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

TSB-A-84 (9) C
Corporation Tax
June 27, 1984

STATE OF NEW YORK
STATE TAX COMMISSION

ADVISORY OPINION PETITION NO. C820928B

On September 28, 1982, a Petition for Advisory Opinion was received from Richard W. Genetelli, C.P.A., of Coopers and Lybrand, 1251 Avenue of the Americas, New York, New York 10020.

At issue is whether interest on loans paid by a taxpayer to its subsidiaries, on funds which the taxpayer then lends to its own parent, would be deductible by the taxpayer when computing its entire net income, for purposes of the Franchise Tax on Business Corporations imposed under Article 9-A of the Tax Law.

The taxpayer in this instance is a holding company incorporated in Delaware. The taxpayer contemplates borrowing funds from its wholly owned subsidiaries and, in turn, lending these same funds to its parent corporation. The parent will use these funds for its own operating requirements, and will pay the taxpayer the same rate of interest which the taxpayer paid to its subsidiaries to acquire the funds.

Section 208.9(b)(6) of the Tax Law provides for an addition to Federal entire taxable income, in computing entire net income for purposes of Article 9-A, of:

in the discretion of the tax commission, any amount of interest directly or indirectly and any other amount directly attributable as a carrying charge or otherwise to subsidiary capital or to income, gains or losses from subsidiary capital.

Inasmuch as the interest expenses at issue herein is patently not "directly" attributable to subsidiary capital (or income, gain or losses therefrom, such items hereinafter, where applicable, subsumed under the rubric of "subsidiary capital"), the dispositive question is whether such interest expense is "indirectly attributable" to subsidiary capital. The reference to indirect attribution was added to the Tax Law by Chapter 715 of the Laws of 1955. This legislation addressed itself to the situation, under the then-existing statute, "where a parent corporation advances funds to its subsidiary and later borrows additional funds to replenish its working capital," nonetheless retaining its entitlement to a deduction for the interest expended in connection with the borrowed funds. McKinney's 1955 Session Laws of New York, 1791. While the Franchise Tax Regulations offer no elucidation of the term "indirectly", and there appear to be no applicable judicial decisions, a number of State Tax Commission decisions point toward the conclusion that interest which is neither directly nor indirectly attributable to subsidiary capital is not subject to the add-back requirement. In B.R. Hewitt, Inc., TSB-H-80(14)C, for example, the Tax Commission concluded that a portion of the taxpayer's interest expense was directly attributable to subsidiary capital (where money was

borrowed in order to provide funds to the subsidiary) and therefore to be added back in full. Certain other interest income, however, having been shown to be neither directly nor indirectly attributable to subsidiary capital, was held not to be subject to a "percentage formula." In Sussex Hall, Inc., TSB-H-81(41)C, the Tax Commission, having concluded that some of the proceeds acquired through the refinancing of a mortgage were utilized to acquire or retain subsidiary capital, held "a proportionate part of the interest paid ... [to be] indirectly attributable to subsidiary capital," such portion to be determined by formulary allocation.

The question here, then, is whether the interest paid by Petitioner is directly attributable to its lending operation. That is, the issue is whether the funds were borrowed for the effectuated purpose of supporting the described operation. Matter of Texaco, State Tax Commission, December 22, 1971; Matter of Chock Full O'Nuts Corporation, State Tax Commission August 11, 1971. It is noteworthy that an issue similar to that treated herein arises under the Internal Revenue Code. Section 265(2) of the code denies a deduction with respect to interest incurred to acquire or carry Federally tax-exempt securities. The Internal Revenue Service, in Rev. Proc. 72-18, applies a "purpose*' test and holds, with respect to corporations not dealers in tax-exempt obligations, that the "purpose to purchase or carry tax-exempt obligations will generally not be inferred with respect to indebtedness incurred or continued to provide funds for carrying on an active trade or business.., unless it is determined that the borrowing was in excess of business needs...". That ruling, similarly, holds that "the purpose to carry tax-exempt obligations will be inferred unless rebutted by other evidence where the taxpayer could reasonably have foreseen at the time of purchasing the tax-exempt obligations that indebtedness probably would have to be incurred to meet future economic needs of the corporation of an ordinary, recurrent variety."

Such considerations appear properly to be applicable to the application of Tax Law §208.9(b)(6). Thus, in the present matter, where Petitioner borrows funds solely in order to make loans to its parent corporation, and did not knowingly render itself subject to the necessity of resorting to such borrowing because of the making of investments in subsidiaries, the interest paid with respect to such borrowing will not be subject to the add-back requirement of Section 208.9(b)(6) of the Tax Law.

DATED: June 12, 1984

s/FRANK J. PUCCIA
Director
Technical Services Bureau

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