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

TSB-A-96 (5) C
Corporation Tax
February 28, 1996

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. C950717A

On July 17, 1995, a Petition for Advisory Opinion was received from Country Bank, P.O. Box 1230, Route 6, Carmel, New York 10512.

The issue raised by Petitioner, Country Bank, is whether a New York banking corporation subject to the "mark-to-market' provisions for securities under section 475 of the Internal Revenue Code ("IRC") is allowed to exclude certain income from entire net income for purposes of Article 32 of the Tax Law. The income in question is income, in taxable years after a loss year, resulting from the mark-to-market rules on stock owned in the loss year to the extent that unrealized losses resulting from those rules on the stock owned in the loss year did not reduce the amount of tax imposed in the loss year.

Section 475 of the IRC was enacted in 1993 (P L 103-66) effective for taxable years ending on or after December 31, 1993. It requires a mark-to-market accounting method for dealers in securities. Most banks are deemed to be securities dealers for this purpose. As a result of this enactment, unrealized gains or losses must now be recognized each taxable year based on the year-end market values of each security being compared with its original basis for the first taxable year, or substituted basis (opening market value) for securities held for more than one year. For the taxable year that the security is sold, gain or loss is recognized as if the security had been sold for its fair market value immediately before the disposition. The dealer will then adjust the amount of any gain or loss subsequently realized, as the result of a disposition of the security, to reflect the gains or losses previously recognized through the application of the mark-to-market rules.

The Petitioner believes that the provisions of section 475 of the IRC could create a hardship for a bank because Article 32 of the Tax Law does not provide for a net operating loss ("NOL") deduction. The problem arises where a bank has large unrealized security losses, generating a NOL for a taxable year and the stock market recovers in subsequent years. The bank will be required to recognize gains, calculated by using the prior year's low year-end market value as substituted basis without being able to offset the "artificial" gain with the prior year's "artificial" loss that is allowed for Federal income tax purposes through the Federal NOL deduction.

Section 475(a) of the IRC provides, as the general rule with respect to securities held by a dealer in securities, that:

> (1) Any security which is inventory in the hands of the dealer shall be included in inventory at its fair market value.
>
> (2) In the case of any security which is not inventory in the hands of the dealer and which is held at the close of any taxable year–

(A) the dealer shall recognize gain or loss as if such security were sold for its fair market value on the last business day of such taxable year, and

(B) any gain or loss shall be taken into account for such taxable year.

Proper adjustment shall be made in the amount of any gain or loss subsequently realized for gain or loss taken into account under the preceding sentence.

Section 475(c)(1) of the IRC provides that the term "dealer in securities" means a taxpayer who–

(A) regularly purchases securities from or sells securities to customers in the ordinary course of a trade or business; or

(B) regularly offers to enter into, assume, offset, assign or otherwise terminate positions in securities with customers in the ordinary course of a trade or business.

The net result of the calculations, for Federal income tax purposes, is nothing more than a timing difference since the economic gain or loss when the security is ultimately sold will be equal to the net gains or losses reported each year based on year-end market values under section 475 of the IRC.

Section 1451 of Article 32 of the Tax Law imposes, annually, a franchise tax on every banking corporation for the privilege of exercising its franchise or doing business in New York State in a corporate or organized capacity.

Section 1455(a) of the Tax Law provides that the basic tax is "[n]ine percent of the taxpayer's entire net income, or the portion thereof allocated to this state, for the taxable year or part thereof."

Entire net income is defined in section 1453(a) of the Tax Law as "total net income from all sources which shall be the same as the entire taxable income (but not alternative minimum taxable income) ... which the taxpayer is required to report to the United States treasury department ... subject to the modifications and adjustments hereinafter provided."

Section 1453(b) through(k) of the Tax Law and sections 18-2.3, 18-2.4 and 18-2.5 of the Franchise Tax on Banking Corporations Regulations, provide for the modifications and adjustments required by section 1453(a) of the Tax Law. Section 1453(b)(3) of the Tax Law provides that entire net income shall be computed without the deduction of any NOL deduction for the taxable year allowable for Federal income tax purposes. Further, under section 1453 of the Tax Law, there is no modification or adjustment applicable to the "mark-to-market" accounting method required by section 475 of the IRC.

Accordingly, pursuant to section 1453 (b) (3) of the Tax Law, banking corporations are not allowed to claim a NOL carryforward, and there is no provision in Article 32 of

the Tax Law to modify or adjust any gain or loss included in Federal taxable income pursuant to the provisions of section 475 of the IRC. Therefore, Petitioner will not be allowed to make any adjustments to entire net income, for any taxable year, to exclude income included in Federal taxable income that is offset by a Federal NOL deduction that is attributable to the application of section 475 of the IRC.

DATED: February 28, 1996

DORIS S. BAUMAN
Director
Technical Services Bureau

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