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

TSB-A-85 (14) C
Corporation Tax
July 8, 1985

STATE OF NEW YORK
STATE TAX COMMISSION

ADVISORY OPINION PETITION NO. C830509B

On May 9, 1983 a Petition for Advisory Opinion was received from Niagara Share Corporation, 70 Niagara Street, Buffalo, New York 14202.

At issue is whether, for taxable years ending December 31, 1980 and December 31, 1981, the computation of the overall investment allocation percentage under Article 9-A of the Tax Law can be based only on the investments that are the source of the entire net income for a regulated investment company where the entire net income of such corporation is comprised solely of foreign taxes withheld on foreign investments with a zero percent issurer's allocation percentage.

Petitioner is a "regulated investment company" as defined in section 851 of the Internal Revenue Code and taxable under section 852 of the Internal Revenue Code. For New York State franchise tax purposes Petitioner is a taxpayer under Article 9-A of the Tax Law. Section 209.7 of the Tax Law, which became effective for taxable years beginning on or after January 1, 1980, defines entire net income of a regulated investment company. Pursuant to section 209.7 for the taxable years at issue, the taxpayer's entire net income is comprised of the modification for foreign taxes withheld on dividends and interest (section 208.9(b)(3)) and the modification for New York State franchise tax imposed (section 208.9(b)(4)).

Petitioner contends that the underlying legislative intent of section 209.7 of the Tax Law was to effectively eliminate the New York State franchise tax for regulated investment companies by essentially adopting the federal definition of "investment company taxable income." Since investment company taxable income allows a deduction for dividends paid to shareholders, it appears to Petitioner that New York State entire net income was intended to be close to if not actually zero.

Petitioner also contends that the modifications for New York State franchise tax purposes have the effect of "creating" income where no income is retained by the regulated investment company. Since a regulated investment company cannot distribute more than the company earns, it is impossible to pass through to the shareholders the foreign taxes withheld. It appears to Petitioner that this result is at odds with the intent of section 209.7 of the Tax Law which was to gain greater conformity with the federal tax treatment of assessing tax on only that portion of income retained by the regulated investment company.

Petitioner argues that since the legislative intent was to effectively eliminate the franchise tax on regulated investment companies, it would seem reasonable to extend this correlation to the computation of allocated investment income by using an issurer's allocation percentage of zero percent for the tax years at issue because entire net income for such years is solely due to foreign source income with a zero percent issurer's allocation percentage.

Accordingly, Petitioner maintains that section 210.3 of the Tax Law, which provides for the allocation of entire net income within and without New York State, should be interpreted to limit the investment capital utilized in the computation of the investment allocation percentage to only that portion of the investment capital which gives rise to entire net income. Petitioner contends that this interpretation of investment capital would eliminate the potential for inequity that would arise whereby an investment allocation percentage would be developed from investment capital that is not a source of the entire net income of the corporation.

Section 209.7 of the Tax Law was added by Chapter 500 of the Laws of 1979. The legislative intent of this addition is shown in the memorandum in support of such Chapter which states that the purpose of such legislation was to encourage regulated investment companies and their management companies to remain within New York State, to invest in New York State business substantial portions of the capital they manage and to encourage other regulated investment companies and their management companies to move into the state. Such memorandum also shows that the intent of the Legislature was to seek to bring about conformity with the federal method for taxing regulated investment companies in New York State in that income distributed to stockholders and thus taxable as part of their personal income would not be taxed first as corporate income of the regulated investment company. This was accomplished in section 209.7 through the definition of entire net income of a regulated investment company.

The language contained in section 209.7 defines entire net income of a regulated investment company and states that the tax of such company be computed under section 210.1(a)(1) or (4) of the Tax Law, that is, the tax measured by allocated entire net income or the minimum tax, respectively, whichever is greater. Section 209.7 defines "entire net income of a regulated investment company" to mean the "investment company taxable income" as defined in section 852(b)(2) (as modified by section 855) of the Internal Revenue Code plus any amount taxable under section 852(b)(3) of the Internal Revenue Code, subject to the modifications required by section 208.9 of the Tax Law, except that the deduction for 50 percent of dividends other than from subsidiaries and a net operating loss deduction are not allowed. The amount computed under the preceding sentence is subject to the modification required by section 210.3(d) and (e) of the Tax Law relating to optional deductions for depreciation and research and development.

The Legislature was aware of the modifications required by section 208.9 of the Tax Law and specifically provided that the modifications under section 208.9(a)(2) (relating to non-subsidiary dividends) and section 208.9(f) (relating to a net operating loss deduction) were not applicable for a regulated investment company. No such exception was included in the law for the modification contained in section 208.9(b)(3) and (4). Section 208.9(b)(3) provides, in part, that entire net income shall be determined without the deduction for taxes on or measured by profits or income paid to any foreign country. Section 208.9(b)4 provides, in part, that entire net income shall be determined without the deduction for taxes imposed by Article 9-A. Accordingly, the amount of these modifications must be included in entire net income for a regulated investment company for purposes of Article 9-A of the Tax Law. Such entire net income may be properly categorized as investment income.

Section 4-7.1(b) of the Business Corporation Franchise Tax regulations provides that a taxpayer whose entire net income consists solely of investment income must allocate such investment income by the investment allocation percentage. The investment allocation percentage is computed pursuant to section 210.3(b) of the Tax Law. Section 210.3(b)(1) of the Tax Law provides the first step in determining an investment allocation percentage and states, in part:

> "multiplying the amount of its investment capital invested in each stock, bond or other security (other than governmental securities) during the period covered by its report by the percentage. . ." (emphasis added)

Accordingly, for taxable years ending December 31, 1980 and December 31, 1981 for New York State franchise tax purposes Petitioner must, pursuant to section 209.7 of the Tax Law, include in the computation of entire net income the modification for taxes on or measured by profits or income paid to any foreign country and for taxes imposed by Article 9-A of the Tax Law. Also, when computing the investment allocation percentage Petitioner must, pursuant to section 210.3(b)(1) of the Tax Law, determine the amount of its investment capital invested in each stock, bond or other security (other than governmental securities) rather than determining such amount solely on its investments in those stocks, bonds or other securities which generated the income on which the foreign taxes were paid.

Petitioner requests that a discretionary adjustment be granted if an adverse opinion is rendered. An Advisory Opinion merely sets forth the applicability of pertinent statutory and regulatory provisions to "a specified set of facts." Tax Law, 171, subd. twenty-fourth; 20 NYCRR 901.1(a). Therefore, it is not within the scope of an Advisory Opinion to determine whether a discretionary adjustment under section 210.8 of the Tax Law should be granted.

DATED: July 3, 1985

s/ANDREW F. MARCHESE
Chief of Advisory Opinions

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