

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

TSB-A-03(3)C
Corporation Tax
April 4, 2003

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO.C021122A

On November 22, 2002, a Petition for Advisory Opinion was received from Robert Ganz, CPA, c/o Spar & Boyer CPAs, 615 Broadway, Hastings-on-Hudson, New York 10706.

The issue raised by Petitioner, Robert Ganz, CPA, is whether the amount of interest paid to an individual shareholder on a loan made to the corporation must be added to federal taxable income, when computing entire net income under section 208.9 of Article 9-A of the Tax Law.

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

An individual owns 100 percent of a company and the individual shareholder lends the company money. The company pays the shareholder interest on the loan during the taxable year.

Applicable Law

Section 208.3 of the Tax Law provides that the term “subsidiary” means “a corporation of which over fifty percent of the number of shares of stock entitling the holders thereof to vote for the election of directors or trustees is owned by the taxpayer.”

Section 208.4 of the Tax Law provides, in part:

The term “subsidiary capital” means investments in the stock of subsidiaries and any indebtedness from subsidiaries ... whether or not evidenced by written instrument, on which interest is not claimed and deducted by the subsidiary for purposes of taxation under article nine-A ... provided, however, that, in the discretion of the commissioner, there shall be deducted from subsidiary capital any liabilities which are directly or indirectly attributable to subsidiary capital.

Section 208.9 of the Tax Law provides, in part:

The term “entire net income” means total net income from all sources, which shall be presumably the same as the entire taxable income (but not alternative minimum taxable income),

(i) which the taxpayer is required to report to the United States treasury department,

* * *
except as hereinafter provided, and subject to any modification required by paragraphs (d) and (e) of subdivision three of section two hundred ten of this article.

(a) Entire net income shall not include:

(1) income, gains and losses from subsidiary capital

Opinion

When a corporation owns a subsidiary as defined in section 208.3 of the Tax Law, and the parent corporation makes a loan to the subsidiary, such loan is an indebtedness of the subsidiary. Such loan will constitute subsidiary capital of the parent corporation under section 208.4 of the Tax Law only when the interest expense paid by the subsidiary to the parent corporation is not claimed and deducted by the subsidiary in computing the subsidiary's entire net income. Since interest expense is a deduction in computing federal taxable income, the subsidiary may accomplish this by adding the interest expense paid to the parent corporation at Line 3 of the subsidiary's Form CT-3 General Business Corporation Franchise Tax Return, which provides for an addition to federal taxable income in computing entire net income for "Interest paid to a corporate stockholder owning more than 50% of issued and outstanding stock." In such case, the parent corporation is allowed a deduction in computing the parent corporation's entire net income for the interest income it receives from the subsidiary on such loan under section 208.9(a)(1) of the Tax Law, as income from subsidiary capital.

However, if the subsidiary deducts the interest expense paid to the parent corporation, i.e., the subsidiary does not add the interest expense to federal taxable income at Line 3 of Form CT-3 when computing the subsidiary's entire net income, the loan is not considered subsidiary capital in the hands of the parent corporation. In that case, the parent corporation is not allowed a deduction under section 208.9(a)(1) of the Tax Law for the interest income it receives from the subsidiary on the loan.

Where an individual shareholder owning more than 50 percent of the stock of a corporation makes a loan to the corporation, there is no provision under Article 9-A of the Tax Law that requires the corporation to add the interest expense that it paid to the individual shareholder to the corporation's federal taxable income when computing its entire net income under section 208.9 of the Tax Law.

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It is assumed for purposes of this Advisory Opinion that the individual shareholder has made a loan to the corporation rather than a contribution to capital.

DATED: April 4, 2003

/s/
Jonathan Pessen
Tax Regulations Specialist IV
Technical Services Division

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