STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
ASTORIA FINANCIAL CORPORATION	:	DECISION DTA NO. 820197
for Redetermination of a Deficiency or for Refund of Franchise Tax on Banking Corporations under Article 32 of the Tax Law for the Years 1999, 2000 and 2001.	: : :	

Petitioner, Astoria Financial Corporation, filed an exception to the determination of the Administrative Law Judge issued on August 10, 2006. Petitioner appeared by Marcum & Kliegman, LLP (Steven P. Bryde, Esq., of counsel). The Division of Taxation appeared by Daniel Smirlock, Esq. (Jennifer Baldwin, Esq., of counsel).

Petitioner filed a brief in support of its exception and a reply brief. The Division of Taxation filed a brief in opposition. Oral argument at petitioner's request was heard on May 21, 2007 in New York, New York.

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

*ISSUE*S

I. Whether a building and equipment of petitioner qualify as "principally used in the ordinary course of taxpayer's trade or business as a broker or dealer" of the type described in Tax Law § 1456(i)(2).

II. Whether petitioner improperly omitted certain assets, including "Net Deferred Tax Asset," in computing "taxable assets" pursuant to Tax Law § 1455 for the years 2000 and 2001.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

Issue One

Petitioner, Astoria Financial Corporation ("Astoria"), and its subsidiaries included in the New York State combined corporation franchise tax returns for the years 1999, 2000 and 2001 are banks and bank holding corporations pursuant to Tax Law Article 32. Astoria's principal place of business is located at One Astoria Federal Plaza, Lake Success, New York. Astoria is the holding company of Astoria Federal Savings and Loan Association ("Astoria Federal").

Prior to the years at issue, Astoria acquired Fidelity New York FSB ("Fidelity"), The Greater New York Savings Bank FSB ("The Greater"), and The Long Island Savings Bank ("LISB"). The acquisitions of Fidelity and The Greater were completed in 1995 and 1997, respectively, both acquisitions were accounted for as purchases, and together generated $281.5 million in total goodwill. The LISB acquisition was completed in 1998, and was accounted for as a pooling-of-interests. LISB's mortgage banking operations included offices in 11 states outside of New York State.

After the acquisition of LISB, Astoria decided to close all such out-of-state offices and consolidate their mortgage operations into one building in New York State. To this end, Astoria Federal purchased an office building in 1999, located at 2000 Marcus Avenue, Lake Success, New York. This building, including its structural components and significant building improvements made thereto during 1999, as well as all tangible personal property located therein, is owned by Astoria Federal, was acquired during 1999 by purchase (per Internal Revenue Code ["IRC"] § 179[d]), is depreciable property (per IRC § 167), has a useful life of four years or more, has a situs in New York, and is principally used (i.e., more than 50% of the building's usable floor space and more than 50% of the operating time of the tangible personal property) in the ordinary course of Astoria Federal's overall business.[1]

For the years 1996, 1997, 1998 and 1999, all of Astoria Federal's employees were located in New York State.

As part of the regular practice of its mortgage banking operations, Astoria originates mortgage loans, purchases mortgage loans, sells mortgage loans and terminates mortgage loans (via both principal repayments and "charge offs"). Each of these aspects of Astoria's mortgage banking operations is described, briefly, as follows:

> <u>Loan Originations</u>: Astoria's loan origination activities include receiving and processing mortgage loan applications and researching the creditworthiness of potential borrowers. Underwriters review the information gathered and determine whether to approve the loans. If a loan is approved, Astoria provides the borrower with cash in exchange for a promissory note. Astoria's mortgage loan originations for the years 1999, 2000, and 2001 totaled $3,338,905,000.00, $1,891,229,000.00 and $3,131,178,000.00, respectively.
>
> <u>Loan Purchases</u>: Astoria purchases mortgage loans, which have already been originated, from third parties. Astoria's mortgage loan purchases for the years 1999, 2000 and 2001 totaled $417,641,000.00, $836,782,000.00 and $1,427,099,000.00, respectively.
>
> <u>Loan Sales</u>: Astoria sells mortgage loans to third parties. Astoria sets loan sale prices, finds buyers, bundles and packages the loans for sale and verifies such sales. Astoria's mortgage loan sales for the years 1999, 2000 and 2001 totaled $490,687,000.00, $125,086,000.00 and $379,929,999.00, respectively.
>
> <u>Loan Terminations</u>: Astoria terminates positions in loans, either as the result of loans being paid off by the borrowers or in instances where the borrower has ceased making loan payments such that Astoria charges the loans off of its books as "bad loans." For the years 1999, 2000 and 2001, Astoria's loan

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[1] The last portion of this finding of fact, stating that the building, structural components, improvements and tangible personal property therein is "principally used . . . in the ordinary course of Astoria Federal's business," is not to be read as a fact that such use is in the "ordinary course of business" as a *"broker or dealer . . . of stocks, bonds or other securities . . .,"* in accordance with Tax Law § 1456(i)(2).

> terminations totaled $1,953,327,000.00, $1,480,860,000.00 and $3,463,650,000.00, respectively.

Included with Astoria's Banking Corporation Combined Franchise Tax Return (Form CT-32-A) for 1999 was a Claim for Investment Tax Credit for the Financial Services Industry (Form CT-44), by which Astoria claimed a credit in the amount of $701,785.00, consisting of $660,000.00 pertaining to the building at 2000 Marcus Avenue and $41,785.00 pertaining to the equipment therein.

As the result of an audit, the Division of Taxation ("Division") issued to Astoria a Notice of Deficiency dated August 4, 2003 asserting, for the year 1999, additional banking corporation franchise tax due in the amount of $701,785.00 plus Metropolitan Transportation District Surcharge due in the amount of $118,301.00, for a total amount of $820,086.00, plus interest. This notice resulted from the Division's disallowance of Astoria's investment tax credit claimed with respect to the building and equipment at 2000 Marcus Avenue.

On July 14, 2005, Astoria filed an Amended Banking Corporation Franchise Tax Return for the year 1999, and a Claim for Credit or Refund of Corporation Tax Paid (Form CT-8) for such year, claiming additional investment tax credit and a resulting tax refund in the amount of $712,277.00 based on additional qualified improvements made to the building at 2000 Marcus Avenue. Subsequent to the date of the hearing, and by mutual agreement of the parties, the Division audited Astoria's claim for additional credit or refund. As a result of this audit, the parties have executed a stipulation whereby the dollar amount of such claim has been reduced to $330,206.00, with such amount remaining in dispute in the same manner as the amount of investment tax credit originally claimed ($701,785.00) and disallowed by the Division.

By including mortgage originations as a qualifying activity for purposes of the investment tax credit, Astoria concluded that all of its "usable" floor space and all of the equipment in the building at 2000 Marcus Avenue were principally used in qualifying activities such that Astoria was entitled to the investment tax credit with respect to such building and equipment. By reference to the floor plans for the building, Astoria presented a breakdown by floor showing total square footage, nonusable square footage and qualifying square footage in the building, as follows:

AREA	NONUSABLE[2]	QUALIFYING	NONQUALIFYING	TOTAL
Cellar	32,002	1,653	0	33,655
First Floor	9,262	24,519	0	33,781
Second Floor	2,376	31,279	0	33,655
Third Floor	2,376	31,279	0	33,655
TOTAL	46,016	88,730	0	134,746

As noted, by including mortgage origination activities as qualifying activities for purposes of determining broker or dealer status, Astoria concluded that 100 percent of the total usable square footage (total square footage [134,746] less nonusable square footage [46,016] equals total usable square footage [88,730]) in the building was "qualifying footage" for purposes of the investment tax credit. While no information was provided as to the amount of time the equipment in the building was used, Astoria reasoned that since all of the activity in the building was qualified activity, then all of the equipment usage was, likewise, qualified usage.

In light of the Division's assertion that mortgage origination activities are not qualifying activities for broker or dealer status, and that the building and equipment therein did not, as a consequence, meet the "principal usage" test under Tax Law § 1456(i)(2), Astoria presented an additional breakdown by floor showing its calculation of qualifying and nonqualifying square

[2] Nonusable business floor space included the square footage for elevators, stairs, bathrooms, cafeterias, lounges and cellar parking area. There is no dispute between the parties as to the total amount treated as nonusable space (***see***, TSB-M-98[08]C).

footage in the building upon the assumption that mortgage origination activities are not qualifying activities, as follows:

AREA	NONUSABLE	QUALIFYING	NONQUALIFYING	TOTAL
Cellar	32,002	1,653	0	33,655
First Floor	9,262	15,069	9,450	33,781
Second Floor	2,376	19,379	11,900	33,655
Third Floor	2,376	17,250	14,028	33,655
TOTAL	46,016	53,352	35,378	134,746

Astoria continues to maintain that mortgage origination activities are qualified activities. However, even assuming such is not the case, by comparing total qualifying square footage (53,352) to total usable square footage (88,730) Astoria concluded that 60.13% of the usable square footage was qualifying square footage, and that the principal usage test for purposes of the investment tax credit was, in any event, met.

In recalculating the qualifying square footage under the assumption that mortgage origination activities were not qualified activities, Astoria continued to assert that the square footage devoted to the activities undertaken in certain areas of the bank, such as the mail room, computer systems, conference rooms and lobby, were properly classified as space entirely used in performing qualified activities, notwithstanding that origination activities occurred in such spaces. For other areas and activities, such as sales, closing rooms, compliance, retail processing, and the like, Astoria utilized a calculation to segregate qualifying activities from origination activities, by square footage, as follows:

QUALIFYING ACTIVITIES	NONQUALIFYING ACTIVITIES
Loans purchased $417,641,000	Loans purchased ..... $ 417,641,000
Loans sold 490,687,000	Loans originated 3,218,269,000
Total $908,328,000	Total $3,635,910,000

By comparing qualifying activities ($908,328,000) to allegedly nonqualifying activities ($3,635,910,000), Astoria calculated that 24.98 % of the usable square footage in these areas was qualified square footage. In turn, in areas where space allocations were made, the calculation of qualified square footage versus nonqualified square footage was based on 24.98%, as computed above, with the exception of:

—the category "appraisal," where Astoria calculated the qualified square footage at 15.247%, based on a comparison of loans sold ($490,687,000) to loans originated ($3,218,269,000); and

—the category "financial accounting," where Astoria calculated the qualified square footage at 23.72%, but did not specify the comparison used to arrive at such percentage.

The results of the foregoing calculations with regard to usable square footage for each area and each floor of the building are presented as follows:

CELLAR[3]

AREA	TOTAL SQ. FOOTAGE	QUALIFYING	NONQUALIFYING
Cellar	33,655	1653	0

FIRST FLOOR

AREA	TOTAL SQ. FOOTAGE	QUALIFYING	NONQUALIFYING
Mail room	864	864	0
Total lobby	1,884	1,884	0
Systems	2,376	2,376	0
Bank attorneys	3,744	3,744	0

[3] As noted in footnote "2", the parties do not dispute the calculation of nonusable business square footage, and such square footage is not included in the presentation of space allocation herein. Further, the Division has raised no dispute to Astoria's claim that 1,653 square feet of cellar space was used as a file room for loans sold and that this space would constitute qualifying square footage for purposes of the principal use test.

Total sales	11,156	2,787	8,369
Closing rooms	1,440	360	1,080
Conference rooms	3,055	3,055	0
Total	24,519	15,070	9,449

SECOND FLOOR

AREA	TOTAL SQ. FOOTAGE	QUALIFYING	NONQUALIFYING
Secondary marketing	8,688	8,688	0
Total compliance	1,680	420	1,260
Systems	2,952	2,952	0
Appraisal	1,028	157	871
Total retail processing	4,442	1,110	3,332
Total underwriting	4,968	1,241	3,727
Broker	1,200	300	900
Conference rooms	2,663	2,663	0
Correspondent	1,273	1,273	0
Financial. accounting	2,385	577	1,808
Total	31,279	19,379	11,898

THIRD FLOOR

AREA	TOTAL SQ. FOOTAGE	QUALIFYING	NONQUALIFYING
Commercial lending	5,440	0	5,440
Real estate owned	1,280	1,280	0
Payment processing	1,936	484	1,452
Collections	3,362	840	2,522
Total foreclosure	2,799	2,799	0
Customer service	2,600	649	1,951
Escrow & tax admin.	3,550	887	2,663
Payoffs	2,040	2,040	0
Conference rooms	3,232	3,232	0
Investor accounting	4,680	4,680	0

Systems	360	360	0
Total	31,279	17,251	14,028

Issue Two

For the years 2000 and 2001, Astoria determined its franchise tax liability on the basis of the alternative minimum tax measured by taxable assets. In determining the basis of tax for years prior to 2000, Astoria computed its alternative minimum tax measured by taxable assets using a balance sheet prepared in accordance with generally accepted accounting principles ("GAAP"). In contrast, for the years 2000 and 2001, Astoria computed its alternative minimum tax measured by taxable assets using a "tax balance sheet." The distinction between the two approaches is that Astoria arrived at its tax balance sheet by excluding or adjusting the amount of certain assets on its GAAP balance sheet which, Astoria asserts, gave rise to no specific income or expense item includible in the calculation of alternative entire net income. Among the various included and excluded asset amounts was the entire amount for goodwill related to Astoria's acquisitions of Fidelity and The Greater, which Astoria eliminated from its GAAP balance sheet in arriving at its tax balance sheet (and hence its taxable assets for alternative minimum tax purposes) on the premise that the annual amortized portion of such goodwill was not a deductible item in calculating Astoria's alternative entire net income.

The particular asset items and adjustment amounts for the two years are as follows:

-YEAR 2000-

ASSET CATEGORY	GAAP BALANCE SHEET	DEBIT (+)	CREDIT (-)	TAX BALANCE SHEET
Trade Notes & Acc'ts Rec'ble				
Accrued Interest Receivable	125,357,757	-----	(19,273,246)	106,084,511
Less: Allowance for bad debt	(2,007,915)	2,007,915	-----	-----
Total Trade Notes & Acc'ts Rec'ble	123,349,842	2,007,915	(19,273,246)	106,084,511
Mortgage and Real Estate Loans	7,663,569,728	4,041,231	(255,047,685)	7,412,563,274
Investment in Service Corp.	5,639,301	-----	(5,639,301)	-----
Mark to Market	(45,119,616)	45,119,616	-----	-----
Building & Other Deprec. Assets				
Office, Properties & Equipment	200,761,150	-----	-----	200,761,150
Less: Accumulated Deprec.	(78,331,425)	-----	(7,428,599)	(85,760,024)
Buildings & Other Deprec. Assets, Net	122,429,725		(7,428,599)	115,001,126
Goodwill	204,649,163	-----	(204,649,163)	-----
Due to/from AFC	272,159	-----	(272,159)	-----
Undistributed Earnings/Service Corps	4,779,646,712	-----	(571,838,026)	4,207,808,686
Deferred Acquisition Costs	1,075,379	-----	(1,075,379)	-----
Misc. Assets	33,250,424	-----	(32,789,810)	460,614
Net Deferred Tax Asset	121,935,415	-----	(121,935,415)	-----

-YEAR 2001-

ASSET CATEGORY	GAAP BALANCE SHEET	DEBIT (+)	CREDIT (-)	TAX BALANCE SHEET
Trade Notes & Acc'ts Rec'ble				
Accrued Interest Receivable	121,488,354	-----	(19,273,246)	102,215,108
Less: Allowance for bad debt	(1,757,252)	1,757,252	-----	-----
Total Trade Notes & Acc'ts Rec'ble	119,731,102	1,757,252	(19,273,246)	102,215,108
Mortgage and Real Estate Loans	8,270,077,081	4,041,231	(255,047,685)	8,019,070,627
Investment in Service Corp.	5,269,201	-----	(5,269,201)	5,639,301
Mark to Market	(3,101,616)	3,101,616	-----	-----
Building & Other Deprec. Assets				
Office, Properties & Equipment	209,293,415	-----	-----	209,293,415
Less: Accumulated Deprec.	(90,622,916)	-----	(7,428,599)	(98,051,515)
Buildings & Other Deprec. Assets, Net	118,670,499		(7,428,599)	111,241,900
Goodwill	185,406,922	-----	(185,406,922)	-----
Due to/from AFC	(1,495,337)	-----	1,495,337	-----
Undistributed Earnings/Service Corps	4,899,709,969	-----	(571,838,026)	4,327,871,943
Misc. Assets	64,822,059	331,132	(70,519,226)	(5,366,035)
Net Deferred Tax Asset	26,474,776	-----	(26,474,776)	-----

Astoria's balance sheet adjustments, as set forth above, resulted in net decreases to total assets for purposes of the alternative minimum tax based on taxable assets for each of the years 2000 and 2001. For 2000, GAAP (book) balance sheet total assets of $22,419,056,703.00 were increased by $51,168,762.00 and decreased by $1,219,948,783.00, to arrive at tax balance sheet total assets of $21,250,276,682.00. For 2001, GAAP (book) balance sheet total assets of $22,770,334,420.00 were increased by $9,231,231.00 and decreased by $1,139,762,344.00, to arrive at tax balance sheet total assets of $21,639,803,307.00. At hearing, Astoria conceded that the adjustment made to "office, properties and equipment" in the amount of $7,428,599.00 for each of the years, represented the annual depreciation on such assets and was incorrectly taken as an adjustment reducing the amount of such assets.

The August 4, 2003 Notice of Deficiency issued by the Division to Astoria (***see,*** findings of fact above) asserted additional banking corporation franchise tax due in the amount of $147,410.00 plus Metropolitan Transportation District Surcharge due in the amount of $25,059.00 for the year 2000, plus interest, and additional banking corporation franchise tax due in the amount of $121,765.00 for the year 2001, plus interest. This additional tax due results from the Division's calculation of Astoria's alternative minimum tax measured by taxable assets using the GAAP balance sheet rather than the tax balance sheet approach.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

Issue One

The Administrative Law Judge concluded that petitioner's origination of loans did not qualify as broker or dealer activity for purposes of testing whether the building at 2000 Marcus Avenue qualified as "principally used in the ordinary course of the taxpayer's trade or business as a broker or dealer in connection with the purchase or sale of . . . securities" within the meaning of Tax Law § 1456(i)(2). He also rejected petitioner's argument that more than 50% of the usable business floor space in the building was used in petitioner's activities as a broker or dealer even after eliminating those origination activities. Petitioner's assertion that 60.13% of the usable floor space was used in qualifying activities was found to be based on the faulty treatment of space devoted to computer systems, lobby, mail room, conference rooms, bank attorneys, and investor accounting. The Administrative Law Judge recalculated the use of floor space for those activities using petitioner's own percentage, 24.98% (***see,*** findings of fact above), and found that even on that theory only 45.34% of usable floor space was devoted to broker or dealer activities.

His calculations are as follows:

CELLAR

AREA	TOTAL SQ. FOOTAGE	QUALIFYING	NONQUALIFYING
Cellar	33,655	1653	0

FIRST FLOOR

AREA	TOTAL SQ. FOOTAGE	QUALIFYING	NONQUALIFYING
Mail room	864	216	648
Total lobby	1,884	471	1413
Systems	2,376	594	1782
Bank attorneys	3,744	3,744	0
Total sales	11,156	2,787	8,369
Closing rooms	1,440	360	1,080
Conference rooms	3,055	763	2,292
Total	24,519	8,935	15,584

SECOND FLOOR

AREA	TOTAL SQ. FOOTAGE	QUALIFYING	NONQUALIFYING
Secondary marketing	8,688	8,688	0
Total compliance	1,680	420	1,260
Systems	2,952	737	2,215
Appraisal	1,028	157	871
Total retail processing	4,442	1,110	3,332
Total underwriting	4,968	1,241	3,727
Broker	1,200	300	900
Conference rooms	2,663	665	1,998
Correspondent	1,272	1,272	0
Financial. accounting	2,384	577	1,808
Total	31,279	15,167	16,111

THIRD FLOOR

AREA	TOTAL SQ. FOOTAGE	QUALIFYING	NONQUALIFYING
Commercial lending	5,440	0	5,440
Real estate owned	1,280	1,280	0
Payment processing	1,936	484	1,452
Collections	3,362	840	2,522
Total foreclosure	2,799	2,799	0
Customer service	2,600	649	1,951
Escrow & tax admin.	3,550	887	2,663
Payoffs	2,040	2,040	0
Conference rooms	3,232	807	2,425
Investor accounting	4,680	4,680	0
Systems	360	90	270
Total	31,279	14,556	16,723

AREA	NON-USABLE	QUALIFYING	NONQUALIFYING	TOTAL
Cellar	32,002	1,653	0	33,655
First Floor	9,262	8,935	15,584	33,781
Second Floor	2,376	15,167	16,111	33,655
Third Floor	2,376	14,556	16,723	33,655
TOTAL	46,016	40,311	48,418	134,746

Total qualifying square footage..40,311
divided by:
Total usable square footage..88,730
Percentage of qualifying square footage..........................45.43%

Issue Two

On the second issue, the Administrative Law Judge found that the assets shown on the balance sheet of petitioner which was prepared for financial accounting purposes based on generally accepted accounting principles were includible in "taxable assets" within the meaning of section 1455(b)(1)(v)(A) of the Tax Law and section 18-5.2 of the regulations except for goodwill. Goodwill was excluded because it would not be taken into account "in the computation of alternative entire net income" as required by the definition set forth in the statute and regulations. With respect to other assets it was determined that the record lacked detail which would support petitioner's assertion that income or expenses of the assets would not be reflected in the computation of alternative entire net income.

ARGUMENTS ON EXCEPTION

With respect to the first issue, petitioner argues in support of its exception that both (i) loan originations without sales of those loans and (ii) terminations of loans as the result of repayment or foreclosure represent qualifying broker or dealer activities for purposes of section 1456(i)(2). Accordingly, in petitioner's view all of the usable floor space in the building at 2000 Marcus Avenue was used in qualifying activities. The Division argues in opposition that origination of a mortgage loan by itself is not a qualifying broker or dealer activity.

On the second issue petitioner asserts that the "net deferred tax asset" should not be included in taxable assets because a taxpayer is not allowed to deduct federal and state taxes in computing alternative entire net income. Petitioner also claims that loans should not be valued at book value based on generally accepted accounting principles but instead should be valued using loan loss reserves computed for tax purposes. The Division argues that petitioner has not sufficiently explained what is included in the net deferred tax asset on its balance sheet in order to justify the elimination of that amount from the tax computation. The Division also points out that the applicable regulations expressly require the use of book values for loans shown on the balance sheet (***see,*** 20 NYCRR 18-5.2[d]).

OPINION

The first issue is whether petitioner is entitled to reduce its franchise tax liability for 1999 by the investment tax credit provided in Tax Law § 1456(i)(2) which provides in part as follows:

> A credit shall be allowed under this subsection with respect to tangible personal property and other tangible property, including buildings and structural components of buildings, which are: depreciable pursuant to section one hundred sixty-seven of the Internal Revenue Code, have a useful life of four years or more, are acquired by purchase as defined in section one hundred seventy-nine (d) of the Internal Revenue Code, have a situs in this state and are (A) principally used in the ordinary course of the taxpayer's trade or business as a broker or dealer in connection with the purchase or sale (which shall include but not be limited to the issuance, entering into, assumption, offset, assignment, termination, or transfer) of stocks, bonds or other securities as defined in section four hundred seventy-five (c)(2) of the Internal Revenue Code, or of commodities as defined in section four hundred seventy-five (e) of the Internal Revenue Code, or (B) principally used in the ordinary course of the taxpayer's trade or business of providing investment advisory services for a regulated investment company as defined in section eight hundred fifty-one of the Internal Revenue Code, or lending, loan arrangement or loan origination services to customers in connection with the purchase or sale (which shall include but not be limited to the issuance, entering into, assumption, offset, assignment, termination, or transfer) of securities as defined in section four hundred seventy-five (c)(2) of the Internal Revenue Code . . . .

For a number of years prior to 1998, the Tax Law provided a credit for investment in property that qualified as "principally used" in the production of goods by manufacturing, processing, assembling, refining, mining, extracting, farming, agriculture, horticulture, floriculture, viticulture and commercial fishing. Similar credit provisions were contained in the personal income tax (Tax Law § 606[a][2]) and the franchise tax on business corporations (Tax Law § 210.12[b][i]). In 1998, the provisions were expanded to extend the credit to the financial services industry to the extent that the investment was made in property "principally used in the ordinary course of the taxpayer's business as a broker or dealer" of the type defined in the statute quoted above (***see,*** Tax Law §§ 210.12, 606[a], 1456[i], as amended by L 1998, ch 56).

The Division's regulations interpreting the statute prior to the 1998 amendments (20 NYCRR §§ 5-2.4[c], 106.1[d][3]) state in part as follows:

> The term *principally used* means more than 50 percent. A building or addition to a building is principally used in production where more than 50 percent of its usable business floor space is used in storage and production. Floor space used for bathrooms, cafeterias and lounges is not usable business floor space. Space used for offices, accounting, sales and distribution is not used in production. Dual purpose machinery is principally used in production when it is used in production more than 50 percent of its operating time.

The provisions as they existed prior to 1998 required that property be "principally used" in specific activities–*e.g.*, manufacturing–while the new additions to the statute require that the property be principally used in the ordinary course of a certain kind of broker or dealer business. Under the original provisions, property used in an integrated business would qualify only if it was used, for example, in manufacturing activities of the business but not in sales or distribution activities of the same business. As a result of the different phrasing of the new provisions, it might be appropriate to test the qualification of property used in an integrated business based on the predominant character of the business. Thus, if the business was predominantly that of a broker or dealer, all property principally used in that business would qualify, regardless of whether the isolated activity in which it was used could be characterized as a broker or dealer activity. If however, broker and dealer activities were merely ancillary or subordinate features of the business, the property would not qualify, even if it were used in those activities. If that approach were taken, it seems reasonable to suppose the character of the business would be determined by weighing such factors as revenue, income, investment, headcount, and floor space of different activities comprising the business. It appears from the facts that the predominant character of petitioner's business was that of a traditional mortgage lender, which makes loans with the purpose of profiting from the repayment of the principal amount with interest. In the present case most of the originated loans were held by petitioner until payment at maturity or termination through foreclosure rather than being packaged and sold through securitization or otherwise. Like the Administrative Law Judge, we do not view this type of business as that of a broker or dealer which seems to require buying from or selling to customers.

If we were instead to fragment petitioner's business into qualifying broker or dealer activities and non-qualifying lender activities and then attempt to allocate floor space between those activities, it would be necessary to make a detailed examination of the use of space in the building. Just how this might be done is unclear. Whatever methodology might be appropriate, petitioner would need to marshal the facts in a convincing way in order to succeed in its argument. This it has not done. Petitioner has relied instead on broad assertions that all of its space qualifies and alternatively that the space of entire departments qualifies without providing persuasive supporting analysis.

The second issue in this case concerns the inclusion of certain assets in the computation of "taxable assets" for purposes of the alternative minimum tax. One of the alternative bases of tax under Article 32 is a tax of one mill on each dollar of "taxable assets" (***see,*** Tax Law § 1455[b]). The statute defines taxable assets as "the average value of total assets" reduced by certain amounts. "Total assets" is in turn defined in pertinent part as follows:

> Total assets are those assets which are properly reflected on a balance sheet the income or expenses of which are properly reflected (or would have been properly reflected if not fully depreciated or expensed or depreciated or expensed to a nominal amount) in the computation of alternative entire net income for the taxable year . . . .

Alternative entire net income means entire net income determined under section 1453 with certain adjustments not here relevant (***see,*** Tax Law § 1453-A).

The definition of total assets is ambiguous as to whether the antecedent of the pronoun "which" in its second appearance is "assets" or "balance sheet." Proximity suggests that "balance sheet" is the correct interpretation. Pointing in the opposite direction is the parenthetical language contained within the subordinate clause which clearly refers to "assets."

If "which" refers to "balance sheet," the provision would appear to mean that the test is met if any income or expenses in a profit and loss statement, and then reflected in the equity section of the balance sheet, were taken into account in computing entire net income. If "which" refers to "assets," the definition of "total assets" would have two parts which must be satisfied if an asset is to be included in that category. First, the asset would have to be "properly reflected on a balance sheet." Second, the "income or expenses" of the particular asset would have to be "properly reflected in the computation of alternative entire net income for the taxable year."

The first interpretation–that "which" refers to "balance sheet"–can be read to support the positions of both parties to this case. From the standpoint of petitioner, since the subordinate clause imposes a tax limitation on the balance sheet, it seems to support the theory that petitioner is correct to have created a tax balance sheet for measuring taxable assets. From the standpoint of the Division, if the only issue is whether the right balance sheet is a tax balance sheet or a financial accounting balance sheet, the Division can assert that it has adopted the latter interpretation in the regulations which have binding effect. The regulations repeat the language of the statute and state in part as follows:

> The term *balance sheet*, for purposes of subdivision (a) of this section, shall mean the balance sheet of the taxpayer prepared from the books and records of the taxpayer in accordance with generally accepted accounting principles

> and used for purposes of preparing the taxpayer's financial statements (20 NYCRR § 18-5.2[d]).

The regulations contain no separate interpretation of the subordinate clause in the statute. This is consistent with the theory that the only issue is the nature of the governing balance sheet--an issue that is resolved by the quoted sentence of the regulations.

The Division interpreted the statute and regulations in an Advisory Opinion (TSB-A-90[26]C, December 24, 1990) which impliedly reads the "which" as referring to "assets." It reads in part as follows:

> Pursuant to section 1455(b)(1)(v)(A) of the Tax Law and section 18-5.2(d) of the Franchise Tax on Banking Corporations Regulations, two criteria must be met when determining total assets for purposes of the asset based alternative minimum tax. Total assets are (1) those assets properly reflected on the balance sheet that is prepared from the books and records of the taxpayer in accordance with generally accepted accounting principles and used for purposes of preparing the taxpayer's financial statements and (2) limited to such assets, the income or expenses of which are properly reflected (or would have been properly reflected if not fully depreciated or expensed or depreciated or expensed to a nominal amount) in either the computation of alternative entire net income for the taxable year or in the computation of the eligible net income of the taxpayer's IBF for the taxable year.

Like the Administrative Law Judge, we are persuaded that this is the correct interpretation even though an advisory opinion does not have the binding effect of a regulation. The alternative reading would reduce the subordinate clause in the statute to mere surplusage by including in the definition virtually every balance sheet and every asset reflected on a balance sheet. Moreover, it would raise a question as to the validity of the regulation that would in effect read out of the statute the tax qualifier in the subordinate clause.

The Division's regulations on the statutory definition should accordingly be read as addressing only the first part of the definition–*viz*. the kind of balance sheet on which the assets must be reflected–and not the statutory words of the second test–*viz*. the reflection of income or expenses of the assets in the computation of entire net income. The regulations thus do not assist us in considering whether this second test is met in the case of the "Net Deferred Tax Asset" on the balance sheets at issue.

Accounting for tax expenses is a highly complex and confusing subject with a long and difficult history and is now governed by Statement of Financial Accounting Standards No. 109, which was issued by the Financial Accounting Standards Board in 1992, and various pronouncements and interpretations of that statement (***see,*** Financial Accounting Standards Board, http://www.fasb.org/pdf/fas109.pdf [accessed October 17, 2007]). A fundamental problem addressed in these rules is that tax expenses may be taken into account for financial accounting purposes in different periods than those prescribed by the tax laws. While the record in this case does not reveal the details of the computation of net deferred tax assets on petitioner's financial balance sheets, it seems self-evident that the computation of Federal taxable income, New York entire net income, New York alternative entire net income and the resulting tax liabilities precede the financial accounting analysis of those liabilities that results in the entry of a net deferred tax asset or net deferred tax liability on the financial balance sheet. It is hard to imagine how these financial accounts could produce income or expense that would be taken into account in computing entire net income and the Division has not suggested any way in which this might occur. Accordingly, we conclude that the net deferred tax asset on petitioner's balance sheet does not meet the statutory test of producing "income or expenses . . . which are properly reflected . . . in the computation of alternative net income for the taxable year."

Much of petitioner's proposed adjustments with respect to other assets appearing on the financial balance sheet seem to be based on confusing the statutory test for including assets in the category of taxable assets–*i.e.*, that they produce income or expenses taken into account in the computation of alternative entire net income–and the method for valuing such included assets. The regulations clearly state that tangible property is to be taken into account at cost and intangible property at book value “shown on the books and records of the taxpayer in accordance with generally accepted accounting principles” (***see,*** 20 NYCRR 18-5.2[c] and [d]). Revaluing assets to produce a tax balance sheet is not permitted under the regulations and petitioner has not asserted that the regulations are inconsistent with the statute in this regard.

Accordingly, it is ORDERED, ADJUDGED, and DECREED that:

1. The exception of Astoria Financial Corporation is granted to the extent of excluding Net Deferred Tax Asset” from “taxable assets” as defined in Tax Law § 1455(b)(1)(v)(A), but is otherwise denied;

2. The determination of the Administrative Law Judge, as modified in accordance with paragraph “1” above, is affirmed;

3. The petition of Astoria Financial Corporation is granted to the extent of excluding “Goodwill” and “Net Deferred Tax Asset” from “taxable assets” as defined in Tax Law § 1455(b)(1)(v)(A), but is otherwise denied; and

4. The Notice of Deficiency dated August 4, 2003, as modified in accordance with paragraph "3" above, is sustained.

DATED: Troy, New York
November 21, 2007

/s/ Charles H. Nesbitt
Charles H. Nesbitt
President

/s/ Carroll R. Jenkins
Carroll R. Jenkins
Commissioner

/s/ Robert J. McDermott
Robert J. McDermott
Commissioner