

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition

of

CARRET & COMPANY, INC.

DECISION

for Redetermination of a Deficiency or for
Refund of Corporation Franchise Tax under
Article 9-A of the Tax Law for the Fiscal Years
Ended September 30, 1979 through September 30, :
1981.

Petitioner, Carret & Company, Inc., 200 Park Avenue, New York, New York
10017, filed a petition for redetermination of a deficiency or for refund of
corporation franchise tax under Article 9-A of the Tax Law for the fiscal years
ended September 30, 1979 through September 30, 1981 (File No. 47868).

A hearing was held before Daniel J. Ranalli, Hearing Officer, at the
offices of the State Tax Commission, Two World Trade Center, New York, New
York, on June 7, 1985 at 9:15 A.M. Petitioner appeared by Jerome R. Rosenberg,
Esq. The Audit Division appeared by John P. Dugan, Esq. (Lawrence A. Newman,
Esq., of counsel).

ISSUE

Whether commodity futures contracts are "securities" within the meaning
and intent of section 208.5 of the Tax Law and 20 NYCRR 3-4.2(c).

FINDINGS OF FACT

1. Petitioner, Carret & Company, Inc., timely filed State of New York
corporation franchise tax reports for fiscal years ended September 30, 1979
through September 30, 1981.

2. **On** August 3, 1983, the Audit Division issued three notices of deficiency
against petitioner for corporation franchise tax due as follows:

<u>Period Ended</u>	<u>Tax</u>	<u>Interest</u>	<u>Total Due</u>
9/30/79	\$18,543.00	\$8,518.00	\$27,061.00
9/30/80	\$ 3,955.00	\$1,481.00	\$ 5,436.00
9/30/81	\$ 360.00	\$ 92.00	\$ 452.00

3. Petitioner claimed a business allocation percentage for each of the years involved. The wage and salary factor of petitioner's business allocation formula included commissions paid to a certain employee. The Audit Division originally determined that said commissions were to be excluded. In a stipulation entered into between petitioner and the Audit Division on June 7, 1985, the Audit Division agreed that said commissions in the amounts of \$45,809.00, \$186,414.00 and \$5,523.00 for the fiscal years ended September 30, 1979, 1980 and 1981, respectively, were includible in the compensation base and were allocable outside New York State. Therefore, the deficiencies for fiscal years ended September 30, 1980 and 1981 are to be cancelled and so much of the deficiency for the year ended September 30, 1979 that includes the change in the business allocation percentage is also to be cancelled in the amount of approximately \$1,244.00. Petitioner's investment allocation percentage and its business allocation percentage for fiscal year ended September 30, 1979 are 7.8468 percent and 88.6017 percent, respectively.

4. The sole remaining issue is the treatment of net gains of \$214,215.00 from the closing of eight soybean contracts during the fiscal year in issue. For Federal income tax purposes, the net gains were derived from short-term capital losses of \$624,885.00 and long-term capital gains of \$839,100.00.

5. Petitioner's employees are investment counselors and stock brokers and dealers who are registered with the National Association of Securities Dealers and the Securities and Exchange Commission. Prior to the year in issue, petitioner had not engaged in any commodity transactions. During fiscal year

ended September 30, 1979, petitioner entered into eight transactions involving the purchase and sale of soybean futures contracts on a recognized exchange. Since petitioner did not ordinarily deal in commodity futures contracts, none of its brokers had any expertise in such transactions and an outside commodity service was employed to act as advisor. Petitioner reported the futures contracts as investment capital and the gain derived therefrom as investment income.

6. On audit, the Audit Division disallowed the inclusion of the futures contracts as investment capital and determined that they constituted business capital because a future contract is not an investment in a corporation but rather is an executory contract of sale which obligates the holder to purchase or sell a specific commodity at an agreed upon price at a future date. Petitioner maintains that commodity futures contracts are capital assets which are bought and sold on recognized exchanges for investment purposes and, in the instant case, not in the ordinary course of business and, therefore, should be considered securities for purposes of the definition of investment capital.

CONCLUSIONS OF LAW

A. That section 208.5 of the Tax Law provides as follows:

"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 payable by their terms on demand or within one year from the date incurred, other than loans or advances outstanding for more than a year as of any date during the year covered by the report, which are attributable to investment capital;".

Section 208.6 of the Tax Law defines "investment income" as "income, including capital gains in excess of capital losses, from investment capital, to the

extent included in computing entire-net income. .." with certain limitations not applicable herein.

B. That 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.

* * *

"(c) The 'other securities' referred to in subdivision (a) of this section are limited 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. Thus 'other securities' include debentures, notes of a type commonly dealt in upon securities exchanges or markets or commonly dealt in as a medium for investment, and certificates of indebtedness which have many of the essential characteristics of bonds, and certificates of interest and other instruments evidencing proprietary rights in corporate enterprises which have many of the essential characteristics of stock. They do not include corporate obligations not commonly known as securities, such as real property bonds and mortgages, chattel bonds and mortgages, contracts of sale, purchase money obligations, short-term notes acquired in the ordinary course of trade or business for services rendered or for sales **of** property which is primarily held for **sale** to customers, bills of lading, **bills** of exchange, bankers' acceptances and other commercial instruments."

C, That, although the commodity futures contracts in question were sold in the open market or on a recognized exchange, they were not issued for the purpose of financing corporate enterprises and providing a distribution of rights in, or obligations of, such enterprises. The contracts do not exhibit the essential characteristics of bonds or the proprietary rights in corporate enterprises which are the essential characteristics of stock. They are merely executory contracts of sale which obligate the holder to purchase or sell a specific commodity at an agreed upon price at a future date. They are not

securities and thus not includible within the definition of investment capital as provided in 20 NYCRR 3-4.2.

D. That commodity futures contracts are not "other securities" within the meaning and intent of section 208.5 of the Tax Law as that phrase **is** interpreted in 20 NYCRR 3-4.2 or under the rule of statutory construction of ejusdem generis. Under the rule of ejusdem generis, where general words follow words of a specific meaning, such general words are not to be construed to their widest extent, but are to be held as applying only to persons **or** things of the same general kind or class as those specifically mentioned. **It is** therefore appropriate to **limit** the meaning of "other securities" to securities of the same general kind **or** class as stocks or bonds. Commodity futures contracts are not of the same general kind **or** class as stocks or bonds even though they are sold in the same market as stocks and bonds.

E. That commodity futures contracts are not "other securities" within the purview **of** the Appellate Division, Third Department, decision **in** Hatter of Avon Products, Inc. v. State Tax Commission (90 AD2d 393). In that case, bankers' acceptances were found to be "other securities" because, among other things, they are issued **for** the purpose of financing the enterprise of the issuer by providing a distribution of the obligations of the issuer. Commodity futures contracts are not issued for the purpose of financing any enterprise and do not provide **for** a distribution of the obligations of any enterprise. Therefore, commodity futures contracts **do** not constitute "other securities" under the rationale of the Avon Products decision.


F. That the petition of Garret & Company, Inc. **is** granted to the extent indicated **in** Finding of Fact "3"; that the Audit Division **is** directed to modify the Notice of Deficiency issued August 3, 1983 for fiscal year ended September 30,

1979 accordingly and to cancel the notices of deficiency issued August 3, 1983 for fiscal years ended September 30, 1980 and September 30, 1981; and that, except as so granted, the petition is in all other respects denied.

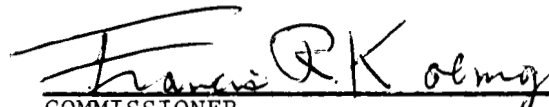
DATED: Albany, New York

STATE **TAX** COMMISSION

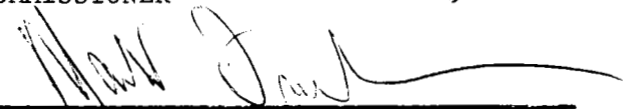
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PRESIDENT



COMMISSIONER



COMMISSIONER