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

TSB-A-86 (16) C
Corporation Tax
September 2, 1986

STATE OF NEW YORK
STATE TAX COMMISSION

ADVISORY OPINION PETITION NO. C841107A

On November 7, 1984, a Petition for Advisory Opinion was received from Eppler, Guerin & Turner, Inc., 2001 Bryan Tower - Suite 2300, Dallas, Texas 75201.

The issue raised is what portion of Petitioner's receipts should be allocated to New York State, pursuant to Article 9-A of the Tax Law, for taxable years ended August 31, 1979, August 31, 1980 and August 31, 1981 as a result of services rendered by Petitioner's floor brokers who act as "$2 brokers" (brokers who execute but do not clear transactions) on the floors of the New York and American Stock Exchanges.

Petitioner, a corporation organized under the laws of the State of Delaware, is engaged in the securities business as a broker and dealer and has its principal place of business in Dallas, Texas. Petitioner does not have an office in New York State, but does have employees located in New York State in the capacity of floor brokers who operate from booths located on the floors of the New York and American Stock Exchanges. The fee for utilizing these booths is less than $10,000 annually.

Petitioner's floor brokers perform all of their services within New York State and are Petitioner's only employees located in New York State. They act as "$2 brokers" and the only services they perform are the execution of buy and sell orders on the floors of the New York and American Stock Exchanges. Petitioner's floor brokers execute orders on behalf of any brokerage firm, including Petitioner, which requests their services. Petitioner's floor brokers do not obtain orders or clear transactions on behalf of Petitioner. All of Petitioner's orders are cleared through the Stock Clearing Corporation and/or the American Stock Exchange Clearing Corporation.

The compensation paid to Petitioner's floor brokers is based on the income they earn for Petitioner in acting as floor brokers. The income they earn is the sum of the amounts received from unrelated firms for executing such firms' orders and the amounts credited to them for executing orders on behalf of Petitioner's customers. However, in order to encourage its floor brokers to give priority to the execution of Petitioner's customers' orders rather than those of unrelated firms, Petitioner credits its floor brokers with a slightly higher amount than what an unrelated third party would pay Petitioner to have Petitioner's floor broker execute the unrelated firm's order. The amount credited to Petitioner's floor brokers for executing Petitioner's customers' orders is higher than the amount which Petitioner would have paid to unrelated floor brokers for execution of Petitioner's customers' orders.

Section 4-4.1(b)(2) of the Business Corporation Franchise Tax Regulations (hereinafter Article 9-A regulations), provides that 100 percent of receipts from services performed in New York State are allocable to New York State. 20 NYCRR 4-4.1 (b)(2).

Section 4-4.3(c) of the Article 9-A regulations pertains to taxpayers who are security and commodity brokers and paragraph (2) of such section 4-4.3(c) states that "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." 20 NYCRR 4-4.3(c)(2).

Section 4-4.3(c)(4) of the Article 9-A regulations provides that for taxable periods commencing on and after January 1, 1978, the taxpayer may allocate commission income on the basis of actual experience if the taxpayer can demonstrate to the satisfaction of the Tax Commission that the allocation pursuant to section 4-4.3(c)(2) of the Article 9-A regulations does not fairly reflect the amount of commission income attributable to New York State. 20 NYCRR 4-4.3(c)(4)

Petitioner believes that the 20 percent allocation of commission income provided pursuant to Article 9-A regulation section 4-4.3(c)(2) represents the presumed arm's length charge for execution and clearing that would be paid by a nonclearing firm to an unrelated clearing firm for executing and clearing transactions for the nonclearing firm. Since Petitioner is not a clearing firm and does not perform clearing services for the orders of its customers or for other firms, it believes that the 20 percent allocation of commissions is inapplicable in Petitioner's case.

Petitioner agrees that its receipts derived from unrelated firms for services performed by Petitioner's floor brokers in New York State are allocable 100 percent to New York State. However, where the Petitioner's floor brokers execute Petitioner's customers' orders in New York State, it is Petitioner's contention that the value of the services performed by its floor brokers cannot exceed the cost of having those services performed by unrelated floor brokers or, put another way, the floor brokerage commissions that Petitioner would have earned if the orders had originated with an unrelated firm. Therefore, Petitioner submits, pursuant to Article 9-A regulation section 4-4.3(c)(4), that the amount of commission income that is attributable to New York State is either the amount Petitioner would have earned on such orders if they had been orders of an unrelated third party or the amount Petitioner would have paid to unrelated floor brokers to obtain execution of these orders.

For taxable years ended August 31, 1979, August 31, 1980 and August 31, 1981, Petitioner's commission income derived from the execution of buy and sell orders on the New York and American Stock Exchanges, should be included in the numerator of Petitioner's receipts factor at a rate of 20 percent where such orders arise without the State, unless the Petitioner can establish to the satisfaction of the Tax Commission, pursuant to 20 NYCRR 4-4.3(c)(4), that such rate does not fairly reflect the amount of commission income attributable to New York State. This regulation places the burden of proof upon Petitioner. Petitioner's burden of proof is not met by merely alleging unfairness. To demonstrate that the allocation to New York State of 20 percent of commission

income does not fairly reflect the amount of commission income attributable to New York State, Petitioner must analyze the total activities involved in the generation of the commission income in question (e.g. through an analysis of relevant expenses) and thereby determine the percentage of the commission income attributable to such activities within and without New York State.

The amounts of commission income that Petitioner would have earned on such orders if they had been orders of an unrelated third party or would have paid to unrelated floor brokers to obtain execution of these orders are irrelevant to this question since they do not demonstrate the extent to which the commission income was generated by activities actually performed within New York State.

The precise portion of the commission income at issue which fairly reflects the amount of commission income attributable to New York State and which is includible in the numerator of the receipts factor in the present matter is a question of fact not susceptible of determination in an Advisory Opinion. An Advisory Opinion merely sets forth the applicability of pertinent statutory and regulatory provisions to "a specified set of facts." Tax Law, 171, subd. twenty-fourth; 20 NYCRR 901.1(a). Inasmuch as the question presented here arises within the context of an audit, the necessary factual determination will be made within such context, in accordance with the principles outlined above.

DATED: September 2, 1986

s/FRANK J. PUCCIA
Director
Technical Services Bureau

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