STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. C090120A

On January 20, 2009, the Department of Taxation and Finance received a petition for Advisory Opinion from [redacted], [redacted] (the "Petitioner") and its affiliates. The Department also received Petitioner's supplemental statement, dated June 10, 2009. Petitioner asks a number of questions regarding the application of the investment tax credit (ITC") available to the financial services industry under section 210.12 of Article 9-A and section 1456(i) of Article 32 of the Tax Law.

Facts

Petitioner and its affiliates have historically filed a combined return under Article 9-A of the Tax Law. Petitioner has completed construction of a new building in Manhattan through a limited liability company (herein "LLC) treated as a partnership for tax purposes. Petitioner owns 99.8% of the member interests in LLC, and an affiliate of Petitioner owns the remaining 0.2%. The building and the land on which it is located is owned by a third party (herein "Landowner"). Landowner leases the land and building to LLC for a term of 60 years. The lease provides that, to the extent permitted by law, LLC shall have the right to all depreciation deductions, investment tax credits and other similar tax benefits attributable to any construction performed by LLC, or to the ownership of the building. It also provides that LLC shall enjoy all the benefits and bear all the burdens of ownership of the building notwithstanding that Landowner holds legal title to it.

Portions of the building were placed in service at the end of Petitioner's 2009 taxable year when occupancy of the building commenced. It is expected that the building will be fully placed in service during Petitioner's 2011 taxable year. By the end of 2011, all floors of the building will be occupied, although there will be room for growth on each floor. The occupants at that time will include registered broker/dealer affiliates of Petitioner.

The construction costs for the building will be depreciable under section 167 of the Internal Revenue Code (the "Code" or "IRC"). Certain portions of the building will be used for lobbies, elevators, stairs, mechanical rooms, and conference rooms. Other portions will contain a cafeteria, dining rooms, a gym and a children's center. Petitioner has selected third-party operators for the cafeteria, dining rooms, gym and children's center. The gym and children's centers will provide support services for employees of Petitioner and its affiliates, and non-employees will not be able to use these facilities.

The building will include a number of conference rooms. Some of these rooms may be on floors that are primarily used by personnel involved in trading stocks and other securities for customers, although the conference rooms are available for use by other employees. Generally, the use by employees not engaged in the trading of securities for customers is less than 20%. Conference rooms may also be located on floors in the building that are used jointly by a department that is engaged in investment banking activities, including the issuance of stock and other securities as part of public underwritings, and by a department that performs merchant banking activities offering a variety of private equity products to customers. The conference rooms on these floors will be used substantially all the time by individuals in the departments on those floors but may also be used by individuals who are employed on other floors of the building.

[redacted] ("Bank") is a wholly-owned subsidiary of Petitioner. Bank is a New York State chartered bank that is engaged in the banking business and is subject to taxation under Article 32 of the Tax Law.

Some of the employees in the building will be employed by affiliated entities of Petitioner that are subject to tax under a different article (Article 32 or 9-A) than the entity that will be claiming the ITC.

Petitioner was a fiscal year taxpayer in 1998 and 1999. Since 1999, Petitioner has made several business acquisitions that have increased the number of employees located in New York who perform functions resulting from, or related to, uses of the building that would qualify the building for purposes of the investment tax credit under Article 9-A or 32 of the Tax Law.

The following issues are raised by Petitioner:

1. With respect to property that becomes qualified property in a tax year after the property is first placed in service, should the ITC be calculated based on the depreciated value of the property as of the beginning of the taxable year in which the building first becomes qualified property?

2. Should floor space used for lobbies, elevators, stairs, mechanical rooms, cafeterias, dining rooms, a gym, and a children's center be considered "nonusable" floor space that is excluded from the calculation of whether more than 50% of the building's usable floor space is used for qualifying activities?

3. Can floor space used for conference rooms that will be used by employees performing both qualifying and non-qualifying activities be allocated between the qualifying and non-qualifying activities for purposes of the "principally used" test based on the actual use of the conference rooms, or, alternatively, based on the headcount of employees performing qualifying versus non-qualifying activities on the floor or floors where the conference rooms are located?

4. For purposes of the back office employment test, should the number of employees employed by the taxpayer in New York State on the 1998 measuring date referred to in Tax Law § 210.12(b)(i) include employees employed on that date by companies that were later acquired by the taxpayer, and should the number of employees actually employed by a taxpayer in the first taxable year in which the ITC is claimed include all employees actually employed by the taxpayer regardless of whether they were new hires by the taxpayer or whether they joined the taxpayer as a result of acquisitions?

5. Do the employment aggregation rules apply regardless of whether the taxpayer's affiliate is subject to tax under the same Tax Law article (9-A or 32) as the taxpayer?

6. For purposes of the "principally used" test, may a taxpayer aggregate its qualifying use of the property with the qualifying use of the property by its affiliated broker-dealers or banks if a formal lease arrangement is not in place?

Analysis

Petitioner is the principal member of LLC, a limited liability company treated as a partnership. As the principal corporate partner, Petitioner is treated under the aggregate theory of partnerships as having an undivided interest in the partnership's assets, liabilities and items of receipts, income, gain, loss and deduction. Business Corporation Franchise Tax Regulations ("Reg."), Section 3.13-1(b). It is also treated as participating in the partnership's transactions and activities. *Id.* Therefore, Petitioner is treated as having acquired an ownership interest of the building for purposes of § 210.12(b)(i)(D). *See John J. Eagan, Norris, McLaughlin & Marcus*, Adv Op Comm T & F, April 29, 1987, TSB-A-87(9)C; *Newport Hydro Associates*, Adv Op Comm T & F, April 29, 1988, TSB-A-88(5)I.

Tax Law § 210.12(b)(i)(D) allows an investment tax credit to taxpayers with respect to tangible personal property and other tangible property, including buildings and structural components of buildings, that is depreciable under Internal Revenue Code ("IRC") § 167; has a useful life of four or more years; is acquired by purchase as defined in IRC § 79; has a situs in the State; and is principally used in the ordinary course of the taxpayer's business as a broker or dealer in connection with the purchase or sale of securities. A similar investment tax credit is allowed for Article 32 taxpayers pursuant to Tax Law § 1456(i)(2).

The amount of the investment tax credit is 5% of the first $350 million of the "investment credit base," and 4% of the amount of this base over $350 million. Tax Law §§ 210.12(a) and 1456(i)(1). The investment credit base is the cost or "other basis" of the property for federal income tax purposes. *Id.* The term "other basis" means the adjusted basis for determining gain or loss which is used as the basis for depreciation under IRC § 167(g). Reg. § 5.2-4(e).[1]

Issue 1

A building is "principally used" for qualifying activities if more than 50% of the usable business floor space is used in qualifying activities. Reg. § 5.2-4(c); *see also* TSB-M-98(8)C. The Department has said that, if property first meets the "principally used" test and becomes "qualified property" in a taxable year after the year in which it is placed in service, the taxpayer may claim the ITC for the year in which the property first becomes qualified property. *Algorex Corporation*, Adv Op Comm T & F, May 17, 1989, TSB-A-89(7)C. The amount of the credit in such a case is the depreciated value of the building in the taxable year in which the property became qualified. *Id.*

The depreciated value of the building in the year of qualification, for purposes of the ITC, is the adjusted basis for determining gain or loss. The adjusted basis of the building at that time is the adjusted basis as of the beginning of the taxable year, less the amount of any depreciation deduction allowed up to the time the gain or loss would have been recognized. If the building first meets the principally used test in 2011 when it is fully placed in service, and all other requirements for the ITC have been satisfied, then Petitioner, as a partner in LLC, may claim the ITC in that taxable year. To determine the appropriate "investment credit base," Petitioner should subtract from the adjusted basis of the property at the beginning of the taxable year the amount of the depreciation deduction that would have been allowed if the building was disposed of at the time it was fully placed in service.

Issue 2

For purposes of determining if more than 50% of the usable floor space is used in qualifying activities, "[f]loor space used for bathrooms, cafeterias and lounges is not usable floor space." Reg. § 5-2.4(c). This regulation lists types of uses that are part of the common areas of a building. Lobbies, elevators, stairs, mechanical rooms, dining rooms, a gym, and a children's center are all similar to the types of uses that are explicitly stated to be "not usable floor space" in Reg. § 5-2.4(c) and must also be excluded from the computation of usable floor space.

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[1] IRC § 167(g) was redesignated as § 167(c) by P.L. 101-508, § 11812(a)(1)-(2).

Issue 3

When a portion of a building such as a conference room is used in both qualifying and non-qualifying activities, it is appropriate to determine the portion of qualifying use. There is no single method that must be employed to determine qualifying use, but the method used by Petitioner must be reasonably calculated to arrive at a fair estimation of the portion of qualifying use and based on reliable records that are in auditable form.

Petitioner asks whether tracking the actual use of conference rooms located on floors shared by departments of Petitioner (and/or its affiliates) that are engaged in both qualifying and non-qualifying activities will be considered an acceptable method to allocate between qualifying and non-qualifying floor space for purposes of the principally used test. Actual use determinations are an appropriate way to show that equipment is principally used in qualifying activities. (*See* TSB-M-98(8)C stating that tracking actual operating time of equipment is an acceptable method to show principal use). Similar actual use determinations may be used for areas such as conference rooms to allocate between qualifying and non-qualifying floor space. However, any particular method to track actual use is subject to review and acceptance by the Audit Division.

Petitioner also asks whether another method, based on a headcount of employees, may be used for the conference rooms located on floors that are jointly used by departments engaged in both qualifying and non-qualifying activities. The headcount would cover the employees on the floor or floors where those conference rooms are located, and would involve a determination of whether the employees perform qualifying or non-qualifying activities. While Petitioner states that the conference rooms will be used substantially all the time by employees from the floors on which they are located, employees from other floors may also use these conference rooms. These facts alone do not provide a basis to conclude that such a method is an acceptable way to allocate the conference room space between qualifying and non-qualifying activities.

Petitioner also proposes that conference rooms located on a floor of the building that is primarily used by employees engaged in qualifying activities (the trading of securities with customers) should be treated as space that is used in qualifying activities. Although the floor in such a case is primarily used by employees performing qualifying activities, the conference rooms on the floor may also be used by employees who are not engaged in qualifying activities. Petitioner estimates the use by these latter employees to be less than 20% of the conference room's total use. Despite these estimates, the stated facts are insufficient to establish that the conference rooms may be treated as principally used in qualifying uses.

Issue 4

The broker dealer investment tax credit requires the taxpayer to show that certain employment levels have been maintained or achieved. One of the tests that satisfies the employment requirement is a showing that the number of employees located in New York during the taxable year the credit is claimed is equal to or greater than 90% of the number of employees located in New York on December 31, 1998. Tax Law § 210.12(b)(i)(III). If the taxpayer was not a calendar year taxpayer in 1998, the 90% employment test will be based on the number of employees located in the State on the last day of the first taxable year ending after December 31, 1998. *Id.* Petitioner states, and it is assumed for purposes of this opinion, that the measuring date for purposes of the 90% test is the last day of Petitioner's first taxable year ending after December 31, 1998.

Petitioner has acquired a number of other businesses since 1999. Tax Law § 210.12(b)(i), however, is silent as to the measurement of employment levels in the case of business mergers and acquisitions. As a result, Petitioner asks whether the number of employees employed by the taxpayer in New York State on the measuring date should include employees of companies that were later acquired by the taxpayer (even though those individuals were employed by a different company on the measuring date). Petitioner also asks the related question whether the number of employees of the taxpayer located in New York in the year the credit is claimed should include the employees of those companies that were acquired after the measuring date.

The Department addressed a similar issue in *The Carborundum Company*, Adv Op Comm T & F, October 27, 1987, TSB-A-87(28)C. In that opinion, the taxpayer asked whether, for purposes of the additional investment tax credit allowed under Tax Law § 210.12-A, the employees of a merged company should be included in the employment test of that provision. The additional credit under § 210.12-A was allowed for the 3 years following the year the taxpayer qualified for the ITC allowed under § 210.12. But the additional credit was available only if the number of employees in those following years was at least 101% of the number of employees in the year preceding the year the ITC was claimed. If the petitioner in *The Carborundum Company* counted the number of employees of the merged company to determine the employment level in the year preceding the year the ITC was claimed (which preceding year was the year prior to the merger), it would have failed the employment test for the additional credit. The Department concluded, however, that the employment test did not require the count for the preceding year to include the employees of the merged company. Moreover, the employment counts for the years following the year the ITC was claimed would include all employees at those times, including any formerly employed by the merged company.

In view of the similarity between the employment test under Tax Law § 210.12-A and the 90% employment test in Tax Law § 210.12(b)(i)(III), we conclude that Petitioner is not required to count the employees of merged or acquired companies on the measuring date. In addition, Petitioner should count all employees during the taxable year the ITC is claimed, regardless of whether those employees are new hires, or joined Petitioner (and/or its affiliates) as a result of acquisitions.

Issue 5

If the uses of the property by the taxpayer and an affiliated broker, dealer, or registered investment advisor are aggregated for purposes of determining whether the property is "principally used" in qualifying activities, the employment test must be met either by each affiliate using the property, or through the aggregation of the support employees of the taxpayer, its affiliated regulated broker dealers, and regulated investment advisors using the property. Tax Law §§ 201.12(b)(i) and 1456(i). There is no requirement that the affiliated regulated brokers, dealers, or regulated investment advisors be subject to tax under the same article of the Tax Law as the taxpayer claiming the ITC. Therefore, Petitioner may aggregate the employees of these affiliates regardless of which article of the Tax Law applies to them.

Issue 6

The last issue is whether a taxpayer may aggregate its use of property with its affiliate(s), or aggregate use by its affiliates to meet the "principally used" test when there is no formal lease with the affiliate. Property purchased by a taxpayer affiliated with a regulated broker or dealer or a registered investment advisor may qualify for a credit if the property is used by the affiliate in qualifying activities. Tax Law § 210.12(b)(i). This subdivision further provides that, for purposes of determining if the principally used test is met, the uses by the taxpayer and its affiliates may be aggregated. *Id.* There is no requirement in

§ 210.12(b)(i) that the use of the property by an affiliate be pursuant to a lease agreement. While subdivision (d) of Tax Law § 210.12 states that a lease of property by a taxpayer to an affiliated broker, dealer, or registered investment advisor will not prevent the property from qualifying for the ITC, this is just an exception to the general rule in subdivision (d) that property leased by a taxpayer does not qualify for the credit. Thus, a formal lease arrangement with an affiliate would permit the aggregation of the affiliate's use, but it is not required for purposes of the "principally used" test.

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/S/
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Director of Advisory Opinions
Office of Counsel

NOTE: An Advisory Opinion is issued at the request of a person or entity. It is limited to the facts set forth therein and is binding on the Department only with respect to the person or entity to whom it is issued and only if the person or entity fully and accurately describes all relevant facts. An Advisory Opinion is based on the law, regulations, and Department policies in effect as of the date the Opinion is issued or for the specific time period at issue in the Opinion.