

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

TSB-A-94 (5) C
Corporation Tax
March 8, 1994

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. C931217A

On December 17, 1993, a Petition for Advisory Opinion was received from Friendly Home Parties, Inc., 25 Corporate Circle, Albany, New York 12203.

The issue raised by Petitioner, Friendly Home Parties, Inc., is whether for purposes of Article 9-A of the Tax Law, a loan from Petitioner to a partnership can be classified as investment capital under section 3-4.2 of the Business Corporation Franchise Tax Regulations (hereinafter "Regulations") and the income from such loan treated as investment income.

Petitioner is a New York S corporation and the partnership is owned by individuals who collectively own a 70 percent interest in Petitioner. As an investment, Petitioner made a demand loan of \$3,500,000 to the partnership and receives interest at a seven percent annual rate of return. An instrument was acquired by Petitioner in exchange for the funds. Petitioner is not principally engaged in the business of lending funds. Petitioner has a substantial amount of other funds invested in cash and cash equivalents for a stated return.

Section 208.5 of the Tax Law defines the term "investment capital" as "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 208.6 of the Tax Law defines the term "investment income" as the sum of (a) income, including capital gains in excess of capital losses, from investment capital and (b) the amounts described in section 208.9(b)(12),(13) and (14) of the Tax Law to the extent included in computing entire net income, less, (c) in the discretion of the commissioner, any deductions allowable in computing entire net income which are directly or indirectly attributable to investment capital or investment income, and (d) such portion of any net operating loss deduction allowable in computing entire net income, as the investment income, before such deduction, bears to entire net income, before such deduction, provided, however, that in no case shall investment income exceed entire net income.

Section 3-4.2 of the Regulations defines the term "investment capital" as follows:

(a)(1) The term investment capital means the taxpayer's investments in stocks, bonds and other securities issued by a corporation (except as provided in paragraph (2) of this subdivision) 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 (emphasis added)

(2) Investment capital does not include:

...

(iii) securities of an individual, partnership, trust or other nongovernmental entity which is not a corporation within the definition contained in section 208.1 of the Tax Law ... (emphasis added)

...

(c) For purposes of paragraph (1) of subdivision (a) of this section, the phrase stocks, bonds and other securities, means:

(1) stocks and similar corporate equity instruments, such as business trust certificates, and units in a publicly traded partnership included in the definition of "corporation" contained in section 208.1 of the Tax Law;

(2) debt instruments issued 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;

(3) qualifying corporate debt instruments ...

(4) options on any item described in paragraph (1), (2), or (3) of this subdivision and not described in paragraph (2) of subdivision (a) of this section, or on a stock or bond index, or on a futures contract on such an index, unless the options are purchased primarily to diminish the taxpayer's risk of loss from holding one or more positions in assets which constitute business or subsidiary capital; and

(5) stock rights and stock warrants not in the possession of the issuer thereof.

Accordingly, a loan to a partnership is not investment capital pursuant to section 208.5 of the Tax Law and section 3-4.2(a)(1) and (2) of the Regulations.

Therefore, where Petitioner makes a loan of \$3,500,000 to a partnership and acquires an instrument issued by the partnership in exchange for the funds, such loan does not constitute investment capital pursuant to section 208.5 of the tax Law and section 3-4.2 of the Regulations, and the interest income attributable to such loan does not constitute investment income pursuant to section 208.6 of the Tax Law.

DATED: March 8, 1994

s/PAUL B. COBURN
Deputy Director
Taxpayer Services Division

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