STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. C960429D

On April 29, 1996, a Petition for Advisory Opinion was received from Donaldson, Lufkin & Jenrette, Inc., 277 Park Avenue, New York, New York 10172.

The issues raised by Petitioner, Donaldson, Lufkin & Jenrette, Inc., are (1) whether certain industrial development bonds constitute investment capital under section 208.5 of the Tax Law and section 3-3.2 of the Business Corporation Franchise Tax Regulations ("Article 9-A Regulations"); (2) whether the interest income received from the bonds constitutes investment income under section 208.6 of the Tax Law; and (3) whether the bonds constitute government securities for purposes of computing the investment allocation percentage under section 4-7.2 of the Article 9-A Regulations.

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

Petitioner ("DLJ") is a party to a project (the "Project") of the New York City Industrial Development Agency (the "IDA"). The Project is fully described in the Advisory Opinion of the Commissioner of Taxation and Finance issued to Petitioner on August 18, 1995, TSB-A-95(36)S (the "Advisory Opinion"). Except where otherwise indicated, each capitalized term used but not defined herein shall have the meaning assigned to such term in the Advisory Opinion.

DLJ is the parent company of a combined group of approximately 40 companies. Certain bonds issued and to be issued in connection with the Project are currently held by the Bond Investment Partners, L.L.C. ("BP"), a Delaware limited liability company having two members and classified as a partnership for Federal income tax purposes. The members of BP are both wholly-owned DLJ subsidiaries and members of the DLJ combined group of companies. The Project is intended to induce certain eligible members of the group of companies of which DLJ is the parent (the "DLJ Group") to retain the DLJ Group's headquarters in New York City (the "City") for approximately 20 years.

In connection with the Project, the IDA has agreed to extend certain benefits to reduce the DLJ Group's costs of retaining its headquarters in the City. Among these benefits is an exemption from sales and use tax pursuant to a project agreement, lease and sales tax letter (collectively, the "Project Agreement") with respect to Acquisitions by the DLJ Group for use at Approved Premises in the City. Pursuant to the Project Agreement, in order to be eligible for exemption from sales and use taxes, Acquisitions must be made by the IDA through one of several designated agents among the members of the DLJ Group.

To finance the Acquisitions, the IDA will from time to time issue industrial development bonds (the "Bonds") which BP will purchase. The Bonds are fully negotiable and may be sold by BP to certain qualified investors not related to DLJ. To date, all Bonds issued in connection with the

Project continue to be held by BP. The Bonds are issued pursuant to the Indenture of Trust (and the applicable Bond Supplemental Indenture of Trust) between the IDA and United States Trust Company of New York, as trustee (the "Trustee"). The Certificate of Determination for each series of the Bonds sets forth specific terms applicable to such series.

The Bonds will bear interest at a rate of between zero and 200 basis points above a market index rate to be selected by the IDA at the time of issuance, either the applicable London Interbank Offered Rate (LIBOR) or the applicable U.S. Treasury securities rate. The Bonds are secured by a pledge of, and payable solely from, rent payments owed by the Group Agents (which are certain members of the DLJ Group but not including BP) to the IDA pursuant to the Financing Lease. Section 2.3(d) of the Financing Lease provides that

> no Series of the Bonds shall be redeemable prior to three (3) years after the date of issuance of such Series of Bonds, except in connection with a retirement of all Bonds upon termination of this [Financing Lease].

The Certificates of Determination with respect to the Bonds already issued, the Series A Bonds (August 18, 1995) and the Series B Bonds (March 15, 1996), implement this requirement and allow for no optional redemption of the Series A Bonds or the Series B Bonds until three years after issuance, i.e., until after August 18, 1998 and March 15, 1999 respectively. In addition, under the Indenture, as long as the Bonds are outstanding notice of any redemption of the Bonds must be received nine months prior to the date of any such redemption. All of the Bonds will mature on March 31, 2016 unless redeemed earlier.

The issues raised in this advisory opinion are similar to those raised in Smith Barney Holdings Inc., Adv Op Comm T & F, January 18, 1996, TSB-A-96(3)C and Travelers Group Inc., Adv Op Comm T & F, January 17, 1996, TSB-A-96(4)C. In those opinions, it was held that the bonds issued by the IDA in connection with the TGI Project constitute investment capital of the holder, except that the bonds that are deemed to be cash are considered to be investment capital only if the holder of the bonds makes the election to treat cash as investment capital. The bonds issued by the IDA in connection with the TGI Project that constitute investment capital (and are not deemed to be cash) constitute governmental securities for purposes of computing the investment allocation percentage under section 4-7.2 of the Article 9-A Regulations. Also, the interest income on the bonds issued by the IDA in connection with the TGI Project that constitute investment capital is investment income.

Section 856 of Article 18-A of the General Municipal Law provides for the organization of industrial development agencies, and section 856.2 of such law provides that an industrial development agency "shall be a corporate governmental agency, constituting a public benefit corporation."

Section 208.5 of the Tax Law defines the term "investment capital" 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, provided, however, that, in the discretion of the commissioner, there shall be deducted from investment capital any liabilities which are directly or indirectly attributable to investment capital .... "

Section 3-3.2(a)(1) of the Article 9-A Regulations provides that the term "investment capital" means the taxpayer's investments in stocks, bonds and other securities issued by a corporation 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. At the election of the taxpayer, cash on hand and cash on deposit may be treated on any report as either investment capital or business capital. Any debt instrument, including a certificate of deposit which is described in section 3-3.2(c)(2) or (3) and not described in section 3-3.2(a)(2) and which 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 such debt instrument which 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 on any day which is not more than six months and one day prior to its date of maturity.

Section 3-3.2(c)(2) of the Article 9-A Regulations provides that the phrase "stocks, bonds and other securities" means, in part: "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 any of the foregoing." Provided, however, debt instruments which are deemed to be cash pursuant to 3-3.2(a)(1) of the Article 9-A Regulations do not constitute stocks, bonds or other securities.

Under section 3-3.2(c)(2) of the Article 9-A Regulations, debt instruments issued by a governmental instrumentality of New York State are included in the phrase "stocks, bonds and other securities" for purposes of section 3-3.2(a)(1) of the Article 9-A Regulations. For these purposes, a governmental instrumentality of New York State includes an industrial development agency organized pursuant to Article 18-A of the General Municipal Law. See, Richard W. Genetelli, Dec St Tax Comm, December 23, 1985, TSB-A-86(2)C; Smith Barney, supra; and Travelers Group, supra.

Accordingly, under section 208.5 of the Tax Law and section 3-3.2 of the Article 9-A Regulations, the Bonds issued by the IDA in connection with the Project constitute investment capital of the holder. Except that, the Bonds that are deemed to be cash pursuant to section 3-3.2(a)(1) of the Article 9-A Regulations are considered to be investment capital only if the holder of the Bonds makes the election to treat cash as investment capital.

Section 208.6 of the Tax Law defines the term "investment income" as follows:

> the sum of (a) income, including capital gains in excess of capital losses, from investment capital, and (b) the amounts described in [section 208.9(b)(12),(13) and

> (14)], to the extent included in computing entire net income, less, (c) in the discretion of the commissioner, any deductions allowable in computing entire net income which are directly or indirectly attributable to investment capital or investment income, and (d) such portion of any net operating loss deduction allowable in computing entire net income, as the investment income, before such deduction, bears to entire net income, before such deduction, provided, however, that in no case shall investment income exceed entire net income.

Accordingly, the interest income on the Bonds issued by the IDA in connection with the Project that constitute investment capital is investment income under section 208.6 of the Tax Law.

Section 4-7.2(a) of the Article 9-A Regulations provides that the investment allocation percentage is computed as follows:

> (1) 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 [section 3-3.4(b)] of this Title. 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 3-3.2(a)(1)] of this Title.
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> (2) Multiply the net value of each such stock, bond or other security by its issuer's allocation percentage.
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> (3) Add all the products determined in paragraph (2) of this subdivision.
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> (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 3-3.2(a)(1)] of this Title.

As previously stated, the Bonds that are issued by the IDA in connection with the Project (which are not deemed to be cash) are governmental securities that constitute investment capital under section 208.5 of the Tax Law and section 3-3.2 of the Article 9-A Regulations. These Bonds do constitute "governmental securities" for purposes of computing the investment allocation percentage under section 4-7.2(a) of the Article 9-A Regulations.

DATED: July 24, 1996

/s/
John W. Bartlett
Deputy Director
Technical Services Bureau

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