

New York State Department of Taxation and Finance
Office of Counsel
Advisory Opinion Unit

TSB-A-10(1)C
Corporation Tax
March 4, 2010

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. C081017A

The Department of Taxation and Finance received a Petition for Advisory Opinion on October 17, 2008 from [REDACTED]. Petitioner asks whether certain distributions from a charitable remainder unitrust to its corporate beneficiary should be treated as business income or investment income under Article 9-A of the Tax Law. We conclude that the distributions should be treated by the corporate beneficiary as business income.

Facts

Petitioner is in the business of investing in different markets such as real estate, partnerships and securities. Petitioner and its shareholders have made the federal S corporation election. The New York S corporation election has not been made but it is likely Petitioner will be deemed to have made the New York election under Tax Law section 660(i).

Petitioner formed a charitable remainder unitrust (the "Trust") in 2003, and in that year contributed to the trust about \$15,000,000 in publicly-traded common stock with an approximate basis of \$400,000. The Trust agreement requires annual distributions to Petitioner of about 8% of the fair market value of the Trust's assets. The Trust sold the contributed stock in 2003 and used the sale proceeds for alternative, and more diversified, investments and to make the required distributions to Petitioner. The sale produced a substantial long-term capital gain for federal income tax purposes. Since that sale in 2003, the Trust has had modest earnings – mostly dividends and interest – from the securities purchased with the sale proceeds from the contributed stock.

The income currently being earned by the Trust would constitute investment income if it were earned directly by Petitioner. The gain on the sale of the contributed stock would have been investment income if the stock had been directly sold, and the gain directly realized by, Petitioner.

Analysis

Corporations taxable under Article 9-A of the Tax Law must compute their tax on four alternative tax bases, and pay the highest amount computed on those bases plus a tax on subsidiary capital. Tax Law § 210.1 One of these four bases is the entire net income base. The entire net income base is the portion of the taxpayer's entire net income allocated within the state. Tax Law § 210.1(a). The starting point for the determination of entire net income is the corporation's federal taxable income, and amounts are then added and subtracted as required by statute. *See*, Tax Law § 208.9. Once entire net income is computed, it is divided into business income and investment income. *See* § 3.2-1(b) of the Business Corporation Franchise Tax Regulations (hereinafter the "Article 9-A Regulations"). In general terms, investment income is income, including capital gains in excess of capital losses, from investment capital to the extent included in computing entire net income, less permitted deductions and a portion of net operating losses. Tax Law § 208.6. Business income is the taxpayer's entire net income minus its investment income. Tax Law § 208.8. The portion of a corporate taxpayer's entire net income allocated to the State is determined by multiplying a taxpayer's business income by the business allocation percentage, and its investment income by the

taxpayer's investment allocation percentage, and then adding the results together. Article 9-A Regulations § 3.2-1(b).

Investment capital means investments in stocks, bonds and other securities, corporate and governmental, not held for sale to customers in the regular course of business, exclusive of subsidiary capital and stock issued by the taxpayer. Tax Law § 208.5. Investment capital does not include securities of an individual, partnership, trust or other nongovernmental entity which is not a corporation. Article 9-A Regulations § 3-3.2[a][2][iii]. Business capital means all assets of the taxpayer other than investment capital and subsidiary capital, less certain liabilities and any cash on hand or on deposit that the taxpayer has elected to treat as investment capital. Tax Law § 208.7(a).

Petitioner receives distributions from the charitable remainder unitrust that it established. Those distributions are characterized as income to Petitioner for federal tax purposes in accordance with the ordering rules set forth in IRC § 664(b), and may be treated as ordinary income, capital gain or other income under that Code provision. While some of that income may be treated as a capital gain, that federal tax treatment does not require a determination that the distribution, or any portion of it, is investment income. *See Matter of Anametrics, Inc.*, Tax Appeals Tribunal, December 21, 1989. Petitioner receives distributions from the trust it established. Petitioner is not receiving income from the assets owned by the trust. Since investment capital does not include an interest in a trust (Article 9-A Regulations § 3-3.2[a][2][iii]), the distributions from the charitable remainder unitrust, to the extent included in Petitioner's entire net income, are considered business income and are not investment income.

DATED: March 4, 2010

/S/

Jonathan Pessen
Director of Advisory Opinions
Office of Counsel

NOTE: An Advisory Opinion is issued at the request of a person or entity. It is limited to the facts set forth therein and is binding on the Department only with respect to the person or entity to whom it is issued and only if the person or entity fully and accurately describes all relevant facts. An Advisory Opinion is based on the law, regulations, and Department policies in effect as of the date the Opinion is issued or for the specific time period at issue in the Opinion.