

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

TSB-H-81(2)C  
Corporation Tax  
January 8, 1981

STATE OF NEW YORK  
STATE TAX COMMISSION

ADVISORY OPINION

PETITION NO. C800825A

On August 25, 1980, a Petition for Advisory Opinion was received from Paul M. Edgette, 824 Maple Avenue, Niagara Falls, New York 14305.

The issue raised in the petition is whether interest income from industrial development bonds issued pursuant to Article 18-A of the General Municipal Law is includible in the computation of entire net income under Articles 9-A and 32 of the Tax Law.

Section 874(2) of the General Municipal Law provides that "Any bonds or notes issued pursuant to this title, together with the income therefrom, as well as the property of the agency, shall be exempt from taxation, except for transfer and estate taxes." Section 876 of the General Municipal Law provides as follows: "The state covenants with the purchasers and with all subsequent holders and transferees of bonds or notes issued by the agency pursuant to this title, in consideration of the acceptance of and payment for the bonds or notes, that the bonds and notes of the agency issued pursuant to this title and the income therefrom, and all moneys, funds and revenues pledged to pay or secure the payment of such bonds or notes shall at all times be free from taxation except for estate taxes and taxes on transfers by or in contemplation of death."

Article 9-A of the Tax Law imposes a franchise tax on business corporations for "... the privilege of exercising...[a] corporate franchise, or of doing business, or of employing capital, or of owning or leasing property in this state in a corporate or organized capacity, or of maintaining an office in this state .... "Tax Law, §209.1. The tax is payable on the basis of entire net income or upon one of three alternate bases. Article 32 of the Tax Law imposes a franchise tax on banking corporations, for the "...privilege of exercising...[a] franchise or doing business in this state in a corporate or organized capacity .... "The basic tax under Article 32, as under Article 9-A, is based on the taxpayer's "entire net income," with alternate tax bases applicable where the same would yield a higher tax.

Under both Articles 9-A and 32 of the Tax Law the computation of "entire net income" starts from the entire taxable income which the taxpayer is required to report to the United States Treasury Department, with certain modifications. One of these modifications is a required addition to the Federal figure of "...any part of any...interest on any kind of stock, securities or indebtedness...", with certain exceptions not here germane. Tax Law §§208.9(b)(2), 1453(b)(1).

It will be seen that by reason of the foregoing statutory provisions entire net income, under both Articles 9-A and 32 of the Tax Law, includes bond interest which is in itself tax exempt, such as Federal, state and municipal bond interest. This is made plain by the Regulations pertaining to Article 9-A, wherein it is stated that "In computing entire net income, federal taxable income must be adjusted by adding to it:

. . .

(2) all interest income which has not been included in computing

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federal taxable income, such as interest on state and municipal bonds and certain obligations of the United States and its instrumentalities, less interest expense incurred to carry such investments, to the extent such interest expense has not been deducted in computing federal taxable income; .... "20 NYCRR3-2.3(a).

The Regulations applicable under Article 32 contain a similar provision, as follows:

"(b) Income from interest is taxable to a corporation or association when received on obligations of the United States (including farm loan bonds), or its territories or possessions or of the District of Columbia, of New York or any other State, or of any county, city, village, road, water, sewer, gas, light, drainage, school or other political subdivision of any State." 20NYCRR31.17

The reason that "tax-exempt" interest is includible in entire net income under Articles 9-A and 32 of the Tax Law is that these articles impose franchise taxes rather than taxes on income. That is, these taxes are imposed upon a privilege, for example the privilege of doing business in New York in a corporate capacity, and the tax is computed on the value of that privilege, which is measured by income (or some alternate basis). The taxpayer's income is thus not itself subjected to tax but is rather used to measure the value of the privilege being taxed, and the income so utilized properly includes all of the income of the taxpayer irrespective of its susceptibility to direct taxation. It has been said, thus, that "...the privilege of doing business in corporate form, which is a legitimate subject of taxation, does not cease to be such because it is exercised in the acquisition and enjoyment of non-taxables .... " Pacific Company v. Johnson 285 U.S. 480, 76 L.Ed. 893 (1931).

Accordingly, interest income from industrial development bonds issued pursuant to Article 18-A of the General Municipal Law are properly includible in entire net income under the Franchise Tax on Business Corporations imposed under Article 9-A of the Tax Law and the Franchise Tax on Banking Corporations imposed under Article 32 of the Tax Law.

DATED: October 24, 1980

s/LOUIS ETLINGER  
Deputy Director  
Technical Services