New York State Department of Taxation and Finance
Office of Tax Policy Analysis
Taxpayer Guidance Division

TSB-A-08(6)C
Corporation Tax
November 6, 2008

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. C070517B

On May 17, 2007, a Petition for Advisory Opinion was received from Renaissance Technologies Corporation, 800 Third Avenue, New York, NY 10022, c/o Nicholas A. Nesi and Harriet Sonnenschein, BDO Seidman, LLP, 330 Madison Avenue, New York, New York 10017. Petitioner, Renaissance Technologies Corporation, submitted additional information regarding the Petition on June 29, 2007.

The issue raised is whether Petitioner's payments for operating and overhead costs that Petitioner is obligated to incur pursuant to a Partnership Agreement, including compensation of employees responsible for management of the Partnership, are expenses attributable to business capital or investment capital for purposes of the Article 9-A corporation franchise tax.

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

Petitioner, a Delaware S corporation, is an investment securities manager with principal offices located at 800 Third Avenue, New York, New York. Petitioner is registered as an "investment advisor" with the Securities and Exchange Commission("SEC") pursuant to the Investment Advisors Act of 1940.

Petitioner also serves as the general partner in various limited partnerships operating as "hedge funds" formed under the Delaware Revised Uniform Limited Partnership Act (hereinafter a representative limited partnership is referred to as "LP"). Hedge funds are pooled investment vehicles, typically formed as limited partnerships, which employ active portfolio management to obtain above average capital gains for their own account. Hedge funds attempt to hedge against downturns in the markets through employing flexible investment strategies, such as short selling, leveraging, and utilizing derivatives (e.g., puts, calls, options, and futures).

Petitioner's rights and obligations with respect to LP are set forth in a Partnership Agreement. Specifically, paragraphs 4.4 and 4.5 set forth the provisions for Compensation and Expenses. Under the Partnership Agreement, Petitioner currently is entitled to receive an annual management fee ("Management Fee") equal to a percentage of the value of the limited partners' respective capital accounts on a set date. In accordance with the Partnership Agreement, the Management Fee is payable by LP in cash on the first day of each fiscal quarter or on any other date on which a capital contribution is received from any partner. In exchange for the fee, Petitioner, the General Partner, has an obligation to pay certain overhead expenses, and for the maintenance of offices, including the salaries, utilities, and office rent.

Specifically, paragraph 4.5(a) of the Partnership Agreement provides, in part:

> In consideration of the payment of the Management Fee to the General Partner . . . General Partner, not the Partnership, will pay all of its operating and overhead costs, including compensation of all employees responsible for management of the Partnership's investments and the General Partner will pay the following expenses:
>
> > (v) certain overhead expenses of the Partnership and the maintenance of offices, including salaries, utilities and office rent.

Petitioner's right to receive a Management Fee from LP is fixed and guaranteed regardless of the fund's performance. LP deducts the Management Fee paid to Petitioner as an expense necessary to generate income. Petitioner includes the Management Fee as business income on its New York State S Corporation Franchise Tax Return.

The Partnership Agreement also provides that Petitioner, as LP's general partner, is entitled to receive allocations of profits generated by LP's investment activities ("Performance Allocation"). The Partnership Agreement provides that Petitioner will receive its distributive share of income or loss, and may receive a Performance Allocation of up to 44 percent of any positive performance change in the limited partners' capital accounts for a given period.

The Performance Allocation is an allocation of profits which are generated from the LP's investment activities and passed through from LP to Petitioner. The Performance Allocation is not fixed and guaranteed; it is made only if there is a positive performance change in a given year. LP does not deduct the Performance Allocation as an expense necessary to generate income. Petitioner includes the Performance Allocation as investment income on its New York State S Corporation Franchise Tax Return.

Applicable law and regulations

Section 208 of the Tax Law provides, in part:

> 5. The term "investment capital" means investments in stocks, bonds and other securities, corporate and governmental, not held for sale to customers in the regular course of business, exclusive of subsidiary capital and stock issued by the taxpayer, provided, however, that, in the discretion of the commissioner, there shall be deducted from investment capital any liabilities which are directly or indirectly attributable to investment capital; …
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> 6. The term "investment income" means income, including capital gains in excess of capital losses, from investment capital, to the extent included in computing entire net income, less, (a) in the discretion of the commissioner, any deductions allowable in computing entire net income which are directly or indirectly attributable to investment capital or investment income, and (b) such portion of any net operating loss deduction allowable in computing entire net income, as the investment income, before such

deduction, bears to entire net income, before such deduction, provided, however, that in no case shall investment income exceed entire net income;

Section 208.9(b) of the Tax Law provides, in part:

Entire net income shall be determined without the exclusion, deduction or credit of:

* * *

(6) in the discretion of the tax commission, any amount of interest directly or indirectly and any other amount directly or indirectly attributable as a carrying charge or otherwise to subsidiary capital or to income, gains or losses from subsidiary capital.

Section 4-8.4 of the Article 9-A Regulations (Regulations) provides:

Deduction of expenses. (a) Investment income must be reduced by any deductions allowed in computing entire net income which are directly or indirectly attributable to investment capital or investment income. Deductions allowed in computing investment income are not taken into account in computing business income.

(b) Deductions allowed in computing entire net income which are directly attributable to investment capital or investment income include, among others: interest incurred to carry investment capital, safe deposit box rentals, financial news subscriptions, salaries of officers and employees engaged in the management and conservation of stocks, bonds and other securities included in investment capital, investment counsel fees, custodian fees, the cost of insurance and fidelity bonds covering investment capital, and legal expenses relating to investment capital.

Opinion

Petitioner, a Delaware S corporation, is an investment securities manager and is registered as an "investment advisor" with the SEC. Petitioner also serves as the general partner in various limited partnerships operating as "hedge funds" formed under the Delaware Revised Uniform Limited Partnership Act ("LP").

Petitioner's rights and obligations with respect to LP are set forth in a Partnership Agreement. Under the Partnership Agreement, Petitioner currently is entitled to receive an annual Management Fee equal to a percentage of the value of the limited partners' respective capital accounts on a set date. In accordance with the Partnership Agreement, the Management Fee is payable by the Partnership in cash on the first day of each fiscal quarter or on any other date on which a capital contribution is received from any partner.

The Partnership Agreement also provides that Petitioner, as LP's general partner, is entitled to receive allocations of profits ("Performance Allocation") generated by LP's investment activities. The Partnership Agreement provides that Petitioner will receive its distributive share of income or loss, and may receive a Performance Allocation of up to 44 percent of any positive performance change in the limited partners' capital accounts for a given period. The Performance Allocation is not fixed and guaranteed; it is made only if there is a positive performance change in a given year.

Article 9-A requires taxpayers to characterize most deductions as either (1) directly attributable to subsidiary, investment, or business capital or (2) not directly attributable to a class of capital. Section 208.6 of the Tax Law provides that deductions that are directly attributable to investment capital are subtracted from income derived from investment capital when computing investment income. The deductions that are not directly attributable to one or more of the three classes of capital are treated as indirectly attributable to the three classes of capital. See Technical Services Bureau memorandum *Attribution of Noninterest Deductions*, January 8, 1996, TSB-M-95(2)C.

Section 4-8.4 of the Article 9-A Regulations requires investment income to be reduced by any amount of deductions that are directly attributable to investment income. Deductions allowed in computing entire net income which are directly attributable to investment capital or investment income include, among others: interest incurred to carry investment capital, safe deposit box rentals, financial news subscriptions, salaries of officers and employees engaged in the management and conservation of stocks, bonds and other securities included in investment capital, investment counsel fees, custodian fees, the cost of insurance and fidelity bonds covering investment capital, and legal expenses relating to investment capital.

Petitioner requests an opinion on whether its payments for certain expenses, including compensation of employees responsible for the management of LP, are treated as deductions attributable to business or investment capital. Noninterest deductions may be attributable to more than one class of capital. At the election of the taxpayer, certain noninterest deductions are irrebuttably presumed to be attributable to business capital, and the taxpayer is only required to substantiate the nature and the amount of the expenses treated as deductions. See TSB-M-95(2)C, *supra*.

Compensation received through a management fee arrangement between the taxpayer and another entity is treated as business income. Noninterest expenses compensated for by the management fee are irrebuttably presumed to be attributable to business income, to the extent that the expenses are reimbursed through the management fee, provided that the fee is paid pursuant to a written agreement and the nature and the amount of the expenses are substantiated. See TSB-M-95(2)C, *supra.*

Petitioner receives a Management Fee as the general partner of LP and in exchange for this fee is required to provide services for and pay the expenses of LP. The fee is payable

pursuant to the written Partnership Agreement. Therefore Petitioner is required to report the management fee income as business income and may make the election to attribute those expense deductions that are reimbursed by the Management Fee to business income, provided that those expenses do not exceed business income and the nature and the amount of the expenses are substantiated. Whether a specific expense is reimbursed through the Management Fee and is thus deductible from business income is determined by examining the written agreement between Petitioner and LP, and verifying the nature and amount of expenses reimbursed, through an examination of the books and records of Petitioner. Such an examination takes place in the conduct of an audit and is not determinable in this Advisory Opinion. An advisory opinion merely sets forth the applicability of pertinent statutory and regulatory provisions to "a specified set of facts." Tax Law, §171.Twenty-fourth; 20 NYCRR 2376.1(a).

All other expenses not reimbursed by the Management Fee pursuant to a written agreement that are deducted by Petitioner must be either directly or indirectly attributed to the appropriate class of capital. Whether an expense is directly attributed to a particular class of capital is determined by whether the expense proximately, and not incidentally, benefits a certain class of capital. If a particular noninterest deduction is attributable to more than one class of capital, Petitioner should directly attribute a portion of such deduction to the class of capital that was proximately benefitted by the expense which gave rise to the deduction. See TSB-M-95(2)C, *supra.*

Any residual noninterest deductions are indirectly attributed to each of the three classes of capital by a formula allocation. The amount of the residual noninterest deductions is determined by subtracting the sum of those noninterest deductions attributed directly to each class of capital from the total amount of attributable noninterest deductions. See TSB-M-95(2)C, *supra.*

DATED: November 6, 2008

/s/
Jonathan Pessen
Tax Regulations Specialist IV
Taxpayer Guidance Division

NOTE: An Advisory Opinion is issued at the request of a person or entity. It is limited to the facts set forth therein and is binding on the Department only with respect to the person or entity to whom it is issued and only if the person or entity fully and accurately describes all relevant facts. An Advisory Opinion is based on the law, regulations, and Department policies in effect as of the date the Opinion is issued or for the specific time period at issue in the Opinion.