STATE OF NEW YORK
STATE TAX COMMISSION

ADVISORY OPINION PETITION NO. C820505A

On May 5, 1982 a Petition for Advisory Opinion was filed by C.I.T. Financial Corporation and Combined Subsidiaries, 650 Madison Avenue, New York, New York 10022.

Petitioner poses two related questions arising under Article 9-A of the Tax Law, which imposes New York's Franchise Tax on Business Corporations. The questions raised are as follows: In filing a Combined Franchise Tax Report as permitted by Tax Law Sec. 211.4, should an intercompany elimination be allowed for the parent company's total investment in subsidiaries which are included in the combined report? Should this elimination be allowed on Form CT-3A as a reduction of Business Capital to the extent that it is not eliminated as Subsidiary Capital?

Petitioner posits a hypothetical example so as to simply frame its questions as to the proper method of computing business capital and subsidiary capital on a combined report. The facts of such hypothetical are as follows. A parent corporation has two groups of wholly owned subsidiaries. The parent files its franchise tax report on a combined basis with one such group (the "included subsidiaries"), but is not permitted to include on a combined report the second group of subsidiaries (the "excluded subsidiaries"). The parent has an investment in the included subsidiaries of $1250, and an investment in the excluded subsidiaries of $750. The parent also has current liabilities of $250 attributable to its investment in the included subsidiaries, a current liability of $150 with respect to its investment in the excluded' subsidiaries, and an additional current liability of $600 attributable to neither subsidiary capital nor investment capital. The included subsidiaries have $2,000 in assets, and $750 in current liabilities. Neither the parent nor the included subsidiaries have any investment capital, and the included subsidiaries themselves have no subsidiary capital. The combined group computes its tax on the basis of total business and investment capital, pursuant to section 210.1(a)(2) of the Tax Law.

The situation here described is expressed in the following table:

Table 1

FINANCIAL STATEMENTS

	Parent	Included Subsidiaries	Excluded Subsidiaries
Investment in Subsidiaries	$2,000	$ -	$ -
Other Assets	3,000	2,000	1,000
Total Assets	$5,000	2,000	$1,000
Current Liabilities	1,000	750	250
Total Capital	$4,000	$1,250	$ 750

Section 208.4 of the Tax Law defines the term "subsidiary capital," in relevant part, as "investments in the stock of subsidiaries . . . [reduced by the amount of] any liabilities payable by their terms on demand or within one year from the date incurred, other than loans or advances outstanding for more than a year as of any date during the year covered by the report, which are attributable to subsidiary capital." The parent's subsidiary capital would thus be equal to $2,000 (investments in the stock of subsidiaries) reduced by $400 (current liabilities of the parent attributable to its investment in all of its subsidiaries), or $1600. This computation is set forth in the following table:

Table II

SUBSIDIARY CAPITAL

	Parent	Subsidiary Capital with respect to Included Subsidiaries	Subsidiary Capital with respect to Excluded Subsidiaries
Investment in Subsidiaries	$2,000	$1,250	$750
Less current liabilities of the parent attributable to its investment in its subsidiaries	400	250	150
Subsidiary Capital	$1,600	$1,000	$600

Section 211.4 of the Tax Law provides for the filing of franchise tax reports on a combined basis. Under this procedure a parent and a subsidiary or group of subsidiaries are treated as a single entity. The various elements going to make up the applicable tax base, such as the entire net income, business capital, investment capital and subsidiary capital of each included corporation, are added together to arrive at combined figures. However, inasmuch as such an addition would result in a distortion where any of the factors comprising these elements arises from an intercorporate transaction, the statute provides for the elimination of such factors arising from intercorporate transactions. For example, a long-term debt from a subsidiary to its parent might constitute an asset of the parent, includible on its own individual report, but does not represent an asset of the combined group and thus is required to be eliminated.

The portion of section 211.4 of the Tax Law applicable to the present matter provides as follows:

> In the case of a combined report the tax shall be measured by the . . . combined capital of all the corporations included in the report . . . [In] computing combined business . . . capital intercorporate stockholdings shall be eliminated and in computing combined subsidiary capital intercorporate stockholdings shall be eliminated.

Pursuant to this statutory provision, then, the parent's holding of $1250 worth of stock in its included subsidiaries in our example is not to be included in the base subject to tax. That is, the parent's ownership of the included subsidiaries is not an asset of the combined group taken as a whole. It is necessary to determine, then, the manner in which such elimination is to be made. As indicated in the above-quoted statutory provision, the parent's subsidiary capital is required to be reduced by the amount of intercorporate stockholdings included therein. The parent's subsidiary capital, as shown in Table II, supra, is $1600. The portion of such $1600 which represents its investment in the included subsidiaries is $1000. Accordingly, in computing the subsidiary capital of the combined group the parent's subsidiary capital of $1600 would be augmented by any subsidiary capital owned by the included subsidiaries, which in this case is zero, and the resultant figure of $1600 would then be reduced by making an elimination of $1000 (the investment in the included subsidiaries which is contained in the parent's subsidiary capital of $1600). In computing combined business capital (neither the parent nor its subsidiaries having any investment capital) the business capital of the parent of $2400 (i.e., total capital of $4,000 from Table I reduced by subsidiary capital of $1600 from Table II) is added to the business capital of the included subsidiaries of $1250, to produce a sum of $3650. Section 211.4 of the Tax Law requires the elimination of inter-corporate stockholdings "in computing combined business capital." Of the intercorporate stockholding (viz., of the parent in the included subsidiaries) of $1250, $1000 was eliminated in the computation of combined subsidiary capital. The remaining intercorporate stockholding of $250 must therefore be eliminated from combined business capital, as required by the statute. The correctness of this interpretation is made manifest by the following consideration. Included in the sum of $3650 (combined business capital) is the included subsidiaries' business capital of $1250, representing the parent's investment in these subsidiaries. It will be remembered, however, that in order to make this investment the parent used only $1,000 of its own funds and borrowed $250. That is why the parent's subsidiary capital with respect to the included subsidiaries is only $1,000. Similarly, the combined group owns, free of current liabilities, only $1,000 of the business capital of the included subsidiaries. The remaining $250 should not be subjected to taxation. Hence its elimination.

The proper computation of the tax base of the combined group is shown in the following completed, albeit abbreviated, version of Schedule M (Computation of Combined Capital) of Form CT-3A (New York State Combined Franchise Tax Report):

	Parent	Included Subsidiaries	Total	Intercorporate Eliminations	Combined Totals
Total Capital	4000	1250	5250	1250	4000
Subsidiary Capital	1600	--	1600	1000	600
Business Capital	2400	1250	3650	250	3400

It may be noted that to exclude the elimination of $250 from business capital would result in the anomalous situation of having the sum of the resultant combined business capital ($3650) and combined subsidiary capital ($600) exceed combined total capital($4000)

Accordingly, under the hypothetical conditions posited by Petitioner, in computing the combined tax bases there should be an intercorporate elimination of the total amount of the parent's investment in the included subsidiaries, including an elimination of that portion of such investment otherwise included in combined business capital.

DATED: June 27, 1983

s/FRANK J. PUCCIA
Director
Technical Services Bureau