STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. C971231C

On December 31, 1997, a Petition for Advisory Opinion was received from Price Waterhouse LLP, 1177 Avenue of the Americas, New York, New York 10036-2798.

The issue raised by Petitioner, Price Waterhouse LLP, is whether a reduction to retained earnings due to a prior period adjustment is treated as a dividend paid for capital stock purposes under section 183 of Article 9 of the Tax Law.

Petitioner submits the following facts as the basis for this Advisory Opinion.

Subsidiary, a wholly-owned subsidiary of Parent, is subject to the franchise tax based on capital stock imposed under section 183 of the Tax Law. For the tax years 1994 through 1996, the earnings of Subsidiary were overstated due to the incorrect booking of a specific expense paid by Parent on behalf of Subsidiary.

Parent and Subsidiary utilize a cashless system of accounting whereby Parent retains all cash from Subsidiary's sales and pays all of its cash expenses. An "intercompany receivable/payable" is set up to be the offset account for these revenues and expenses. As Subsidiary is profitable, the natural balance of this account is an intercompany receivable on Subsidiary's books.

Parent's payment of Subsidiary's income tax expense is part of this cashless system of accounting. However, due to an internal oversight, these tax payments were not properly reflected on the books of Subsidiary. (Tax payments made on behalf of Subsidiary were not deducted by the Parent in its computation of Subsidiary's net income.) Therefore, Subsidiary's net after-tax earnings and net worth have been overstated by the amount of this expense.

Subsidiary paid dividends from its current earnings to Parent, but the increase in earnings due to the non-booking of tax did not compose part of these dividends.

As the tax expense was not properly booked, the resultant "intercompany receivable" was also overstated. To correct this error, Subsidiary is proposing to make the following prior period adjustment: debit - retained earnings and credit - intercompany receivable.

Section 183 of the Tax Law provides for a franchise tax on transportation and transmission corporations based on the net value of issued capital stock employed in New York State. The franchise tax required to be paid under section 183 is the highest tax computed by the following three methods:

1. Allocated value of issued capital stock multiplied by the tax rate of 1.5 mills.

2. Allocated value of issued capital stock on which dividends are paid at a rate of 6 percent or more multiplied by the tax rate of .375 mills for each 1 percent of dividends paid. The rate of 1.5 mills is applied to capital stock on which dividends are not paid or are paid at a rate of less than 6 percent.

3. Minimum tax of $75.

The phrase "dividends paid" is not defined in section 183. Therefore, in an Opinion of Counsel, Dept of T&F, August 12, 1966, Op. Counsel 1966 NYTB-V.3, p. 17, holding that an earned surplus distribution was a dividend, Counsel looked to the Court of Appeals in construing the term "dividends" under the franchise tax imposed by section 186 of the Tax Law. The Court of Appeals stated as follows: "a dividend on corporate stock implies a division or distribution of corporate profits." (People Ex Rel Adams Electric Light Co v Graves, 272 NY 77,79) The Opinion of Counsel also looked to section 510(b) of the Business Corporation Law governing the definition of dividends. Such section states that "[d]ividends may be declared or paid and other distributions may be made out of surplus only, so that the net assets of the corporation remaining after such declaration, payment or distribution shall at least equal the amount of its stated capital...." Section 102(a)(13) of the Business Corporation Law defines surplus as "the excess of net assets over stated capital." In the Opinion of Counsel, a wholly owned subsidiary which had an earned surplus in excess of $45 million, received $39 million from the parent as a contribution to capital surplus, and as part of the same transaction paid the parent a dividend of $41 million. The subsidiary had to pay the dividend tax on the full amount of $41 million, the tax was not limited to the portion which was in excess of the amount received from the parent corporation.

In this case, the proposed reduction to Subsidiary's retained earnings is not a distribution from current or accumulated earnings and profits. It is an accounting entry that properly restates Subsidiary retained earnings to reflect the reimbursement of income taxes paid by Parent on behalf of Subsidiary in prior years. This prior period adjustment does not constitute a dividend for purposes of computing the franchise tax on capital stock imposed under section 183 of the Tax Law.

/s/

DATED: March 24, 1998

John W. Bartlett
Deputy Director
Technical Services Bureau

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