STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
BROOKE-BOND GROUP (U.S.), INC.	:	DECISION DTA No. 810951
for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Fiscal Year Ending June 30, 1988.	:	

Petitioner Brooke-Bond Group (U.S.), Inc., c/o Unilever U.S., Inc., Tax Department, 800 Sylvan Avenue, Englewood Cliffs, New Jersey 07632, filed an exception to the determination of the Administrative Law Judge issued on November 10, 1994. Petitioner appeared by Douglas J. McCormack, Esq. The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Robert J. Jarvis, Esq., of counsel).

Petitioner filed a brief on exception. The Division of Taxation filed a brief in opposition. Oral argument was held on June 8, 1995. Petitioner filed a reply brief which was received on July 3, 1995, and began the six-month period for the issuance of this decision.

Commissioner DeWitt delivered the decision of the Tax Appeals Tribunal. Commissioners Dugan and Koenig concur.

ISSUE

If a taxpayer's New York State entire net income is less than its Federal net operating loss deduction in a given year, may its New York State net operating loss deduction for that year equal its entire net income and be less than the Federal net operating loss deduction taken for the same year.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for findings of fact "5" and "11" to which footnotes have been added correcting a typographical error and pointing out a computational error, respectively. The Administrative Law Judge's findings of fact (with additional footnotes as indicated) are set forth below.

The parties have stipulated to the issues and the agreed facts. That stipulation is incorporated herein together with other facts in the record.

Petitioner, Brooke-Bond Group (U.S.), Inc. (hereinafter, "petitioner"), is a holding company in New York City which performs management services for its subsidiaries.[1] Petitioner's fiscal year ends June 30th. Reference herein to any of the subject tax years refers to a fiscal year ending June 30th.

The parties agree that petitioner had New York State entire net income (loss) before application of any New York State net operating loss ("NYS NOL") deductions, carrybacks or carryforwards for the years 1980, 1981, 1986, 1987 and 1988 as follows:

YEAR	ENTIRE NET INCOME AMOUNT
1980	$(1,313,905)
1981	(3,525,796)
1986	737,950
1987	1,860,269
1988	2,185,519

In the tax year ended June 30, 1981, petitioner had a Federal net operating loss ("Federal NOL") which it carried forward to subsequent taxable years. For Federal purposes, petitioner did not use all of its Federal NOL carryforwards until June 30, 1988.

The parties agree that petitioner had Federal taxable income (loss) before application of any Federal NOL deductions, carrybacks or carryforwards, and was entitled to use its Federal NOL's as follows:

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[1]Petitioner's New York City address was not made part of the record.

FYE	6/30/80	6/30/81	6/30/86	6/30/87	6/30/88[2]
Federal Taxable Income Before NOL Deduction	$(1,845,321.00)	$(4,059,296.00)	$1,558,039.00	$1,864,595.00	$1,875,269.00
NOL Deduction					
1980 CB/CF[3] to 1977-1985	784,518.00				
1980 CF to 1986	1,060,803.00		(1,060,803.00)		
1981 CF to 1986		497,236.00	(497,236.00)		
1981 CF to 1987		1,864,595.00		(1,864,595.00)	
1981 CF to 1988		1,697,465.00			(1,697,465.00)
Federal Taxable Income after NOL	$ -0-	$ -0-	$ -0-	$ -0-	$ 177,804.00

The Division of Taxation ("Division") conducted a franchise tax audit ("the audit") of petitioner's business for 1988.

The NYS NOL deductions taken on petitioner's filed tax returns for 1986, 1987 and 1988 did not exceed the Federal NOL deductions taken by petitioner for the same years.

The Division and petitioner agree that Brooke-Bond was required to apply $784,518.00 of its NYS NOL for the tax year ended June 30, 1980 to income for the years 1977 through 1985, and that Brooke-Bond properly carried forward a NYS NOL deduction of $529,387.00 from 1980 to 1986, which deduction Brooke-Bond applied against its 1986 New York State entire net income of $737,950.00, leaving a balance of New York State entire net income of $208,563.00 in 1986 before application of any other NYS NOL carryforward amounts (see below).

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[2] We modify the heading of the last column of the chart in finding of fact "5" of the Administrative Law Judge's determination to read "6/30/88" to correct a typographical error.

[3] CB means carryback. CF means carryforward.

The Division and petitioner disagree as to the manner in which the NYS NOL carryforward of $3,525,796.00 from the year ended June 30, 1981 should be applied in 1986, 1987 and 1988, respectively.

Petitioner computed its NYS NOL deduction for each of the tax years ended June 30, 1986 and June 30, 1987 as being equal to its entire net income for those years, respectively. As a result, petitioner carried forward $208,563.00 of its 1981 NYS NOL to 1986 and $1,860,269.00 of its 1981 NYS NOL to 1987. The remaining portion of the 1981 NYS NOL, $1,456,964.00, was carried forward and applied to petitioner's 1988 entire net income of $2,185,519.00, leaving a balance in said entire net income of $728,555.00.

The following shows petitioner's calculations:

FYE	6/30/80	6/30/81	6/30/86	6/30/87	6/30/88
NYS Entire Net Income Before NOL Deduction	$(1,313,905.00)	$(3,525,796.00)	$737,950.00	$1,860,269.00	$2,185,519.00
NYS NOL Deduction					
1980 CB/CF to 1977-1985	784,518.00				
1980 CF to 1986	529,387.00		(529,387.00)		
1981 CF to 1986		208,563.00	(208,563.00)		
1981 CF to 1987		1,860,269.00		(1,860,269.00)	
1981 CF to 1988		1,456,964.00			(1,456,964.00)
NYS Entire Net Income after NOL	$ -0-	$ -0-	$ -0-	$ -0-	$ 728,555.00

Upon audit of petitioner, the NYS NOL deduction for fiscal years ending June 30, 1986 and June 30, 1987 was determined to be equal to the Federal NOL deduction taken for those years, respectively. As a result, the auditor carried forward $1,028,652.00 of petitioner's 1981 NYS NOL to 1986 and $1,864,595.00 to 1987. The remaining portion of the 1981 NYS NOL, $632,544.00, was carried forward and applied against petitioner's 1988 entire net income of $2,185,519.00, leaving a balance in entire net income of $1,552,975.00[4] (see below).

[4]We add this footnote to finding of fact "11" of the Administrative Law Judge's determination to reflect that, due to a computational error by the auditor, the amount of "$1,552,975.00" should have been "$1,552,970.00."

Division's Audit Computation FYE	6/30/80	6/30/81	6/30/86	6/30/87	6/30/88
NYS Entire Net Income Before NOL Deduction	$(1,313,905.00)	$(3,525,796.00)	$ 737,950.00	$1,860,269.00	$2,185,519.00
NYS NOL Deduction					
1980 CB/CF to 1977-1985	784,518.00				
1980 CF to 1986	529,387.00		(529,387.00)		
1981 CF to 1986		1,028,652.00	(1,028,652.00)		
1981 CF to 1987		1,864,595.00		(1,864,595.00)	
1981 CF to 1988		632,544.00			(632,544.00)
NYS Entire Net Income after NOL	$ -0-	$ -0-	$ (820,089.00)	$ (4,326.00)	$1,552,975.00

In the Division's view, the negative entire net income for 1986 and 1987 after applying the NOL deduction (see above), was lost and could not be carried forward to 1988 as a net operating loss.

As a result of the audit, the Division determined that petitioner was entitled to credit for overpayments in tax for 1986 and 1987. After giving credit for such overpayments, the Division issued a Statement of Audit Adjustment and a Notice of Deficiency to petitioner, both dated January 25, 1991, asserting additional corporation franchise tax due for fiscal year ending June 30, 1988 in the amount of $122,854.00, plus interest. As a result of the audit, Division also issued a Statement of Audit Adjustment and a Notice of Deficiency to petitioner, both dated January 25, 1991, asserting additional, corresponding Metropolitan Transportation Authority Surcharge for fiscal year ending June 30, 1988 in the amount of $20,885.00, plus interest.

Petitioner made a timely request for a conciliation conference with the Division's Bureau of Conciliation and Mediation Services. As a result of such conference, a Conciliation Order (CMS No. 111571), dated April 10, 1992, was issued to petitioner sustaining the statutory notices. Thereupon, petitioner filed a petition with the Division of Tax Appeals and the instant proceeding ensued.

OPINION

Corporate franchise tax imposed pursuant to Article 9-A of the Tax Law is based on the entire net income of a corporation, as that term is defined in Tax Law § 208(9). In calculating entire net income, a NOL deduction is allowed pursuant to section 208(9)(f).

Tax Law § 208(9)(f) states, in pertinent part, that:

> "A net operating loss deduction shall be allowed which shall be presumably the same as the net operating loss deduction allowed under section one hundred seventy-two of the internal revenue code [the corresponding Federal deduction] . . ., except that in every instance where such deduction is allowed under this article:
>
> "(1) any net operating loss included in determining such deduction shall be adjusted to reflect the inclusions and exclusions from entire net income required by paragraphs (a), (b) and (g) hereof, . . .
>
> * * *
>
> "(3) such deduction shall not exceed the deduction for the taxable year allowed under section one hundred seventy-two of the internal revenue code . . ." (emphasis added).

Section 3-8.1 of the Division's regulations (20 NYCRR) provides that for purposes of Article 9-A, as for Federal income tax purposes, a NOL may be carried back three years and carried forward for as many as 15 years following the loss year.

In his determination, the Administrative Law Judge upheld the Division's position that when a taxpayer's New York State entire net income is less than its Federal NOL deduction in a given year, the New York State NOL deduction for that year may not be lower than the Federal NOL deduction. He found that petitioner did not meet its burden to show that its interpretation

of Tax Law § 208(9)(f) was the only reasonable interpretation or that the Division's interpretation was irrational.

On exception, petitioner argues that when New York State entire net income is smaller than Federal taxable income before taking the NOL deductions (as it was for petitioner in its fiscal years ending June 30, 1986 and June 30, 1987), petitioner should be allowed to take a smaller loss deduction for New York State purposes than it did for Federal purposes. Petitioner's New York State NOL carried forward should not be required to be any larger than is necessary to reduce its entire New York State net income to zero, even if that means its New York State NOL deduction is smaller than the allowable Federal NOL deduction taken for the same year. By doing so, it will retain the unused NOL to carry it forward in later years. Petitioner argues that Tax Law § 208(9)(f) and the Division's regulations create a ceiling rather than a floor with respect to the allowable New York State NOL deduction for any given year. While the taxpayer may not take a New York State NOL deduction greater than the corresponding Federal deduction, the statute and the regulations do not prohibit the deduction from being a lesser amount. Petitioner argues that the Division's position is unreasonable and irrational because it is internally inconsistent. The Division's position permanently disallows a portion of the New York State NOL deduction otherwise available for carryforward to subsequent years. Therefore, the Division has made it impossible for petitioner to claim a New York State NOL deduction which is the same as the Federal deduction in future years.

The Division, in opposition, argues that Tax Law § 208(9)(f) requires that the Federal and New York State NOL deductions in each year must be the same amounts whether or not the resulting Article 9-A entire net income, after application of the NOL deduction, is a positive or negative amount. If the Division is correct, since petitioner carried forward a NOL of $1,558,039.00 from 1981 to 1986 for Federal purposes, petitioner must carry forward that same amount for New York State franchise tax purposes. This will result in a negative entire net income of $820,089.00 for 1986. Similarly, petitioner must carry forward a NOL of $1,864,595.00 for 1987 which will result in a negative entire net income for 1987 of $4,326.00.

Further, petitioner will lose the ability to carry forward a corresponding amount of its New York State NOL to future years.

The focal point of disagreement between the Division and petitioner is whether the term "presumably the same as" in Tax Law § 208(9) requires that the New York State NOL deduction always be identical in amount to the Federal NOL deduction for a given year except as it may be modified by a specific provision of section 208(9)(f). The Division's regulations (sections 3-8.2 and 3-8.5) provide examples of situations in which the New York State NOL deduction equals the Federal NOL deduction for given years, even when it produces a negative New York State entire net income. Footnotes to these examples explain the resultant negative taxable income.

The footnote to Example 4 of section 3-8.2 concerning negative taxable income states that:

> "Since allowance of the net operating loss deduction results in a net loss [of entire net income] for the carry back year, the taxpayer will be subject to tax for that year on one of the alternative bases mentioned in section 3-1.2 of this Part. It should be noted that the $10,000 loss [in New York State entire net income] shown above may be subtracted in determining the base of the alternative tax measured by entire net income plus compensation paid to officers and stockholders. It may not, however, be carried back or forward to any other year as a net operating loss deduction (see explanation in text following Example 4)" (emphasis added).

The "text following Example 4" reads as follows:

> "Although deductions totaling only $85,000 are allowed for 1970 and 1971 on account of the $95,000 [New York State] loss sustained in 1973, the $10,000 balance may not be carried back as a deduction in 1972 or carried forward to any year subsequent to 1973. This is because, for Federal income tax purposes, the entire amount of the 1973 loss was used in 1970 and 1971, so no Federal operating loss deduction will be allowed in any other year for such loss, and the deduction for purposes of article 9-A may not exceed the Federal deduction" (emphasis added).

The footnote to Example 1 of section 3-8.5 states that: "This [$720.00 negative taxable income] loss may not be carried back or forward as a net operating loss deduction."

Stated briefly, the Division seeks to transform the arithmetic result reached in each of these examples, i.e., a negative income, into the universal principle that the full dollar amount

of the Federal NOL deduction must be used for purposes of the State operating loss deduction, even if it produces a negative income. We cannot agree.

First, the principles applied in the examples are not involved in this case. Example 4 of section 3-8.2 is based on the principle that a State NOL deduction must arise from the same source year as the Federal NOL deduction. This rule was sustained in Aetna Casualty & Surety Co. v. Tax Appeals Tribunal (___ AD2d ___ [October 26, 1995]). Example 1 of section 3-8.5 is based on the principle that the aggregate State NOL allowable as a carryback or carryforward cannot be larger than the Federal aggregate number.

Second, we find no basis in the statute which supports the Division's position.

The purpose of Tax Law § 208(9)(f), according to legislative history, was to conform New York State law to Federal law with respect to NOL deductions in order to protect corporations with cyclical fluctuations in earnings from the disadvantage of paying relatively higher taxes in good years without receiving credit for losses in bad years (McKinney's 1961 Session Laws of New York, ch 713, pp. 2121-2122; see also, Matter of American Can Co. v. State Tax Commn., 37 AD2d 649, 323 NYS2d 6; Matter of Telmar Communications Corp. v. Procaccino, 48 AD2d 189, 369 NYS2d 208).

A NOL deduction is provided for Federal purposes by section 172 of the Internal Revenue Code. As part of the statutory scheme of section 172, there is a limitation on the amount of NOL carryback or carryover for any one year. The "taxable income so computed [for any taxable year] shall not be considered to be less than zero" (Internal Revenue Code § 172[b][2][B]). Once a zero taxable income is reached, the balance of the NOL is to be carried forward or backward and applied to reduce the income from other years. Nothing in Tax Law § 208(9)(f) indicates that a contrary result is intended for New York State purposes. Yet, as we have noted, the Division's interpretation of Tax Law § 208(9)(f) would require this petitioner to forego a NOL deduction of $824,415.00 otherwise available to reduce its New York State entire net income for 1988. To require that petitioner lose the ability to carry forward or backward a portion of its New York State NOL simply to achieve conformity with the amount of the

Federal deduction seems at odds with the fundamental purpose for which Tax Law § 208(9)(f) was enacted.

Case law has held that the Federal NOL deduction is the starting point for computation of the New York State NOL deduction. In Matter of Royal Indem. Co. v. Tax Appeals Tribunal (148 AD2d 845, 539 NYS2d 510, affd 75 NY2d 75, 550 NYS2d 610), the court held that, in the calculation of a franchise tax assessment, New York State NOL deductions are limited to those amounts that are "Federally allowable" (see, Matter of American Employers' Ins. Co. v. State Tax Commn. of Dept. of Taxation & Fin., 114 AD2d 736, 494 NYS2d 513; Matter of Eveready Ins. Co. v. New York State Tax Commn., 129 AD2d 958, 515 NYS2d 339, lv denied 70 NY2d 604, 519 NYS2d 1027; Matter of Telmar Communications Corp. v. Procaccino, supra; Matter of Lehigh Valley Indus., Tax Appeals Tribunal, May 5, 1988).[5] The term "Federally allowable" has been interpreted as meaning "the amount of the Federal deduction required to reduce Federal taxable income to zero" (Matter of Royal Indem. Co., Tax Appeals Tribunal, February 19, 1988, affd Matter of Royal Indem. Co. v. Tax Appeals Tribunal, supra, citing Matter of Telmar Communications Corp., State Tax Commn., June 20, 1974, affd Matter of Telmar Communications Corp. v. Procaccino, supra). In our decision in Matter of Lehigh Valley Indus. (supra), we stated:

> "[t]he Article 9-A net operating loss deduction from entire net income is permitted by section 208.9(f) of the Tax Law. This section's description of the deduction begins with the statement that the deduction '[s]hall be presumably the same as the net operating loss deduction allowed under section one hundred seventy-two of the internal revenue code . . . .' (Tax Law § 208.9[f] [emphasis added]). From this Federal starting point, certain modifications, exclusions and limitations are required (Tax Law § 208.9[f][1],[2],[3] and [4]), but the starting point clearly is the Federal deduction. It is completely consistent with the normal use of the term 'deduction' to find that it means the amount as well as the source of the Federal number."

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[5]Royal Indemnity, American Employers' Insurance and Eveready Insurance dealt with provisions in Article 33 of the Tax Law concerning the imposition of franchise tax on insurance companies, which provisions are regarded as being in pari materia and construed in a like manner as substantially identical provisions in Article 9-A (L 1974, ch 649, § 12). These articles provide analogous net operating loss deductions.

To find that the Division's position is a correct interpretation of the statute we must accept that the phrase "presumably the same as" in Tax Law § 208(9)(f) is not only a starting point for calculation of the New York State NOL deduction but, unless it is modified by the specific provisions of Tax Law § 208(9)(f)(1), the New York State NOL must be "always the same as" the Federal deduction. We do not agree with this premise. It seems clear that the Legislature anticipated that, in some situations, the New York State NOL would exceed the Federal NOL. In those cases, the Legislature specifically provided that the New York State NOL deduction could not exceed the Federal deduction for a particular year (Tax Law § 208[9][f][3]). However, there is no corresponding provision in Tax Law § 208(9)(f) that provides that the New York State NOL deduction can never be less than the Federal deduction.

Indeed, the Courts have recognized that situations may arise where the taxpayer may never be able to deduct all of its New York State NOLs (see, Matter of American Employers' Ins. Co. v. State Tax Commn. of Dept. of Taxation & Fin., supra; Matter of Royal Indem. Co. v. Tax Appeals Tribunal, supra). However, in each of these cases, the inability of the taxpayer to fully use its New York State NOL for particular years was clearly based on provisions in the statute limiting such deductibility.

There is no basis shown here for preventing petitioner from limiting its New York State NOL deduction to the amount of its State entire net income for the particular years at issue (1986, 1987 and 1988). To do so seems at odds with the legislative purpose behind Tax Law § 208(9)(f). Petitioner has met the requirement that in each of the years at issue its New York State NOL deduction did not exceed its Federal NOL deduction. Further, for each year at issue, the amounts of NOL petitioner carried forward for its New York State NOL deduction were from the same source year(s) and in a lesser amount than that which comprised the Federal NOL deduction (see, Aetna Casualty & Surety Co. v. Tax Appeals Tribunal, supra). No basis appears for requiring a taxpayer to calculate a negative New York State entire net income in a year when its Federal NOL deduction exceeds the New York State entire net income for the sole purpose of achieving parity with the Federal NOL deduction.

Simply put, we find that petitioner has shown that the interpretation by the Division is incorrect. Therefore, we reverse the determination of the Administrative Law Judge and grant the exception of petitioner.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Brooke-Bond Group (U.S.), Inc. is granted;

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

3. The petition of Brooke-Bond Group (U.S.), Inc. is granted; and

4. The notices of deficiency dated January 25, 1991 are cancelled.

DATED: Troy, New York
December 28, 1995

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

/s/Francis R. Koenig
Francis R. Koenig
Commissioner

/s/Donald C. DeWitt
Donald C. DeWitt
Commissioner