
"§ 1503. Computation of entire net income

(a) The entire net income of a taxpayer shall be its total net income from all sources which shall be presumably the same as the life insurance company taxable income, mutual insurance company taxable income or taxable income, as the case may be, which the taxpayer is required to report to the United States treasury department, for the taxable year or, in the case of a corporation exempt from federal income tax but not exempt from tax under section fifteen hundred one, the taxable income which such taxpayer would have been required to report but for such exemption, except as hereinafter provided. (emphasis added).

C. Section 1503(b) provides modifications to be made in computing entire net income. Paragraph 2 of section 1503(b) provides that entire net income shall be determined without the exclusion, deduction or credit of certain

---

<sup>4</sup> It is recognized that section 10 of Chapter 480 of the Laws of 1978, effective December 8, 1978, amended section 1503 of the Tax Law by inserting the phrase "taxable income of partnership".

items. One of these items is set forth in Tax Law §1503(b)(2)(G) which, during the period in issue, provided as follows:<sup>5</sup>

"(G) in the case of a life insurance company, the provisions of subparagraph (B) of this paragraph shall not apply to the policyholder's share of the items described in such subparagraph. For purposes of this subparagraph, the policyholder's share of such items means the amount, if any, of each such item excludable in determining taxable investment income or gain or loss from operations under sections eight hundred four or eight hundred nine, respectively, of the internal revenue code."

D. That since entire net income in this instance is premised upon life insurance taxable income which is required to be reported to the United States, a brief examination of the Federal principles for the taxation of insurance corporations is warranted.

E. That section 802(b) of the Internal Revenue Code, which sets forth the basic scheme for taxation of life insurance companies, defines life insurance taxable income as follows:

"(b) Life Insurance Company Taxable Income Defined.- For purposes of this part, the term "life insurance company taxable income" means the sum of-

- (1) the taxable investment income (as defined in section 804) or, if smaller, the gain from operations (as defined in section 809),
- (2) if the gain from operations exceeds the taxable investment income, an amount equal to 50 percent of such excess, plus
- (3) the amount subtracted from the policyholders' surplus account for the taxable year, as determined under section 815."

F. That section 802(b) of the Internal Revenue Code establishes that gains from operations, as defined in section 809 of the Internal Revenue Code, is not necessarily determinative in computing life insurance company taxable income. In this instance, the parties have stipulated that petitioner's total Federal Taxable Income was the amount by which taxable investment income

---

<sup>5</sup> It is acknowledged that section 33 of Chapter 788 of the Laws of 1978, effective December 31, 1978, relettered former subparagraph (G) as subparagraph (I).

exceeded \$250,000.00. Thus, the gains from operations calculation, although required to be computed, basically had no effect on petitioner's federal taxable income [see H. R. Rep. No. 432, Part 2, 98th Cong., 2nd Session 1391 (1984)].

G. That since petitioner's federal taxable income was based on taxable investment income and not gains from operations, petitioner properly applied the company's shares computed under section 804 of the Internal Revenue Code pertaining to taxable investment income.

H. That it is noted that since petitioner's federal taxable income was based upon taxable investment income, the instructions accompanying the State of New York Franchise Tax Returns for Insurance Corporations were inapplicable.

I. That the petition of The Prudential Life Insurance Company of America is granted and the notices of deficiency are to be modified in accordance with Finding of Fact "17"; the notices of deficiency, as modified, are sustained.

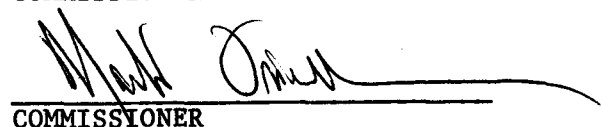
DATED: Albany, New York

STATE TAX COMMISSION

MAY 08 1985

  
PRESIDENT

\_\_\_\_\_  
COMMISSIONER

  
COMMISSIONER

4/16/85  
I abstain!!  
Francis R. Koenig