

New York State Department of Taxation and Finance
Office of Tax Policy Analysis
Technical Services Division

TSB-A-03(3)I
Income Tax
June 11, 2003

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. I021213A

On December 13, 2002, a Petition for Advisory Opinion was received from George Lavenia, 315 East 86th Street Apt. 4KE, New York, NY 10028.

The issue raised by Petitioner, George Lavenia, is whether a deduction is allowed, under Article 22 of the Tax Law, for the amortization of bond premiums he paid on bonds as described below.

Petitioner submits the following facts as the basis for this Advisory Opinion.

Petitioner purchased at a premium municipal bonds issued by states other than New York State, such as bonds of the State of Washington. Because the bonds yielded tax exempt interest for federal income tax purposes, Petitioner was required to amortize the premium. Each year, Petitioner was required to reduce the basis in the bonds by the amortization for the year. However, such amortized amount is not deductible in determining federal taxable income.

For New York State personal income tax purposes, Petitioner was required to add to his federal adjusted gross income the interest income he received each year that was attributable to the municipal bonds. The municipal bonds are not used by Petitioner in a trade or business.

For tax year 1999, Petitioner claimed itemized deductions for federal income tax purposes and the standard deduction for New York personal income tax purposes.

Applicable Law

Section 611(a) of the Tax Law provides:

General. The New York taxable income of a resident individual shall be his New York adjusted gross income less his New York deduction and New York exemptions, as determined under this part.

Section 612(a) of the Tax Law provides:

General. The New York adjusted gross income of a resident individual means his federal adjusted gross income as defined in the laws of the United States for the taxable year, with the modifications specified in this section.

Section 612(b)(1) of the Tax Law contains a modification and provides that there shall be added to federal adjusted gross income:

Interest income on obligations of any state other than this state, or of a political subdivision of any such other state unless created by compact or agreement to which this state is a party, to the extent not properly includible in federal adjusted gross income;

Section 612(c)(10) of the Tax Law contains a modification and provides that there shall be subtracted from federal adjusted gross income:

Ordinary and necessary expenses paid or incurred during the taxable year for (i) the production or collection of income which is subject to tax under this article but exempt from federal income tax, or (ii) the management, conservation or maintenance of property held for the production of such income, and the amortizable bond premium for the taxable year on any bond the interest on which is subject to tax under this article but exempt from federal income tax, to the extent that such expenses and premiums are not deductible in determining federal adjusted gross income and are attributable to a trade or business carried on by the taxpayer.

Section 613 of the Tax Law provides:

The New York deduction of a resident individual shall be his New York standard deduction unless he elects to deduct his New York itemized deduction under the conditions set forth in section six hundred fifteen.

Section 615(a) of the Tax Law provides:

General. If federal taxable income of a resident individual is determined by itemizing deductions from his federal adjusted gross income, he may elect to deduct his New York itemized deduction in lieu of his New York standard deduction. The New York itemized deduction of a resident individual means the total amount of his deductions from federal adjusted gross income, other than federal deductions for personal exemptions, as provided in the laws of the United States for the taxable year, with the modifications specified in this section, except as provided for under subsection (f) of this section.

Section 615(d)(3) of the Tax Law contains a modification and provides that the total amount of deductions from federal adjusted gross income shall be increased by:

[O]rdinary and necessary expenses paid or incurred during the taxable year for (i) the production or collection of income which is subject to tax under this article but exempt from federal income tax, or (ii) the management, conservation or maintenance of property held for the production of such income, and the amortizable bond premium for the taxable year on any bond the interest on which is subject to tax under this article but exempt from federal income tax, to the extent that such

expenses and premiums are not deductible in determining federal adjusted gross income and are not subtracted from federal adjusted gross income pursuant to paragraph (10) of subsection (c) of section six hundred twelve.

Section 103 of the Internal Revenue Code (IRC) provides, in part:

(a) Exclusion. Except as provided in subsection (b), gross income does not include interest on any State or local bond.

(b) Exceptions. Subsection (a) shall not apply to

(1) Private activity bond which is not a qualified bond. Any private activity bond which is not a qualified bond (within the meaning of section 141).

(2) Arbitrage bond. Any arbitrage bond (within the meaning of section 148).

(3) Bond not in registered form, etc. Any bond unless such bond meets the applicable requirements of section 149.

Section 171 of the IRC contains the provisions for amortizable bond premium, and provides, in part:

(a) General rule. In the case of any bond, as defined in subsection (d), the following rules shall apply to the amortizable bond premium (determined under subsection (b)) on the bond:

(1) Taxable bonds. In the case of a bond (other than a bond the interest on which is excludable from gross income), the amount of the amortizable bond premium for the taxable year shall be allowed as a deduction.

(2) Tax-exempt bonds. In the case of any bond the interest on which is excludable from gross income, no deduction shall be allowed for the amortizable bond premium for the taxable year.

(3) Cross reference. For adjustment to basis on account of amortizable bond premium, see section 1016(a)(5).

(b) Amortizable bond premium.

(1) Amount of bond premium. For purposes of paragraph (2), the amount of bond premium, in the case of the holder of any bond, shall be determined

(A) with reference to the amount of the basis (for determining loss on sale or exchange) of such bond,

(B)(i) with reference to the amount payable on maturity or on earlier call date, in the case of any bond other than a bond to which clause (ii) applies, or and [sic]

(ii) with reference to the amount payable on maturity (or if it results in a smaller amortizable bond premium attributable to the period to earlier call date, with reference to the amount payable on earlier call date), in the case of any bond described in subsection (a)(1) which is acquired after December 31, 1957, and

(C) with adjustments proper to reflect unamortized bond premium, with respect to the bond, for the period before the date as of which subsection (a) becomes applicable with respect to the taxpayer with respect to such bond.

In no case shall the amount of bond premium on a convertible bond include any amount attributable to the conversion features of the bond.

(2) Amount amortizable. The amortizable bond premium of the taxable year shall be the amount of the bond premium attributable to such year. . . .

* * *

(e) Treatment as offset to interest payments. Except as provided in regulations, in the case of any taxable bond

(1) the amount of any bond premium shall be allocated among the interest payments on the bond under rules similar to the rules of subsection (b)(3), and

(2) in lieu of any deduction under subsection (a), the amount of any premium so allocated to any interest payment shall be applied against (and operate to reduce) the amount of such interest payment.

For purposes of the preceding sentence, the term “taxable bond” means any bond the interest of which is not excludable from gross income.

Section 1012 of the IRC contains the provisions for basis of property, and provides:

The basis of property shall be the cost of such property, except as otherwise provided in this subchapter and subchapters C (relating to corporate distributions and adjustments), K (relating to partners and partnerships), and P (relating to capital gains and losses). . . .

Section 1016 of the IRC contains the provisions for adjustment to basis, and provides, in part:

(a) General rule. Proper adjustment in respect of the property shall in all cases be made

* * *

(5) in the case of any bond (as defined in section 171(d)) the interest on which is wholly exempt from the tax imposed by this subtitle, to the extent of the amortizable bond premium disallowable as a deduction pursuant to section 171(a)(2), and in the case of any other bond (as defined in section 171(d)) to the extent of the deductions allowable pursuant to section 171(a)(1) (or the amount applied to reduce interest payments under section 171(e)(2)) with respect thereto;

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Pursuant to section 1012 of the IRC, when a premium is paid to buy a bond, the premium is part of the basis of the bond. If the bond yields taxable interest, section 171(a)(1) of the IRC allows a taxpayer a deduction for the amortizable bond premium for the taxable year. Section 171(e) of the IRC provides that the amount of the bond premium is allocated among the interest payments on the bond, and in lieu of a deduction, the amount of the premium allocated to any interest payment is allowed as an offset to the interest payments. This reduces the amount of interest income otherwise includible in federal gross income. When a taxpayer amortizes the bond premium over the life of the bond, the basis of the bond is correspondingly reduced by the amount of the amortized bond premium pursuant to section 1016(a)(5) of the IRC. If the bond yields tax exempt interest, a taxpayer must amortize the premium. However, section 171(a)(2) of the IRC provides that this amortized amount is not allowed as a deduction in determining taxable income for the taxable year. Further, each year the basis in the bond must be reduced by the amortization for the year.

Pursuant to section 612(b)(1) of the Tax Law, a taxpayer is required to add to his federal adjusted gross income interest income attributable to municipal bonds of other states that are exempt for federal income tax purposes. No deduction is allowed in determining New York adjusted gross income for the amortizable bond premium not deductible in determining federal adjusted gross income unless the premium is attributable to a trade or business carried on by the taxpayer.

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However, pursuant to section 613 of the Tax Law, a resident individual is allowed a New York standard deduction unless the taxpayer elects to deduct his or her New York itemized deduction pursuant to section 615 of the Tax Law. If federal taxable income is determined by itemizing deductions, section 615(d)(3) of the Tax Law allows taxpayers to increase the amount of federal itemized deductions for amortizable bond premiums for the taxable year on any bond the interest on which is subject to New York State personal income tax to the extent the premiums are not deductible in determining federal adjusted gross income and are not subtracted from federal adjusted gross income in determining New York adjusted gross income. Unlike section 612(c)(10) of the Tax Law, the New York itemized deduction allowed pursuant to section 615(d)(3) of the Tax Law does not require that the premium be attributable to a trade or business carried on by the taxpayer.

In this case, since Petitioner did not elect to deduct his New York itemized deduction pursuant to section 615 of the Tax Law in determining his New York taxable income for tax year 1999, no deduction is allowed pursuant to section 615(d)(3) of the Tax Law. Further, since the premium paid is not attributable to a trade or business carried on by Petitioner, no deduction is allowed in computing New York adjusted gross income pursuant to section 612(c)(10) of the Tax Law for the amortizable bond premium for the municipal bonds of other states.

DATED: June 11, 2003

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