STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petitions of **JEFFERIES GROUP LLC & SUBSIDIARIES** for Redetermination of Deficiencies or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Periods January 1, 1997 through December 31, 2007.	: : : : : :	DETERMINATION DTA NOS. 829218 AND 829219

Petitioner, Jefferies Group LLC[1] & Subsidiaries, filed petitions for redetermination of deficiencies or for refund of corporation franchise tax under article 9-A of the Tax Law for the periods January 1, 1997 through December 31, 2007.

A videoconferencing hearing via CISCO Webex was held before Winifred M. Maloney, Administrative Law Judge, on December 13, 2021 through December 17, 2021, and continued to completion on January 10, 2022 through January 12, 2022, with all briefs to be submitted by December 1, 2022, which date began the six-month period for issuance of this determination. The six-month period was extended an additional three months pursuant to 20 NYCRR 3000.15 (e) (1). Petitioner appeared by Blank Rome (Irwin M. Slomka, Esq., Craig, B. Fields, Esq., and Kara M. Kraman, Esq., of counsel) and the Division of Taxation appeared by Amanda Hiller, Esq. (Bruce Lennard, Esq., of counsel). After reviewing the entire record in this matter, Winifred M. Maloney, Administrative Law Judge, renders the following determination.

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[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.

ISSUES

I. Whether the Division of Taxation properly 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[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

The parties entered into a stipulation of facts, dated October 22, 2021, in connection with this matter. Such stipulated facts have been substantially incorporated into the findings of fact set forth herein.

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

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[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.

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 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.

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[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.

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. Jefex is headquartered at 520 Madison Avenue, New York, New York.

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).

8. In addition to the institutional intermediaries listed in finding of fact 7, “similar financial intermediaries and collective investment vehicles” 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.

9. 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.”

10. Petitioner filed General Business Corporation Combined Franchise Tax returns (CT-3-A returns) and General Business Corporation MTA Surcharge returns[4] (CT-3M/4M returns) in New York State for its tax years ending December 31, 1997 through December 31, 2007 (tax years 1997 through 2007).

11. 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.

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

13. 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

14. The Division prepared four reports of audit in this matter.

15. 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.

16. Audit X258556467 covered an audit period of tax years 2003 through 2007 and was similarly limited in scope to petitioner's claims for ITCs and associated EICs in each of these years.

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[4] A taxpayer filing a CT-3-A return under article 9-A that does business, employs capital, owns or leases property, maintains an office, or derives receipts from activity in the Metropolitan Commuter Transportation District must also file a CT-3M/4M return and pay a metropolitan transportation business tax (MTA surcharge).

17. Audit X660332549 covered an audit period of tax years 2001 through 2004 and was a general verification field audit for each of these years. Tax years 2001 and 2002 were included in this audit solely for the purpose of addressing a refund claim based upon petitioner's filed federal form 1120X amended tax returns.

18. 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

19. In audit X358650671, it was noted that a previous audit for tax years 1999 through 2002 (Audit X185257649) resulted in agreed-upon adjustments to petitioner's entire net income (ENI) and a consent to field audit adjustment was signed in June 2005. It was also noted, however, that Audit X185257649 failed to recompute petitioner's minimum taxable income base (MTIB) in light of the adjustments to petitioner's ENI. Therefore, petitioner's MTIB in the tax years 1999 through 2002 was recomputed in Audit X358650671 solely for the purpose of recomputing the proper tax due in those years so as to determine the amount of petitioner's ITC/EIC utilization in those years.

20. 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. Petitioner is not pursuing its $10,303.00 refund claim for tax year 1998 relating to the ITC.

21. 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.

22. 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

23. Through its 2013 amended CT-3-A returns for the tax years 2003 through 2007, petitioner reported a reduction 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.

24. On its 2013 amended CT-3-A returns for tax years 2003 through 2007, petitioner reported a reduced 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 and 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.

25. 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."

26. Petitioner's claims for refunds of $5,620,066.00 were not based solely upon claims for increased ITC/EIC but also included claims for refund based upon its reported reductions of the receipts factor for the tax years 2003 through 2007 based on the location of underlying investors of institutional intermediaries, resulting in lesser amounts of corporation franchise tax and MTA surcharge before credits in the audit period covered by Audit X258556467.

Audit X660332549

27. 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). Review of the Tax Field Audit Record (audit log) indicates that initially, this general verification field audit was assigned to an auditor in the Division's midwestern regional office located in Des Plaines, Illinois (Chicago office), on June 1, 2006. An audit log entry for July 23, 2010 indicates that this audit was transferred from the Chicago office and reassigned to auditor Winston Dipchand on that date, and that "[f]our boxes of documents related to this audit" were "received from the Chicago office."

28. 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.

29. 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 of these amended federal returns, the Division made adjustments that resulted in a reduced ENI base. 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.

30. In its 2013 second amended CT-3-A returns for tax year 2001, petitioner claimed $109,092.00 of ITC and $150,867.00 of EIC for an ITC/EIC total of $259,959.00. The Division preliminarily determined that, in tax year 2001, petitioner was entitled to $21,236.00 of ITC and $262,930.00 of EIC for an ITC/EIC total of $256,518.00 after an estimated 10% recapture of the ITC was applied. The Division concluded that petitioner did not substantiate that certain of the property accepted on audit as qualifying for the ITC was retained for its entire useful life.

31. 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.

32. In its 2013 second amended CT-3-A returns for tax year 2002, petitioner claimed $52,086.00 of ITC and $205,413.00 of EIC for an ITC/EIC total of $257,499.00. The Division preliminarily determined that, in tax year 2002, petitioner was entitled to $20,345.00 of ITC and

$24,173.00 of EIC for an ITC/EIC total of $16,101.00 after an estimated 10% recapture of ITC in the amount of $28,417.00 was applied.

33. 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.

34. 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.

35. 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, however, accept petitioner's sourcing methodology for its receipts factors for these years.

36. For tax years 2003 and 2004, the Division adjusted petitioner's reported receipts factor by sourcing to New York petitioner's receipts from its brokerage commissions, principal transactions including accrued interest, investment banking, margin interest, clearing fees, management fees, miscellaneous income and other interest, using petitioner's tax year 2006 allocation percentages as adjusted by the Division for each of the above-mentioned revenue streams. By using this methodology, 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%. The

application of petitioner's tax year 2006 allocation percentages to petitioner's receipts from its brokerage commissions, principal transactions including accrued interest, investment banking, margin interest, clearing fees, management fees, miscellaneous income and other interest for the 2003, 2004, 2005 and 2006 tax years was agreed to by petitioner and the Division.

37. Based upon its determination that petitioner's receipts factor was 27.5532% and 24.7437% for tax years 2003 and 2004, respectively, the Division determined petitioner's BAP was 30.2999% and 30.6836%. for tax years 2003 and 2004, respectively.

38. On its original CT-3-A return for tax year 2003, petitioner reported its combined ENI to be $152,918,191.00. Based upon the add back of certain royalty payments, the Division adjusted petitioner's ENI to be $176,729,910.00, of which $157,055,646.00 was determined by the Division to be business income before allocation. 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.

39. On its original and amended CT-3-A return for tax year 2004, petitioner reported its combined ENI to be $197,923,450.00. Based upon the add back of certain royalty payments, the Division adjusted petitioner's ENI to be $197,981,542.00, of which $167,336,205.00 was determined by the Division to be business income before allocation. 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.

40. 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.

41. Based upon petitioner's adjusted business income and investment income amounts for tax years 2003 and 2004, and the BAP and IAP figures for these years, the Division

determined that, for tax year 2003, petitioner's ENI base was $47,981,189.00 and its ENI base tax amount, before credits, was $3,598,589.00; and that, for tax year 2004, petitioner's ENI base was $51,957,679.00 and its ENI base tax amount, before credits, was $3,896,826.00.

42. Using these ENI base tax amounts for the tax years 2003 and 2004, the Division determined that, for tax year 2003, petitioner's total corporation franchise tax, after credits, was $3,475,569.00; and that, for tax year 2004, petitioner's total corporation franchise tax, after credits, was $3,799,344.00. After crediting petitioner for taxes previously paid in these years, 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.

43. Using the ENI base amounts that it determined for tax years 2003 and 2004, 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.

44. After netting the allowable refund amounts of corporation franchise and MTA surcharge for tax years 2001 and 2002, totaling $127,918.00 and $26,876.00, respectively, and the additional corporation franchise tax and MTA surcharge amounts for tax years 2003 and 2004, totaling $593,954.00 and $84,475.00, respectively, the Division determined that petitioner owed an additional tax amount of $525,635.00 plus interest for the audit period covered by Audit X660332549 (tax years 2001 through 2004).

45. 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.

46. 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.

47. 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."

48. Petitioner's claims for refunds of $4,197,445.00 were not based solely upon claims for increased 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 X660332549.

Audit X056125664

49. The audit period of Audit X056125664 was tax years 2005 through 2007. Review of the Income/Franchise Field Audit Bureau Report of Audit Metro-NYC Regional Office (audit report) indicates that petitioner's file "was forwarded to the Metro-NYC Regional Office for a general verification field audit." On March 3, 2010, this audit was assigned to Mr. Dipchand.[5]

50. 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.

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[5] There are no audit log entries prior to March 4, 2010, on which date Mr. Dipchand, among other things, "[p]rinted returns for all years under audit." However, the audit file includes a consent to extend the statute of limitations for the period January 1, 2005 through December 31, 2005 to September 1, 2010 that was received by the Division's Chicago office on July 2, 2009.

51. 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.

52. 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.

53. On its original and amended CT-3-A returns for tax year 2005, petitioner reported its ENI to be $271,807,917.00. Based upon a federal revenue agent report (RAR), the Division adjusted petitioner's ENI to be $253,379,236.00, of which $205,953,211.00 was determined to be business income before allocation. The Division determined this business income amount by subtracting its adjusted amount of investment income before allocation of $47,426,025.00 from petitioner's ENI amount of $253,379,236.00.

54. On its original CT-3-A returns for tax year 2005, petitioner reported total investment income, before the attribution of expenses to that income, of $130,728,404.00. To arrive at the adjusted investment income before allocation amount of $47,426,025.00, the Division subtracted $55,529,083.00 that it determined to be business income, and $2,957,836.00 of interest expenses

and $5,697,913.00 of non-interest expenses that it determined to be attributable to investment income, from petitioner's total reported investment income amount of $130,728,404.00. The Division also subtracted a decrease in capital gains amount of $19,117,547.00 as a result of the RAR.

55. For tax year 2005, the $55,529,083.00 that the Division determined to be business income instead of investment income included $28,331,000.00 of "Stock Borrow" net income and other items of income. The Division attributed $2,957,836.00 of interest expenses and $5,697,913.00 of non-interest expenses to investment income.

56. 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.

57. 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.

58. 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%.

59. On its original CT-3-A returns for tax year 2006, petitioner reported its ENI to be $265,142,143.00. Based upon a federal RAR, the Division adjusted petitioner's ENI to be $265,171,929.00 of which $136,998,792.00 was determined to be business income before allocation. The Division determined this business income amount by subtracting the amount of petitioner's reported investment income, as adjusted by the Division, before allocation in the amount of $128,173,137.00 from petitioner's adjusted ENI amount of $265,171,929.00.

60. On its original and amended CT-3-A returns for tax year 2006, petitioner reported a total investment income amount, before the attribution of expenses to that income, of $620,825,776.00. To arrive at the adjusted investment income before allocation amount of $128,173,137.00, the Division subtracted $449,725,759.00 that it determined to be business income, and $36,679,593.00 of interest expenses and $6,247,288.00 of non-interest expenses that it determined to be attributable to investment income, from petitioner's total reported investment income amount of $620,825,776.00.

61. For tax year 2006, the $449,725,759.00 that the Division determined to be business income instead of investment income included $378,928,000.00 of "Stock Borrow" net income, $4,485,000.00 of "Interest Income from Swap Col," $6,060,000.00 of Interest Income: [FIMAT] Dep," and other items of income. The Division attributed $36,679,593.00 of interest expenses and $6,247,288.00 of non-interest expenses to investment income.

62. For tax year 2006, the Division reclassified $41,255,944.00 of petitioner's reported $93,581,524.00 of investment income from its principal transactions to be business income, leaving $52,326,120.00 as investment income.

63. 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.

64. 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.

65. 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%.

66. On its original CT-3-A returns for tax year 2007, petitioner reported ENI of $232,925,529.00. Based upon a federal RAR, the Division adjusted petitioner's ENI to be $233,889,158.00, of which the Division determined business income to be $201,329,879.00 before allocation. The Division determined this business income amount by subtracting its adjusted amount of petitioner's investment income before allocation of $32,559,279.00 from its adjusted amount of petitioner's ENI of $233,889,158.00.

67. On its original and amended CT-3-A returns for tax year 2007, petitioner reported a total investment income amount, before attribution of expenses, of $1,053,646,266.00. To arrive at the adjusted investment income before allocation amount of $32,559,279.00, the Division subtracted $859,638,909.00 that it determined to be business income, and $151,599,249.00 of interest expenses and $9,848,829.00 of non-interest expenses that it determined to be attributable

to investment income, from petitioner's total reported investment income amount of $1,053,646,266.00.

68. For tax year 2007, the $859,638,909.00 that the Division determined to be business income instead of investment income included $839,652,000.00 of "Stock Borrow" net income, $9,405,116.00 of "Interest Income from Swap Col," $6,803,735.00 of "Interest Income: FIMAT Dep," and other items of income. The Division attributed $151,599,249.00 of interest expenses and $9,848,829.00 of non-interest expenses to investment income.

69. 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.

70. 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.

71. 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.

72. 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%.

73. For tax years 2005, 2006 and 2007, the Division applied an IAP of 2% to investment income, which percentage was agreed to between the parties.

74. Based upon the Division's adjusted business income and investment income amounts for tax years 2005, 2006 and 2007, the adjusted BAP figures and the agreed-upon IAP figure for these years, the Division determined that, for tax year 2005, petitioner's ENI base was $62,559,218.00 and its ENI base tax amount, before credits, was $4,691,941.00; that, for tax year 2006, petitioner's ENI base was $44,184,107.00 and its ENI base tax amount, before credits, was $3,313,808.00; and that, for tax year 2007, petitioner's ENI base was $42,234,262.00 and its ENI base tax amount, before credits, was $2,998,633.00. Using these ENI base tax amounts for tax years 2005, 2006 and 2007, the Division determined that, for tax year 2005, petitioner's total franchise tax, after credits, was $4,553,100.00; that, for tax year 2006, petitioner's total franchise tax, after credits, was $2,700,604.00; and that, for tax year 2007, petitioner's total corporation franchise tax, after credits, was $2,492,928.00. After crediting petitioner for corporation franchise taxes previously paid in these years, the Division determined that, for tax year 2005, petitioner was due a refund of corporation franchise tax of $563,534.00; that for tax year 2006, petitioner owed additional corporation franchise tax of $1,863,179.00; and that, for tax year 2007, petitioner owed additional corporation franchise tax of $1,813,730.00.

75. The Division also used the ENI base amounts for the tax years 2005, 2006 and 2007 to determine that, for tax year 2005, petitioner was due a refund of MTA surcharge of $109,710.00; that, for tax year 2006, petitioner owed additional MTA surcharge of $400,753.00; and that, for tax year 2007, petitioner owed additional MTA surcharge of $394,022.00.

76. Combining the refund amounts of corporation franchise tax and MTA surcharge for tax year 2005 and the additional corporation franchise tax and MTA surcharge amounts for tax years 2006 and 2007, 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).

77. At the conclusion of Audit X056125664, the Division issued to petitioner a notice of deficiency, assessment ID no. 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.

78. 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.

79. 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."

80. Petitioner's claims for refunds of $1,394,243.00 were not based solely upon claims for increased 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 X056125664.

Bureau of Conciliation and Mediation Services

81. 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 L-047323899 and sought a redetermination of the amounts set forth in those notices.

82. 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 L-047299919 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,[6] plus interest.

83. In recomputing the net principal amount of tax due under notice of deficiency L-047299919 to be $360,819.00, BCMS left the Division's overpayment determination for tax year 2001 unchanged. For tax year 2002, BCMS increased the amount of total ITC and EIC allowed from $16,101.00 to $22,182.00 resulting in an increased refund from $23,459.00 to $29,540.00

84. For tax year 2003, BCMS did not adjust petitioner's ENI amount of $176,729,910.00 but it increased petitioner's investment income before allocation amount as adjusted by the Division and decreased petitioner's BAP as adjusted by the Division.

85. For tax year 2003, BCMS did not adjust petitioner's "Everywhere" business receipts but it reduced petitioner's New York business receipts for "Principal Transactions: Trading P&L" as adjusted by the Division from $7,504,931.00 to $6,455,608.00 as the result of using a

[6] 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."

reduced allocation percentage from 20.3844% to 17.5343%. This, in turn, resulted in a reduction of the adjusted receipts factor from 27.5532% to 27.4098% and a reduction of the adjusted BAP from 30.2999% to 30.2282%.

86. For tax year 2003, BCMS increased petitioner's investment income as adjusted by the Division from $19,674,265.00 to $23,539,380.00.

87. For tax year 2004, BCMS did not adjust petitioner's ENI amount of $197,981,542.00 but it increased petitioner's investment income before allocation amount as adjusted by the Division and decreased petitioner's BAP as adjusted by the Division.

88. For tax year 2004, BCMS did not adjust petitioner's "Everywhere" business receipts, but it reduced petitioner's New York business receipts for "Principal Transactions: Trading P&L" as adjusted by the Division from $10,955,392.00 to $9,423,634.00 as a result of using a reduced allocation percentage from 20.3844% to 17.5343%. This, in turn, resulted in a reduced adjusted receipts factor from 24.7437% to 24.5716% and a reduced adjusted BAP from 30.6836% to 30.5976%.

89. For tax year 2004, BCMS increased petitioner's investment income as adjusted by the Division from $30,645,337.00 to $32,019,870.00.

90. For tax year 2003, BCMS reduced petitioner's combined ITC/EIC claim amount, as adjusted by the Division and net of a 10% deemed recapture, from $126,558.00 to $125,612.00. For tax year 2004, BCMS reduced petitioner's combined ITC/EIC claim amount, as adjusted by the Division and net of a 10% deemed recapture, from $113,307.00 to $113,253.00.

91. For tax year 2005, BCMS did not adjust petitioner's ENI amount of $253,379,236.00 as adjusted by the Division but increased petitioner's adjusted investment income before allocation amount and decreased petitioner's adjusted BAP.

92. For tax year 2005, BCMS increased petitioner's "Everywhere" business receipts for "Principal Transactions: Trading P&L" as adjusted by the Division from $104,500,680.00 to $128,600,392.00 and increased petitioner's adjusted New York business receipts for "Principal Transactions: Trading P&L" from $21,301,798.00 to $22,549,162.00. This, in turn, resulted in a reduced adjusted receipts factor from 20.9413% to 20.5793% and a reduced adjusted BAP from 29.9149% to 29.7339%.

93. For tax year 2005, BCMS adjusted petitioner's investment income by increasing it from $47,426,025.00 to $51,365,538.00.

94. For tax year 2006, BCMS did not adjust petitioner's ENI amount of $265,171,929.00 but it decreased petitioner's investment income before allocation amount and decreased petitioner's adjusted BAP.

95. For tax year 2006, BCMS reduced petitioner's "Everywhere" business receipts for "Principal Transactions: Trading P&L" as adjusted by the Division from $117,414,649.00 to $116,379,281.00 and reduced petitioner's New York business receipts for "Principal Transactions: Trading P&L" from $23,934,228.00 to $20,406,277.00. This, in turn, resulted in a reduction of the adjusted receipts factor from 22.447% to 22.1512% and a reduction of the adjusted BAP from 30.3803% to 30.2042%.

96. For tax year 2006, BCMS reduced petitioner's investment income as adjusted by the Division from $128,173,137.00 to $115,405,473.00.

97. For tax year 2007, BCMS did not adjust petitioner's ENI amount of $233,889,158.00 as adjusted by the Division but it increased petitioner's adjusted investment income before allocation amount and decreased petitioner's adjusted BAP.

98. For tax year 2007, BCMS increased petitioner's "Everywhere" business receipts for "Principal Transactions: Trading P&L" as adjusted by the Division from $205,774,837.00 to $260,856,390.00 and increased petitioner's adjusted New York business receipts for "Principal Transactions: P&L" from $12,815,328.00 to $16,245,720.00. This, in turn, resulted in a reduction of the adjusted receipts factor from 20.6541% to 20.0375% and a reduction of the adjusted BAP from 20.6542% to 20.0375%.

99. For tax year 2007, BCMS increased petitioner's investment income as adjusted by the Division from $32,559,279.00 to $138,712,410.00.

100. For tax year 2005, BCMS increased the amount of investment tax credits, employment incentive credits, and unused credits available for carryover, less deemed 10% recapture (net investment tax credits) allowed petitioner, from $154,441.00 to $154,457.00.

101. For tax year 2006, BCMS reduced the amount of net investment tax credits allowed petitioner from $617,904.00 to $606,398.00. For the tax year 2007, BCMS reduced the amount of net investment tax credits allowed petitioner from $886,352.00 to $439,538.00.

102. 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). The Division takes the position that Jefco's cash on deposit and on demand relating to its securities lending transactions did not qualify for the cash election.

103. 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.

104. 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.

105. 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.

106. 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.

107. 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.[7]

108. 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.

109. 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.

110. 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.

111. 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.

112. 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.

113. 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.

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[7] 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.

114. For each of the tax years 2003 through 2007, Jefco received brokerage 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.[8]

115. For each of the tax years 2003 through 2007, Jefex received brokerage 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.

116. 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 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.

117. For each of the tax years 2003 through 2007, Jefco received management 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:

[8] 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.

$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.

118. For each of the tax years 2003 through 2007, BCMS determined that Jefco received clearing 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.

119. 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.

120. 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.

121. 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.

122. 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.

123. 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.

124. 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.

125. 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.[9] 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.

126. 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

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

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.

127. 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.

128. 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.

129. 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.

130. 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.

131. 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.

132. 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.

133. 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.

134. 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.

135. 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 State for configuration and customization by its information technology department, which petitioner contends were then sent to Jefco's offices in New York State 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 State for configuration and customization by its information technology department in their entirety.

136. For tax year 2007, the Division disallowed 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 State to be placed in service there: $12,463.00.

Cash Election – Securities Lending Transactions

137. As noted above, 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).

138. 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.

139. 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.

140. 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.

141. 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.

142. 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.

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

144. 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.

145. 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.

146. 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."

147. 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.

148. 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.

149. 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.

150. 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.

151. 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).

152. 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."

153. At the hearing, the auditor testified that he felt that he was "bound by" the Manion letter in disallowing Jefco's cash election.

154. 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

155. 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.

156. 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.

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

158. 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.

159. For each of the tax years 2006 and 2007, the Division 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.

160. The Division disallowed petitioner's cash election for its cash collateral on interest rate swaps, and for its cash on deposit with FIMAT, for the same reasons it disallowed petitioner's cash election for its securities lending transactions.

Broker-Dealer Sourcing: General

161. 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,[10] and not based upon the locations of the institutional intermediaries that requested the transactions resulting in those receipts.

162. 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.

163. 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.

164. 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.

[10] 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.

165. 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.

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

167. 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.

168. 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.

169. A 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.

170. 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.

171. 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.

172. 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.

173. 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.

174. 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.

175. Jefco executed securities trades for both “retail” and “institutional” investors, for which Jefco received brokerage commissions.

176. 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.

177. 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.

178. 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.

179. 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.

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

181. Mr. Franko testified that he considered a 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.

182. 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.

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

184. 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.

185. 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 a 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.

186. 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.

187. 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.

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

189. 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.

190. 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.

191. 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.

192. 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.

193. 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.

194. 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.

195. 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.

196. 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 affect the net return of the investors in the mutual fund.

197. 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."

198. 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

199. 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.

200. Jefco engages in principal transactions involving both equities and fixed income securities.

201. 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.

202. 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.

203. 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.

204. In both types of principal transactions described in findings of fact 202 and 203 above, Jefco generally does not know the identity or location of the party to whom the securities are sold.

205. 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.

206. When Jefco sells securities through an institutional intermediary, such as a 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.

207. 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).

208. 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.

209. 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.

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

211. 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.

212. 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 State address.

213. The auditor sourced to New York State 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.

214. 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.

215. 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.

216. 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 US unknown fixed income NY 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.[11]

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.[12]

217. 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."

218. 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."

219. 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

220. 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.

221. 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

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[11] 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%).

[12] 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%).

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.

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

223. 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

224. 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.

225. 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.

226. 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.

227. Mr. Franko testified that it is the investor or participant in the institutional investor that bears the cost of margin interest.

228. 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 advisor for providing advisory and management services to their clients.

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

230. Mr. Franko testified that while management fees are charged to the institutional investor, they are borne by the investors or participants in that entity.

231. 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

232. 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).

233. 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).

234. 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?

235. 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.

236. Dr. Cody testified that from an economic perspective, when determining who the customer is, he looks at whose money is at stake.

237. Dr. Cody noted that in the securities industry, customers can engage in trading and investment in securities both directly and indirectly.

238. 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.

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

240. 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.

241. 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.

242. Dr. Cody 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.

243. 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.

244. Dr. Cody testified that from an economic perspective, 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.

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

246. 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.

247. 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.

248. 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.

249. 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%.

250. 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.

251. Dr. Cody demonstrated 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.

252. 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.

253. 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

254. 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).

255. 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).

256. 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.

257. 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.

258. 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.

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

260. 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.

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

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

263. 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 arbitrary 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

264. 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.

265. 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).

266. 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).

267. 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.

268. Mr. Francis Oyenuga, the audit supervisor for the ITC audit, testified that he believed that taxpayers are required to follow the G-Notice.

269. 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.

270. 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 5 of the 7 activities of the investment banking department described in the G-Notice qualified for the ITC.

271. 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.

272. 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.

273. 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 1 of the 3 activities of the prime brokerage department described in the G-Notice qualified for the ITC.

274. 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.

275. 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.

276. 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.

277. 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

278. 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.

279. 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.

280. 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.

281. 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.

282. The area of "capital markets" covers both investment banking, including mergers, acquisitions and restructuring, and prime brokerage.

283. 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."

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

285. 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).

286. 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.

287. 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.

288. 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.

289. 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.

290. 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.

291. 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.

292. 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

293. 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 <u>not</u> activities in connection with the purchase or sale of securities pursuant to section 210.12(b)(i)(D)" (emphasis in original).

294. 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.

295. 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.

296. 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.

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

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

299. 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

300. Mr. Strumeyer testified that the term "prime broker" refers to the main broker for a hedge fund.

301. 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.

302. 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 <u>not</u> 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).

303. 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.

304. 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 <u>not</u> 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).

305. 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.

306. 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.

307. 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.

308. 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

309. 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.

310. 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.

311. The audit supervisor was unable to identify any written requirement that conditioned allowance of the ITC on the taxpayer providing an invoice for every item of qualifying property.

312. 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.

313. 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

314. 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.

315. 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.

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

317. The audit supervisor testified that to determine the useful life of an item of property on which the ITC was claimed, the Division examined the federal depreciation schedules, but claimed that the taxpayer did not provide the Division with the federal depreciation schedules.

318. 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

item in an outlined box and petitioner's bolded response to same. Where necessary, petitioner's response referenced tabulated document enclosures.[13]

319. 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).

320. 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.

321. 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.

322. 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.

323. 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.

324. 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.

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

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

326. 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

327. 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.

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

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

330. Pursuant to 20 NYCRR 3000.15 (d) (6), petitioner submitted 214 proposed findings of fact.[14] In accordance with State Administrative Procedure Act (SAPA) § 307 (1), proposed findings of fact 1 through 20, 22 through 65, 67 through 104, 106 through 128, 130 through 158, 160 through 166, 168 through 175, 177, 179 through 192, 194 through 199, 201 through 204, and 207 through 214 are supported by the record, and have been combined, renumbered, and substantially incorporated herein. Proposed findings of fact 21, 105, 129, 159, 167, 176, 178, 193, 200, 205 and 206 have been modified to more accurately reflect the record, and have been

[14] It is noted that the Division did not appear to challenge any of petitioner's proposed findings of fact.

combined, renumbered, and substantially incorporated herein, as modified. Proposed finding of fact 66 is rejected as conclusory.

331. The Division submitted 39 pages of unnumbered proposed findings of fact as part of its post-hearing brief. Given that they are unnumbered, this determination will not make rulings on them (***see*** SAPA § 307 [1]).

CONCLUSIONS OF LAW

A. Article 9-A of the Tax Law imposes a franchise tax on all domestic and foreign corporations doing business, employing capital, owning or leasing property, or maintaining an office in New York State (***see*** Tax Law § 209 [1] [a]). Corporations located or doing business within the Metropolitan Commuter Transportation District are also subject to an additional surcharge tax (***see*** Tax Law former § 209-B).

B. In New York, corporate taxpayers report their tax liability based upon their computation of the highest of four income bases (Tax Law former § 210 [1] [a-d]). A corporation's entire net income base is computed by calculating its entire net income, generally consisting of its investment income (Tax Law former § 208 [6]) and its business income (Tax Law former § 208 [8]; ***see*** Tax Law former §§ 210 [1] [a]; [3]; 208 [9]; 209 [1]). In turn, the corporation's investment income and business income are allocated to New York pursuant to the corporation's IAC (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.

C. Tax Law former § 208 (6) defined "investment income," in relevant part, as:

> "income, including capital gains in excess of capital losses, from investment capital, to the extent included in computing entire net income, less, (a) in the discretion of the commissioner, any deductions allowable in computing entire net income which are directly or indirectly attributable to investment capital or investment income . . . ."

Tax Law former § 208 (5) defined "investment capital," in relevant part, as

> "investments in stocks, bonds and other securities . . . not held for sale to customers in the regular course of business, exclusive of subsidiary capital and stock issued by the taxpayer, provided, however, that, in the discretion of the commissioner, there shall be deducted from investment capital any liabilities which are directly or indirectly attributable to investment capital . . . ."

D. Business income means entire net income minus investment income (Tax Law former § 208 [8]). Tax Law former § 208 (7) (a) defined "business capital" as

> "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"* (emphasis added) (cash election).

During the years 2001 through 2007, the regulations defining investment capital stated: "At the election of the taxpayer, cash on hand and cash on deposit may be treated on any report as either investment capital or business capital" (20 NYCRR 3-3.2 [a] [1]).

E. For tax years 2001 through 2007, petitioner elected to treat the cash collateral that it used in connection with its securities lending transactions as investment capital, and the resulting income as investment income. For tax years 2006 and 2007, petitioner elected to treat the cash collateral furnished in its interest rate swap transactions, and its cash on deposit with FIMAT as investment capital, and the resulting income as investment income. While the Division was conducting its audits for tax years 2001 through 2007, petitioner timely filed amended article 9-A returns making such cash elections and refund claims related to same. The Division denied petitioner's cash election to treat the cash collateral that it used in connection with its securities lending transactions, interest rate swap transactions, and its cash on deposit with FIMAT as investment capital.

F. The Division asserts that petitioner's cash collateral used in connection with its securities lending transactions, interest rate swap transactions and FIMAT activity was not "cash

on deposit" as contemplated by Tax Law former § 208 (7) (a) and that, therefore, the cash election was not available to petitioner. The Division further asserts that petitioner's lending transactions, interest rate swap transactions and FIMAT activity were core business activities of petitioner and that income derived from petitioner's cash collateral employed in these business activities was business income. Petitioner contends that the cash collateral that it used in connection with its securities lending transactions, interest rate swap transactions, and its cash on deposit with FIMAT was "cash on deposit" as that term is used in Tax Law former § 208 (7) (a) and, therefore, qualified for the statutory cash election. Petitioner further contends that the Division did not have the authority to disregard this valid cash election.

G. The term "cash on deposit" as it is used in Tax Law former § 208 (7) (a) is not defined by statute. Where this occurs, the words of the statute "may be given their ordinary meaning . . . with any ambiguity in the statute to be construed most strongly in favor of the taxpayer and against the government" (***see Matter of Manhattan Cable TV Servs. v Freyberg***, 49 NY2d 868, 869 [1980]; ***see also*** McKinney's Cons Laws of NY, Book 1, Statutes §§ 234, 313 [c]). A cash "deposit" is defined as "something placed for safekeeping: as (a) money deposited in a bank" or "(b) money given as a pledge or down payment" (Webster's Tenth New Collegiate Dictionary, 310 [1993]).

H. During the years 2001 through 2007, Jefco engaged in securities lending transactions in which it both borrowed and lent securities. When Jefco borrowed securities from a counterparty, it deposited cash collateral with the counterparty and earned interest income on the cash collateral. When Jefco lent securities to a counterparty, the counterparty deposited cash collateral with Jefco and Jefco incurred interest expense payable to the counterparty. The amount of interest income earned, and interest expense incurred by Jefco in its securities lending

transactions was based upon the amount of cash collateral deposited in a given transaction. Although it does not dispute this fact, the Division argues that the definition of "cash on deposit" is more developed in 20 NYCRR 3-3.2 (a) (1). It maintains that 20 NYCRR 3-3.2 (a) (1) describes what is and what is not deemed to be cash on hand and cash on deposit. The Division contends that the definition contained in its regulations makes clear that "not all deposits of cash may be elected to be either business[,] or investment capital." Contrary to the Division's claim, its regulation does not limit the definition of "cash on hand and on deposit" to short-term debt instruments. Rather, it expanded the definition to include certain short-term debt instruments (***see*** 20 NYCRR 3-3.2 [a] [1]). When it deemed certain short-term debt instruments to be "cash on hand and on deposit," the Division created an additional class of assets that qualified for the cash election. In its securities lending transactions, petitioner deposited cash with securities lenders as collateral for the securities it borrowed. The cash collateral that Jefco deposited in a securities lending transaction at all times belonged to Jefco and was returned to it when Jefco returned the borrowed securities. This cash collateral is clearly "cash on deposit" under the plain meaning of that term (***see*** conclusion of law G). The Division's interpretation of the statutory term "cash on deposit" to include certain short-term debt instruments, and to exclude actual cash deposited with a bank or other institution, is contrary to the statute's plain language.

The Division argues that the 2007 amendments to 20 NYCRR 3-3.2 specifically excluded repurchase agreements and securities lending agreements from the definition of investment capital (***see*** 20 NYCRR 3-3.2 [a] [2] [viii]) and, in the 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*** 20 NYCRR 3-3.2 [g]). It further contends that 20 NYCRR 3-3.2 (g) prohibited registered securities brokers or dealers from electing to treat cash deposited in a

securities lending transaction as investment capital. The Division argues that such prohibition would be applicable to petitioner's claimed election to treat the cash collateral deposited in its securities lending transactions as investment capital for tax year 2007. Because Tax Law former § 208 (7) (a) does not contain any limitations on making the cash election for actual cash, the Division's interpretation of the 2007 amendments to 20 NYCRR 3-3.2 as prohibiting taxpayers from electing to treat cash deposited in a securities lending transaction is incorrect. Moreover, the Division's regulation amendments only addressed the availability of the cash election for "securities lending agreements" and not for actual cash collateral. As such, those amendments have no bearing on the case where the election was made for actual cash collateral.

In sum, petitioner's election to treat the cash collateral that it used in connection with its securities lending transactions as investment capital was valid.

I. For tax years 2006 and 2007, Jefco earned interest income from cash collateral that it provided in interest rate swap transactions. Jefco earned interest on interest rate swap transactions in a manner similar to the way it derived interest income from cash collateral furnished in securities lending transactions. The cash collateral petitioner provided in interest rate swaps is clearly "cash on deposit" under the plain meaning of that term (***see*** conclusion of law G). Neither the Division's regulations, nor any other published guidance provided that such cash collateral was ineligible for the cash election. As such, petitioner made a valid cash election for cash collateral furnished in interest rate swap transactions.

For tax years 2006 and 2007, Jefco earned interest income from cash on deposit with FIMAT. Clearly, petitioner's "cash on deposit with FIMAT" is "cash on deposit" under the plain meaning of the term (***id.***). Neither the Division's regulations, nor any other published

guidance provided that such cash was ineligible for the cash election. As such, petitioner made a valid cash election for its cash on deposit with FIMAT.

J. The Division asserts that the cash used in connection with petitioner's securities lending transactions, interest rate swap transactions and FIMAT activity was not cash on deposit for purposes of the Tax Law former § 208 (7) (a) election. It further asserts that the cash was not cash on deposit because it was clearly used for a business purpose. The Division claims that deference should be given to its interpretation of the statute. In ***Kurcsics v Merchants Mut. Ins. Co.*** (49 NY2d 451, 459 [1980]), the Court stated:

> "Where the interpretation of a statute or its application involves knowledge and understanding of underlying operational practices or entails an evaluation of factual data and inferences to be drawn therefrom, the courts regularly defer to the governmental agency charged with the responsibility for administration of the statute. If its interpretation is not irrational or unreasonable, it will be upheld [citations omitted]. Where, however, the question is one of pure statutory reading and analysis, dependent only on accurate apprehension of legislative intent, there is little basis to rely on any special competence or expertise of the administrative agency and its interpretive regulations are therefore to be accorded much less weight."

Here, the question does not entail "an evaluation of factual data and inferences to be drawn therefrom" (***id.***); rather, it is one of pure statutory interpretation, the meaning of the statutory term "cash on hand or on deposit."

Tax Law former § 208 (7) (a), which provides the cash election, is a tax imposition statute as income from cash is taxed as business income or taxed as investment income. Therefore, as a matter of statutory construction, it must be "construed most strongly against the government and in favor of the citizen" (***see Matter of Grace v New York State Tax Commn.***, 37 NY2d 193, 196 [1975], ***rearg denied*** 37 NY2d 816 [1975], ***lv denied*** 338 NE2d 330 [1975]; ***see also Matter of Wegmans Food Mkts., Inc. v Tax Appeals Trib. of State of NY***, 33 NY3d 587, 592 [2019]; ***Matter of TransCanada Facility USA, Inc.***, Tax Appeals Tribunal, May 1, 2020).

Tax Law former § 208 (7) (a) is clear. There is no qualifying language limiting the taxpayer's cash election, and there is no requirement that the cash be used for investment purposes. The Division's interpretation that excludes actual cash deposited in connection with business transactions from the definition of "cash on hand and on deposit" is irrational and unreasonable. The statute places no limitation on the availability of the cash election for actual cash. Petitioner's interpretation that its actual "cash on deposit" qualifies for the statutory cash election is the only reasonable interpretation.

K. Given the foregoing, the Division's denial of petitioner's Tax Law former § 208 (7) (a) election to treat the net income from its securities lending transactions, interest rate swap transactions, and cash on deposit with FIMAT was improper. The Division is directed to adjust petitioner's investment income and business income for tax years 2001 through 2007 in accordance with conclusions of law H, I and J.

L. As noted in conclusion of law B, the corporation's investment income and business income are allocated to New York pursuant to the corporation's IAC (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),[15] 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 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

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[15] 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]).

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 percentages (***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 services.

M. In reviewing petitioner's BAP for tax years 2003 and 2004, the Division accepted petitioner's property factors and payroll factors. The Division did not, however, accept petitioner's sourcing methodology for its receipts factor for these years. For tax years 2005 and 2006, the Division accepted petitioner's property factors and payroll factors of its BAP; however, the Division did not accept petitioner's sourcing methodology for its receipts factor for

these years. For tax year 2007, the Division did not accept petitioner's sourcing methodology for its receipts factor.[16]

As noted above, 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 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 term "institutional intermediaries," as used by petitioner, refers to registered and non-registered investment advisors (together referred to for simplicity as RIAs) and to institutional investors such as mutual funds, pension funds and hedge funds (collectively, investment vehicles). 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 listed in petitioner's books and records and not based upon the locations of the underlying investors of the institutional intermediaries. At issue is the application of Tax Law former § 210 (3) (a) (9), which generally required that a registered securities broker-dealer source revenues in its receipts factor based upon the addresses of the customers responsible for paying those revenues. The dispute between the Division and petitioner is who is the "customer responsible for paying" the revenues to Jefco, most significantly, its brokerage commissions and gross income from principal transactions, and how those revenues should be sourced in its receipts factor.

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[16] There was no property or payroll factor applicable for tax year 2007 (***see*** Tax Law former § 210 [3] [a] [10] [A] [ii]).

N. With respect to its receipts constituting brokerage commissions, petitioner asserts that the sourcing of brokerage commissions earned through Jefco's relationships with institutional intermediaries is the largest component of the disputed brokerage commissions at issue. Petitioner argues that Jefco's clients are overwhelmingly RIAs and institutional investors, and less than 5% of Jefco's clients are retail clients, i.e., individuals, the sourcing of whose receipts are not in dispute. It further argues that "[s]ince the vast majority of Jefco's securities trades are made at the request of RIAs on behalf of their institutional investor clients, the vast majority of Jefco's commissions are generated by securities trades on behalf of the underlying investors in those institutional investors." Petitioner argues that "[a]lthough RIAs directed Jefco to execute securities trades, they are neither Jefco's 'customers' for broker-dealer sourcing purposes, nor are they 'responsible for paying brokerage commissions to Jefco under the Tax Law.'" Petitioner points out that the RIA makes investment decisions for institutional investors, but it cannot itself execute securities trades. Therefore, a RIA uses broker-dealers, such as Jefco, to execute trades on behalf of its clients. Those broker-dealers are paid brokerage commissions to execute those trades. For trades directed by a RIA for an institutional investor, such as a mutual fund, the commissions are paid from the institutional investor's custodian bank through the DTCC securities clearance and settlement process. The custodian banks hold the custodial accounts of the institutional investors. Mr. Franko, one of petitioner's expert witnesses, explained that institutional investors are required to place the securities and monies belonging to their shareholders in custodial accounts for the underlying investors. The payment of the broker-dealer commissions comes directly from the institutional investor's custodial account containing the funds of its shareholders, i.e., the underlying investors. As such, petitioner maintains that "the commissions are paid with the funds of the underlying investors; they are not paid by the

RIA." Petitioner notes that two of its expert witnesses "unequivocally testified that RIAs are not responsible for, and do not pay, brokerage commissions to securities broker-dealers such as Jefco that execute trades at their request." It further notes that the Division did not present any evidence to the contrary, and the auditor admitted that he had no evidence of any RIA paying brokerage commissions to Jefco. Nonetheless, the auditor concluded that the RIAs were Jefco's customers responsible for paying those commissions because the RIAs' names appear in Jefco's records.

Petitioner also contends that Jefco's institutional investor clients are not the "customers responsible for paying" the brokerage commissions. It argues that the mutual funds and other institutional investors represented by RIAs are also not customers "responsible for paying" because they are acting on behalf of their investors. Petitioner's expert on mutual funds, Mr. Gersten, testified that the underlying investors of a mutual fund bear the various costs of the funds, and that those costs must be disclosed to the investors. Costs such as advisory fees, custodial fees and legal fees are reflected in the "expense ratio" of the mutual fund, which reduces the investors' net return from the fund. "Trading costs" incurred by the mutual fund, such as brokerage commissions, are reflected as part of the fund's purchase price of the securities acquired, which also reduces the investors' net return from the fund. Petitioner asserts that "[j]ust as direct investors in securities bear these costs, so too do indirect investors in securities through mutual funds bear those costs, which also reduce their net returns on their investments." It further asserts that the mutual funds pay the commissions out of custodial accounts held on behalf of those investors. Petitioner points out that Mr. Franko explained that the commissions paid to Jefco come from the custodian bank holding those custodial accounts on behalf of underlying investors, i.e., the commissions are paid with the funds of the underlying investors.

Jefex, a related securities broker-dealer, primarily executed securities trades on the NYSE on behalf of Jefco's clients, the vast majority of which, as noted above, are RIAs and institutional investors. The Division sourced to New York 63.8458% of total commissions earned by Jefex in 2006. The auditor concluded that the RIAs and institutional investors were Jefex's customers responsible for paying the brokerage commissions and sourced Jefex's receipts to the mailing addresses of the RIAs and institutional investors in Jefex's records. Petitioner asserts that Jefex's institutional investor clients are not the customers responsible for paying the commissions. Rather, the underlying investors of the institutional clients are the customers responsible for paying Jefex's commissions.

O. Jefco engages in principal transactions in equities and fixed income securities. As it did when sourcing commissions in its amended CT-3-A returns, if petitioner determined that a transaction was through an intermediary, it applied a reasonable approximation of the location of the underlying investors, unless it was clear from its records that the underlying investors were located either outside or inside of New York State. For example, for Jefco's income from principal transactions with state, local and foreign government pension plans, petitioner presumed that the pension plan and its beneficiary employees and retirees were located in that state, locality or foreign country of the pension plan. In addition, petitioner also used a reasonable approximation for transactions executed through an exchange where Jefco did not know the identity of the other party. For those principal transactions executed through an exchange, the Division sourced the gross income based on an approximation of the location of Jefco's customers based on New York State's share of population using U.S. Census data. The sourcing of this latter category of principal transactions is not in dispute. The sole issue in dispute regarding the sourcing of income from principal transactions involves those sales made

through institutional intermediaries, such as RIAs. If the institutional intermediary's address in Jefco's records was in New York State, the auditor sourced 100% of the income to the State. Petitioner contends that when Jefco engages in principal transactions through an institutional intermediary for the purchase or sale of securities, the underlying investor is Jefco's customer.

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" (***see*** Tax Law former § 210 [3] [a] [9] [A] [iii]). 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.***). Petitioner contends that the term "customer" should be interpreted to have the same meaning as the phrase "customer responsible for paying." In the absence of a controlling statutory definition, words are generally construed as having "their usual and commonly understood meaning, and in that connection [courts] have regarded dictionary definitions as 'useful guideposts' in determining the meaning of a word or phrase" [citation omitted] (***see Rosner v Metropolitan Prop. & Liab. Ins. Co.***, 96 NY2d 475, 478-80 [2001]). The dictionary definition of the word "customer" is "one that purchases a commodity or service" (Webster's Tenth New Collegiate Dictionary, 286 [1993]). The dictionary definition of the word "purchase" is "to obtain by paying money or its equivalent" (Webster's Tenth New Collegiate Dictionary, 948 [1993]). In other words, a "customer" is a person that pays for a commodity or service from another. Petitioner maintains that a RIA is not Jefco's "customer" in a principal transaction for broker-dealer sourcing purposes because it does not actually purchase securities itself. Rather, the RIA is acting in the capacity of an investment advisor to the institutional

investor such as a mutual fund and one of the services the RIA provides in that capacity is to place purchase and sale orders for securities on behalf of the fund. Petitioner asserts that "[a]lthough an institutional investor does 'purchase' securities, it merely functions as a vehicle for the indirect investment in securities by the true customers – i.e., the underlying investors in the institutional investor." Petitioner contends that it is the underlying investors that are Jefco's customers with regards to its gross proceeds for principal transactions.

Petitioner sourced Jefco's margin interest, management fees, and clearing fees based upon an approximation of the locations of the underlying investors of institutional investors involved in the securities transactions. As it did for Jefco's commission receipts, the Division sourced Jefco's margin interest, management fees, and clearing fees based upon the location of the institutional intermediaries in Jefco's records. 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. Mr. Franko testified that it is the investor or participant in the institutional investor that bears the cost of margin interest. Petitioner contends that Jefco's margin interest should be sourced based upon a reasonable approximation of the location of the underlying investors of the institutional investors. With respect to management fees, 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 RIA, for providing advisory and management fees from funds that it managed as well as from third-party managed funds. Mr. Franko further explained that while management fees are charged to the institutional investor, they are borne by the investors or participants in that entity. Petitioner asserts that Jefco's management fees should be sourced based upon a reasonable approximation of the underlying investors of the institutional investors. With respect to clearing fees, Mr. Franko explained that clearing fees are charged by

registered broker-dealers that are members of the DTCC to brokerage firms to "clear" trades through the DTCC. When an introducing broker requests a trade through a clearing broker in a securities correspondent relationship, the clearing broker charges a clearing fee which is eventually paid by the introducing broker's customer. Petitioner contends that "[i]n essence, clearing fees are a commission paid for executing a trade," and pursuant to Tax Law former § 210 (3) (a) (9) (C) "they should be sourced in the same way as brokerage commissions." Petitioner asserts that Jefco's clearing fees should be sourced based upon an approximation of the location of the underlying investors of the institutional investors.

P. Tax Law former § 210 (3) (a) (9) provides the manner in which a securities broker-dealer such as petitioner must source its receipts from, among other revenue streams, brokerage commissions, principal transactions, margin interest, management fees and clearing fees. Although the facts show that the underlying investors of the institutional intermediaries are the customers responsible for paying petitioner, Tax Law former § 210 (3) (a) (9) does not allow a look through to the underlying investor as Tax Law former § 210 (3) (a) (6) does with respect to the sourcing of RIAs' revenues. As such, 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. Therefore, 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.

Q. 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 maintains 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 asserts that this discretionary authority to adjust a taxpayer's allocation overrides the application of Tax Law former § 210 (3) (a) (9) (D), as it does for all statutory apportionment provisions under Tax Law former § 210 (3) (a), "where such application does not 'fairly and properly' apportion income reasonably attributable to the State." Petitioner claims that in this case, the Division should be required to exercise its discretionary authority to source petitioner's brokerage receipts based upon a reasonable approximation of the locations of the underlying investors of the institutional intermediaries in petitioner's books and records in order to fairly and properly apportion petitioner's income to the State consistent with customer-based sourcing. In its brief, the Division contends that petitioner is not seeking a "genuine discretionary adjustment," because Jefferies is not "unique in the universe of registered securities or commodities brokers and dealers." The Division cites to ***Matter of Principal Mutual Life Insurance Company***, for the proposition that "under no circumstances is it appropriate to use the discretionary authority . . . to affect an industry-wide change to the statutory rules applicable to all" broker-dealers (***Matter of Principal Mut. Life Ins. Co.***, Tax Appeals Tribunal, January 13, 2000). Petitioner argues that Jefferies should not be precluded from entitlement to a discretionary adjustment to effectuate a fair apportionment because of the possibility that the adjustment, if ultimately upheld by the Tax Appeals Tribunal (Tribunal), could be used by another taxpayer with similar facts. Petitioner further argues that "such a limitation would render the discretionary authority meaningless, for it would impose a burden on a taxpayer – and,

for that matter on the Department – to show that its application was limited to a unique set of facts." Petitioner asserts that no such limitation appears in the Tax Law.

The Division's reliance on ***Matter of Principal Mutual*** is misplaced. In ***Principal Mutual***, the Tribunal held that the Division could not invoke a discretionary adjustment provision under the insurance corporation tax to adjust the statutory apportionment formula because the Division failed to show that the statutory formula did not properly reflect the taxpayer's activity, business or income within the State. The language quoted by the Division that "no individual determination was made" by the Division "as required" referred to the long-standing requirement that in order to apply the discretionary authority, it must first be shown that the statutory formula results in an improper apportionment for the taxpayer. The Tribunal, in its decision, did not condition application of the discretionary authority to situations shown to be unique to the taxpayer. Petitioner is not seeking the application of the discretionary authority for the entire securities broker-dealer industry. As petitioner correctly pointed out, the Division has made no showing that the application of the discretionary authority in this case would apply to all securities broker-dealers and has misinterpreted the ***Principal Mutual*** decision as holding that if the discretionary adjustment is applicable to other taxpayers, it would preclude its application here. The Division's claim that a decision in the taxpayer's favor applying the discretionary adjustment authority to Tax Law former § 210 (3) (a) (9) (A) (iii) and Tax Law former § 210 (3) (a) (9) (D) "would set up the possibility of a precedential decision at the Tax Appeals Tribunal that could affect the entire industry" is irrelevant as to whether it should be applied to the taxpayer's facts.

R. In support of its position that the Division should be required to exercise its discretionary authority to source its receipts using a reasonable approximation of the location of

its customers, i.e., the underlying investors of the institutional intermediaries involved in the securities transactions, petitioner presented the testimony of Dr. Cody, an expert in the fields of economics and finance. Dr. Cody testified that from an economic perspective, the customers in the securities industry who pay the securities transactions costs are the individual investors, whether they invest in securities directly or invest indirectly through a mutual fund or some other investment vehicle. Dr. Cody testified that as an economist, when he determines who the customer is, he looks at "whose money is at stake." When an investor makes an investment decision to invest in a mutual fund or other collective investment vehicle, he is obligating himself to paying the costs associated with those investments and putting his money at stake at that time. Dr. Cody reached the same conclusion as did Mr. Franko and Mr. Gersten, who were admitted as experts in various aspects of the financial services industry, that the individual underlying investor responsible for paying is Jefco's customer.[17] Having concluded that it is the individual underlying investors that economically are Jefco's customers who pay securities transactions costs to Jefco, Dr. Cody examined various ways to approximate the locations of those individual underlying investors when their locations are unknown. Dr. Cody prepared a BEA analysis containing data from the Bureau of Economic Analysis, U.S. Department of Commerce. The BEA analysis showed that New York's share of GDP, which is a measure of expenditures nationwide, was on average 7.88% during the tax years 2003 through 2007. 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 the tax years 2003 through 2007. The BEA analysis showed that New York's share of the U.S. population, or U.S. Census, was on average

[17] Although Dr. Cody specifically opined on Jefco's customers, his conclusions apply equally to Jefex.

6.48% during the tax years 2003 through 2007. Dr. Cody testified that although he believed all three methods reasonably approximated the location of Jefco's customers, he 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 methods he examined because using New York's share of GDP or personal disposable income takes into account economic characteristics relating to expenditures unrelated to investment activities. In its brief, petitioner acknowledged "that using U.S. Census data based on New York population effects a reasonable, straightforward and verifiable approximation of the location of its customers."

The Division's calculation of Jefco's receipts factor for tax year 2006 was approximately 22.44%.[18] The Division's calculation of Jefco's receipts factor for the tax year 2007 was 20.65%. An approximation of the location of Jefco's underlying investor customers based on U.S. Census data would result in a receipts factor of 6.48% for those customers. Dr. Cody found the Division's allocation method to be "very distortive" from an economic perspective. From an economic perspective, the method the Division used to allocate the receipts factor of Jefco's receipts grossly overstates, by a factor of three to four times, the results reached using an allocation method that reasonably approximates the location of the individual investors, i.e., the customers. Dr. Cody also demonstrated, by reference to the BEA analysis he prepared, that the Division's computation of the allocation percentage was larger than both the population and the GDP of the entire Mideast Region that includes not just New York, but also, New Jersey,

[18] Petitioner and the Division agreed to apply Jefco's 2006 receipts allocation factor from its brokerage commissions, principal transactions (including accrued interest), investment banking, margin interest, clearing fees and other interest to tax years 2003 through 2005.

Pennsylvania, Maryland, the District of Columbia and Delaware. Dr. Cody testified that the information contained in the BEA analysis reinforced his conclusion that the Division's calculation, which was based on the location of the institutional intermediary, including RIAs, was "grossly overstated."

Given Dr. Cody's cogent analysis, it is clear the Division's method to allocate the receipts factor of Jefferies' 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. Based upon Dr. Cody's BEA analysis, I find that using New York's share of the U.S. Census, i.e., 6.48%, is appropriate in this case. It is noted that the auditor sourced Jefco's gross income from principal transactions executed through an exchange based on an approximation of the location of Jefco's customers based on New York State's share of the population using U.S. Census data. Specifically, the auditor used U.S. Census data to source 30% and 43%, respectively, of petitioner's gross income from principal transactions executed through an exchange, for tax years 2006 and 2007, respectively. The Division is directed to exercise its discretionary authority and use the U.S. Census data, i.e., 6.48% to source Jefco's and Jefex's receipts allocation factor from its brokerage commissions, principal transactions (including accrued interest), investment banking, margin interest, management fees, clearing fees and other interest for tax years 2006 and 2007. The Division is also directed to apply the resulting receipts allocation factor for tax year 2006 to tax years 2003 through 2005, as agreed to by the parties.

S. The next issue is the Division's disallowance of portions of petitioner's claimed ITCs and EICs. As noted above, petitioner claimed ITCs and the related EICs for tax years 1997 through 2007. In reviewing those claims, the Division conducted two separate limited scope

audits, one covering the audit period of tax years 1997 through 2002 (Audit X358650671) and the other covering the audit period tax years 2003 through 2007 (Audit X258556467). In its petition, petitioner challenged the Division's disallowance of portions of the claimed ITC and EIC for each of the tax years 1999 through 2007. In its brief, petitioner states that it is no longer pursuing its ITC and EIC claims for tax years 1999 through 2002. For tax years 2003 through 2007, petitioner timely claimed on its amended CT-3-A returns ITC and EIC for property that Jefco principally used in the ordinary course of its trade or business as a broker or dealer in connection with the purchase or sale of securities. As result of the Division's audit of the claimed ITC and EIC for tax years 2003 through 2007, it disallowed a substantial portion of the ITC and EIC on various grounds. Although petitioner does not agree with the Division's disallowance of any of its ITC and related EIC claims, it is limiting its challenge to the Division's disallowance of a substantial portion of petitioner's claimed ITC for property used by Jefco's investment banking, prime brokerage, and research departments and the related EIC for tax years 2003 through 2007.

T. During the tax years 2003 through 2007, the Tax Law allowed an ITC for tangible personal property and other tangible property located in New York State that was purchased and placed in service on or after October 1, 1998 that met certain conditions, including the property 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] [i] [D]).

Taxpayers were also entitled to an EIC for each of the two years immediately following the year in which the ITC was allowed, at a percentage of the ITC tax base, provided certain employment requirements in New York State were met (***see*** Tax Law former § 210 [12-D]).[19]

When interpreting a statute, the fundamental rule of statutory construction is to effectuate the intent of the legislature (***see Matter of Watchtower Bible and Tract Socy. of New York, Inc.***, Tax Appeals Tribunal, July 16, 2020, citing ***Matter of 1605 Bookcenter, Inc. v Tax Appeals Trib. of State of N.Y.***, 83 NY2d 240, 244 [1994], ***cert denied*** 513 US 811 [1994]). "[W]hen the language of a tax statute is unambiguous, it should be construed so as to give effect to the plain meaning of the words used (citation omitted)" (***id.***, quoting ***New York State Assn. of Counties v Axelrod***, 213 AD2d 18, 24 [3d Dept 1995], ***lv dismissed*** 87 NY2d 918 [1996]). Where possible, every word must be given meaning because the language of the statute is the clearest indicator of legislative intent (***see id.***).

Tax credits are a form of tax exemption and should be construed in the same manner as statutes creating exemptions (***see Purcell v New York State Tax Appeals Trib.***, 167 AD3d 1101, 1103 [3d Dept 2018], ***lv denied*** 33 NY3d 913 [2019], ***appeal dismissed*** 33 NY3d 999 [2019]). "Statutes creating exemptions must be strictly construed against the taxpayer, and, if ambiguity arises, against the exemption, although such statutes should not be interpreted so narrowly as to defeat their settled purposes" (***id.***, quoting ***Matter of Piccolo v New York State Tax Appeals Trib.***, 108 AD3d 107, 111-112 [3d Dept 2013]). Petitioner must prove it is entitled to the credit, showing that their interpretation is the only reasonable construction (***see id.***). However, construction of an exemption or credit should not be so narrow as to defeat the provision's settled purpose (***Matter of Grace v New York State Tax Commn.***, 37 NY2d at 196).

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[19] There is no dispute that petitioner met the EIC requirements for the tax years in issue.

U. 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. 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], 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. The Division determined the extent to which Jefco's investment banking, prime brokerage, and research departments were "qualifying departments" based upon the G-Notice. The Division's workpapers for its floor space analysis contained basic information for each of the leasehold improvements for which the ITC was claimed, including the floor on which the leasehold improvement was made, the business unit and cost center to which the improvement was related, and the total square footage of the improvement. The workpapers also show the portion of the square footage for which the ITC was allowed, and the auditor's reason for why all or part of the claimed ITC was disallowed. In the Division's ITC workpapers, one of Jefco's departments is identified as "General IB" (Jefco's "General Investment Banking" department). For each leasehold improvement made to floors occupied by the General IB department, the auditor determined that only 71.4268% of that department's floor

space was used in a qualifying activity, and therefore only that percentage of the floor space was included in calculating whether the 50% use test was met. This partial qualification was determined based upon the G-Notice's conclusion that 5 of 7 business departments/units of Investment Banking are qualifying activities. For Jefco's "IB Restructuring" (Investment Banking – Restructuring) or "IB M&A" (Investment Banking Mergers & Acquisitions) departments, the auditor concluded that none of that floor space was used for a qualifying activity, also based solely on the G-Notice. With respect to Jefco's prime brokerage department, the auditor concluded that only 33.33% of the floor space used by the prime brokerage department was used for a qualifying activity. This partial qualification was determined based upon the G-Notice's conclusion that 1 of 3 business departments/units of prime brokerage are qualifying activities. 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. The auditor made that determination based upon the conclusion in the G-Notice.

The auditor also applied the G-Notice in determining whether items of tangible property placed in service at 520 Madison Avenue qualified for the ITC. Applying the G-Notice, if the auditor determined that an item of tangible property was used by what he determined to be a nonqualifying department, the auditor disallowed the ITC for that property. Specifically, the Division disallowed the ITC claimed by petitioner for items of property used by the restructuring and merger and acquisitions (M&A) units of Jefco's investment banking department, and Jefco's prime brokerage and research departments. The Division also completely disallowed the ITC for certain items of tangible property used by Jefco's General Investment Banking department, despite finding that 71.4268% of the activities engaged in by Jefco's investment banking department were qualifying activities. When asked why the ITC was disallowed for some of the

property used by the General Banking department, the audit supervisor responded that it was because they did not know which department within investment banking was using the property.

V. Petitioner contends that the property used by Jefco's investment banking, prime brokerage and research departments was property used in connection with the purchase or sale of securities, and such property was qualified for purposes of Tax Law former § 210 (12) (b) (i) (D). Petitioner asserts that the Division erred in relying upon the G-Notice in determining whether the tangible property used by Jefco's investment banking, prime brokerage and research departments was qualifying property. It further asserts that the G-Notice misinterpreted the law and is itself erroneous in several respects. The Division contends that the information presented in the G-Notice is a current statement of its "policy-directed interpretation of the laws and regulations applicable to Petitioner's claims for ITC." It asserts that petitioner's disagreements with the conclusions in the G-Notice do not control. The Division further asserts that petitioner failed to show that the Division's interpretation of Tax Law former § 210 (12) (b) (i) (D) is irrational, or that its interpretation of the statute is the only reasonable interpretation with respect to its claimed ITC for leasehold improvements and tangible property used by Jefco's investment banking, prime brokerage and research departments.

New York tax guidances (NYT-Gs) "are informational statements of the division's interpretation of the Tax Law and regulations and are based on a particular set of facts" and can consist of "redacted versions of selected letters and memoranda and responses to withdrawn petitions for advisory opinion" (***see*** 20 NYCRR 2375.7 [a] [1]). "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" (20 NYCRR 2375.7 [c]). The G-Notice was not issued in connection with petitioner or its facts and is not binding on petitioner. The G-

Notice simply represents the Division's interpretation of the ITC statute, but without being subjected to the scrutiny of the regulation promulgation process under SAPA. The Court of Appeals has held that:

> "An agency's interpretation of the statutes it administers must be upheld absent demonstrated irrationality or unreasonableness, but where the question is one of *pure statutory reading and analysis*, dependent only on accurate apprehension of legislative intent, there is little basis to rely on any special competence or expertise of the administrative agency" (***Lorillard Tobacco Co. v Roth***, 99 NY2d 316, 322 [2003] [emphasis added] [citations omitted]).

The question of whether property is used in an activity qualifying for the ITC, and specifically the meaning of the statutory phrase "in connection with the purchase or sale . . . of stocks, bonds, or other securities," is one of pure statutory interpretation. In general, when disputes as to the meaning of the terms in Tax Law former § 210 (12) that grant the ITC have arisen, courts have found that "the ordinary, everyday meaning of these terms is to be applied" (***see Leisure Vue v Commissioner of Taxation & Fin.***, 172 AD2d 872, 873 [3d Dept 1991] [upholding the Division's interpretation of terms contained in Tax Law former § 210 (12) (b) (i) relating to the production of goods by manufacturing]). Here, the G-Notice fails to apply the ordinary meaning of the crucial statutory language, and therefore the Division's reliance upon the G-Notice as its basis for disallowing the ITC for property used by petitioner's investment banking, prime brokerage and research departments fails for the following reasons.

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 G-Notice based this conclusion on the fact that the financial services ITC statute that was originally introduced in the New York Legislature also permitted the ITC for

property used in the ordinary course of the trade or business of an “investment advisor” as well as of a broker or dealer. According to the G-Notice, the removal of “investment advisor” from the draft statute meant that the Legislature intended that any advisory services provided by a broker-dealer, even in connection with the purchase or sale of stock, are nonqualifying. However, this interpretation is not supported by the plain language of Tax Law former § 210 (12) (b) (i) (D), which contains no such limitation. 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.” Mr. Strumeyer, petitioner’s expert witness on investment banking, explained that financial planning and advisory services within the investment banking department are “integral” to restructurings and mergers and acquisitions and that such transactions cannot be accomplished without the provision of financial planning. Nevertheless, in reliance on the G-Notice, the Division disallowed the ITC for tangible property used in connection with the ordinary securities broker-dealer activities of restructuring and M&A solely due to the removal of the term “investment advisor” from the draft statute, concluding that restructuring and M&A activities involve investment advisory services and are therefore not “deemed connected” to the purchase or sale of securities. Although the Division does not consider restructuring and M&A activities to be connected to the purchase or sale of securities, Mr. Strumeyer further explained the restructuring and M&A activities indisputably are connected to the purchase or sale of securities. As such, the Division’s interpretation of the statute is irrational and unsupportable.

The G-Notice also cites to the New York (NY) Senate’s Memorandum in Support of A.9094C (Ch. 56 of the Laws of 1998), and its reference to “assembly line” functions. Neither support the Division’s position denying the ITC for property used for restructuring and M&A

activities that result in the sale of securities. The NY Senate's Memorandum in Support provided:

> "[Q]ualifying 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*" (NYT-G-07[4]C [July 12, 2007], p. 10, citing Senate Mem in Support of A.9094C, L 1998 ch 56 [emphasis added]).

Critically, this Senate Memorandum does not characterize property used by a broker-dealer in providing restructuring and M&A activities that necessarily involve planning and advisory services as not being a qualifying "assembly line" function of a broker-dealer. To the contrary, it expressly recognizes that securities dealers engage in other activities besides "plain vanilla" securities trading, for example, restructuring and M&A activities. Moreover, the legislative intent is to be ascertained first from the words of the statute, and if there is no ambiguity, the inquiry must stop there (***see*** McKinney's Cons Laws of NY, Book 1, Statutes § 92). In this case, there is no need to consult the legislative history since the statutory language is clear and unambiguous.

In its brief, the Division claims that the G-Notice explains investment advisory services are "in the nature of management decisions," as in ***Matter of Epic Chemicals*** (State Tax Commn., October 30, 1981), "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 Division's reliance on ***Matter Epic Chemicals*** is misplaced. In ***Epic Chemicals***, 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 Chemicals***, the State Tax Commission correctly concluded that the computers did not qualify for the manufacturing ITC. Whether property is used in the "manufacturing" process and whether property is used "in connection with the purchase or sale of securities" are completely different inquiries. A manufacturer's use of a computer to help make internal production decisions is a far cry from a broker-dealer's provision to its customers of advisory services in connection with the purchase or sale of securities. ***Matter of Epic Chemicals*** is wholly inapplicable to this case.

As noted above, the Division concluded that only 33.33% of the floor space used by Jefco's prime brokerage department was used for a qualifying activity. This partial qualification was determined based upon the G-Notice's conclusion that 1 of 3 business departments/units of prime brokerage are qualifying activities. As a result, the auditor determined that Jefco's prime brokerage department was not a qualifying department for ITC purposes. Therefore, the Division disallowed the ITC claimed by petitioner for leasehold improvements and tangible property used by Jefco's prime brokerage department. The term "prime broker" generally refers to the main broker for a hedge fund or an investment manager. The role of a prime broker is to provide trade processing, risk monitoring, trade executions, industry information, and similar services to hedge funds and investment managers. The G-Notice concluded that providing information to assist hedge funds, i.e., noncorporate collective investment vehicles, in making

securities purchase and sale decisions is not an activity "in connection with" the purchase or sale of securities. 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 claims that "it is clear" that providing information to assist hedge funds in making purchase and sale decisions is not an activity "in connection with the purchase or sale of securities," for the same reason that Jefco's investment banking department's restructuring and M&A activities do not qualify, i.e., because it is the same as providing investment advisory services. The Division's arguments regarding investment advisory services are equally unavailing for prime brokerage activities as they were for the investment banking's restructuring and M&A activities. In addition, the Division's arguments ignore the fact that a hedge fund is "an actively managed investment vehicle" that does not retain a broker-dealer, i.e., a prime broker, like Jefco for investment advisory services. Mr. Strumeyer described the prime broker's role as allowing the hedge fund to focus on investment strategy and how it makes money, while the prime broker handled securities executions, locating securities, and other functions for a hedge fund to operate.

The Division also claims that property used to speed execution of securities trades and increase the flow of information 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 Division's "assembly line" argument fails for several reasons. First, the passing reference in the Senate Memorandum in Support to property used for "assembly line" functions of the securities industry as an example of a type of qualifying property does not limit the ITC to

property that is used in "assembly line" functions of the securities industry; indeed, that language appears nowhere in the statute. Clearly, the application of an "assembly line" concept to determine qualification for the manufacturing ITC to the service of buying or selling securities lacks support since the purchase or sale of securities is not conducted through an "assembly line" process. Whether property is used in the "manufacturing" and "assembling" of goods under the manufacturing ITC, and whether property is used "in connection with the purchase or sale of securities" are completely different inquiries. Lastly, the G-Notice references the NY Assembly Memorandum in Support of A.9094C (Ch. 56 of the Laws of 1998) that states explicitly that the financial services industry ITC law "extends the ITC to the financial services and the banking industry for investments in equipment used for security trading practices, *including computers and telecommunications technology*" presumably including equipment and technology that is used to speed execution of securities trades and increase the flow of information (NYT-G-07[4]C, July 12, 2007, citing Assembly Mem in Support of A.9094C, L 1998, ch 56 [emphasis added]). The Division's disallowance of the ITC for execution and information flow technology "pertaining to the purchase and sale of securities" is irrational and unsupportable.

With respect to Jefco's research department, the auditor determined that none of the floor space used by the research department was used in a qualifying activity. The auditor made that determination based upon the conclusion in the G-Notice. As a result, the Division disallowed the ITC claimed by petitioner for leasehold improvements and tangible personal property used by Jefco's research department. 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." These

arguments are unavailing when applied to research. As Mr. Strumeyer explained, research is an ordinary and routine activity performed by broker-dealers in connection with the purchase and sale of securities, the principal purpose of which is to determine whether it is a good time to buy or sell securities. 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*" (emphasis added). The Division fails to recognize, however, 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." As such, the Division is without authority to read such language into the statute.

Ultimately, the Division frames the issue of whether research services, as well as investment banking and prime brokerage services, are "in connection with" the purchase and sale of securities essentially as a difference of opinion, with the Division claiming that its opinion should prevail if it is not irrational and if petitioner does not prove that its opinion is the only reasonable one. This is incorrect. Since this is a question of statutory interpretation, i.e., the meaning of the phrase "in connection with the purchase or sale of securities," the Division's interpretation of the statute is not entitled to deference (***see Lorillard Tobacco Co. v Roth***, 99 NY2d at 322). Furthermore, even if a deferential standard of interpretation applies, such interpretation may not be so narrow so as to defeat the ITC provision's settled purpose (***see Matter of Grace v New York State Tax Commn.***, 37 NY2d at 196). The Division's interpretation does defeat the purpose of the ITC to "extend[] the ITC to the financial services

and the banking industry for investments in equipment used for security trading practices" (NYT-G-07[4]C, July 12, 2007, citing Assembly Mem in Support of A.9094C, L 1998, ch 56). The Division's narrow interpretation of the Tax Law former § 210 (12) (b) (i) (D) is both irrational and unreasonable, and inconsistent with its purpose. It denies the ITC for tangible property principally used in the regular course of a securities broker-dealer's activities in connection with the purchase and sale of securities. Petitioner's interpretation of the statutory language in Tax Law former § 210 (12) (b) (i) (D) is the only reasonable one.

W. Based upon the foregoing, the Division's disallowance of the ITC claimed by petitioner for tax years 2003 through 2007 for the leasehold improvements and the tangible property used by Jefco's investment banking, prime brokerage and research departments was improper.

X. Petitioner challenges the Division's disallowance of 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 Division disallowed the ITC for that item. 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. The audit supervisor admitted that he could not identify any audit guidelines or other guidance that conditioned allowance of the ITC on the taxpayer providing an invoice for every single item of qualifying property. When asked, 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 provided the vast majority of the invoices. 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. Petitioner

further asserts that "[i]t cannot reasonably be expected that a taxpayer should retain actual invoices for every asset purchased and placed on its books and records, often many years after they were purchased and placed in service." The Division argues that petitioner is making a "bare claim" without support for the 6% of the invoices that were not provided. The Division claims that it needed those invoices to determine how much an item cost, which of petitioner's departments used the item, and where the item was placed in service. Although an invoice would show the cost of the item, it would almost certainly not establish where and on which floor the property would be used, or which of petitioner's departments was using the item. Despite the Division's claim that the invoices were necessary to verify the cost of the property on which the ITC was claimed, those costs were shown in petitioner's contemporaneous books and records. These were the same books and records upon which the Division relied in conducting nearly every other aspect of its ITC audit, including petitioner's records for the cost of an item, the nature of the item, the floor upon which it was used, and the department by which it was used. Petitioner's failure to provide approximately 6% of the invoices over a five-year period is a "red herring" that cannot reasonably justify the Division's disallowance of petitioner's claimed ITC for those purchases. Therefore, the Division's disallowance of the claimed ITC for items of property for which Jefco did not produce an invoice was improper.

Y. Petitioner is also challenging the Division's disallowance of the claimed ITC for computer software. The Division disallowed in its entirety petitioner's ITC claims for purchases of computer software for the tax years 2003 through 2007. The Division, in its brief, 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. In its brief, the Division stated the reason for disallowing petitioner's ITC claims for computer software as follows:

> "Similarly, the record does not indicate that Petitioner's software was connected to Petitioner's assembly line production processes of a broker or dealer. Accordingly, it was rational and reasonable of the Division to disallow Petitioner's ITC claims for computer software when it has not been otherwise established by Petitioner, on an item-by-item basis, that such software was connected with the purchase or sale of securities."

As noted above, the NY Assembly Memorandum in Support of A.9094C (Ch. 56 of the Laws of 1998) summarizes the ITC expansion for securities as extending "the ITC to financial services and the banking industry for investments in equipment used for security trading practices, including computers and telecommunications technology" (NYT-G-07(4)C [July 12, 2007], p. 10, citing Assembly Mem in Support A.9094C, L 1998, ch 56 [emphasis added]). Computers and telecommunications technology are expressly mentioned as items that would qualify for the ITC; however, the Assembly Memorandum in Support did not limit the ITC to those items. Since software is a type of "technology," it should also qualify if used in connection with securities trading. Despite this legislative history expressly providing that the ITC for the financial services industry is meant to encompass "investments in equipment used for securities trading practices," the G-Notice reached the unsupportable conclusion that electronic trading activities such as "building the on-line trading system capability of [e]lectronic [t]rading and enabling the trading of securities" and "being responsible for the networking infrastructure and Internet connectivity functions" of a trading website are not activities in connection with the purchase and sale of securities. The Division's claim that petitioner has not established "on an item-by-item basis" that the software was connected with the purchase and sale of securities, is meritless. 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 the legislative intent behind it. The Division's disallowance of petitioner's claimed ITC for purchases of computer software for tax years 2003 through 2007 was improper.

Z. In addition, petitioner is challenging the Division's recapture of 10% of petitioner's ITC and EIC for tax years 2003 through 2007, based upon the Division's arbitrary assumption that 10% of petitioner's qualifying property ceased being in a qualified use prior to the end of its useful life. The Division's justification for this arbitrary disallowance is that petitioner did not provide federal depreciation schedules for the items for which it claimed the ITC. The Division's justification is baseless. In its ITC IDR response, petitioner did provide the auditor with a depreciation schedule, including a reconciliation of that depreciation schedule to its federal form 1120, as well as its federal forms 4797. The Division claims that the federal forms 4797 provided to the auditor, and submitted into evidence, "provided no information whatsoever about the useful life and depreciation of its items of tangible property." The Division's claim is false. 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. 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). It is noted that for four of the five years at issue, the forms 4797 show that petitioner disposed of no property, and in 2007 only, there was a small disposition amount. It was revealed at the hearing that the auditor was in possession of these forms but disregarded them. It is clear that the Division did not have the authority to recapture any of petitioner's ITC and EIC, and its

recapture is not permitted. Accordingly, the Division's arbitrary 10% recapture of petitioner's claimed ITC and EIC for tax years 2003 through 2007 was unreasonable and improper.

AA. Based upon the foregoing, the Division erred in disallowing 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. The Division is directed to recompute the ITC and EIC claimed for tax years 2003 through 2007 in accordance with the foregoing conclusions of law V, W, X, Y, and Z.

BB. The last issue to be addressed is petitioner's claim that the Division's apportionment of Jefco's and Jefex's receipts violates the Commerce and the Due Process Clauses of the United States Constitution. When apportioning the income of an interstate enterprise, "[the] apportionment formula [applied by the state] must, under both the Due Process and Commerce Clauses, be fair" (***see Container Corp. of Am. v Franchise Tax Bd.***, 463 US 159, 169 [1983], ***reh denied*** 464 US 909 [1983] [citations omitted]). In order to be fair, "the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated" (***id.***). An apportionment formula will be struck down if it either results in attributing income to the state out of all proportions to the business transacted in the state, or it "has led to a grossly distorted result," such conditions being distinct and separate (***see Container Corp. of Am. v Franchise Tax Bd.***, 463 US at 170; ***see also Norfolk & W. R. Co. v Missouri State Tax Commn.***, 390 US 317, 326 [1968]). Petitioner contends that in this case, the Division's application of an apportionment formula that allocates Jefco's receipts based upon the location of the institutional intermediaries, rather than the underlying investors who are actually its customers, attributes income to New York State that is out of all proportion to where that income is considered to be generated under Tax Law former § 210 (3) (a) (9) and leads to a grossly

distorted result. Petitioner maintains that the broker-dealer sourcing statute expressly provides for customer-based sourcing. Receipts from brokerage commissions, margin interest, management fees and clearing fees are "deemed to arise from services performed at the mailing address in the records of the taxpayer of the customer who is responsible for paying" (***see*** Tax Law former § 210 [3] [a] [9] [A] [i], [ii], [vii]; [C]). A taxpayer may also elect to have its gross income from principal transactions sourced based upon the mailing address of its customers in its records (***see*** Tax Law former § 210 [3] [a] [9] [A] [iii]). Petitioner asserts that when a taxpayer's receipts are deemed to arise from services performed at the customers' locations outside of New York, then the Division's "sourcing of those receipts to New York based upon a non-customer's address cannot reflect a 'reasonable sense of how that income is generated,' as required under ***Container Corp. supra***." Petitioner also asserts that the same can be said for the Division's sourcing of gross income from principal transactions based upon the address in Jefco's records of entities that are not Jefco's customers. Petitioner argues that the Division's sourcing of Jefco's receipts also produced a grossly distorted result. It claims that the Division's calculation of Jefco's receipts allocation factor for tax year 2006 was 22.44%, which it also applied to tax years 2003 through 2005, and its calculation of Jefco's receipts allocation factor for tax year 2007 was 20.65%. While petitioner's sourcing of Jefco's receipts using an approximation of the location of Jefco's underlying investor customers based upon U.S. Census data results in a receipts allocation factor of 6.48% for tax years 2006 and 2007. Petitioner further claims that Dr. Cody testified that the Division's allocation method was "very distortive from an economic perspective" 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 the individual investors, i.e., the customers.

Petitioner asserts that the Division's method of allocating Jefco's receipts violates the Commerce and Due Process Clauses 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. In support of its distortion theory, petitioner cites ***Hans Rees' Sons, Inc. v North Carolina***, where the Supreme Court found that a statutory method of allocation that overstated a taxpayer's income from sources in the state by 300% to 400% "operated unreasonably and arbitrarily" in allocating the taxpayer's income "out of all appropriate proportion to the business transacted" in that state (***see Hans Rees' Sons, Inc. v North Carolina***, 283 US 123, 135 [1931]). Petitioner contends that the Division's allocation of Jefco's income in this case leads to a similarly distorted result that overstates its receipts allocation factor by a factor of three or four.

The Division asserts that:

> "Petitioner's distortion argument only works if it is accepted that Tax Law § 210(3)(a)(9) embraces Petitioner's theory that its customers are the underlying investors and the Division was wrong to source the receipts otherwise; and if Tax Law § 210(3)(a)(9)(D) and subclause (iii) of Tax Law § 210(3)(a)(9)(A) are ignored."

The Division claims that its method of sourcing petitioner's receipts was 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." Contrary to the Division's claim, Jefco maintains sales offices in numerous states throughout the country, including California, Connecticut, Massachusetts, New Jersey, and New York.

The Division also asserts that petitioner's Due Process Clause and Commerce Clause claims must be denied because they do not constitute an "as applied" constitutional challenge to Tax Law former § 210 (3) (a) (9). To the contrary, petitioner is challenging the Division's

application of the broker-dealer sourcing statute to its own set of facts and its specific records. The facts show that it is the underlying investors that are responsible for petitioner's receipts at issue, and records which generally contain the name and mailing address of the intermediary that is acting on behalf of the underlying investors, rather than the underlying investors themselves. In petitioner's case, the Division's application of Tax Law former § 210 (3) (a) (9) results in its receipts being sourced based upon the location of intermediaries that petitioner has established through clear and cogent evidence, do not pay those receipts. The Division's allocation method was very 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 the individual investors, i.e., the customers. This results in an unconstitutional distortion of petitioner's income that does not accurately reflect how that income is generated.

CC. The petitions of Jefferies Group LLC & Subsidiaries are granted in accordance with conclusions of law K, R, AA and BB, but in all other respects are denied; notice of deficiency L-047299919, as modified by BCMS, and notice of deficiency L-047323899, as modified by BCMS, are hereby modified in accordance with conclusions of law K, R, AA and BB. The Division is directed to recompute notices of deficiency L-047299919 and L-047323899, each as modified at BCMS, in accordance with conclusions of law K, R, AA and BB, and issue any appropriate refunds.

DATED: Albany, New York
August 31, 2023

/s/ Winifred M. Maloney
ADMINISTRATIVE LAW JUDGE