

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

TSB-A-96 (3) C
Corporation Tax
January 18, 1996

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. C951002B

On October 2, 1995, a Petition for Advisory Opinion was received from Smith Barney Holdings Inc., 388 Greenwich Street, New York, New York 10013.

The issues raised by Petitioner, Smith Barney Holdings Inc., are (1) whether certain industrial development bonds constitute investment capital under section 208.5 of the Tax Law, (2) whether the interest income received from the bonds constitutes investment income under section 208.6 of the Tax Law and (3) whether the bonds constitute government securities for purposes of the investment allocation percentage under section 4-7.2(a) of the Business Corporation Franchise Tax Regulations ("Article 9-A Regulations").

Petitioner presents the following facts. Travelers Group Inc. is a party to a project of the New York City Industrial Development Agency (the "IDA"). Certain bonds issued and to be issued in connection with a transaction ("TGI Project") between the IDA and Travelers Group Inc. are held by Petitioner, a wholly-owned subsidiary of Travelers Group Inc. The TGI Project is intended to induce certain eligible members of the group of companies of which Travelers Group Inc. is the parent (the "Travelers Group") to retain their headquarters in New York City for approximately 15 years.

In connection with the TGI Project, the IDA has agreed to extend certain benefits to reduce the Travelers Group's costs of retaining its headquarters in New York. Among these benefits is an exemption from sales and use tax pursuant to a project agreement, lease and sales tax letter (collectively, the "Agreement") with respect to certain equipment to be used by the Travelers Group at its headquarters. Pursuant to the Agreement, in order to be eligible for exemption from sales and use taxes, purchases of the equipment (the "Acquisitions") must be made by the IDA through one of several designated agents among the members of the Travelers Group. (See Smith Barney Inc., and Travelers Group Inc., Adv Op Comm T & F, August 18, 1995, TSB-A-95(35)S.)

To finance the Acquisitions, the IDA issues industrial development bonds (the "Bonds") from time to time, which are purchased by an affiliate of Travelers Group Inc. To date, the Bonds sold in connection with the TGI Project have been sold to, and remain held by, Petitioner. The Bonds are issued pursuant to a trust indenture and a bond supplemental indenture between the IDA and United States Trust Company of New York, as trustee. The Bonds carry interest at a rate determined by the IDA, generally based upon a market index such as LIBOR or Treasury Bonds. The Bonds are secured by a pledge of, and payable solely from, certain payments owed by members of the Travelers Group to the IDA pursuant to the Agreement. The Bonds will mature on August 20, 2010, unless redeemed earlier pursuant to the Agreement.

Section 856 of Article 18-A of the General Municipal Law provides for the organization of industrial development agencies, and section 856.2 of such law provides that an industrial development agency "shall be a corporate governmental agency, constituting a public benefit corporation."

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, there shall be deducted from investment capital any liabilities which are directly or indirectly attributable to investment capital "

Section 3-3.2(a)(1) of the Article 9-A Regulations provides 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. At the election of the taxpayer, cash on hand and cash on deposit may be treated on any report as either investment capital or business capital. Any debt instrument, including a certificate of deposit which is described in section 3-3.2(c)(2) or (3) and not described in section 3-3.2(a)(2) and 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.

Section 3-3.2(c) of the Article 9-A Regulations, as amended and renumbered effective October 27, 1993, provides that the phrase "stocks, bonds and other securities" means, in part: "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." Provided, however, debt instruments which are deemed to be cash pursuant to 3-3.2(a)(1) of the Article 9-A Regulations do not constitute stocks, bonds or other securities.

In Richard W. Genetelli, Dec St Tax Comm, December 23, 1985, TSB-A-86(2)C, the issue of whether industrial development bonds issued by a municipal industrial development agency qualify as investment capital was addressed under section 34.2 of the Article 9-A Regulations as it existed in 1985. It was held that the bonds met the criteria set forth in section 3-4.2(c) of the Article 9-A Regulations as it existed then, and that the bonds constituted investment capital for purposes of Article 9-A of the Tax Law. At that time, section 3-4.2(c) of the Article 9-A Regulations described the types of securities which were includible as "other securities" for purposes of section 208.5 of the Tax Law and provided that "other securities" were "limited to securities issued by governmental bodies and securities issued by corporations of a like nature as stocks and bonds, which are customarily sold in the open market or on a recognized exchange, designed as a means of investment, and issued for the purpose of financing corporate enterprises and providing a distribution of rights in, or obligations of, such enterprises " Section 3-4.2 was amended on November 16, 1989 and amended and renumbered as section 3-3.2 effective October 27, 1993.

Under current section 3-3.2(c)(2) of the Article 9-A Regulations, debt instruments issued by a governmental instrumentality of New York State are included in the phrase "stocks, bonds and other securities" for purposes of section 33.2(a)(1) of the Article 9-A Regulations. For these purposes, a governmental instrumentality of New York State includes an industrial development agency organized pursuant to Article 18-A of the General Municipal Law.

Accordingly, under section 208.5 of the Tax Law and section 3-3.2 of the Article 9-A Regulations, the Bonds issued by the IDA in connection with the TGI Project constitute investment capital of the holder. Except that the Bonds that are deemed to be cash pursuant to section 3-3.2(a)(1) of the Article 9-A Regulations are considered to be investment capital only if the holder of the Bonds makes the election to treat cash as investment capital.

Section 208.6 of the Tax Law defines the term "investment income" as follows:

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)], 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.

Accordingly, the interest income on the Bonds issued by the IDA in connection with the TGI Project that constitute investment capital is investment income under section 208.6 of the Tax Law.

Section 4-7.2(a) of the Article 9-A Regulations provides that the investment allocation percentage is computed as follows:

(1) Ascertain the average net value of each stock, bond or other security, other than governmental securities, included in the taxpayer's investment capital, pursuant to [section 3-3.4(b)] of this Title. The phrase "stock, bond or other security" as used in this paragraph does not include cash, even if treated as investment capital pursuant to [section 3-3.2(a)(1)] of this Title.

(2) Multiply the net value of each such stock, bond or other security by its issuer's allocation percentage.

(3) Add all the products determined in paragraph (2) of this subdivision.

(4) Divide the sum obtained in paragraph (3) of this subdivision by the net value of the taxpayer's total investment capital exclusive of cash, even if such cash is treated as investment capital pursuant to [section 3-3.2(a)(1)] of this Title.

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Accordingly, the Bonds that are issued by the IDA in connection with the TGI Project, that constitute investment capital (and are not deemed to be cash) under section 208.5 of the Tax Law and section 3-3.2 of the Article 9-A Regulations, do constitute "governmental securities" for purposes of computing the investment allocation percentage under section 4-7.2(a) of the Article 9-A Regulations.

DATED: January 18, 1996

s/DORIS S. BAUMAN
Director
Technical Services Bureau

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