STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
AMSTERDAM SAVINGS BANK	:	DECISION DTA No. 808445
for Redetermination of a Deficiency or for Refund of Franchise Tax on Banking Corporations under Article 32 of the Tax Law for the Year 1988.	: :	

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on June 25, 1992 with respect to the petition of Amsterdam Savings Bank, 11 Division Street, Amsterdam, New York 12010, for redetermination of a deficiency or for refund of franchise tax on banking corporations under Article 32 of the Tax Law for the year 1988. Petitioner appeared by KPMG Peat Marwick (Brian C. Flynn, C.P.A.). The Division of Taxation appeared by William F. Collins, Esq. (Kenneth J. Schultz, Esq., of counsel).

Both the Division of Taxation and petitioner submitted a letter brief. Oral argument was not requested.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUE

Whether petitioner may properly be required to add back to Federal taxable income 60% of a loss sustained on the sale of stock in a corporate subsidiary.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

Petitioner, Amsterdam Savings Bank, provides commercial and retail banking services in the Albany area and west, to Syracuse, New York.

During 1988, petitioner owned three subsidiaries:

(a) F.H. Doherty Associates Inc. ("Doherty") of Syracuse, New York, the principal business activity of which was real estate;

(b) 19 Front Street, Inc., of Binghamton, New York, the principal business activity of which was real estate; and

(c) ASB Insurance Agency, Inc., of Amsterdam, New York, the principal business activity of which was brokerage.

Petitioner filed a Combined New York State Franchise Tax Return for Banking Corporations with its above-mentioned subsidiaries for 1988. On Schedule D of petitioner's United States Corporation Income Tax Return for said year, petitioner had deducted a long-term capital loss of $418,495.00 on the sale of its Doherty stock. The capital loss more than offset two long-term capital gains of $287,240.00 and $115,493.00 attributable to non-subsidiary investments, resulting in a net long-term capital loss of $15,762.00.

Upon audit, it was determined that petitioner was required to add back to Federal taxable income the loss incurred on the sale of the Doherty stock. The auditor explained the addback as follows:

> "Taxpayer sold stock of its subsidiary F.H. Doherty on 8/2/88. Taxpayer incurred a loss in the amount of ($418,495). NYS Tax Law Reg. [sic] Sec. 1453(e)(11)(2) requires that a loss on the sale of subsidiary stock must be added back to entire net income at a rate of 60% of the loss deducted on the Federal return.
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> | | |
> |---|---|
> | Loss on sale of F.H. Doherty | (402733) |
> | 60% addback % | 60% |
> | Subsidiary loss required to be added back | 241640"[1] |

On May 1, 1990, the Division of Taxation issued a statement of Audit Adjustment and Notice of Deficiency to petitioner for 1988 asserting a deficiency of $12,329.00 in tax and $1,589.00 in interest, for a total of $13,918.00, based on the adjustment for the

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[1] Worksheet attached to Exhibit "E," Field Audit Report.

Doherty stock.[2] It is noted that the caption of the Notice of Deficiency states: "NOTICE OF DEFICIENCY - ARTICLE 9-A, TAX LAW". The Statement of Audit Adjustment, however, does not refer to Article 9-A, but indicates that the applicable tax article is Article 32.

The 1988 Corporation Franchise Tax packet CT-32-P, containing the returns and instructions for Article 32 of the Tax Law, states the following with respect to dividend income, gains, or losses from subsidiary capital which are to be reported as subtractions on Line 41 of Form CT-32:

> "Attach a list showing the names of the subsidiaries and the amount of dividend income, gains and losses from each.... Deduct from subsidiary dividends any Section 78 dividends deducted at line 36 which are attributable to dividends from subsidiary capital. If losses from subsidiary capital exceed dividends and gains from subsidiary capital, the net loss is multiplied by 60% and the result is shown in brackets as a negative deduction."

OPINION

In the determination below, the Administrative Law Judge held that Tax Law § 1453(e)(11)(ii) does not require losses from subsidiary capital to be added back to Federal taxable income in determining entire net income for purposes of applying the franchise tax under section 1451(a). Specifically, the Administrative Law Judge stated that while the language of section 1453(e) is somewhat ambiguous, this provision, as well as its legislative history, is devoid of any language indicating that losses from subsidiary capital should be added back, and that to assume that the Legislature had intended the addback of the loss in the absence of proof of such intent would be "'speculative and conjectural'" (Determination, p. 11, citing Matter of Federal Ins. Co. v. State Tax Commn., 146 AD2d 888, 536 NYS2d 595, 597).

On exception, the Division of Taxation (hereinafter the "Division") concedes that a literal reading of section 1453(e)(11)(ii) appears to mean that a loss deducted on the Federal return requires no modification for New York purposes. However, the Division argues that because such a literal reading of this provision results in the unintended non-reciprocal tax treatment of

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[2] The tax was actually computed on a net increase to Federal taxable income of $136,985.00. This net increase was comprised of the $241,640.00 addback for the Doherty loss and $36,901.00 for nontaxable municipal interest required to be added back, less $141,556.00 for a special dividend deduction per the Federal return which was not required to be added back to income. The latter two items were not discussed at the hearing or addressed in the briefs.

gains and losses from subsidiary capital and contravenes the Legislature's intent to make this tax analogous to the franchise tax on general business corporations under Article 9-A, the Tribunal should look behind the literal language of the provision and apply it in a manner consistent with this legislative intent. The Division states "[t]he inconsistent treatment of losses from subsidiary capital which results from a literal reading of § 1453(e)(11) demonstrates that there is a drafting error in the language of § 1453(e)" (Division's letter on exception, p. 1).

In response, petitioner argues that the argument set forth by the Division is in direct conflict with its own interpretation of section 1453(e)(11)(ii) contained in the regulations. In addition, petitioner contends that because the language contained in section 1453(e)(11)(ii) is unambiguous and the words are plain and clear, there is no occasion to resort to other means of interpretation. Alternatively, petitioner contends that although the legislative history indicates a desire to align this franchise tax with that under Article 9-A, the Division ignores the statement that "many differences remain between the taxation of these two types of corporations" and cites several examples.

We affirm the determination of the Administrative Law Judge, but not on the same reasoning.

Tax Law § 1451(a) imposes a tax on every banking corporation "[f]or the privilege of exercising its franchise or doing business in [New York] in a corporate or organized capacity." The tax is to be computed under Tax Law § 1455, which provides that the tax imposed under section 1451 is to be the greater of: (a) a basic tax, calculated at 9% of a taxpayer's entire net income allocated to New York; or (b) an alternative minimum tax. In this case, both petitioner in filing its return and the Division in issuing the notice of deficiency utilized the former method in calculating petitioner's tax liability.

The term "entire net income" is defined as "total net income from all sources," which is equal to the "entire taxable income . . . which the taxpayer is required to report to the United States treasury department . . . subject to the modifications and adjustments hereinafter

provided" (Tax Law § 1453[a], emphasis added; see also, 20 NYCRR 18-2.2).[3] Therefore, it is clear that Federal taxable income is the starting point for determining the amount upon which franchise tax is calculated under section 1451(a).

Section 1453(e)(11) provides:

> "(e) There shall be allowed as a deduction in determining entire net income, to the extent not deductible in determining federal taxable income:
>
> * * *
>
> "(11) (i) seventeen percent of interest income from subsidiary capital,[4] and
>
> "(ii) sixty percent of dividend income, gains and losses from subsidiary capital."

This dispute focuses on the construction of section 1453(e)(11)(ii). The Division argues that this provision requires petitioner to add 60% of its loss on the Doherty stock back to its entire net income. Petitioner argues that this provision does not require it to take any action with respect to this loss because the loss was deductible in determining petitioner's Federal taxable income.

In construing the meaning of a statute, the primary consideration is to "ascertain and give effect to the intention of the Legislature" (McKinney's Cons Laws of NY, Book 1, Statutes § 92[a], at 176-182; see, Matter of Sutka v. Conners, 73 NY2d 395, 541 NYS2d 191; Matter of American Communications Technology v. State of New York Tax Appeals Tribunal, ___ AD2d ___ [Jan. 7, 1993]). "Where words of a statute are free from ambiguity and express plainly, clearly and distinctly the legislative intent, resort may not be had to other means of

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[3] Alternate definitions applicable to corporations which are either exempt from Federal income tax or organized outside the United States have been omitted, as they are not relevant here (see, Tax Law § 1453[a][2], [3]).

[4] Tax Law § 1450(e) defines the term "subsidiary capital" as:

> "[i]nvestments in the stock of subsidiaries and any indebtedness from subsidiaries, exclusive of accounts receivable acquired in the ordinary course of trade or business for services rendered or for sales of property held primarily for sale to customers . . . ."

interpretation" (McKinney's Cons Laws of NY, Book 1, Statutes § 76, at 168-172; see, Matter of American Communications Technology v. State of New York Tax Appeals Tribunal, supra). Therefore, the first step in ascertaining the legislative intent is to examine the words and language used in the statute.

As the prefatory language of section 1453(e) clearly states, taxpayers shall be allowed a deduction in determining "entire taxable income." Although not defined in either the Tax Law or the Internal Revenue Code, "deduction" is a term of art with a well-established meaning in the area of taxation, and is defined as "amounts allowed by law to reduce income prior to application of the tax rate to compute the amount of tax which is due" (West's Tax Law Dictionary 131 [1992 ed], emphasis added). Although the Division concedes that a literal reading of section 1453(e)(11)(ii) supports petitioner's position, it contends that the literal language of a statute will not always be controlling where it contravenes the legislative intent or leads to an unreasonable result, citing Le Drugstore Etats Unis v. New York State Bd. of Pharmacy (33 NY2d 298, 352 NYS2d 188). Thus, it asserts that, based on the legislative history of this provision, losses from subsidiary capital are to be added back to entire net income rather than allowed as a deduction. However, we find this argument to be flawed for several reasons. First, in making this argument, the Division takes the position that section 1453(e)(11)(ii) was intended to produce a result directly opposite to that which the literal language of the statute accomplishes (i.e., an increase rather than a reduction in entire net income). Second, the Division's interpretation of section 1453(e)(11)(ii) ignores the statutory language that a deduction for losses on subsidiary capital be allowed only to the extent that the loss was "not deductible in determining federal taxable income" (Tax Law § 1453[e], emphasis added). By contrast, the Division seeks to add back petitioner's losses because they were deductible in determining Federal taxable income. In our opinion, if the Legislature intended such a result -- which is a radical departure from the literal meaning of section 1453(e)(11)(ii) -- it would have so provided in the statute.

Third, an examination of the other subsections within section 1453 supports a literal reading of section 1453(e). It is a fundamental rule of statutory construction that "[a] statute or legislative act is to be construed as a whole, and all parts of an act are to be read and construed together to determine the legislative intent" (McKinney's Cons Laws of NY, Book 1, Statutes § 97, at 211-219). Section 1453(b) states that: "[e]ntire net income shall be computed without the deduction or exclusion of" and then lists several items subject to this directive, one of which is: "(3) any net operating loss deduction for the taxable year allowable for federal income tax purposes" (Tax Law § 1453[b], emphasis added).[5] This provision is significant, as it demonstrates the language chosen by the Legislature to state the requirement that certain Federal deductions are to be added back in computing entire net income under Article 32. If, in fact, one of the legislative goals of section 1453(e) was to add back losses on subsidiary capital, it is difficult to imagine that, at the time subsection (e) was added in 1985, the Legislature would have spurned the existing language of section 1453(b), which produces in an unambiguous manner the result urged by the Division (i.e., a reduction, rather than an increase, in entire net income). If the Legislature intended for entire net income to be calculated "without the deduction or exclusion of" losses on subsidiary capital, it would have chosen language to that effect (see, Tax Law § 1453[b]).

Based on our examination of the provisions of section 1453(e)(11)(ii), we fail to see any legislative intention that losses on subsidiary capital recognized at the Federal level be added back to entire net income for purposes of calculating franchise tax. Further, the legislative history of these amendments fails to support the Division's argument. The Division cites an excerpt from the Governor's Memorandum in support of the 1985 Amendments to Article 32, which states:

> "The bill . . . revises the franchise tax on banking corporations to make the tax analogous to the franchise tax on general business corporations [and] reforms the structure of State and New York City bank taxes in order to make taxation of banks simpler, more predictable and consistent with taxation of other businesses . . .

[5] See also, Tax Law § 1453(b)(9), (11).

> (McKinney's Session Laws of NY, 1985, vol. 2 at 3290, emphasis added)".

The Division also cites an excerpt from the Executive Department Memorandum, which states that the purpose of the bill is to revise "the franchise tax on banking corporations to make the rate and calculation of the tax analogous to the franchise tax on general business corporations" (McKinney's Session Laws of NY, 1985, vol. 2 at 3032, emphasis added).

In light of this statutory purpose, the Division contends that section 1453(e)(11)(ii) should be interpreted in a manner consistent with its counterpart under Article 9-A, Tax Law § 208(9)(a)(1), which states: "[e]ntire net income shall not include . . . income, gains and losses from subsidiary capital." However, the Division overlooks the fact that the Legislature did not intend for banking corporations to be taxed in a manner identical to general business corporations. This is reflected in the following excerpt from the State Executive Department Memorandum:

> "[i]t should be noted that while the changes made by this bill will tax banking corporations in a manner similar to general business corporations in many respects, many differences remain between the taxation of these two types of corporations. This is appropriate because banking corporations are still subject to regulatory restrictions and are not yet indistinguishable from general business corporations" (McKinney's Session Laws of New York, 1985, vol. 2 at 3037; emphasis added).

Based on these excerpts, it is apparent that the legislative history of section 1453(e) does not support an interpretation which directly contradicts the clear language of the statute (Matter of Federal Ins. Co. v. State Tax Commn., supra).

Support for our decision can also be found in Matter of Federal Ins. Co. v. State Tax Commn. (supra). The dispute in that case arose over an insurance franchise tax assessment under Tax Law Article 33. There, the State Tax Commission disallowed the petitioner a deduction for investment expenses. These expenses were incurred in the production of interest income, which was exempt from Federal tax, but was required to be added back to Federal taxable income to arrive at "entire net income" (Tax Law § 1503[b][2][B], [b][3]). Although this interest expense was deducted at the Federal level, it was claimed again by the petitioner for

state purposes under Tax Law § 1503(b)(3)[B], which allowed a deduction for "ordinary and necessary expenses paid or incurred during the taxable year attributable to income which is subject to tax under this Article but exempt from federal income tax." In upholding the State Tax Commission's disallowance of the deduction, the Supreme Court held that although Article 33 did not specifically prohibit double deductions, it could not be inferred from this omission that the Legislature intended to allow a double deduction (see, Matter of Federal Ins. Co., Sup Ct, Albany County, April 24, 1987, Bradley, J.). In reversing, the Appellate Division, Third Department concluded that there was "no demonstrated legislative intent which would justify a deviation from the plain language" of section 1503(b)(3) (Matter of Federal Ins. Co. v. State Tax Commn., supra, 536 NYS2d 595, 597).

In the case before us, the Division does not merely seek, as in Federal Ins. Co., to read additional language in the statute; rather it seeks to rewrite the phrase "[t]here shall be allowed as a deduction in determining entire net income, to the extent not deductible in determining federal taxable income" (Tax Law § 1453[e]), replacing "allowed as a deduction" with "included," and "included" for "deductible." Further, the Division does not seek to eliminate a double deduction as in Federal Ins. Co. but, instead seeks to disallow a portion of a deduction altogether. As we stated earlier, the Division has directed us to no legislative intent to justify such an extreme altering of the statute (Matter of Federal Ins. Co. v. State Tax Commn., supra; Matter of United States Life Ins. Co. in the City of New York, Tax Appeals Tribunal, April 2, 1992).

Accordingly, it is ORDERED, ADJUDGED, and DECREED that:

1. The exception of the Division of Taxation is denied;

2. The determination of the Administrative Law Judge is affirmed;

3. The petition of Amsterdam Savings Bank is granted; and

4. The notice of deficiency dated May 1, 1990 is cancelled.

DATED: Troy, New York
March 11, 1993

/s/John P. Dugan
John P. Dugan
President

/s/Maria T. Jones
Maria T. Jones
Commissioner