STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
ESSEX RENTAL CORPORATION F/K/A HYDE PARK ACQUISITION CORP.	:	DETERMINATION
	:	DTA NO. 824536
for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Year 2007.	:	
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Petitioner, Essex Rental Corporation f/k/a Hyde Park Acquisition Corp., filed a petition for redetermination of a deficiency or for refund of corporation franchise tax under Article 9-A of the Tax Law for the year 2007.

On January 24, 2013, petitioner, appearing by John J. Fielding, CPA, and the Division of Taxation, appearing by Amanda Hiller, Esq. (Clifford Peterson, Esq., of counsel), waived a hearing and agreed to submit this matter for determination based on documents and briefs submitted by June 30, 2013, which date began the six-month period for the issuance of this determination. After review of the evidence and arguments presented, Timothy Alston, Administrative Law Judge, renders the following determination.

ISSUE

Whether petitioner has established entitlement to certain subtractions from its entire net income as claimed on its 2007 franchise tax return.

FINDINGS OF FACT

1. Petitioner, Essex Rental Corporation, then known as Hyde Park Acquisition Corp., timely filed a New York General Business Corporation Franchise Tax Return (Form CT-3) for

the tax year ended December 31, 2007. Petitioner paid franchise tax for the 2007 tax year as measured by its entire net income (ENI).

2. In computing its ENI on the return, petitioner reported $2,786,736.00 in "interest on federal, state, municipal, and other obligations not included in [federal taxable income]" (Form CT-3, line 2). Petitioner also reported subtractions from ENI totaling $416,767.00 (Form CT-3, line 15 ["other subtractions"]). A list attached to the return identified these subtractions as "abandoned deal cost" of $193,164.00 and "NYC general corporation tax" of $223,603.00.

3. The Division of Taxation (Division) subsequently audited petitioner's return and concluded that petitioner improperly subtracted the $416,767.00 from its ENI. By letter dated December 1, 2009, the Division advised petitioner of its position and further advised, as a consequence of such disallowance, of a proposed audit adjustment of $29,590.00 in additional franchise tax due and $6,377.00 in additional Metropolitan Commuter Transportation District (MCTD) surcharge, plus interest, for the 2007 tax year.

4. By letter dated January 14, 2010, petitioner advised the Division of its disagreement with the proposed audit adjustment, citing the Division's regulations (20 NYCRR 3-2.3) in support of its position that any expenses attributable to the interest on municipal bonds exempt from federal income tax but included in ENI are properly deductible. Petitioner also asserted that its method of reporting the expenses was improper in that the expenses should not have been subtracted on line 15 of the return but should have been netted against the interest income on line 2.

5. By letter dated February 5, 2010, the Division requested additional information regarding the subtractions for "abandoned deal cost" and "NYC general corporation taxes." Specifically, the Division requested that petitioner "provide a more complete description of the

interest income these expenses are attributable to, the nature of the expense in relation to the income, and the precise relationship between both subtractions and their inclusion in the federal computation of federal taxable income." The Division also requested "an explanation of the New York City taxes and where they are reported on the income statement of the federal corporate tax return." The Division made similar requests to petitioner by letters dated March 16, 2010 and July 12, 2010.

6. Petitioner did not respond to any of these requests for additional information.

7. On September 24, 2010, the Division issued to petitioner a Notice of Deficiency asserting $29,590.00 in additional franchise tax due, $6,377.00 in additional MCTD surcharge, plus interest, for the 2007 tax year. The deficiency is premised on the disallowance of the claimed subtractions from ENI referenced above.

8. By letter dated March 3, 2012, petitioner's representative advised the Division that the $223,639.00 for "NYC general corporation taxes" represents the amount of general corporation tax paid to New York City for the tax year 2007 and that such tax was paid solely on the municipal bond interest that was not subject to federal income taxation. Petitioner's representative further advised that the $193,164.00 for "abandoned deal costs" was "directly associated with raising the funds that gave rise to the interest income on the municipal securities." Both categories of expenses were, according to the March 3, 2012 letter, "ordinary and necessary for the business of earning the municipal interest income" and neither was "deductible for federal tax purposes. . . because the income associated with them was exempt from federal tax."

9. With its letter dated March 3, 2012, petitioner submitted a copy of its 2007 New York City General Corporation Tax Return (Form NYC-3L) reporting tax liability of $223,639.00 as

measured by entire net income. ENI as calculated on the city return started with a loss of $66,649.00 as reported federal taxable income. Additions to ENI on the city return consisted of federally exempt interest not included in federal taxable income of $2,786,736.00, New York State franchise tax deducted on the federal return of $32.00 and New York City general corporation tax deducted on the federal return of $36.00. Subtractions from ENI on the City return consisted of the abandoned deal costs of $193,164.00.

10. Petitioner's 2007 U.S. Corporation Income Tax Return (Form 1120) indicates a deduction for abandoned deal costs of $31.00. The Net Income (Loss) Reconciliation (Form 1120, Schedule M-3, Statement 7) reports abandoned deal costs per income statement of $193,195.00, a permanent difference of a negative $193,164.00 and a deduction per the return, as indicated above, of $31.00.

11. Petitioner's Form 1120 in evidence also reports a deduction of $67,068.00 for taxes. Statement 2 attached to the return indicates that $36.00 of this total is allocable to "New York City taxes - Based on income."

SUMMARY OF THE PARTIES' POSITIONS

12. Petitioner contends that the expenses at issue, i.e., "abandoned deal costs" and "NYC corporation taxes" were properly subtracted from its municipal bond interest income in calculating its ENI. Petitioner asserts that the relevant regulation (20 NYCRR 3-2.3) allows taxpayers to deduct from municipal bond interest income any expenses attributable to the interest income but denied deductibility for Federal purposes. Petitioner further asserts that the instructions to the Form CT-3 support its interpretation of the regulation. Petitioner asserts that the subject expenses meet these criteria for subtraction from interest income.

13. The Division contends that petitioner has not met its burden to show that the subject expenses were related to the municipal bond interest income. Even if it had shown such a relationship, the Division contends that such expenses do not qualify for subtraction from petitioner's municipal bond interest income because the regulation in question limits the subtraction to "interest expense incurred to carry" such bonds. Even accepting petitioner's description of the expenses at issue, the Division maintains that the expenses at issue do not fall within this narrow category. The Division further contends that the instructions to Form CT-3 cannot provide a deduction not allowed in the Tax Law or regulations.

CONCLUSIONS OF LAW

A. Article 9-A of the Tax Law imposes a franchise tax on all domestic and foreign corporations doing business, employing capital, owning or leasing property, or maintaining an office in New York State (Tax Law § 209[1]).

B. New York corporate taxpayers report their tax liability based on their computation of the highest of four income bases, one of which is entire net income (Tax Law § 210[1][a-d]). As noted, petitioner's liability for the year at issue was based on its entire net income.

C. As relevant herein, Tax Law § 208(9) defines "entire net income" as "total net income from all sources, which shall be presumably the same as the entire taxable income . . .which the taxpayer is required to report to the United States treasury department . . . except as hereinafter provided."

D. As the "except as hereinafter provided" language suggests, the Tax Law and the Division's regulations provide for various adjustments in the computation of entire net income. Among such adjustments, Tax Law § 208(9)(b)(2) is relevant to the present matter. That section

provides, generally, that ENI shall be determined without the exclusion, deduction or credit of any income from interest on any kind of securities or indebtedness.

E. The Division's regulations interpret Tax Law § 208(9)(b)(2), in relevant part, as follows:

> In computing entire net income, Federal taxable income must be adjusted by adding to it . . . all interest income which has not been included in computing Federal taxable income, such as interest on State and municipal bonds . . . , *less interest expense incurred to carry such investments*, to the extent that such interest expense has not been deducted in computing Federal taxable income. (20 NYCRR 3-2.3[a][2]; emphasis added.)

F. The regulation thus requires the adding back of interest income that is exempt from federal income tax in the calculation of ENI, but allows for the netting against such interest income the "interest expense incurred to carry" the investments yielding such interest income. Here, neither the abandoned deal costs nor the corporation taxes as described by petitioner (***see*** Finding of Fact 8) were interest expenses, much less interest expenses "incurred to carry" the subject investments; that is, interest paid to borrow money to purchase the municipal bonds that provided the added-back interest income.[1] Contrary to petitioner's contention, then, the plain language of the regulation does not provide for the subtraction of the claimed expenses.

G. Petitioner contends that the instructions to Form CT-3 support its position that the expenses as described in Finding of Fact 8 may be subtracted from federally exempt interest

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[1] Where a word in a statute is not defined in the statute or regulations, it is appropriate to use a dictionary definition to ascertain the word's ordinary, everyday meaning (***see Matter of Publishers Clearing House***, Tax Appeals Tribunal, July 22, 1997). Regulations are subject to the same rules of construction as statutes (***see Matter of Nelson***, Tax Appeals Tribunal, April 21, 2011). "To carry" in this context means "to possess or hold" (***see*** Black's Law Dictionary [9th ed., 2009]).

income. Specifically, petitioner notes the Division's instruction for line 2 of Form CT-3,"Interest on federal, state, municipal and other obligations not included in [federal taxable income]," that provides, in relevant part:

> Enter all interest received or accrued from federal, state, municipal, and other obligations that was exempt from federal income tax and is, therefore, not included on line 1. You may deduct from this amount any expenses attributable to that interest but denied deductibility under IRC section 265 (Instructions for Forms CT-4, CT-3 and CT-3ATT [Form CT-3/4-I(2007)], p. 12).

The instruction's language may indeed be broader than the relevant regulation, as it allows the deduction of "any expenses attributable to [the federally exempt] interest" while the regulation, as noted, permits only the deduction of "interest expense incurred to carry such investments." Regulations, however, have the force and effect of law (***see Matter of Shorter***, Tax Appeals Tribunal, July 31, 1997), while instructions "in themselves have no legal effect, unless such effect is specifically provided for by law" (***see*** 20 NYCRR 2375.8[c]). Clearly, then, in any conflict between regulatory and instructional language, the regulations control. As discussed, the language of the regulation requires a finding against petitioner.

H. Even if petitioner's interpretation of the relevant regulation, made by reference to the Division's instructions for line 2 of Form CT-3 as noted above, is correct, its contention must fail because it has not shown that subject expenses were denied deductibility under section 265 of the Internal Revenue Code (IRC) as required by the instructions. IRC § 265(a)(1) denies deductibility for ordinary and necessary expenses allocable to federally tax-exempt interest income (***see*** IRC § 265[a][1]). Petitioner, however, did deduct a small portion of both the abandoned deal costs and the New York City general corporation tax (***see*** Findings of Fact 10 and 11). This suggests that the expenses were not "denied deductiblity under IRC section 265" and were therefore not properly deductible from ENI even under petitioner's interpretation.

I. Petitioner also argued that the instructions for line 6 of Form CT-3 offered additional support for its contention that the New York City general corporation taxes were properly deductible from ENI.[2] That line requires the add back of New York State and other state and local taxes deducted on the federal return. The instruction for this line also advises taxpayers: "However, do not include New York City taxes." This argument is rejected. The fact that New York City taxes are not added back to ENI provides no logical support to the proposition that such taxes are deductible from ENI.

J. Finally, again assuming that petitioner's interpretation of the regulation was correct, its claim with respect to the abandoned deal costs must fail given the insufficient evidence in the record linking those costs with the federally exempt interest income. The March 3, 2012 letter from petitioner's representative to the Division's representative (***see*** Finding of Fact 8) is the only evidence in support of petitioner's claim that the abandoned deal costs gave rise to the municipal bond interest income.[3] The record, however, lacks any evidence of the source of the representative's knowledge of this alleged fact. The claim thus lacks competency and is therefore not credible (***see Matter of Impath, Inc.***, Tax Appeals Tribunal, January 8, 2004). Furthermore, the March 3, 2012 letter is unsworn. Uncorroborated factual claims therein are thus properly accorded little evidentiary weight (***see Matter of Café Europa***, Tax Appeals Tribunal, July 13, 1989). Accordingly, even assuming petitioner's interpretation of the law is correct, in the absence of any credible evidence linking the abandoned deal costs to the bond interest, petitioner has failed to show that such expenses were attributable to the municipal bond interest

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[2] In its brief, petitioner erroneously referred to line 3 of the CT-3 in making this argument.

[3] In contrast, the claim made in the letter asserting a link between the New York City general corporation taxes and the bond interest is corroborated by tax returns in evidence.

at issue and has therefore, on this separate and independent basis, failed to prove entitlement to the claimed adjustment.

K. The petition of Essex Rental Corporation f/k/a Hyde Park Acquisition Corp. is denied and the Notice of Deficiency, dated September 24, 2010, is sustained.

DATED: Albany, New York
December 5, 2013

/s/ Timothy Alston
ADMINISTRATIVE LAW JUDGE