New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB-A-95 (15) C
Corporation Tax
September 5, 1995

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. C950306A

On March 6, 1995, a Petition for Advisory Opinion was received from Deloitte & Touche, LLP, Two World Financial Center, South Tower 8th Floor, New York, New York 10281-1426.

The issue raised by Petitioner, Deloitte & Touche, LLP, is how to determine if an instrument is a "qualifying corporate debt instrument" for purposes of section 3-3.2(d)(2)(ii) of the Business Corporation Franchise Tax Regulations ("Article 9-A Regulations") when a combined report is filed.

Corporation A, a New York taxpayer, is in the business of providing diversified asset management and consulting services. Corporation A owns all the stock of Corporation B, also a New York taxpayer. Corporation B makes secured and unsecured loans to third party corporations, many of whom are customers of Corporation A.

Corporation A and Corporation B satisfy the unitary business and distortion requirements of sections 6-2.2 and 6-2.3, respectively, of the Article 9-A Regulations, and accordingly file their franchise tax reports on a combined basis for both New York State and New York City. On a separate company basis, Corporation B derives more than 50 percent of its gross receipts from interest and net gains from loan transactions. However, the Corporation A and Corporation B combined group derives less than 50 percent of its gross receipts from interest and net gains from loan transactions.

Section 208.5 of the Tax Law provides that the term "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, provided, however, that, in the discretion of the Commissioner of Taxation and Finance, there shall be deducted from investment capital any liabilities which are directly or indirectly attributable to investment capital.

Section 3-3.2(c) of the Article 9-A Regulations provides that the phrase "stocks, bonds and other securities" means, among other things, "qualifying corporate debt instruments".

Section 3-3.2(d)(1) of the Article 9-A Regulations defines the term "qualifying corporate debt instruments" as all debt instruments issued by a corporation other than the following:

(i) instruments issued by the taxpayer or a DISC;

(ii) instruments which constitute subsidiary capital in the hands of the taxpayer;

(iii) instruments acquired by the taxpayer for services rendered or for the sale, rental or other transfer of property, where the obligor is the recipient of the services or property; however, where a taxpayer sells or otherwise transfers property which is investment capital in the hands of such taxpayer (e.g., stock) and receives in return a corporate obligation issued by the recipient of such property, such corporate obligation, if it is not otherwise excluded from the category of investment capital, would constitute investment capital in the hands of the taxpayer;

(iv) instruments acquired for funds if:

(a) the obligor is the recipient of such funds;

(b) the taxpayer is principally engaged in the business of lending funds; and

(c) the obligation is acquired in the regular course of the taxpayer's business of lending funds;

(v) accepted drafts (such as banker's acceptances and trade acceptances) where the taxpayer is the drawer of the draft;

(vi) instruments issued by a corporation which is a member of an affiliated group which includes the taxpayer; and

(vii) accounts receivable, including those held by a factor.

Section 3-3.2(d)(2)(ii) of the Article 9-A Regulations states that "[a] taxpayer is 'principally engaged in the business of lending funds', for purposes of [section 3-3.2(d) of the Article 9-A Regulations], if during the taxable year more than 50 percent of its gross receipts consist of interest from loans or net gain from the sale or redemption of notes or other evidences of indebtedness arising from loans made by the taxpayer. For purposes of the preceding sentence, receipts do not include return of principal or nonrecurring, extraordinary items."

With respect to the provisions for investment capital in Article 9-A of the Tax Law, such provisions are structured so as to give presumably preferential treatment to portfolio assets. Therefore, the exclusion from investment capital contained in section 3-3.2(d)(1)(iv) of the Article 9-A Regulations was created because a taxpayer that is principally engaged in the business of lending funds that receives a debt instrument acquired from the recipient of such funds where the recipient is the obligor on the debt instrument has not made a portfolio investment in that debt instrument. Such debt instrument acquired in the regular course of the taxpayer's business of lending funds is, accordingly, properly classified as business capital rather than accorded investment capital status.

Section 6-3.2 of the Article 9-A Regulations provides that in all cases where a combined report is required or permitted, a combined franchise tax report must be submitted on form CT-3-A and a separate franchise tax report must be filed for each corporation in the combined group on form CT-3.

Therefore, pursuant to section 6-3.B of the Article 9-A Regulations, when determining whether a taxpayer is "principally engaged in the business of lending funds" where a taxpayer is a member of a combined group filing a combined report, it is appropriate to compute the gross receipts test, under section 3-3.2(d)(2)(ii) of the Article 9-A Regulations, on the basis of the individual taxpayer that is in the business of lending funds and that received the corporate debt instrument in question.

Section 3-3.8 of the Article 9-A Regulations provides that in computing combined investment capital on a combined report, all intercorporate stockholdings, intercorporate bills, intercorporate notes receivable and payable, intercorporate accounts receivable and payable and other intercorporate indebtedness must be eliminated.

Accordingly, pursuant to section 6-3.2 of the Article 9-A Regulations, when Corporation A and Corporation B file on a combined basis, each corporation must file a separate franchise tax report in addition to the combined report. On Corporation B's separate report, Corporation B computes its investment capital on an individual basis in accordance with section 3-3.2 of the Article 9-A Regulations. When Corporation A and Corporation B compute combined business capital and combined investment capital on the combined report, the eliminations provided in section 3-3.8 of the Article 9-A Regulations must be made.

DATED: September 5, 1995

s/PAUL B. COBURN
Deputy Director
Taxpayer Services Division

NOTE: The opinions expressed in Advisory Opinions are limited to the facts set forth therein.