

New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB-A-87 (6) C
Corporation Tax
April 6, 1987

STATE OF NEW YORK
STATE TAX COMMISSION

ADVISORY OPINION

PETITION NO. C861203B

On December 3, 1986, a Petition for Advisory Opinion was received from Independence One Mortgage Corporation, 23800 Northwestern Highway, P.O. Box 5076, Southfield, Michigan 48086-5076.

The issues raised by Petitioner are based on the following facts. The issues are: (1) Will Petitioner be taxable as a banking corporation under Article 32 of the Tax Law; (2) Will Petitioner be taxed as a separate entity apart from its parent and any other affiliated corporation; and (3) Will the amounts received from the sale of mortgage backed securities be non-taxable receipts within the meaning of Article 32 and not included in either the numerator or denominator of the receipts factor.

Facts

Petitioner is a Michigan corporation which is a wholly owned subsidiary of Michigan National Bank of Detroit, a national banking association, which, in turn, is a wholly owned subsidiary of Michigan National Corporation, a Michigan corporation. Neither Michigan National Bank of Detroit nor Michigan National Corporation carry on any business in New York State.

Petitioner's principal business activity is the origination and servicing of first mortgages and deeds of trust on residential real estate located throughout the United States. Its principal office is in Southfield, Michigan. Petitioner carries on mortgage origination activities through offices located in numerous states and is preparing to open an office in White Plains, New York or some other appropriate location in New York other than New York City.

It is anticipated that Petitioner's New York office will contain 2,500 square feet, and employ approximately 15 people with an annual payroll of approximately \$300,000. The persons employed in the New York office will carry on all activities appropriate to the origination and closing of mortgage loans secured by real estate located in New York. The servicing of these mortgages will not be carried out in New York, but rather at Petitioner's home office in Michigan.

Petitioner is reimbursed for a portion of the amounts used to fund the loans it originates through participation in the mortgage backed securities programs of Federal National Mortgage Association (FNMA) and Government National Mortgage Association (GNMA). These programs are designed to assist mortgage bankers such as Petitioner in the funding of mortgage loans. Under these programs groups of mortgages originated in various states, including New York, are pooled and used to back securities which are sold on the secondary market and administered in accordance with trust indentures. In the case of FNMA the mortgages are

actually sold by Petitioner to FNMA, while in the case of GNMA the mortgages are assigned in blank but are not actually transferred to GNMA except in certain cases. In both instances the mortgage documents themselves remain in Michigan with a custodian acting on behalf of FNMA or GNMA. Petitioner is responsible for marketing the mortgage backed securities and does so through the New York offices of various securities dealers. In the case of FNMA the securities are issued by FNMA, while in the case of GNMA they are issued by Petitioner. In both cases the securities carry the guaranty of FNMA or GNMA. Upon completion of the sale of the securities on the secondary market, the proceeds are remitted to Petitioner directly by the securities dealers.

In most cases Petitioner retains the right and obligation to service the mortgages and the fees received by Petitioner for such servicing are one of its primary sources of income. As already noted, the servicing activities are carried on by Petitioner from its Michigan office rather than from the originating offices. Essentially, the mortgage backed securities program is not intended to be either a money making or money losing activity of Petitioner, although it is possible that Petitioner may make or lose money depending upon the fluctuation in interest rates between the time the mortgages are executed and the date the securities are sold on the secondary market.

The mortgage backed securities programs have no connection with New York State other than the marketing of the securities by the New York offices of the securities dealers. All transactions with FNMA, GNMA and the securities dealers are carried on via telephone, wire and correspondence from Petitioner's Michigan office.

Petitioner contends that amounts received from the sale of mortgage backed securities are not taxable receipts within the meaning of Article 32 of the Tax Law, and are not included in either the numerator or denominator of the receipts factor because such amounts represent a return of capital.

Issue 1

Section 1451 of the Tax Law imposes an annual franchise tax on every banking corporation for the privilege of doing business in New York State in a corporate or organized capacity during the taxable year.

Section 1452(a) of the Tax Law defines "banking corporation". Section 1452(a)(9) of the Tax Law provides that a corporation 65% or more of whose voting stock is owned or controlled directly by a national banking association that is doing a banking business, is a banking corporation provided that the corporation whose voting stock is so owned or controlled is principally engaged in a business, regardless of where conducted, which (i) might be lawfully conducted by a national banking association or (ii) is so closely related to banking or managing or controlling banks as to be a proper incident thereto, as set forth in section 4(c)(8) of the Federal Bank Holding Company Act of 1956, as amended.

Based on the facts presented, Petitioner is a banking corporation pursuant to section 1452(a)(9) of the Tax Law and is a taxpayer under Article 32 of the Tax Law pursuant to section 1451 of the Tax Law.

Issue 2

Section 1452(a)(3) provides that a national banking association which is doing a banking business is a banking corporation. As stated previously, a banking corporation is not a taxpayer unless it is doing business in New York State.

Section 21-2.6 of the Franchise Tax on Banking Corporations regulations (hereinafter "Article 32 regulations") provides that a banking corporation or bank holding company which is not a taxpayer cannot be included in a combined return unless it is part of a unitary business with the other corporations in the group and the Tax Commission determines that the inclusion of such corporation is necessary in order to properly reflect the tax liability of one or more banking corporations or bank holding companies included in the group because of:

(1) intercorporate transactions; or

(2) some agreement, understanding, arrangement or transaction existing between the taxpayer and any other combinable corporation, whereby the activity, business, income or assets of the taxpayer within New York State is improperly or inaccurately reflected. See Subpart 21-2 of the Article 32 regulations - Combined Returns.

The purpose of combined reporting is to avoid distortion of, and more realistically portray true income of, closely related businesses. (Matter of Coleco Inds. v. State Tax Comm., 92 AD2d 1008, aff'd 59 NY2d 994). A combined report may not be required unless it will avoid distortion of and more realistically portray true income of closely related businesses. No single factor is decisive in properly reaching a determination that requiring combined reporting fulfills the statutory purpose (id. at 1009). Therefore, the existence of distortion must be decided based on the factual situation in each case.

Distortion is a question of fact not susceptible of determination in an 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, subd. twenty-fourth; 20 NYCRR 901.1(a). Therefore, a determination cannot be made in this advisory opinion as to whether Petitioner should file its tax return as a single entity or whether a combined return including Petitioner and its parent or any other affiliated corporations should be permitted or required pursuant to Subpart 21-2 of the Article 32 regulations.

Issue 3

Under Article 32 of the Tax Law, the basic tax is measured by entire net income, or the portion thereof allocated to New York State. When computing the alternative minimum tax one of the bases is measured by alternative entire net income or the portion thereof allocated to New York State. Alternative entire net income is entire net income with certain deductions disallowed. Entire net income is defined in section 1453 of the Tax Law as total net income from all sources which shall be the same as the entire taxable income which the taxpayer is required to report to

the United States Treasury Department for purposes of the federal income tax imposed by chapter one of the Internal Revenue Code with the adjustments described in section 1453(b) through (i) of the Tax Law.

Therefore, the amounts Petitioner receives from the sale of mortgage backed securities that are backed by mortgages originated and sold in the secondary market are taxable under Article 32 of the Tax Law to the extent such receipt is included in Petitioner's federal taxable income or included in Petitioner's adjustments made pursuant to section 1453(b) through (i) of the Tax Law, provided such receipt is allocated to New York State.

A taxpayer which has entire net income or alternative entire net income derived from business carried on both within and without New York State determines the portion of its entire net income or alternative entire net income that is derived from business carried on within New York State by use of the entire net income allocation percentage or alternative entire net income allocation percentage, respectively. One of the factors of the allocation percentages is the receipts factor.

When computing the receipts factor, section 19-6.9(c) of the Article 32 regulations states that "[a] receipt from the sale of a capital asset is not a business receipt and is not included in the receipts factor. For example, the receipt from the sale of a capital asset as scrap or at a gain is not included in the receipts factor." An identical provision is provided in the receipts factor for business corporations under Article 9-A of the Tax Law and is also contained in section 4-4.6(e) of the Business Corporation Franchise Tax regulations. In fact, section 19-6.9(c) of the Article 32 regulations is modeled after such section 4-4.6(e). However, section 4-4.6(e) is expanded to include the following definition of capital assets: "property that is not held by the taxpayer for sale to customers in the regular course of its business."

The amounts Petitioner receives from the sale of mortgage backed securities that are backed by mortgages originated and sold in the secondary market and administered in accordance with trust indentures are clearly transactions that occur in the regular course of Petitioner's business. Therefore, such receipts are not derived from the sale of capital assets as contemplated by section 19-6.9(c) of the Article 32 regulations.

Since the receipts at issue are derived from mortgages issued by Petitioner, the treatment of any income derived from the sale of such mortgages is described in section 19-6.2 of the Article 32 regulations. Section 19-6.2 provides that gross income from a loan is allocated to New York State if such income is attributable to a loan which is located in New York State. A loan is located where the greater portion of income producing activity relating to the loan occurred, provided however, that in the case of a taxpayer described in section 1452(a)(9) of the Tax Law, a loan attributed by such taxpayer to a bona fide office without New York State is presumed to be properly attributed. However, such presumption may be rebutted if the Tax Commission demonstrates that the greater portion of income producing activity relating to the loan did not occur without New York State.

To determine where the greater portion of income producing activity relating to a loan occurred, consideration is given to such activities as the solicitation, investigation, negotiation, final approval and administration of the loan. Each loan has its own characteristics. In some cases, one or more of the activities to be considered may not be present. The significance to be accorded to each activity depends upon the facts in each case.

Gross income from a loan includes interest and fees, such as arrangement, commitment and management fees but does not include the repayments of principal.

Accordingly, when Petitioner sells the mortgage backed securities, the portion of the receipt that is a repayment of the principal of the mortgage is not included in either the numerator or denominator of the receipts factor. However the balance, if any, of the receipt from such sale is a taxable receipt that is included in the denominator of the receipts factor and is also included in the numerator of the factor if the mortgage is located in New York State.

In addition, any income earned from the servicing of the mortgage is a taxable receipt that is included in the denominator of the receipts factor and is also included in the numerator of the factor if the mortgage is located in New York State.

DATED: April 6, 1987

s/FRANK J. PUCCIA
Director
Technical Services Bureau

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