

New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

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(8.5) Corporation Tax
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Taxation of S Corporations and Their Shareholders

Shareholder Treatment of State and City
Corporation Taxes Paid by Electing New York
S Corporations

The Tax Department has received numerous inquiries as to whether the New York State Corporate Franchise Tax and the New York City General Corporation Tax can be characterized as "income taxes." This issue is important to shareholders of electing New York S corporations as they are required, in determining New York adjusted gross income, to add to federal adjusted gross income their pro rata share of the corporation's deductions for state, local and foreign income taxes and to subtract from federal adjusted gross income their pro rata share of the corporation's refunds of these taxes.

Section 607(a) of the Tax Law provides that any term used in Article 22 of the Tax Law shall have the same meaning as when used in a comparable context in the Internal Revenue Code, unless a different meaning is clearly required. Section 164(a)(3) of the Internal Revenue Code allows a deduction for: "State and local, and foreign, income ... taxes." In determining what constitutes an "income tax" under section 164(a)(3) of the Code, the federal courts agree that such a tax must be a "net income tax"; that is, a direct tax on gain or profits, and that gain is a necessary ingredient of income. See Stratton's Independence, Ltd. v. Howbert, 231 US 399, 415; Eisner v. Macomber, 252 US 189, 207; and Bank of America National T. & S. Assoc. v. US, 459 F.2d 513, 517-8.

The New York State Corporate Franchise Tax and the New York City General Corporation Tax are not "income taxes" within the above definition. Northern Finance Corp. v. Tax Commission, 290 U.S. 601, 54 Sup. Ct. 230; and Matter of Bankers Trust New York Corporation v. Department of Finance, 120 AD 2d 992, 502 N.Y.S. 2d 567. Accordingly, shareholders of electing New York S corporations, in determining New York adjusted gross income, are not required to add to federal adjusted gross income their pro rata share of the S corporation's deduction for these taxes, and may not subtract from federal adjusted gross income their pro rata share of the S corporation's refunds of these taxes.