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

TSB-A-91(3)C
Corporation Tax
January 22, 1991

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. C901003A

On October 3, 1990, a Petition for Advisory Opinion was received from Morrison & Foerster, 1290 Avenue of the Americas, New York, New York 10036-2774.

The first issue raised by Petitioner, Morrison & Foerster, is whether a dividend declared, in 1985, by a second-tier subsidiary to its direct parent and then effectively assigned by that direct parent to its own parent may be excluded by the ultimate parent from its New York entire net income as income from subsidiary capital pursuant to section 208.9(a)(1) of the Tax Law. The second issue raised is whether the direct parent must now amend its corporate records and its New York State franchise tax return to reflect the assignment of such dividend in 1985.

Corporation S is a wholly owned subsidiary of corporation D. In 1985, S's board of directors declared a $X,000 dividend to D, its "shareholder of record," and reflected that declaration in its minutes.

D is wholly owned by corporation P. Petitioner contends that P, through its ownership of D, is therefore the beneficial owner of S.

With the de facto agreement of D, the $X,000 dividend declared by S to D was paid to P. D, due to an oversight, did not record in its minutes the assignment of the $X,000 dividend to P. However, D did declare a $Y,000 dividend to P.

P's records show it received the total $X+Y,000 dividends in cash. In determining its entire net income for purposes of the New York corporate franchise tax, P deducted all of the $X+Y,000 dividends from its federal taxable income, as income from subsidiary capital. (P, D and S, along with other affiliated companies, filed a federal consolidated return.)

Section 208.9(a)(1) of the Tax Law provides that entire net income shall not include income, gains and losses from subsidiary capital. Section 3-2.4(a)(1) of the Business Corporation Franchise Tax Regulations (hereinafter "Regulations"), provides that in computing entire net income, federal taxable income is adjusted by subtracting from it, all dividends, interest and gains from subsidiary capital (but not any other income from subsidiaries).

Sections 208.3 and 208.4 of the Tax Law define "subsidiary" and "subsidiary capital" as follows:

> 3. 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;

4.(a) 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, thirty-two or thirty-three of this chapter ....

Section 3-6.2 of the Regulations further defines the term "subsidiary" as follows:

(a) The term 'subsidiary' means a corporation which is controlled by the taxpayer, by reason of the taxpayer's ownership of more than 50 percent of the total number of the shares of stock of such corporation, issued and outstanding, which entitle the holder of the shares to vote at elections of its directors or trustees. The determination of whether or not particular shares of a corporation's stock entitles the holders of such shares to vote for the election of directors or trustees of the corporation depends on the actual legal situation with respect to voting rights, as it exists from time to time.

* * *

(b) The test of ownership is actual beneficial ownership, rather than mere record title as shown by the stock books of the issuing corporation. A corporation will not be considered to be a subsidiary because more than 50 percent of the shares of its voting stock is registered in the taxpayer's name, unless the taxpayer is the actual beneficial owner of such stock. However, a corporation will not be considered a subsidiary if more than 50 percent of the shares of its voting stock is not registered in the taxpayer's name, unless the taxpayer submits proof that it is the actual beneficial owner of such stock.

* * *

(d) In any case where the record holder of shares of voting stock of a corporation is not the actual beneficial owner of the stock, or where the right to vote such stock is not possessed by the record holder or by the actual beneficial owner of the stock, a full and complete statement of all relevant facts must be submitted.

Therefore, the concept of beneficial ownership of stock does not apply to situations involving three or more tier corporate structures unless there has been some transfer of rights in the stock, for example, where there has been a transfer of stock without transfer of legal title or where the transferee of the stock is not yet the holder of record on the books of the corporation, or where there has been a transfer to a trustee. (Sears Industries, Inc., Dec St Tax Comm, July 26, 1985, TSB-H-85(33)C; see generally Yelencsics v Commissioner, 74 TC 1513; Flagg-Utica Corp. v Baselice, 14 Misc 2d 476.)

A dividend has been defined as a corporate profit set aside, declared, and ordered by the board of directors to be paid to the stockholders upon demand or at a fixed time, and as a portion of the earnings of a corporation distributed to stockholders on a percentage basis (see,

In the Matter of Mortimer's Will, 12 Misc 2d 744; In the Matter of Reed's Will, 173 Misc 314).

Herein, P is not the owner of any stock of S. In addition, there is no evidence that P received beneficial ownership of the stock of S so as to entitle P to claim S as a wholly-owned subsidiary. Therefore, S cannot be considered a subsidiary of P as "subsidiary" is defined in section 208.3 of the Tax Law and section 3-6.2 of the Regulations. Accordingly, income payable from S to P is not income from subsidiary capital as defined in section 208.4 of the Tax Law. However, S is a subsidiary of D and the $X,000 dividend declared by S was properly payable to D, the dividend's owner of record and S's sole shareholder. By operation of law, it immediately became D's property. Inadvertently, D failed to record the receipt of the $X,000 and formally declare an equal dividend of its own to P, but simply allowed the cash to be paid directly by S to P. Since the $X,000 was the property of D, it was effectively distributed by D as a dividend to its parent P.

Accordingly, the entire $X+Y,000 received by P in 1985 is considered dividend income from D and is treated as income from subsidiary capital. When P computes entire net income for taxable year 1985, P may subtract such dividend income from federal taxable income pursuant to section 208.9(a)(1) of the Tax Law and section 3-2.4(a)(1) of the Regulations.

It is not within the scope of an advisory opinion to state what action should be taken by any corporation with respect to amending its corporate records or amending its New York State tax returns. 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).

DATED: January 22, 1991

s/PAUL B. COBURN
Deputy Director
Taxpayer Services Division

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