STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petitions

of

JEFFERIES GROUP LLC & SUBSIDIARIES

for Redetermination of Deficiencies or for Refund of Corporate Franchise Tax under Article 9-A of the Tax Law for the Periods January 1, 1997, through December 31, 2007.

DECISION
DTA NOS. 829218 AND 829219

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on August 31, 2023. The Division of Taxation appeared by Amanda Hiller, Esq. (Bruce Lennard, Esq., of counsel). Petitioner (Jefferies Group LLC & Subsidiaries)[1] appeared by Blank Rome LLP (Irwin M. Slomka, Esq., Craig, B. Fields, Esq., and Kara M. Kraman, Esq., of counsel).

The Division of Taxation filed a brief in support of the exception. Petitioner filed a brief in opposition. The Division of Taxation filed a brief in reply. Petitioner filed a sur-reply brief. Oral argument was heard in Albany, New York, on August 22, 2024, which date began the six-month period for issuance of this decision.

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

ISSUES

I. Whether the Division of Taxation properly denied petitioner's Tax Law former § 208

---

[1] Jefferies Group LLC is the successor in interest to Jefferies Group, Inc. In 2013, after the tax years at issue, Jefferies Group, Inc., became a limited liability company and changed its name to Jefferies Group LLC.

(7) (a) election to treat the net income from its securities borrowing and securities lending transactions, interest rate swap transactions, and cash on deposit with FIMAT[2] as investment capital.

II. Whether the Division of Taxation properly disallowed petitioner's claimed sourcing methodology used to compute the business receipts factor of the business allocation percentage.

III. Whether the Division of Taxation properly disallowed a substantial portion of petitioner's claimed investment tax credits and employment incentive credits.

IV. Whether the Division of Taxation's apportionment of petitioner's receipts violates the Commerce Clause and the Due Process Clause of the United States Constitution.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge, except that we have modified, condensed, and deleted some findings of fact in order to reflect the record more fully and clearly. We have merged findings of fact 7 and 8; 14 through 18; 27 and 28; 31 and 33; 35 through 40; 42 and 43; 46 and 47; 49 and 50; 56 and 57; 63 and 64; 69 through 71; 77 through 79; 151 and 152; 153 and 154; 158 and 159; 175 and 176; 196 and 197; 200 and 201; 214 and 215; 227 and 228; 230 and 231; 236 and 237; 241 and 242; 243 and 244; 252 and 253; 269 and 270; 272 and 273; 275 and 276; 281 and 282; 294 and 295; and 300 and 301. We have modified and condensed findings of fact 20, 27, 36, 37, 38, 39, 42, 43, 49, 76, 102, 196, 240 and 251. We have deleted findings of fact 10, 19, 22, 26, 30, 32, 41, 44, 48, 53, 54, 55, 59, 60, 61, 62, 66, 67, 68, 73, 74, 75, 80, 83, 84, 85, 86, 87, 88, 89, 90, 91, 92, 93, 94, 95, 96, 97, 98, 99, 100, 101, 160, 311 and 317, and we have renumbered the findings of fact accordingly. We also have not restated the Administrative Law Judge's findings of fact 330 and 331, as those facts merely

[2] FIMAT is a futures trading business that is a subsidiary of Societe Generale Group. As a result of a merger, on January 1, 2008, FIMAT became Newedge Group.

summarize the Administrative Law Judge's treatment of the parties' respective proposed findings of fact below. Additionally, the Division's 39 pages of unnumbered proposed findings of fact submitted below are substantially incorporated herein to the extent they are supported by the record. The findings of fact as so modified are set forth below.

1. In this matter, two petitions were filed by petitioner, Jefferies Group LLC & Subsidiaries, in protest of notices of deficiency and notices of disallowance issued to its predecessor in interest, Jefferies Group, Inc. During tax years 1997 through 2007, Jefferies Group, Inc. (JEFG), was the parent of a combined group including Jefferies & Company, Inc. (Jefco) and Jefferies Execution Services, Inc. (Jefex). Since JEFG was the parent of the combined group including Jefco and Jefex, the term "petitioner" shall refer to that combined group now known as Jefferies Group LLC & Subsidiaries and to its individual subsidiaries, Jefco and Jefex, as members of that combined group.

2. For tax years 1997 through 2007, JEFG filed combined article 9-A corporation franchise tax returns (combined article 9-A tax returns) and consolidated federal form 1120 corporation income tax returns (consolidated form 1120 returns).[3] Both Jefco and Jefex were included in these combined article 9-A tax returns and consolidated form 1120 returns.

3. JEFG and its subsidiaries "operate as a full-service global investment bank and institutional securities firm focused on growth and middle-market companies and their investors." They "offer these companies capital raising, merger and acquisition, restructuring and other advisory services, and provide investors fundamental research and trade execution in equity, equity-linked, high yield and investment grade fixed income securities, as well as

[3] On the first day of the hearing, petitioner's representative stated that the years 1997 through 2000 were no longer at issue in this proceeding.

commodities and derivatives." JEFG and its subsidiaries "also provide asset management services and products to institutions and other investors."

4. Jefco is a registered securities broker-dealer primarily engaged in the business of providing equity, corporate and municipal debt, securities dealer and brokerage services, and underwriting and investment banking services. Jefco also executes transactions in high yield securities, domestic and international convertible securities, international equity securities, options, preferred stocks, financial futures and other similar products.

5. Since 2001, Jefco has been headquartered at 520 Madison Avenue, New York, New York, where most corporate and back-office support functions, including executive management, finance and legal are conducted. Jefco maintains sales offices in numerous states throughout the country, including California, Connecticut, Massachusetts, New Jersey, and New York.

6. Jefex is a registered securities broker-dealer whose business primarily consists of providing securities execution services on the New York Stock Exchange (NYSE) and other national and regional exchanges and electronic marketplaces, principally for Jefco but also for other financial intermediaries. Jefex owns seats on the NYSE and provides execution services for stocks and options listed on the NYSE and on other major exchanges.

7. Jefco and Jefex derive commissions from executing brokerage transactions in equity securities at the direction of domestic and international institutional intermediaries such as registered investment advisors (RIAs), pension funds, hedge funds, mutual funds, registered securities brokers or dealers, and similar financial intermediaries and collective investment vehicles (collectively, institutional intermediaries) which may also include commercial banks, savings and loan associations, Employee Retirement Income Security Act of 1974 (ERISA)

employee benefit plans, profit sharing plans, insurance companies, educational and other endowment funds, trust funds, venture capital funds, and private equity funds.

8. The parties have stipulated that the investors in mutual funds, hedge funds and similar collective investment vehicles and the beneficiaries of pension funds, ERISA employee benefit plans and similar retirement plans, including collective investment vehicles managed by registered and non-registered investment advisors are collectively the "underlying investors."

9. On or about September 15, 2005, petitioner filed its first amended CT-3-A and CT-3M/4M returns (hereafter, collectively, CT-3-A returns) for the tax year 2001.

10. On or about September 14, 2006, petitioner filed its first amended CT-3-A returns for tax year 2002.

11. On or about January 8, 2013, petitioner filed amended CT-3-A returns for each of the tax years 1999 through 2007 including second amended CT-3-A returns for tax years 2001 and 2002. In the receipts factor of its 2013 amended CT-3-A returns for tax years 2001 through 2007, petitioner sourced brokerage commissions and certain other revenues to New York State based upon what it asserts is an approximation of the location of the underlying investors.

Procedural History

12. The Division prepared four reports of audit in this matter: Audit X358650671 covered an audit period of tax years 1997 through 2002 and was limited in scope to petitioner's claims for investment tax credits (ITCs) and associated employment incentive credits (EICs) in each of these years; Audit X258556467 covered an audit period of tax years 2003 through 2007 and was limited in scope to petitioner's claims for ITCs and associated EICs in each of these years; Audit X660332549 covered an audit period of tax years 2001 through 2004 and was a general verification field audit for each of these years; and Audit X056125664 covered an audit

period of tax years 2005 through 2007 and was a general verification field audit for each of these years.

Audit X358650671

13. Through its 2013 amended CT-3-A returns for the tax years 1998 through 2002, petitioner reported a reduction of its business allocation percentage (BAP) resulting from a reduction of its receipts factor, an increase of its investment income and a corresponding decrease of its business income. Petitioner's amended CT-3-A returns were based upon its position that its brokerage commissions and gross income from principal transactions, including accrued interest on those transactions, should be sourced based upon the location of the underlying investors of the institutional intermediaries and not based upon the locations of the institutional intermediaries in the transactions resulting in these receipts. Petitioner also claimed ITC and EIC not previously claimed. Based upon these amended CT-3-A returns, petitioner sought refunds of corporation franchise tax and MTA surcharge in the tax years 1997 through 2002 totaling $4,809,229.00.

14. In a notice of disallowance for audit period January 1, 1997 through December 31, 2002, dated June 21, 2017, the Division denied petitioner's claims for refunds equaling $4,809,229.00 for one or more of the following reasons: "[b]ared [sic] by statute" or "[i]mproper receipt factor allocation method." The notice of disallowance also informed petitioner that its claims for refunds for the tax years 1997 through 2002 relating to ITC/EIC would be addressed in Audit X660332549. Additionally, petitioner's claims for refunds of $4,809,229.00 were not based solely upon claims for ITC/EIC but also included claims for refunds based upon lesser amounts of corporation franchise tax and MTA surcharge before credits in the audit period covered by Audit X358650671.

Audit X258556467

15. Through its 2013 amended CT-3-A returns for the tax years 2003 through 2007, petitioner reported a lowering of its BAP resulting from a reduction of its receipts factor and claimed ITC/EIC amounts. Petitioner sought refunds of corporation franchise tax and MTA surcharge for the tax years 2003 through 2007 totaling $5,620,066.00. These claims were denied by the Division.

16. Petitioner reported a lower BAP resulting from a reduced receipts factor on the grounds that its brokerage commissions, gross income from principal transactions (including accrued interest), margin interest, clearing fees and management fees should be sourced based upon the location of the underlying investors of the institutional intermediaries, not based upon the locations of the institutional intermediaries in the transactions resulting in these receipts and an increase in investment income and a corresponding reduction in business income. Petitioner also claimed additional ITC/EIC for tax years 2003 through 2007.

17. The Division issued a notice of disallowance to petitioner in connection with audit X258556467, dated June 21, 2017, in which it disallowed petitioner's claims for refunds in the amount of $5,620,066.00 because "[t]he claim [sic] for refund were addressed under Case No. X056125664 and X660332549."

Audit X660332549

18. The audit period of Audit X660332549 (tax years 2001 through 2004) had a two-year overlap with the audit period of Audit X358650671 (tax years 1997 through 2002). During the course of this audit, a total of 12 consents extending the period of limitations for assessment of franchise tax under articles 9 (except section 180), 9-A, 13, 32, 33 and 33A of the Tax Law

(consents) were executed that extended the statute of limitations for the period January 1, 2003 through December 31, 2004 to December 31, 2017.

19. Audit X660332549 included tax years 2001 and 2002 to address a refund claim made by petitioner for those years based upon federal forms 1120X it filed that reported additional expenses and consequent reduced federal taxable income (FTI) in those years. As a result, for tax year 2001, the Division reduced petitioner's ENI by $306,640.00 to $138,237,793.00 and, for the tax year 2002, the Division reduced petitioner's ENI by $397,866.00 to $136,428,553.00.

20. Of the ITC/EIC total amount of $256,518.00 that the Division preliminarily determined petitioner was entitled to in tax year 2001, the Division disallowed $147,426.00 because it concluded this amount was not timely claimed. As a result of the adjustments made to petitioner's ENI base for tax years 2001 and 2002 and the approved ITC/ETC amounts for these years, the Division determined that petitioner was entitled to refunds for corporation franchise tax and MTA surcharge for these years totaling $154,794.00.

21. In petitioner's 2013 amended CT-3-A returns for tax years 2003 and 2004, petitioner allocated its business income to New York using a BAP based upon a receipts factor that sourced its business receipts based upon the locations of the underlying investors of the institutional intermediaries with which it did business and not based upon the locations of the institutional intermediaries themselves. Petitioner also reduced a portion of its business income and instead reported it as investment income because it claimed a cash election under Tax Law former § 208 (7) with respect to that income.

22. In Audit X660332549, the Division accepted petitioner's property factors and payroll factors of its BAP for the tax years 2003 and 2004. The Division did not accept petitioner's sourcing methodology for its receipts factors for these years. The Division determined

petitioner's receipts factor for tax year 2003 was 27.5532% and its receipts factor for tax year 2004 was 24.7437%. Accordingly, the Division determined petitioner's BAP was 30.2999% and 30.6836%. for tax years 2003 and 2004, respectively.

23. On its original CT-3-A return for tax year 2003, petitioner reported its combined ENI to be $152,918,191.00. The Division determined that petitioner had $157,055,646.00 of business income in tax year 2003 by adjusting petitioner's reported total combined investment income amount of $32,579,564.00 to $19,674,265.00. On its original and amended CT-3-A return for tax year 2004, petitioner reported its combined ENI to be $197,923,450.00. The Division determined that petitioner had $167,336,205.00 of business income in tax year 2004 by adjusting petitioner's reported total combined investment income amount of $58,481,807.00 to $30,645,337.00. For tax years 2003 and 2004, the parties agreed to the application of an investment allocation percentage (IAP) of 2% to apportion petitioner's investment income.

24. The Division determined that, for tax year 2003, petitioner owed additional corporation franchise tax of $489,667.00 and that, for tax year 2004, petitioner owed additional corporation franchise tax of $65,002.00. The Division determined that, for tax year 2003, petitioner owed additional MTA surcharge of $104,287.00 and that, for tax year 2004, petitioner owed additional MTA surcharge of $19,473.00.

25. At the conclusion of Audit X660332549, the Division issued to petitioner a notice of deficiency, assessment ID L-047299919, dated October 17, 2017, which asserted additional corporation franchise tax and MTA surcharge due in the amount of $678,249.00, interest due in the amount of $960,324.06 and assessment payments/credits in the amount of $154,794.00, for a total amount due of $1,483,959.06, for the period January 1, 2003 through December 31, 2004.

26. On October 20, 2017, in connection with Audit X660332549, the Division also issued a letter to petitioner indicating that petitioner owed additional tax of $523,635.00 plus interest for a total of $1,480,386.00. The Division issued a notice of disallowance to petitioner in connection with audit X660332549, dated October 20, 2017, in which it disallowed petitioner's claims for refunds in the amount of $4,197,445.00 because "[t]he methodology used to compute the receipts factor of the business allocation percentage was disallowed."

Audit X056125664

27. The audit period of Audit X056125664 was tax years 2005 through 2007. During the course of this audit, a total of 10 consents were executed that extended the statute of limitations for the period January 1, 2005 through December 31, 2007 to December 31, 2017.

28. In petitioner's 2013 amended CT-3-A returns for tax years 2005 through 2007, petitioner allocated its business income to New York using a BAP calculated using a receipts factor that sourced its commissions, management fees and gross income from principal transactions including accrued interest, based upon an approximation of the locations of the underlying investors of the institutional intermediaries with which it did business and not based upon the locations of the institutional intermediaries themselves. Petitioner sourced its clearing fees and margin interest based upon an approximation of the locations of the customers of the introducing broker-dealers. Petitioner also reported certain income as investment income rather than business income because it claimed a cash election under Tax Law former § 208 (7) with respect to that income.

29. In Audit X056125664, the Division accepted petitioner's property factors and payroll factors of its BAP for tax years 2005 and 2006. There was no property or payroll factor applicable for tax year 2007.

30. In computing petitioner's receipts factor for tax year 2005, the Division determined that petitioner had business receipts allocable to New York totaling $214,772,053.00 and "everywhere" business receipts totaling $1,025,591,955.00. Petitioner had reported business receipts allocable to New York of $191,465,738.00 and "everywhere" business receipts of $356,638,557.00. For tax year 2005, the Division sourced petitioner's business receipts from its brokerage commissions, principal transactions, clearing fees, management fees and margin interest to New York based upon the locations of the institutional intermediaries in petitioner's books and records and not based upon the locations of the underlying investors of the institutional intermediaries. The application of the 2006 revenue stream allocation percentages to 2005 was agreed to by petitioner and the Division.

31. For tax year 2005, based upon its determination that petitioner had business receipts allocable to New York totaling $214,772,053.00 and "everywhere" receipts totaling $1,025,591,955.00, the Division calculated petitioner's receipts factor to be 20.9413% and its BAP to be 29.9149%.

32. In recomputing petitioner's receipts factor for tax year 2006, the Division determined that petitioner had business receipts allocable to New York totaling $252,245,299.00 and "everywhere" business receipts totaling $1,123,851,068.00. Petitioner had reported business receipts allocable to New York of $126,156,033.00 and reported "everywhere" business receipts of $20,339,898.00. For tax year 2006, the Division sourced petitioner's business receipts from its brokerage commissions, gross income from principal transactions, clearing fees, management fees and margin interest to New York based upon the locations of the institutional intermediaries with which petitioner did business and not based upon the locations of the underlying investors of the institutional intermediaries.

33. For tax year 2006, based upon its determination that petitioner had business receipts allocable to New York totaling $252,245,299.00 and "everywhere" receipts totaling $1,123,851,068.00, the Division calculated petitioner's receipts factor to be 22.4447% and its BAP to be 30.3803%.

34. For tax year 2007, the Division reclassified $1,855,888.00 of petitioner's reported $56,937,441.00 of investment income from its principal transactions to be business income, resulting in adjusted investment income of $55,081,553.00. In computing petitioner's receipts factor for tax year 2007, the Division determined that petitioner had business receipts allocable to New York totaling $254,765,073.00 and "everywhere" business receipts totaling $1,233,482,502.00. Petitioner reported business receipts allocable to New York of $73,579,628.00 and "everywhere" business receipts of $83,796,799.00. For tax year 2007, the Division sourced petitioner's business receipts from its brokerage commissions, principal transactions, clearing fees, management fees and margin interest to New York based upon the locations of the institutional intermediaries with which petitioner did business and not based upon the locations of the underlying investors of the institutional intermediaries.

35. For tax year 2007, based upon its determination that petitioner had business receipts allocable to New York totaling $254,765,073.00 and "everywhere" receipts totaling $1,233,482,502.00, the Division calculated petitioner's receipts factor to be 20.6541% and its BAP to be 20.6542%.

36. The Division determined that petitioner owed an additional tax amount of $3,798,440.00 plus interest for the audit period covered by Audit X056125664 (tax years 2005 through 2007).

37. At the conclusion of Audit X056125664, the Division issued to petitioner a notice of deficiency, assessment ID L-047323899, dated October 17, 2017, which asserted additional corporation franchise tax and MTA surcharge due in the amount of $4,471,684.00, interest due in the amount of $4,099,559.73 and assessment payments/credits in the amount of $673,244.00, for a total amount due of $7,897,999.73 for tax years 2006 and 2007. On October 20, 2017, in connection with Audit X056125664, the Division issued a letter to petitioner indicating that petitioner owed additional tax of $3,798,440.00 plus interest for a total of $7,878,893.00. On October 20, 2017, in connection with Audit X056125664 (tax years 2005 through 2007), the Division issued a notice of disallowance to petitioner, in which it disallowed petitioner's claims for refund in the amount of $1,394,243.00, in full, because "[t]he methodology used to compute the receipts factor of the business allocation percentage was disallowed."

Bureau of Conciliation and Mediation Services

38. On January 12, 2018, petitioner timely filed requests for conciliation conference (requests) with the Bureau of Conciliation and Mediation Services (BCMS). In its requests, petitioner protested the two notices of deficiency, assessment ID nos. L-047299919 and L047323899 and sought a redetermination of the amounts set forth in those notices.

39. On December 7, 2018, BCMS issued a single conciliation order, CMS No. 000301157, that recomputed the amount of additional tax due under notice of deficiency L047299919 to be $360,819.00 and recomputed the amount of additional tax due under notice of deficiency L-047323899 to be $2,320,216.00, for a total net principal amount due of $2,681,035.00[4], plus interest.

[4] The notation at the bottom of the conciliation order indicates that the "tax amounts shown are after the payments on Assessments, effective 10/6/2017, from refund offsets. Assessment #L047299919-1 - $154,794.00 and Assessment #L047323899-7 - $673,244.00."

40. For each of the tax years 2001 through 2007, petitioner made a statutory election to treat Jefco's cash on deposit and on demand relating to its securities lending transactions as investment capital (cash election) and the resulting net interest income as investment income, pursuant to Tax Law former § 208 (7).

41. For each of the tax years 2001 through 2004, petitioner filed timely amended returns making the cash election for securities lending transactions which resulted in an increase of its total reported "combined investment income before allocation" to the following amounts: for tax year 2001: $40,561,022.00; for tax year 2002: $25,974,918.00; for tax year 2003: $58,367,782.00; and for tax year 2004: $83,975,949.00 and a corresponding decrease in total reported business income.

42. The refund claim amounts attributable to the cash elections made in petitioner's timely filed amended returns for tax years 2001 and 2002 were not included in the computation of the Division's October 17, 2017 notice of deficiency, assessment ID L-047299919, for a total amount due of $1,483,959.06; or in the Division's October 20, 2017 letter to petitioner indicating that petitioner owed additional tax of $523,635.00 plus interest for a total of $1,480,386.00; or in the Division's October 20, 2017 notice of disallowance disallowing petitioner's refund claims in the total amount of $4,197,445.00.

43. The refund claim amounts attributable to the cash elections made in petitioner's timely filed amended returns for tax years 2003 and 2004 were not included in the computation of the Division's October 12, 2017 notice of deficiency, assessment ID L-047299919, for a total amount due of $1,483,959.06; or in the Division's October 20, 2017 letter to petitioner indicating that petitioner owed additional tax of $523,635.00 plus interest for a total of $1,480,386.00; or in

the Division's October 20, 2017 notice of disallowance disallowing petitioner's refund claims in the total amount of $4,197,445.04.

44. For each of the tax years 2005 through 2007, the Division reclassified Jefco's reported net interest income from its securities lending transactions from investment income to business income.

45. For each of the tax years 2005 through 2007, the Division reduced petitioner's reported investment income by removing interest income from Jefco's securities lending transactions in the following amounts as set forth in schedule E1 of the BCMS schedules for assessment L-047323899: for tax year 2005: $28,331,000.00; for tax year 2006: $378,928,000.00; and for tax year 2007: $839,652,000.00.[5]

46. For each of the tax years 2005 through 2007, the Division reduced petitioner's reported interest expense by removing interest expense related to Jefco's securities lending transactions in the following amounts as set forth in schedule E3 of the BCMS schedules for assessment L-047323899: for tax year 2005: $10,969,392.00; for tax year 2006: $290,810,000.00; and for tax year 2007: $780,850,000.00.

47. For each of the tax years 2005 through 2007, the Division reduced petitioner's reported investment interest expense by removing net interest income from Jefco's securities lending transactions in the following amounts: for tax year 2005: $17,361,608.00; for tax year 2006: $88,118,000.00; and for tax year 2007: $58,802,000.00.

48. For tax years 2006 and 2007, Jefco derived income from swap collateral transactions in which it earned interest on cash provided in connection with interest rate swap transactions.

[5] The "BCMS schedules" for assessment L-047323899 accompanied the BCMS conciliation conferee's letter, dated October 30, 2018, relating to tax years 2005 through 2007.

49. For tax years 2006 and 2007, the Division reclassified petitioner's reported net interest income from its swap collateral transactions from investment income to business income.

50. For tax years 2006 and 2007, BCMS adjusted petitioner's reported total investment income by removing interest income from petitioner's swap collateral transactions in the following amounts: for tax year 2006: $4,485,000.00; and for tax year 2007: $9,405,116.00.

51. For tax years 2006 and 2007, BCMS adjusted petitioner's total investment income by removing interest income from cash on deposit with FIMAT in the following amounts: for tax year 2006: $6,060,000.00; and for tax year 2007: $6,803,735.00.

52. For each of the tax years 2003 through 2007, Jefco received commissions from executing brokerage transactions in equity securities at the direction of institutional intermediaries in the following amounts set forth as "Commissions: Jefco" in the BCMS schedules (Everywhere Column): for tax year 2003: $365,348,626.00; for tax year 2004: $382,108,460.00; for tax year 2005: $346,197,025.00; for tax year 2006: $380,379,339.00; and for tax year 2007: $308,210,844.00.[6]

53. For each of the tax years 2003 through 2007, Jefex received commissions for executing brokerage transactions in equity securities at the direction of institutional intermediaries in the following amounts set forth as "Commissions: Jefex" in the BCMS schedules ("everywhere" column): for tax year 2003: $54,886,437.00; for tax year 2004: $61,900,656.00; for tax year 2005: $48,888,469.00; for tax year 2006: $42,099,345.00; and for tax year 2007: $34,230,619.00.

54. For each of the tax years 2003 through 2007, Jefco received margin interest from the customers of introducing broker/dealers and from certain institutional intermediaries in the

[6] The BCMS schedules for assessment L-047299919 accompanied the BCMS conciliation conferee's letter, dated October 30, 2018, relating to tax years 2003 and 2004.

following amounts set forth as "Margin Interest" in the BCMS schedules (Everywhere column): for tax year 2003: $3,335,394.00; for tax year 2004: $5,684,904.00; for tax year 2005: $11,658,555.00; for tax year 2006: $19,245,186.00; and for tax year 2007: $26,374,759.00.

55. For each of the tax years 2003 through 2007, Jefco received fees for management and advisory services in connection with investment accounts managed by institutional intermediaries in the following amounts set forth as "Management Fees" in the BCMS schedules (Everywhere column): for tax year 2003: $3,885,362.00; for tax year 2004: $9,733,036.00; for tax year 2005: $32,903,726.00; for tax year 2006: $43,528,556.00; and for tax year 2007: $11,488,448.00.

56. For each of the tax years 2003 through 2007, BCMS determined that Jefco received fees in connection with securities correspondent relationships it had with other registered securities broker/dealers in which Jefco acted as the clearing firm in the following amounts set forth as "Clearing Fees" in the BCMS schedules (Everywhere column) for tax year 2003: $14,877,037.00; for tax year 2004: $19,119,901.00; for tax year 2005: $22,628,933.00; for tax year 2006: $14,981,411.00; and for tax year 2007: $12,948,315.00.

57. For each of the tax years 2003 through 2007, Jefco received gross income from principal transactions resulting from the execution of trades in the following amounts set forth as "Principal Transactions: Trading P&L" in the BCMS schedules (Everywhere column): for tax year 2003: $36,817,030.00; for tax year 2004: $53,743,998.00; for tax year 2005: $128,600,392.00; for tax year 2006: $116,379,281.00; and for tax year 2007: $260,856,390.00.

58. For each of the tax years 2003, 2004 and 2006, Jefco received accrued interest from principal transactions in the following amounts set forth as "Other Interest" in the BCMS

schedules ("everywhere" column): for tax year 2003: $34,336,959.00; for tax year 2004: $25,914,355.00; and for tax year 2006: $53,055,325.00.

59. For each of the tax years 2005 and 2007, Jefco received accrued interest from principal transactions in the following amounts set forth as "Other Interest" in the attached Statement 4 documents from petitioner's respective federal form 1120 tax filings for those tax years: 2005: $45,835,383.00; and 2007: $77,291,900.00.

60. For each of the tax years 1999 through 2002, Jefco claimed the following amounts of ITC on its amended CT-3-A returns: for tax year 1999: $98,055.00; for tax year 2000: $301,735.00; for tax year 2001: $109,092.00; and for tax year 2002: $52,086.00. For each of the tax years 1999 through 2002, Jefco subsequently revised its ITC claims to the following amounts: for tax year 1999: $814,268.00; for tax year 2000: $181,365.00; for tax year 2001: $116,093.00; and for tax year 2002: $76,248.00. For each of the tax years 1999 through 2002, the Division disallowed Jefco's claimed ITC amounts in their entirety.

61. For each of the tax years 2003 through 2007, Jefco timely claimed the following amounts of ITC on its amended CT-3-A returns: for tax year 2003: $172,167.00; for tax year 2004: $182,827.00; for tax year 2005: $348,315.00; for tax year 2006: $835,386.00; and for tax year 2007: $860,505.00.

62. For each of the tax years 2003 through 2007, BCMS allowed the following amounts of ITC: for tax year 2003: $110,219.00; for tax year 2004: $61,126.00; for tax year 2005: $81,409.00; for tax year 2006: $551,838.00; and for tax year 2007: $185,225.00.

63. For each of the tax years 1999 through 2002, Jefco claimed the following amounts of EIC on its amended CT-3-A returns set forth in the "Summary of Investment Tax Credit (ITC) Per Audit" on page 2 of the BCMS ITC schedules: for tax year 1999: $5,151.00; for tax year

2000: $49,028.00; for tax year 2001: $150,867.00; and for tax year 2002: $205,413.00.[7] For each of the tax years 1999 through 2002, Jefco subsequently revised its EIC claims to the following amounts: for tax year 1999: $5,081.00; for tax year 2000: $412,215.00; for tax year 2001: $497,816.00; and for tax year 2002: $148,729.00. For each of the tax years 1999 through 2002, the Division disallowed Jefco's revised claimed EIC amounts in their entirety.

64. For each of the tax years 2003 through 2007, Jefco timely claimed the following amounts of EIC on its amended CT-3-A returns as set forth in the "Summary of Investment Tax Credit (ITC) Per Audit" on page 2 of the BCMS ITC schedules: for tax year 2003: $80,589.00; for tax year 2004: $112,126.00; for tax year 2005: $177,497.00; for tax year 2006: $265,571.00; and for tax year 2007: $591,850.00.

65. For each of the tax years 2003 through 2007, BCMS allowed the following amounts of EIC: for tax year 2003: $19,722.00; for tax year 2004: $65,121.00; for tax year 2005: $85,673.00; for tax year 2006: $71,268.00; and for tax year 2007: $316,624.00.

66. For each of the tax years 2003 through 2007, BCMS recaptured 10% of the allowed ITC and EIC in the following amounts: for tax year 2003: $4,329.00; for tax year 2004: $12,994.00; for tax year 2005: $12,625.00; for tax year 2006: $16,708.00; and for tax year 2007: $62,311.00.

67. For each of the tax years 2003 through 2007, Jefco claimed ITC relating to the following amounts of purchases of property used by its investment banking department: for tax year 2003: $2,407,098.00; for tax year 2004: $1,000,324.00; for tax year 2005: $256,979.00; for tax year 2006: $719,003.00; and for tax year 2007: $1,956,917.00.

---

[7] These amounts are mislabeled as "ENI Claimed on the Original Amended Returns" in the BCMS ITC schedules.

68. For each of the tax years 2003 through 2007, the Division disallowed ITC for the following amounts of Jefco's purchases of property used by its investment banking department: for tax year 2003: $526,970.00; for tax year 2004: $763,828.00; for tax year 2005: $151,594.00; for tax year 2006: $389,520.00; and for tax year 2007: $1,607,190.00.

69. For each of the tax years 2003 through 2007, Jefco claimed ITC relating to the following amounts of purchases of property used by its prime brokerage business unit: for tax year 2003: $32,869.00; for tax year 2004: $0.00; for tax year 2005: $59,580.00; for tax year 2006: $1,509,131.00; and for tax year 2007: $474,146.00.

70. For each of the tax years 2003 through 2007, the Division disallowed ITC for the following amounts of Jefco's purchase of property used by its prime brokerage unit: for tax year 2003: $0.00; for tax year 2004: $0.00; for tax year 2005: $22,200.00; for tax year 2006: $1,351,596.00; and for tax year 2007: $451,761.00.

71. For each of the tax years 2003 through 2007, Jefco claimed ITC relating to the following amounts of purchases of property used by its research department: for tax year 2003: $41,301.00; for tax year 2004: $29,514.00; for tax year 2005: $83,407.00; for tax year 2006: $292,345.00; and for tax year 2007: $57,974.00. For each of the tax years 2003 through 2007, the Division disallowed ITC for the amounts of Jefco's purchases of property used by its research department in their entirety.

72. For each of the tax years 2003 through 2007, Jefco claimed ITC relating to the following amounts of purchases of computer software: for tax year 2003: $48,766.00; for tax year 2004: $111,143.00; for tax year 2005: $1,303,739.00; for tax year 2006: $788,873.00; and for tax year 2007: $3,507,192.00. For each of the tax years 2003 through 2007, the Division disallowed ITC for the amounts of Jefco's purchases of computer software in their entirety.

73. For each of the tax years 2003 through 2007, Jefco claimed ITC relating to the following amounts of purchases of property that was delivered to Jefco in states other than New York for configuration and customization by its information technology department, which petitioner contends were then sent to Jefco's offices in New York to be placed in service there: for tax year 2003: $734,121.00; for tax year 2004: $0.00; for tax year 2005: $17,956.00; for tax year 2006: $15,253.00; and for tax year 2007: $1,432,955.00. For each of the tax years 2003 through 2007, the Division disallowed ITC for the amounts of purchases of property that were delivered to Jefco in states other than New York for configuration and customization by its information technology department in their entirety.

74. For tax year 2007, the Division disallowed the ITC for the following additional amounts of Jefco's purchases of property that were delivered to Jefco in New Jersey and on which New Jersey sales tax was paid, which petitioner contends was for the purpose of configuration and customization by petitioner's information technology department, and then sent to Jefco's offices in New York to be placed in service there: $12,463.00.

Cash Election – Securities Lending Transactions

75. For each of the tax years 2001 through 2007, petitioner made a statutory election on its amended CT-3-A returns to treat Jefco's cash on hand and on deposit relating to its securities lending transactions as investment capital and the resulting net interest income as investment income pursuant to Tax Law former § 208 (7).

76. Petitioner filed timely amended CT-3-A returns making the cash election to treat its net interest income derived from its securities lending transactions as investment income for each of the tax years 2001 through 2007 and made refund claims relating to those elections.

77. For each of the tax years 2001 through 2004, the Division did not allow petitioner's cash election with respect to its securities lending transactions but did not include the disallowed refund claim amounts in either its notices of deficiency or its notices of disallowance.

78. For each of the tax years 2005 through 2007, the Division disallowed petitioner's cash election with respect to its securities lending transactions and reduced petitioner's reported investment income by removing net interest income from Jefco's securities lending transactions and reclassifying it as business income.

79. Jefco engages in securities lending transactions in which it borrows securities to cover short sales and to complete transactions in which customers have failed to deliver securities by the required settlement date and lends securities to other broker-dealers that need the securities for similar purposes.

80. When Jefco borrows securities from a counterparty including a bank or other institution, it deposits cash collateral with the counterparty and earns interest income on the cash collateral.

81. When Jefco lends securities to a counterparty, the counterparty deposits cash collateral with Jefco and Jefco incurs interest expense payable to the counterparty.

82. The amount of interest income earned and interest expense incurred by Jefco in its security lending transactions is based upon the amount of cash collateral deposited in a given transaction.

83. When the party that borrowed the securities returns the securities to the party that loaned the securities, the lender returns the cash collateral to the borrower.

84. At the hearing, Mr. Bradley Katinas, the head of United States (U.S.) trading at Jefco, who was involved with "hundreds of thousands" of securities lending transactions at

Jefco, testified that the majority of Jefco's securities lending transactions consist of "matched book transactions."

85. In a matched book transaction, Jefco borrows securities from one party and lends them to another party in a manner that enables Jefco to derive net interest income on the use of the cash collateral.

86. When Jefco acts as a securities borrower in a matched book transaction, it provides cash collateral to the party that loans Jefco the securities. According to Mr. Katinas, Jefco provides cash collateral equal to between 100% to 105% of the market value of the borrowed securities. The securities lender deposits that cash collateral and pays an agreed upon interest rate to Jefco on the cash collateral.

87. When Jefco acts as a securities lender in a matched book transaction, it receives and deposits the cash collateral from the party that borrows the securities. Jefco pays an agreed upon interest rate to the securities borrower on that cash collateral.

88. Jefco earns net interest income from the cash collateral that it provides in its matched book securities lending transactions, which is the difference between the interest it receives when acting as a borrower of securities and the interest it pays when acting as a lender of securities.

89. The Division disallowed petitioner's cash election with respect to its securities lending transactions based upon the conclusions contained in a letter from Nonie Manion, then Director of Audits, to Mr. William Luna at Jefco, dated March 20, 2012 (Manion letter). As relevant to the cash election issue, the Manion letter stated only that petitioner's position "runs contrary to the well-established consistently applied Department treatment of such income as business income."

90. At the hearing, the auditor testified that he felt that he was "bound by" the Manion

letter in disallowing Jefco's cash election. The auditor testified that the Division's disallowance of petitioner's cash election with respect to the net interest income from securities lending transactions was "because the Department considered that transaction as a business transaction," and "not an investment [transaction]."

Cash Election – Other Income

91. For each of the tax years 2006 and 2007, petitioner made a timely statutory cash election to treat Jefco's cash on hand and on deposit relating to its collateral furnished in interest rate swaps and its cash on deposit with FIMAT as investment capital and the resulting interest income as investment income.

92. Jefco earned interest income from the cash collateral that it furnished in interest rate swap transactions, which the Division's auditor testified was similar to the way Jefco derived interest income from cash collateral furnished in securities lending transactions.

93. Jefco earned interest income from cash collateral that it placed on deposit with FIMAT.

94. For each of the tax years 2006 and 2007, the Division disallowed petitioner's cash election with respect to cash collateral on interest rate swap transactions, and reclassified petitioner's reported net interest income from these transactions from investment income to business income. The Division further disallowed petitioner's cash election with respect to its cash on deposit with FIMAT and reclassified petitioner's reported interest income from its cash on deposit with FIMAT from investment income to business income.

Broker-Dealer Sourcing: General

95. For tax years 2003 through 2007, petitioner reported a reduced BAP resulting from a reduced receipts factor on its timely-filed amended CT-3-A returns, taking the position that its

brokerage commissions, gross income from principal transactions (including accrued interest), margin interest, clearing fees and management fees should be sourced based upon the location of the underlying investors of the institutional investors[8] and not based upon the locations of the institutional intermediaries that requested the transactions resulting in those receipts.

96. In the receipts factor of its amended CT-3-A returns for tax years 2003 through 2007, petitioner sourced its brokerage commissions, management fees and gross income from principal transactions (including accrued interest), based upon an approximation of the locations of the underlying investors of the institutional intermediaries with which it did business and not based upon the locations of the institutional intermediaries themselves.

97. In the receipts factor of its amended CT-3-A returns for tax years 2003 through 2007, petitioner sourced its clearing fees and margin interest based upon an approximation of the locations of the customers of the introducing broker-dealers.

98. For each of the tax years 2003 through 2007, the Division sourced petitioner's brokerage commissions, principal transactions, margin interest, clearing fees and management fees to New York based upon the locations of the institutional intermediaries in petitioner's books and records and not based upon the locations of the underlying investors of the institutional intermediaries.

99. For tax years 2003, 2004 and 2006, the Division sourced petitioner's "other interest" income using the 2006 percentage that it used to source petitioner's receipts from margin interest.

100. Petitioner and the Division have stipulated that for the purposes of this case the

[8] The term "institutional investors" is a generic term that generally refers to collective investment vehicles such as mutual funds, hedge funds and pension funds, as distinguished from RIAs, which primarily advise and manage client investments.

allocation percentages ultimately determined for tax year 2006 will also apply to tax years 2003 through 2005 with respect to brokerage commissions, principal transactions (including accrued interest), margin interest, clearing fees, management fees, and other interest.

Broker-Dealer Sourcing: Commissions

101. A securities broker-dealer executes securities trades to carry out the purchase or sale of securities in securities markets on behalf of its retail and institutional clients. The securities broker-dealer charges a brokerage commission in exchange for executing those trades.

102. Jefco and Jefex both derive commissions from executing brokerage transactions in equity securities entered into at the direction of institutional intermediaries such as RIAs, pension funds, hedge funds, mutual funds, registered securities brokers or dealers and similar financial intermediaries and collective investment vehicles.

103. An RIA, sometimes referred to as an "investment manager," provides investment advice and money management for three broad categories of clients, specifically mutual funds and other pooled investment vehicles, high net worth individuals and separately managed accounts such as pension plans and 401 (k) plans.

104. Depending upon the dollar amount of total client assets that it manages, a U.S. investment advisor must register with either the U.S. Securities and Exchange Commission (SEC) or with state securities regulators and thereafter is termed a "registered investment advisor" or RIA.

105. Megan Cerchia, an officer of petitioner responsible for state and local tax compliance, prepared an analysis of Jefco's brokerage commissions by client category for the 2006 tax year (exhibit 18). Using worldwide brokerage commissions generated by more than 30 client category types as reflected in Jefco's books and records, she concluded that 77.3280% of

Jefco's brokerage commissions in 2006 were derived through its arrangements with RIAs, and an additional 5.0962% of brokerage commissions were derived through arrangements with non-registered investment advisors, which performed a similar function to RIAs. Therefore, 82.424% of Jefco's brokerage commissions were earned through arrangements with registered and non-registered investment advisors.

106. Ms. Cerchia testified that, with the exception of individuals whose commissions represented only 0.7460% of Jefco's brokerage commissions, the majority of the other client categories – whose commissions constituted the balance of Jefco's commissions in 2006 – were various types of institutional intermediaries.

107. The sourcing of Jefco's brokerage commissions received from its "retail," i.e., its individual customers, which were sourced based upon their address in Jefco's books and records, is not in dispute.

108. Ms. Cerchia testified that she first ascertained the percentages of brokerage commissions earned by various client categories worldwide and then applied those percentages to total brokerage commissions reported on Jefco's federal form 1120, because Jefco only maintained breakdowns of commissions by client category based upon "worldwide commissions." Ms. Cerchia explained that her reference to "worldwide commissions" was to brokerage commissions received by both petitioner's U.S. and non-U.S. affiliates. Petitioner's non-U.S. affiliates were not includable in petitioner's combined article 9-A tax returns.

109. Jefco executed securities trades for both "retail" and "institutional" investors, for which Jefco received brokerage commissions. Jefex primarily provided execution services to Jefco which requested those execution services for trades that Jefco made on behalf of its clients, as well as for other institutional investors, for which Jefex received brokerage commissions.

110. Thomas A. Franko testified at the hearing on behalf of petitioner and was admitted as an expert in financial services, broker-dealer trading, trade executions, clearing and regulation. Among the professional positions held by Mr. Franko during his 30-year career in the securities industry was Associate General Counsel and later General Counsel and Managing Director for Pershing LLC, the world's largest securities clearing firm, from 1986 through 2006.

111. Mr. Franko testified that a "retail investor" refers to an individual who opens an account with his or her broker-dealer and directly invests in securities.

112. Mr. Franko testified that an "institutional investor" refers to a legal entity that is acting on behalf of other parties, such as a mutual fund, hedge fund or pension fund, that invests in various types of securities on behalf of underlying investors such as in the case of mutual funds or hedge funds and pensioners, in the case of pension funds.

113. Mr. Franko testified that institutional investor clients of a broker-dealer are always representing underlying investors.

114. Mr. Franko testified that he considered an RIA to be different than an institutional investor, describing it instead as acting as the disclosed agent of a customer for the purpose of executing a trade in a customer account that is carried by the broker-dealer.

115. RIAs make investment decisions for their institutional and retail clients but cannot execute trades. Therefore, they arrange for securities broker-dealers to execute securities trades on behalf of those clients, for which the broker-dealers are paid brokerage commissions.

116. RIAs are compensated by the mutual fund, pension fund or similar collective investment vehicles that they manage or advise.

117. Mark D. Gersten testified at the hearing on behalf of petitioner and was admitted as an expert in the field of mutual funds and other pooled investment vehicles. Mr. Gersten worked

for more than 35 years in the mutual fund industry. He held various senior positions during his 26-year career at Alliance Bernstein, a large, registered investment advisory firm, from 1985 through 2011. Among the positions he held at Alliance Bernstein was Senior Vice President, Global Fund Administration, where he was the most senior official for operations relating to mutual funds and other pooled investment vehicles.

118. Mr. Gersten testified that one type of institutional investor is a mutual fund. A mutual fund is a corporate entity, usually established and managed by an RIA, that pools investor funds from the public in order to invest in securities. Investors acquire shares of stock in the mutual fund. Investing in securities through a mutual fund allows those investors to derive the benefits of the professional money management services being provided by the RIA to the fund.

119. Mr. Gersten testified that another type of institutional investor is a hedge fund. A hedge fund is usually a partnership entity that also functions as a collective investment vehicle for investors. It is subject to less government regulation than mutual funds.

120. Mr. Franko testified about another type of institutional investor, a government or private pension fund, which also functions as a collective investment vehicle by investing in securities on behalf of current and retired employees in order to provide for a sufficient return for their retirement.

121. Jefco's clients are predominately RIAs and institutional investors. Less than 5% of Jefco's clients are retail clients, i.e., individuals.

122. Mr. Franko and Mr. Gersten both testified that RIAs are not responsible for and do not pay the brokerage commissions to securities broker-dealers such as Jefco that execute securities trades at their request.

123. At the hearing, the Division's auditor admitted that he had no evidence of any RIA

paying brokerage commissions to Jefco. The auditor testified that he nonetheless concluded that the RIAs were Jefco's customers responsible for paying those commissions because the RIAs' names appear in Jefco's books and records.

124. The Depository Trust & Clearing Corporation (DTCC) is the world's largest financial post-trade infrastructure organization. It is responsible for confirming the agreed-upon terms of a sale of securities, i.e., clearing and for the transfer of funds to and from the accounts of the parties to the transaction and the delivery of the securities between the parties, i.e. settlement.

125. Mr. Franko testified that in the case of securities trades for institutional investors, brokerage commissions are paid to securities broker-dealers, such as Jefco, from each institutional investor's custodian bank through the DTCC securities clearance and settlement process.

126. Mr. Franko testified that brokerage commissions are never paid to the broker-dealer by the investment manager, i.e., the RIA or other investment advisor.

127. Mr. Gersten testified that in the case of securities trades executed on behalf of a mutual fund, an institutional investor, it is the mutual fund's custodian bank that pays the brokerage commissions to Jefco.

128. Mr. Gersten testified that although the mutual fund's custodian bank pays the brokerage commissions, it is the underlying investors in the mutual fund who economically bear those commissions. This is because the commissions are added to the purchase price that the shareholder investors pay for stock of the mutual fund.

129. Mr. Gersten explained that mutual funds incur two broad categories of costs: direct operating costs, such as management and administrative fees and trading costs, such as

brokerage commissions. Both categories of costs impact the net return of the investors in the mutual fund. Since investors in mutual funds provide the only source of capital for the funds, all trading costs of the funds including brokerage commissions "must necessarily come out of [the investors'] savings or the income earned on that savings."

130. Jefco does not know the identity or mailing address of the underlying investors in its institutional investor clients and does not know the identity of the underlying investors on whose behalf the RIAs and other institutional intermediaries are acting when the RIAs and other institutional intermediaries instruct Jefco to execute trades on behalf of their clients.

Broker-Dealer Sourcing: Principal Transactions

131. Jefco derives gross income from engaging in principal transactions in securities as a dealer or market maker. It engages in principal transactions from its offices in California, Connecticut, New Jersey, New York, and Texas.

132. Jefco engages in principal transactions involving both equities and fixed income securities. In the regular course of its business, Jefco engages in principal transactions by taking securities positions as a market maker to facilitate customer transactions as well as for its own proprietary risk trading.

133. When Jefco engages in a principal transaction to facilitate a client transaction, it acts as a principal to a client and commits capital. For example, if a client wishes to sell a large block of stock, Jefco would buy the stock, put the shares on its own balance sheet and attempt to sell those shares at a price higher than what Jefco paid for them.

134. Alternatively, when Jefco engages in a principal transaction for its own proprietary risk trading, Jefco is speculating on a specific security going up or down in value. For example,

if Jefco believes that a specific stock will rise in value, it will buy shares of that stock with the aim of selling those shares at a profit when they appreciate.

135. In both types of principal transactions described in findings of fact 133 and 134 above, Jefco generally does not know the identity or location of the party to whom the securities are sold.

136. When Jefco engages in sales of securities in principal transactions through a securities exchange, it does not know the identity or location of the party to whom the securities are sold.

137. When Jefco sells securities through an institutional intermediary, such as an RIA, it knows the identity of the institutional intermediary and in some instances, the identity of the institutional investor on whose behalf the RIA is acting, but it does not know the identity of the underlying investors in the institutional investor.

138. During the course of the Division's audit of petitioner's CT-3-A returns, petitioner provided the auditor with a detailed 41-page analysis of petitioner's customers for all of its equities principal transactions for tax year 2006 (exhibit V). Petitioner also provided the auditor with a detailed 100-page analysis of petitioner's customers for all of its fixed income principal transactions for tax year 2006 (exhibit W).

139. The auditor testified that he only reviewed schedules provided by petitioner related to its originally filed CT-3-A returns (exhibit S) but refused to review the detailed schedules relating to petitioner's amended CT-3-A returns (exhibits V and W), allegedly because "their methodology was not in keeping with" the Tax Law.

140. The auditor testified that he considered the "institutional intermediary" to be the customer and that he disallowed the taxpayer's methodology of sourcing its gross income from

principal transactions based upon the Manion letter.

141. The auditor testified that the Division sourced Jefco's receipts from principal transactions based upon the location of the "institutional intermediaries" in the transactions.

142. In its amended CT-3-A returns, petitioner used the same methodology to source gross income from principal transactions as it used to source brokerage commissions, that is, based upon an approximation of the location of the underlying investors.

143. In instances where petitioner was able to determine that the underlying investors of a particular institutional investor were located outside of New York, for example, where the name of the institutional investor was the "Retirement Plan of Saudi Arabia," it sourced the gross income from those principal transactions outside of New York whether or not the institutional investor's "c/o" address in its records was a New York address.

144. The auditor sourced to New York Jefco's gross income from fixed income and equity securities principal transactions if the schedules provided by petitioner (exhibits V and W) showed an institutional intermediary, such as an RIA or other broker-dealer, with a New York address.

145. The auditor sourced petitioner's gross income from principal transactions to New York whenever it involved an institutional intermediary with a New York address, regardless of whether the underlying investors of the institutional intermediary were located outside of New York State. For example, the auditor sourced petitioner's gross income from principal transactions with the Retirement Plan of Saudi Arabia based upon the retirement plan's investment advisor's "c/o" address in New York State. Similarly, the auditor also sourced to New York State petitioner's gross income from principal transactions with the Michigan

Retirement System based upon the retirement plan's investment advisor's address in New York State.

146. For tax year 2006, where the party to whom equities and fixed income securities were sold was unknown, the auditor sourced petitioner's gross income from those transactions, totaling $26,374,383,305.00, based upon the percentage of New York's population to the entire population of the United States according to the U.S. Census data, i.e., 6.4826%. Based upon the application of that percentage, the auditor determined that U.S. unknown fixed income New York receipts were $1,709,745.00. A review of schedule D5 of the BCMS workpapers indicates that the auditor also used the U.S. Census percentage for equities and determined the "Split of DTCC: US 104,611,798,100.00 x 6.4826% NY Census 6,781,564,424.00" and "Split of Unknown: US 245,713,230.00 x 6.4826% NY Census 15,928,606.00." For tax year 2006, the Division sourced $131,231,894,635.00, or 30% of petitioner's gross income from principal transactions using U.S. Census data.[9]

In tax year 2007, the Division sourced $1,063,720,475,990.00, or 43% of petitioner's principal transactions equities "Split of DTCC," using the U.S. Census data.[10]

147. The auditor testified that where the customer purchasing the securities was unknown, such as transactions cleared through the DTCC, the Division agreed to source the gross income from principal transactions based upon U.S. Census records, "as there was no other way to go about it" and he testified that he considered this approach to be "reasonable."

---

[9] These numbers are derived from schedule D5, which indicates that there was $441,058,740,175.00 of gross receipts from principal transactions and that the Division sourced $131,231,894,635.00 ($26,374,383,305.00 + $104,611,798,100.00 + $245,713,230.00) of those transactions using U.S. Census data ($131,231,894,635.00/$441,058,740,175.00 = 30%).

[10] A review of the schedule D8 of the BCMS workpapers indicates that in tax year 2007, there were $2,477,320,713,714.00 of gross receipts from principal transactions and the Division sourced $1,063,720,475,990.00 of those transactions, i.e., the transactions processed through the DTCC where the counterparty was unknown, using U.S. Census data ($1,063,720,475,990.00/$2,477,320,713,714.00 = 43%).

148. The auditor testified that the U.S. Census was used for DTCC receipts where the customer was unknown "because we realized not all of the unknowns would be New York."

149. According to the auditor, he, his supervisor, and his section head approved the decision to use the U.S. Census to source gross income from principal transactions where the customer was unknown.

Accrued Interest from Principal Transactions

150. For each of the tax years 2003 through 2007, Jefco received accrued interest from principal transactions. The amounts were set forth as "Other Interest" in the Division's BCMS schedules.

151. Accrued interest on principal transactions refers to interest that accrues daily on, for example, a municipal bond, but that is paid quarterly or semi-annually. When there is a change in ownership of the municipal bond, the purchaser is required to pay the accrued interest to the seller for the period that has not yet been paid through the date of sale.

152. The Division sourced Jefco's receipts from "Other Interest" based upon the location of the institutional intermediaries with which Jefco transacted.

153. In its amended CT-3-A returns, petitioner sourced its gross income from principal transactions (including accrued interest), based upon an approximation of the locations of the underlying investors of the institutional intermediaries with which it transacted and not based upon the locations of the institutional intermediaries themselves.

Broker-Dealer Sourcing: Margin Interest, Clearing Fees, and Management Fees

154. Petitioner sourced its margin interest, clearing fees, and management fees based upon an approximation of the locations of the underlying investors of the institutional

intermediaries with which it transacted and not based upon the locations of the institutional intermediaries themselves.

155. The Division sourced Jefco's receipts from clearing fees, margin interest, and management fees based upon the location of the institutional intermediaries in the transactions.

156. Margin interest is generated when a broker-dealer such as Jefco lends the purchaser of a security a portion of the purchase price and charges margin interest on that loan.

157. Mr. Franko testified that it is the investor or participant in the institutional investor that bears the cost of margin interest. Mr. Franko explained that management fees are charged by broker-dealers that are either dually registered as RIAs or that have an affiliate registered as a registered investment adviser for providing advisory and management services to their clients.

158. Jefco generated asset management fees from funds that it managed as well as from third-party managed funds.

159. Mr. Franko testified that while management fees are charged to the institutional investor, they are borne by the investors or participants in that entity. Mr. Franko explained that clearing fees are charged by registered broker-dealers that are members of the DTCC to brokerage firms to "clear" or execute trades through the DTCC. In such a case, when an introducing broker requests a trade through a clearing broker, the clearing broker charges a clearing fee to the related trade which is eventually paid by the introducing broker's customer.

Reasonable Approximation

160. Dr. Brian Cody testified at the hearing on behalf of petitioner as an expert in the fields of economics and finance. Dr. Cody has worked in the field of applied economics for over three decades, consulting with global companies in an array of industries to plan, document and defend their transfer pricing policies. He was admitted as an expert witness and provided

hearing and deposition testimony on transfer pricing and other economic issues in U.S. Federal District Court, U.S. Federal Bankruptcy Court, numerous state tax and district courts and the Superior Court of Justice (Ontario, Canada).

161. Dr. Cody attended the first seven days of the hearing, up to and including the day he testified, and he heard the testimony offered by both petitioner's and the Division's witnesses. Among other things, he heard the auditor's testimony regarding the BCMS schedules for tax years 2006 and 2007 related to assessment L-047323899 (exhibit J, joint exhibit 36) and reviewed the joint stipulation of facts (exhibit J).

162. Dr. Cody was asked to provide expert opinion testimony on three questions from an economic perspective: (i) who are the customers in the securities industry; (ii) who pays the cost of transactions in the securities industry; and (iii) what is a reasonable measure for approximating the location of those customers when their specific identity and location are not known.

163. Dr. Cody gave the following expert opinions from an economic perspective in response to those questions: (i) the customers are the individual investors; (ii) the individual investors pay the costs; and (iii) several different measures for approximating customer location yield reasonable results, with U.S. Census Bureau information being the best measure he considered.

164. Dr. Cody testified that from an economic perspective, when determining who the customer is, he looks at whose money is at stake. Dr. Cody noted that in the securities industry, customers can engage in trading and investment in securities both directly and indirectly.

165. Direct investments in specific securities are made by directly purchasing those securities through a broker-dealer, while indirect investments in securities are made through mutual funds, pension plans, 401(k)s and similar collective investment vehicles.

166. Dr. Cody testified that while direct investors manage their own investments, indirect investors pay another party to manage and administer their investments.

167. According to Dr. Cody, investment managers, including RIAs, act in a fiduciary capacity and provide investment management services to investors, do not have money at stake, and from an economic perspective are not the customers.

168. Dr. Cody testified that economically it is the individual investors, not the investment managers or the institutional investors, that pay the costs of the transactions in the securities industry. Dr. Cody further testified that when an investor makes an investment decision to buy or sell securities, he obligates himself to pay the costs associated with those investments such as commission fees at that time.

169. Dr. Cody testified that from an economic perspective, the customers in the securities industry are the individual investors, and it makes no difference whether or not they own securities directly or invest indirectly through a mutual fund or some other investment vehicle. Dr. Cody testified that the most reasonable method to approximate the locations of customers in the securities industry when their locations are unknown is to use U.S. Census Bureau information.

170. Dr. Cody prepared an analysis containing data from the Bureau of Economic Analysis, U.S. Department of Commerce (BEA analysis).

171. The BEA analysis showed that New York's share of gross domestic product, which

is a measure of expenditures nationwide, was on average 7.88% during tax years 2003 through 2007.

172. The BEA analysis showed that New York's share of disposable personal income, which measures how much income people have at their disposal to spend on things like food, housing, recreation, and investments, was on average 7.16% during tax years 2003 through 2007.

173. The BEA analysis showed that New York's share of the U.S. population, or U.S. Census, was on average 6.48% during tax years 2003 through 2007.

174. The Division's calculation of Jefco's receipts allocation factor for tax year 2006 was approximately 22%, which it also applied to tax years 2003 through 2005. The Division's calculation of Jefco's receipts allocation factor for tax year 2007 was approximately 20%.

175. Dr. Cody testified that the method the Division used to allocate Jefco's receipts grossly overstates, by a factor of three or four, the results reached using an allocation method that reasonably approximates the location of the individual investors, i.e., the customers.

176. Dr. Cody observed that the Division's computation of the allocation percentage exceeded the gross domestic product of the entire Mideast Region that includes not just New York, but also New Jersey, Pennsylvania, Maryland, the District of Columbia and Delaware.

177. Dr. Cody testified that using New York's share of the U.S. Census to source Jefco's receipts from customers, i.e., the individual investors, when it does not know their location was the most reasonable method because it is a direct and reliable measure of where individual investors are likely to be located. Dr. Cody testified that, in his opinion, using the U.S. Census was the most reasonable because the other two measures take into account other economic characteristics relating to expenditures that do not necessarily relate to investment activities.

ITC/EIC: Background

178. For each of the tax years 2003 through 2007, petitioner timely claimed the ITC for tangible personal property and other tangible property that was "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" pursuant to Tax Law former § 210 (12) (b) (i).

179. For each of the tax years 2003 through 2007, petitioner timely claimed the EIC, which was calculated based upon petitioner's ITC claims for the two immediately preceding tax years, pursuant to Tax Law former § 210 (12-D).

180. For each of the tax years 2003 through 2007, petitioner claimed the ITC for qualified property, including leasehold improvements, that was used by Jefco's investment banking department.

181. For each of the tax years 2003 and 2005 through 2007, petitioner claimed an ITC for qualified property, including leasehold improvements, that was used by Jefco's prime brokerage department.

182. For each of the tax years 2003 through 2007, petitioner claimed an ITC for qualified property, including leasehold improvements, that was used by Jefco's research department.

183. Petitioner claimed the ITC in connection with purchased computer software.

184. The Division conducted a separate audit of petitioner's claimed ITC and EIC for tax years 2003 through 2007 (ITC audit). The Division disallowed a portion of petitioner's claimed ITC for qualified property used by Jefco's investment banking, prime brokerage and research departments.

185. The Division disallowed in its entirety petitioner's claimed ITC for its purchases of computer software.

186. The Division disallowed the claimed ITC for every item of property for which petitioner did not provide an invoice.

187. For each of the tax years 2003 through 2007, the Division deemed that 10% of petitioner's allowed ITC should be recaptured based upon the assumption that 10% of petitioner's qualifying property ceased to be in qualified use prior to the end of its useful life.

ITC: Floor Space Analysis for Leasehold Improvements

188. A portion of petitioner's ITC claims related to leasehold improvements that it made to floor space used by Jefco's investment banking, prime brokerage and research departments.

189. In order to determine whether such leasehold improvements were principally used for qualifying activities, the Division applied a 50% use test to each floor, under which if 50% or more of the floor space to which improvements were made was used by a qualifying department, then the ITC would be allowed for the leasehold improvements (floor space analysis).

190. The Division's auditor determined whether the floor space used by Jefco's investment banking, prime brokerage, and research departments qualified for the ITC based upon the guidance issued by the Division's Office of Tax Policy Analysis, Taxpayer Guidance Division, dated July 12, 2007, (NYT-G-07[4]C), *Property Qualifying for the Investment Tax Credit for the Financial Services Industry* (G-Notice).

191. The G-Notice is an "informational statement" that is based upon a particular set of facts or circumstances" and "is limited to the facts set forth therein." The G-Notice was based upon the facts involving a taxpayer entirely unrelated to Jefco.

192. Mr. Francis Oyenuga, the audit supervisor for the ITC audit, testified that he

believed that taxpayers are required to follow the G-Notice.

193. In performing the floor space analysis for Jefco's leasehold improvements, the Division determined that only 71.4268% of the floor space used by Jefco's investment banking department qualified for the ITC. The Division's determination that only 71.4268% of the space used by Jefco's investment banking department qualified for the ITC was based upon the conclusion reached in the G-Notice that only five of the seven activities of the investment banking department described in the G-Notice qualified for the ITC.

194. The audit supervisor admitted that neither he, nor the auditor, made a determination as to whether Jefco's investment banking department and other departments functioned in the same way as the business units described in the G-Notice.

195. In performing the floor space analysis, the Division determined that only 33.33% of the floor space used by Jefco's prime brokerage department qualified for the ITC. The Division's determination that only 33.33% of the floor space used by Jefco's prime brokerage department qualified for the ITC was based upon the conclusion reached in the G-Notice that only one of the three activities of the prime brokerage department described in the G-Notice qualified for the ITC.

196. The audit supervisor admitted that neither he, nor the auditor, made a determination as to whether Jefco's prime brokerage department functioned in the same way as the business units described in the G-Notice.

197. In performing the floor space analysis, the Division determined that none of the floor space was used by Jefco's research department in a qualifying activity under the ITC. The Division's determination that none of the floor space used by Jefco's research department

qualified for the ITC was based upon the conclusion in the G-Notice that the research department at issue did not engage in qualifying activities.

198. The audit supervisor admitted that neither he nor the auditor made a determination as to whether Jefco's research department functioned in the same way as the research department described in the G-Notice.

ITC: Property Related to Investment Banking

199. The Division disallowed the ITC for tangible property related to Jefco's "Investment Banking – General" department, despite its determination that over 71% of Jefco's investment banking activities qualified for the ITC.

200. The Division disallowed the ITC for property placed in service in Jefco's "Investment Banking – Restructuring" and "Investment Banking – M & A (mergers and acquisitions)" departments based upon the conclusion reached in the G-Notice stating that they do not qualify.

201. The audit supervisor admitted that despite concluding that 71% of the investment banking activities qualify for the ITC, the Division still sometimes disallowed the ITC for property placed in service in Jefco's general investment banking department because he did not know which part of the investment banking division was using the property.

202. Petitioner presented the testimony of Mr. Gary Strumeyer at the hearing. Mr. Strumeyer was admitted as an expert in the fields of capital markets and investment banking. Mr. Strumeyer was the president and chief executive officer (CEO) of Bank of New York Capital Markets for eight years. Mr. Strumeyer taught at the university level in the areas of capital markets and has published three books on capital markets. The area of "capital markets"

covers both investment banking, including mergers, acquisitions and restructuring and prime brokerage.

203. Mr. Strumeyer was asked by petitioner to give his opinion on whether certain activities identified in the G-Notice are "in connection with the purchase and sale of securities."

204. Mr. Strumeyer testified that he was familiar with petitioner's business and had reviewed petitioner's 2006 form 10-K in evidence.

205. Regarding investment banking, the G-Notice states that a securities broker-dealer's:

> "activities of providing related financial advisory services to help plan for the underlying transaction that creates the client's stock or debt capital needs such as a merger, acquisition, divestiture or some other restructuring, are not activities in connection with the purchase or sale of securities pursuant to section 210.12(b)(i)(D) of the Tax Law" (emphasis in original).

206. Mr. Strumeyer testified that mergers and acquisitions and restructurings cannot be accomplished without planning, including the provision of financial advisory services to help plan the transactions.

207. Mr. Strumeyer testified in his 30 years of experience, he had never known transactions such as those described on page 13 of the G-Notice to be accomplished without financial planning and that such financial planning is integral to the transaction.

208. Mr. Strumeyer explained that mergers and acquisitions are connected with and integral to the sale of securities and that the sole reason a person would advise in the planning or structuring of a merger or acquisition is to effect a securities transaction, i.e., to ultimately buy or sell securities.

209. Mr. Strumeyer testified that a restructuring is very similar to a merger or acquisition and is generally undertaken by a company under financial duress that then works with its advisors on how to raise more equity, such as by selling off a division.

210. Mr. Strumeyer testified that restructurings are related to the sale of securities in the same way that a merger or acquisition is related to the sale of securities.

211. Mr. Strumeyer further observed that the statute interpreted in the G-Notice, Tax Law former § 210 (12) (b) (i) (D), states that the purchase and sale of securities is not limited to, but includes the "issuance, entering into, assumption, offset, assignment, termination, or transfer" of securities, which are not terms generally used in straight sales of securities but are terms used in mergers, acquisitions, restructurings, and similar transactions.

212. Mr. Strumeyer testified that in his experience the provision of advisory services to assist with planning an underlying securities transaction, such as a restructuring or merger or acquisition as described on page 13 of the G-Notice, are connected with and integral to the purchase or sale of securities.

ITC: Property Related to Research

213. Regarding research activities, the G-Notice states that a broker-dealer's research department:

> "performs a differentiated research effort that is firmly aligned with the interests of [the taxpayer's] investing clients as an important part of its Equities business. The activities of engaging in global research to provide industry expertise, independent thinking, and timely insights to investors are not activities in connection with the purchase or sale of securities pursuant to section 210 (12) (b) (i) (D)" (emphasis in original).

214. Mr. Strumeyer testified that the research activities discussed on page 18 of the G-Notice were connected with and integral to the purchase and sale of securities. Mr. Strumeyer testified that there are three categories of research that an investment banking department typically undertakes: macro research, equities research and fixed income research.

215. Macro research generally involves looking at the geopolitical and economic climate to make a general determination of whether it is a good time to buy or sell securities.

216. Equities research involves researching at a more granular level to determine whether it is the right time to buy or sell specific stocks.

217. Fixed-income research involves researching whether it is a good time to buy or sell specific fixed income securities.

218. In Mr. Strumeyer's opinion, all three categories of research undertaken by an investment banking department are connected with and integral to the purchase and sale of securities.

ITC: Property Related to Prime Brokerage

219. Mr. Strumeyer testified that the term "prime broker" refers to the main broker for a hedge fund. Mr. Strumeyer testified that the role of the prime broker is to provide trade processing, risk monitoring, trade executions, industry information and similar services to hedge funds.

220. Regarding prime brokerage activities, the G-Notice states that "the activity of providing information to assist investment managers and hedge funds in making purchase and sale decisions are not activities in connection with the purchase or sale of securities pursuant to section 210 (12) (b) (i) (D) of the Tax Law" (emphasis in original).

221. Mr. Strumeyer testified that the activity of providing information to assist investment managers and hedge funds in making purchase and sale decisions are "absolutely" connected with and integral to the purchase and sale of securities for the same reasons that research activity is connected with the purchase and sale of securities. He testified that the providing of such information was analogous to the provision of information by a sommelier at a restaurant relating to the purchase of a bottle of wine.

222. Regarding prime brokerage activities, the G-Notice also states that it:

> "is not clear from the facts whether the activities of developing and implementing key technologies to speed execution and increase the flow of information are conducted by employees of the Prime Brokerage segment. In any event, these activities are not activities in connection with the purchase or sale of securities pursuant to section 210 (12) (b) (i) (D) of the Tax Law" (emphasis in original).

223. Mr. Strumeyer explained that much of the work in the purchase and sale of securities and specifically in prime brokerage, is done by machines and is algorithm driven.

224. Mr. Strumeyer explained that particularly in the area of high-frequency trading, "it is all about latency and speed" at which orders can be executed once information is released, for example, news that Pfizer was releasing its COVID-19 vaccine to the world, because all of the hedge funds compete to get their order in first.

225. Mr. Strumeyer testified that as a result of the competition to have the fastest execution, prime brokerage departments invest substantial funds to make their trading technology faster than their competitors.

226. Mr. Strumeyer testified that the implementation of key technology and related activities described in paragraph (b) of page 16 of the G-Notice are activities connected with and integral to the purchase and sale of securities.

ITC: Missing Invoices

227. The audit supervisor testified that if he and the auditor did not have the invoice for a particular purchase of property in the binders and boxes of ITC documents supplied by petitioner during the audit, the Division disallowed the ITC for that item.

228. The schedule that the Division submitted into evidence which lists the property for which the Division allowed the ITC lists thousands of items of purchased property over a five-year period.

229. The audit supervisor did not know if the Division has any type of mitigating policy

allowing the ITC in the absence of a specific invoice where the taxpayer has provided the vast majority of the invoices.

230. For the thousands of items of property for which petitioner claimed the ITC for the years 2003 through 2007, petitioner provided to the auditor approximately 94% of the invoices for those purchases.

ITC: Recapture

231. For each of the tax years 2003 through 2007, the Division deemed that 10% of petitioner's allowed ITC should be recaptured based upon the assumption that 10% of petitioner's property qualifying for the ITC ceased to be in qualified use prior to the end of its useful life.

232. The audit supervisor admitted that neither he nor the auditor found any evidence that property for which the ITC was allowed was disposed of before the expiration of its useful life.

233. The audit supervisor admitted that "[t]here's no basis or anything" in the statute or regulations for applying a 10% recapture and that he, the auditor and their supervisor "came up with the ten percent number" on their own.

234. Petitioner submitted into evidence at the hearing its January 21, 2015 written response to an information document request (IDR) relating to the ITC, which was prepared by Ms. Cerchia of Jefferies (ITC IDR response). This 9-page ITC IDR response listed each IDR – 61- item in an outlined box and petitioner's bolded response to same. Where necessary, petitioner's response referenced tabulated document enclosures.[11]

[11] Neither the referenced attached IDR dated January 7, 2015, nor the referenced enclosures were attached to this exhibit.

235. In that ITC IDR response, petitioner responded to Request #4 which asked that petitioner provide a depreciation schedule, including a reconciliation of that depreciation schedule to the federal form 1120. Specifically, petitioner provided the depreciation schedules for tax years 2000 through 2007 in "**Tabs #2 -9**," and a "**reconciliation to the Federal Form 4562, *Depreciation and Amortization***" (emphasis in original).

236. Ms. Cerchia testified, and the ITC IDR response demonstrates, that petitioner provided a depreciation schedule during the course of the audit and made a good faith effort to reconcile it to the federal form 1120.

237. Petitioner submitted into evidence its federal form 4797, Sales of Business Property (form 4797), for each of the tax years 2004, 2005, 2006 and 2007.

238. Ms. Cerchia testified that the forms 4797 were attached to petitioner's form 1120 returns, and that complete forms 1120, including forms 4797, were attached to petitioner's combined article 9-A returns for the years at issue.

239. Form 4797 evidences whether petitioner sold or otherwise disposed of any depreciable property during the years in issue or had any property involuntarily converted or recaptured for federal income tax purposes.

240. Ms. Cerchia testified that Jefco's form 4797 for each of the tax years 2004, 2005 and 2006 did not report any sales or disposition of property by Jefco. There was no form 4797 for 2003 because there was nothing to report on the form.

241. Ms. Cerchia testified that Jefco's 2007 form 4797 reported a disposition of property resulting in a $103,792.00 loss.

242. The amount recaptured by the Division for 2007 was $62,311.00, which was equal to 10% of the prior year's allowed ITC and EIC of $623,106.00 that would have been based

upon total qualifying property of approximately $12,462,120.00, of which approximately $1,246,212.00 would have been taken out of service before the end of its useful life.

ITC: Software

243. For tax years 2003 through 2007, petitioner claimed the ITC with respect to software purchased by Jefco. The auditor denied 100% of the ITC claimed by petitioner for software for those years.

244. For tax years 2000 and 2001, petitioner claimed the ITC with respect to software purchased by Jefco.

245. For tax years 2000 and 2001, the auditor allowed a portion of the ITC claimed by petitioner for software.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

Citing Tax Law former § 208, the Administrative Law Judge noted that "business capital" means "all assets, other than subsidiary capital, investment capital and stock issued by the taxpayer, less liabilities not deducted from subsidiary or investment capital except that cash on hand and on deposit shall be treated as investment capital or as business capital as the taxpayer may elect." For tax years 2001 through 2007, petitioner elected to treat the cash collateral (used in connection with securities lending transactions) as investment capital and timely filed amended article 9-A returns making such elections and refund claims related to the same. In her determination, the Administrative Law Judge upheld petitioner's election to treat cash collateral used in connection with its securities lending transactions as investment capital[12]. The Administrative Law Judge held that the regulation did not limit the definition of cash on

[12] During the years 2001 through 2007, Jefco engaged in securities lending transactions in which it both borrowed and lent securities. It used cash as a collateral and either earned interest income or accrued interest expense.

hand and cash on deposit to short-term debt but rather expanded it to include certain short-term debt instruments. The Administrative Law Judge found the definition of a cash "deposit" to be "something placed for safekeeping: (a) money deposited in a bank" or "(b) money given as a pledge or down payment" (Webster's Tenth Collegiate Dictionary, pg. 310 [1993]).

The Administrative Law Judge found that the Division's interpretation of: (1) "cash on deposit," which included certain short-term debt instruments and excluded cash deposited with a bank or other institution, was contrary to the statute's plain language; and (2) a 2007 amendment to former 20 NYCRR 3-3.2, which prohibited taxpayers from electing to treat cash deposited in its securities lending transactions as investment capital, was incorrect. The Administrative Law Judge determined that the Division's regulation amendments only addressed the availability of the cash election for "securities lending agreements" and not for actual cash collateral.[13]

As for the 2007 amendment, the Administrative Law Judge held that Tax Law former § 208 (7) (a) does not contain any limitations on making the cash election for actual cash on deposit. Further, the Administrative Law Judge concluded that it does not contain qualifying language limiting petitioner's cash election, nor does it require the cash to be used for investment purposes. For these reasons, the Administrative Law Judge held that the cash collateral petitioner provided in interest rate swap transactions and the cash on deposit with a futures trading business, constitute "cash on deposit" under the plain meaning of the term and that petitioner made valid cash elections for these activities.

---

[13] The Division argued that the 2007 amendments to former 20 NYCRR 3-3.2 specifically excluded repurchase agreements and securities lending agreements from the definition of investment capital (***see*** former 20 NYCRR 3-3.2 [A] [2] [viii]) and, in case of such agreements held by registered securities brokers or dealers, explicitly provided that such agreements did not constitute cash on hand or cash on deposit (***see*** former 20 NYCRR 3-3.2 [g]) (contending that this subsection prohibited registered securities brokers or dealers from electing to treat cash deposited in a securities lending transaction as investment capital).

The Administrative Law Judge disagreed with the Division that the cash used in connection with the described activities was not cash on deposit as it was clearly used for a "business" purpose. In doing so, the Administrative Law Judge determined that the Division's interpretation that excludes actual cash deposited in connection with business transaction from "cash on hand and on deposit" is irrational and unreasonable. Thus, the Administrative Law Judge directed the Division to adjust petitioner's investment income and business income for the tax years 2001 through 2007.

The Administrative Law Judge found that the underlying investors of the institutional intermediaries are the "customers responsible for paying" petitioner but recognized that "former § 210 (3) (a) (9) does not allow a look through to the underlying investor . . ." As such, the Administrative Law Judge found that petitioner could not source receipts based on an approximation of its underlying investors. Relying on petitioner's expert witness's testimony, the Administrative Law Judge noted that the Division's method for allocating petitioner's receipts "grossly overstates, by a factor of three or four times, the results reached using an allocation method that reasonably approximates the location of the individual investors, i.e., the customers." Further, the Administrative Law Judge noted that the use of New York's share of the U.S. Census data was appropriate in this instance. Accordingly, the Administrative Law Judge directed the Division to exercise its discretionary authority and use the U.S. Census data to source petitioner's receipts allocation factor from its brokerage commissions, principal transactions, investment banking, margin interest, management fees, clearing fees and other interest.

For each of the tax years 2003 through 2007, Jefco claimed the ITC for its purchases of tangible property, including leasehold improvements, used by its investment banking, prime

brokerage, and research departments at its New York offices. The Division disallowed a substantial portion of these claims based on the Department's G-notice (***see*** NYT-G-07[4]C), *Property Qualifying for the Investment Tax Credit for the Financial Services Industry*). The Administrative Law Judge found that petitioner's interpretation of Tax Law former § 210 (12) (b) (i) (D), namely, that property used in connection with the purchase or sale of securities was qualified for purposes of Tax Law former § 210 (12) (b) (i) (D), was the only reasonable one. The Administrative Law Judge noted that the ITC statute applicable to broker-dealers required that in order to qualify for the ITC, the property must be 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 four hundred seventy-five (e) of the Internal Revenue Code" (***see*** Tax Law former § 210 [12] [b] [ii] [D]). Accordingly, the Administrative Law Judge found the Division's disallowance of the taxpayer's claimed ITCs was improper.

The Administrative Law Judge also found that the Division's disallowance of claimed ITCs for items of property for which petitioner did not have an invoice was improper because these costs were shown in petitioner's books and records, on which the Division had relied in conducting other aspects of the ITC audit.

The Administrative Law Judge held that the Division was not authorized to recapture any of petitioner's ITCs and EICs as petitioner did provide the auditor with a depreciation schedule to its federal form 1120, as well as forms 4797, thus demonstrating that such property was not disposed of before the end of its useful life.

The Administrative Law Judge found that the Division's allocation method was distortive because the Division's calculation of the receipts allocation factor grossly overstated by a factor of three or four times the results reached using an allocation method that reasonably approximates the location of individual investors, i.e., the customers, thus resulting in an impermissible distortion of petitioner's income.

ARGUMENTS ON EXCEPTION

On exception the Division argues that it did not err in disallowing petitioner's cash collateral election as investment income. The Division contends that former 20 NYCRR 3-3.2 (a) (2) provides that investment capital does not include futures contracts, forward contracts and securities lending agreements (as described in former 20 NYCRR 3-3.2 [g]). According to the Division, the Administrative Law Judge misinterpreted the regulation and stated that 20 NYCRR 3-3.2 (g) applies only to securities lending agreements themselves and not the cash used as collateral in those transactions.

The Division asserts that the Administrative Law Judge erred in directing a discretionary adjustment. On the amended tax returns, petitioner sourced the receipts (for determining the receipts factor) using a "wealth factor" leading to a reasonable approximation of where those customers had their addresses. The Division argues that the Administrative Law Judge's conclusion that the underlying investors of the institutional intermediaries were petitioner's customers responsible for paying petitioner's receipts is inconsistent with the proof at the hearing as petitioner identified the intermediaries as its customers several times during conversations with the Division. The Division insists that the Administrative Law Judge's reliance on U.S. Census data is misplaced as it presupposes that investors are evenly spread throughout the United States and that the amounts of their investments are equivalent throughout the United States.

The Division asserts that its disallowance of the claimed ITCs and EICs was proper. In support the Division argues that the G-Notice concluded that providing related financial services to help plan for the underlying transaction that creates the client's stock or debt capital needs such as a merger, acquisition, divestiture, or some other restructurings are *not* activities in connection with the purchase or sale of securities pursuant to Tax Law former § 210.12 (b) (i) (D). As such the denial of petitioner's claimed ITCs for their investment banking department was proper.

For the prime brokerage, the Division contends that the G-Notice concluded that the activity of providing information to assist investment managers and hedge funds in making purchase and sale decisions and the activities of developing and implementing key technologies, are not activities in connection with purchase or sale of securities pursuant to Tax Law former § 210 (12) (b) (i) (D). Accordingly, the Division asserts that these activities are not part of "assembly line" production processes of a broker-dealer.

In order to justify the denial for the ITCs for petitioner's research department, the Division argues that the Legislature's intent in enacting Tax Law former § 210 (12) (b) (i) (D) was to extend the ITC to the financial services industry for investments similar to investments in buildings, equipment and facilities used for production that qualify for manufacturers. Thus, the Division asserts that the disallowance pertaining to the research department was proper.

The Division argues that it is unreasonable and impractical for the Division to approve ITC in specific amounts for specific items with no supporting documentation. Accordingly, the Division insists that their denial of the ITCs in case of missing invoices was proper.

The Division justifies their 10% recapture by asserting that Federal forms 4797 provided no information about the useful life and depreciation of its items of tangible property approved

for ITC. The Division contends that since petitioner's software was not connected to petitioner's assembly line production processes of a broker-dealer, the denial of the ITCs for the computer software was proper.

Lastly, the Division asserts that there is no unconstitutional distortion when the receipts of a broker-dealer are sourced to the taxpayer's branch or office that generated the transactions that generated the receipts for brokerage commissions, margin interest and management and clearing fees or to the taxpayer's branch, office or employee within the state awarded production credits as a result of principal transactions. In this instance, the transactions that generated the receipts primarily took place in petitioner's branches or offices in New York City. Accordingly, the Division's apportionment of petitioner's receipts does not violate the Commerce Clause and the Due Process Clause of the United States Constitution.

Petitioner, in its reply brief, asserts that the Division's interpretation of Tax Law former § 208 (7) (a) as limiting the cash election to cash that has not been invested in deposited or committed to an instrument or asset that is either investment income or business income is contrary to the plain meaning of the statute. Petitioner contends that Division's interpretation of the Tax Law is contrary to the plain meaning of the statute that permits taxpayers to elect to treat cash on deposit as investment income or business income.

Petitioner cites advisory opinion TSB-A-92(3)C and asserts that it undermines the Division's position that the cash election is unavailable for cash used for business purposes because it allowed a taxpayer to make the cash election for cash it received from its payroll service clients that it deposited in its own account and invested before making necessary payroll tax withholding deposits to appropriate taxing authorities. Additionally, petitioner argues that the Division's reliance on the 2007 amended regulation(s) was not in effect for six of the seven

years at issue. Petitioner further contends that the regulation does not exclude cash collateral provided in securities lending transactions from the definition of cash on deposit or cash on hand, instead, it merely provides that securities lending transactions do not constitute cash on hand or on deposit and is not investment capital.

Next, petitioner argues that RIAs and other institutional investors are not the customers responsible for paying the commissions, fees and receipts and that the Administrative Law Judge correctly concluded that the underlying individual investors in the mutual funds and other institutional investors are customers paying the commissions. Petitioner asserts that the term "customer" should have the same meaning as "customer responsible for paying." Further, petitioner argues that the Administrative Law Judge rightfully directed the Division to apply its discretionary authority to source petitioner's gross income from principal transactions using the U.S. census data.

Petitioner argues that the Administrative Law Judge correctly rejected the Division's claim that petitioner was not entitled to discretionary adjustment under ***Matter of Principal Mutual Life Insurance Company*** (***see Matter of Principal Mut. Life Ins. Co.***, Tax Appeals Tribunal, January 13, 2000). Additionally, petitioner contends that the Division has made no showing that petitioner's sourcing rules would have industry-wide implications. Petitioner contends that discretionary allocation should be considered on a taxpayer-by-taxpayer basis. Accordingly, petitioner asserts that the Administrative Law Judge correctly concluded that Division's method of sourcing customer receipts was distortive and required a discretionary adjustment based on U.S. Census.

Next, petitioner argues that the Division erred in disallowing the claimed ITCs and EICs. In support of their argument, petitioner asserts that the Division's reliance on the G-notice is

misplaced as a G-notice does not have any legal force or effect. The conclusions in the G-notice relate to a different taxpayer and the facts discussed therein are distinguishable. Additionally, petitioner claims that the Legislature intended to include all the related activities of a broker-dealer (mergers, acquisitions, restructuring etc.) within the meaning of the purchase and sale of securities, which is contrary to the conclusion reached in the G-notice. Petitioner argues that computer software and related technologies should qualify as assembly line functions of a broker-dealer activity. Therefore, according to petitioner, purchases thereof would be eligible for the claimed ITCs.

Petitioner did not provide invoices for a small fraction of the property for which the Division denied the ITC. Petitioner asserts that the Administrative Law Judge properly held that petitioner's failure to provide six percent of thousands of invoices over a seven-year period is a "red herring" that cannot justify the Division's denial of the claimed ITC's.

Petitioner contends that the Administrative Law Judge properly determined that the Division did not have the authority to recapture any of petitioner's claimed ITC and EIC and that such recapture was unreasonable.

Petitioner argues that the Division erred in disallowing the ITCs for the computer software based on the reliance on the G-notice. The Division held that petitioner had not established on an item-by-item basis that the software at issue was used in its assembly line functions. However, petitioner argues that petitioner provided cost, cost center, floor, etc. for each item of software.

Lastly, petitioner contends that the Division's sourcing of the receipts based on the addresses of the entities that are not the customers does not reflect a reasonable sense of how the income is generated as it produces a grossly overstated result. Accordingly, petitioner asserts

that the Division's apportionment of petitioner's receipts violates the Commerce Clause and the Due Process Clause of the United States Constitution.

OPINION

The Administrative Law Judge concluded that petitioner's election to treat cash collateral used in connection with its securities lending transactions as investment capital was the correct treatment. Finding that the term was not defined under the statute, the Administrative Law Judge found that the definition of "deposit" is "something placed for safekeeping: (a) money deposited in a bank" or "(b) money given as a pledge or down payment" (Webster's Tenth Collegiate Dictionary, 310 [1993]). The Administrative Law Judge held that the regulation did not limit the definition of cash on hand and cash on deposit to short-term debt, but rather expanded it to include certain short-term debt instruments.

We begin our analysis by examining what comprises a securities lending transaction. Typically, most securities lending transactions involve the pledging of cash collateral (***see*** Adrian et. al., "***Repo and Securities Lending***," *Federal Reserve Bank of New York Staff Reports*, no. 529, [December 2011] [revised February 2013]). The lender of a security pays interest at a predetermined rate on the cash collateral to the borrower of the securities (***id.***). In addition to the return generated through the lending transaction, lenders of securities seek to earn an additional return through investment of the cash collateral (***id.***).

The next question to be addressed is whether the cash collateral used in Jefco's securities lending transactions qualifies to be treated as "cash on deposit" under the Tax Law. The term "cash on deposit" as used in Tax Law § 208 (7) (a) is not defined under Article 9-A (***see*** Advisory Opinion TSB-A-02[10]C). We agree with the Administrative Law Judge that an undefined statutory term must be construed according to its ordinary and accepted meaning at the

time of enactment (***see Matter of Sunoco, Inc. (R&M) Combined Affiliates (n/k/a Sunoco [R&M], LLC), et al.***, Tax Appeals Tribunal, November 18, 2024; ***see also Matter of Catalyst Repository Sys., Inc.***, Tax Appeals Tribunal, July 24, 2019). We have held that "cash on deposit" means nothing more than cash deposited in a bank or similar institution, both for safekeeping and to earn income (***see Matter of C. Czarnikow, Inc.***, Tax Appeals Tribunal, April 25, 1991).

Here, in determining whether the cash collateral used in Jefco's securities lending transactions equates to money deposited in a bank or a similar institution, both for safekeeping and to earn income, it is appropriate to look at its function and search for substance over form with emphasis on economic reality (***see Matter of Avon Prods. v State Tax Commn.***, 90 AD2d 393, 394-395 [3d Dept 1982]; ***see also United Hous. Found v Forman***, 421 US 837 [1975], ***rehearing denied*** 423 US 884 [1975]). Petitioner's principal operating subsidiary, Jefco, engages in securities lending transactions as a securities borrower, where it earns interest income on the cash collateral that it posts with the securities lender. When Jefco engages in the transactions as a securities lender, it incurs interest expenses on the cash collateral that the securities borrower posts with it. The cash collateral that Jefco deposits in a securities lending transaction belongs to Jefco at all times and is returned to it when Jefco returns the borrowed securities. Therefore, the cash collateral used in these transactions is the functional equivalent of cash pledged or cash deposited temporarily for safekeeping as the ownership is always retained by Jefco.

Additionally, we agree with the Administrative Law Judge that Tax Law former § 208 (7) (a) contains no qualifying language limiting the taxpayer's cash election or any requirement that the cash be used for investment purposes. Accordingly, petitioner's interpretation that its cash

collateral constitutes "cash on deposit" for purposes of the statutory cash election is the only reasonable interpretation. On exception, both the Division and petitioner cite to an advisory opinion TSB-A-92[3]C (February 25, 1992) discussing the cash election with respect to a company involved in payroll processing. We note that advisory opinions are not binding except with respect to the person to whom the opinion is issued (***see*** Tax Law § 171 [twenty-fourth]). Additionally, the facts set forth in the advisory opinion are distinguishable from those in the instant case. In TSB-A-92[3]C, "cash on deposit" pertains to amounts given over to a corporation for the payroll services provided by that corporation, whereas here the "cash on deposit" relates to securities borrowing and securities lending transactions, interest rate swap transactions, and cash on deposit with FIMAT.

Therefore, the Division improperly denied petitioner's Tax Law former § 208 (7) (a) election to treat the net income from its securities borrowing and securities lending transactions, interest rate swap transactions, and cash on deposit with FIMAT as investment capital.

Next, we address whether the Division properly disallowed petitioner's claimed sourcing methodology used to compute the business receipts factor of the business allocation percentage. A corporation's investment income and business income are allocated to New York pursuant to the corporation's IAP (Tax Law former § 210 [3] [b]) and its BAP (Tax Law former § 210 [3] [a]), with the resulting amounts totaled to arrive at the corporation's ENI. In accordance with Tax Law former § 210 (3) (a)[14], the corporation's BAP is determined by: (i) the percentage which the average value of the taxpayer's real and tangible property within the state bears to the average value of all the taxpayer's real and tangible property wherever situated (the property

[14] Tax Law former § 210 (3) (a) (10) (A) provides for modifications to the manner in which the BAP is computed for tax years beginning on or after January 1, 2006 and before January 1, 2007 (***see*** Tax Law former § 210 [3] [a] [10] [A] [i]); and for tax years beginning on or after January 1, 2007, the BAP shall be a percentage provided for in Tax Law former § 210 (3) (a) (2) (***see*** Tax Law former § 210 [3] [a] [10] [A] [ii]).

factor); (ii) the percentage which the receipts of the taxpayer from sales, services, rentals, royalties and all other business transactions within the state bear to the total amount of the taxpayer's receipts from sales, rentals, royalties and all other business transactions, whether within or without the state (the receipts factor); (iii) the percentage of the total wages, salaries and other personal service compensation of employees within the state, except general executive officers, to the total wages, salaries and other personnel service compensation of all the taxpayer's employees within and without the state, except general executive officers (the wage factor); and (iv) adding the determined percentages and dividing the result by the number of factors used (***see*** Tax Law former § 210 [3] [a] [1-4]).

With respect to the receipts factor of a registered securities or commodities broker or dealer, such as petitioner, Tax Law former § 210 (3) (a) (2) (B) (iv) provides that the receipts specified in Tax Law former § 210 (3) (a) (9) "shall be deemed to arise from services performed within the state to the extent set forth in such paragraph." Tax Law former § 210 (3) (a) (9) provided customer-based sourcing rules for certain categories of receipts, including brokerage commissions, margin interest, gross income including any accrued interest from principal transactions, certain underwriting revenues, interest on loans to affiliated entities, account maintenance fees, and fees for management and advisory service.

For tax years 2003 through 2007, petitioner reported a lowered BAP resulting from a reduced receipts factor on its timely-filed amended CT-3-A returns, sourcing brokerage commissions, gross income from principal transactions including accrued interest, margin interest, clearing fees and management fees based upon the locations of the underlying investors of the institutional intermediaries with which it did business and not based upon the locations of the institutional intermediaries themselves. The main issue is to determine who is the "customer

responsible for paying" petitioner and how the revenues should be properly sourced for New York tax purposes.

The Department of the Treasury, through the Financial Crimes Enforcement Network (FinCEN), and the Securities and Exchange Commission (SEC) jointly adopted a final rule to implement section 326 of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (USA PATRIOT Act). On July 23, 2002, Treasury and the SEC jointly proposed a rule to implement section 326 with respect to brokers or dealers in securities (broker-dealers). The Department of Treasury codified the regulation at 31 CFR 103.122. Pursuant to 31 CFR § 103.121 (a) (3) (i) (A), a "customer" generally is "a person that opens a new account." "[U]nder this rule, a broker-dealer is not required to look through a trust, or similar account to its beneficiaries, and is required only to verify the identity of the named accountholder. Similarly, with respect to an omnibus account established by an intermediary, a broker-dealer is not required to look through the intermediary to the underlying beneficial owners if the intermediary is identified as the accountholder" (68 FR 25113 [2003]). Based on the definition adopted by the Treasury and the SEC, we disagree with petitioner that its customers are the "underlying investors" and not the institutional intermediaries.

As per subclauses (i), (ii), and (vi) of Tax Law former § 210 (3) (a) (9) (A), receipts constituting brokerage commissions, margin interest and account maintenance fees, respectively, shall be deemed to arise from services performed at the mailing address in the records of the taxpayer of the customer who is responsible for paying such receipts. Pursuant to Tax Law former § 210 (3) (a) (9) (D), if, for purposes of subclause (i), (ii) or (vi) of Tax Law former § 210 (3) (a) (9) (A), the taxpayer is unable to determine from its records the mailing address of the

customer, the receipts enumerated in any of those subclauses are deemed to arise from services performed at the branch or office of the taxpayer that generates the transaction for the customer that resulted in such receipts.

Pursuant to Tax Law former § 210 (3) (a) (9) (A) (iii), a registered securities broker-dealer's "gross income . . . from principal transactions for the purchase or sale" of securities is sourced, at the taxpayer's election, based upon the "mailing addresses of . . . customers in the records of the taxpayer." While substantially similar to the statutory language for sourcing brokerage commissions and certain other revenues, the statutory language for principal transactions does not specify that the receipts be sourced to the mailing address of the customer "who is responsible for paying" (***id.***). Additionally, Tax Law former § 210 (3) (a) (9) does not allow a look-through to the underlying investor and petitioner cannot source its receipts based upon an approximation of the location of the underlying investors.

Therefore, we agree with the Administrative Law Judge that the Division properly applied Tax Law former § 210 (3) (a) (9) in sourcing petitioner's receipts from brokerage commissions, principal transactions, margin interest, management fees and clearing fees to the mailing addresses variously associated by petitioner in its records with its receipts. Furthermore, as the Administrative Law Judge correctly concluded that Tax Law former § 210 (3) (a) (9) did not allow the look-through to the underlying investor, petitioner could not source its receipts based upon an approximation of the location of the underlying investors.

Although it has been determined that the provisions of Tax Law former § 210 (3) (a) (9) do not permit petitioner to source its receipts based upon an approximation of the location of its underlying investors, petitioner contends that the Division should be required to apply its discretionary authority to source the receipts in such a manner. Petitioner presents the same

arguments on exception as below, namely that the Division has the discretionary authority to "effect a fair and proper allocation of the income and capital," under Tax Law former § 210 (8), "which it cannot unreasonably refuse to apply."

Petitioner presented testimony of Dr. Brian Cody who testified that from an economic perspective, the Division's method (sourcing the receipts to the intermediaries) grossly overstates the results reached during an allocation method that reasonably approximates the location of individual investors, i.e., the customers. Relying on the BEA (Bureau of Economic Analysis), Dr. Cody further stated that New York's share of U.S. census was a most appropriate method for souring the receipts as population is a direct and reliable measure of where individual investors are likely to be located.

The BEA analysis employed by Dr. Cody showed that New York's share of the U.S. population, or U.S. Census, was on average 6.48% during tax years 2003 through 2007. The Division's calculation of Jefco's receipts allocation factor for tax year 2006 was approximately 22%, which it also applied to tax years 2003 through 2005. The Division's calculation of Jefco's receipts allocation factor for tax year 2007 was approximately 20%.

Dr. Cody concluded that using New York's U.S. Census percentage to source Jefco's receipts was the most reasonable because population is a direct and reliable measure of where individual investors are likely to be located. In Dr. Cody's opinion, using the U.S. Census was preferable to the other allocation methods he considered because using New York's share of GDP or personal disposable income takes into account economic characteristics relating to expenditures unrelated to investment activities. We disagree.

As discussed above, the law is clear and does not allow for a look-through to source the receipts using any form of reasonable approximation of the location of the underlying investor

(***see*** Tax Law former § 210 [3] [a] [9]). Therefore, Jefco's customers for purposes of the statute are not the underlying investors, and the use of discretionary authority by the Division is not warranted here as pursuant to Tax Law former § 210 (3) (a) (9) (A) (iii), a registered securities broker-dealer's "gross income . . . from principal transactions for the purchase or sale" of securities is sourced, at the taxpayer's election, based upon the "mailing addresses of . . . customers in the records of the taxpayer." Accordingly, we find that petitioner's receipts from brokerage commissions and gross income from principal transactions must be sourced to the mailing addresses of customers in petitioner's books and records and, if petitioner does not have those mailing addresses, then to the branch or office responsible for the transactions that generated such receipts.

Turning now to the question of the disallowed ITCs, for each of the tax years 2003 through 2007, Jefco claimed the ITC for its purchases of tangible personal property, including leasehold improvements, used by its investment banking, prime brokerage and research departments at its offices located at 520 Madison Avenue, New York, New York. In addition, Jefco claimed the ITC in connection with purchased computer software.

The Division disallowed the ITC for a substantial portion of these claims based upon the Department's G-Notice. In determining whether the leasehold improvements made to floor space at 520 Madison Avenue occupied by Jefco's investment banking, prime brokerage, and research departments were made to floor space "principally used" for qualifying activities, i.e., in connection with the purchase or sale of securities, the Division applied the 50% use test (***see*** TSB-M-98[8][C] [December 1998]) to each floor (floor space analysis). Under its floor space analysis, if 50% or more of the floor space with leasehold improvements was used by a "qualifying department," then the Division determined that the more than 50% use test was met

and allowed the ITC for the leasehold improvements made to that floor. The floor space analysis was applied on a floor-by-floor basis.

Relying on the G-Notice, the Division concluded that providing related financial services to help plan for the underlying transaction that creates the client's stock or debt capital needs such as a merger, acquisition, divestiture, or some other restructurings are *not* activities in connection with the purchase or sale of securities pursuant to Tax Law former § 210 (12) (b) (i) (D). The Division found that the activity of providing information to assist investment managers and hedge funds in making purchase and sale decisions and the activities of developing and implementing key technologies, are *not* activities in connection with purchase or sale of securities pursuant to Tax Law former § 210 (12) (b) (i) (D). The Division asserts that these activities are not part of "assembly line" production processes of a broker-dealer (***see Matter of Epic Chem.***, State Tax Comm., October 30, 1981). On exception the Division maintains the same arguments regarding the G-Notice as below and claims that the G-Notice explains that the investment advisory services are "in the nature of management decisions," as in ***Matter of Epic Chemicals***,[15] "and are not part of the 'assembly line' production processes of the securities industry such as trading and other security dealer activities of a broker or dealer."

The G-Notice also concluded that the activities of developing and implementing key technologies "to speed execution and increase the flow of information activities pertaining to the purchase or sale of securities" are not qualifying activities, and therefore property used in conjunction with those activities does not qualify for the ITC. The Division also claims that property used to speed execution of securities trades and increase the flow of information

[15] As decisions of a body of coordinate jurisdiction, the State Tax Commission decisions are not binding precedent for us but are entitled to respectful consideration (***see Matter of Racal Corp.,*** Tax Appeals Tribunal [May 13, 1993], citing ***Matter of Cruikshank***, 169 Misc 514 [Sur Ct, Kings County 1938]).

activities pertaining to the purchase or sale of securities is nonqualifying because the activities are not part of the "assembly line production processes of a broker or dealer and therefore not activities in connection with the purchase or sale of securities." The G-Notice citing the New York State Assembly's Memorandum in Support of Bill A.9094C (Chapter 56 of the Laws of 1998) explains that the New York State Senate's Memorandum in Support of the bill notes that this provision will:

> "extend the State's Investment Tax Credit, currently offered to manufacturers for investing in tangible property within New York State, to the State's financial services and banking industries. The credit would be made available for those investments in tangible property, including qualifying property held by corporations or individuals either directly or through one or more partnerships engaged in financial services that are similar to the investments that now qualify for manufacturers. Examples include investments in computer and telecommunications technology used for '*assembly line*' functions of the securities industry such as trading and other security dealer activities" (***see*** G-Notice at 10).

The primary issue regarding the disallowance of the ITCs in dispute is whether a portion of Jefco's tangible property that it purchased and placed in service was "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 . . . stocks, bonds or other securities" (Tax Law former § 210 [12] [b] [i] [D]). The Division based its disallowance of the ITCs related to Jefco's investment banking, prime brokerage and research department on the G-Notice.

We find that "New York tax guidances are informational statements of the division's interpretation of the Tax Law and regulations and are based on a particular set of facts. Tax guidances consist of redacted versions of selected letters and memoranda and responses to withdrawn petitions for advisory opinion" (20 NYCRR § 2375.7 [a] [1]). Additionally, "New York tax guidances are advisory in nature and are merely explanatory. Accordingly, tax guidances do not have legal force or effect, do not set precedent, and are not binding" (***see*** 20

NYCRR § 2375.7 [c]). Accordingly, a G-Notice is merely an informational statement of the Division's interpretation of the law based on a particular set of facts and circumstances. Therefore, unlike a regulation, a G-Notice is not entitled to deference.

Additionally, we note that the conclusions in the G-Notice at issue are limited to the facts involving another taxpayer and are premised on facts and circumstances that differ from the present case. Therefore, the Administrative Law Judge properly found that since the G-Notice was not issued in connection with petitioner or its facts and is not binding on petitioner.

According to the Assembly memorandum accompanying the bill jacket, the Legislature's intent in enacting Tax Law former § 210 (12) (b) (i) (D) was to extend the ITC to the financial services industry for investments similar to investments in buildings, equipment and facilities used for production that qualify for manufacturers (***see*** Assembly's Mem in Support of Bill [A.9094C] [L 1996, ch 56]). We find that the Division's reliance on ***Epic Chem.*** is misplaced. In ***Epic Chem.***, the State Tax Commission ruled that computers used by a chemical manufacturer to make mathematical calculations relating to altering chemical formulas that were used to make management decisions were not eligible for the manufacturing ITC because the computers did not act upon any raw materials and were not involved in the manufacturing process. The manufacturing ITC statute required that in order to qualify for the ITC, the property must be "principally used by the taxpayer in the production of goods," such as by "manufacturing." Modeled after the long-since repealed federal investment tax credit, it specifically limited "manufacturing" to "the process of working raw materials into wares suitable for use" or similar processes using prepared materials (***see*** Tax Law former § 210 [12] [b] [ii] [A]). In light of this definition, in ***Epic Chem.***, the State Tax Commission concluded that the computers did not qualify for the manufacturing ITC. We have given this decision by the State Tax Commission

respectful consideration; however, the distinct facts and circumstances under ***Epic Chem.*** renders it unpersuasive, especially given the subsequent legislative expansion of the credit to include broker dealers.

The Division disallowed the ITC for property used by petitioner's investment banking department in connection with restructuring and M&A activities and departments because the G-Notice concluded that providing related "financial advisory services" to help plan for restructuring and M&A transactions was not an activity "in connection" with the purchase and sale of securities. The Division's interpretation is not supported by the plain language of Tax Law former § 210 (12) (b) (i) (D). The statutory language provides that the ITC is available for tangible property "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." The financial planning and advisory services within the investment banking department are integral to restructuring and M&A activities.

According to petitioner's witness, Mr. Strumeyer, broker-dealers offer investment advisory services to provide insights into market trends, investment opportunities, and risk assessment. Additionally, as a part of their core function, investment banks provide strategic valuation, deal structuring, and advisory services on debt restructuring and M&A transactions. As Mr. Strumeyer explained that mergers and acquisitions are connected with and integral to the sale of securities and that the sole reason a person would advise in the planning or structuring of a merger or acquisition is to affect a securities transaction, i.e., to ultimately buy or sell securities. Therefore, we disagree with the Division that property used in petitioner's investment banking department in connection with restructuring and M&A activities and departments was not qualified for the claimed ITCs.

Next, providing information to assist hedge funds in making securities sale and purchase decisions is certainly an activity "in connection with" the sale or purchase of securities. Unlike the chemical manufacturing company in ***Epic Chem.***, much of the work done in a prime brokerage involves high speed internet and is machine and algorithm driven as described in testimony given by petitioner's expert witness, Mr. Strumeyer. Mr. Strumeyer testified that the activity of providing information to assist investment managers and hedge funds in making purchase and sale decisions is "absolutely" connected with and integral to the purchase and sale of securities for the same reasons that research activity is connected with the purchase and sale of securities. As Mr. Strumeyer testified that in order to have the fastest execution, prime brokerage departments invest substantial funds to make their trading technology faster than their competitors. Thus, prime brokerage activities are a core function of a broker-dealer and are activities connected with and integral to the purchase and sale of securities.

With respect to Jefco's research department, the auditor determined that none of the floor space used by the research department was used for a qualifying activity in order to claim the ITC. The auditor made that determination based upon the conclusion in the G-Notice. Specifically, the Division claims that the G-Notice properly disallowed the ITC for tangible property used to provide research to investing clients because "research, just as investment advisory services, is not part of the assembly line production processes of a broker or dealer, and therefore not an activity in connection with the purchase or sale of securities."

Petitioner provides investors fundamental research and trade execution in equity, equity-linked, high yield and investment grade fixed income securities, as well as commodities and derivatives (***see*** finding of fact 3). Mr. Strumeyer testified that research is an integral function of broker-dealers as it helps them to determine the right time to buy or sell a security. Regarding

the legislative history, the Division argues that petitioner "miss[es] the point that the Legislature's intent in enacting Tax law former § 210 (12) (b) (i) (D) was to extend the ITC to the financial services industry for investments similar to the investments in buildings, equipment and facilities used for the production that qualify for manufacturers". As the Administrative Law Judge correctly determined that the ITC available to broker-dealers is materially different from the manufacturing ITC. There is no language whatsoever relating to "production" or "assembling" in the ITC statute available to broker-dealers, nor is there any suggestion that the property must be of the type that would "qualify for manufacturers." Here, the Division is trying "to compare apples to oranges" (***see Matter of Barclay's Group, Inc. (USA) and Affiliates***, Tax Appeals Tribunal, January 27, 2005). Therefore, we disagree with the Division's claim that petitioner's research activities are *not* activities in connection with the purchase or sale of securities pursuant to Tax Law former § 210 (12) (b) (i) (D).

The Division disallowed the ITC for items of property for which Jefco did not produce an invoice. The audit supervisor testified that where petitioner did not provide an invoice for a particular purchase of property during the audit, the ITC was disallowed. For the thousands of items of tangible personal property for which petitioner claimed the ITC for the tax years 2003 through 2007, petitioner provided to the auditor approximately 94% of the invoices for those purchases. Petitioner asserts that the Division's denial of the ITC for items of property for which petitioner was unable to produce an invoice was unreasonable as the cost of each item were shown in Jefco's contemporaneous books and records, which the Division relied on in conducting nearly every other aspect of the ITC audit (***see*** https://www.tax.ny.gov/bus/recordkeeping/investment.htm). Therefore, we agree with the

Administrative Law Judge that the Division's disallowance of the claimed ITC for items of property for which Jefco did not produce an invoice was improper.

The Division recaptured 10% of the allowed ITC and EIC based on its unsupported assertion that 10% of Jefco's qualifying property ceased to be in a qualified use prior to the end of its useful life. The Division claims that it applied the 10% recapture based on its estimate that 10% of petitioner's property items must have either been disposed of or ceased to be in qualified use at the time of the audit. The Division's justification rationale for this disallowance is that petitioner did not provide federal depreciation schedules for the items for which it claimed the ITC. However, in its ITC IDR response, petitioner did provide the auditor with a depreciation schedule, including a reconciliation of that depreciation schedule to its federal forms 1120, as well as its federal forms 4797. The Division claims that the federal forms 4797 provided to the auditor did not provide any information about the useful life and depreciation of its items of tangible property. The form 4797 reports whether petitioner sold or otherwise disposed of any depreciable property or had any property involuntarily converted or recaptured for federal income tax purposes in a given year.

We agree with the Administrative Law Judge that such dispositions or conversions are what trigger federal depreciation recapture, as well as the ITC recapture pursuant to Tax Law former § 210 (12) (g) (1). As below, here on exception, the Division cannot explain as to how they reached the *ten percent number* for the ITC recapture. Therefore, we find that the Division's disallowance of a substantial portion of the investment tax credits and the employment incentive credits claimed by petitioner and recapturing 10% of the same, for tax years 2003 through 2007 was improper as contrary to the Division's claim, petitioner had provided the necessary depreciation schedules.

The Division disallowed in its entirety petitioner's ITC claims for purchases of computer software for the tax years 2003 through 2007. The Division cites to the G-Notice analysis of the activities of the "Electronic Trading" business unit of "Corporation X" an entity that purchased "computers and data communications equipment" to conduct an electronic trading business. According to the Division, the G-Notice concluded that the group's activities were not "part of the assembly line production processes of a broker or dealer" and therefore property purchased for that unit did not qualify for the ITC. The Division claimed that petitioner has not established "on an item-by-item basis" that the software was connected with the purchase and sale of securities. The record shows that petitioner provided the same cost, cost center, department, floor and description for each item of computer software that it provided for all the property for which it claimed the ITC. The Division's disallowance of petitioner's claimed ITC for computer software is contrary to the plain language of Tax Law former § 210 (12) (b) (i) (D) and as such was improper.

Finally, petitioner raises constitutional challenges to the Division's apportionment of petitioner's receipts. We note that we do not have jurisdiction on considering facial challenges to the constitutionality of a statute (***see Matter of HDV Manhattan, LLC, Anthony F. Grant, Michael A. Grant, Joseph A. Sullo and Jason Mohney***; Tax Appeals Tribunal, February 12, 2016 citing ***Matter of A&A Serv. Sta., Inc.***, Tax Appeals Tribunal, October 15, 2009). However, this Tribunal is empowered to consider "whether the application of a statute to a particular set of facts violates the constitution" (***id.***). The burden is on petitioner to prove that a statute, as applied, is unconstitutional (***see Matter of Brussel***, Tax Appeals Tribunal, June 25, 1992).

Petitioner asserts that the Division's method of allocating Jefco's receipts violates the Commerce and Due Process Clauses of the United States Constitution because it attributes income to New York State out of all proportion to the income that the law deems to be generated in the state (***see generally Matter of British Land [Md.] v Tax Appeals Trib. of State of N.Y.***, 85 NY2d 139 [1995]). As such, petitioner contends that the Division's interpretation and application of Tax Law former § 210 (3) (a) (9) (D) and Tax Law former § 210 (3) (a) (9) (A) (iii) to petitioner's receipts leads to a distorted result that overstates its receipts allocation factor by three or four times. The Division claims that its method of sourcing petitioner's receipts is not distortive because "the transactions that generated the receipts in issue took place in its branches or offices in New York City," and "[p]etitioner did not engage in business transactions around the country."

We agree with the Division that Tax Law former § 210 (3) (a) (9) (D) and Tax Law former § 210 (3) (a) (9) (A) (iii) require sourcing either to the taxpayer's branch or office that generated the transactions giving rise to the receipts for brokerage commissions, margin interest and management and clearing fees, or to taxpayer's branch, office or employee within the state awarded production credits as a result of its principal transactions. Accordingly, we find that petitioner's customers, for purposes of the statute, are institutional intermediaries in the books and records of petitioners and not the underlying investors of such institutional intermediaries. We find no unconstitutional distortion when the receipts of a broker-dealer are sourced to the taxpayer's branch or office that generated the transactions that gave rise to the receipts for brokerage commissions, margin interest and management and clearing fees or to the taxpayer's branch, office or employee within the state awarded production credits as a result of principal transactions.

Therefore, the Division's apportionment of petitioner's receipts under Tax Law former § 210 does not violate the Commerce Clause and the Due Process Clause of the United States Constitution as applied (***see Matter of Weber***, Tax Appeals Tribunal, August 25, 2016).

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the Division of Taxation is granted in part and denied in part;

2. The determination of the Administrative Law Judge is affirmed in part and reversed in part;

3. The petitions of Jefferies Group LLC & Subsidiaries are granted in part and denied in part; and

4. The Division of Taxation is directed to recompute notices of deficiency L-047299919 and L-047323899, dated October 17, 2017, as modified at BCMS, in accordance with this decision, and issue any appropriate refunds.

DATED: Albany, New York
February 20, 2025

/s/ Jonathan S. Kaiman
Jonathan S. Kaiman
President

/s/ Cynthia M. Monaco
Cynthia M. Monaco
Commissioner

/s/ Kevin A. Cahill
Kevin A. Cahill
Commissioner