STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. C040127A

On January 27, 2004, a Petition for Advisory Opinion was received from Amper, Politziner & Mattia, P.C., 6 East 43rd Street, New York, NY 10017.

The issues raised by Petitioner, Amper, Politziner & Mattia, P.C., are:

1.Whether a New York State insurance company ("Company") may carry back any amount of the 2002 New York net operating loss (NOL) to the 1997 taxable year for purposes of Article 33 of the Tax Law.

2. If the answer to Issue 1 is yes, is there a limitation on the amount?

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

Company is a New York State insurance company that is taxable under Article 33 of the Tax Law. This Advisory Opinion assumes that Company is a calendar year taxpayer.

For taxable year 1997, Company reported federal taxable income of $1,887,257. For taxable year 1997, Company's New York entire net income (after NOL carryback) was $2,306,761.

For taxable year 1999, Company incurred a federal NOL of $1,889,455 and a New York NOL of $391,402. Company filed federal and New York carryback claims to carry back the taxable year 1999 NOLs to taxable year 1997.

For federal income tax purposes, Company carried back and utilized $1,887,257 of the taxable year 1999 NOL to offset all of the taxable year 1997 federal taxable income.

For purposes of Article 33 of the Tax Law, Company carried back and utilized $391,402, which was all of the taxable year 1999 New York NOL, to offset a portion of Company's taxable year 1997 New York entire net income. This carryback reduced New York entire net income for taxable year 1997 to $2,306,761.

For taxable year 2002, Company incurred a federal NOL of $14,727,812 and a New York NOL of $13,683,040.

For federal income tax purposes, Company was not able to carry back any of the taxable year 2002 federal NOL to taxable year 1997, because the taxable year 1999 federal NOL that was carried back to taxable year 1997 offset all of the taxable year 1997 federal taxable income.

Applicable law and regulations

Internal Revenue Code (IRC) section 172(b) contains rules for net operating loss carrybacks and carryovers, and provides, in part:

> (1) Years to which loss may be carried. –
>
> (A) General rule. Except as otherwise provided in this paragraph, a net operating loss for any taxable year –
>
> > (i) shall be a net operating loss carryback to each of the 2 taxable years preceding the taxable year of such loss, and
> >
> > (ii) shall be a net operating loss carryover to each of the 20 taxable years following the taxable year of the loss.
>
> * * *
>
> (F) Retention of 3-year carryback in certain cases. –
>
> * * *
>
> (H) In the case of a taxpayer which has a net operating loss for any taxable year ending during 2001 or 2002, subparagraph (A)(i) shall be applied by substituting "5" for "2" and subparagraph (F) shall not apply.
>
> (2) Amount of carrybacks and carryovers. – The entire amount of the net operating loss for any taxable year (hereinafter in this section referred to as the "loss year") shall be carried to the earliest of the taxable years to which (by reason of paragraph (1)) such loss may be carried. The portion of such loss which shall be carried to each of the other taxable years shall be the excess, if any, of the amount of such loss over the sum of the taxable income for each of the prior taxable years to which such loss may be carried....

Section 1503(b)(4) of Article 33 of the Tax Law provides that in computing entire net income:

> Any "net operating loss deduction" or "operations loss deduction" allowable under sections one hundred seventy-two or eight hundred ten of the internal revenue code, respectively, which is allowable to the taxpayer for federal income tax purposes:
>
> (A) shall be adjusted to reflect the modifications required by the other paragraphs of this subdivision;

> (B) shall not, however, exceed any such deduction allowable to the taxpayer for the taxable year for federal income tax purposes; and
>
> (C) shall not include any such loss incurred in a taxable year beginning prior to January first, nineteen hundred seventy-four or during any taxable year in which the taxpayer was not subject to the tax imposed under section fifteen hundred one.

Section 3-8.5 of the Business Corporation Franchise Tax Regulations (Article 9-A Regulations) contains the rules for aggregating net operating losses, and provides:

> When the net operating losses of two or more years, or the portions of net operating losses of two or more years, are carried back or carried forward to be deducted from the income of one particular taxable year, the [Commissioner of Taxation and Finance] requires that an aggregate method of deducting the losses be used. The taxpayer must compute the aggregate of the Federal net operating losses to be carried to the particular taxable year, and, also, compute the aggregate of the net operating losses under article 9-A for such year.
>
> After computing the two aggregate figures, whichever of the two (Federal or State) is smaller is the aggregate net operating loss which is allowable as a carry back or carry forward to the particular taxable year. The limitations described in subdivisions (b), (c) and (d) of section 3-8.2 of this Subpart apply in deducting the aggregate of losses. [Examples omitted]

Opinion

Section 1503(b)(4)(B) of the Tax Law has been interpreted to mean that a New York NOL deduction may not exceed the amount of the federal NOL absorbed in the same year (*Matter of Royal Indemnity Company v Tax Appeals Tribunal*, 75 NY2d 75), and that the federal and state NOL deduction must arise from the same source year (see *Matter of the Aetna Casualty and Surety Company*, 214 AD2d 238; *Lehigh Valley Industries,* Tax Appeals Tribunal, May 5, 1988, citing *Matter of Eveready v State Tax Commn*, 129 AD2d 958, *lv denied* 70 NY2d 604). Although *Lehigh Valley*, *supra,* arose under Article 9-A of the Tax Law, under *Royal Indemnity Company*, *supra,* the regulations and case law under section 208.9(f) of Article 9-A of the Tax Law are equally applicable to section 1503(b)(4) of the Tax Law.

In *Lehigh Valley, supra*, the petitioner argued that section 3-8.5 of the Article 9-A Regulations, which contains the rules for the aggregation of losses, supported its claim that a New York NOL deduction need not originate in the same year as the federal NOL deduction. The Tribunal found that since the petitioner did not have NOLs from two or more years that it was seeking to carry back or forward, the rule of section 3-8.5 of the Article 9-A Regulations was not applicable to determining the petitioner's entire net income.

In *Matter of the Aetna Casualty and Surety Company*, *supra*, the issue was whether section 1503(b)(4) of the Tax Law prohibited the deduction of any NOL in excess of the amount the taxpayer carried back or forward from the same year when calculating the NOL deduction claimed on its federal income tax return. The Appellate Division addressed whether the losses deducted on the franchise tax return must arise in the same source year or years as those deducted on the federal return (a requirement known as "source year conformity.") The Appellate Division stated, in part:

> Tax Law section 1503(b)(4) expressly permits a taxpayer to utilize, when calculating its income for franchise tax purposes, the NOL deduction that it claimed on its Federal income tax return for the corresponding year. This deduction must be modified in certain respects, with the resulting figure to be deducted from taxable income, but, significantly, only to the extent that it does not exceed the Federal deduction (see, Tax Law section 1503(b)(4)(B)). Because the statute begins with the deduction claimed on the Federal return, the Department has taken the position - which we have implicitly upheld (see, *Matter of Eveready Ins. Co. v New York State Tax Commn.*, 129 AD2d 958, 959, *lv denied* 70 NYS2d 604; *Matter of American Employers' Ins. Co. v State Tax Commn.*, 114 AD2d 736, 737-738) - that it allows the deduction of only those losses that made up the Federal deduction, namely, those incurred in the same year(s). Given that the modifications made to the Federal deduction, when calculating the State deduction, do not encompass the inclusion of losses from other years, the Department's interpretation cannot be said to be unreasonable. Therefore, it must be upheld (see, *Matter of Custom Shop Fifth Ave. Corp. v Tax Appeals Tribunal of State of N.Y.,* [195 AD2d 702, 704]. Petitioners' attempt to rely on the regulation governing aggregation of losses from multiple years (see, NYCRR 3-8.5) to circumvent the source year conformity rule is also unavailing, for, as the Tribunal notes, that regulation incorporates similar limitations on deductibility.
>
> It bears noting that this "source year" limitation has also been recognized, and apparently accepted, by the Court of Appeals, which found in the *Matter of Royal Indem. Co. v Tax Appeals Tribunal* (75 NY2d 75,78) that the petitioner therein, having already utilized its Federal losses from 1974 and part of 1975, would never be able to deduct its corresponding State losses (see also, *Matter of American Employers' Ins. Co. v State Tax Commn.*, *supra*, at 738). Moreover, the Department's argument, that true conformity with Federal operation loss rules cannot be achieved by requiring numerical conformity only, provided an additional, reasonable basis for the Tribunal's decision.

With respect to Issue 1, for taxable year 1999, Company had a federal NOL of $1,889,455. Pursuant to IRC section 172, Company carried back and utilized $1,887,257 of the taxable year 1999 NOL to offset all of its federal taxable income for taxable year 1997. For taxable year 1999, Company had a New York NOL of $391,402. Pursuant to section 1503(b)(4) of the Tax Law, Company carried back and utilized all of the taxable year 1999 New York NOL to offset a portion of its New York entire net income for taxable year 1997. After this adjustment, Company's New York entire net income for taxable year 1997 was $2,306,761.

For taxable year 2002, Company incurred a federal NOL of $14,727,812 and a New York NOL of $13,683,040. Pursuant to section 1503(b)(4)(B) of the Tax Law, and following *Royal Indemnity, supra; Aetna Casualty and Surety, supra; Eveready, supra; and Lehigh Valley, supra*, the federal and state NOL deductions must arise from the same source year. For federal income tax purposes, none of the taxable year 2002 federal NOL was allowable as a carry back to taxable year 1997 because Company's federal taxable income for taxable year 1997 was previously reduced to zero when Company carried back its taxable year 1999 federal NOL to taxable year 1997. Accordingly, none of the taxable year 2002 New York NOL may be carried back to taxable year 1997 to reduce Company's New York entire net income for taxable year 1997.

In light of the conclusion reached in Issue 1, Issue 2 is moot.

DATED: October 1, 2004

/s/
Jonathan Pessen
Tax Regulations Specialist IV
Technical Services Division

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