

STATE OF NEW YORK

STATE TAX COMMISSION

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In the Matter of the Petition :  
of :  
Federal Insurance Co. : AFFIDAVIT OF MAILING  
for Redetermination of a Deficiency or for :  
Refund of Corporation Tax under Article 33 of :  
the Tax Law for the Year 1979. :

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State of New York :

ss.:

County of Albany :

David Parchuck/Janet M. Snay, being duly sworn, deposes and says that he/she is an employee of the State Tax Commission, that he/she is over 18 years of age, and that on the 15th day of October, 1986, he/she served the within notice of Decision by certified mail upon Federal Insurance Co. the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Federal Insurance Co.  
51 John F. Kennedy Pkwy.  
Short Hills, NJ 07478

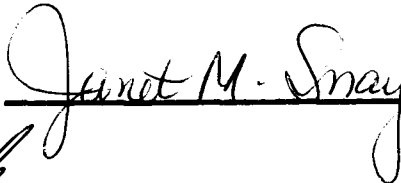
and by depositing same enclosed in a postpaid properly addressed wrapper in a post office under the exclusive care and custody of the United States Postal Service within the State of New York.

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  
15th day of October, 1986.

  
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Authorized to administer oaths  
pursuant to Tax Law section 174

  
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STATE OF NEW YORK

STATE TAX COMMISSION

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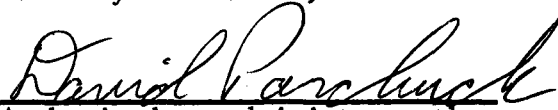
David Parchuck/Janet M. Snay, being duly sworn, deposes and says that he/she is an employee of the State Tax Commission, that he/she is over 18 years of age, and that on the 15th day of October, 1986, he served the within notice of Decision by certified mail upon Eugene Chester, the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

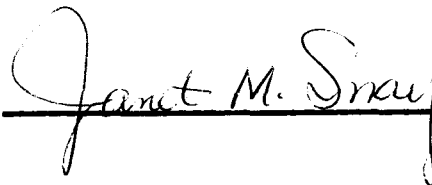
Eugene Chester  
Everett, Johnson & Breckinridge  
20 Exchange Place  
New York, NY 10005

and by depositing same enclosed in a postpaid properly addressed wrapper in a post office 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  
15th day of October, 1986.

  
Authorized to administer oaths  
pursuant to Tax Law section 174

  
\_\_\_\_\_

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

October 15, 1986

Federal Insurance Co.  
51 John F. Kennedy Pkwy.  
Short Hills, NJ 07478

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) 1090 & 1519 of the Tax Law, a proceeding in court to review an adverse decision by the State Tax Commission may be instituted only under Article 78 of the Civil Practice Law 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  
Audit Evaluation Bureau  
Assessment Review Unit  
Building #9, State Campus  
Albany, New York 12227  
Phone # (518) 457-2086

Very truly yours,

STATE TAX COMMISSION

cc: Taxing Bureau's Representative

Petitioner's Representative:  
Eugene Chester  
Everett, Johnson & Breckinridge  
20 Exchange Place  
New York, NY 10005

STATE OF NEW YORK

STATE TAX COMMISSION

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In the Matter of the Petition	:	
of	:	
FEDERAL INSURANCE CO.	:	DECISION
for Redetermination of a Deficiency or for	:	
Refund of Corporation Tax under Article 33	:	
of the Tax Law for the Year 1979.	:	

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Petitioner, Federal Insurance Co., 51 John F. Kennedy Parkway, Short Hills, New Jersey 07478, filed a petition for redetermination of a deficiency or for refund of corporation tax under Article 33 of the Tax Law for the year 1979 (File No. 51730).

On March 26, 1986, petitioner, by its duly authorized representatives, Everett, Johnson & Breckinridge, Esqs. (Eugene Chester, Esq., of counsel), waived a hearing and submitted its case for decision based upon the entire file, including a stipulation of facts, and briefs to be filed by April 15, 1986. After due consideration of the file the Commission renders the following decision.

#### ISSUE

Whether in computing its entire net income for 1979, petitioner may properly deduct \$599,371.00 representing investment expenses incurred in earning federally tax-exempt income.

#### FINDINGS OF FACT

1. Petitioner, Federal Insurance Company ("Federal"), is an insurance corporation organized under the laws of the State of New Jersey. Federal is engaged in the insurance business in New York State as a property and casualty insurer.

2. Federal timely filed a New York State franchise tax return under Article 33 (Form CT-33) for the taxable year 1979.

3. Federal is a member of an affiliated group of corporations whose parent is The Chubb Corporation, and Federal's income and deductions are included in the consolidated federal income tax return filed by The Chubb Corporation. For purposes of Tax Law Article 33, Federal's income and deductions were computed as if it were filing on a separate basis for federal income tax purposes.

4. In computing its entire net income for the year 1979, Federal deducted \$599,371.00 representing investment expenses incurred on federally tax-exempt income (see Finding of Fact "10", infra.).

5. On August 16, 1982, the Audit Division issued to Federal a "Statement of Audit Adjustment" which increased the amount of tax-exempt interest included in Federal's entire net income by \$599,371.00. In turn, Federal's franchise tax liability for 1979 was increased by \$11,555.00.

6. On August 16, 1982, the Audit Division issued to Federal a Notice of Deficiency asserting tax due in the amount of \$11,555.00, plus interest of \$1,102.31. Such amounts were, however, offset by other adjustments and by a credit due Federal for its 1980 taxable year.

7. The adjustment of \$599,371.00 eliminated petitioner's claimed deduction for expenses attributable to income subject to tax under Article 33 but exempt from federal income tax. The Audit Division's disallowance is based on the assertion that the same expenses had already been deducted for federal income tax purposes, and, therefore, could not be deducted again under Article 33.

8. This identical issue, regarding the deduction of certain investment expenses, had been raised previously upon audit of Federal's 1977 and 1978 New

York State Franchise Tax Returns under Article 33. For both 1977 and 1978, this issue was resolved in favor of Federal at a pre-hearing conference held on November 19, 1981.

9. On September 29, 1983, Federal filed a claim for refund (Form CT-8), requesting a refund of \$11,555.00 in tax and \$1,102.00 in interest. This claim was denied by the Audit Division in a letter dated February 3, 1984.

10. The parties have, by a duly executed stipulation, agreed that the \$599,371.00 which petitioner deducted in computing its entire net income for the calendar year 1979 represented the investment expense petitioner incurred which was allocable to interest wholly exempt from tax under the Internal Revenue Code.

11. In effect, the Audit Division has increased petitioner's tax exempt interest amount for 1979 from \$25,828,314.00 to \$26,427,685.00, by adding back \$599,371.00 of investment expenses attributable to such tax exempt interest. Petitioner admits that such investment expenses were deducted in arriving at Federal taxable income, but maintains that such expenses are properly again deductible in computing entire net income under Tax Law Article 33.

#### CONCLUSIONS OF LAW

A. That Tax Law Article 33 provides for a franchise tax upon insurance corporations, such as petitioner, based upon a portion of their "entire net income". Tax Law Section 1503(a) defines "entire net income" as

"total net income from all sources which shall be presumably the same as the ... taxable income ... which the taxpayer is required to report to the United States treasury department, for the taxable year ... except as hereinafter provided."

B. That Tax Law section 1503(b) sets forth various modifications required to be made to convert federal "taxable income" (as above) to "entire net income". Tax Law section 1503(b)(2)(B) requires an insurance company to add to

its federal taxable income all of the tax exempt interest it earned and excluded from federal taxable income. Tax Law Section 1503(b)(3) in turn provides, in part, as follows:

"In determining entire net income, there shall be subtracted interest on indebtedness incurred or continued to purchase or carry obligations or securities the income from which is subject to tax under this article but exempt from federal income tax and 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...". (Emphasis added.)

The evident purpose of the quoted paragraph is to permit the deduction of expenses associated with income taxable under Article 33, where the income is exempt from federal taxation and the associated expenses accordingly disallowed.

C. That in computing federal taxable income petitioner properly deducted from its gross income the (tax exempt) interest income it earned from the sources specified in Internal Revenue Code ("I.R.C.") section 103 (I.R.C. § 832[c][7]). In addition, petitioner properly deducted as ordinary and necessary expenses those investment expenses attributable to the above tax exempt interest income (I.R.C. §§ 832[c], 265[1]).<sup>1</sup> Thus, in sum, petitioner's federal taxable income as properly reported to New York State (Form CT-33, Schedule B, line 23) did not include any tax exempt interest income earned by petitioner and did include a deduction for \$599,371.00 representing investment expense incurred by petitioner in connection with such tax exempt interest income.

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1 I.R.C. § 265(1) bars deduction of expenses allocable to tax exempt income, except tax exempt interest income against which expenses are deductible (except I.R.C. § 212 expenses). Also, I.R.C. § 265(2) bars deduction of interest expense on borrowings incurred or continued to earn tax exempt interest income. Petitioner had, in any event, no interest expense on borrowings incurred or continued to produce tax exempt interest income.

D. That in computing entire net income, petitioner was not entitled to again deduct the investment expenses related to tax exempt interest. "[T]ax deductions and exemptions depend upon clear statutory provisions and the burden is on the taxpayer to establish a right to them (citation omitted)." (Matter of Scholastic Bus Service, Inc. v. State Tax Comm., 498 N.Y.S.2d 278, 280 [3rd Dept., 1986].) Here petitioner failed to establish its right to a double deduction.

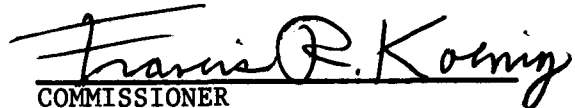
E. That the petition of Federal Insurance Co. is hereby denied.


DATED: Albany, New York

STATE TAX COMMISSION

OCT 15 1986

  
PRESIDENT

  
COMMISSIONER

  
COMMISSIONER



STATE OF NEW YORK

TAX APPEALS BUREAU

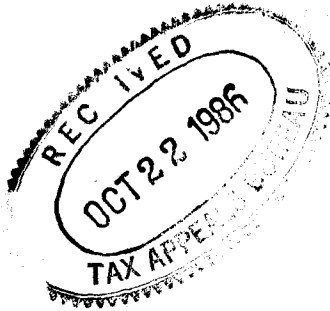
ALBANY, N. Y. 12227

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provided

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MAIL



**Federal Insurance Co.**

51 John F. Kennedy Pkwy.

Short Hills, NJ 07478

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Willard, N. C. H. 1963. *Journal of the Royal Society of Medicine* 56: 101-104.



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

October 15, 1986

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51 John F. Kennedy Pkwy.  
Short Hills, NJ 07478

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

NYS Dept. Taxation and Finance  
Audit Evaluation Bureau  
Assessment Review Unit  
Building #9, State Campus  
Albany, New York 12227  
Phone # (518) 457-2086

Very truly yours,

STATE TAX COMMISSION

cc: Taxing Bureau's Representative

Petitioner's Representative:  
Eugene Chester  
Everett, Johnson & Breckinridge  
20 Exchange Place  
New York, NY 10005

STATE OF NEW YORK

STATE TAX COMMISSION

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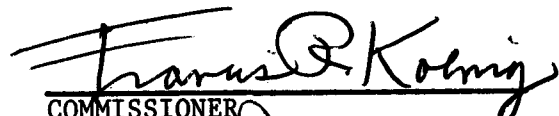
E. That the petition of Federal Insurance Co. is hereby denied.


DATED: Albany, New York

STATE TAX COMMISSION

OCT 15 1986

  
PRESIDENT

  
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