ASSESSMENT OF PUBLIC COMMENT

DEPARTMENT OF TAXATION AND FINANCE

Written comments were received regarding proposal TAF-37-12-00005-P from the Securities Industry and Financial Markets Association (SIFMA) and from the law firm, McDermott Will & Emery.

SIFMA noted that it generally endorses the approach of the rule and offers general suggestions to clarify the treatment of the issues.

SIFMA's first comment concerns situations where substantial intercorporate transactions are absent. SIFMA states that section 211.4 of the Tax Law indicates that the general purpose of filing combined reports is to accurately reflect the New York income and capital of groups of related corporations. SIFMA suggests that the rule should include specific language affirming this principle and indicating the rules are the same regardless of whether taxpayers are seeking permission to file combined reports or the Commissioner is seeking to compel them to file combined reports. Under Section 211.4(a)(4) of the Tax Law, in the absence of substantial intercorporate transactions, no combined report will be required unless the Commissioner determines it is necessary to properly reflect the tax. Sections 6-2.1(b) and 6-2.3(d) of the rule indicate that combined reports may also be permitted in these circumstances. The Department feels no further statements are necessary.

SIFMA notes that the rule's reference to voting power rather than simply to the number of the shares in the stock ownership test in section 6-2.2(a)(3) of the rule is "a welcome change". SIFMA suggests, however, that the rule should provide that voting power has reference to the ability to elect the corporation's board of directors, noting that it is common for corporations to provide that certain classes of stock can vote only on particular issues, but not in elections of directors. It was also suggested that the rule should provide that voting

power is determined by reference to the ability to elect directors as of a specific time such as the close of the corporation's taxable year. The Department agrees that voting power for the election of the board of directors is generally determinative of control for the purpose of the capital stock requirement and will be considered for the test. The Department recognizes, however, that it is possible that there could be other arrangements whereby the voting power for the election of the board of directors is not so determinative. The Department does not feel any further clarification is necessary.

With respect to the substantial intercorporate transactions test, SIFMA questions the relationship between the provision indicating that the activity of "incurring expenses that benefit, directly or indirectly, one or more related corporations" is considered and the statement that "[i]ntercorporate cost allocations are not considered." SIFMA requests that this relationship be clarified. The Department agrees and has made changes to sections 6-2.3(b)(2) and 6-2.3(b)(3) of the rule to clarify that intercorporate cost allocations of expenditures that benefit related corporations are not considered receipts or expenditures in determining if there are substantial intercorporate transactions. It is also clarified that expenditures for service functions, such as payroll processing and personnel services, are not considered expenditures that benefit related corporations.

SIFMA states that it would be helpful if the rule clarified the meaning of "regardless of the transfer price for such intercorporate transactions" in the determination of substantial intercorporate transactions. It was asked whether the phrase meant that the actual price used for intercorporate transactions would be the determining factor in analyzing whether the intercorporate transactions are substantial. It was suggested that it would be helpful if the regulations provided that the amount of the intercorporate transaction will be based on the actual price charged and cannot be increased or decreased by transfer pricing analysis except in egregious and abusive cases. The Department does not disagree with SIFMA, but does not feel a clarification is necessary or warranted. The test measures receipts and expenditures on a taxpayer's books. If adjustments for transfer

pricing affecting receipts and expenditures occur at the federal level, the test would need to be readministered accordingly.

SIFMA suggests that it would be helpful if the rule provided that combined or separate filing status established on audit will continue for future taxable years unless there is a change in circumstances and that the burden of proof should be on the party (whether the Department or taxpayer) seeking to show a change in circumstances. The Department does not believe this would be appropriate. The inclusion or exclusion of a corporation in a combined report is based on the facts and circumstances in each taxable year and is subject to revision or disallowance on audit. This is expressed in section 6-2.4(b) and 6-2.4(c) of the existing regulations.

SIFMA proposes the inclusion of an express statement that ineligible corporations in a combined report (e.g. alien corporations) are taken into account in determining the existence of substantial intercorporate transactions in the ten-step process in section 6-2.3(c) of the proposed rule. The Department believes it is clear the test is performed on all corporations in the tentative combined group prior to the removal of any ineligible corporations in step ten. No clarification is necessary.

SIFMA indicates that it would be helpful if the rule specifically referred to the treatment of stapled corporations (certain alien corporations filing as domestic corporations for federal income tax purposes) and indicated whether these corporations are treated as alien or domestic corporations for combined reporting purposes. The Department points out that Tax Law section 211.4(a)(5) provides that a corporation organized under the laws of a country other than the United States is not required or permitted to make a combined report. No changes were made to the proposed rule.

SIFMA recommends that the rule provide some guidance as to when the Commissioner would permit or require a corporation included in a combined reporting group to change its taxable year. Section 6-3.2(b) of the rule provides that where a corporation has a different taxable year from that of the taxpayer designated as

parent, the applicable taxable year of such corporation to be included in the combined group is the taxable year that ends within the taxable year of the designated parent. The intent of this provision is to not preclude a related corporation from making a combined report merely because it has a different accounting period. The Commissioner may allow a corporation to conform to the accounting period of the group regardless of its federal accounting period. The Department believes these are isolated instances and no clarification is necessary.

SIFMA proposes it would be helpful if the Department also applied a limited period for applying the asset transfer test for assets not required to be depreciated or amortized for Federal income tax purposes. The Department points out that the proposed rule provides that in the case of an asset not required to be depreciated or amortized for Federal income tax purposes, the test is applied for each year the asset is reflected on the books and records of the transferee under generally accepted accounting principles. The Department did consider further limiting the period for applying the test, but felt that the asset could generate gross income for as long as it was on the transferee's books and records. Therefore, the Department feels no limitation is warranted.

SIFMA states that the regulations should be generally effective as of January 1, 2007 as the amendments made by Chapter 60 of the Laws of 2007 apply to taxable years beginning on or after that date. However, SIFMA states it would be helpful if the rule were to expressly allow taxpayers to rely on the Department's prior guidance provided in a technical memorandum, TSB-M-08(2)C, until the publication of the rule or a designated effective date. Since some of the amendments in the rule represent a departure from the interpretations taken in the TSB-M, the Department has, based upon this comment, provided that the amendments would apply to taxable years beginning on or after January 1, 2013.

McDermott Will & Emery questions whether federal mark-to-market adjustments included in the computation of entire net income are properly included in the substantial intercorporate transactions test.

McDermott Will & Emery suggests that these are not the types of transactions that the test is attempting to measure and therefore should not be included. The Department agrees that these transactions should not be included in the substantial intercorporate transactions test. Mark-to-market adjustments under the Internal Revenue Code result in a gain or loss adjustment accounted for in the computation of federal taxable income. These adjustments are not considered a receipt or expenditure. Since the substantial intercorporate transactions test is based upon a corporation's receipts or expenditures, the Department feels it is clear that the existing language sufficiently addresses the concern. No changes were made to the amendments as a result of this comment.

McDermott Will & Emery questions whether an alien corporation (e.g., an alien banking corporation subject to the Franchise Tax on Banking Corporations imposed by Article 32 of the Tax Law) in a tentative combined group under the Business Corporation Franchise Tax imposed by Article 9-A of the Tax Law should apply the substantial intercorporate transactions test using receipts and expenses from its effectively connected income or its worldwide income. The Department has consistently interpreted the substantial intercorporate transactions test as an Article 9-A test. There is nothing in these amendments that changes that interpretation. The test is based upon entire net income computed on a worldwide basis regardless of a related corporation's NYS franchise tax filing status (e.g. Article 9, Article 32, or Article 33). The Department feels that the existing regulations are clear and no changes to the proposed rule are necessary.

McDermott Will & Emery raised several questions regarding example 7 in section 6-2.7 of the rule regarding a common pool of employees. Example 7 in the rule is derived from example 7 in Section 6-2.3(f) of the existing regulations. It is also included in technical memorandum, TSB-M-08(2)C. The conclusion of the example in the technical memorandum was slightly modified to illustrate the application of the updated substantial intercorporate transactions test. The example in the rule is identical to the example in the technical memorandum. The Department's position is that this example is only meant to illustrate how the test works for

a certain set of facts and is not intended to be all inclusive. The Department feels it is not feasible to try and address a multitude of hypothetical questions and fact patterns by regulations. No changes were made to the rule as a result of this comment.