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N.Y. Administrative Law Judge (ALJ) Holds Taxpayer's Motives for Acquiring Stock and How Stock Is Used Irrelevant in Determining Investment Capital

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A New York administrative law judge recently held in ***Matter of C.V. Starr & Co., Inc.*** that income received by a taxpayer from its ownership of common stock was investment income. In so holding, the ALJ addressed an important issue for many New York taxpayers and concluded that a taxpayer's motive or intent for acquiring and holding stock and the manner in which the taxpayer used that stock are irrelevant to the determination of whether that stock qualifies as investment capital for corporate income tax purposes.

On April 18, 2013, an administrative law judge (ALJ) granted a motion for summary determination filed by McDermott Will & Emery LLP on behalf of C.V. Starr & Co. Inc. (Starr) and held that income received by Starr from its ownership of common stock in American International Group Inc. (AIG Stock) was investment income. In so holding, the ALJ addressed an important issue for many New York taxpayers and concluded that a taxpayer's motive or intent for acquiring and holding stock and the manner in which the taxpayer used that stock are irrelevant to the determination of whether that stock qualifies as investment capital for corporate income tax purposes.

Starr acquired the AIG Stock at issue in 1970, in a transaction in which Starr transferred certain of its assets (certain insurance agencies, land and a building) to AIG in exchange for the AIG Stock. Starr acquired and continued to hold the AIG Stock with the expectation that Starr would earn a profit or return from its mere ownership of the AIG Stock in the form of dividends and capital gains. On audit, the Division of Taxation (Division) concluded that the AIG Stock did not qualify as investment capital, and reclassified all of the dividend income that Starr received from the AIG stock as business income, rather than investment income, on the basis that Starr did not acquire and hold the AIG Stock as an "investment."

For New York corporate income tax purposes, investment income is defined as all "income … from investment capital," and investment capital is defined as "investments in stocks, bonds and other securities, corporate and governmental, not held for sale to customers in the regular course of business, exclusive of subsidiary capital and stock issued by the taxpayer." The sole issue in this matter was whether Starr made an "investment in" the AIG Stock.

The Division argued that Starr did not acquire and hold the AIG Stock as an "investment" because

Starr did not acquire and hold the AIG Stock “for its own account.” Because Starr had historically offered executives of AIG the opportunity to purchase shares of Starr’s own common stock (Starr Plan), the Division argued that Starr did not hold the AIG Stock for its own account, but instead held it for the benefit and enjoyment of AIG and its senior executives because Starr used the returns it received on the AIG Stock to compensate its shareholders (including the AIG executives that participated in the Starr Plan).

The ALJ determined that the term “investment” should be construed and applied according to its commonly understood meaning as the outlay of money or capital in return for property or some other possession from which a profit or return is expected. Applying this construction to Starr’s AIG Stock, the ALJ held that the undisputed facts showed that Starr acquired the AIG Stock in exchange for its own capital, and held the stock for some 35 years thereafter with “both the expectation (or hope) of a return thereon as well as the risk of no return or a loss due to the poor performance by the investee (AIG),” and thus acquired the stock as an “investment.” Notably, the ALJ stated that “[n]either the motive for making an acquisition of a given type of item otherwise qualifying as investment capital, nor the investor’s subsequent use of the returns gained from that acquired item (i.e., dividends and capital appreciation over time) serve to negate the fact that such acquisition was an investment.” The ALJ refused to adopt the Division’s additional requirement that a taxpayer acquire the stock “for its own account,” and noted that even if there were such a requirement it was clearly met in this case because the AIG Stock was held for the benefit of Starr and its shareholders.

The Division did not file an exception (*i.e.*, an appeal), so the ALJ’s determination is final.

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