# New York State Bar Association

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# Tax Section
# Report on Draft Business Apportionment Factor Regulations

Tax #2 May 26, 2017

**Report No. 1369**

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## I. Introduction

This report[1] comments on draft regulations (the "**Draft Regulations**") under New York State Tax Law Article 9-A prepared by the New York State Department of Taxation and Finance (the "**Department**"), dated September 30, 2016, that are intended to clarify and interpret the general rules contained in Section 210-A of the Tax Law for determining a corporation's business apportionment fraction. The Draft Regulations are intended to provide guidance in interpreting certain provisions of the 2014 and 2015 New York State budget legislation (together, the "**Legislation**") that, among other things, adopted a market-sourcing apportionment regime for all receipts that are included in the computation of a taxpayer's business allocation percentage.

As with other recently issued draft regulations, the Tax Section appreciates the Department's openness in making the Draft Regulations widely available on its website for comment before they are formally proposed pursuant to Article 2 of the State Administrative Procedure Act. We again commend the Department for having prepared generally clear and comprehensive guidance for businesses and practitioners in this entirely new aspect of the Tax Law. This report offers the Tax Section's comments and recommendations on certain of the Draft Regulations.

## II. Background

The Legislation made significant changes to the rules governing the apportionment of business income and capital under Article 9-A. The Legislation retained the receipts-only apportionment scheme of prior law, while converting to a market-sourcing regime (also known as a customer sourcing regime) and eliminating the disparate apportionment rules that previously applied to general business corporations and banking corporations. Under the new law, both categories of corporations are subject to the same apportionment rules.

The Legislation imposed specific market-based sourcing rules for receipts from sales of tangible personal property and electricity, rentals and royalties, sales and licenses of digital products, various financial instruments, railroad and trucking services, aviation services, advertising, and gas transmission and transportation services. For receipts not specifically addressed, the Legislation includes a category for receipts from "other services and other business receipts."

The Tax Section has previously commented on the draft regulations addressing receipts from "other services" and "other business receipts."[2] This report focuses on the draft regulations addressing the

[1] The principal drafters of this report were Jack Trachtenberg, Joshua E. Gewolb, Maria Eberle, Lindsay M. LaCava, Alysse McLoughlin, Elizabeth Pascal, Dennis Rimkunas, Leah Robinson and Irwin M. Slomka. Helpful comments were received from Andrew Braiterman, Peter Faber, Michael Farber, Maria Jones, Stephen Land, Richard Nugent, Art Rosen, and Michael Schler. This report reflects solely the views of the Tax Section and not those of the NYSBA Executive Committee or House of Delegates.

[2] Report 1339, New York State Bar Association Tax Section, Report on Draft New York State Business Apportionment Factor Regulations (Mar. 8, 2016).

specific market-based sourcing rules noted above. This is a challenging area, as there are many competing considerations to balance including administrability, certainty of outcome, availability of information, and prevention of manipulation. While the purpose of apportionment is to obtain a reasonable sense of how taxpayers generate income, in this case, the determination of the proper apportionment is made more complex by the explicit economic development rationale for the Legislation.[3] Determining where a customer received the benefit of a service is inherently difficult. For many types of receipts, the location of the "market" for the product or service is potentially difficult to determine or may be based on facts that may not be known to the taxpayer or even knowable--and that may be subsequently disputed on audit. The burden placed on taxpayers to gather and maintain information about their customers must be considered, and the need for precision balanced against certainty of outcome. Line drawing and the use of simplifying assumptions further administrability, but may create opportunities for abuse or, alternatively, may result in the distortion of the taxpayer's in-State income and raise constitutional concerns. Given these competing considerations, we appreciate the Department's efforts in the regulations to provide workable guidance on these difficult issues across a broad spectrum of types of business activity. Given the significance of the shift to a market-based receipts sourcing regime, our goal in providing these comments is to assist the Department in maintaining a workable corporation income tax regime that taxpayers can rely on in completing their returns. Where relevant, we have noted the underlying policy and tax administration considerations that animate our remarks and highlighted cases in which we believe that further consideration of specific issues is warranted.[4]

## III. Executive Summary

The principal conclusions of this report are as follows:

1. *Receipts from Unusual Events.* ***While we believe that the exclusion for unusual events is reasonable, we note that there is not specific statutory authority for this exclusion. The definition of unusual event requires clarification.***

2. *Definition of Commercial Domicile.* ***Additional guidance and examples regarding the determination of commercial domicile should be added to the Draft Regulations. In addition, the Draft Regulations with respect to determining the commercial domicile of alien corporations should be clarified.***

3. *Rents and Royalties.* ***The interaction of the Draft Regulation addressing receipts from the rental of real and tangible property with the Draft Regulation regarding reimbursed expenses should be clarified. The special rule for receipts from the rental of motor vehicles and other rolling stock should be reviewed to ensure that information required to facilitate compliance is available.***

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[3] See 2013 Legis. Bill Hist. NY A.B. 8559, Part A.

[4] The Draft Regulations affect whether a corporation has nexus in New York under New York's economic nexus rules. Under New York Tax Law § 209.1(b), a corporation has nexus if it has receipts in New York of one million dollars or more in the taxable year. For this purpose, New York receipts means the receipts included in the numerator of the apportionment factor determined under New York Tax Law § 210-A(1). The Draft Regulations may thus affect whether a corporation has nexus as they determine the receipts in the numerator of the apportionment factor.

4. *Qualified Financial Instruments.* ***The Tax Law provides that ownership of one financial instrument for which a mark-to-market election has been made will cause other, non-mark-to-market financial instruments described in the same statutory clause to be considered QFIs. While the Draft Regulations generally follow this approach, they deviate from this approach with respect to two statutory clauses. We review the consistency of this approach with the statute. In addition, the provisions of the Draft Regulations that attempt to limit partnership instruments that can qualify as QFIs should be expanded to include additional guidance.***

5. *Receipts and Net Gains from Loans.* ***The Draft Regulations with respect to sourcing interest would benefit from technical clarifications, particularly issues concerning multiple borrowers/guarantors. In addition, we recommend that the Department consider modifying the Draft Regulations that source interest on loans not secured by real property to the borrower's commercial domicile by making this rule a rebuttable presumption.***

6. *Net Income From Reverse Repurchase Agreements and Securities Borrowing Agreements.* ***The language in the Draft Regulations providing for a distinction in sourcing between reverse repurchase agreements and securities borrowing agreements is inconsistent with the statutory language and should be modified.***

7. *Advertising Sales.* ***We have concerns that the Draft Regulations with respect to advertising sales go beyond the language of the statute in addressing receipts from advertising-related services, in addition to advertising itself. We believe that the receipts from advertising or marketing services should be apportioned using the rules created for service receipts.***

8. *Investment Companies.* ***The Draft Regulations expand the definition of "investment company" beyond the narrow statutory definition to add any non-corporate entity "that pools capital from passive investors and that trades or makes investments in stocks, bonds, securities, commodities, loans, or other financial assets, but that does not otherwise conduct a trade or business." This additional category of investment companies should be removed.***

## IV. Discussion

### A. Receipts from Unusual Events

1. Draft Regulations

Draft Regulation Section 4-1.1(b) defines business receipts[5] to include receipts, net income, net gains and other items described in Section 210-A of the New York Tax Law that are received "in the regular

[5] New York Tax Law § 210-A(1) utilizes the term "receipts." However, the Draft Regulations also refer to "business receipts," *see, e.g.*, Section 4-1.1, and "gross receipts," *see, e.g.*, Section 4-2.7. Unless a distinction is intended, we recommend that the terminology be conformed.

course of the taxpayer's business," provided such amounts are includible in the computation of the taxpayer's entire net income for the year. The Draft Regulations then state that "receipts from sales of real, personal, or intangible property that arise from unusual events are not included in New York receipts or everywhere receipts."[6] Because receipts from unusual events are excluded from the definition of business receipts, they are not reflected in the apportionment factor. Presumably, the income generated by unusual events would ultimately be apportioned by an apportionment factor that was determined without regard to the event.

2. Comments

(a) Statutory Authorization

New York Tax Law Section 210-A does not specifically authorize an exclusion for unusual events. The statute first explains that the apportionment factor is determined by including "only those receipts, net income, net gains, and other items described in this section that are included in the computation of the taxpayer's business income."[7] The subsequent subsections relate to the items included with respect to particular types of income. These subsections each suggest that all receipts generating business income be included without specific reference to an exclusion for "unusual events."[8]

Though the statute does not specifically authorize an exclusion for unusual events, we believe that the exclusion in the Draft Regulations is reasonable: The apportionment factor may not represent a reasonable sense of how the taxpayer generates its income if significant transactions outside of the ordinary course of business are included. In addition, the exclusion is supported by the legislative reenactment doctrine, which holds that reenactment of a statue by the legislature is an implicit approval of existing administrative interpretations.[9] Prior to the Legislation, New York Tax Law § 210.3(a)(2) did not provide for any exclusion for sales of capital assets or sales outside the ordinary course of business; however regulations specifically provided for such exclusions.[10]

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[6] Draft Regulations § 4-1.1(b).

[7] N.Y. TAX LAW § 210-A.1.

[8] *See, e.g.*, N.Y. TAX LAW § 210-A.2.(a).

[9] *See Cottage Sav. Ass'n v. Comm'r*, 499 U.S. 554, 561 (1991); *National Elevator Indus. Inc. v. New York St. Tax Comm.*, 65 A.D.2d 304, *rev'd on other grounds,* 49 N.Y.2d 538 (1980).

[10] *See* Regulation § 4-4.1 (providing that business receipts includes only "gross income received in the regular course of the taxpayer's business."); Regulation § 4-4.6(e) (stating that receipts from sales of capital assets are not business receipts and are not included in the receipts factor of the business allocation percentage).

As an alternative to the approach in the Draft Regulations, receipts and net gains from unusual events could instead be included in computing the apportionment factor but then treated as potential situations in which alternative apportionment may be appropriate. *See* N.Y. TAX LAW § 210-A.11. *See also* Uniform Division of Income for Tax Purposes Act § 18; MTC Reg. IV.18(a). The Tax Law provides that if it appears that the apportionment factor determined pursuant to the statutory formula does not result in a proper reflection of the taxpayer's business income or capital within the state, the Commissioner is authorized in his or her discretion to adjust it, or the taxpayer may request that the Commissioner adjust it, by, among other methods, excluding one or more items in such determination. N.Y. TAX LAW § 210-A.11. Treating unusual events as a circumstance in which alternative apportionment may be applied would allow deviation from the statutory formula, but only in cases where alternative apportionment is available under general principles.

### (b) Definition of Unusual Event

The Draft Regulations do not define the phrase "unusual event." It would be helpful to have additional clarity as to what constitutes an unusual event. The Draft Regulations require the inclusion of receipts "received in the regular course of the taxpayer's business," but in determining what this phrase means, there are a number of possible factors such as frequency of the event and the relationship of the event to the taxpayer's business. If frequency is the issue, how infrequent must an event be to constitute an unusual event? What if the event, though infrequent, is customary in the regular course of the type of trade or business being conducted or within the scope of the taxpayer's trade or business? How long a time period is considered in determining whether an event is unusual? Can an event that was once unusual cease to be unusual if it recurs? To what extent does the language defining "business receipts" as those received "in the regular course of the taxpayer's business" bear on the definition of "unusual event"?

It would also be helpful to have additional examples. The existing examples relate primarily to major corporate transactions. It would be useful to have further examples that probe the boundaries between events that are unusual and those that occur in the ordinary course. For instance, Example 2 relates to a sale of all of the assets of a division; what if just a single material factory or plant were sold and such divestitures are anticipated to occur again in the future? In addition, it would be useful for the examples to identify the reason why the events at issue do or do not constitute unusual events. For instance, Example 4 indicates that quarterly interest payments to a corporation under a note do not constitute an unusual event, stating that they are earned in the regular course of the corporation's business. It would be helpful to have further explanation of the rationale. The only fact noted is the frequency of payments, but it is unclear as to whether this is the rationale for the result or whether some other fact (*i.e.*, the nature of the corporation's business) gives rise to this conclusion.[11]

In addition, we have significant concerns regarding Examples 5, 6, and 7 of Draft Regulation Section 4-1.1(d). These examples are intended to explain when gains from the sale of stock are or are not included in the receipts factor, based on whether or not the gain was generated by an unusual event. However, New York Tax Law Section 210-A.5(G) provides that gain from the sale of stock must be excluded from the numerator and the denominator of the apportionment factor, regardless of whether or not the sale is an unusual event.[12] Thus, these examples are potentially confusing and should be

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Under constitutional principles, apportionment formulas must meet both an internal consistency test and an external consistency test. *See Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159 (1983), *Disney Enterps., Inc. v. Tax Appeals Tribunal of the St. of N.Y.*, 10 N.Y.3d 392 (2008). The internal consistency test requires that the apportionment formula be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business's income being taxed. The external consistency test requires that the factor or factors used in the apportionment formula reflect a reasonable sense of how income is generated and prohibits a state from taxing value that is not connected with it. *Id.* Under these principles, if receipts are included in the tax base there is some authority that they should be represented in the apportionment factor. *See People ex rel. Alpha Portland Cement Co. v. Knapp et al*, 230 N.Y. 48 (1920), *cert. denied*, 256 U.S. 702 (1921) (invalidating a statutory scheme that taxed income from bonds and other similar intangibles but did not include them in the apportionment factor). This principle is known as factor representation. The denial of factor representation for receipts from unusual events should be considered in light of these principles.

[11] For example, if the note was the result of a sale of an asset that would otherwise be an unusual event, how would this affect the treatment of the interest on the note?

[12] N.Y. TAX LAW § Sec. 210-A.5(G) ("Dividends from stock, net gains (not less than zero) from sales of stock and net gains (not less than zero) from the sale of partnership interests are not included in either the numerator or denominator of the apportionment fraction unless the commissioner determines pursuant to

removed or else redrafted to explain why the gains are being considered for inclusion in the factor in light of Tax Law Section 210-A.5(G).

**(c)** Limitation to Receipts from Sales

The language of the exclusion in the Draft Regulations is limited to business receipts from "*sales*" of real, personal or intangible property that are unusual events. (Emphasis added.) It is unclear whether this limitation is intentional because Example 4 addresses a situation involving interest payments, which are obviously not receipts from a "sale."[13] While the regulations conclude that this example does not involve an unusual event, they do so after reviewing the specific facts with respect to the interest payments, suggesting (contrary to the regulatory language referencing "sales") that if those facts were not present, the receipt of interest payments could indeed be an unusual event. This is confusing and could engender controversy. There are recognition events that potentially could constitute unusual events that are not in the nature of sales, encompassing the entire universe of income types (*e.g.*, payments of interest, rents, royalties, contractual fees, etc.) It would be useful to have clarity as to whether these are or could be unusual events.

## B. Definition of Commercial Domicile

1. Draft Regulations

New York Tax Law Section 210-A.5 provides apportionment rules for qualified financial instruments. One of the methods for assigning those receipts involves the use of customer sourcing. New York Tax Law Section 210-A.5(a)(2) states that where a customer is a business entity, it is deemed to be located in the state of its commercial domicile. New York Tax Law Section 210-A.5(e) provides a hierarchy for determining where a customer's commercial domicile is located. Based on information that is known, or could reasonably be determined, the commercial domicile is determined based on "(i) the seat of management and control of the business entity; and (ii) the billing address of the business entity in the taxpayer's records."[14]

Draft Regulation Section 4-1.3(a) provides additional details regarding commercial domiciles. Draft Regulation Section 4-1.3(a)(1) merely repeats the statutory hierarchy. Draft Regulation Section 4-1.3(a)(2) adds guidance for business entities that are sole proprietorships, indicating that the seat of management for a sole proprietorship (step (i) of the hierarchy) is its principal place of business. Draft Regulation Section 4-1.3(a)(3) addresses a business entity that is an alien corporation that is not treated as a domestic corporation under Internal Revenue Code Section 7701. The Draft Regulations state that the seat of management and control for the alien corporation "must be the location within a state of the United States or the District of Columbia from which the corporation's United States trade or business is principally managed and controlled."

Several examples illustrate application of a commercial domicile approach for determining where a business customer is located. These include Draft Regulation Section 4-2.5(d), *Examples* 1 and 2 (loans not secured by real property), Draft Regulation Section 4-2.9(c) *Example* 1 (interest income on deposits) and Draft Regulation Section 4-2.9(d)(2), *Example* 1 (payments in lieu of dividends).

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subdivision eleven of this section that inclusion of such dividends and net gains (not less than zero) is necessary to properly reflect the business income or capital of the taxpayer.").

[13] Draft Regulations § 4-1.1(b), *Ex.* 4,

[14] N.Y. TAX LAW § 210-A.5(e).

### 2. Comments

As noted above, Draft Regulation Section 4-1.3(a)(1) repeats the language of New York Tax Law Section 210-A.5 virtually verbatim, describing the hierarchy to be applied when assigning receipts from certain financial transactions involving business customers. The first step of the hierarchy looks to the seat of management and control of its counterparty business entity with which the taxpayer engaged in a financial transaction. Some additional guidance as to how a taxpayer is to determine the seat of management and control of the business entity would be helpful. This is one of many circumstances that highlight the difficulty of establishing a regime in which receipts are sourced based on facts of which the taxpayer may not be aware. It should be noted that each example involving commercial domicile states as a fact where the customer is domiciled. None of the examples demonstrates how one determines where the seat of management and control is located.

Draft Regulation Section 4-1.3(a)(3) dictates that the seat of management and control for an alien corporation "must be the location within a state of the United States or the District of Columbia from which the corporation's United States trade or business is principally managed and controlled." We read this language as stating that United States trades or businesses conducted by alien corporations may not have a foreign principal place of management, and requiring taxpayers to look for a United States-based seat of management. It is not clear to us that a United States-based seat of management will always be present. If an alien entity conducts a trade or business in the United States, those activities could be managed from outside of the United States. This section does not explain how one determines where the seat of control is when the activities are not managed in the United States. We can think of no logical reason to treat alien corporations differently from United States corporations with respect to determining the seat of management and control. Each United States corporation is deemed to have one seat of management and control; the rule for each alien corporation should be the same, even if that location is outside of the United States. Moreover, treating alien corporations differently from domestic corporations for this purpose would seem to violate the Constitution's foreign commerce clause in that the tax burden for a business having alien customers would be computed differently than a business having solely domestic customers.[15] It is also difficult to conceive how this different treatment for two such businesses can, in both instances, satisfy the Due Process and Commerce Clause requirements that the apportionment formula reflect the taxpayer's business activity in the state.[16] Additionally, there are currently no examples that address this provision; we believe that it would be helpful if examples were added. In addition, in the financial products industries, a taxpayer may not always have a customer's (payor's) billing address in its records. In such instances, a rule that allows the taxpayer to use other available information regarding the customer's location could be warranted.

## C. Rents and Royalties

### 1. Draft Regulations

New York Tax Law Section 210-A.3 provides apportionment rules for receipts from rentals and royalties. New York Tax Law Section 210-A.3(a) addresses receipts from rentals of real and tangible personal property, and assigns those receipts to where the property is located. New York Tax Law Section 210-A.3(b) addresses receipts from the use of intellectual property and assigns those receipts to where the property is used. New York Tax Law Section 210-A.3(c) addresses receipts from closed

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[15] *Japan Line, Ltd. v. Cnty of L.A.*, 441 U.S. 434 (1979); *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977); *Kraft General Foods, Inc. v. Iowa Dept. of Rev. and Fin.*, 505 U.S. 71 (1992); *Levin, Tax Comm'r of Ohio v. Commerce Energy, Inc.*, 560 U.S. 413 (2010).

[16] *Hans Rees' Sons, Inc. v. N.C. ex rel. Maxwell, Comm'r of Rev.*, 283 U.S. 123 (1931), *Moorman Mfg. Co. v. Bair, Dir. of Rev. of Iowa*, 437 U.S. 267 (1978), *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159 (1983).

circuit and television event rights, and assigns those receipts to where the athletes or entertainers perform the event.

Draft Regulation Section 4-2.2(a) provides additional details regarding receipts from the rental of real and tangible property. The provision indicates that all amounts received by the taxpayer for use of the property are included as receipts and that gross receipts from property that is subleased are to be included in the apportionment factor.

Draft Regulation Section 4-2.2(a)(4) provides a special rule for receipts from the rental of motor vehicles and other rolling stock (such as trucks and construction equipment). Those receipts would be included in the sales factor numerator based on a fraction, the numerator of which would be the number of miles operated within New York and the denominator of which would be the total number of miles operated.

Draft Regulation Section 4-2.2(b) provides additional details regarding receipts from licenses of intellectual property (such as patents, copyrights, trademarks, and similar items). Such receipts would include all amounts received by the taxpayer for use, "whether or not paid as royalties" and would be assigned based on where used.

2. Comments

Draft Regulation Section 4-2.2(a) addresses receipts from the rental of real and tangible property and indicates that "all amounts received by the taxpayer" for use of the property are included as receipts. It is unclear how this provision interacts (if at all) with proposed Draft Regulation Section 4-1.1(c), which states that business receipts do not include certain reimbursed expenses.[17] For example, if a landlord pays a utility bill on behalf of a customer and is then reimbursed (based on a contractual agreement that the tenant reimburse the landlord), would that amount be included in the rental receipts base pursuant to Draft Regulation Section 4-2.2(a) or excluded pursuant to Draft Regulation Section 4-1.1(c)?

Draft Regulation Section 4-2.2(a)(4) creates a special rule for receipts from the rental of motor vehicles and other rolling stock, requiring that those receipts be included in the sales factor numerator based on a fraction, the numerator of which is the number of miles operated within New York and the denominator of which is the total number of miles operated. We question whether the data need to apply this provision are practically available. While some business-to-business commercial rental agreements may provide for the tracking of miles, the rules may present practical concerns with respect to rentals of cars by individuals. We do not know whether geographic mileage for such rentals is ordinarily tracked and relevant records are ordinarily maintained. In addition, it seems likely that rental of items such as construction equipment may not be on a mileage basis. We urge reconsideration of this provision. As an alternative, receipts from rentals of motor vehicles or other rolling stock could be sourced to the location where the customer takes delivery of the motor vehicle or other rolling stock.

## D. Qualified Financial Instruments

1. Draft Regulations

The New York Tax Law provides market sourcing rules for financial instruments, with different sourcing methods applicable to different varieties of financial instruments. Under these rules, financial

[17] Specifically excluded are (i) expenses paid for by the taxpayer on behalf of a customer that are received from the customer in advance or received from the customer and placed by the taxpayer into a separate account, provided the reimbursement does not exceed the amount of expenses and (ii) reimbursements received by the taxpayer under a cost-sharing arrangement the taxpayer has with another company, where that cost-sharing arrangement does not include any mark-up of the expense. Draft Regulation Sec. 4-1.1(c).

instruments are segregated into different categories based on the kind of financial instrument. Different categories of financial instruments and the relevant sourcing rules applicable to each category of financial instrument are set forth in separate clauses of the Tax Law. For example, clause (A) of New York Tax Law Section 210-A.5(a)(2) sets forth the sourcing rules for interest and net gains from loans, while clause (B) sets forth the sourcing rules for interest and net gains from federal, state, and municipal debt. It should be noted that even within each clause, there may be different sourcing rules for different varieties of financial instruments. For example, even though loans secured by real property and loans not secured by real property are both covered by clause (A), interest and net gains from loans secured by real property are subject to different sourcing rules from interest and net gains from loans not secured by real property.

2. Comments

**(a)** Qualified Financial Instruments

As an alternative to the complex market sourcing rules set forth for the different receipts from financial instruments, the Tax Law provides that taxpayers can elect to use a simpler sourcing method for certain financial instruments that satisfy particular requirements. These special financial instruments are referred to as qualified financial instruments ("**QFIs**"), and the taxpayer can elect to use a fixed-percentage method in allocating its receipts from QFIs. Thus, a taxpayer can elect to source 8% of its receipts from QFIs to New York under the fixed percentage method, instead of using the market sourcing rules to source such receipts. This election is made on a year-by-year basis, is irrevocable, and must be made on an original, timely filed return. If the taxpayer makes the election to use the fixed-percentage method, then all of the taxpayer's receipts from QFIs in the same category must be sourced under the fixed-percentage method for the year in which the election is made.

The Tax Law defines a QFI as a certain specified financial instrument that is "of a type" described in certain clauses of New York Tax Law Section 210-A.5(a)(2) – loans; federal, state, and municipal debt; asset backed securities and other government agency debt; corporate bonds; stock and partnership interests; "other financial instruments"[18]; and physical commodities – "that has been marked to market in the taxable year by the taxpayer under section 475 or section 1256 of the internal revenue code."[19] The Tax Law further provides that, "if the taxpayer has in the taxable year marked to market a financial instrument *of the type* described in any of the *[sic]* clauses (A), (B), (C), (D), (G), (H) or (I) of subparagraph two of this paragraph, then any financial instrument within that type described in the above specified clause or clauses that has not been marked to market by the taxpayer under section 475 or section 1256 of the internal revenue code is a qualified financial instrument in the taxable year."[20] The Tax Law then specifies that loans secured by real property cannot be QFIs – even if those loans are marked to market.

As noted above, a taxpayer can elect to source all of its receipts – including interest, net gain, and mark-to-market gain – from all of its QFIs under the fixed percentage method instead of using the market sourcing rules for the sourcing of such receipts. To the extent the taxpayer has financial instruments that are not QFIs – whether because they are real estate loans that cannot qualify as QFIs, even if marked to market, or because the taxpayer does not have any financial instrument of the same type that

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[18] The category of "other financial instruments" is defined by New York Tax Law Section 210-A.5(a)(2)(H) to encompass financial instruments that do not fall into the other statutory categories.

[19] N.Y. TAX LAW § 210-A.5(a).

[20] *Id.* (emphasis added).

are marked to market – receipts from such financial instruments must be subject to the market sourcing rules and are not eligible for sourcing under the fixed percentage method.

The Tax Law language providing that ownership of one financial instrument for which a mark-to-market election has been made will cause other, non-mark-to-market financial instruments to be considered QFIs is not clear as to which non-mark-to-market financial instruments will be affected. That mark-to-market financial instruments "of the type described" in a clause of the Tax Law will impact non-mark-to-market financial instruments "within that type" could mean that a mark-to-market election for any one financial instrument mentioned in one of those clauses will cause all financial instruments mentioned in that clause to be a QFI. Alternatively, the statutory language could mean that a mark-to-market election for *any* one type of financial instrument mentioned in one of those clauses will cause *all* financial instruments *of that same type* that are mentioned in that one clause to be a QFI. Under the first interpretation, the "type" of financial instrument would be the type specified in the whole clause, such as loans described in clause (A); federal, state, and municipal debt described in clause (B); asset backed securities and other government agency debt described in clause (C); etc. Under the second interpretation, the "type" of financial instrument would be more granular and could, for example, in clause (B) refer to federal debt, state debt, and municipal debt separately, with each being considered a separate type.

A sentence in the apportionment provision of the Tax Law may provide support for the view that the first interpretation is what the Legislature intended. That sentence specifies that "if the only loans that are marked to market by the taxpayer under Section 475 or Section 1256 of the internal revenue code are loans secured by real property, then no loans shall be qualified financial instruments…."[21] Because the customer-sourcing rules for all loans – including loans secured by real property – are set forth in clause (A), it would follow that this specification would not be needed if the mark-to-market election of one financial instrument mentioned in a clause was not supposed to affect all financial instruments described in that same clause. However the Tax Law is nonetheless ambiguous on this point.

The Draft Regulations adopt the first interpretation for financial instruments set forth in clauses (A) [loans], (B) [federal, state, and municipal debt], (C) [asset backed securities and other government agency debt], (D) [corporate bonds], and (I) [physical commodities], thus treating all of the financial instruments in each of these clauses as one type of financial instrument for purposes of the mark-to-market election. With respect to the stock and partnership interests addressed in clause (G) and the "other financial instruments" addressed in clause (H), however, the Draft Regulations adopt the second interpretation. More specifically, the Draft Regulations provide that whether *stocks* owned by a taxpayer will be QFIs will be determined separately from whether *partnership interests* owned by a taxpayer will be QFIs, despite the fact that the apportionment rules for stock and partnership interests are both described in the same clause of the Tax Law, clause (G).[22] Similarly, the Draft Regulations specify that the determination of whether "other financial instruments" will be considered QFIs will be conducted separately for different categories of "other financial instrument," despite the fact that all "other financial instruments" are included in clause (H) of the Tax Law.[23] Use of the second approach in classifying financial instruments as QFIs may result in some financial instruments not being considered QFIs, even though they would been under the first approach. In other words, the more categories of "other financial instruments" that exist, the less likely that a taxpayer will have a marked-to-market instrument in each category, and thus the less likely that all of its "other financial instruments" will be considered QFIs eligible to use the fixed-percentage method. If some of a

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[21] *Id.*

[22] Draft Regulations § 4-2.4(a)(2)(ii).

[23] Draft Regulations § 4-2.4(a)(2)(iii).

taxpayer's "other financial instruments" are not considered QFIs, the taxpayer will need to obtain the detailed customer sourcing information required by statute concerning each stream of income generated by those non-QFI instruments.

**(b)** Netting

For purposes of the market-sourcing method of sourcing receipts from most financial instruments, the Tax Law specifies that such receipts will include net gains (not less than zero).[24] In addition, as discussed below, with respect to physical commodities, the Tax Law specifies that such receipts will include net income (not less than zero).[25] Furthermore, a separate provision specifies that, with respect to all financial instruments, mark-to-market gain (not less than zero) will also be included in the receipts factor.[26] The Tax Law, however, does not clearly provide guidance as to how to determine the proper amount of net gains, net income, and mark-to-market gains to be included in the apportionment formula when the fixed percentage election is made.

The Draft Regulations do attempt to provide some guidance and instructions for netting income and gain among QFIs for which the fixed-percentage method election is in effect. Due to the lack of clarity in the statute, we commend the Department for providing guidance concerning the proper method to use. However, the Draft Regulations may be too complex to serve their purpose effectively. As noted, the option to use the fixed-percentage method in sourcing receipts from QFIs offers taxpayers a simpler option for the sourcing of these receipts as compared to the complex, granular customer sourcing rules. Thus, promulgation of a netting rule that adds complexity to use of the fixed-percentage method may not be appropriate for such method.

In addition, the Draft Regulations themselves add further uncertainty to the method to be used in making this computation. The Draft Regulations specify that, when using the fixed-percentage method, the amount of the net gain, net income, and mark-to-market gain to be included in the numerator and the denominator of the apportionment formula should be determined separately for "each type of qualified financial instrument that would be subject to the same market sourcing method in Tax Law section 210-A.5(a)(2) and the applicable regulations if not for the fixed percentage method..."[27] However, it is not clear what is meant by each type of QFI that would be subject to the same sourcing method. For example, as discussed below, for market sourcing purposes – but not necessarily for purposes of the fixed-percentage method election – the Draft Regulations seem to take the position that net interest income (not less than zero) from reverse repurchase agreements and net interest income (not less than zero) from securities borrowing agreements should be determined separately, even though the Tax Law appears to require that such computation be performed on an aggregate basis. However, the Tax Law and the Draft Regulations also specify that 8% of net interest income from reverse repurchase agreements and securities borrowing agreements is to be included in the numerator and 100% in the denominator of the taxpayer's apportionment formula. It is not clear whether, for determining net interest to be included in determining the fixed-income percentage, net interest income from reverse

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[24] N.Y. TAX LAW § 210-A.5(a)(2)(A), (B), (C), (D), (G), (H).

[25] N.Y. TAX LAW § 210-A.5(a)(2)(I).

[26] It should be noted that the language used in the Tax Law is not always consistent concerning what receipts from financial instruments should be included in the receipts factor. For example, the Tax Law provides: "Under the fixed percentage method, eight percent of all net income (not less than zero) from qualified financial instruments is included in the numerator of the apportionment fraction. All net income (not less than zero) from qualified financial instruments is included in the denominator of the apportionment fraction." N.Y. TAX LAW § 210-A.5(a)(1). Presumably this is supposed to include *all* receipts from qualified financial instruments, as was clarified by the Department in Draft Regulations § 4-2.4 (c)(1).

[27] Draft Regulations § 4-2.4(c)(1).

repurchase agreements and securities borrowing agreements will be determined on an aggregate basis since these instruments are subject to the same sourcing method. Clarification would be helpful as to this point.

Alternatively, in the interest of simplicity, it may make sense merely to net gain or net income for purposes of the fixed-income percentage separately among all financial instruments covered by the same market sourcing clause. While the statute does not require this approach, we believe it would be helpful as a matter of administrative convenience.

Furthermore, we note that part of the netting guidance is set forth in the section discussing sourcing in a combined reporting context.[28] We recommend that the Draft Regulations explicitly explain the netting rules and the rationale for such rules in a dedicated section.

**(c)** Partnership Interests

The Draft Regulations generally state that "[i]f a taxpayer has marked to market a partnership interest, then any other partnership interest that has not been marked to market is also a qualified financial instrument."[29] The Draft Regulations, however, limit partnership interests that can be considered QFIs to those that meet the definition of a "security" under Internal Revenue Code Section 475(c).[30] That section describes instruments that will be considered securities, including, among other things, "any partnership or beneficial ownership interest in a widely held or publicly traded partnership or trust."[31] In contrast, the Tax Law does not explicitly limit the "partnership interests" that could be treated as a QFIs to those interests described in Section 475(c).[32]

Under Clause (G) corporate dividends and net gains from sales of corporate stock or partnership interests are excluded from the apportionment factor.[33] Clause (G) broadly refers to "partnership interests" and "corporate stock" without mentioning Section 475. Thus, in the context of apportionment of net gains from sales of corporate stock or partnership interests, the Tax Law does not distinguish between the sales of widely held stock or partnership interests and sales of stock of a closely held corporation or non-widely held partnership interests. By limiting partnership interests qualifying as QFIs to those described in Section 475(c), the Draft Regulations provide that only sales of widely held partnership interests that meet the definition of a "security" under Section 475(c) can qualify as QFIs.

We assume from the addition of the Section 475(c) limitation that the Department is concerned about treating nonpublic partnership interests as QFIs where a taxpayer is utilizing New York Tax Law Section 210-A.5(a) to permit a mark-to-market election for one partnership interest to allow all of its other partnership interests to qualify as QFIs. While this limitation is not readily apparent from the Tax Law itself, we believe that Section 210-A.5(a), which allows QFI treatment for financial instruments that are not marked-to-market where they are of the same "type" as financial instruments that are marked-to-market, provides authority for the limitation. The Draft Regulations conform the

[28] Draft Regulations § 4-2.4(c)(1).

[29] Draft Regulations § 4-2.4(a)(2)(ii).

[30] Draft Regulations § 4-2.4(a)(3)(v).

[31] Internal Revenue Code § 475(c)(2)(B). Internal Revenue Code § 475(c)(2)(F) also includes in the definition of security, a position that is a hedge with respect to an item that is characterized as a security. While this could include a partnership in certain circumstances, those circumstances would seem to be rare.

[32] N.Y. TAX LAW § 210-A.5(a).

[33] N.Y. TAX LAW § 210-A.5(a)(2)(G).

classification of partnership interests to the other types of financial instruments in Section 210-A.5(a) by requiring that to qualify as a QFI the instrument must meet the definition of a "security" under Section 475(c), which only a partnership interest that is widely held or publicly traded can. In contrast, all corporate stock meets the definition of a "security" under Section 475(c). While this means that under the Draft Regulations nonpublic corporate stock could qualify as a QFI while nonpublic partnership interests could not, that difference results from the definition of a "security" under Section 475(c), and it is reasonable to interpret the reference in Section 210-A.5(a) to financial instruments that are the same "type" as meaning instruments that qualify as securities under Section 475(c).

## E. Receipts and Net Gains from Loans

### 1. Draft Regulations

Section 4-2.5 of the Draft Regulations addresses the Tax Law provisions that apply customer sourcing to a corporation's interest income and net gains from loans. Under the Tax Law, interest income from loans secured by real property is included in the numerator of the apportionment factor if the loan is secured by real property located in New York, and interest income from all loans secured by real property is included in the denominator of the factor.[34] Interest income from loans not secured by real property is sourced in the apportionment factor based on the location of the borrower.[35] The location of an individual borrower is the individual's billing address on the corporation's books, and the location of a business entity borrower is the entity's commercial domicile.[36]

Net gains (not less than zero) from sales of loans secured by real property are included in the numerator of the apportionment factor by multiplying the net gain by the ratio of gross proceeds from the sales of loans secured by real property located in New York to gross proceeds from sales of loans secured by real property everywhere.[37] Net gains (not less than zero) from sales of loans not secured by real property are included in the numerator of the apportionment formula by multiplying the net gains by the ratio of gross proceeds from sales of loans to purchasers located in New York to gross proceeds from sales of loans to all purchasers.[38]

The Draft Regulations define a loan secured by real property as any loan in which real property constitutes 50% or more of the aggregate value of the collateral for the loan at the time the loan is originated. Conversely, a loan not secured by real property is any loan in which real property constitutes less than 50% of the aggregate value of the collateral for the loan when originated.[39] The determination of the type of loan, the fair market value of the real property and the borrower's location is made at the time of origination and is redetermined only if the loan is refinanced.[40] Example 2 in the Draft Regulations involves a loan not secured by real property made to a corporate borrower having a commercial domicile in New York at the time of origination. Five years after the loan is originated, the borrower changes its state of commercial domicile to State X. Under the example, the interest income

[34] N.Y. TAX LAW § 210-A.5(2)(A)(i).

[35] N.Y. TAX LAW § 210-A.5(2)(A)(ii).

[36] N.Y. TAX LAW § 210-A.5(2).

[37] N.Y. TAX LAW § 210-A.5(2)(A)(iii).

[38] N.Y. TAX LAW § 210-A.5(2)(A)(iv).

[39] Draft Regulations § 4-2.5(a)(1) and (b)(1).

[40] Draft Regulations § 4-2.5(c).

on the loan continues to be includible in the numerator even after the borrower's commercial domicile changes.[41]

2. Comments

Overall, we think the regulation provides a workable framework for taxpayer compliance. For example, although the statute sources interest from loans secured by real property based on where the real property is located, it does not directly address situations where a loan is secured by both real property and other property. The Draft Regulations adopt a reasonable approach whereby the loan will be considered secured by real property if at the time of loan origination the fair market value of the real property represents at least 50% of the aggregate value of the collateral for the loan. This approach allows taxpayers to make the determination as to whether to treat a loan as secured by real property using objective criteria solely in the year the loan is originated and avoids the potential for manipulation.

There are a number of technical matters that we would suggest be clarified. We believe that the statutory reference to "interest" rather than to "net interest" reflects a legislative intent to include gross interest, rather than interest income net of related interest expense, in the apportionment factor. In contrast, the statute refers to the inclusion of "*net gains* from *sales* of loans" (emphasis added). To avoid possible uncertainty, we suggest that the regulation make explicit that gross interest income from loans is includable in the apportionment factor. It would also be helpful to make clear that the inclusion in the apportionment factor of interest from loans (and net gains from the sale of loans) applies whether or not the taxpayer is a bank or other financial institution that is in the business of making loans.

For loans not secured by real property, the statute creates separate rules for determining the location of the borrower depending on whether the borrower is an individual or a business entity, a distinction not limited to interest on loans. It would be helpful for the regulations to make clear that where a business entity is the borrower under such a loan, but an individual is also liable under the loan agreement (whether jointly, secondarily or as a guarantor), the location of the business entity (and not the individual's location) will be determinative.

The approach of the Draft Regulations that interest income is sourced based on facts as they exist at the time of loan origination is not apparent from the statute itself. Nonetheless, we believe that the approach taken in the Draft Regulations is reasonable. It eases compliance for taxpayers while creating desired certainty both for taxpayers in preparing their tax returns and for the Department in reviewing those returns. It would undoubtedly place a considerable burden on many taxpayers that make loans not secured by real property to require, for example, that they annually determine the commercial domicile of the borrower. Therefore, we generally agree with the approach taken by the Draft Regulations in determining the source of interest income on loans based on the facts at the time of origination.

However, while we favor the certainty that the Draft Regulations provide, which for loans not secured by real property looks to the borrower's location at the time of loan origination except in the case of a loan refinancing, there may be extraordinary situations in which it is appropriate to deviate from this basic rule regarding loan origination. For example, the taxpayer may have clear and convincing evidence to demonstrate that regardless of the borrower's commercial domicile at the time of loan origination, the loan proceeds are only used by the borrower to acquire business assets or to fund a particular business operation at a location other than the borrower's commercial domicile. Another example is where the loan is secured by collateral consisting solely of tangible personal property that the taxpayer can show with clear and convincing evidence is located entirely at a single location of the borrower other than the borrower's commercial domicile. In such cases, and possibly others, it may not

[41] Draft Regulations § 4-2.5, *Ex.* 2.

make sense to deem the borrower's commercial domicile as the proper location to source interest from a particular loan.

The Department should consider modifying the Draft Regulations as they pertain to interest on loans not secured by real property made to business entities by making Draft Regulation Section 4-2.5(c) a rebuttable presumption with respect to a particular loan. The party seeking to deviate from the presumption would bear the burden of proving that a departure from the basic rule is appropriate as the commercial domicile is not the most relevant factor for determining the sourcing of interest. Such party would be required to demonstrate, by clear and convincing evidence, that (i) the facts in existence at the time of loan origination do not reflect the borrower's location for a particular loan and that (ii) the loan is directly attributable to a single location of the borrower other than its commercial domicile.

We recognize that making Draft Regulation Section 4-2.5(c) a rebuttable presumption to some extent lessens the desired certainty for sourcing interest in the apportionment factor, but we believe the regulations should provide some flexibility to both taxpayers and the Department with regard to the sourcing of interest on loans in limited circumstances. A rebuttable presumption should not apply to the sourcing of interest on loans secured by real property, or to net gains from the sale of loans whether or not secured by real property, because the law already provides an appropriate customer sourcing method for such loans and loan sales.

There may also be situations where, after applying the "commercial domicile" hierarchy in Draft Regulation Section 4-1.3(a)(1) (which looks first to the business entity borrower's seat of management and control and, if not discernable upon reasonable inquiry, then to the borrower's billing address in the taxpayer lender's records), the borrower's commercial domicile remains not readily apparent to the taxpayer after exercising due diligence In those situations, the regulations should provide a default sourcing rule that is consistent with the overall approach of the regulation toward simplifying compliance and providing certainty to taxpayers, while at the same time minimizing the potential for manipulation. One possible default approach could be to permit the taxpayer to source the loan to the borrower's address as reflected in the underlying loan agreement between the parties, provided the address reflects a *bona fide* business location of the borrower and a has a substantive connection with underlying loan. We have similar concerns with balancing compliance and taxpayer certainty against potential manipulation in cases in which the borrower business entity is part of a group of related corporations. A taxpayer lender should not be required somehow to trace, at the time of loan origination, how an unrelated borrower intends to use the lent funds, in order to source the interest on the loan. In most cases, the lender will not be in a position to know where a borrower that conducts business in many states, directly or through affiliates, will be using the loan proceeds, and money is, of course, fungible. Similarly, we favor the use of a single borrower location for sourcing interest income, even where the borrower is a member of a unitary group of corporations that employs a centralized cash management system (subject to the Commissioner's discretion to use alternative apportionment to reflect income properly discussed below).

On the other hand, we are mindful that the regulations should not result in the creation of a loophole whereby, for example, a borrower in New York could designate an affiliated Delaware finance company as the nominal borrower, thereby allowing the taxpayer lender to source the interest income from the loan outside New York State. One possible approach in the case of a borrower that is part of a group of affiliated corporations would be to source interest income to the commercial domicile of the actual corporate borrower, unless the taxpayer knows, or upon reasonable inquiry would know, that the borrower is merely the financing arm for one or more affiliated corporate entities. In these cases, one possible approach could be that interest income from the loan could be sourced to the commercial domicile of the parent of the borrower's consolidated group for federal income tax purposes at the time of loan origination.

In those instances involving loans where more than one member of a corporate group is designated as a borrower under a loan agreement, we favor a practical approach that would source the loan to the commercial domicile of the corporate member having the greatest net equity at the time of loan origination. While there is no ideal solution, this approach would be consistent with the general thrust of the Draft Regulations, which determine borrower location at the time of loan origination. It also avoids the taxpayer having to determine the commercial domicile of multiple entities, and reduces the possibility of manipulation. As a practical matter, a taxpayer that lends funds to members of a corporate group of borrowers may require access to the net equity of each borrower in the loan agreement. Another approach could be, as discussed above, to source the interest income to the commercial domicile of the parent of the borrowers' federal consolidated group.

Regardless of the approach taken in the regulations, we believe that the Department always retains the authority under Tax Law Section 210-A.11 to adjust the apportionment factor in cases of manipulation of the sourcing rules that do not result in a fair reflection of the taxpayer's in-State income and activities. The use of this discretionary authority, however, would need more fairly to reflect the location of the borrower consistent with the overall market state approach under the Tax Law. In addition, as another tool to avoid manipulation, the Department has the ability to disregard financial arrangements that lack a business purpose and economic substance, including for purposes of computing the apportionment factor.

## F. Net Income from Reverse Repurchase Agreements and Securities Borrowing Agreements

### 1. Draft Regulations

The Draft Regulations provide rules for netting the interest income (not less than zero) from reverse repurchase agreement and securities borrowing agreements for purposes of determining the amount of net income to include in the apportionment formula. For these purposes, the interest income from reverse repurchase agreements and securities borrowing agreements are netted against the taxpayer's interest expense from repurchase agreements and securities lending agreements. Draft Regulation Section 4-2.6(b) and (c) indicate that this computation should be performed separately for reverse repurchase agreements and for securities borrowing agreements.

### 2. Comments

The Tax Law specifies no distinction in sourcing between reverse repurchase agreements and securities borrowing agreements.[42] However the regulations indicate that the determination of net income from such agreements should be determined on a separate basis including both reverse repurchase agreements and securities borrowing agreements. Draft Regulation Section 4-2.6(b) and (c). This provision is inconsistent with the statute. The statutory language does not allow for regulations to

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[42] New York Tax Law § 210-A.5(a)(2)(E) states as follows: "Eight percent of net interest income (not less than zero) from reverse repurchase agreements and securities borrowing agreements shall be included in the numerator of the apportionment fraction. Net interest income (not less than zero) from reverse repurchase agreements and securities borrowing agreements is included in the denominator of the apportionment fraction. Net interest income from reverse repurchase agreements and securities borrowing agreements is determined for purposes of this subdivision after the deduction of the interest expense form the taxpayer's repurchase agreements and securities lending agreements but cannot be less than zero. For this calculation, the amount of such interest expense is the interest expense associated with the sum of the value of the taxpayer's repurchase agreements where it is the seller/borrower plus the value of the taxpayer's securities lending agreements where it is the securities lender, provided such sum is limited to the sum of the value of the taxpayer's reverse repurchase agreements where it is the purchaser/lender plus the value of the taxpayer's securities lending agreements where it is the securities borrower."

provide that losses from reverse repurchase agreements cannot be used to offset interest income from securities borrowing agreements, and vice versa.

## G. Advertising Sales

### 1. Draft Regulations

New York Tax Law Section 210-A(8) creates apportionment rules for receipts from advertising. Under the statutory rules, receipts from sales of print advertising are sourced to New York based on delivery of the newspaper or periodical into New York and receipts from radio or television ads are sourced to New York, based on number of viewers or listeners in New York. The statute then has a catch-all provision for advertising delivered by other types of media, the receipts from which are sourced to New York also based on the number of viewers or listeners in New York.

Draft Regulation Section 4-2.14 seeks to apply New York Tax Law Section 210-A(8) to a broad array of advertising receipts and provides examples of how the sourcing rules would apply.

### 2. Comments

In several places relating to advertising sales, we believe that the Draft Regulations go beyond the language and intent of the statute. The statute focuses specifically on receipts from advertising itself. The Draft Regulations, however, expand this scope to include receipts from certain advertising-related services, in addition to advertising itself.

For example, Draft Regulation Section 4-2.14(a)(2) provides sourcing rules for "receipts for providing an advertising or marketing service," including "consultation on and development of advertising or marketing campaigns." Similarly, Draft Regulation Section 4-2.14(c) apportions such service receipts based on the number of "intended targets of such advertising or marketing campaigns" in New York. Draft Regulation Section 4-2.14(c)(i) states that to determine the location of "intended targets," a taxpayer must rely on statistics and information utilized as part of the market research or advertising strategy, if available, or "other sources of information" about the location of intended targets. If the Commissioner determines that the method is not reasonable or not applied in a consistent manner, the Commissioner can substitute another method.

We think receipts from advertising or marketing services should be apportioned using the rules created for service receipts, because the language of New York Tax Law Section 210-A(8) is limited to receipts from the advertising itself. This would eliminate the need for a methodology based on "intended targets," a concept that may be difficult to apply, may be subject to discretionary adjustments, and may involve confidential and sensitive information.

## H. Receipts from Services Provided to Investment Companies

### 1. Draft Regulations

Section 4-2.12 of the Draft Regulations addresses receipts from services provided to investment companies. New York Tax Law Section 210-A.5(d) provides that receipts for services provided to an "investment company" are sourced based on the investment company's shareholders' residences. It provides a definition of investment company as "a regulated investment company, as defined in section 851 of the internal revenue code, and a partnership to which section 7704(a) of the internal revenue code applies (by virtue of section 7704(c)(3) of such code) and that meets the requirements of section 851(b) of such code."[43]

[43] N.Y. TAX LAW §210-A.5(d)(2)(B).

2. Comments

The Draft Regulations expand the definition of "investment company" beyond the statutory definition. New York Tax Law Section 210-A.5(d)(2)(B) states the definition of investment company. The Draft Regulations define the term investment company by first repeating the statutory language, and then, in addition, creating an entirely new category of investment companies which comprise any non-corporate entity "that pools capital from passive investors and that trades or makes investments in stocks, bonds, securities, commodities, loans, or other financial assets, but that does not otherwise conduct a trade or business."[44] This could include private equity funds and investment funds generally, including closely-held partnerships. This additional category of investment companies goes beyond the statutory authority and should be removed.

Section Chair: Michael Farber, Esq.

[44] Draft Regulations Sec. 4-1.2(b)(1)(ii).