New York State Department of Taxation and Finance
Office of Tax Policy Analysis
Technical Services Division

TSB-A-01(18)C
Corporation Tax
May 30, 2001

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. C000721A

On July 21, 2000 a Petition for Advisory Opinion was received from Sumitomo Trust & Banking Co. (USA), 527 Madison Avenue, New York, New York 10022. The Petition was modified on September 14, 2000.

The issues raised by Petitioner, Sumitomo Trust & Banking Co. (USA), are:

1. Whether it is entitled to allocate its entire net income within and without New York State for purposes of section 1454(b)(1) of the Tax Law.

2. Assuming the answer to Issue 1 is yes, to what extent are the Custody Fees it receives under the Custody Agreements, described below, allocable to New York State for purposes of computing the receipts factor of the entire net income allocation percentage under section 1454(a)(2) of the Tax Law, where Petitioner retains agents located outside of New York State to perform substantially all of the custodial services for the customers.

Petitioner submits the following facts, including additional facts submitted September 14, 2000, as the basis for this Advisory Opinion.

Petitioner is a New York State chartered trust company which was formed primarily to engage in the commercial banking business. Petitioner is a wholly-owned subsidiary of The Sumitomo Trust & Banking Co., Ltd., a Japanese corporation engaged in the international banking business (the "Parent"). The Parent's principal office is located in its country of incorporation. The Petitioner's only office is located in New York City. Petitioner does not maintain any offices outside of New York State.

As part of its operations, Petitioner is engaged in providing custodial services to unrelated entities and certain affiliated entities (collectively, the "Customers") with respect to their investments in various securities. Substantially all of the Customers are entities incorporated outside of the United States and are referred to Petitioner by employees of the Parent located and working outside of New York State. The Parent is the principal contact for substantially all communications between the Customers and Petitioner.

Petitioner enters into a Global Custody Agreement (a "Custody Agreement") with each of the Customers pursuant to which the Customer appoints Petitioner as its global custodian with respect to all of the shares, stocks, debentures, bonds, notes, bills and other investments owned by the Customer (the "Securities") and all of the Customer's cash that is deposited with or received by

Petitioner from time to time for the Customer's account. The terms of all of the Custody Agreements entered into between Petitioner and the Customers are substantially identical in substance.

Pursuant to a Custody Agreement, Petitioner maintains an account in the name of the Customer (a "Custodial Account") to which all money and securities received or delivered for the account of, or on behalf of, the Customer are credited or debited, as the case may be. Substantially all of the Securities (other than those of United States issuers) are to be held outside of the United States. A Custody Agreement expressly authorizes Petitioner (i) "to engage any one or more banks or other financial organizations as its sub-custodian or sub-custodians for the purpose of holding (separately or commingled) or servicing any securities" held for the Custodian (a "Sub-Custodian"), and (ii) to designate a bank or any financial institution "as its agent" for the purpose of opening and maintaining the Customer's account, providing currency conversions and forwarding to and receiving from the Customer any direction, notice, request, consent, institution statement or other instrument (an "Agent"). Petitioner's use of a Sub-Custodian or Agent does not affect any of its direct duties and responsibilities under the Custody Agreement and all references in a Custody Agreement to Petitioner also includes any Sub-Custodian or Agent.

A Custody Agreement obligates Petitioner to furnish the Customer with (i) a monthly statement of the financial condition of its Custodial Account, (ii) written advice of transactions entered into for the Customer's account from time to time, and (iii) all notices, announcements and other forms and documents which it receives with respect to the Securities held in the Customer's Custodial Account. In consideration for the custodial services provided to the Customer under the Custody Agreement, Petitioner is entitled to receive specified fees pursuant to a Custody Fee Schedule (the "Custody Fees").

Because the Customers and their Securities are located outside of the United States and Petitioner does not maintain any offices outside of New York City, Petitioner designates one or more foreign banks or other financial institutions as a Sub-Custodian(s) for each Custodial Account. A Sub-Custodian is selected through the joint decision of Petitioner and the Parent. In consideration for the sub-custodial services provided by a Sub-Custodian, Petitioner pays to the Sub-Custodian a substantial portion of the Custody Fees it receives from the Customer. All of the Sub-Custodians provide custodial services in the ordinary course of their business and maintain their principal offices in a foreign country. The personnel of the Sub-Custodian that render the sub-custodial services to Petitioner are located in offices outside of the United States.

Under a Custody Agreement, Petitioner enters into a sub-custody agreement with the Sub-Custodian to perform certain specified services relating to the Custody Account on behalf of Petitioner. However, with certain limited exceptions, the Sub-Custodian is expressly required to follow the instructions of Petitioner in the performance of these services. The sub-custody agreement also requires the Sub-Custodian to keep Petitioner informed as to the transactions in

which it engages and to ascertain Petitioner's instructions before acting on certain information. At least one of the sub-custody agreements specifically grants the Sub-Custodian a power of attorney to act "in the name of and on behalf" of Petitioner.

Employees of Petitioner assigned to its New York City office are responsible for (i) drafting the Custody Agreement, (ii) monitoring the performance of each Sub-Custodian, (iii) consolidating the monthly statements provided by each Sub-Custodian with respect to a Custodial Account of a particular Customer, and (iv) assisting the Customers, when needed from time to time, in connection with the documentation with respect to any proxies or other corporate actions relating to a corporation whose securities are subject to the Custody Agreement. Employees of the Parent located outside of the United States (i) are primarily responsible for communicating with the Customers, and (ii) review substantially all monthly statements furnished by Petitioner to a Customer. From time to time Petitioner sends its employees or officers to meetings at the offices of the Sub-Custodians located outside of New York State to discuss matters relating to the Custody Agreements.

For purposes of computing its entire net income under Article 32 of the Tax Law, Petitioner includes the Custody Fees it receives from the Customers in its federal gross income and claims a deduction for the portion of the Custody Fees it pays to the Sub-Custodians.

Discussion

Section 1454(b)(1) of the Tax Law provides that "[i]f a taxpayer's entire net income is derived from business carried on both within and without the state, the portion thereof which is derived from business carried on within the state shall be determined by multiplying its entire net income by the income allocation percentage ...."

Section 19-1.1(c) of the Article 32 Regulations provides that the phrase *business carried on* means "doing business" as defined in section 16-2.7 of the Article 32 Regulations, provided the income or expenses from such business are required to be included in the computation of the taxpayer's alternative entire net income.

Section 16-2.7 of the Article 32 Regulations provides, in pertinent part:

> (a) The term *doing business* is used in a comprehensive sense and includes all activities which occupy the time or labor of people for profit. Every corporation organized for profit and carrying out any of the purposes of its organization is deemed to be doing business for purposes of the tax. In determining whether a corporation is doing business, it is immaterial whether its activities actually result in a profit or a loss.

(b) Whether a corporation is doing business in New York State is determined by the facts in each case. Consideration is given to such factors as:

(1) the nature, continuity, frequency and regularity of the activities of the corporation in New York State;

(2) the purposes for which the corporation was organized;

(3) the location of its offices and other places of business;

(4) the employment in New York State of agents, officers and employees; and

(5) the location of the actual seat of management or control of the corporation.

In Bleakley Platt & Schmidt, Adv Op Comm of T & F, December 13, 1990, TSB-A-90(25)C, it was held that a foreign bank that had no employees, offices or agents in New York was not subject to tax under Article 32 if its contacts with the state were limited to security interests in property located in New York. The bank made loans to New York residents and businesses which were accepted, processed, approved and serviced at the corporation's Connecticut office. The fact that the bank acquired a security interest in property within New York and acquired title to property located in New York through foreclosure of security interests did not, by itself, cause the bank to be doing business in New York. Also, the hiring of independent contractors located in New York did not constitute doing business in New York. However, the bank could be subject to franchise tax if corporate officers regularly visited New York to negotiate the loans or if an agency relationship existed between the corporation and a person or entity conducting business in New York. Furthermore, the closing of loans in New York might constitute doing business in New York. In all cases, the totality of circumstances determined the bank's taxable status.

For purposes of Article 9-A of the Tax Law, the definition of doing business contained in section 1-3.2(b) of the Business Corporation Franchise Tax Regulations is identical to the definition of doing business for purposes of section 16-2.7(a) of the Article 32 Regulations. In GEF Funding Corp, Adv Op Comm T & F, January 26, 1988, TSB-A-88(2)C, it was held that for purposes of Article 9-A of the Tax Law, the activities of a corporation do not constitute doing business in New York State where the corporation is engaging in mortgage loan activities when the loans are secured by real property located in New York State but the acceptance of applications, processing, approval and servicing of the loans are conducted at the corporation's office outside New York State. However, it was also held that a corporation could be subject to tax if it is determined that an agency relationship exists between such corporation and a person or entity and the agent is conducting the corporation's business in New York State.

To ascertain the existence of an agency relationship, the relationship of the parties must be examined. "An agency is a fiduciary relationship which results from a manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and the consent by the other to act." Custom Management Corp v NY St Tax Commn, 148 AD2d 919, 920, citing Meese v Miller, 79 AD2d 237, 241. (emphasis added) Generally, the existence of an agency relationship is a question of fact not susceptible of determination in an Advisory Opinion. However, a Power of Attorney is a written authorization to an agent to perform specified acts in behalf of its principal, which acts, when performed, shall have a binding effect upon the principal. It is an instrument by which the authority of one person to act in the place and stead of another as attorney in fact is set forth. It is a contract of agency, that is, an authorization by a principal for the accomplishment on its behalf of a particular purpose or the performance of a particular act. (2A NY Jur 2d Agency §64)

In The Daiwa Bank, Limited, Adv Op Comm T&F, February 2, 1998, TSB-A-98(1)C, the petitioner was a bank organized outside of the United States, that was a banking corporation subject to tax under Article 32 of the Tax Law. After the petitioner was required to cease its operations in New York State by the New York State Superintendent of Banks and the Board of Governors of the Federal Reserve System (the "Order"), the petitioner surrendered its New York banking license to maintain a branch in New York City on February 2, 1996, after which the petitioner did not conduct a banking business in New York State or operate a branch, agency, loan production office, representative office or bona fide office in New York State. However, the petitioner continued to be a banking corporation (because of its activities in Japan) and it would continue to be subject to tax under Article 32 if it was considered to be doing business in New York State, pursuant to section 16-2.7 of the Article 32 Regulations, after it ceased its banking operations in New York. Pursuant to the Order, the petitioner was permitted to establish a service subsidiary in the United States. It appeared that pursuant to the Order, the sole business of the subsidiary was limited to administering the books and records required by bank regulatory agencies, administering the petitioner's ongoing affairs and other matters with federal, state and local tax authorities and regulatory bodies, defending or prosecuting any action, inquiry or investigation to which petitioner became a party, and administering the orderly termination of petitioner's banking operations in the United States. To accomplish this, the petitioner executed a power of attorney granting limited authority to two employees of the subsidiary. The opinion held that an agency relationship existed between petitioner and the subsidiary.

With respect to Issue 1, Petitioner states that some of the Sub-Custodians have the power to take actions that bind Petitioner, and at least one has a power of attorney. Following Daiwa Bank, supra, if it is determined that an agency relationship exists between Petitioner and at least some of the Sub-Custodians, then where the agents are performing services for Petitioner outside of New York State, Petitioner is deemed to be carrying on business outside of New York State. Accordingly, pursuant to section 1454(b)(1) of the Tax Law and section 19-1.1of the Article 32

Regulations, if Petitioner is performing services without New York State through agents, Petitioner may allocate its entire net income within and without New York State.

However, it is not within the scope of this Advisory Opinion to determine whether an agency relationship exists between Petitioner and the Sub-Custodians. The determination of such existence is a factual matter that is not susceptible of determination in this Advisory Opinion. An Advisory Opinion merely sets forth the applicability of pertinent statutory and regulatory provisions to "a specified set of facts." Tax Law,§171.Twenty-fourth; 20 NYCRR 2376.1(a).

With respect to Issue 2, section 1454(b)(1) of the Tax Law and Subpart 19-2 of the Article 32 Regulations provide that the portion of entire net income which is derived from business carried on within New York State is determined by multiplying entire net income by the entire net income allocation percentage. The entire net income allocation percentage is determined by a formula consisting of a payroll factor determined under section 1454(a)(1) of the Tax Law, a receipts factor determined under section 1454(a)(2) of the Tax Law, a deposits factor determined under section 1454(a)(3), and an additional factor equal to the receipts factor and an additional factor equal to the deposits factor, which factors are added together and divided by the number of percentages so added together.

Section 1454(a)(2)(H) of the Tax Law, provides that in computing the receipts factor, "[a]ll receipts from the performance of services not described [in section 1454(a)(2)(A) through (G)] are earned within the state if the services are performed in the state. When a service is performed both within and without the state, the receipts shall be allocated within and without the state in accordance with rules and regulations of the [Commissioner of Taxation and Finance]."

Section 19-6.7 of the Article 32 Regulations provides that for purposes of computing the receipts factor:

> (a) Receipts for services performed by the taxpayer's employees regularly connected with or working out of a New York State office of the taxpayer are allocated to New York State if such services are performed within New York State.
>
> (b) When allocating receipts for services performed, it is immaterial where such receipts are payable or where they are actually received.
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> (c) Where services are performed both within and without New York State, the portion of the receipt attributable to services performed within New York State is determined on the basis of the relative value of, or amount of time spent in performance of, such services within New York State, or by some other reasonable method. Full details must be submitted with the taxpayer's return.

In this case, if it is determined in Issue 1, that Petitioner is performing the custodial services provided for Customers both within and without New York State, Petitioner may allocate its entire net income within and without New York State, and the numerator of the receipts factor may be determined as follows. Petitioner's employees perform the services provided within New York State, and services performed outside of New York State are performed by the Sub-Custodians, except for the occasions that an employee or officer of Petitioner meets with a Sub-Custodian outside of New York State to discuss matters relating to the Custody Agreements. Under section 19-6.7(c) of the Article 32 Regulations, a reasonable method to determine the portion of Petitioner's Custody Fees for custodial services provided in New York State is to use Petitioner's costs attributable to the performance of services by the Sub-Custodians. Assuming that the services provided by the Sub-Custodians are performed at third-party arm's length rates, it is presumed that Petitioner's costs attributable to the performance of such services are the fees reflected in the sub-custodian agreements. Therefore, the portion of Petitioner's Custody Fees for providing custodial services outside of New York State would be the amount of the fees Petitioner pays to the Sub-Custodians, and the balance of the Custody Fees would be the portion that is attributable to the services provided within New York State.

Note that section 19-6.7(c) of the Article 32 Regulations provides that a taxpayer may use some other reasonable method to determine the portion of Petitioner's receipts for providing custodial services for customers that is attributable to services performed within New York State, and that the taxpayer must submit full details with its return.

DATED: May 30, 2001

/s/
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NOTE: The opinions expressed in Advisory Opinions are limited to the facts set forth therein.