

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

TSB-H-80-(519)-I
Income Tax
March 2, 1981

STATE OF NEW YORK
STATE TAX COMMISSION

ADVISORY OPINION

PETITION NO. I800527A

On May 27, 1980 a Petition for Advisory Opinion was received from PLA Standard Corporation, 4000 Veterans Memorial Highway, Bohemia, New York 11716.

The issue raised is whether certain constructive distributions to shareholders constitute dividends or a return of capital and gain from the sale or exchange of property.

In the course of an audit by the Department of Taxation and Finance covering the years ending June 30, 1975, 1976 and 1977 it was proposed by an auditor that certain expense deductions claimed for each of such years be disallowed and charged instead as constructive distributions to the recipients, corporate officers who are also shareholders. Petitioner had no current earnings and profits for the first two of the three years in question, but for the third such year had current earnings and profits in excess of the proposed constructive distribution. At no time did Petitioner have accumulated earnings from which the proposed constructive distributions could be deemed to have been made. Petitioner requests an opinion as to the manner in which such distribution would be characterized in the hands of the recipients, should the auditor's proposed determination be adopted.

Section 316 of the Internal Revenue Code defines "dividends" as any distribution of property made by a corporation to its shareholders out of its earnings and profits accumulated after February 28, 1913, or out of its earnings and profits of the taxable year, (and prior to the beginning of the taxable year of the distribution).

Section 301 of the Code states that a distribution of property made by a corporation to a shareholder with respect to its stock shall be treated as follows:

- 1) That portion of the distribution which is a dividend (as defined in section 316) shall be included in gross income.
- 2) That portion of the distribution which is not a dividend shall be applied against and reduce the adjusted basis of the stock.
- 3) ...that portion of the distribution which is not a dividend, to the extent that it exceeds the adjusted basis of the stock, shall be treated as gain from the sale or exchange of property.

Accordingly, since Petitioner had neither current nor accumulated earnings with respect to the first two years in question, any constructive distribution made during such years would be treated as a return of capital to the extent of the stock basis. Any excess would be treated as a gain from the sale or exchange of property. The proposed constructive distribution made during the third year would be treated as dividend income.

Dated: September 15, 1980

s/LOUIS ETLINGER
Deputy Director
Technical Services Bureau