

50% of Interest Received on Loans to Finance ESOP Plans
Not Deductible for Franchise Tax Purposes

New York State does not conform with the Federal treatment of interest received in conjunction with ESOP transactions.

The Federal Tax Reform Act of 1984 provides for a new section 133 of the Internal Revenue Code. This section permits a partial exclusion in the computation of Federal taxable income for interest received by certain lenders on loans pertaining to an Employee Stock Ownership Plan (ESOP).

Under these IRC provisions, banks, insurance companies or other commercial lenders are entitled to exclude from taxable income 50% of the interest received on loans to an ESOP or to an employer corporation, the proceeds of which are applied by the plan to acquire employer securities. This interest exclusion pertaining to indebtedness incurred to acquire employer securities after July 18, 1984 applies whether the loan was granted to the ESOP itself or to the sponsoring corporation which, in turn, lends the proceeds to the ESOP.

Interest on loans between related persons may not be recognized for this partial interest exclusion. The full details of this limitation are contained in Section 133(b) of the IRC.

The Federal exclusion of 50% is not recognized in the computation of entire net income for New York State Franchise Tax purposes. Provisions for the modifications are already provided in Articles 9-A, 32 and 33 of the Tax Law at sections 208.9(b)(2), 1453(b)(1)* and 1503 (b) (2) (B) .

*Although section 1453(b)(1) was amended by Chapter 298 of the Laws of 1985, the modification for this Section is still required both in the original Law and in the Law as amended.