

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

TSB-A-88 (21)C
Corporation Tax
September 29, 1988

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. C880718A

On July 18, 1988, a Petition for Advisory Opinion was received from The Lomas & Nettleton Company, 2001 Bryan Tower, Dallas, Texas 75265.

The issue raised is the treatment of mortgage loan origination and resale activities under Article 9-A of the Tax Law. Specifically, the questions are:

(1) Assuming that Petitioner is subject to tax under Article 9-A of the Tax Law, would the sales of FNMA and GNMA certificates ("Sales") be considered to be New York business receipts?

(2) Assuming that Petitioner is subject to tax under Article 9-A of the Tax Law, would the receipts from the Sales be considered "New York State business receipts" for purposes of determining Petitioner's business allocation percentage?

(3) Would the gross proceeds or only the net gain, if any, realized upon the Sales be included in the computation of Petitioner's "business receipts?"

(4) If the gross proceeds realized upon the Sales are included in the computation of Petitioner's business receipts, would the Tax Commission, in the circumstances described above and pursuant to Regulation Section 4-2.2(c), adjust Petitioner's business allocation percentage to more properly reflect Petitioner's New York activity and income?

(5) Would the income from origination fees, servicing fees and interest on retained loans and certificates be considered "New York State business receipts" for purposes of determining Petitioner's business allocation percentage?

Facts

Petitioner, incorporated in Connecticut, conducts a mortgage banking business and maintains an office and employees in New York through which Petitioner originates mortgage loans secured by New York real property. To avoid the financial risks associated with a substantial investment in mortgage loans, Petitioner packages the loans together with non-New York mortgage loans and exchanges them for certificates issued by the Federal National Mortgage Association ("FNMA") or the Government National Mortgage Association ("GNMA"). An out-of-state office of Petitioner then sells the FNMA and GNMA certificates through New York brokers. Substantially all steps in the FNMA and GNMA sale negotiation process (which consists primarily of telephone negotiations) occur outside of New York. However, a New York bank, acting as agent for Petitioner, delivers the

certificates to the buyers and receives payment for the certificates in New York. An out-of-state office of Petitioner services the loans from outside New York. (Servicing requires no New York activities except in the occasional case of foreclosure.)

Petitioner's income consists of origination fees paid by mortgagors, servicing fees in the form of retained portions of cash flow of mortgage loans, gain realized on the sale of the FNMA and GNMA certificates, and interest on retained loans and certificates. (For federal income tax purposes, income is not realized on the exchange of loans for FNMA and GNMA certificates. Rev. Rul. 70544, 1970-2 C.B. 6; Rev. Rul. 70-545, 1970-2 C.B. 7; Rev. Rul. 84-10 1984-1 C.B. 155.) Servicing activities are performed predominately in Texas as determined on a cost of performance basis. The gross proceeds from the sales of certificates greatly exceeds the profit, if any, realized on such sales. For example, the sale of a \$50,000,000 GNMA certificate typically would generate a profit of \$50,000 to \$100,000. In some cases, losses are incurred on the sale of certificates. Accordingly, if such gross proceeds were included in the computation of Petitioner's "business receipts," as that term is used in sections 4-4.1 and 4-4.6 of the Business Corporation Franchise Tax Regulations (hereinafter "Article 9-A regulations"), Petitioner's New York business receipts factor could be distorted and disproportionate in size to its payroll and property factors.

Discussion

The conducting of a mortgage banking business and the maintenance of an office in New York State would make Petitioner subject to the franchise tax under Article 9-A of the Tax Law.

Section 210.1 of the Tax Law provides that, except in the case of a small business taxpayer, the tax imposed by section 209.1 of the Tax Law is the sum of the highest of the amounts prescribed by the entire net income base, the capital base, the minimum taxable income base and the fixed dollar minimum, plus the amount prescribed by the subsidiary capital base.

When computing the entire net income base, a taxpayer must determine the portion of entire net income to be allocated within New York State. Generally, business income is allocated by the business allocation percentage as provided in section 210.3(a) of the Tax Law. Subpart 4-4 of the Article 9-A regulations provides the rules for determining the receipts factor of such percentage.

Section 4-4.1 of the Article 9-A regulations provides that the term business receipts means gross income received in the regular course of the taxpayer's business, provided such receipts are includible in the computation of the taxpayer's entire net income for the taxable year. All business receipts for the period covered by the report must be taken into account.

Section 210.3(a)(2)(D) of the Tax Law provides that the numerator of the receipts factor includes "other business receipts" (e.g., other than from sales of tangible personal property, the performance of services, and from rents and royalties) "earned within the state." The income here in question (origination fees, servicing fees, gain realized on the sale of FNMA and GNMA certificates and interest on retained loans and certificates) falls within the category of "other business receipts."

In CIT Financial Corporation, State Tax Commission Advisory Opinion, March 8, 1983, TSB-A-83(7)C, it was determined that the precise portion of interest income from a loan that is to be included in the numerator of the receipts factor 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). However, the opinion does give guidance in making such determination by stating that where the labor needed to establish and maintain (make and service) a loan is performed at more than a minimal level, in both New York and another state, the interest income derived from such loan is "earned within" both New York and such other state. To determine what portion of the income is attributable to New York, consideration should be given to such activities as solicitation, investigation, negotiation, approval and administration. The activity of loan approval can be of negligible import; as where it is merely pro forma, or of the highest importance, depending upon the circumstances of any given loan transaction. As stated in Walter E. Heller & Co., Decision of the State Tax Commission, September 19, 1980, TSB-H-80(29)C, "[i]t is the situs where...the financing...[is] performed which is determinative of whether the receipts are includible in the numerator of the receipts factor "

Accordingly, where the activities conducted in connection with a loan transaction were performed both within and without New York State, the portion of the interest income and the loan origination fees attributable to such loan that is to be included in the numerator of the receipts factor is a matter of fact and is determined by applying the above guidelines to the circumstances of the particular loan. See GEF Funding Corp., Commissioner of Taxation and Finance Advisory Opinion, January 26, 1988, TSB-A-88(2)C.

Section 4-4.1 of the Article 9-A regulations provides that business receipts means gross income. With regard to the sale of a FNMA or GNMA certificate, only the gain on such sale is included within gross income. Accordingly, only the gain on such sale is included in the receipts factor.

In determining when the gain on the sale of a FNMA or GNMA certificate should be included in the numerator of the receipts factor, the rationale of CIT Financial and Walter E. Heller should be followed. That is, when activities attributable to the sale of the certificate are performed in New York State. Again, this is a question of fact and the precise portion of the gain to be included

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in the numerator of the receipts factor is not susceptible of determination in an Advisory Opinion. It must be determined based on the circumstances of sale of the particular certificate. See GEF Funding Corp., infra.

The servicing fees received from contractual agreements to service loans or securities that have been sold (i.e. FNMA and GNMA certificates) should be allocated to New York State and included in the numerator of the receipts factor if the services were performed in New York State, pursuant to section 4-4.3 of the Article 9-A regulations.

DATED: September 29, 1988

FRANK J. PUCCIA
Director
Technical Services Bureau

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