

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

TSB-A-88 (7)C  
Corporation Tax  
March 18, 1988

STATE OF NEW YORK  
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. C871123A

On November 23, 1987, a Petition for Advisory Opinion was received from American International Group, Inc., 70 Pine Street, 24th Floor, New York, New York 10270.

The issue raised is whether, for purposes of the corporate franchise tax imposed under Article 9-A of the Tax Law, Subpart F income that is attributable to the "50 percent of dividends other than from subsidiaries" that is included in entire net income is investment income earned from investment capital.

On September 9, 1987, the Commissioner of Taxation and Finance issued to Petitioner an Advisory Opinion stating that Subpart F income is deemed to be a dividend for purposes of Articles 9-A and 33 of the Tax Law (TSB-A-87(23)C). Under Article 9-A, if the Subpart F income is attributable to subsidiary capital, 100 percent of the dividend is deducted from the taxpayer's federal taxable income pursuant to section 208.9(a)(1) of the Tax Law. If the Subpart F income is not attributable to subsidiary capital, 50 percent of such dividend may be deducted from the taxpayer's federal taxable income pursuant to section 208.9(a)(2) of the Tax Law. Petitioner now questions the treatment of the 50 percent of the dividend that is included in Petitioner's entire net income.

Petitioner is a holding company which, through its direct and indirect subsidiaries, is primarily engaged in a wide range of insurance and insurance related activities in the United States and overseas. Petitioner's foreign operations in many cases are conducted by its controlled foreign corporations as that term is defined by Internal Revenue Code section 957. Pursuant to the federal Subpart F income rules, Petitioner is required to report as taxable income certain of the earnings of its controlled foreign corporations. Internal Revenue Code section 958 provides that in determining controlled foreign corporation status, constructive ownership rules apply. Thus, Petitioner reports as Subpart F income the earnings of directly owned controlled foreign companies and earnings of controlled foreign corporations that are directly owned by other controlled foreign corporations.

For federal income tax purposes, Petitioner reports Subpart F income from corporations in which it has an indirect investment in addition to the Subpart F income from corporations in which it has a direct investment. The amount reported is in proportion to Petitioner's ownership of each corporation.

Petitioner contends that the Commissioner of Taxation and Finance recognizes that Subpart F income is in essence dividend income and that can only result from an investment in stock.

Petitioner states that it is not a dealer in securities and its controlled foreign corporations are not held for sale to customers in the regular course of business. Therefore, Petitioner contends that the stock of the companies are either subsidiary or investment capital. Third-tier companies and companies whose ownership by Petitioner does not exceed 50% have been determined not to be subsidiaries by the Commissioner. Thus, Petitioner feels that the stock of these companies must necessarily represent investment capital of Petitioner and the Subpart F income is investment income apportioned to New York pursuant to Section 210.3(b).

Petitioner errs in its contention that dividend income can only result from an investment in stock. In the case of Subpart F income, such income is undistributed and is not a dividend, as the term "dividend" is commonly defined. Subpart F income is income that is "deemed" (treated as) a dividend for purposes of the deductions allowed by sections 208.9(a)(1) and (2) of the Tax Law.

Entire net income consists of investment income and business income. Business Income is defined in section 208.8 of the Tax Law as entire net income minus investment income. Investment income is defined in section 208.6 of the Tax Law as income from investment capital, to the extent included in computing entire net income, less certain deductions.

Investment capital, is defined in section 208.5 of the Tax Law as 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, less certain deductions.

The statute clearly states that investment income is derived from investment capital. Accordingly, Petitioner may include as investment income, Subpart F income that is deemed a dividend but only to the extent that Petitioner has an investment, but not more than 50 percent, in the stock of the corporation generating the Subpart F income.

When Petitioner receives Subpart F income that is deemed a dividend from a corporation in whose stock Petitioner does not have an investment (e.g., second-tier corporation), such income is not derived from investment capital and, thus, cannot be investment income. Accordingly, such deemed dividend must be business income.

It should be noted that when Petitioner computes the receipts factor of its business allocation percentage, the amount of Subpart F income that is deemed a dividend and which constitutes business income is included in the denominator of the factor as "other business receipts". However, since the Subpart F income that is deemed a dividend is not earned within New York State, the amount of such dividend is not included in the numerator of the factor.

DATED: March 18, 1988

s/FRANK J. PUCCIA  
Director  
Technical Services Bureau

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