

Receipts Factor Methodology For The Owners Of Single Member Limited Liability Companies That Are Registered Broker-Dealers

The Department of Taxation and Finance has received inquiries as to whether a corporation, under circumstances detailed below, may be considered to be a registered securities broker or dealer (“broker-dealer”) for purposes of computing its receipts factor pursuant to Tax Law § 210(a)(3)(9) even though the corporation itself does not qualify as such a broker-dealer.¹

At the outset it is important to note that, effective for years beginning on or after January 1, 2015, Tax Law § 210-A (L.2014, ch. 59, Part A, § 16) created a new apportionment scheme for Article 9-A. Although the Department specifically references the Tax Law sections in effect prior to January 1, 2015, Tax Law § 210-A(5) also provides for specific treatment of receipts that arise from various transactions involving registered securities brokers-dealers for which a definition is provided therein. Accordingly, the analysis in this NYT-G will apply to taxable years beginning prior to, on or after January 1, 2015.

In addition, for years beginning on or after January 1, 2015, the apportionment factor replaces the business allocation percentage. Tax Law § 210-A(1). Herein, the Department will use “apportion” interchangeably with “allocate.”²

The entity known as Brokerage is registered with the Securities and Exchange Commission (“SEC”) and the Financial Industry Regulatory Authority (“FINRA”)³ as a broker-dealer and maintains its own Central Registration Depository (“CRD”) number.⁴

Brokerage is a limited liability company that is wholly-owned by a related party identified herein as Partnership D.

Partnership D is not registered with the SEC as a broker-dealer. It reports its federal and New York taxable income as a partnership. Partnership D is five percent owned by an unidentified third party and 95 percent owned by a related party known as Investment Adviser.

¹ The Department’s conclusions apply also to the computation of a receipts factor for purposes of the Metropolitan Transportation Business Tax Surcharge, if applicable. Tax Law § 209-B(2)(b)(iv) (for tax years beginning prior to January 1, 2015); Tax Law § 209-B(2)(b)(ii) (for tax years beginning on or after January 1, 2015).

² For the years ending before January 1, 2015, New York historically used “allocate” when referring to its formulary apportionment scheme for corporations. This usage should not be confused with other states’ use of a specific allocation method to determine the source or sources of income that cannot be apportioned.

³ FINRA is “an independent, not-for-profit organization authorized by Congress to protect America’s investors by making sure the securities industry operates fairly and honestly.” <http://www.finra.org/about>.

⁴ The CRD is “the central licensing and registration system for the U.S. securities industry and its regulators.” <http://www.finra.org/industry/crd>.

Investment Adviser is not registered as a broker-dealer with the SEC, but it is registered with that organization as an investment adviser and maintains its own CRD number. Investment Adviser is also registered with FINRA as the indirect owner of Brokerage. It is entitled to conduct SEC regulated broker-dealer activities under Brokerage's license. Under that license, certain of Investment Adviser's employees perform broker-dealer activities. Investment Adviser and its employees qualify as "associated persons" of Brokerage.⁵

Investment Adviser is a limited partnership. It is 40 percent owned by an unrelated third party and 60 percent owned by a related entity identified herein as Taxpayer.

Investment Adviser reports its federal and New York taxable income as a partnership. It directly and through its direct and indirect ownership interests in Partnership D and Brokerage receives transaction fees, monitoring fees, and management fees from the funds and other accounts it manages.

Taxpayer is not a broker-dealer registered with the SEC. With respect to its direct interest in Investment Adviser and its indirect interest in Partnership D, Taxpayer computes its tax under the aggregate method pursuant to 20 NYCRR 3-13.3.

New York subjects Taxpayer to an annual franchise tax. Tax Law § 209(1). That tax is imposed on the highest of several different bases (Tax Law § 210[1]), which, as relevant here, is Taxpayer's entire net income base. Taxpayer's entire net income base is comprised, in part, of business income (Tax Law §§ 208[9], 210[3]), which is allocated to New York by Taxpayer's business allocation percentage or BAP. Tax Law § 210(3)(a).

The Legislature intended Taxpayer's BAP to properly reflect its "activity, business income or capital ... within the State." Tax Law § 210(8). New York's allocation of Taxpayer's business income to the State must be "fair" and "actually reflect a reasonable sense of how [the] income is generated." *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 169 (1983). To determine Taxpayer's income "that is reasonably related to" its activities conducted within the State, New York only has to roughly approximate the income Taxpayer earns within its geographic boundaries. *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 273 (1978), *reh'g den'd*, 439 U.S. 885 (1978); *Exxon Corp. v. Wisconsin Dep't of Revenue*, 447 U.S. 207, 223 (1980).

For all years beginning on or after January 1, 2007, Taxpayer's receipts factor is the sole factor that comprises its BAP. Tax Law §§ 210(3)(a)(2), 210(3)(a)(10)(A)(ii).

The State's inclusion of receipts in the numerator of Taxpayer's receipts factor is not intended to tax those receipts. *Matter of Disney Enters., Inc. & Combined Subsidiaries v. Tax Appeals Tribunal*, 10 NY3d 392, 399 (2008). Rather, the numerator of New York's receipts

⁵ Individuals and entities that are "Associated Persons" of a registered broker-dealer generally do not have to separately register with the SEC as a broker-dealer. See <https://www.sec.gov/divisions/marketreg/bdguide.htm>, Part II.D.1 [*Guide to Broker-Dealer Registration* (April 2008)]. But registered broker-dealers "must file a Form U-4 with the [applicable securities self-regulatory organization] for each associated person who will effect transactions in securities when that person is hired or otherwise becomes associated. Form U-4 is used to register individuals and to record these individuals' prior employment and disciplinary history." *Id.*, Part III.E.

factor is intended to reflect “the location of [Taxpayer’s] customers” within the State. *Matter of Disney Enter., Inc. & Combined Subsidiaries*, Tax Appeals Tribunal, October 13, 2005, *affd on other grounds*, *Matter of Disney Enter., Inc. v Tax Appeals Tribunal*, 40 AD3d 49 (2007), *affd* 10 NY3d 392 (2008).

The Legislature provided for several categories of receipts (See, e.g., Tax Law § 210(3)(a)(2)(B) including a category for receipts from the performance of services. Tax Law § 210(3)(a)(2)(B). Deemed to be receipts from services, the receipts of “a registered securities ... broker or dealer” (Tax Law § 210(3)(a)(2)(B)(iv)) are sourced to a site that is intended to represent the location of the broker-dealer’s customers, e.g., the customers’ mailing addresses. Tax Law § 210(3)(a)(9)(A)(i)-(vii). The term “registered securities ... broker or dealer” signifies, in part, “a broker or dealer registered as such by the [SEC].” Tax Law § 210(3)(a)(9)(B).

As applicable here, the term “‘broker’ means any person engaged in the business of effecting transactions in securities for the account of others” (15 U.S.C. § 78C(a)(4)(A)) and the term “‘dealer’ means any person engaged in the business of buying and selling securities for such person’s own account through a broker or otherwise.” *Id.*, § 78C(a)(5). An “‘associated person of a broker or dealer’ signifies [in part] ... any person directly or indirectly controlling, controlled by, or under common control with such broker or dealer, or any employee of such broker or dealer.” *Id.*, § 78C(a)(18). A corporation can qualify as a “person” for purposes of these definitions of “broker” or “dealer” or “associated person.” *Id.*, § 78C(a)(9).

Only those persons registered as a broker-dealer with the SEC or who qualify as an “associated person” may engage in the purchase and sale of securities. *Matter of William v. Giordano*, SEC Release No. 36742 S.E.C. (January 19, 1996) [1996 WL 21031]; *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1574 (9th Cir.1990), *cert. denied*, 499 U.S. 976 (1991). Clearly, an “associated person” that purchases and/or sells securities is not itself a registered broker-dealer of securities.

A general business corporation computing its tax with respect to its interest in a partnership using the aggregate method “is treated as *participating* in the partnership’s transactions and activities.” (emphasis added) 20 NYCRR 3-13.1(b). The corporation calculates its receipts factor by dividing the total of its own business receipts within New York and “its distributive share of the partnership’s business receipts within ... New York” by the total of the corporation’s own receipts earned from “within and without New York” and “its distributive share of the partnership’s business receipts from within and without” the State. 20 NYCRR 4-6.5(a)(2)(ii); see also 20 NYCRR 4-6.5(a)(1).

When computing its receipts factor, a taxpayer partner that uses the aggregate method provided for in 20 NYCRR 3-13.3 to determine its distributive share of the receipts of a partnership that is a registered securities broker-dealer shall apply the allocation rules of § 210(3)(a)(9) to that distributed share. 20 NYCRR 4-4.7(c).

Taxpayer contends that, as an “associated person” of Brokerage, Investment Adviser is entitled to conduct SEC regulated broker-dealer activities under Brokerage’s broker-dealer license and, as such, Investment Adviser ought to be treated as a registered securities broker-dealer for purposes of Tax Law § 210(3)(a)(9). In turn, because Taxpayer is a partner in Investment Adviser, Taxpayer claims that it too qualifies as such a registered broker-dealer. The Department has arrived at a contrary conclusion.

Investment advisers can and do perform the same activities as brokers-dealers registered with the SEC without being so registered.⁶ Indeed, an investment adviser may separately register with the SEC as a broker-dealer.⁷

At the time § 210(3)(a)(9) was enacted, the SEC allowed investment advisers, as “associated persons,” to buy and sell securities without the need to be registered with the SEC as securities brokers-dealers. Yet the Legislature specifically did not extend the rules in § 210(3)(a)(9) to the receipts of “associated persons” that engaged in broker-dealer activities; the enacted rules reference only securities broker-dealers registered with the SEC.

Investment Adviser chose not to register with the SEC as a broker-dealer. In the absence of such registration, Investment Adviser’s status as an “associated person” cannot qualify its receipts for treatment as the receipts of a registered securities broker-dealer. The Department may not extend the application of § 210(3)(a)(9) “beyond the clear impact of the language used” therein by the Legislature. *Yonkers Racing Corp. v. State*, 131 AD2d 565, 567 (1987).

Partnership D is the sole owner of Brokerage. As a single member limited liability company (“SMLLC”), for tax purposes, Brokerage is considered to be a disregarded entity (See 26 CFR § 301.7701-3[b][1][ii]; NYS Tax Publication 16, p. 5) and, as such, it is treated as a part of Partnership D. NYS Tax Publication 16, p. 5; TSB-A-16(1)C; TSB-A-13(11)C. As a result, Partnership D’s business receipts include the business receipts earned by Brokerage. Those receipts are distributed to Investment Adviser, which in turn distributes them to Taxpayer.

Taxpayer must identify the portion of its distributive share of Partnership D’s receipts that represent Brokerage’s receipts from broker-dealer activities described in § 210(3)(a)(9)(A)(i)-(vii). Having done so, Taxpayer must include in its receipts factor its distributive share of those receipts of Brokerage apportioned as registered securities broker-dealer receipts. See TSB-A-13(11)C. However, Brokerage’s status as a registered broker-dealer with the SEC cannot serve to qualify Taxpayer, Investment Adviser or Partnership D as registered securities broker-dealers. Other than the afore-mentioned portion of Investment Adviser’s or Partnership D’s receipts that represent the receipts of Brokerage that qualify for treatment as broker-dealer receipts, neither Taxpayer’s distributive share of Investment Adviser’s or Partnership D’s receipts, nor its own receipts, can be apportioned as the receipts of a registered securities broker-dealer. *Id.*

The Department’s conclusion above would also apply if Brokerage was “a broker or [a] dealer registered [with] the Commodities Futures Trading Commission [“CFTC”]”⁸ and

⁶ See <https://www.sec.gov/news/studies/2011/913studyfinal.pdf> [SEC, *Study on Investment Advisers and Broker-Dealers as Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (January 2011), pp. 7, 12].

⁷ *Id.*, p. 12.

⁸ The CFTC apparently has a registration scheme for futures professionals that is different from the SEC’s registration requirements for a securities broker-dealer. See <https://www.nfa.futures.org/NFA-registration/index.HTML>. The Department does not decide herein which futures professionals qualify as “a broker or dealer registered” with the CFTC.

Partnership D, Investment Adviser and Taxpayer did not qualify as such a broker or a dealer. Tax Law § 210(3)(a)(9)(B).

In TSB-A-13(11)C, the Department analyzed the status of a taxpayer that was not a registered securities broker-dealer, but was the single member of several limited liability companies that were such broker-dealers. That taxpayer was “deemed to be a registered [securities] broker-dealer and” the Department instructed the taxpayer that it could use the method provided in Tax Law § 210(3)(a)(9)(A)(iii) to apportion income “passed through to it” from its direct and indirect ownerships in those SMLLCs. TSB-A-13(11)C. The Department made no conclusion as to whether the taxpayer may consider itself to be a registered securities broker-dealer for purposes of the treatment of its own receipts. *Id.* The Department’s interpretation in this informational statement has always been its position regarding the computation of the receipts factor under facts as those presented in TSB-A-13(11)C or as presented herein.

Also, in TSB-A-13(11)C and TSB-A-16(1)C, the Department concluded that a partner in a partnership that was a registered broker-dealer with the SEC was itself deemed to be a registered securities broker-dealer in regards to the partner’s distributive share of the partnership’s receipts. After further consideration, the Department has determined the better view under the facts as presented in those two TSB-As is that the partner may compute its distributive share of the partnership’s receipts as if the partner was a registered securities broker-dealer. See, e.g., 20 NYCRR 3-13.1(b).

Finally, the purpose for an apportionment or allocation statute, e.g., Tax Law § 210(3), is different from a statute that imposes a penalty or tax on a person or entity, e.g., Tax Law §§ 29, 209(1), or a statute that sets forth the qualifications for a taxpayer to claim a tax credit. See, e.g., Tax Law § 15. Regardless of its interpretations in TSB-A-13(11)C and in this informational statement, for the imposition of a tax or penalty or for the qualifications for a tax credit the Department attributes the characteristics and qualifications of a SMLLC to its single member. See, e.g., L. 2017, Ch.59, Part Q.

Note: An NYT-G is an informational statement of the Department’s interpretation of the law, regulations, and Department policies and is usually based on a particular set of facts or circumstances. It is accurate on the date issued and is limited to the facts set forth therein. NYT-Gs are published to provide information and guidance to taxpayers, Department personnel, and tax professionals. Subsequent changes in the law or regulations, judicial decisions, Tax Appeals Tribunal decisions, or changes in Department policies could affect the validity of the information presented in an NYT-G. The information provided in this document does not cover every situation and is not intended to replace the law or change its meaning.