

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

TSB-A-86 (2) C
Corporation Tax
December 23, 1985

STATE OF NEW YORK
STATE TAX COMMISSION

ADVISORY OPINION

PETITION NO. C850925A

On September 25, 1985, a Petition for Advisory Opinion was received from Richard W. Genetelli, c/o Coopers & Lybrand, 1251 Avenue of the Americas, New York, New York 10020.

The issues presented herein are (1) whether industrial development bonds issued by a municipal industrial development agency qualify as investment capital for purposes of the Franchise Tax on Business Corporations imposed pursuant to Article 9-A of the Tax Law, and (2) whether the failure to treat such industrial development bonds as investment capital on its corporate franchise tax report as originally filed bars the taxpayer from asserting such bonds as investment capital at a later time.

Petitioner presents the following hypothetical situation for purposes of this Petition for Advisory Opinion. The taxpayer is an investment company incorporated in New York State. The company's sole asset is its investment in municipal industrial development bonds from which it generates interest income. The bonds were issued to finance the operations of a partnership, one of whose partners is the parent corporation of the investment company. Petitioner contends that industrial development bonds qualify as investment capital rather than business capital. In addition, Petitioner contends that there is no bar in the statute or regulations to prohibit the reclassification of such bonds as investment capital after the original tax report was filed.

Article 9-A of the Tax Law classifies a taxpayer's capital into three categories - subsidiary capital, investment capital, and business capital.

Section 208.5 of the Tax Law, defines the term "investment capital" as follows:

"The term 'investment capital' means investments in stocks, bonds and other securities, corporate and governmental, not held for sale to customers in the regular course of business, exclusive of subsidiary capital and stock issued by the taxpayer, provided, however, that, in the discretion of the tax commission, there shall be deducted from investment capital any liabilities payable by their terms on demand or within one year from the date incurred, other than loans or advances outstanding for more than a year as of any date during the year covered by the report, which are attributable to investment capital."

The use of the phrase "stocks, bonds and other securities" in section 208.5 of the Tax Law indicates an intention to include as investment capital only those "bonds" which are securities. Although the Franchise Tax Regulations contain no definitions for the terms "bonds" or "securities", it is appropriate to look to the description of "other securities" found in section 3-4.2(c) of the Franchise Tax Regulations to determine if such bonds are properly included in investment capital. South-Western Publishing Company, State Tax Commission Advisory Opinion, TSB-H-81(35)C.

Section 3-4.2(c) of the Business Corporation Franchise Tax Regulations describes the types of securities which are includible as "other securities" for purposes of section 208.5 of the Tax Law as follows:

"The 'other securities' referred to in subdivision (a) of this section are limited to securities issued by governmental bodies and securities issued by corporations of a like nature as stocks and bonds, which are customarily sold in the open market or on a recognized exchange, designed as a means of investment, and issued for the purpose of financing corporate enterprises and providing a distribution of rights in, or obligations of, such enterprises...."

In determining whether a particular security qualifies as investment capital, it is necessary to look to the function of the instrument, to search for substance over form with emphasis on economic reality. Matter of Avon Products, Inc. v. State Tax Commission, 90 AD2d 393 (3d Dept 1982).

The industrial development bonds at issue herein meet the criteria set forth in section 3-4.2(c) of the Franchise Tax Regulations. The bonds are designed as a means of investment and are customarily sold in the open market. They are negotiable instruments issued for the purpose of financing corporate enterprises and providing a distribution of obligations of such enterprises. Based on the previously mentioned statute, regulations, and decisions, the industrial development bonds at issue constitute investment capital for purposes of Article 9-A of the Tax Law.

Section 1087(a) of the Tax Law states, in part:

". . . Claim for credit or refund of an overpayment of tax under Article. . . 9-A. . . shall be filed by the taxpayer within three years from the time the return was filed or two years from the time the tax was paid, whichever of such periods expires the later. . . ."

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Pursuant to section 1087(a) of the Tax Law, the taxpayer may amend its corporate franchise tax report to reclassify the industrial development bonds as investment capital and claim any credit or refund of a resulting overpayment within 3 years from the time the return was filed or 2 years from the time the tax was paid, whichever expires the later.

DATED: December 23, 1985

s/FRANK J. PUCCIA
Director
Technical Services Bureau

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