

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

TSB-M-87 (6)C  
Corporation Tax  
April 10, 1987

Discretionary Adjustment To The  
Investment Allocation Percentage

Introduction

This memorandum reflects the policy of the New York State Department of Taxation and Finance in exercising the discretionary powers granted to the Tax Commission by Section 210.8 of Article 9-A of the Tax Law. To date the Department of Taxation and Finance has not adopted a policy with regard to Section 210.8 and, in fact, has only infrequently invoked its discretionary authority in the investment allocation percentage area. However, recent audit activity has indicated transactions which the Department can only conclude are abusive and contrary to the underlying intent of the law. Accordingly, under appropriate circumstances the Tax Commission will now consider using its authority under Section 210.8 of the Tax Law, on a case by case basis. The Tax Commission will consider a discretionary adjustment to a taxpayer's investment allocation percentage for taxable years ending on or after May 26, 1983, for which the statute of limitations has not expired under Section 1083 of the Tax Law.

Background

If it appears to the Tax Commission that a taxpayer's investment allocation percentage does not properly reflect the activity, business, income or capital of a taxpayer within New York State, under Section 210.8 of the Tax Law, the Tax Commission is authorized in its discretion to adjust a taxpayer's investment allocation percentage by excluding one or more assets in computing that percentage, provided that the income therefrom is also excluded in determining entire net income. This discretion is used only where the statutory method of allocating investment income does not properly reflect the activity, business, income or capital of the taxpayer within New York State.

In Matter of Barney's v. Dept of Finance, 93 AD2d 642, aff'd 61NY2d 786 (a case involving the provision in the Administrative Code of the City of New York corresponding to Section 210.8), the Appellate Division and the Court of Appeals upheld the authority of New York City's Director of Finance to exercise his authority and exclude one or more assets in computing a taxpayer's investment allocation percentage. Thus, the provisions of Section 210.8 of the Tax Law with regard to the investment allocation percentage are valid and in appropriate circumstances, the Tax Commission may exercise its authority to make a discretionary adjustment to a taxpayer's investment allocation percentage.

After the Barney's case was decided, the New York City Department of Finance adopted a policy of reviewing a taxpayer's investment capital for the purpose of determining whether a discretionary adjustment was warranted whenever a taxpayer's investments in allocable securities represented less than 15 percent of the taxpayer's investment capital and the income from such

investments represented less than 15 percent of the taxpayer's investment income. However, the Court of Appeals in the Matter of Forbes v. Department of Finance, 66 NY 2d 243, found the statute and the 15 percent policy to be illegal as applied to Federal obligations. The Department's policy concerning the Forbes case is reflected in TSB-M-86(6)C.

Discretionary Adjustment

The Tax Commission will invoke its discretionary authority pursuant to section 210.8 of the Tax Law on a case by case basis. In determining whether to invoke its discretionary authority, the Tax Commission will consider all relevant factors. Key factors that will be considered include the amounts, types and characteristics of investments, acquisition dates of investments and the length of time such investments are held. Once it has been determined that a taxpayer's investment allocation percentage does not properly reflect the taxpayer's activities within New York State, the Tax Commission may adjust the formula by excluding one or more assets from it. The formula will not be adjusted in any other manner than that prescribed by statute.

Example:

The following example illustrates the effects of such a discretionary adjustment. This example is not to be interpreted as setting forth guidelines for discretionary adjustment. It does, however, indicate a scenario in which the Tax Commission would invoke its discretionary power to adjust the taxpayer's investment allocation percentage.

Form CT-3, Schedule D of Corporation XYZ discloses the following investment activity:

<u>Description of Investment</u>	<u>Number of Shares</u>	<u>Net Average Fair Market Value</u>	<u>Issuer's Allocation Percentage</u>	<u>Value Allocated to New York State</u>
BVB Corporation Stock	5	\$ 200	5%	10
Total		\$ 200		10
Certificate of Deposit Investment Capital		\$1,500,000 \$1,500,200		

The taxpayer reported the following investment income in Schedule B of Form CT-3:

50% of dividends from BVB Corporation	\$ 10
Interest income on certificate of deposit	150,000
Total investment income for allocation	\$150,010

Upon review, the following additional facts were ascertained. The corporation had business income of \$50,000. The corporation files its reports on a calendar year basis. The corporation filed its return timely and paid tax on the allocated capital base in the amount of

\$8,750. The certificate of deposit was made January 1 of the taxable period, renewable on January 1 of each succeeding year. Prior to its acquisition of the BVB stock on December 1 of its taxable period the corporation had no other investments of this type. Also, the BVB stock was sold on January 15 of the year following the taxable period under review.

The application of the investment allocation percentage of 5% to investment income of \$150,010 would result in only \$7,500.50 being included in allocated entire net income. Since the inclusion of the investment in BVB Corporation stock in the calculation of the investment allocation percentage causes the taxpayer's investment income and capital within New York State to be improperly reflected, the investment in BVB Corporation is excluded from the computation of the taxpayer's investment allocation percentage. The income from this investment (\$10) is also excluded from the computation of the taxpayer's entire net income. The taxpayer's investment allocation percentage now becomes zero. As such, and in accordance with Section 210.3(b)(3) of the Tax Law, the business allocation percentage (80%) is applied to revised investment income of \$150,000 (\$150,010 - \$10 BVB dividend = \$150,000). This results in the inclusion of \$120,000 of investment income in the taxpayer's allocated entire net income. The taxpayer's allocated entire net income now becomes \$160,000 ( $[\$50,000 + \$150,000] \times 80\%$ ). This results in a revised tax liability of \$16,000 ( $\$160,000 \times 10\%$ ), not \$8,750 as previously reported.