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

TSB-A-87 (1) I
Income Tax
March 2, 1987

STATE OF NEW YORK
STATE TAX COMMISSION

ADVISORY OPINION PETITION NO. I860917A

On September 17, 1986, a Petition for Advisory Opinion was received from Brown Brothers Harriman & Co., 59 Wall Street, New York, New York 10005.

The issue raised is whether Petitioner must include in its taxable income for taxable years 1982, 1983 and 1984, pursuant to section 612(b)(4) of Article 22 of the Tax Law, interest paid on indebtedness incurred or continued to purchase or carry United States Treasury securities, the interest income on which is exempt from New York State personal income tax under Article 22 of the Tax Law.

Petitioner is a New York limited partnership established as a "private banker" under Article IV of the New York State Banking Law. As such, Petitioner has received an authorization certificate from the New York Superintendent of Banks permitting it to engage in the general banking business and is subject to regulation by the New York Superintendent of Banks. Petitioner conducts traditional banking activities, including the taking of deposits and the making of commercial loans. In addition, during each of the tax years at issue, Petitioner maintained a portfolio of U.S. Treasury securities, the interest income from which is exempt from New York tax. Petitioner also conducts brokerage activities, but all of the deductions in question involve interest on bank deposits, federal funds transactions and repurchase agreements, all of which relate exclusively to Petitioner's banking type activities.

When computing federal adjusted gross income, section 265(2) of the Internal Revenue Code denies the deduction for interest paid on indebtedness incurred or continued to purchase or carry obligations the interest on which is exempt from tax. However, Rev. Proc. 70-20, 1970-2 C.B. 499, modified by Rev. Proc. 83-91, 1983-2 C.B. 618, clearly confirms the position initially taken by the Bureau of Internal Revenue in I.T. 2028, C.B. III-l, 296 (1924) that indebtedness incurred by a bank in the ordinary course of its banking business is not to be treated as indebtedness incurred or continued to purchase or carry tax-exempt securities within the meaning of Internal Revenue Code section 265(2). For federal income tax purposes, under Rev. Proc. 70-20 and for many years prior thereto, Petitioner has regularly been allowed to deduct interest paid on its indebtedness which are incurred in the normal course of banking activities even though the bank holds tax-exempt obligations.

A partnership, itself, is not subject to the personal income tax under Article 22 of the Tax Law, but the partnership must nevertheless compute its income from New York State sources. Each partner must include in its New York taxable income, its distributive share of the partnership's income, gain, loss and deduction. The New York taxable income of a resident or nonresident individual is computed by subtracting from the New York adjusted gross income the individual's New York deduction and New York exemptions.

The New York adjusted gross income of a resident individual is the individual's federal adjusted gross income with the modifications required by section 612 of the Tax Law. Section 632 of the Tax Law sets forth the computation of a nonresident individual's New York adjusted gross income.

Section 617(a) of the Tax Law provides that when computing New York adjusted gross income of a resident partner, any modification described in section 612(b), (c) or (d) or section 615(c) or (d)(2) or (3) which relates to an item of partnership income, gain, loss or deduction shall be made in accordance with the partner's distributive share, for federal income tax purposes, of the item to which the modification relates. Section 617(b) of the Tax Law provides that each item of partnership income, gain, loss or deduction shall have the same character for a resident partner under Article 22 as for federal income tax purposes.

Section 637(c) of the Tax Law provides that when computing New York adjusted gross income of a nonresident partner, any modification described in subsection (b) or (c) of section 612 which relates to an item of partnership income, gain, loss or deduction shall be made in accordance with the partner's distributive share for federal income tax purposes, of the item to which the modification relates, but limited to the portion of such item derived from or connected with New York sources.

Section 612(b)(4) of the Tax Law requires that there be added to federal adjusted gross income in computing New York adjusted gross income "[i]nterest on indebtedness incurred or continued to purchase or carry obligations or securities the income from which is exempt from tax under this article, to the extent deductible in determining federal adjusted gross income." Unquestionably, section 612(b)(4) of the Tax Law was modeled upon IRC §265(2). Section 612(b)(4) was intended to mirror section 265(2) and to have the same meaning and application as section 265(2).

Section 607(a) of the Tax Law provides that "[a]ny term used in this article shall have the same meaning as when used in a comparable context in the laws of the United States relating to federal income taxes, unless a different meaning is clearly required." It is now beyond question that when an interpretation of a law of the United States relating to federal income taxes is established by the Internal Revenue Service through a Revenue Ruling or a Revenue Procedure, such federal interpretation will be followed for New York State personal income tax purposes, as well.

Accordingly, it is determined that to the extent that interest which Petitioner incurs or continues to purchase or carry indebtedness in the ordinary course of its banking business is allowed as a deduction under section 163(a) of the Internal Revenue Code and is not disallowed under section 265(2) of the Internal Revenue Code pursuant to Rev. Proc. 70-20 as modified by Rev. Proc. 83-91, such interest will also be allowed as a deduction for New York State personal income tax purposes and will not be disallowed under section 612(b)(4) of the Tax Law. However, any such interest incurred in the course of its brokerage activities would be disallowed under section 612(b)(4) of the Tax Law.

Therefore, when computing New York taxable income, Petitioner's partners are not required to make the modification required by section 612(b)(4) of the Tax Law to the extent that interest paid on indebtedness incurred or continued to purchase or carry United States Treasury securities, the interest on which is exempt from Article 22 of the Tax Law, is incurred or continued by Petitioner in the ordinary course of its banking business pursuant to Rev. Proc. 70-20, as modified by Rev. Proc. 83-91.

DATED: March 2, 1987

s/FRANK J. PUCCIA
Director
Technical Services Bureau

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