

New York State Department of Taxation and Finance
Office of Tax Policy Analysis
Technical Services Division

TSB-A-01(13)C
Corporation Tax
January 10, 2001

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. C000919A

On September 19, 2000, a Petition for Advisory Opinion was received from KPMG LLP, 345 Park Avenue, 38th Floor, New York, New York 10154.

The issue raised by Petitioner, KPMG LLP, is whether a bank is required to recapture a portion of its New York State bad debt reserve when computing entire net income, under Article 32 of the Tax Law, when the amount of current year loans outstanding has decreased below the amount of base year loans outstanding or when the current year experience ratio has decreased below the base year ratio.

Petitioner submits the following facts as the basis for this Advisory Opinion.

The taxpayer, Bank, is a banking corporation subject to Article 32 of the Tax Law. Pursuant to section 585(c) of the Internal Revenue Code ("IRC"), Bank is a "large" bank that is not permitted to use the reserve method in computing its federal bad debt deduction. Instead, Bank must use the specific charge-off method under section 166(a) of the IRC.

Petitioner states that in computing entire net income under section 1453 of the Tax Law, Bank is required to apply the provisions of section 1453(i) in computing its bad debt deduction. In general terms, this deduction will be the greater of the following two amounts:

Method 1: The amount necessary to increase the balance of the New York State bad debt reserve for losses on loans (computed as of the close of the current taxable year) to the amount which results from multiplying current year loans outstanding by the current year's experience ratio (i.e., the ratio of (a) the sum of bad debts adjusted for recoveries sustained during the current taxable year and the five preceding years to (b) the sum of loans outstanding at the close of such six taxable years); or

Method 2: The amount necessary to increase the balance of the New York State reserve for losses on loans (calculated as of the close of the taxable year) to the lesser of (a) the balance of the bad debt reserve at the close of the taxpayer's base year, or (b) if the amount of loans outstanding at the close of the taxable year is less than the amount of loans outstanding at the close of the base year, the amount which results from multiplying the current year loans outstanding by the ratio of (1) base year reserves to (2) base year loans outstanding.

During Bank's fiscal 2000 taxable year, its current year balance of outstanding loans decreased to a level less than Bank's base year loans outstanding. The decrease in Bank's loans resulted from the maturation of existing loans coupled with retrenchment strategies and redeployment of capital. Additionally, Bank's fiscal 2000 experience ratio dropped below the base year experience ratio. The decrease in the experience ratio resulted from a large charge-off that occurred in 1994 which is no longer a part of the six year moving average.

Bank's reserve for bad debts calculated under the six year moving average provided by section 1453(i) of the Tax Law has not decreased in correspondence to the reduction of the loan balance. For discussion purposes, Petitioner assumes the following amounts:

	<u>Base Year Fiscal 1988</u>	<u>Preceding Year Fiscal 1999</u>	<u>Current Year Fiscal 2000</u>
Outstanding Loans	\$6 billion	\$7 billion	\$5 billion
Experience Ratio	.5000%	.8000%	.3000%
Tentative Allowable Reserve (Method 1)	\$30 million	\$56 million	\$15 million
Allowable Reserve Using Base Year Ratio (Method 2)			\$25 million

Under the facts set forth above, Petitioner states that Bank's current year balance of loans outstanding has decreased below its base year amount of loans outstanding. In addition, the current year experience ratio (the six year moving average of bad debt losses sustained to total loans outstanding) has declined below the ratio existing during Bank's base year. However, the New York reserve has not decreased in correspondence to the reduction of the loan balance. As a result, using the hypothetical numbers set forth above, Bank has an allowable fiscal 2000 reserve of \$25 million (under Method 2). This is \$31 million less than the beginning reserve balance of \$56 million and \$5 million less than the base year reserve balance of \$30 million.

Discussion

Section 1453(a) of the Tax Law provides that entire net income means total net income from all sources which shall be the same as the entire taxable income (but not alternative minimum taxable income) which the taxpayer is required to report to the United States Treasury Department subject to the modifications and adjustments provided in section 1453 of the Tax Law.

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Section 1453(b)(11) of the Tax Law provides an add modification for a taxpayer subject to the provisions of section 585(c) of the IRC for the amount allowed as a deduction pursuant to section 166 of the IRC. Section 1453(i) of the Tax Law provides a subtraction modification for a taxpayer subject to the provisions of section 585(c) of the IRC that is not subject to section 1453(h) of the Tax Law, whereby the taxpayer may deduct an amount equal to or less than the amount determined pursuant to section 1453(i) of the Tax Law. In this case, Bank is not allowed a deduction under section 1453(i) of the Tax Law, to increase its New York State reserve for losses on loans, for a taxable year during which the amount of Bank's current year loans outstanding has decreased below the amount of base year loans outstanding or the current year experience ratio has decreased below the base year ratio.

There is no provision in section 1453 of the Tax Law to recapture an amount previously allowed as a deduction under section 1453(i) of the Tax Law. Accordingly, for any taxable year that the amount of Bank's current year loans outstanding has decreased below the amount of base year loans outstanding or the current year experience ratio has decreased below the base year ratio, no recapture of a previous deduction allowed pursuant to section 1453(i) of the Tax Law is required to reduce the balance of the New York State bad debt reserve for losses on loans.

DATED: January 10, 2001

/s/
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NOTE: The opinions expressed in Advisory Opinions are limited to the facts set forth therein.