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

TSB-A-88 (2)C
Corporation Tax
January 26, 1988

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. C870603B

On June 3, 1987, a Petition for Advisory Opinion was received from GEF Funding Corp., c/o Thacher Proffitt & Wood, Two World Trade Center, New York, New York 10048.

The issue raised is the New York State franchise tax treatment of Petitioner's activities if it engages in the mortgage loan origination and resale activities described in the three alternative sets of facts presented below.

Alternative #1

Facts

Petitioner, incorporated under the Laws of the State of Delaware, engages in the business of making and servicing mortgage loans, many of which are insured by the Federal Housing Administration ("FHA") or guaranteed by the Veterans Administration ("VA"). Petitioner does not originate (make) loans in New York, does not own loans secured by real property situated in New York, and has no office in New York. To avoid the financial risks associated with a substantial investment in mortgage loans, Petitioner packages the loans, exchanges them for certificates issued by the Federal National Mortgage Association ("FNMA") or the Government National Mortgage Association ("GNMA"), and 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.

Question

Would Petitioner be "doing business," "employing capital," or "owning or leasing property," as those terms are used in New York State Business Corporation Franchise Tax Regulation ("Article 9-A regulations") section 1-3.2, and therefore be subject to the business corporation franchise tax imposed by Article 9-A of the Tax Law?

Discussion

The business corporation franchise tax imposed by section 209.1 of Article 9-A of the Tax Law is imposed on every foreign corporation, unless specifically exempt, for the privilege of doing business, or of employing capital, or of owning or leasing property in New York State in a corporate or organized capacity, or of maintaining an office in New York State.

Section 1-3.2(b) of the Article 9-A regulations provides that:

(1) [t]he term doing business is used in a comprehensive sense and includes all activities which occupy the time or labor of men for profit. Regardless of the nature of its activities, every corporation organized for profit and carrying out any of the purposes of its organization is deemed to be "doing business" for the 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.

(2) 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:

(i) the nature, continuity, frequency, and regularity of the activities of the corporation in New York State, compared with the nature, continuity, frequency, and regularity of its activities elsewhere;

(ii) the purposes for which the corporation was organized, compared with its activities in New York State;

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

(iv) the income of the corporation and the portion thereof derived from activities in New York State;

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

(vi) the location of the actual seat of management or control of the corporation. 20 NYCRR 1-3.2(b)

Section 1-3.2(c) of the Article 9-A regulations provides that:

[t]he term "employing capital" is used in a comprehensive sense. Any of a large variety of uses, which may overlap other activities, may give rise to taxable status. In general, the use of assets in maintaining or aiding the corporate enterprise or activity in New York State will make the corporation subject to tax. Employing capital includes such activities as:

(1) maintaining stockpiles of raw materials or inventories; or

(2) owning materials and equipment assembled for construction. 20 NYCRR 1-3.2(c)

Section 1-3.2(d) of the Article 9-A regulations provides that:

[t]he owning or leasing of real or personal property within New York State constitutes an activity which subjects a foreign corporation to tax. Property owned by or held for the taxpayer in New York State, whether or not used in the taxpayer's business, is sufficient to make the corporation subject to tax.

Property held, stored, or warehoused in New York State creates taxable status. Property held as a nominee for the benefit of others creates taxable status. 20 NYCRR 1-3.2 (d)

Under this Alternative, Petitioner does not originate loans in New York State, does not own loans secured by real property in New York State, nor does it have an office in New York State. The process of exchanging loans for FNMA and GNMA certificates is conducted by Petitioner outside New York State. The negotiations for the sale of the certificates is also conducted by Petitioner outside New York State. Petitioner's only contact with New York State is with the New York bank which delivers the FNMA and GNMA certificates to the buyers and receives payment for the certificates in New York State. Based on the above definitions of doing business, employing capital and owning or leasing property, it is apparent that the activities of Petitioner in New York State under this Alternative are insufficient to make Petitioner subject to tax under Article 9-A of the Tax Law.

Alternative #2

Facts

In addition to the activities described in Alternative #1, Petitioner, from its office outside New York, accepts applications over the telephone for home mortgage loans from New York borrowers secured by real property situated in New York. The applications are processed and approved outside of New York, all communications between Petitioner and potential borrowers are conducted by mail or telephone. Once approval has been granted on an application, Petitioner arranges for an unrelated New York bank to extend credit to the New York borrower. The New York bank is engaged in a general banking business and is not the exclusive agent of Petitioner. After the loan has been made by the New York bank, Petitioner purchases the loan from the New York bank and holds the New York bank harmless from any loss which may occur due to interest rate changes. The loans are then serviced by Petitioner from outside New York. (Servicing requires no New York activities except in the occasional case of foreclosure.) The New York loans are then packaged, exchanged and sold in the manner described in Alternative #1, above.

Questions

(1) As a result of the activities described above and in Alternative #1, would Petitioner be "doing business," "employing capital," or "owning or leasing property," as those terms are used in Article 9-A regulation section 1-3.2, and therefore be subject to tax under Article 9-A of the Tax Law?

(2) Would the answer to question (1), above, be different if the loans to the New York borrowers were made in New York by an entity controlled by or affiliated with Petitioner?

As described in this Alternative, Petitioner's activities, including acceptance of application, processing, approval and servicing of a mortgage loan secured by real property located in New York

State, are conducted at Petitioner's office outside New York State. Accordingly, these activities do not constitute doing business in New York State.

Petitioner has an arrangement with an unrelated bank whereby Petitioner does all of the work regarding a loan but does not extend the funds. The unrelated bank actually makes the loan (extends the funds) to the borrower. Subsequently, Petitioner purchases the loan from the bank.

If Petitioner's arrangement with the unrelated bank does not create an agency relationship with the bank, then these activities do not create a taxable status for Petitioner since it is not doing business, employing capital, owning or leasing property in New York State or maintaining an office in New York State.

However, if the unrelated bank is found to be the agent of Petitioner, Petitioner could be found to be doing business, employing capital, owning or leasing property or maintaining an office in New York through its agent. The totality of Petitioner's circumstances and its relationship with the bank will determine Petitioner's taxable status in such a case.

Additionally, if the credit extended to the New York borrowers is extended by a New York bank controlled by or affiliated with Petitioner such control or affiliation could create a taxable status for Petitioner.

It has been held that if the affairs of a subsidiary or affiliated corporation are so dominated and controlled by its parent or affiliate that the dominated and controlled corporation is the alter ego of the other, then the nexus of one with New York State for tax jurisdiction purposes will provide sufficient nexus with New York State for the other. CIT Fin. Services Consumer Co. v. Director, Div. of Taxation, supra; Minnesota Tribune Co. v. Commissioner of Taxation, 37 NW2d 737; Franklin Mint Corp. v. Tully, 94 AD2d 877, aff'd, 61 NY2d 980. (Other cases supporting a finding of nexus premised on a parent/subsidiary relationship include Aldens, Inc. v. Tully, 49 NY2d 525; Reader's Digest Association, Inc. v. Mahin, 44 Ill. 2d 354, 255 NE2d 458, appeal dismissed, 399 US 919).

Alternatively, section 6-2.5 of the Article 9-A regulations provides that where a foreign corporation is not subject to tax, it will not be required to be included in a combined report unless the requirements described in section 6-2.2 of such regulations have been met and the Department of Taxation and Finance determines that inclusion is necessary to properly reflect the tax liability of one or more taxpayers included in the group because of:

(1) substantial intercorporate transactions; or

(2) some agreement, understanding, arrangement or transaction whereby the activity, business, income or capital of any taxpayer is improperly or inaccurately reflected. (See Subpart 6-2 of the Article 9-A regulations Combined Reports.)

Note that the existence of alter ego or agency status and the need to file a combined report are all questions 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).

Alternative #3

Facts

Petitioner conducts a mortgage banking business and maintains an office and employees in New York. Petitioner originates mortgage loans secured by New York real property, packages these loans together with non-New York mortgage loans and exchanges them for FNMA and GNMA certificates, in the manner described in Alternative #1, above. An out-of-state office of Petitioner then sells the FNMA and GNMA certificates, and services the loans from outside New York in the manner described in Alternatives #1 and #2, above. Petitioner's income consists of origination fees paid by mortgagors, servicing fees, 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. 70-544, 1970-2 C.B. 6; Rev. Rul. 70-545, 1970-2 C.B. 7; Rev. Rul. 84-10 1984-1C.B. 155.) 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.

Questions

(1) Assuming that Petitioner is subject to tax under Article 9-A of the Tax Law, would any of the above described sales be considered to be a New York business receipt?

(2) Assuming that Petitioner is subject to tax under Article 9-A of the Tax Law, would the receipts from the sales of the FNMA and GNMA certificates as described above 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 sale of the certificates be included in the computation of Petitioner's "business receipts."

(4) If the gross proceeds realized upon the sale of the certificates are included in the computation of Petitioner's business receipts, would the Tax Commission, in the circumstances described above and pursuant to Article 9-A regulation section 4-2.2(c), adjust Petitioner's business allocation percentage to more properly reflect Petitioner's New York activity and income?

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.

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 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.

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: January 26, 1988

s/FRANK J. PUCCIA
Director
Technical Services Bureau

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