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

TSB-A-89 (10) I
Income Tax
February 1, 1989

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. Z880923A

On September 23, 1988, a Petition for Advisory Opinion was received from Bryan R. Sullivan, 200 E. Randolph Drive, Suite 7750, Chicago, Illinois 60601.

The issue raised is whether, under several sets of circumstances, a nonresident individual is subject to tax under Article 22 of the Tax Law when the individual has commodity trading profits or receives dividends from a corporation. Specifically:

(1) when the individual appears frequently, if not daily, on the floor on a New York City exchange to execute his own trades;

(2) when the individual reports his trading activities on Schedule C of his federal income tax return and reports his business address as either the out-of-state residence or the address of the New York exchange on which he trades.

(3) when the individual owns the corporation;

(4) when the business of the corporation is expanded to clear the trades of the individual's profit sharing plan; or

(5) when the business of the corporation is expanded to clear the trades of other individuals.

Facts

Client A, who is a resident of New Jersey, is a commodities trader. Client A trades solely for his own account. He does not perform any services as a dealer or broker.

Client A enters into numerous trades for his own account. At one time, he cleared his trades through various clearing members of commodities exchanges, but the clearing costs were prohibitively high. In order to reduce those costs, Client A formed Corporation X. The corporation was incorporated in New York. Client A has always owned 100 percent of the corporation's stock, and has always held all officer positions except vice-president. Another employee of Corporation X has always held the vice-president's office. Corporation X leases an office in Manhattan.

Corporation X lists four exchange memberships among its assets. Two of the memberships are titled in Client A's name, and two of the memberships are titled in the name of Corporation X's vice-president. Client A actually owns the memberships, and grants Corporation X permission to use the seats to obtain corporate privileges on the exchanges. Client A receives no payments from

Corporation X for its use of the memberships. This format is followed because a corporation cannot register a membership in its own name. A membership must be registered in an individual's name.

The sole business of Corporation X is clearing or processing trades. Corporation X does not trade for its own account. Furthermore, Corporation X is not a futures commission merchant. Pursuant to requirements of the Commodity Futures Trading Commission, Corporation X is thus permitted to clear trades only for its officers and shareholders. To date, Corporation X has cleared only Client A's trades. Client A materially participates in the trade or business activities of Corporation X. Client A pays fees to Corporation X for clearing his trades.

Corporation X has elected subchapter S status for federal income tax purposes and has filed federal subchapter S returns each year. A similar election has not been filed for New York purposes. Accordingly, Corporation X files New York franchise tax reports as a regular "C" corporation.

Corporation X might in the future distribute dividends to Client A. In addition, Corporation X might begin to clear trades in addition to Client A's personal trades. Specifically, Corporation X might begin clearing the trades of Client A's profit sharing plan, as well as the trades of individuals who have no ownership interest in Corporation X.

Client A is also considering whether to report his individual trading on Schedule C of his federal return. No income would be reported on Schedule C. Instead, the "other income" line would refer to a statement which would read as follows:"Taxpayer is a trader and all income is properly reported on Schedule D and Form6781." Trading expenses would be reported as ordinary and necessary business expenses on Schedule C, rather than as investment expenses on Schedule A.

Discussion

Petitioner states that Client A is a nonresident individual who has income from intangible personal property, namely, trading profits from trading commodities for his own account and dividends from wholly owned Corporation X.

Section 601(e) of the Tax Law imposes a personal income tax for each taxable year on a nonresident individual's taxable income which is derived from sources in New York State. The tax is equal to the tax computed as if the individual were a resident, reduced by certain credits and multiplied by a fraction, the numerator of which is the individual's New York source income and the denominator of which is the individual's federal adjusted gross income.

Section 631 of the Tax Law provides that:

> (a) General. The New York source income of a nonresident individual shall be the sum of the net amount of items of income, gain, loss and deduction entering into his federal adjusted gross income, as defined in the laws of the United States for the taxable year, derived from or connected with New York sources ....

(b) Income and deductions from New York sources.

(1) Items of income, gain, loss and deduction derived from or connected with New York sources shall be those items attributable to:

(A) the ownership of any interest in real or tangible personal property in this state; or

(B) a business, trade, profession or occupation carried on in this state;

. . . .

(2) Income from intangible personal property, including annuities, dividends, interest, and gains from the disposition of intangible personal property, shall constitute income derived from New York sources only to the extent that such income is from property employed in a business, trade, profession, or occupation carried on in this state.

. . . .

(d) Purchase and sale for own account. A nonresident, other than a dealer holding property primarily for sale to customers in the ordinary course of his trade or business, shall not be deemed to carry on a business, trade, profession or occupation in this state solely by reason of the purchase and sale of property or the purchase, sale or writing of stock option contracts, or both, for his own account.

For federal income tax purposes, it must be determined whether Client A's activities constitute the conduct of a trade or business. Section 162 of the Internal Revenue Code provides a deduction for "trade or business expenses". However, the term "trade or business" is not defined in either the Internal Revenue Code or the Treasury Regulations promulgated thereunder. Historically, a facts, and circumstances approach has been used in determining when an activity is considered a trade or business. In 1987, the U.S. Supreme Court found that the offering of goods and services is not an absolute prerequisite to be considered in a trade or business. In Commissioner v. Groetzinger, a full-time gambler, who had no other profession or employment and who did not place bets for others or give tips, but did gamble solely for his own account, was considered to be the equivalent to a securities speculator by the Tax Court. The Appeals Court affirmed and the Supreme Court agreed.(94 L. Ed. 2d 25; 107 S. Ct. 980). In Groetzinger, the Supreme Court stated that "[t]o be engaged in a trade or business, the taxpayer must be involved in the activity with continuity and regularity and the taxpayer's primary purpose for engaging in the activity must be for income or profit." Therefore, an individual investor who devotes time to actively trading his own portfolio could argue that he is engaged in a trade or business, for federal income tax purposes, if he can show a profit motive.

Generally, when an activity constitutes a trade or business for federal income tax purposes, such activity would be treated as a trade or business for New York State personal income tax purposes. However, under section 631(d) of the Tax Law, a nonresident individual who executes trades for the individual's own account on the floor of a stock exchange in New York City, is not

deemed to be carrying on a business, trade, profession or occupation in New York State, unless the individual is a dealer holding property primarily for sale to customers in the ordinary course of the individual's trade or business.

Herein, Client A is frequently on the floor of a New York City stock exchange executing his own trades. However, Client A is not a dealer or trader of securities and Client A's trading profits are derived solely from trading commodities for his own account. Therefore, pursuant to section 631(d) of the Tax Law, it is irrelevant whether or not Client A's activities of trading commodities for his own account are deemed to be a trade or business for federal income tax purposes and reported on Schedule C of Client A's federal income tax return. Such activities would not be deemed to be a trade or business for New York State income tax purposes and such trading profits would not be subject to tax under Article 22 of the Tax Law.

Section 631(b) of the Tax Law provides that income from intangible property, including dividends, is income from New York State sources when such income is from property employed in a business, trade, profession or occupation carried on in New York State. Section 131.5(a) of the Personal Income Tax Regulations provides the following example:

> A, a resident of New Jersey, owns 100 percent of the stock of X Corporation, which operates a store in New York State. In 1980, the corporation pays A a salary of $20,000, all of which was earned in New York State, and a dividend of $2,000. A's income from New York State sources is his salary of $20,000, since the dividend is not income derived from New York State sources and thus not taxable for New York State personal income tax purposes.

Herein, Corporation X is a non-electing S corporation that is subject to tax under Article 9-A of the Tax Law. The New York State Court of Appeals, in People v. American Bell Telephone Co., 117 N.Y. 241, 255, has stated "[i]n no legal sense can the business of a corporation be said to be that of its individual stockholders." Therefore, it is immaterial where the business of Corporation X is conducted or the nature of its activities. The activities of Corporation X do not constitute the conduct of a business, trade, profession, or occupation of Client A, the sole stockholder. It is immaterial where the business of Corporation X is conducted or the nature of its activities.

Accordingly, the dividends Client A receives from Corporation X are not subject to tax under Article 22 of the Tax Law, pursuant to section 631(b)(2) of the Tax Law. It should be noted, that, pursuant to section 631(b)(1)(B) of the Tax Law, if Client A performs services for Corporation X

and receives compensation, such compensation would be subject to tax if such services were performed in New York State. See section 131.4 of the Personal Income Tax Regulations for guidance in determining the portion of such compensation that is derived from New York State sources.

DATED: February 1, 1989

s/FRANK J. PUCCIA
Director
Technical Services Bureau

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