STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
TD HOLDINGS II, INC.	:	DETERMINATION DTA NO. 825329
for Redetermination of a Deficiency or for Refund of Franchise Tax on Banking Corporations under Article 32 of the Tax Law for the Fiscal Year Ended October 31, 2007.	:	

Petitioner, TD Holdings II, Inc., filed a petition for redetermination of a deficiency or for refund of franchise tax on banking corporations under Article 32 of the Tax Law for the fiscal year ended October 31, 2007.

On March 25 and 26, 2014, respectively, petitioner, appearing by McDermott Will & Emery LLP (Arthur R. Rosen, Esq., and Lindsay M. LaCava, Esq.), and the Division of Taxation, appearing by Amanda Hiller, Esq. (Robert J. Tompkins, Esq., and Bruce D. Lennard, Esq., of counsel), waived a hearing and submitted this matter for determination based on documents and briefs to be submitted by August 22, 2014, which date commenced the six-month period for issuance of this determination. After due consideration of the documents and arguments submitted, Herbert M. Friedman, Jr., Administrative Law Judge, renders the following determination.

ISSUE

Whether petitioner was required, pursuant to Article 32 of the Tax Law, to use a net operating loss (NOL) deduction to decrease its entire net income in a year in which its banking

corporation franchise tax liability was not measured by entire net income, but rather another applicable basis.

FINDINGS OF FACT[1]

1. Petitioner, TD Holdings II, Inc., is, and at all relevant times was, a Delaware corporation with a principal place of business in New York, New York. During the years 2005 through 2007, petitioner was subject to tax under Tax Law Article 32, the franchise tax on banking corporations.

2. TD Securities (USA) LLC and Toronto Dominion (Texas) LLC are wholly-owned subsidiaries of petitioner (Subsidiaries) and treated as disregarded entities for federal income tax and New York banking corporation franchise tax purposes.

3. Petitioner properly filed its New York banking corporation franchise tax returns for the tax years 2005 through 2007.[2] These returns included the income, deductions, and apportionment factors of petitioner and its Subsidiaries.[3]

4. For the years 2005 through 2007, petitioner and its Subsidiaries were included in a consolidated return with a larger group of entities for federal income tax purposes.

5. In order to determine their New York banking corporation franchise tax liability for the years 2005 through 2007, petitioner and its Subsidiaries prepared pro forma federal income tax returns (pro forma returns) that properly reflected the income and deductions that they would have reported if they had filed their own consolidated federal income tax returns.

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[1] The facts in this matter are not in dispute. The Findings of Fact herein include those contained in a Joint Stipulation of Facts that was submitted by the parties and other relevant facts in the record.

[2] The tax years discussed in this determination run from November 1 of the prior year through October 31 of the referenced year (e.g., the tax year 2007 runs from November 1, 2006 through October 31, 2007).

[3] As petitioner's subsidiaries were disregarded entities, petitioner filed the New York returns at issue in its name.

6. Petitioner used the amounts reflected on the pro forma returns in order to compute its New York banking corporation franchise tax liability for the years 2005 through 2007.

7. Based on the pro forma returns, petitioner and its Subsidiaries incurred a loss of $11,747,046.00 during the 2005 tax year for federal income tax purposes (2005 Federal NOL).

8. Petitioner and its Subsidiaries incurred a loss of $9,259,151.00 during the 2005 tax year for New York banking corporation franchise tax purposes (2005 New York NOL).

9. For federal income tax purposes, based on the federal taxable income reflected on the pro forma returns, petitioner was properly entitled to carry forward and use $3,767,459.00 of the 2005 Federal NOL for the 2006 tax year and carry forward and use the remaining $7,979,587.00 of the 2005 Federal NOL for the 2007 tax year.

10. Petitioner did not use any of the 2005 New York NOL on its 2006 New York banking corporation franchise tax return. Instead, it carried forward and used the entire 2005 New York NOL on its 2007 New York banking corporation franchise tax return.

11. The federal and New York NOL deductions reported by petitioner based on the pro forma returns and New York banking corporation franchise tax returns are summarized as follows:

	2005 Tax Year	**2006 Tax Year**	**2007 Tax Year**
Federal Taxable Income /(Loss) Reflected on the Pro Forma Returns	($11,747,046)	$3,767,459.00	$33,346,431.00
Federal NOL Deduction Based on Income/(Loss) Reflected on the Pro Forma Returns	$0	($3,767,459.00)	($7,979,587.00)

New York Entire Net Income/(Loss) Reflected on Article 32 Returns	($9,259,151.00)	$6,608,498.00	$34,605,022.00
New York NOL Deduction Reflected on Article 32 and Applied in Computing Entire Net Income	$0	$0	($9,259,151.00)

12. During the period at issue, pursuant to Tax Law § 1455, New York banking corporation franchise tax was imposed on one of the following four alternate bases, whichever resulted in the highest tax: (1) 7.5% of allocated entire net income; (2) 0.0001 of each dollar of taxable assets or portion thereof allocated to New York; (3) 3% of alternative entire net income (i.e., entire net income with certain adjustments) or portion thereof allocated to New York; or (4) $250.00, which served as a minimum tax.

13. Pursuant to Tax Law § 1455, petitioner calculated and paid New York banking corporation franchise tax for the tax year 2005 in the amount of $1,291,219.00 based on its taxable assets allocated to New York. Petitioner's allocated entire net income for that year was a negative number, even without application of any of its 2005 New York NOL, and therefore was not used as a basis for the tax.

14. For the tax year 2006, petitioner calculated and reported its allocated entire net income to be $5,557,159.00 which, multiplied by the tax rate of .075, resulted in a tax of $416,787.00, without application of any of the 2005 New York NOL deduction. The computed tax on its allocated alternative entire net income was even less. Therefore, pursuant to Tax Law § 1455, petitioner calculated and paid New York banking corporation franchise tax for 2006 in

the amount of $907,043.00 based on its taxable assets allocated to New York of $9,070,433,524.00.

15. Petitioner did not claim a New York NOL deduction on its 2006 return. Instead, petitioner was required to pay New York banking corporation franchise tax on its asset base, regardless of whether a NOL deduction was applied in computing entire net income, because the tax on its asset base exceeded the tax on its entire net income base.

16. For the 2007 tax year, petitioner paid New York banking corporation franchise tax in the amount of $2,217,729.00 based on its entire net income base, which far exceeded the tax on either its asset base or allocated alternative entire net income base. Petitioner used its entire 2005 New York NOL deduction in calculating the tax for 2007.

17. Following an audit of petitioner's banking corporation franchise tax returns for the years 2005, 2006 and 2007, the Division of Taxation (Division) issued to petitioner a Notice of Deficiency, dated August 3, 2012, asserting additional banking corporation franchise tax of $241,444.00, additional metropolitan transportation business tax under Tax Law § 1455-B in the amount of $49,254.00, and interest in the amount of $82,596.83 for the 2007 tax year.

18. In arriving at the deficiency, the Division reduced the amount of petitioner's 2005 New York NOL available to be carried forward and used for tax year 2007 from $9,259,151.00 to $5,491,692.00 on the basis that $3,767,459.00 of it was required to be used in the 2006 tax year.

SUMMARY OF THE PARTIES' POSITIONS

19. Petitioner argues that it was not required to use $3,767,459.00 of the 2005 New York NOL to reduce its entire net income for the 2006 tax year (thereby leaving all $9,259,151.00 of the 2005 New York NOL available to be carried forward and used in later years) because it

computed and paid New York banking corporation franchise tax on its asset base and, therefore, entire net income played no role in the computation of its final liability under Article 32 for that year. Petitioner concedes that if it prevails, the additional tax and interest reflected in the Notice of Deficiency should be recomputed by using a New York NOL deduction in the amount of $7,979,587.00 to reduce its entire net income for the 2007 tax year.

20. The Division maintains that petitioner was required to use $3,767,459.00 of the 2005 New York NOL on its 2006 banking corporation franchise tax return to reduce its entire net income for that year even though petitioner did not pay tax on its entire net income base. Hence, the Division states that the amount of petitioner's 2005 New York NOL available to be carried forward and used for the 2007 tax year should be reduced to $5,491,692.00 and its liability adjusted accordingly.

CONCLUSIONS OF LAW

A. Article 32 of the Tax Law imposes a franchise tax on a banking corporation "[f]or the privilege of exercising its franchise or doing business in [New York State] in a corporate or organized capacity" (Tax Law § 1451[a]). For the period at issue, the tax was measured by the greater of 1) a percentage (in this case, seven and one-half percent) of the taxpayer's entire net income, or a portion thereof that is allocated to New York State; 2) one-tenth of a mill upon each dollar of taxable assets, or the portion thereof allocated to New York; 3) three percent of the taxpayer's alternative entire net income, or portion thereof allocated to New York for the taxable year; or 4) $250.00 (***see*** Tax Law § 1455).

B. Pursuant to Tax Law § 1453(a), entire net income includes total net income from all sources, which is the same as federal taxable income, with some adjustments and modifications (***see also*** 20 NYCRR 18-2.2[b]). One such adjustment relates to NOL deductions. In

computing entire net income, a taxpayer is required to add back any federal NOL deduction to its federal taxable income and is then permitted to deduct a New York NOL (***see*** Tax Law § 1453; 20 NYCRR 18-2.3[a][3]).

C. Tax Law § 1453(k-1) provides 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, 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 the other provisions of this section,
>
> (2) such deduction shall not include any net operating loss sustained during any taxable year beginning prior to [January 1, 2001], or during any taxable year in which the taxpayer was not subject to tax impose by this article,
>
> (3) such deduction shall not exceed the deduction for the taxable year allowed under section one hundred seventy-two of the internal revenue code . . . , and
>
> (4) the net operating loss deduction allowed under section one hundred seventy-two of the internal revenue code shall . . . be determined as if the taxpayer had elected under such section to relinquish the entire carryback period with respect to net operating losses."

D. In the instant case, petitioner calculated each of the three bases discussed in Tax Law § 1455 for the tax year 2006 and determined that the tax on its allocated assets base far exceeded that on either its entire net income or allocated alternative entire net income. In doing so, petitioner found it unnecessary and, therefore, chose not to claim a New York NOL deduction for that year in computing its entire net income, even though it claimed a federal NOL deduction of $3,767,459.00, because it concluded that the tax would be paid on its asset base, regardless of application of the New York NOL. Instead, petitioner chose to carry over the New

York NOL deduction to the following year, where a comparable federal NOL deduction existed. Application of the relevant statutes, cases, and legislative history supports petitioner's position.

Tax Law § 1453(k-1) requires that petitioner's New York NOL deduction be "presumably the same as" its federal NOL for the same year, subject to the limitation that the former not exceed the latter. As petitioner correctly points out, however, Tax Law § 1453(k-1) does not prohibit it from using a New York NOL deduction that is less than its federal NOL deduction (or not using a New York NOL deduction at all) when the New York banking corporation franchise tax is paid on an alternative basis, such as the asset base. Indeed, the Legislature's use of the phrase "presumably the same as," rather than "the same as" or "exactly the same as" in Tax Law § 1453(k-1) indicates that a taxpayer's New York NOL deduction may differ from its federal NOL deduction (***see*** McKinney's Cons Laws of NY, Book 1, Statutes § 363 ["omissions in a statute cannot be supplied by construction"]; ***see also Kurcsics v. Merchants Mut. Ins. Co.***, 49 NY2d 451 [1980]). Here, petitioner found it unnecessary to use the 2005 New York NOL whatsoever to reduce its entire net income for 2006 in order to ascertain its proper tax liability. Contrary to the Division's argument, petitioner was not required by the plain language of the statute to hypothetically apply the 2005 New York NOL to an entire net income that was already sufficiently low enough to cause use of an alternative tax base.

E. The Tribunal has been instructive on this question when addressing a similar issue under Tax Law Article 9-A in ***Matter of Brooke-Bond Group (U.S.), Inc.*** (Tax Appeals

Tribunal, December 28, 1995). In considering Tax Law § 208(9)(f)[4], a nearly identical statute, the Tribunal held that:

> "[i]t 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."

In fact, the Tribunal allowed the taxpayer in ***Matter of Brooke-Bond Group*** to take a smaller NOL deduction for New York State purposes than it did for federal purposes, and to retain the unused NOL to carry forward to later years. The Tribunal emphasized that the taxpayer had met the requirements that its New York NOL deduction had not exceeded its federal NOL deduction and that the amounts of NOL carried forward for its New York NOL deduction were from the same source years and in a lesser amount than that which comprised the federal NOL deduction (***see Matter of Aetna Casualty & Surety Co. v. Tax Appeals Tribunal***, 214 AD2d 238 [1995], ***lv denied*** 87 NY2d 811 [1996]). Most significantly for the case at bar, the Tribunal in ***Matter of Brooke-Bond Group*** concluded that there was no basis for preventing a taxpayer from limiting its New York State NOL deduction to the amount of its entire net income for the sole purpose of achieving parity with the federal NOL deduction. Thus, since petitioner's entire net income was not used here as a basis for the tax, it was unnecessary for it to claim a hypothetical New York NOL deduction.

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[4] Tax Law 208(9)(f) states, in pertinent part, "[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 . . . ." As is the case with Tax Law § 1453(k-1), section 208(9)(f) goes on to expressly limit the maximum New York NOL deduction to the claimed federal NOL deduction, but requires no minimum deduction. It is well settled that where provisions in different articles within the Tax Law are substantially identical, the provisions should be regarded as being in pari materia and construed in a like manner (***see Matter of Royal Indemnity Company v. Tax Appeals Tribunal***, 75 NY2d 75 [1989]). Neither party in this matter disputes the applicability of this legal tenet here.

F. Moreover, petitioner correctly points out that the legislative history and policy behind the New York State NOL deduction support its interpretation. The New York banking corporation franchise tax NOL deduction, adopted in 1997, was intended to serve the same purpose as the Article 9-A NOL deduction (***see*** Mem of Senate Rules Comm, Bill Jacket, L 1997, ch 389). The Article 9-A NOL deduction, first incorporated into the Tax Law in 1961, was added to ensure that taxpayers with fluctuating earnings would not be punished compared to those with steady earnings (***see*** State of New York Dept of Tax & Fin, Report to the Governor, Bill Jacket, L 1961, ch 713; ***see also Matter of Telmar Communications Corp. v. Procaccino***, 48 AD2d 189 [1975]). Likewise, the federal NOL deduction rules, upon which the New York NOL deduction was modeled, "were designed to permit a taxpayer to set off its lean years against its lush years, and to strike something like an average taxable income computed over a period longer than one year" (***Lisbon Shops, Inc. v. Kohler***, 353 US 382, 386 [1957]). In ***Matter of Brooke-Bond Group***, the Tribunal added that "[t]o 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 [f]ederal deduction seems at odds with the fundamental purpose for which Tax Law § 208(9)(f) was enacted." Thus, as petitioner rightly asserts, to accomplish this legislative goal, as reiterated by the Tribunal, it is clear that the applicability of a NOL deduction must be tied to a taxpayer's income. Consistent with this policy, it was unnecessary for petitioner in the instant case to apply a NOL deduction to lower its entire net income for the 2006 tax year when that income was already below the level triggering invocation of the alternative tax base.

G. The Division's argument centers on petitioner's need to demonstrate its entitlement to the claimed deduction "by demonstrating that the only reasonable interpretation of applicable

law so provides him" (***Matter of Howes v. Tax Appeals Tribunal***, 159 AD2d 813 [1990]; ***see Matter of Grace v. New York State Tax Commn.***, 37 NY2d 193 [1975]). It is true that "the burden is on the taxpayer seeking the deduction to establish his right to it" (***Matter of Grace v. New York State Tax Commn.***). In maintaining that petitioner fails to meet this burden, the Division emphasizes that the "presumably the same as" language in Tax Law § 1453(k-1) should not be broadly interpreted, as petitioner states, but actually means that the allowable New York NOL deduction is the same as the federal NOL deduction except for the possibility of the certain inclusions or exclusions from entire net income enumerated in Tax Law § 1453. Moreover, citing to ***Matter of Refco Properties, Inc.*** (Tax Appeals Tribunal, July 11, 1996), the Division asserts that the "presumably the same as" language also requires that the ordering rules of IRC § 172 must be followed when using a New York NOL as a deduction. Finally, the Division maintains that petitioner's reliance on ***Matter of Brooke-Bond Group*** is misplaced. According to the Division, ***Matter of Brooke-Bond Group*** is actually consistent with its argument and simply stands for the clear principle that, at a minimum, a taxpayer is required to reduce its entire net income to zero with NOL deductions under all circumstances, to the extent possible.

Petitioner, however, has persuasively refuted the Division's argument. First, petitioner correctly points out that although Article 32 clearly provides for a maximum New York NOL deduction, it does not describe a minimum deduction. The Division's reading of Tax Law § 1453 (k-1), and its "presumably the same as" provision, is too narrow. Meanwhile, petitioner rightly emphasizes that in relying on the federal ordering rules to create such a minimum, the Division misses the critical distinction between the federal corporate income tax and the New York banking franchise corporation tax - while federal corporate income tax is always based on

income, the tax under Article 32 can be based on something other than income. As a result, there may be years in which income is not the basis for ascertaining the tax under Article 32 and, therefore, it is unnecessary, even under the federal ordering rules, to carry over a NOL. Such is the case here. Following the Tribunal's rationale in ***Matter of Brooke-Bond Group***, the unused New York NOL deduction would be allowable in a subsequent year as long as petitioner's claimed NOL deduction in the later year did not exceed its federal NOL for that year and was from the same source year as the federal NOL. On the other hand, the Tribunal in ***Matter of Brooke-Bond Group*** did not address the issue of whether a taxpayer is required to use a NOL deduction to reduce its entire net income to zero in all cases, as the Division suggests. In sum, the Division's reading of ***Matter of Brooke-Bond Group*** is too expansive.

Additionally, the Division's reliance on ***Matter of Refco Properties*** is in error. That case simply stands for the proposition that a taxpayer's New York NOL deduction under Article 9-A[5] cannot exceed its federal NOL deduction for a given year. The Division correctly states that the Tribunal pointed out that the federal NOL deduction allowed in a given year is a function of both the amount of available loss carried to that year and the amount of taxable income in that year. Likewise, the Division properly argues that the ordering rules discussed in ***Matter of Refco Properties*** operate to require a New York taxpayer to carry any available New York NOL to the earliest of the taxable years to which such loss may be carried and to use the New York NOL as a deduction to the maximum extent possible. The Division, however, ignores that in our case, petitioner does not benefit in any way from the academic use of the 2005 New York NOL on its 2006 return. Petitioner simply did not use income as a basis for its tax and, thus, did not need the New York NOL deduction in that year. Furthermore, petitioner does not claim a

[5] ***See*** Footnote 3.

New York NOL deduction that exceeds its federal NOL. Hence, the principle from ***Matter of Refco Properties*** is inapplicable here.

H. Petitioner has clearly and convincingly demonstrated that it was not required to use a NOL deduction to unnecessarily decrease its entire net income for the tax year 2006, when its banking corporation franchise tax liability was not measured by entire net income, but rather another applicable basis. Given the facts presented, petitioner's is the only reasonable interpretation of the Article 32 provisions at issue. Hence, the Division's application of a $3,767,459.00 NOL deduction to that year is improper and must be canceled. Petitioner correctly concedes, however, that an adjustment to its 2007 return is warranted. Although petitioner was not required to claim a New York NOL deduction for the 2006 tax year, its 2007 New York NOL must be capped at $7,979,587.00 in order not to exceed its federal NOL for that year. Therefore, petitioner's 2007 liability must be recomputed based on the use of a New York NOL of $7,979,587.00, rather than the $9,259,151.00 claimed on its return.

I. The petition of TD Holdings II, Inc. is granted to the extent indicated in Conclusion of Law H, and the Division of Taxation is directed to modify the Notice of Deficiency issued to petitioner in accordance therewith.

DATED: Albany, New York
January 22, 2015

/s/ Herbert M. Friedman, Jr.
ADMINISTRATIVE LAW JUDGE