



August 5, 2011

Mr. Robert Plattner  
Deputy Commissioner  
Department of Taxation and Finance  
W.A. Harriman Campus  
Albany, NY 12227

Dear Rob:

In response to your request for comments to the June 2010 corporate tax reform bill draft (“proposed legislation”), I am providing the following suggestions on behalf of the members of the Securities Industry and Financial Markets Association<sup>1</sup> (“SIFMA”). The following comments are being submitted for consideration and are intended to further the Department’s objectives to provide equity amongst taxpayers, promote economic efficiency, allow for simplicity and ease of compliance and administration, provide more stability in revenue collection and maintain the economic competitiveness of New York. These comments should result in revenue neutrality based on the estimated tax liability under the present law and the estimated tax liability using a 6.5% tax rate under the proposals contained in the bill draft with the following suggestions contained in the Recommendations section. As you are aware, combined corporate tax rates together with high personal and property tax rates currently create disincentives for businesses to locate and expand in New York. While the changes discussed here are beneficial to our members, SIFMA continues to support initiatives to address tax rates on all levels of government.

We have also added a Clarifications section that lists the provisions that are contained in the proposed legislation but we feel need some further development to accomplish New York’s tax reform objectives.

**Recommendations:**

Net Income from Sales of Physical Commodities

Physical commodities are included in the definition of securities whose income can be accounted for under Section 475 of the Internal Revenue Code. The objective of ease of compliance and

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<sup>1</sup> The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit <http://www.sifma.org>.



administration will be furthered if physical commodities are included in the definition of qualified financial instruments.

The trading of physical commodities can often be intermingled with the trading of financial instruments, such as the trading of options and other hedges on these commodities. The current proposed legislation, which excludes physical commodities from the definition of a qualified financial instrument, provides two separate ways of sourcing receipts from physical commodities depending upon whether the commodity is physically delivered or not and the provision is silent on how options on the physical commodities are sourced. Presumably, options on physical commodities may continue to be treated as qualified financial instruments. Therefore, the present proposed legislation may result in the sourcing of receipts on a related transaction by three separate methods.

The sourcing of receipts from physical commodities is a top priority because the proposed legislation will result in different sourcing of receipts on related transactions and will severely hinder the stated goals of simplicity and ease of compliance and audit administration. The revenue impact to New York is not substantial and should result in the objective of revenue neutrality.

#### Receipts Constituting the Primary Spread or Selling Concession from Underwritten Securities

The proposed legislation provides that these receipts shall be deemed to be generated within the state to the extent that production credits are awarded to branches, offices or employees of the taxpayer within the state. This provision represents a continuance of the current law that is based on the principle that receipts should be sourced based upon the office that is principally involved in the generation of income. In order to make New York more competitive with other states from a tax perspective, the state has changed many of its receipts sourcing provisions to provide that receipts should be sourced based upon customer locations.

We recommend that all receipts from underwriting should be sourced based upon customer location which is consistent with the sourcing rules for most industries and is in accordance with the policy to make the state competitive with other states from a tax perspective. This change will remove the disincentive for locating underwriters in New York. In addition, different firms utilize production credits for different purposes, using inconsistent methodologies. In order for there to be audit consistency, production credits should not be utilized for this sourcing purpose. The objectives of economic efficiency and audit administration are best served by treating these fees similarly for all taxpayers based on the market location of the payer.

The revenue impact of this recommendation will also result in revenue neutrality for the proposed legislation by partially offsetting the elimination of the subsidiary capital section of the current law and the restricted definition of investment capital.

#### Interest Income from Subsidiaries

The proposed legislation provides for an exemption from income for dividends from a corporation that is conducting a unitary business with the taxpayer but is not included in the combined report.

This exempt income is reduced by interest expense incurred or deemed to be related to the earning of this income.

We recommend that the definition of “other exempt income” also include interest income received from unitary businesses that are not included in the combined report. There should not be a difference in the taxation of income received from a subsidiary due to whether a taxpayer finances the subsidiary’s operation by equity, resulting in dividend income, or debt, resulting in interest income.

Under the proposed legislation, most domestic subsidiaries will be included in the combined tax return and the adoption of this recommendation will primarily affect interest received from foreign subsidiaries. Since interest income from foreign subsidiaries is not sourced to the state under the proposed legislation, exempting the income (net of interest expense) should not have a significant impact on revenue for the state.

#### Certain Receipts as a Result of a Securities Correspondent and other Institutional Relationships

The proposed legislation requires the taxpayer to receive customer sourcing information from other taxpayers. If the taxpayer is unable to obtain this information, the taxpayer is required to source the receipt from the branch that generated the transaction. Based on informal communications with other broker/dealers and institutional clients, this information will generally not be available and will result in the sourcing of most of these receipts to the state.

Compliance and audit administration would both be enhanced by clarifying that all such receipts qualify for the 8% qualified financial instrument location. There also appears to be inconsistency in the drafting of the provision. Other income subject to the 8% election should include all income from correspondent and institutional customer activities. In such relationships (whether with another broker-dealer, hedge fund, etc.), the market sourcing is the location of the ultimate customer.

#### Asset Management Fees

Similarly to correspondent relationships, taxpayers may receive asset management fees from numerous funds, and the associated customer sourcing information is often unavailable. These fees are generally calculated based on a percentage of assets under management. Many of them are earned from multiple tiers of entities (e.g., “fund of funds” scenarios) and there can be numerous investors in each fund, making sourcing determinations even more challenging. Again, if the taxpayer is unable to obtain this information, the taxpayer is required to source the receipts to the branch that generated the transaction.

The 8% qualified financial instrument election looks at the average amount of business conducted in New York as a percentage of the total country. Use of such a “census” approach is a practical method for sourcing these types of fees, since customer data will be difficult both to obtain and to audit.



Compliance and audit administration would both be enhanced by clarifying that all such receipts qualify for the 8% qualified financial instrument location.

#### New York City Conformity

In order to maintain efficiencies, New York City should conform to the reform proposals. This will enable the continuation of joint audits which enhances administration and compliance between the two agencies.

#### **Clarifications:**

##### Investment Capital

The word “indirect” should be added to Section 208-4 in order to clarify that stock that is held indirectly through an ownership interest in a partnership qualifies if the stock meets the other requirements contained in Section 208-5. This is consistent with the State’s current use of the aggregate method.

The word “investments” contained in the first sentence of Section 208-5 should be changed to “interests” to make it consistent with the definition contained in Section 208-4. The definition contained in the proposal will continue the current uncertainty of the subjective intentions of a taxpayer at the time when the stock is acquired. The six month holding period seems to be the objective standard that determines whether stock qualifies as investment capital.

The last sentence of Section 208-6 should be clarified to state that only taxpayers in the combined group that have made an election under Section 210-a(5)(a)(1)(A) must report all income as business income. Other taxpayers in the combined group who have not made the election since they are not subject to the provisions of Section 475 of the IRC should continue to be able to report investment income.

##### Financial Instrument

Section 210-a(5) defines a qualified financial instrument as an instrument if it is marked to market under Section 475 of the Internal Revenue Code. The definition should be clarified to include all positions that are marked to market under Section 475. For example, it is unclear whether foreign currency transactions that are accounted for under Section 475 are included as “instruments.”

##### Definition of Unitary Business

The proposed legislation does not define a unitary business. The closest language to a definition seems to be contained in Section 208-5 in the investment capital definition where it states that “if the taxpayer owns or controls, directly or indirectly, less than twenty percent of the stock of a corporation that entitles the holders thereof to vote for the election of trustees or directors, that corporation will be presumed to be conducting a business that is not unitary with the business of the taxpayer.” Is this language creating a bright line test which would mean that greater than 20%



ownership or control creates a unitary business? If so, it should be recognized that this 20% threshold could only be allowed to the extent constitutionally permissible. If corporations would not be considered to be involved in a unitary business under the principles of the US constitution, then they could not be compelled to file as part of a combined return.

#### Sourcing of Receipts Based upon Commercial Domicile of Customer

In lieu of sourcing receipts based upon the commercial domicile of the customer, it is recommended that a hierarchy of sourcing similar to the hierarchy that is presently contained in the provision for sourcing receipts from other services and other business receipts be included.

#### MTA Conformity

The MTA base and tax rate for calculating the surtax should be the same as the regular corporate franchise tax base.

We understand that your willingness to introduce the proposal in the next legislative budget session depends somewhat on having general support for it and, while there are of course varying views among our members on various aspects of it, there is a broad consensus of support for it among the SIFMA membership.

As always, if you need additional information or have any questions regarding our comments, please call me at 212-313-1233. Thank you for your consideration.

Sincerely,

N/S

Nancy Donohoe Lancia  
Managing Director, State Government Affairs