New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB-A-97(15)C
Corporation Tax

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. C970321B

On March 21, 1997, a Petition for Advisory Opinion was received from Coopers & Lybrand, LLP, 1301 Avenue of the Americas, New York, New York 10019-6013.

The issue raised by Petitioner, Coopers & Lybrand, LLP, is whether the "distortion" requirement of section 6-2.3 of the Business Corporation Franchise Tax Regulations ("Article 9-A Regulations"), may be satisfied by two or more corporations seeking to file combined reports where one of the corporations is taxed as a "cooperative" under Subchapter T of the Internal Revenue Code ("IRC").

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

Corporation X, a New York taxpayer, is an investment banking firm which is involved in all major areas of investment banking, securities sales and trading, securities research, investment advising, money management and risk arbitrage. Its principal activity is that of a full-service broker-dealer providing a wide range of financial services to retail and institutional clients, including securities and options brokerage, investment banking and investment advisory services. It also trades in corporate, government, municipal and federal agency securities for its own account.

Corporation X owns 80 percent of the voting stock of Corporation Y, another New York taxpayer. Corporation Y acts as a clearing broker for Corporation X and other broker-dealers and is treated for federal income tax purposes as a non-exempt cooperative under Subchapter T (sections 1381-1388) of the IRC. As a clearing broker, Corporation Y processes and settles the securities transactions of Corporation X and its other owners (the "patrons") in exchange for fees. Fees charged by Corporation Y generally approximate its cost of providing clearing services to Corporation X and its other patrons, rather than an arm's length charge. In fact, amounts charged to Corporation X and its other patrons for services provided by Corporation Y are sometimes less than cost because Corporation Y engages in certain other income-producing activities related to its cooperative business, the income from which is used to offset the cost of the services provided to Corporation X and its other patrons. Corporation Y derives more than 50 percent of its receipts from the fees which it charges for services provided to Corporation X.

As a cooperative, Corporation Y distributes the taxable income which it earns in the conduct of its cooperative business to Corporation X and its other patrons in proportion to their volume of business with Corporation Y. Corporation Y is allowed to deduct these distributions ("patronage dividends"), and as a consequence, Corporation Y generally does not report federal taxable income or loss. Petitioner states that to qualify as patronage dividends under section 1388(a) of the IRC, distributions of earnings derived from patronage-related activities must be made pursuant to a pre-existing obligation of the

cooperative to pay such amounts, and must be based on the quantity or value of business done with or for each patron, not on the basis of relative stockholdings.

Petitioner is not asking whether the distortion requirement is actually satisfied, rather, the question focuses on whether a finding of distortion would necessarily be precluded where one or more of the corporations seeking permission to file a combined report is a cooperative and generally reports no federal taxable income or loss. It is assumed that Corporation X and Corporation Y satisfy the stock ownership and unitary business requirements for filing a combined report.

Section 6-2.1 of the Article 9-A Regulations provides that:

> (a) Every corporation is a separate taxable entity and shall file its own report. However, the [Commissioner of Taxation and Finance], in [his] discretion, may require a group of corporations to file a combined report or may grant permission to a group of corporations to file a combined report where:
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> (1) the requirement of stock ownership or control (as described in section 6-2.2(a) of this Part) is met;
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> (2) the group of corporations is engaged in a unitary business (as described in section 6-2.2(b) of this Part); and
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> (3) the other requirement set forth in section 6-2.3 ... of this Part ... has been met.
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> (b) Each corporation in the combined report must compute and show the tax which would have been required to be shown if filed on a separate basis.
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> (c) The decision to permit or require a combined report will be based on the facts in each case using the requirements set forth in this Part.

Section 6-2.3 of the Article 9-A Regulations provides that:

> (a) If the capital stock and unitary business requirements described in section 6-2.2 of this Part have been met, the [Commissioner of Taxation and Finance] may permit or require a group of taxpayers to file a combined report if reporting on a separate basis distorts the activities, business, income or capital in New York State of the taxpayers. The activities, business, income or capital of a taxpayer will be presumed to be distorted when the taxpayer reports on a separate basis if there are substantial intercorporate transactions among the corporations.
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> ...

(c) In determining whether there are substantial intercorporate transactions, the [Commissioner of Taxation and Finance] will consider transactions directly connected with the business conducted by the taxpayer, such as:

(1) manufacturing or acquiring goods or property or performing services for other corporations in the group;

(2) selling goods acquired from other corporations in the group;

(3) financing sales of other corporations in the group; or

(4) performing related customer services using common facilities and employees.

Service functions will not be considered when they are incidental to the business of the corporation providing such service. Service functions include, but are not limited to, accounting, legal and personnel services. The substantial intercorporate transaction requirement may be met where as little as 50 percent of a corporation's receipts or expenses are from one or more qualified activities described in this subdivision. It is not necessary that there be substantial intercorporate transactions between any one member with every other member of the group. It is, however, essential that each corporation have substantial intercorporate transactions with one other corporation or with a combined or combinable group of corporations...

(d) If a taxpayer fails to meet the presumption of distortion because it does not have substantial intercorporate transactions with any corporation described in section 6-2.2 of this Part or with a combined or combinable group of such corporations and if the filing of a report on a separate basis nevertheless results in a distortion of such taxpayer's activities, business, income or capital in New York State then the [Commissioner of Taxation and Finance] will permit or require the filing of a combined report. If a taxpayer meets the presumption of distortion because it has substantial intercorporate transactions with any corporation described in section 6-2.2 of this Part or with a combined or combinable group of such corporations and if the filing of a report on a separate basis does not result in a distortion of such taxpayer's activities, business, income or capital in New York State, then the [Commissioner of Taxation and Finance] will not permit or require the filing of a combined report....

In this case, it is assumed that Corporation X and Corporation Y meet the stock ownership requirement and the unitary business requirement of section 6-2.1 of the Article 9-A Regulations. The third requirement set forth in section 6-2.3 of the Article 9-A Regulations discusses the distortion of activities, business, income or capital in New York State of a group of taxpayers that may occur if they report on a separate basis. The fact that Corporation Y does not generally

have federal taxable income or loss would not preclude the finding of distortion of the activities, business, income or capital between Corporation X and Corporation Y pursuant to section 6-2.3 of the Article 9-A Regulations.

However, the question of whether Corporation X and Corporation Y meet the distortion requirement set forth in section 6-2.3 of the Article 9-A Regulations is a question of fact that is not susceptible of determination in an advisory opinion. Tax Law, §171.Twenty-fourth; 20 NYCRR 2376.1(a).

/s/
DATED: June 26, 1997 John W. Bartlett
Deputy Director
Technical Services Bureau

NOTE: The opinions expressed in Advisory Opinions are limited to the facts set forth therein.