ASSESSMENT OF PUBLIC COMMENT

DEPARTMENT OF TAXATION AND FINANCE

Written comments were received regarding proposal TAF-43-07-00015-P from the Securities Industry and Financial Markets Association (SIFMA). SIFMA states that it brings together the shared interests of more than 650 securities firms, banks and asset managers. The Department also received written comments regarding the proposal from Citigroup, Inc. and The Partnership for New York City.

SIFMA asserts that the proposed rule is inconsistent with the Tax Law and that it would result in a significant increase in tax liability for the securities industry. SIFMA notes that it has submitted an alternative proposal under which income from reverse repurchase agreements and securities borrow agreements (i.e., securities lending agreements from the perspective of the securities borrower) would be treated as investment income.

With respect to its assertion that the proposed rule is inconsistent with the Tax Law, SIFMA contends that "it is clear that under the existing statute a taxpayer's holding of a stock, bond or other security is investment capital as long as the property is not held for sale to customers in the regular course of business" and that "[t]he reverse [repurchase agreement] interest that is created when cash is paid by the buyer of the security in a [repurchase agreement] or the interest that is created when a security is borrowed is cash on hand and on deposit (or deemed cash if such interest is for no longer than six months and one day) in the taxpayer's hands and can be treated as either investment capital or business capital as the taxpayer elects." SIFMA contends, further, that there is no support in statute for addressing registered securities brokers and dealers differently from other taxpayers. The Department has examined repurchase agreements and securities lending agreements and the way they are used in the securities industry over the course of several years. As a result of this examination, the Department has determined that a better interpretation of the Tax Law is that reverse repurchase agreements and securities borrow agreements held by registered securities brokers and dealers do

not constitute cash on hand or on deposit and are not investment capital. It is noted that, in interpreting the relevant statutory provisions, it has been a longstanding and well-established practice to examine the parties to the transaction (see, 20 NYCRR 3-3.2[d][1][[iv] regarding taxpayers principally involved in the business of lending funds) and the nature of the transaction (see, 20 NYCRR 3-3.2 [d][1][[iii] regarding instruments acquired for the sale of goods or services).

SIFMA also disagrees with proposed new section 4-4.7 regarding receipts of registered securities brokers or dealers for purposes of computing the receipts factor of the business allocation percentage under Tax Law section 210.3(a)(9). SIFMA asserts that the proposed rule includes income from repurchase agreements and securities lending agreements in gross income from principal transactions for purposes of allocation without regard to whether the transaction involves the purchase or sale of such assets. SIFMA also maintains that interest expense should not be considered a cost of the securities in determining gross income and that there is no support for the position that interest expense from the transactions may not exceed interest income. As to the first point, SIFMA might be misreading the proposed rule. The proposed rule is not referring to the purchase or sale of repurchase agreements and securities lending agreements but to the purchase or sale of the underlying securities that are transferred pursuant to such agreements. Furthermore, the Department believes it to be a proper interpretation of the statute to include the interest expenses as a cost and to not allow gross income to be reduced below zero for purposes of calculating the receipts factor.

With respect to SIFMA's assertion that the proposed rule would result in a significant tax liability increase for the securities industry, it is noted that SIFMA did not submit any estimates or documentation in support of this position. It is further noted that the Regulatory Impact Statement (RIS) submitted with the proposed rule acknowledged that the change in interpretation may have a tax liability impact on particular taxpayers depending on their individual circumstances. It is also acknowledged that the liability of taxpayers under this proposal would be greater than the liability that would be calculated under a methodology that treats

the income as investment income and does not properly match expenses to income. However, as stated in the RIS, "[t]he Department has determined that ultimately there is no measurable tax liability impact on an industry-wide basis between the interpretation of the current rule, with a proper matching of expenses to income, and this rule." The Department has not received information that would change this assessment. Moreover, the rule sets forth what the Department believes is a better interpretation of the statute.

Under SIFMA's alternative proposal, income from reverse repurchase agreements and securities borrow agreements would be treated as investment income to the extent of the lesser of 0.15% (15 basis points) of the average amount of these transactions or 35% of the taxpayer's entire net income. This alternative does not take into account a taxpayer's actual income and expenses from this activity. Furthermore, it treats the income from reverse repurchase agreements and securities borrow agreements as investment income. The Department does not believe this treatment is appropriate.

Citigroup urges the Department to withdraw the proposed rule and asserts that the provisions that the repurchase agreements and securities lending agreements held by registered securities brokers and dealers constitute business capital are contrary to law. As discussed, the Department believes that the rule represents a proper interpretation of the statutory provisions. Citigroup estimates that the industry-wide additional tax liability under the rule would be fifty million dollars when compared to a calculation using a proper matching of expenses to income. It appears that these estimates presume that income from securities lending agreements would have been previously treated as investment income. The Department does not agree with this position. Moreover, Citigroup does not provide sufficient information to confirm its estimates or to change the assessment in the RIS for the proposed rule. Citigroup also urges consideration of the industry proposal discussed above. Again, the Department does not believe the treatment in the alternative proposal is appropriate.

The Partnership for New York City urges the Department to withdraw the proposed rule and work with the financial services industry to develop an approach that would facilitate both administration and compliance using the alternative proposal developed by the financial services industry. The Department has worked with the industry and reviewed their alternative proposal. As discussed in the previous paragraphs, the Department does not believe the industry's alternative proposal is appropriate.

No changes were made to the rule as a result of these comments.