

Investment Capital and Income

The Forbes Case

Background

A recent opinion of the New York State Court of Appeals (Matter of Forbes, Inc. v. Department of Finance, 66 NY2d243, cert. denied, ____ U.S. ____) has held that New York City's treatment of federal government obligations for general corporation tax purposes is discriminatory and therefore in violation of federal law.

The Forbes case dealt with the provision of City law that sets forth the method for computing a taxpayer's investment allocation percentage. The investment allocation percentage is computed as a fraction, with allocated corporate investments in the numerator and all investments except obligations of the United States and its instrumentalities (hereinafter federal paper) and obligations of New York State, its political subdivisions and its instrumentalities (hereinafter New York paper), and cash, in the denominator. Income from federal paper, as well as from New York paper, and cash (where the election is made to treat cash as investment capital, is allocated by the resulting percentage. However, if that percentage is zero, interest income from Federal and New York paper and bank accounts is allocated by the taxpayer's business allocation percentage. The Court of Appeals held that this scheme discriminated against federal paper in violation of 31 U.S.C. 742 (now 34 U.S.C. 3124 (a)).

The Forbes decision also found the City's practical application of the statute to be discriminatory insofar as it was the City's audit policy to delete from the computation of the investment allocation percentage corporate stocks and paper where the taxpayer's investment in that type of asset (and where its income from such investments) represented less than 15% of its total investment and income from such investments, respectively. The statute provides that if a taxpayer's investment allocation percentage is zero, then interest from federal paper, New York paper and bank accounts (where the cash election is made) is to be allocated based on the taxpayer's business allocation percentage.

A provision of the New York City statute gives the Director of Finance the discretion to delete an asset from the calculation of the investment allocation percentage where it is felt to cause distortion. The same discretion exists under New York State's Tax Law, but the Tax Department has not adopted such a rule.

Revised Policy

Since New York City's statutory provision pertaining to the treatment of investment income (and investment capital) is identical to New York State's statute on the subject, the State intends to abide by the Forbes decision in its administration of the Tax Law. Therefore, the following will apply:

1. Federal paper will be included in the denominator of the investment allocation percentage.
2. Where the investment allocation percentage is zero, interest income from federal paper will not be allocated by the taxpayer's business allocation percentage. Only interest from bank accounts and New York paper is to be allocated by the business allocation percentage under such circumstances. Income from federal paper will not be taxable if the investment allocation percentage is zero.
3. Claims for credit or refund which are filed within the time limitation provided by Section 1087(a) of the Tax Law and claims for credit or refund on the basis of payment under protest will be granted. Interest will be paid pursuant to § 1088 of the Tax Law.

Claims for Credit or Refund Procedure

Claims for credit or refund of corporate franchise taxes paid will be allowed pursuant to the provisions of Tax Law Section 1087. Such claims must be filed on Form CT-8. Do not use an "amended return" to file the claim. Doing so will unnecessarily delay the processing of the claim. A separate CT-8 must be filed for each period for which a credit or refund is being claimed.