

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petition :
of :
ANAMETRICS, INC. : DECISION
for Redetermination of a Deficiency or for :
Refund of Corporation Franchise Tax under :
Article 9-A of the Tax Law for the years 1979, :
1980 and 1981. :

Petitioner, Anametrics, Inc., 30 Rockefeller Plaza, New York, New York 10112, filed an exception to the determination of the Administrative Law Judge issued on December 8, 1988 with respect to its petition for revision of a redetermination of a deficiency or for refund of corporation franchise tax under Article 9-A of the Tax Law for the years 1979, 1980 and 1981 (File No. 801768). Petitioner appeared by Steven C. Feinman, CPA. The Division of Taxation appeared by William F. Collins, Esq. (Anne W. Murphy, Esq., of counsel).

Neither party filed a brief. Oral argument, at the petitioner's request, was scheduled to be held on July 19, 1989. Petitioner did not appear for oral argument.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUE

Whether the gain or loss from the sale of precious metal contracts constitutes investment income as defined in Tax Law § 208(6).

FINDINGS OF FACTS

We find the facts as determined by the Administrative Law Judge and such facts are stated below and we find an additional fact as indicated below.

Petitioner, Anametrics, Inc. (hereinafter "Anametrics"), was in the business of providing financial advisory services, including a newsletter, to its clients. Anametrics frequently invested

for its own account in various securities and other investment devices. During the years in issue, 1979, 1980 and 1981 (hereinafter the "audit period"), and specifically in 1979 and 1980, Anametrics purchased and sold contracts for gold and silver. It reported the gain or loss from the sales of these contracts on Schedule D of its Federal Form 1120, United States Corporation Income Tax Return, for the respective years.

During the course of the audit, petitioner executed two consents extending the period of limitation for the assessment of tax under Article 9-A for the years 1979 and 1980 until December 31, 1984.

On November 2, 1984, the Division of Taxation issued to Anametrics three statements of audit adjustment based upon a field audit of petitioner's books and records. One Statement of Audit Adjustment was issued for each of the years in the audit period. The statements contained the following explanations:

	<u>Period Ended</u> <u>12/31/79</u>	<u>Period Ended</u> <u>12/31/80</u>	<u>Period Ended</u> <u>12/31/81</u>
Tax per audit	\$1,859.00	\$61,721.00	\$4,249.00
Tax per report	1,218.00	31,730.00	3,783.00
Deficiency	614.00 [sic] ¹	29,991.00	466.00

The Statement of Audit Adjustment issued for the year 1979 set forth a tax deficiency of \$641.00 and interest of \$417.00, for a total of \$1,058.00. For the year 1980, the Statement of Audit Adjustment set forth a tax deficiency of \$29,991.00 and interest of \$16,593.00, for a total of \$46,584.00. For the year 1981, the Statement of Audit Adjustment set forth a tax deficiency of \$466.00 and interest of \$186.00, for a total amount due of \$652.00.

On November 2, 1984, the Division issued three notices of deficiency to Anametrics which set forth the following amounts of tax and interest due for each of the periods:

¹ Schedule A of the field audit report submitted in evidence as the Department's Exhibit "H" indicates that the correct deficiency for the period ended 12/31/79 was calculated to be \$641.00, which also corresponds to the amount of the deficiency set forth at the top of the Statement of Audit Adjustment and also on the Notice of Deficiency. It appears that the statement of "\$614.00" in the explanation was a mere transposition of numerals.

<u>Period Ended</u>	<u>Tax</u>	<u>Interest</u>	<u>Total Due</u>
12/31/79	\$ 641.00	\$ 417.00	\$ 1,058.00
12/31/80	29,991.00	16,593.00	46,584.00
12/31/81	466.00	186.00	652.00

Petitioner disputes only that portion of the deficiency which was based upon the Division's disallowance of petitioner's inclusion of its gain or loss from the sales of metals contracts in computing its investment income for the years 1979 and 1980. Said disallowance was a result of the Audit Division's conclusion that metals contracts do not fall within the definition of "other securities" as that term is defined in the regulations and, therefore, the gain or loss from said sales should be excluded from investment income or loss and included in business income or loss.

We find in addition to the facts found by the Administrative Law Judge that the metal contracts at issue were traded in the open market or on a recognized exchange.

OPINION

The Administrative Law Judge determined that the precious metal contracts purchased and sold by petitioner did not exhibit the essential characteristics of securities. Thus, they were not includable within the definition of investment capital as provided in 20 NYCRR 3-4.2.

Petitioner on exception argues that the precious metal contracts properly fall within the meaning of "other securities" and therefore ought to be treated as investment capital under 20 NYCRR 3-4.2(a).

We affirm the determination of the Administrative Law Judge.

Tax Law § 208(5) defines investment capital as follows:

"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 tax commission, there shall be deducted from investment capital any liabilities which are directly or indirectly attributable to investment capital."

Tax Law § 208(6) defines investment income, in pertinent part, as follows:

"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"

The regulation at 20 NYCRR 3-4.2 provides, in relevant part, as follows:

"(a) The term investment capital means the total of the average fair market value of the taxpayer's investments in stocks, bonds and other securities issued by any corporation (other than the taxpayer, a subsidiary or a DISC) or by the United States, any state, territory or possession of the United States, the District of Columbia, or any foreign country, or any political subdivision or governmental instrumentality of any of the foregoing."

The term "other securities" is limited in the regulations to:

". . . securities issued by governmental bodies and securities issued by corporations of a like nature as stocks and bonds, which are customarily sold in the open market or on a recognized exchange, designed as a means of investment, and issued for the purpose of financing corporate enterprises and providing a distribution of rights in, or obligations of, such enterprises." (20 NYCRR 3-4.2[c]).

The Appellate Division recently held that commodities futures contracts did not constitute "other securities" within the definition of 20 NYCRR 3-4.2[c] (Matter of Carret & Co. v. State Tax Commn., 148 AD2d 40; 543 NYS2d 216). We find Carret controlling. In that decision the court, quoting a United States Supreme Court decision, stated that the test for determining if an interest is a security is whether the scheme involves "an investment of money in a common enterprise with profits to come solely from the efforts of others" (Matter of Carret & Co. v. State Tax Commn., *supra*, 543 NYS2d 216, 217 quoting Securities & Exch. Commn. v. Howey Co., 328 US 293, 301). Here petitioner was in no way involved in a common enterprise. The expectation of profit did not depend upon the continuing efforts of any third party; it arose solely from the speculative hope that the market price of the underlying precious metal would vary in petitioner's favor, permitting purchase or sale at a profit. Thus, under the Howey test, the precious metal contracts at issue failed to meet the requirements for a security.

Petitioner neither addresses the court's decision in Carret nor challenges the validity of the Department's regulations but simply contends that the precious metal contracts are "other

securities" and, hence, constitute investment capital under subdivision 5 of § 208 of the Tax Law. The court in Carret explicitly ruled that the regulation at issue is in harmony with the spirit and purpose of the statute (Matter of Carret & Co., supra). Plainly, 20 NYCRR 3-4.2(c) limits "other securities" to those securities that meet all of the elements enunciated therein.

In determining whether the gain or loss from the trading of precious metal contracts falls within "other securities" in the regulations, it is proper to look to the function of these instruments, to search for substance over form with emphasis on economic reality (Matter of Avon Products, Inc. v. State Tax Commn., 90 AD2d 393; 458 NYS2d 278). First, there is no dispute that the metal contracts are sold in the open market or on a recognized exchange.

Next we must decide whether petitioner's metal contracts were designed as a means of investment. Investment is defined as "[a]n expenditure to acquire property or other assets in order to produce revenue . . . [t]he placing of capital or laying out of money in a way intended to secure income or profit from its employment" (Black's Law Dictionary 741 [5th ed. 1979]). It is clear that petitioner purchased the metal contracts with the expectation of financial gain. As such, they are a means of investment. The transaction in this case is distinguishable from the one found in Matter of Pohatcong Investors, Inc. (Tax Appeals Tribunal, December 1, 1988) where the petitioner's income did not come from the purchase of the instrument, but rather solely from the creation and sale of the option itself.

We next address whether the metal contracts were created for the purpose of financing corporate enterprises and providing a distribution of rights in, or obligations of such enterprises. The precious metal contracts were executory contracts binding the holder to purchase or sell gold or silver at a specific price at a future date. They were not issued for the purpose of financing corporate enterprises and did not distribute any rights in or obligations of a corporate entity (Carret & Co. v. State Tax Commn., 148 AD2d 40; 543 NYS2d 216).

Petitioner argues that since the Internal Revenue Service treats the gain on the trading of precious metal contracts as a capital gain, it is inconsistent for the Department of Taxation to

treat the same as an item of business capital. Other than making this assertion, petitioner has presented no argument demonstrating that the federal income tax treatment of these contracts requires, or even suggests, that such contracts should be treated as investment capital for purposes of the corporate franchise tax.

In sum, we conclude that the precious metal contracts do not constitute "other securities" in the regulations and the income from the trading of such instruments is not investment income as defined in Tax Law § 208(6).

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the petitioner, Anametrics, Inc., is denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petition of Anametrics, Inc. is denied; and
4. The three notices of deficiency issued on November 2, 1984 are sustained.

DATED: Troy, New York
December 21, 1989

/s/John P. Dugan
John P. Dugan
President

/s/Francis R. Koenig
Francis R. Koenig
Commissioner

/s/Maria T. Jones
Maria T. Jones
Commissioner