STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. C920610C

On June 10, 1992, a Petition for Advisory Opinion was received from Price Waterhouse, 153 East 53rd Street, New York, New York 10022.

The issue raised by Petitioner, Price Waterhouse, is whether municipal put bonds constitute investment capital as defined by section 3-4.2 of the Business Corporation Franchise Tax Regulations (hereinafter "Regulations").

The type of bonds at issue are municipal put bonds normally issued to finance long term assets. Accordingly, the bonds' maturity will generally coincide with the estimated life of the asset being financed. The maturity date of the bonds is usually in excess of ten years.

At the underwriting, the issuer, usually a governmental agency, can opt to either fix a rate on the bond until its final maturity or elect to use the short-term put financing structure. A put allows investors the opportunity to redeem their bonds, at par, on a specified date in the future. The put structure allows the issuer to select any number of successive short-term put or financing periods if rates are believed to be declining or the ability to lock in a fixed rate if rates are believed to be in an upward trend. The put bonds can be classified into three major categories as follows: Mandatory Puts, Optional Puts and Third Party Puts.

> Mandatory Put ("MP") - Requires the automatic redemption of all investors' bond holdings for par value on the put date. Prior to the MP date, investors will be notified of the issuer's intentions to select another MP period or to fix the bond's coupon to its stated long term maturity. Current owners will then be given the opportunity to renew their ownership until the new put date or fixed maturity date.
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> Optional Put ("OP") - Requires the investor to initiate the redemption of their bonds for par value on the put date. If the investor does not initiate the redemption, the investor will continue to hold the bond at the new rate that is determined for the new holding period.
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> Third Party Put ("TPP") - Can either be similar to MP bonds or OP bonds. Unlike the traditional MP or OP bonds where bonds are redeemed at par from the primary issuer, TPPs require bond owners to put their bonds to a third party, on a prescribed date, for par redemption. The unorthodox structure of the TPP causes these types of bonds to yield approximately 10 to 25 basis points more than their conventional MP and OP counterparts.

Section 3-4.2(a)(1) of the Regulations provides, in part, that:

> The term "investment capital" means the taxpayer's investments in stocks, bonds and other securities issued by a corporation ... or by the United States, any state, territory or possession of the United States, the District of Columbia, or any foreign country, or any political subdivision or governmental instrumentality of any of the foregoing ... Any debt instrument ... which is payable by its terms on demand or within six months and one day from the date on which the debt was incurred is deemed to be cash on hand or on deposit. Any such debt instrument which is payable by its terms more than six months and one day from the date on which the debt was incurred is deemed to be cash on hand or on deposit on any day which is not more than six months and one day prior to its date of maturity .... [emphasis added]

Although section 3-4.2 of the Regulations does not define the term "date of maturity", the term "maturity" has been defined as follows: "the date at which an obligaeion, such as the principal of a bond or note, becomes due." [emphasis added] Black's Law Dictionary 883 (Sth ed. 1979).

Since the MP bond structure requires the automatic redemption of such a bond on a put date (unless the MP is renewed as discussed below), the MP bond, in essence, becomes due at each put date during the life of the bond. Thus, the put date of an MP bond represents the "date of maturity" as that term is contemplated pursuant to section 3-4.2 of the Regulations.

In addition, an MP bond requires the automatic redemption of a bond on a put date for par value unless the investor renews the bond (presumably under new terms) until a new put date or maturity date. Example 1 in section 3-4.2 (a)(1) of the Regulations includes, in part, the following example:

> [o]n July 1, 1990, Corporation A purchased a four month qualifying corporate debt instrument on the day it was issued and renewed it, with the identical terms on November 1, 1990 ... The renewal of the four month debt instrument purchased on July 1, 1990 is treated as the creation of a second, separate debt instrument, each of the two instruments being due within six months and one day of the date on which the debt was incurred. [emphasis added]

This example suggests that by renewing a debt on a certain date, such renewal causes such date to become the maturity date for the first debt since a second debt is created under such circumstances. In applying this example to the MP bond instrument, if an investor of an MP bond renews the bond on a put date such renewal is treated as the creation of a second, separate debt instrument, and, therefore, causes such put date to become a maturity date. Thus, this example supports the proposition that a put date represents a maturity date.

Based on the foregoing conclusion that a put date represents a maturity date and on section 3-4.2 of the Regulations, if a put date of an MP bond is within six months and one day from the date on which the MP bond was issued, such bond is deemed to be cash on hand or on deposit during such period of time. Furthermore, an MP bond is deemed to be cash on hand or on deposit on any day which is not more than six months and one day prior to each put date thereafter. In addition, an MP bond is deemed to be cash on hand or on deposit on any day which is not more than six months and one day prior to the long term date of maturity stated on the bond. However, if an investor fixes an MP bond coupon to its long term maturity date, and thereafter is not allowed to either redeem or renew such bond on any put date during the balance of the term of the bond, the MP bond will then be deemed to be investment capital except for the six months and one day period prior to such final maturity date, during which period it will be classified as cash.

The OP bond requires an investor to initiate the redemption of such a bond on a put date, and if such redemption does not occur then the investor will continue to hold the OP bond at a new rate for a new holding period. Thus, if an investor redeems an OP bond on a particular put date such bond should be treated as cash for the six months and one day period prior to such put date for reasons stated above. If, on the other hand, the investor does not redeem an OP bond on a put date, by holding such bond at new terms (new rate and holding period) such debt is renewed and, therefore, it should be treated as a second debt instrument, pursuant to Example 1 of section B-4.2(a)(1) of the Regulations. Thus, under such circumstances, the OP bond should be classified as cash for the six months and one day period prior to the put date in question.

A TPP bond can either be similar to a MP bond or an 0P bond, however, TPPs require bond owners to put their bonds to a third party, on a prescribed date for par redemption. Thus, a TPP bond could be treated as either an MP or OP bond depending upon whether it has the features of an MP or OP bond, and, therefore, the same rules as discussed above should be applied to the particular TPP bond in question.

In conclusion the MP, OP or TPP bonds as described herein should be classified as cash during each six months and one day period prior to each put date in such bonds (except when an MP bond coupon is fixed to the maturity date as discussed above). Furthermore, the bonds should be classified as cash for the six months and one day period prior to the final long term maturity date stated on such bonds if a bond is redeemed on such date. At all other times such bonds should be classified as investment capital.

DATED: October 13, 1992

s/PAUL B. COBURN
Deputy Director
Taxpayer Services Division

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