

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

TSB-A-81 (3) C
Corporation Tax
July 23, 1981

STATE OF NEW YORK
STATE TAX COMMISSION

ADVISORY OPINION PETITION NO. C800805A

On August 5, 1980, a Petition for Advisory Opinion was filed by Wedbush, Noble, Cooke, Inc., P.O. Box 30014, Terminal Annex, Los Angeles, California 90030.

The issue raised in the Petition is the proper method of allocation, for fiscal years ending on June 30, 1976, 1977, 1978, 1979 and 1980, of receipts from:

1. profits on sales as a specialist on the American Stock Exchange,
2. profits on sales as a market-maker in the over-the-counter market, and
3. commissions on the execution of buy and sell orders on the American and New York Stock Exchanges, where such orders originated outside of New York.

This issue is raised within the context of Article 9-A of the Tax Law, which imposes the Franchise Tax on Business Corporations.

Petitioner is a stock and bond brokerage firm having its home office in California and maintaining offices in nine western states. It is a member of the American, New York, Pacific and Philadelphia stock exchanges and the Chicago Board of Options Exchange. During the years at issue, all of its data processing and clearing activities were performed in California. Its income-producing New York activities were limited to buying and selling for its own account as a specialist on the American Stock Exchange, buying and selling for its own account as a market-maker in the over-the-counter market and executing buy and sell orders on the American and New York Stock Exchanges, such orders having originated at offices outside of New York.

Article 9-A of the Tax Law provides for the allocation of business income within and without New York on a formulary basis. The formula utilized includes a receipts factor consisting of the ratio of receipts attributable to New York (the numerator) to the total amount of the taxpayer's receipts (the denominator). Tax Law, S210.3. Taxpayers' receipts are divided into various categories, including "receipts from compensation for services" and "other business receipts." Each is governed by an explicit attribution rule. At issue herein is the portion of the receipts from each of the three activities described above which is to be included in the numerator of the fraction constituting Petitioner's receipts factor.

Receipts from Petitioner's market-making and specializing activities constitute "other business receipts," within the above-described scheme. Their inclusion within a taxpayer's receipts factor is governed by Section 4-4.6 of the Franchise Tax Regulations, as follows:

"(a) All business receipts earned by the taxpayer in New York State are allocated to New

York State Receipts from the sale of intangible personal property included in business capital, held by the taxpayer as a dealer for sale to customers in the regular course of business, are business receipts and are allocated to New York State if the sales were made in New York State or through a regular place of business of the taxpayer in New York State." 20 NYCRR 4-4.6(a).

Accordingly, 100% of Petitioner's receipts from its New York market-making and specializing activities, as described above, are includible in the numerator of the fraction constituting Petitioner's receipts factor.

Commissions on the execution of buy and sell orders on the American and New York Stock Exchanges where such orders originate at a bona fide established office of the Petitioner located outside New York and are transmitted to a New York State place of business for execution, constitute receipts from compensation for services, and are allocable pursuant to Section 4-4.3(c) of the Franchise Tax Regulations.

Prior to its amendment in 1979, Section 4-4.3 of the Franchise Tax Regulations required security and commodity brokers to allocate 40% (in the case of stocks) or 50% (in the case of bonds and commodities) of such commissions to New York. 20 NYCRR4-4.3(c)(1). Such requirement was applicable to taxable periods commencing prior to January 1, 1978. For taxable periods commencing on and after January 1, 1978, pursuant to the Franchise Tax Regulations as amended on September 12, 1979, the following applies:

"(c) Taxpayer which are security and commodity brokers must allocate commissions derived from the execution of purchases or sales orders for the accounts of customers in the following manner:

...

(2) For taxable periods commencing on and after January 1, 1978, if the order originates at a bona fide established office of the taxpayer located outside New York State and is transmitted to the New York State place of business for execution on an exchange located in New York State, 20 percent of the commission in the case of stocks, bonds and commodities must be allocated to New York State and included in the gross income attributable to New York State in the taxable period in which such order is executed.

...

(4) For taxable periods commencing on and after January 1, 1978, the taxpayer may allocate commission income on the basis of actual experience if he can demonstrate to the satisfaction of the Tax Commission that the allocation pursuant to paragraphs (2) and (3) of this subdivision does not fairly reflect the amount of commission income attributable to New York State."

In light of the foregoing amendment, the Technical Services Bureau of the Taxpayer Services Division of the Department of Taxation and Finance, at the express direction of the State Tax Commission, published a memorandum setting forth the audit policy adopted by the State Tax Commission applicable to open cases concerning stockbrokerage corporations for all taxable periods commencing before January 1, 1978. Technical Services Bureau Memorandum TSB-M-79(9)C.

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Pursuant to such memorandum, Petitioner must allocate the income in question pursuant to the terms of Section 4-4.3(c) as it existed prior to the above-described amendment, except that a "change in the allocation of commission income under the original 60-40 rule will be allowed where the taxpayer can substantiate that such rule does not reflect the actual execution rate in effect for the taxable period." However, it is also there provided that such allocation may in no event be at a rate of less than 20%.

Accordingly, Petitioner's commission income derived from the execution of buy and sell orders on the New York and American Stock Exchanges, where such orders arise without the State as described above, should be included in the numerator of Petitioner's receipts factor, as follows. For taxable periods commencing on or after January 1, 1978 such income should be included at a rate of 20% unless the Petitioner can establish, on the basis of actual experience, pursuant to 20 NYCRR 4-4.3(c)(4), that another rate is appropriate. For taxable periods commencing prior to January 1, 1978 the applicable rate is 40% (in the case of stocks) or 50% (in the case of bonds), unless Petitioner can establish that another rate (but not lower than 20%) would be reflective of the actual execution rate.

DATED: July 17, 1981

s/LOUIS ETLINGER
Deputy Director
Technical Services Bureau