REPORT #676

TAX SECTION

New York State Bar Association

REPORT ON
PROPOSED AMENDMENTS
TO THE NEW YORK CITY
GENERAL CORPORATION TAX REGULATIONS

December 20, 1990

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TAX SECTION
New York State Bar Association

December 27, 1,990

Hon. James W. Wetzler
Commissioner of Taxation and Finance
Building 9
W.A. Harriman Campus
Albany, New York 12227

Dear Commissioner Wetzler:

Enclosed is a copy of a report submitted by our Committee on New York City Tax Matters to the New York City Department of Finance. The report considers proposed amendments to portions of the New York City General Corporation Tax regulations dealing with investment capital and investment income.

The primary focus of our report is the goal of conformity between New York City's investment capital regulations and the New York State investment capital regulations relating to the franchise tax on business corporations applicable to taxable years beginning on or after January 1, 1990.

We wish to call your attention to three issues that arose in our consideration of the City's regulations. In our opinion, as set forth in the report, both the City and State regulations should: (a) offer taxpayers the option of retroactive application (see pages 3-4), (b) not disqualify instruments from investment capital treatment because they were acquired in return for the provision of goods or services by the taxpayer, and (c) insert a grandfather provision into the which excludes instruments issued by corporate ## a from C investment capital (see pages 11-12)

Notwithstanding our belief that the State and City regulations reach an inappropriate result with respect to these issues, we have recommended that the City not unilaterally alter its regulations with respect to these issues. We do, however, call upon both the State and City jointly to revise the regulations in these areas. These recommendations are consistent with the views expressed in the report of our Committee on New York State Tax Matters on the draft corporate franchise tax regulations relating to investment capital, submitted to your office on February 10, 1989. See pages 9 and 21 of that report.

Furthermore, we recommend that in the future the State and City consult each other at early stages during the administrative regulation process and attempt to minimize both formalistic and substantive differences in the regulatory interpretation of identical statutory language.

Sincerely yours,

Arthur A. Feder
Chair

cc: Marilyn Kaltenborn, Esq.
Chief of Tax Regulations
Department of Taxation and Finance

Hon. Carol O8Cleireacain
Commissioner of Finance
The City of New York -

Susan Grossman, Esq.
Acting Deputy Commissioner for Legal Affairs
New York City Department of Finance

Tax Report #676

TAX SECTION
New York State Bar Association

December 27, 1,993

Susan Grossman, Esq.
Acting Deputy Commissioner for Legal Affairs
New York City Department of Finance
345 Adams Street
Brooklyn, New York 11201

Re: Proposed New York City General Corporation Tax Regulations

Dear Ms. Grossman:

We enclosed the report prepared by our committee on New York City Tax Matters commenting on the proposed amendments to portions of the New York City General Corporation Tax regulation dealing with investment capital and investment income. This is report that was referred to in our letter to Mr. Slomka dated November 19, 1990, and it has now received the final approval of the Executive Committee of the Tax Section.

The primary focus of the report is the goal of conformity between New York City’s investment capital regulation and the New York State investment capital regulations relating to the franchise tax on business corporations, applicable to taxable years beginning on or after January 1, 1990.

In furtherance of this goal, the report recommends substantive changes in the City’s regulation and they relate to (1) the treatment of a corporate partner’s interest in a partnership or joint venture (see page 4), (2) the election tm treat cash as business or investment capital (see pages 5-7), (3) futures and forward contracts (see pages 8-9), (4) securities held to secure accounts of customers (see page 9), and (5) the list of factors which is indicative that a repurchase agreement should be characterized as a loan (see page 12). We also call your attention to three other issues that are discussed in the report. In our opinion, as there set forth, both the City and State regulations should: (a) offer taxpayers the option of retroactive application (see pages 3-4), (b) not disqualify instruments from investment capital treatment because they were acquired in return for the provision of goods or services by the taxpayer (see pages 9-11), and (c) insert a grandfather provision into the rule which excludes instruments issued by corporate affiliates from investment capital (see pages 11-12).

Notwithstanding our belief that the State and City regulations reach an inappropriate result with respect to these issues, we have recommended that the City not unilaterally alter its regulations with respect to these issues. We do, however, call upon both the State and City jointly to revise the regulations in these areas.

Furthermore, we recommend that in the future the State and City consult each other at early stages during the administrative regulation process and attempt to minimize both formalistic and substantive differences in the regulatory interpretation of identical statutory language.

We appreciate the opportunity to comment on the regulations and remain, as always, available to discuss our comments further.

Sincerely yours,

Arthur A.Feder
Chair

cc: Hon. Carol O'Cleireacain
Commissioner of Finance
The City of New York

Hon. Kathleen Grim
First Deputy Commissioner
New York City Department of Finance

Ellen E. Hoffman, Esq.
Director, Tax Law Division
New York City Department of Finance

Tax Report #676

REPORT
ON
PROPOSED AMENDMENTS
TO THE
NEW YORK CITY
GENERAL CORPORATION TAX
RGULATIONS

NEW YORK STATE BAR ASSOCIATION TAX SECTION

COMMITTEE ON NEW YORK CITY TAX MATTERS

December 20, 1990

December 20, 1990

New York State Bar Association

Tax Section

Report on Proposed Amendments to the
New York City General Corporation Tax Regulations[1]

This report comments on the amendments to the New York City General Corporation Tax Regulations proposed by the New York City Department of Finance (“Proposed Regulations”) on October 19, 1990, relating primarily to the definition of investment capital and investment income. The most significant provisions of the Proposed Regulations are: (1) money market mutual funds and corporate and government debt instruments payable on demand or within six months and one day would be considered "cash on hand or on deposit”, while such debt instruments, including certificates of deposit, would not be so considered until they were within six months and one day of their maturity date; (2) business or investment capital classification of various investment and financial instruments would be modernized; (3) the allocation of debt instruments issued by the United States and New York State and the calculation of the issuers’ allocation percentages would reflect recent statutory changes; (4) the election to treat cash as investment capital or business

1 This report was prepared by Ronald Rabkin and Arthur R. Rosen. Helpful comments were received from Robert J. Levinsohn and Arthur A. Feder.

capital for each taxable year would be irrevocable; and (5) instruments issued by members of the taxpayer's affiliated group would be excluded from investment capital.

The classification of items as business or investment capital is critical since business capital (and therefore business income) is apportioned to New York based on the owner's (or recipient's) New York business allocation percentage (using the three factors of property, payroll, and receipts) while investment capital (and therefore investment income) is apportioned according to the New York capital allocation percentage of the issuer of the investment. The classification of an item as “cash on hand or on deposit” is significant because such items may generally be treated as either investment capital or business capital, at the taxpayer's election.

Many of our comments relate to conformity of the Proposed Regulations with the investment capital and income portions of the New York State Corporate Franchise Tax Regulations ("State Regulations”). Where the statutory provisions are identical it is desirable for New York State and City tax regulations to coincide with respect to -substance, as well as form. Uniformity in wording between the State Regulations and the Proposed Regulations will promote taxpayer understanding of the Proposed Regulations, and may also limit the opportunities for differing future judicial and administrative interpretations. By way of example, on page seven of this report, we have illustrated every deviation from the State Regulations in section 3-31(a)(3) of the Proposed Regulations. It would be helpful if all other inconsistencies in wording between the State Regulations and the Proposed Regulations were similarly adjusted.

Our interest in conformity extends even to instances where it appears that the State Regulations reach an inappropriate result. In this report we raise issues of retroactivity, treatment of instruments acquired in return for the transfer of property or performance of services, and the treatment of indebtedness issued by affiliated corporations. The Proposed Regulations have followed the State Regulations in these cases, and although we believe the State should change its position regarding these issues we do not think that the City should make these changes unilaterally. We believe, however, that the benefits of conformity outweigh the advantages of adopting our comments with respect to these matters. We do, however, urge both the City and the State jointly to consider changing their position regarding these issues.

The Proposed Regulations would generally be effective for taxable years beginning on or after January 1, 1990. Taxpayers should be permitted to elect to apply the Proposed Regulations retroactively. The major portion of the Proposed Regulations consists of rules and interpretations of existing law, not caused by changes in the underlying tax statute. Accordingly, we recommend that both the State Regulations and the Proposed Regulations give taxpayers the option to apply the revised interpretation of the law on a retroactive basis. We do not, however, think that the Proposed Regulations should adopt this treatment in the absence of a conforming change in the State Regulations.

The Proposed Regulations should contain provisions regarding the treatment of a corporate partner's interest in a partnership or joint venture. We recommend that the Proposed Regulations adopt the newly enacted portions of the State Regulations on this issue.[2] The State Regulations contain a “look-through” policy, in which a corporate partner will take into account its proportionate part of the partnership's items of business and investment income and capital in the computation and apportionment of its New York tax base.[3] Furthermore we suggest that both the City and the State consider expanding look-through treatment to include grantor trusts and similar conduit type entities where a corporation is treated as the substantial owner for Federal income tax purposes.

Our comments on specific sections of the Proposed Regulations are set forth below. We have also attached to this report a copy of

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2 State Regulation section 4-6.5 was adopted on November 21, 1990.

3 State Regulation section 4-6.5 includes provisions relating to an election by certain corporate limited partners to be taxed on their limited partnership interests on a separate accounting basis. The New York City General Corporation Tax regulations do not provide a similar election scheme for corporate limited partners.

the Proposed Regulations marked to indicate those portions addressed in this report and to show other, less significant comments.

1) section 3-3l(a)(2)(ii) - This subsection states that the election to treat cash as business or investment capital is irrevocable for each taxable year, must be made on the original return, and may not be made or changed on an amended return. Proposed Regulation subsection 3-32(d)(2) states that in the absence of an affirmative election, the taxpayer will be deemed to have elected to treat cash as business capital. The concept of an irrevocable election regarding the treatment of cash is not supported by the underlying tax law and is not found in the State Regulations.

This irrevocable election rule is contrary to the rule generally followed, which allows taxpayers to amend returns within the periods of the appropriate statute of limitations. New York City tax auditors will have the opportunity to examine and possibly to recast the taxpayer's filing position and the resulting adjustments may make it desirable for the taxpayer to change an election previously made under this regulation. It seems inappropriate to prevent a taxpayer from altering its treatment of cash, especially when this becomes necessary due to changes caused by a tax audit. See Petition of Autotote Limited, 90-1 N.Y.T.C. T-183 (Division of Tax Appeals, Tax Appeals Tribunal, April 12,1990).

The New York State Department of Taxation and Finance has considered and rejected the possibility of requiring an irrevocable election regarding the treatment of cash. Although dealing with the same underlying statutory language, New York State declined to insert this provision based upon the Department's perception of insufficiently clear statutory authority to justify this approach.

The argument that this provision is necessary on the grounds of administrative convenience is not persuasive. The taxing authority is notified of the taxpayer's treatment of cash when the return is filed. The taxpayer may unilaterally change its position with respect to this issue only through an amended return, which it may properly file within the statute of limitations period. Binding the taxpayer to its original filing position in the case of audit changes by the taxing authority does not favor administrative convenience, but rather administrative unfairness.

It is uncertain how the requirement that the election be made on the original return would apply if the taxpayer prepared its return in such a way that it had no cash and thus made no election on its original return. Presumably upon an audit adjustment, or when an amended return is filed, the taxpayer would be deemed to have made an election to treat cash as business capital under Proposed Regulation 3-32 (d) (2). This arbitrary result would be inequitable.

If the irrevocable election requirement and the presumption that cash is business capital if no election is made are not abandoned, then reference to this presumption should be inserted. On the fourth line of this subsection, after "(see 3-32(d) of these regulations for election to treat cash as business capital)...” insert "<u>and if no election is made it will be presumed to have irrevocably elected to treat cash as business capital for that taxable year</u>."

2) <u>Section 3-31(a)(3)</u> - The wording of this subsection should match the wording of State Regulation section 3-4.2(a)(l). In the first paragraph words such as “which” are replaced by "that1', the phrase "on any day1' is replaced by "as of the first day”, “Any such debt instrument”, is replaced by “Any debt instrument”, "a 'money market’ fund” is replaced by “a money market fund”. Any benefits from these drafting differences are outweighed by potential complications in taxpayer understanding and judicial interpretation of the Proposed Regulations.

In the third paragraph of this subsection the words used in the State Regulations are copied exactly, but the sentences have been reordered. This serves no purpose we can discover.

We have considered whether it is appropriate to classify governmental and corporate securities having maturities within six months and one day as cash. Administrative Code Section 11-602(6) provides that "cash on hand or on deposit” may be treated as business capital or investment capital, as the taxpayer may elect.

On a practical level governmental and corporate debt instruments are considered to be securities, whatever their maturities, and thus more akin to investment capital than cash. Furthermore we anticipate unsophisticated corporate taxpayers will incur compliance problems in tracking the remaining maturities and properly categorizing debt instruments. We do, however, appreciate the difficulty of distinguishing between cash type instruments such as 30 day bankers acceptances and short term certificates of deposit, and governmental and corporate debt instruments with short maturity dates. We recognize that it may not be practical to classify all instruments, other than instruments payable on demand and money market mutual funds, as investment capital. We also are mindful of the benefits of conforming with the State Regulations on this matter. Accordingly, we believe that the treatment of this issue in the Proposed Regulations is reasonable.

3) Section 3-31(a)(4)(E) - This subsection treats as investment capital assets reflected on the taxpayer's books and records in connection with futures and forward contracts, which hedge other investments of the taxpayer. Futures and forward contracts are not treated as assets on a balance sheet under generally accepted accounting principles, although they may be reflected in notes to the balance sheet. The State Regulations have excluded futures and forward contracts from the definition of investment capital because they are not listed as assets on the taxpayer's balance sheet. While we recognize that there is

some support for treating these instruments as capital, in the interests of conformity we recommend that the Proposed Regulations follow the State Regulations and eliminate futures and forward contracts from investment capital.

4) Section 3 – 31(a) (4)(F) - This subsection excludes from investment capital "... stocks, bonds or other securities held to secure accounts of customers”. Presumably this provision applies to customer owned securities held by the taxpayer as collateral. This suggests that property held by the taxpayer as collateral is to be included in investment capital, when in fact the customer must pay capital-based and income-based taxes on such property. This language should be deleted.

5) Section 3- 31(c)(1) - This subsection deviates from the State Regulations by omitting "... units in a publicly traded partnership ..." from inclusion in the tern "stocks, bonds and other securities”. These limited partnerships are not “corporations” for purposes of the New York City Administrative Code although they are “corporations” under Federal and State tax law. In view of the statutory differences it is appropriate to exclude units in a publicly traded partnership from the definition of stocks, bonds and other securities.

6) Section 3-32 (d) (1) (C) - This section and the corresponding section of the State Regulations look to the circumstances regarding a taxpayer's acquisition of an instrument to determine whether it is business or investment capital. It states that instruments received in connection with the

transfer of property (other than investment capital) or the performance of services, will be considered business capital, if the obligor is the recipient of the property or services.

New York tax law does not categorize income as business or investment capital based upon whether it is earned from business or non-business activities, but instead focuses on the nature of the investment instrument. The Proposed Regulation disregards this principle and attempts to classify an item based upon its source, rather than its characteristics. Attempting to adopt UDIPTA-type[4] business and non-business concepts through regulations is inappropriate. Of course, in calculating entire net income the taxpayer must include the value of instruments received in return for goods or services and must apportion such value by its business allocation percentage. However, thereafter, income generated by this asset should be apportioned based upon the normal rules. It is not proper to treat a taxpayer one way if it receives a debt instrument in return for the performance of services and another if it receives cash which it then invests in the same kind of instrument. We recommend that both the State and City regulations provide that instruments received in these circumstances be classified according to their characteristics, consistent with applicable law, and not according to the nature of the transaction in which the instruments were received. We do not, however, recommend that the Proposed Regulations be revised to correct the treatment of this issue unless a conforming change is made in the State Regulations.

7) Section 3-31(d)(1)(F)- This section alters the existing regulations and excludes from investment capital all obligations owed to the taxpayer by a member of the taxpayer's affiliated group. Some New York City corporate taxpayers relied upon the

[4] Uniform Division of Income for Tax Purposes Act.

existing regulations when they structured their corporate finances. Consequently these corporations hold debt obligations from subsidiaries, designed to be identical to debt instruments traded on the open market so as to qualify for investment capital treatment under the current regulations. These corporations treat such instruments as investment capital in accordance with the existing regulations and would be injured if required to allocate interest received from such debt according to their business allocation percentages, rather than their investment allocation percentages. The option of having the subsidiary forego the tax deduction for interest paid (so that the interest payment would be exempt subsidiary income) may not always be practical (for example, when the subsidiary is partially owned by the public) .To remedy this situation, we recommend that affiliated company debt obligations, whether issued for services, property, or cash, issued before January 1, 1990, be governed by the former regulation. Taxpayers holding demand instruments, however, should be governed by the new rule after December 31, 1991, and taxpayers holding other affiliated company debt should be governed by the new rule upon the original maturity (without extensions) of term obligations in existence before January 1, 1990. After January 1, 1990 corporations may structure their corporate finances according to the new rules. As previously noted, we make this recommendation conditional upon the adoption of a similar transitional provision under the State Regulations.

8) section 3-31(f) - The wording of this section should conform exactly with the corresponding section of the State Regulations. The Proposed Regulations omit a factor used in the State Regulations to determine whether the purchaser/lender in a repurchase transaction is the owner of the securities. Section 3-31(f) (2) fails to include "a requirement that the same or identical securities be resold or returned”. See State

Regulations section 3-4.2(f)(2)(i). Since fungibility is a basic consideration in determining whether a purchaser/lender owns the securities, the Proposed Regulations should include this factor.

9) Section 3-32(d)(2) - On the eighth line of this subsection after”... will be presumed to have made an irrevocable election to treat cash as business capital...” insert “for that taxable vear”. This will make clear that the presumption only applies for a taxable year for which no election is made.

10) Section 3 – 33(b) - On the fourteenth line of this subsection after “...average value shown..."insert” (or which should have been shown. if not so shown)”. This insertion conforms with the State Regulations and addresses the situation in which an item is not actually shown on the taxpayer's books and records.

11) Section 4-41(b)(l) - On the tenth line of this subsection after “Administrative Code title 11, Chapter 6, Subchapter 4" insert” (Transportation Corporation Tax)”.This allows the reader to easily identify that Chapter 6 , Subchapter 4 of the Administrative Code relates to the transportation corporation tax.

12) Section 4-41(b)(6)(E)(F) - To distinguish the concepts of “issuer's allocation percentage” and “issuers or obligors” it would be helpful if: subsection 4-41(b)(6)(E) was renumbered 4-41(b)(6), subsection 4-41(b)(6)(F) was renumbered 4-41(b)(7) , and the remainder of subsection 4-41(b)(6) was renumbered 4-41(b1(81.

BSIS AND PURPOSE OF PROPO SED AMENDMENTS

These proposed amendments update the treatment of investment capital and investment income under the General Corporation Tax imposed by chapter 6 of title 11 of the Administrative Code. The current rules were promulgated prior t o the development or widespread use of a variety of financial instruments t h a t have entered the marketplace i n recent years. These amendments generally follow corresponding amendments to the New York State Franchise 'fax Regulations governing the treatment of the various instruments. The amendments also reflect recent legislative changes to the General Corporation Tax law.

The proposed amendments define investment capital to include a broad range of corporate debt instruments with certain specified exemptions and eliminate the current regulatory requirement that securities be "of a like nature as stocks and bonds ..." The amendments specifically address the treatment of repurchase agreements, options, banker’s acceptances, future and forward contracts, and GNMA pass through certificates and interests in REMICs.

The amendments also include specific rules governing the election to treat cash as investment or business capital and expand the definition of cash to include shares in money market mutual funds and debt instruments t h a t are either payable on demand or within six months and one day.

Changes in the treatment of United States and New York State obligations pursuant to section 17 of Chapter 525 of the Laws of 1988, and changes in the calculation of issuer's allocation percentages pursuant to section 52 of Chapter 241 of the Laws of 1989, are also reflected in the proposed amendments.

Carol O’Cleireacain
Commissioner of Finance

THE CITY OF NEW YORK
DEPARTMENT OF FINANCE

NOTICE OF OPPORTUNITY TO COMMENT ON
PROPOSED AMENDMENT TO RULES RELATING TO THE
NEW YORK CITY GENERAL CORPORATION TAX

NOTICE IS HEREBY GIVEN PURSUANT TO THE AUTHORITY VESTED IN the Commissioner of Finance by sections 389(b) and 1043 of the New York City Charter and section 11-687(1) of the Administrative Code of the City of New York, and in accordance with the requirements of section 1043 of the New York City Charter, that the New York City Department of Finance intends to adopt the following proposed Amendments to Rules Relating to the New York City General Corporation Tax, which are necessary to carry out the powers and duties delegated to the Commissioner of Finance by sections 11-602 and 13-604 of the Administrative Code of the City of New York.

Written comment regarding these proposed rules must be submitted to the office of Irvin M. Slomka, Deputy Commissioner for Legal Affairs, 345 Adam Street, Brooklyn, New York, 11201 on or before November 19,1990.

A public hearing shall be held on November 19,1990 At 345 Adams Street, 3rd Floor, Brooklyn, New York at 9:30 A.M. Persons seeking to testify are requested to notify Natalie Homs at (718) 403-3755 at least three business days prior to the date scheduled for the hearing, although such notice is not required by law.

Written comments and an audio tape recording of oral comments received at the hearing will be available for public review within a reasonable time after receipt, by appointment between the hours of 9:00 A.M. and 5.00 P.M. on weekdays at the office of Gerald Koszer, Records Access Officer, 345 Adams Street, 3rd Floor, Brooklyn, New York. Note: New matter underscored; old matter in brackets [] to be deleted.

<u>Amendments To Rules Relating To The New York City General Corporation Tax</u>

Section 1. Paragraph (2) of subdivision (a) of section 3-1 of the Rules of the Commissioner of Finance Relating to the New York City General Corporation Tax (Subchapter 2 of Chapter 6 of Title 11 of the Administrative Code of the City of New York), promulgated August 15,1968, Is amended to read as follows:

(2) its investment capital and Investment income (capital Invested in stocks and securities of corporations other than subsidiaries and in governmental securities, and the income therefrom] <u>see section 3-31 of these regulations - Definition of Investment Capital and section 4-52 - Definition of Investment income</u>); and

§2. Section 3-31 of such rules is amended to read as follows:

§3-31. Definition of investment capital (Sec. [R46-2.0.4] 11-602.4. Administrative Code). (a) [The term Investment capital means the total average fair market value of the taxpayer’s investments in stocks, bonds and other securities issued by any corporation (other than the taxpayer or a subsidiary) or by the United States, any state. territory or possession of the United States, the District of Columbia, or any foreign country, or any political subdivision or governmental instrumentality of any of the foregoing. It includes any loan to a subsidiary, the interest on which is claimed by the subsidiary as a deduction for purposes of a tax imposed by Chapter 46, Title R, Part II or Part III of the Administrative Code, provided such loan is evidenced by a bond or other security. At the election of the taxpayer, it also includes cash on hand and on deposit to the extent not included in subsidiary capital (see S3-52, infra). Unless the Commissioner of Finance specifically authorized to the contrary, there shall be deducted from each Item of investment capital any liabilities payable by their terms on demand or within one year from the date incurred, other than loans or advances outstanding for more than a year as of any date during the year covered by the report, which are attributable to that Item of investment capital (see S3-32, Infra).

(b) Investment capital does not include stocks, bonds and other securities held by the taxpayer for sale to customers in the regular course of business. Nor does it include investments in securities of an individual, partnership, trust or other nongovernmental entity which is not a corporation.

(c) The other securities referred to in the definition of investment capital are limited to securities Issued by governmental bodies and securities issued by corporations, of a like nature as stocks md bonds which are customarily sold in the open market or on a recognized exchange, designed as a means of investment, and issued for the purpose of financing corporate enterprises and providing a distribution of rights in, or obligations of, such enterprises. Such other securities thus include debentures, notes of a type commonly dealt in upon securities exchanges or markets or commonly dealt in as a medium for investment and certificate of indebtedness which have many of the essential characteristics of bands, and certificates of interest and other instruments evidencing proprietorship right in corporate enterprises which have many of the essential characteristics of stock. They do not include corporate obligations not commonly known as securities, such as real property or chattel bonds and mortgages, contracts of sale, purchase money obligations, short-term notes acquired in the ordinary count of trade or business for services rendered or for sales of property which it primarily held for sale to customers, bills of lading, bills of exchange, bankers' acceptances and other commercial instruments.

(d) At the election of the taxpayer, cash on hand and on deposit may be treated on any report as investment capital or as business capital (§3-32, Infra), to the extent that an election is not made to treat it as subsidiary capital(§3-52, infra). Certificates of deposits seemed to be cash. Election may not be made to treat part of such investment capital and part as business capital. No election to treat investment capital may be made where there is no other Investment capital.1

(1) The term “investment capital” means the taxpayer’s investments in stocks, bonds and other securities issued by a corporation (except as provided in paragraph (4) of this subdivision) or-by the United States, any state. Territory or possession of the united States, the District at Columbia, or any foreign country, or any political subdivision or governmental Instrumentality of any of the foreign (see subdivisions (c) - (h) of this section).

(2) (I) If in s taxable year, r taxpayer has investment capital but no business capital, cash on hand and cash on deposit must be treated on all reports for the taxable year as investment capital.

(ii) If in a taxable year taxpayer has both business and investment capital. The taxpayer may elect to treat cash on hand and cash on deposit, as defined in paragraph (3) of this subdivision, as investment capital (see §3-32(d) of these regulations for election to treat cash as business capital). Once an election is made for a taxable year, it shall be irrevocable for that taxable year. The election must be made on the original return for the taxable year; any purported election made on an amended return is invalid. A separate election must be made for each taxable year. A taxpayer may not elect to treat part of its cash as investment capital end part as business capital. No election to treat cash as investment capital may be made where the taxpayer has no investment capital exclusive of cash.

(3) Any debt instrument, including a certificate of deposit described in paragraph(2) or (3) of subdivision (c) of this section and not described in paragraph (4) of this subdivision (a) that is payable by its terms on demand or within six months and one day from the date on which the debt was Incurred, is deemed to be cash on hand or on deposit. Any debt instrument that is payable by its terms more than six months and one day from the date on which the debt was incurred is deemed to be cash on hand or on deposit as of the first day that is not more than six months and one day prior to its date of maturity. Cash also includes shares in a money market mutual fund. A money market mutual fund is a no-load, open-end investment company registered under the Federal Investment Company Act of 1940 that attempts to maintain a constant net asset value per share and holds itself out to be a money market fund.

Example: On February 1, 1990, Corporation A, a calendar year taxpayer purchased a certificate of deposit with a maturity date of January 31. 1991. Which was a qualifying corporate debt instrument as that term is defined in subdivision (d) of this section. On July 1, 1990, Corporation A purchased a four-month qualifying corporate debt instrument on the day it was issued and renewed it, with the identical terms, on November 1, 1990. Corporation A bought a qualifying corporate debt instrument on August 1, 1990, the day it was issued, with maturity date of February 2, 1991. On September 1, 1990, the corporation bought a nine-month qualifying corporate debt instrument which had been issued on January 1, 1990 and was due on October 1, 1990.

The renewal of the four-month debt instrument purchased on July 1, 1990 is treated as the creation of a second, separate debt instrument, each of the two instruments being due with six months and one day of the date on which the debt was incurred. For the taxable year ending December 31,1990, the two-four months debt instruments and the debt instrument due on February 2, 1991 are deemed to be cash. The debit instrument due on February 2, 1991 is deemed to be cash because it is due within six months and one day from the date on which it was issued.

The nine-month debt instrument is deemed to be cash because each day on which the taxpayer owned it was a day not more than six months and one day prior to its maturity date.

The one-year certificate of deposit is deemed to be cash on July 30, 1990 (the first day not more than six months and one day before its maturity date of January 31, 1990) and each day thereafter.

(4) Investment capital does not Include :

(A) stock issued by the taxpayer;
(B) stocks, bonds or other securities constituting subsidiary capital;
(C) securities issued by an individual, Partnership, trust or other nongovernmental entity that is not a corporation within the definition contained in Administrative Code §Ill-602.1 e.g., Federal National Mortgage association and Government National Mortgage Association pass-through Certificates)
(D) regular interests and residual interests in a real estate mortgage investment conduit (REMIC), as defined in section 860D of the internal Revenue Code;
(E) assets reflected in the taxpayer's books and in connection with future contracts and forward contracts except as provided in subdivision (g) of this section; or
(F) stocks, bond and other securities held by the taxpayer for sale to customer in the regular course of its business and stocks, bonds or other securities held to secure accounts of customers.

(b) The amount of investment capital is determined as set forth in subdivision (b) of section 3-33 of these regulations.

(c) For purpose of paragraph (1) of subdivision (a) of this section, the phrase “sticks, bonds and other securities”

(1) stocks and similar corporate equity instruments, such as business trust certificates;

(2) debt instruments issued by the United States, any state, territory or possession of the United States, the District of Columbia, or any foreign country, or any political subdivision or governmental instrumentality of nay of the foregoing;

(3) qualifying corporate debt instruments (see subdivision (d) of this section);

(4) options on any item described in paragraph (1), (2), or (3) of this subdivision and not described in paragraph (4) of subdivision (a) of this section, or on a stock or bond index, or on a futures contract on such an Index, unless the options are purchased primarily to diminish the taxpayer's risk of loss from holding one or more positions in assets that constitute business or subsidiary capital; and

(5) sock rights and stock warrants not in the possession of the issuer thereof

Provided, however, debt instruments described in paragraph (2) or (3) of this subdivision that are deemed to be cash pursuant to paragraph (3) of subdivision (a) of this section do not constitute stocks, bonds or other securities.

(d) Qualifying corporate debt instruments. (1) The term “qualifying corporate debt Instruments" means all debt instruments issued by a corporation other than the following:

(A) instruments Issued by the taxpayer:

(B) instruments that constitute subsidiary capital in the hands of the taxpayer;

(C) instruments acquired by the taxpayer for services rendered, or for the sale, rental or other transfer of property, where the obligor is the recipient of the service or property; however, where a taxpayer sells or otherwise transfers property that is investment capital in the hands of such taxpayer (e.g., stock) and receives in return a corporate obligation issued by the recipient of such property, such corporate obligation, if it is not otherwise excluded from the category of investment capital, would constitute investment capital in the hands of the taxpayer;

(D) Instruments acquired or funds if (1) the obligor is the recipient of such funds, (ii) the taxpayer is principally engaged in the business of lending funds, and (iii) the obligation is acquired in the regular course of the taxpayer's business of lending funds;

(E) accepted drafts (such as banker's acceptances and trade acceptances) where the taxpayer is the drawer of the draft;

(F) instruments issued by a corporation that is a member of an affiliated group that includes the taxpayer; and

(G) accounts receivable, including those held by r factor.

(2) Terms used in this subdivision shall have the meaning prescribed as follows:

(A) Affiliated group the term “affiliated group” means a corporation or corporations and the common parent of such corporation or corporations. The “common parent” of a corporation or corporations means an individual, corporation, partnership, trust or estate that owns or controls, either directly or indirectly, at least 80% of the voting stock of such corporation or of each of such corporations. An affiliated group also includes all other corporations at least 80% of the voting stock of which is owned or controlled, either directly or indirectly, by one or more of the corporations included in the affiliated group, or by the common parent and one or more of the corporations included in the affiliated group.

(B) Principally engaged in the business of lending funds. A taxpayer is "principally engaged in the business of lending funds" for purpose of this subdivision if, during the taxable year, more than 50 percent of its receipts consist of interest from loans or net gain from the sale or redemption of notes or other evidences of indebtedness arising from loans made by taxpayer. For purpose of the proceeding sentence, receipt do not include return of principal or non-recurring, extraordinary items.

(e) For purposes at this section, the phrase "stocks, bonds and other securities" includes instruments held in book entry form.

(f) Repurchase agreements. (l) "Repurchase agreement" is a term used to describe a transaction in which one party (the seller/borrower) sel1s securities to a second party (the purchaser/lender) and simultaneously contracts to repurchase the same or identical securities. Depending upon the nature of the agreement, in some instances the purchaser/lender in fact will have purchased the securities, whereas in other instances the transfer of funds to the seller/borrower in fact will constitute a loan collateralized by the securities.

If the purchaser/lender is a taxpayer, it is necessary to determine whether the result of such a transaction is the holding by the purchaser/lender of investment capital. If, as a result of the repurchase agreement, the purchaser/lender owns the securities and the securities are encompassed with the definition of investment capital contained in subdivision (a) of section, such securities will constitute investment capital in the hands of the purchaser/lender. If the purchaser/lender has not acquired ownership of the securities, then it is a lender of funds and has acquired a debt instrument issued by the seller/borrower collateralized by the securities. Unless such debt instrument constitutes cash pursuant to paragraph (3) of subdivision (##) of this section, where such debt instrument is encompassed within the definition of investment capital contained in subdivision (a) and (c) of this section, such instrument will constitute investment capital in the hands of the purchaser/lender. Otherwise, it will constitute either business capital or subsidiary capital.

(2) in a repurchase transaction, the question of whether the purchaser/lender is the owner of the securities, rather than the owner of a debt instrument issued by the seller/borrower, turns on whether such purchaser/lender has acquired the economic benefit and burdens of ownership of the securities.

The purchaser/lender is the owner of the securities if it (A) has the right freely to dispose of or pledge the securities to a third party and (B) has acquired the opportunity for profit and bears the risk of loss deriving from changes in the market value of the securities. All of these factors must be present simultaneously in order for a transfer of ownership to be recognized. The absence of any of these factors will render the transaction a loan. In such event, the purchaser /lender would be viewed as having acquired a debt instrument of the seller/borrower, collateralized by the securities. Where there is ambiguity as to the existence of any of the factors, recourse may be had to an examination of various other features of the transaction. Features that are consistent with a characterization of the transaction as a loan, but that are not dispositive in and of themselves are:

(i) an obligation on the part of the purchaser/lender, where it sells the securities upon the failure of the seller/borrower to "repurchase" the securities, to turn over to the seller/borrower the proceeds in excess of the amount due to the purchaser/lender from the seller/barrower, and a right on the part of the purchaser/lender to hold the seller/borrower liable for any deficiency arising from such sale;

(ii) an obligation on the part of the seller/borrower to pay interest at a Stipulated rate;

(iii) a disparity at the time of the initial transaction between the fair market value of the securities and the amount paid or advanced by the purchaser/lender;

(iv) a right o n the part of the purchaser/lender to require additional collateral if the market value of the securities declines (e.g., a-mark-to market provision); and

(v) failure to treat the transaction as a sale or exchange for Federal income tax purposes; e.g., with respect to the reporting of gain or loss on each of the two purported sales, or the exclusion by the seller/borrower under Internal Revenue Code section 103(a) of Interest, if any, earned on the securities during the period between the initial “sale" and the “repurchase.”

(g) Investment capital shall include assets reflected in 'the taxpayer’s books and records in connection with futures or forward contracts if such contracts substantially diminish the taxpayer’s risk of loss from holding one or more positions in assets that constitute investment capita1or it such contracts substantially diminish the taxpayer's risk of loss from making short sale of assets that constitute investment capital. If the taxpayer holds more positions in futures or forward contracts than are reasonably necessary to substantially diminish its risk of such losses, assets attributable to the excess positions in futures or forward contracts are not included in investment capital.

(h) The following example illustrates some of the provisions of this selection.

Example: Corporation A is a manufacturing corporation and a taxpayer. It owns \0,000 shares of stock in Corporation B (a manufacturing firm that has 5,000.000 shares of stock issued and outstanding). a $1,000,000 Government National Mortgage Association (GNMA) pass-through certificate, a $1,000,000 Federal National Mortgage Association (FNMA) pass-through certificate and a $100,000 FNMA debenture. Corporation A's investment capital consists of the shares of stock in Corporation- B, and the FNMA debenture. The FNMA debenture constitutes investment capital because it is a qualifying corporate debt investment issued by a corporation. Although the FNMA and GNMA certificates are guaranteed by FNMA and GNMA, respectively, they do not constitute investment capital because they are issued by a trust and thus are not "corporate or governmental.”

§3. The title and subdivision (c) of section 3-32 of such rules are amended to read as follows:

§3-32. Definition of business capital (S(R46-2.0.61 11-602.6, Administrative Code).

(c) The term business capital includes loans to a subsidiary, the interest on which is claimed by and allowed to the subsidiary as r deduction for purposes of any tax imposed by [Chapter 46, title R, Part II or Part III] Title II. Chapter 6, Subchapter 2 or Subchapter 3 of the administrative Code provided such loans [are] do not [evidenced by bonds or other securities] constitute investment capital pursuant to section 3-31 of these regulations [It also includes corporate obligations not commonly known as securities, such as real property bonds and mortgage chattel bonds and mortgages, contracts of sale, purchase money obligations, short-term notes required in the ordinary course of trade or business for service rendered or for sales of property which is primarily held for sale to customers, bills of lading, bills of exchange, bankers' acceptances and other commercial instruments].

§4. Subdivision (d) of section 3-32 of such rules is amended to read as follows:

(d) [At the election of the] (1) If in a taxable year a taxpayer, cash may be treated as either] has business capital [or] but no investment capital, [subject to the limitations set for in subdivision (d) of section 3-31] cash in hand and cash on deposit (as defined in section 3-31(a)(3)of these regulations)must be treated on all reports for the taxable year as business capital.

(2) if in a taxable year a taxpayer has both business and investment capital, the taxpayer may elect to treat cash on hand cash on deposit (as defined in section 3-31(a)(3)) of these regulations as business capital. A taxpayer may not elect to treat part of its cash as business capital and part as investment capital. No election to treat cash as business capital may be made [where there is] if the taxpayer has no [other] business capital exclusive of cash. Any taxpayer who may elect under this paragraph (2) will be presumed to have made an irrevocable election to treat cash as business capital unless such taxpayer properly elects under section 3-31(a)(2)(ii) of these regulations to treat cash on hand and on deposit as investment capital.

§5. Subdivision (b) of section 3-33 of such rules is amended to read as follows:

(b) the amount of the investment capital of the taxpayer is [total average fair market value, during the period covered by the report, of all the assets of the taxpayer which constitute investment capital, less certain current liabilities (§3-31, supra)] determined as follows:

(1) ascertain the average value of each item of investment capital (including cash, where the election does ###### in paragraph (2) of subdivision(a) of section 3-31 of these ##### is made);

(2) ascertain the net value of each such item by subtracting from the average value of each such item average liabilities that are directly or indirectly attributable to that item; and

(3)add the net values so arrived at.

The average value of a marketable security included in investment capital is its average fair market value, and the average value of an item of investment capital that is not a marketable security is the average value shown on the books and the records of the taxpayer in accordance with generally accepted according principles.

§6. Subdivision (c) of section 3-52 of such rules is amended to read as follows:

(c) indebtedness on which any interest is deducted by the subsidiary in outing any tax imposed on the subsidiary under [Chapter 46,Title R, Part II or Part III] Title II, Chapter 6, Subchapter 2 or Subchapter 3 of the Administrative Code may not be included in the taxpayers subsidiary capital. Such indebtedness is includible in investment capital if it meets the definition of investment capital as set forth in section 3-31 of these regulations [evidenced by a bond or other corporate security]; otherwise, it constitutes business capital.

Example- [A subsidiary owes the taxpayer $100,000 on open account, and in computing its entire net income for the calendar year 1966 for New York City tax purposes under either Chapter 46, Title R, Part II or Part III of the Administrative Code does not claim my part of the interest thereon as a deduction, but does claim such interest, or some part thereof, as a deduction for the calendar year 1967. Such indebtedness is includible in the taxpayer's subsidiary capital on its report due on March 15, 1967, based on the calendar year 1966. However, such indebtedness is includible in the taxpayer's business capital on its report due on March 15, 1968, based on the calendar year 1967]. The taxpayer, parent, loaned its subsidiary $100,000. In computing entire net income for the taxable year 1990 for New York City General Corporation Tax purposes under Title 11, Chapter 6, Subchapter 2 of the Administrative Code, the subsidiary did not claim any part of the interest as a deduction. The subsidiary did claim such interest, or some part of it, as a deduction for taxable year 1991. The indebtedness is includible in the taxpayer's subsidiary capital on its report for taxable year 1990. However, for taxable year 1991 such indebtedness is includible in the taxpayer's investment capital if it meets the definition of investment capital as set forth in section 3-31 of these regulations. Otherwise it is business capital.

§7. Subdivision (a) of section 4-1 of such rules is amended to read as follows:

§4-1. General Rules for Allocation, (a) [Part II,] Title [R] 11, Chapter [46] 6 Subchapter 2 of the Administrative Code provides for separate allocations of business income and capital, investment income and capital, and subsidiary capital. Business income and capital generally are allocated by a business allocation percentage determined by three factors: tangible property, business receipts and payrolls ([SS] sections 4-10 through 4-28, infra). Investment income and capital [generally] are allocated by an investment al1ocation percentage determined [by the amount of capital employed in New York City by the corporations, and the location of the governments, issuing the taxpayer’s investments (Secs.] pursuant to sections 4-10 through 4-43[, infra)] of these regulations. Subsidiary capital [generally is allocated by a subsidiary allocation percentage determined by the amount of capital employed in New York City by the taxpayer's subsidiaries ([§] -section 4 -70, infra).

§8. Subdivision (c) of section 4-40 of these rules is amended to read as follows:

(c)(l) For tax years beginning before January 1, 1989, If [II] the investment income (before allowance of my net operating loss deduction) of a taxpayer not reporting on a combined basis is more than 85 [per cent] percent of its entire net income

(before allowance of any net operating loss deduction) and its investment capital is more than 85 [per cent] percent of its total business and investment capital, It may elect to allocate its entire net income and total business a d investment capital by the investment allocation percentage,

2) [In other cases,] Except as provided in paragraph (1) of this subdivision, if a taxpayer [which] has both business and investment capital, but hrs only investment income or has investment income and a business loss, the taxpayer must [allocates] allocate its entire net income and its investment capital by the investment allocution percentage. Its business capital is allocated by the business allocation percentage.

§9. Section 4-41 of such rules is amended to read as follows:

§4-41. Computation of Investment Allocation Percentage (S [R46-4.0.3(b) 11- 604 3(b). Administrative Cobs). (a) The investment allocation percentage is computed as follows:

(1) [the taxpayer’s average aggregate investments in the stocks, bonds and other securities issued by any corporation, except the taxpayer or a subsidiary, are allocated separately on the basis of the amount of capital or issued capital stock, gross direct premiums (in the case of an insurance company) or net income (in the case of a bank or trust company) of such corporation allocated to New York City under Title R or Title QQ of Chapter 46 of the Administrative Code for the previous year;

(2) all amounts of investment capital thus allocated to New York City are added together, and the sum thus obtained is divided by the average total of the taxpayer's investment capital, exclusive of cash, obligations of the United States and its instrumentalities and obligations of New York State, its political subdivision and instrumentalities. Investments must be taken at average fair market value determined as provided in sections 3-34 and 3-35, supra. Investments do not include any securities held by the taxpayer for sale to customers in the regular course of business (see §3-31, supra)]

Ascertain the average net value of each stock, bond or other security, other than governmental securities, included in the taxpayer’s investment capital,pursuant to subdivision (b)of section 3-33 of these regulations. The phrase “stock, bond or other security” as used in this paragraph does not include cash, even if treated as investment capital pursuant to section 3-31(a)(2) of these regulations.

(2) Multiply the net value of each such stock, bond or other security by its issuer’s allocation percentage.

(3) Add all the products determined in paragraph (2) of this subdivision.

(4) Divide the sum obtained in paragraph (3) of this subdivision by the net value of the taxpayer’s total investment capital, exclusive of cash even if such cash

is treated as investment capital pursuant to section 3-31(a)(2) of these regulations.

(b) [In computing the investment allocation percentage, the following calculations are required to be made:

(1) ascertain separately, in the manner prescribed in section 3-35, the average fair market value of the taxpayer’s total investment in the stocks, bonds and other securities issued by any corporation, except the taxpayer and its subsidiaries;

(2) multiply the average fair market value of the taxpayer’s total investment in each such corporation by the percentage of the entire capital or the issued capital stock, grow direct premiums or net income of such corporation allocable to New York City on the New York City tax report of such corporation under Title QQ or R, Chapter 46 of the Administrative Code for its preceding tax year, without regard to any minimum. In case such corporation was not doing business in New York City and, therefore, was not required to file r New York City t a x report for the preceding year, the percentage of the entire capital, capital stock, premiums or net income of such corporation allocable to New York City is zero;

(3) add together all the products determined as set forth above;

(4) divide the sum obtained under (3), above, by the average fair market value of the taxpayer’s total investment capital exclusive of cash, obligations of the United States and its instrumentalities and obligations of New York State, its political subdivisions and its instrumentalities. The resulting percentage is the taxpayer's investment allocation percentage]

(1) The issuer's allocation percentage of an issuer of or obligor (other than an issuer or obligor subject to tax under Title 11. Chapter 6, Subchapter 3, Part 4 of the Administrative Code and other than in the case of an option on a stock or bond index or an option on a futures contract on such an index) on a stock, bond or other security constituting investment capital is computed as follows:

Tax Applicable to Issuer or Obligor	Issuer’s Allocation Percentage
Administrative Code Title II, Chapter 6, Subchapter 4	Percentage of Issued capital stock required to be allocated within New York City on its report for the preceding Year
Administrative Code Title II, Chapter 6, Subchapter 11 (Utility Tax)	Percentage of equal to a fraction, the numerator of which is the gross income of a utility corporation included on its New York City Utility Tax reports for periods during the preceding year, and the denominator of which is the gross income of the corporation as defended in Title II, Chapter II of the Code of such periods, except that it shall include income from sources within and without the city.
Administrative Code Title II, Chapter 6, Subchapter 2 (General Corporation Tax)	Percentage of entire capital required to be allocated within New York City of its report for the preceding year equal to the sum of allocated business capital allocated investment capital and allocated subsidiary capital divided by the sum of business capital. Investment capital and subsidiary capital).

(2) In the case of an issuer at obligor subject to tax under Title: 11, Chapter 6, Subchapter 3. Part 4 of the Administrative Code, the issuer's allocation percentage shall be determined as follow:

(A).In the case of s banking corporation described in section 11-640 (a)(1)(8) of the Administrative Code that is organized under the laws of the United States, this state or any other state of the United States, the Issuer's allocation percentage shall be its alternative entire net income allocation percentage, as defined in section 11-642(c) of the Administrative Code, for the preceding year. In the case of such a banking corporation whose alternative entire net income for the preceding year is derived exclusively from business carried on within the city, its issuer's allocation percentage shall be 100%.

(B) In the ease of a banking corporation described in section 11-640(a)(2) of the Administrative Cods that is organized under the laws of country other than United States, the issuer’s allocation percentage #### determined by dividing (i) the amount described in section 11-642(a)(2)(i) of the Administrative Code with respect to such issuer or obligor for the preceding year, by (ii) the gross income of such issuer or obligor from all sources within and without the United States, for such preceding year whether or not included in alternative entire net income for such year.

(C) In the case of an issuer or obligor described in section 11-64O(a)(9) or 11-640 (d)(2)of Administrative Code, the issuer's allocation percentage shall be determined by dividing the portion of the capital of the issuer or obligor allocable to the city for the preceding year by the entire capital wherever located of the issuer or obligor for the preceding year.

(3) For purposes of paragraph (1) and (2) of this subdivision of determining issuer’s allocation percentage, the term "preceding year” means the taxable year of the 1ssuer or obligor ending during the taxpayer's immediately prior taxable year. In general, if no taxable year of the issuer or obligor ends within the taxpayer’s immediate prior taxable year, then the term “preceding year” means the latest taxable year of the issuer or obligor ending before the taxpayer's immediately prior taxable year. If an issuer or obligor was not required to file a report or return for the preceding year, as defined above, the issuer's allocation percentage is zero.

The taxable year of an issuer or obligor that is a utility corporation subject to tax under Title 11, Chapter 11 of the Administrative Code is the utility's federal taxable year.

(4) If a report or reports for the preceding year are required but not filed, or if filed do not contain information that would permit the determination of such issuer's allocation percentage, then, at the discretion of the Department of Finance, the issuer's allocation percentage to be used shall be-either (A) the issuer's allocation percentage derived from the most recently filed report or return of the issuer or obligor, or (B) a percentage calculated by the Department of Finance to

reasonably indicate the degree of economic presence in the City of the issuer or obligor during the preceding year.

(5) The issuer’s allocation percentage of an option on a stock or bond index, or an option on a futures contract on such an index, will be calculated by the Department of Finance in such a manner as to reasonably indicate the economic presence in the City of the issuers of and obligors on the stocks, bonds or other securities included in the computation of the index.

(6) Issuers or t obligors. (A) The issuer of stock is the corporation a portion of the equity of which is represented by such stock. Thus, the issuer of X Corporation stock is X Corporation; the issuer of Federal National Mortgage Association stock -is the Federal National Mortgage Association.

(B) The issuer of, or obligor on, a bond or note is the maker of the instrument. A guarantor of a bond or note is not the issuer or obligor.

(C) The issuer of, or obligor on, a banker’s acceptance is the accepting bank, irrespective of endorsements by other banks. Where banker's acceptances have been acquired in aggregate form, as in round lot trading, each banker's acceptance shall be treated separately for purpose of this paragraph.

(D) The issuer of, or obligor on, a trade acceptance is the party that has accepted the draft.

(E) The issuer’s allocation percentage for an option is equal to the issuer’s allocation percentage, of the entity which Is the issuer of, or obligor on, the item that is the subject of the option unless the subject of the option is a stock or bond index or a futures contract on such an index. For the computation of the issuer's allocation percentage of an option on a stock or bond index or of an option on a futures contract on such an index, see section 4-4l(b)(5) of these regulations.

(F) The issuer’s allocation percentage for a stock right or stock warrant is equal to the issuer's allocation percentage of the issuer of, or obligor on, the stock which may be acquired when such right or warrant is exercised.

(c) The issuer’s allocation percentage with respect to any stock, bond or other securities may be obtained from the Department of Finance upon the written request of any

<ins>corporation subject to tax under Subchapter 2 of Chapter 6 of Title 11 of the Administrative Code. The request must be in duplicate and specify the correct name of each entity for which an issuer’s allocation percentage is needed.</ins>

§l0. Section 4-42 of such rules is REPEALED.

[Reg. Sec. 4-42. Governmental securities. (a) Govunmenta1 securities include bond, notes, certificates and other obligations evidencing indebtedness, issued by the United States, New York State, or any other state, territory, possession of the United States, the District of Columbia, any foreign country, or any political subdivision or instrumentality of any of the foregoing.

(b) In the computation of the investment allocation percentage,

1) all governmental securities are excluded from the numerator, and

(2) all obligation of the United States and its instrumentalities and all obligations of New York State, its political subdivisions and its instrumentalities excluded from the denominator, and all other governmental securities are included in the denominator.

The effect, therefore, is to attribute wholly outside New York City, all bonds of states other than New York State, territories, the District of Columbia, foreign countries and their subdivisions and instrumentalities; and d to allocate obligations of the United Sates and its instrumentalities and obligations of New York State, its political subdivision and its instrumentalities according to the average percentage established for all other investments.

(c) For allocation of net income where the allocation percentage is zero and where taxpayer’s securities consist wholly of obligations of the United States and its instrumentalities, and of obligation of New York State, its political subdivisions and its instrumentalities, see section 4-50, infra.]

§11. Subdivisions (d)and (e) of section 4-50 of such rules ate amended and repealed, respectively, as follows:
(d) If [the] <ins>a taxpayer’s</ins> investment allocation percentage is zero, interest received on bank accounts, on obligations of the United States and its instrumentalities and on obligation of New York State, its political

subdivisions and its instrumentalities] is [multiplied] allocated by the business allocation percentage; [In other words, such interest is treated as business income. However, the preceding sentence does not apply where the taxpayer has the right to and does elect, pursuant to subdivision(c) of section 4-40, supra, to allocate itsentire net income by its investment allocation percentage] (See $4-54, infra, for application of allocation percentage where net operating loss deduction is involved.)

[(e) Where the taxpayer owns no securities other than obligations of the United States and its instrumentalities and obligations of New York State, its political subdivisions and its instrumentalities, its allocation percentage is zero, and the income from such securities is multiplied by the business allocation percentage, except where the taxpayer has the right to and does elect, pursuant to subdivision (c) of section 4-40, supra, to allocate its entire net income by its investment allocation percentage.]

§12. Section 4-52 of such rules is amended to read at follows:

§4-52. Definition of investment income ([§R46-2.0.5] §11-602.5, Administrative Code).

(a) [The term investment income means the total of the gross amount of interest and dividends from investment capita1 and the gross amount of capital gains in excess of capital losses from the sale or exchange of investment capital, to the extent that such interest, dividends and excess of capital gains are includible in computing entire net income, less specified deductions (see §54-53 and 4-54, infra); provided that in no case may investment income excess entire net income. If a taxpayer has no business income, its investment income is its entire net income. For definition of investment capital, nee section 3-14 supra]

(1) The term “investment income” means income from investment capital to the extent included in computing entire net income, less any deductions allowable in computing entire net income that are directly or indirectly attributable to investment capital or investment income and less such portion of any net operating loss deduction allowable in computing entire net income as described in section 4- 54 of these regulations. Income from investment capital includes dividends from investment capital, interest from investment capital and capital gain in excess of capital losses from the sale or exchange of investment capital.

(2) Investment income also includes gain (or loss) from closing out a position in a futures or forward contract if such contract substantially diminishes the taxpayer's risk of loss from holding one or more position in assets that constitute investment capital. If the taxpayer holds more positions in futures or forward contracts than are reasonably necessary to substantially diminish its risk to loss from holding such position in assets constituting investment capital, the gain (or loss) attributable to any such excess position in futures or forward contracts is not investment income.

(3) Investment income also includes gain (or loss) from short sales of assets that constitute investment capital.

(4) Investment income also includes gain (or loss) from closing out a position in a future or forward contract if such contract substantially diminishes the taxpayer's risk o f loss from making short sales of assets that constitute investment capital. If the taxpayer holds more positions in futures or forward contracts than are reasonably necessary to substantially diminish its risk of loss from such sales, the gain (or loss) attributable to any such excess positions in futures or forward contracts is not investment income.

(5) investment income also includes premium income from an unexercised covered call option if the item which covers the call is an asset consulting investment capital. However, premium income from unexercised put option is not investment income.

(b) In no case may investment income be greater than entire net income. If a taxpayer has no business income, its investment income shall be deemed to be equal to its entire net income. For definition of investment capital, see section 3-31 of these regulations.

(c) In computing investment income, dividends and interest from investment capital are includible in the same manner and to the same extent as in computing entire net income. Thus, [since] where only one half of dividends from nonsubsidiary corporations is included in computing entire net income under section 11-602.8(a)(2), only one half of such dividends is included in computing investment income. Capital gains and losses are included in computing entire net income in the same manner and to the same extent as for Federal income tax purposes, subject to the modification provided in section (R46-2.0.8(h)] ll-602.8(h). Accordingly, in computing investment income, capital gains and losses from sales and exchanges of assets constituting investment capita1 are included in the same manner and to the same extent as for Federal income tax purposes, subject to the modification provided in section [R46-2.0.8(h)] 11-602.8(h).

§13. Section 4-53 of such ruler is amended to read as follows:

§4-53. Deduction of expenses (§11-602.5, Administrative Code),-Investment income must be reduced ,by any deductions, allowable in computing entire net income, which are directly or indirectly attributable to investment capital or investment income. [such deductions] Deductions [may] allowable in computing investment income are not [be] taken into accounting in computing business income.

(b) Deductions allowable in computing entire net income which are directly attributable to investment capital or investment income include among others[.]:e interest incurred to carry investment capital, safe deposit box rentals, financial news subscriptions, salaries of officers and employees engaged in the management and conversation of stocks, bonds and other securities issued in investment capital, investment counsel fees, custodian fees, the cost of insurance and fidelity bonds covering investment capital, and legal expenses relating to investment capital.

§14. These amendments shall take effect as provided in subdivision e of section
1043 of the charter, except that the amendments made by sections 2, 3 and 12, other than the amendment made by such section 12 with reference to the direct or indirect attribution of deductions to investment capital or investment income, shall apply to taxable years beginning on or after January I, 1990; provided, however, that except with respect to any section 1256 contract that is marked-to-market pursuant to section 1256(a) of the Internal Revenue Code on the last business day of the taxpayer's taxable year immediately preceding its first taxable year beginning on or after January 1, 1990, the amendments made by these regulations (a) which classify options as investment capital and (b) which classify as investment income (1) the income from certain futures and forward contract transactions, (2) the income from certain short sales and (3) premium income from certain unexercised covered call option, shall apply only to position taken during taxable years beginning on or after January l, 1990.