STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition of The Employers' Fire Insurance Co.	:	
	:	AFFIDAVIT OF MAILING
for Redetermination of a Deficiency or a Revision of a Determination or a Refund of Corporation Tax under Article 33 of the Tax Law for the Year 1976	:	

State of New York
County of Albany

Jay Vredenburg, being duly sworn, deposes and says that he is an employee of the Department of Taxation and Finance, over 18 years of age, and that on the 3rd day of April, 1981, he served the within notice of Decision by certified mail upon The Employers' Fire Insurance Co., the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

The Employers' Fire Insurance Co.
One Beacon St.
Boston, MA 02108

and by depositing same enclosed in a postpaid properly addressed wrapper in a (post office or official depository) under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the petitioner herein and that the address set forth on said wrapper is the last known address of the petitioner.

Sworn to before me this
3rd day of April, 1981.

Connie A. Hagglund

J. Vredenburg

STATE OF NEW YORK
STATE TAX COMMISSION

In the Matter of the Petition of The Employers' Fire Insurance Co.	:	
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State of New York
County of Albany

Jay Vredenburg, being duly sworn, deposes and says that he is an employee of the Department of Taxation and Finance, over 18 years of age, and that on the 3rd day of April, 1981, he served the within notice of Decision by certified mail upon John S. Breckinridge the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Mr. John S. Breckinridge
Everett, Johnson & Breckinridge
20 Exchange Pl.
New York, NY 10005

and by depositing same enclosed in a postpaid properly addressed wrapper in a (post office or official depository) under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the representative of the petitioner herein and that the address set forth on said wrapper is the last known address of the representative of the petitioner.

Sworn to before me this
3rd day of April, 1981.

J. Vredenburg

Anne A. Haggerty

STATE OF NEW YORK
STATE TAX COMMISSION
ALBANY, NEW YORK 12227

April 3, 1981

The Employers' Fire Insurance Co.
One Beacon St.
Boston, MA 02108

Gentlemen:

Please take notice of the Decision of the State Tax Commission enclosed herewith.

You have now exhausted your right of review at the administrative level. Pursuant to section(s) 1503 of the Tax Law, any proceeding in court to review an adverse decision by the State Tax Commission can only be instituted under Article 78 of the Civil Practice Laws and Rules, and must be commenced in the Supreme Court of the State of New York, Albany County, within 4 months from the date of this notice.

Inquiries concerning the computation of tax due or refund allowed in accordance with this decision may be addressed to:

NYS Dept. Taxation and Finance
Deputy Commissioner and Counsel
Albany, New York 12227
Phone # (518) 457-6240

Very truly yours,

STATE TAX COMMISSION

cc: Petitioner's Representative
John S. Breckinridge
Everett, Johnson & Breckinridge
20 Exchange Pl.
New York, NY 10005
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition of THE EMPLOYERS' FIRE INSURANCE COMPANY for Redetermination of a Deficiency or for Refund of Franchise Tax on Insurance Corporations under Article 33 of the Tax Law for the Year 1976.	DECISION

Petitioner, The Employers' Fire Insurance Company, One Beacon Street, Boston, Massachusetts 02108, filed a petition for redetermination of a deficiency or for refund of franchise tax on insurance corporations under Article 33 of the Tax Law for the year 1976 (File No. 26091).

Petitioner, by its attorneys, Everett, Johnson & Breckinridge, Esqs. (John S. Breckinridge, Jr., Esq., of counsel), and the New York State Department of Taxation and Finance, by its attorney, Ralph J. Vecchio, Esq. (Berthlynn Davis-McIntosh, Esq., Deputy Counsel) entered into and executed a Stipulation of Facts. On May 22, 1980, petitioner, by its attorneys, waived a formal hearing and consented to submission of this matter to the State Tax Commission. The following decision is rendered upon the file as presently constituted and upon the aforementioned Stipulation of Facts.

ISSUE

Whether petitioner is entitled to a 1976 New York net operating loss deduction, based on a net operating loss sustained in 1975.

FINDINGS OF FACT

1. On November 3, 1978, the Audit Division issued to petitioner, The Employers' Fire Insurance Company ("EFIC"), a Notice of Deficiency asserting

additional franchise taxes due under Article 33 of the Tax Law for the year 1976 in the amount $3,387.00, plus interest thereon. On September 14, 1978, the Division had issued to EFIC a statement of audit adjustment which explained the assertion of said deficiency as follows:

> "The net operating loss deduction has been disallowed since this amount was not claimed for federal tax purposes."

2. EFIC is an insurance corporation organized under the laws of the State of Massachusetts and licensed to do an insurance business in the State of New York as a property and casualty insurer.

3. Petitioner filed timely New York State franchise tax returns under section 187 of the Tax Law for 1972 and 1973, and under Article 33 for 1974, 1975 and 1976.

4. In its New York State franchise tax return for 1974, EFIC reported entire net income of $33,640.00, of which $3,952.00 was its allocated entire net income. Since the amount of tax based upon EFIC's allocated business and investment capital exceeded the tax upon its allocated entire net income, EFIC did not pay any tax on its allocated entire net income for 1974.

5. In its franchise tax return for 1975, EFIC reported a net operating loss of $3,741,054.00 and an allocated entire net income amounting to a loss of $331,813.00.

6. EFIC's 1975 Federal net operating loss was carried back for Federal income tax purposes to years prior to 1974 and was utilized in full as a Federal net operating loss deduction in such years.

7. In its New York State franchise tax return for 1976, EFIC claimed a net operating loss deduction.

8. The Department of Taxation and Finance takes the position that EFIC is not entitled to a net operating loss deduction in 1976 under Article 33

unless it had a 1976 Federal net operating loss deduction. The Department further takes the position that EFIC's 1975 New York net operating loss is available as a New York carryback and should be carried back to taxable years prior to January 1, 1974, the date Article 33 became effective. As the entire amount of EFIC's 1975 Federal net operating loss was carried back and deducted for Federal income tax purposes in years prior to 1974, the Department ruled that EFIC is not entitled to claim its 1975 New York net operating loss as a deduction in its 1976 New York return.

9. If EFIC's 1975 New York net operating loss is available as a carryback to 1974, and was carried back to reduce EFIC's entire net income in 1974, there would be no change in EFIC's 1974 franchise tax liability because its liability for that year was not determined by reference to entire net income.

10. EFIC takes the position that it is entitled to a 1976 New York net operating loss deduction for its 1975 New York net operating loss and that the amount of that deduction equals $3,707,414.00, its 1975 New York net operating loss of $3,741,054.00, less the amount of its 1974 entire net income, $33,640.00, and that it is entitled to a refund as a result of such deduction.

CONCLUSIONS OF LAW

A. That for taxable years commencing before January 1, 1974, insurance corporations such as petitioner were subject to the tax imposed by section 187 of Article 9 of the Tax Law. The tax was measured by the insurance corporation's premiums written on risks located or resident in this state.

B. That for taxable years commencing on or after January 1, 1974, insurance corporations are subject to two franchise taxes imposed by Article 33 of the Tax Law.

Section 1501 imposes a franchise tax similar to that which is imposed on business corporations by Article 9-A. Pursuant to section 1502, this tax is calculated on one of four alternative bases, the first being the taxpayer's entire net income or the portion thereof allocated to New York.

In addition, section 1510 imposes a tax, similar to that imposed by former section 187, measured by the taxpayer's premiums.

C. That section 1503 sets forth the rules by which entire net income is calculated. A net operating loss deduction is permitted by paragraph 4 of subdivision b, as follows:

> "Any 'net operating loss deduction'...allowable under section[ ] one hundred seventy-two...of the internal revenue code...which is allowable to the taxpayer for federal income tax purposes:
> (A) shall be adjusted to reflect the modifications required by the other paragraphs of this subdivision;
> (B) shall not, however, exceed any such deduction allowable to the taxpayer for the taxable year for federal income tax purposes; and
> (C) shall not include any such loss incurred in a taxable year beginning prior to January first, nineteen hundred seventy-four or during any taxable year in which the taxpayer was not subject to the tax imposed under section fifteen hundred one."

D. That section 1503(b)(4) of Article 33 and section 208.9(f) of Article 9-A, which allow the corporate taxpayer subject to taxation under said respective articles a net operating loss deduction, are substantially similar and are to be construed in a like manner.

> "The provisions in article thirty-three of the tax law, which article is added by section one of this act, shall be construed so that the provisions of such article which are the same as or are substantially identical with those in article nine-a of the tax law shall be regarded as being in pari materia and shall be construed in a like manner." L. 1974, Ch. 649, section 12.

E. That the allowance, by the aforementioned statutes, of net operating loss carryback and carryforward is intended to conform New York practices with Federal practices, and to assist new businesses and those with fluctuating

incomes. See Telmar Communications Corp. v. Procaccino, 48 A.D.2d 189 (3d Dept. 1975); American Can Co. v. State Tax Commission, 37 A.D.2d 649 (3d Dept. 1971); Governor's Memorandum, N.Y.S. Legislative Annual 1961, 461; Dept. of Taxation and Finance Memorandum to the Governor, S. Int. No. 2842, Pr. No. 4441, April 6, 1961 (L. 1961, Ch. 713 Bill Jacket).

F. That it has been the long-standing, consistent policy of the Tax Commission to confine the amount of the New York net operating loss deduction to that amount actually absorbed for Federal purposes in the taxable year in question. Section 3.12(d), Ruling of the State Tax Comm., March 14, 1962; 20 NYCRR 3-8.2(d) (eff. January 1, 1976); Matter of Telmar Communications Corp., State Tax Comm., June 20, 1974; Matter of Savin Business Machines Corp., State Tax Comm., March 24, 1970; Matter of Hi-Lo Food Centers, Inc., State Tax Comm., March 9, 1970; Matter of Spedcor Electronics Inc., State Tax Comm., March 9, 1970; Matter of Vision Associates, Inc., State Tax Comm., March 9, 1970.

G. That other jurisdictions, which utilize Federal corporate income as a base for taxation and which permit carryback and/or carryforward of net operating losses, have articulated policies, promulgated regulations and rendered decisions similarly limiting the state net operating loss deduction to that actually taken by the taxpayer in that year for Federal purposes. See, e.g., Fla. Stat. Section 220.13(b)(1)(c).

In its interpretation of section 44-11-11(b) of the Rhode Island General Laws,[1] that state's taxing authority held that where the Federal net

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[1] "A net operating loss deduction shall be allowed which shall be the same as the net operating loss deduction allowed under section 172 of the internal revenue code of 1954, except that...(2) such deduction shall not include any net operating loss sustained during any taxable year beginning prior to January 1, 1975, or during any taxable year in which the taxpayer was not subject to the tax imposed by this chapter, (3) such deduction shall not exceed the deduction for the taxable year allowable under section 172 of the internal revenue code of 1954...".

operating loss deduction for 1975 was carried back and used up in 1972, 1973 and 1974 and there was consequently no carryforward to 1976 or thereafter, there would likewise be no carryforward for state purposes although, by statute, the state net operating loss deduction could not be utilized against Rhode Island 1972, 1973 or 1974 taxable income. R.I. Tax Rep. (CCH) ¶10-558, Bulletin, November 6, 1974.

The Delaware State Tax Board determined that net operating losses incurred subsequent to January 1, 1958 (thereby qualifying for deduction under the applicable statute) were not deductible on state corporate returns if they had been exhausted by carrybacks to pre-1958 years on Federal returns. Del. Tax Rep. (CCH) ¶10-710.51, Docket Nos. 238, 239; July 27, 1962.

H. That more recently, the Supreme Court of Illinois has affirmed a decision of the Appellate Court which held that a net operating loss is deductible for state income tax purposes only in the same manner and amount as is deducted on the taxpayer's Federal return for that year. The taxpayer's net operating loss was reflected only on its state income tax return after computation of its Federal taxable income on a separate return basis; because it filed a consolidated Federal return with its subsidiary, no net operating loss appeared thereon. The taxpayer was not entitled to carry back to 1969 and 1970 a 1971 net operating loss, inasmuch as such loss was completely absorbed when applied against 1968 Federal taxable income; this was so, even though there existed no state income tax act in 1968 and consequently, none of the net operating loss could be absorbed in that year. Bodine Electric Co. v. Allphin, 2 Ill. Tax Rep. (CCH) ¶201-052, affd., 410 N.E.2d 828 (1980).

I. That the United States Supreme Court, in its examination of the Congressional intent underlying section 172 of the Internal Revenue Code,

found that "waste" of the loss deduction was indeed tolerated under certain circumstances; timing accidents might occur which "rob" a taxpayer of the fullest benefit of the deduction.

> "Congress may, of course, be lavish or miserly in remedying perceived inequities in the tax structure. While there is no doubt that Congress through the loss carryover provisions did intend to reduce the arbitrariness inherent in a taxing system based on annual accounting, the history of the loss offset provision does not support the respondent's vision of a Congress seeking perfection in the realization of its objective." United States v. Foster Lumber Co., Inc., 429 U.S. 32, 43-44 (1976).

The Court held that both capital gain and ordinary income must be included in the taxable income offset by the loss deduction before any loss excess might be carried forward, notwithstanding that the full benefit of the loss deduction was not reflected in reduced tax liability: for the year to which the loss was carried back, the taxpayer had used the alternative tax computation method, and its ordinary income was less than the loss deduction.

J. That Article 33 contains a significant feature specifically designed to ease the burden of retaliatory taxation by other states: a retaliatory tax credit. Section 1511(c). Dept. of Taxation and Finance Memorandum to the Governor, A. Int. No. 12272, May 30, 1974 (L. 1974, Ch. 649 Bill Jacket).

K. That the authorities cited by petitioner in support of its position present circumstances and issues sufficiently dissimilar to the instant case that they may be deemed not controlling herein.

Warren-Connolly Co. v. State Tax Commission, 42 A.D.2d 369 (3d Dept. 1973), concerned the periods to which a net operating loss may be carried back where the taxpayer has a short taxable year in the carryback period, caused by its changing from a calendar year to a fiscal year.

In the Matter of Avien, Inc., 532 F.2d 273 (2d Cir. 1976), the Second Circuit sustained Avien's carryforward of its post-1966 losses, stating that

the New York City General Corporation Tax Law expressly provides that carrybacks and carryforwards must be to "taxable" years; inasmuch as the tax was not imposed prior to 1966, there were no "taxable" years prior to 1966 to which a carryback could be made. Insurance companies such as petitioner, which were exercising a corporate franchise or carrying on business in a corporate or organized capacity within New York, had "taxable" years prior to the effective date of Article 33 since they were subject to the tax imposed by section 187 of the Tax Law.

Graham v. State Tax Commission, 48 A.D.2d 444 (3d Dept. 1975), precludes the Tax Commission from denying an Article 22 nonresident taxpayer a net operating loss deduction carryback or carryforward, which is based solely on items of income, gain, loss or deduction derived from or connected with New York sources, even though there may have been no net operating loss deduction carryback or carryforward for Federal purposes. A nonresident taxpayer under Article 22 allocates items of income, gain, loss and deduction to New York using the principles of separate accounting.

The Court of Appeals (February, 1981) reversed the order of the Appellate Division in Sheils v. State Tax Commission, 72 A.D.2d 896, and reinstated the determination of the Commission (October 3, 1977), making reference to Gurney v. Tully, 51 N.Y.2d 818, revg., 67 A.D.2d 303.

L. That, in accordance with section 1503 of the Tax Law and section 172 of the Internal Revenue Code, the net operating loss sustained by petitioner in 1975 must be carried back to 1971, 1972 and 1973 before it may be carried forward to 1976 and thereafter. There can be no carryforward of a net operating loss to years in which there was no Federal net operating loss carryforward stemming from the same loss.

M. That the petition of The Employers' Fire Insurance Company is hereby denied, and the Notice of Deficiency issued November 3, 1978 is sustained in full.

DATED: Albany, New York

APR 0 3 1981

STATE TAX COMMISSION

PRESIDENT

COMMISSIONER

COMMISSIONER