NEW YORK CITY TAX APPEALS TRIBUNAL
ADMINISTRATIVE LAW JUDGE DIVISION

In the Matter of the Petition	:	**DETERMINATION**
Of	:	**TAT(H)10-19(GC)et al.**
The McGraw-Hill Companies, Inc.	:	

Murphy, C.A.L.J.

Petitioner The McGraw-Hill Companies, Inc. filed Petitions with the New York City (City) Tax Appeals Tribunal (Tribunal), dated July 28, 2010, protesting April 15, 2010 Notices of Disallowance of Claims for Refund of City General Corporation Tax (GCT) requested for the periods ended December 31, 2003 through December 31, 2007. Petitioner also filed Petitions with the City Tribunal, dated October 12, 2011, protesting the August 17, 2011 Notice of Determination of GCT due for the periods ended December 31, 2006 and December 31, 2008.

A Hearing was held in this matter on September 19, 20 and 21, 2012, pursuant to Section 1-12 of the Tribunal Rules of Practice and Procedure (Rules). The representatives for the parties entered into a Stipulation on September 18, 2012 (Stipulation), agreeing to certain facts and submitting documents. At the proceeding additional exhibits were submitted and testimony was taken. Petitioner appeared by Peter L. Faber and Robert J. McDermott, of McDermott Will & Emery, LLP, New York, NY. The Commissioner of Finance (Commissioner or Respondent) was represented by Frances J. Henn, Senior Counsel and Joshua M. Wolf, Assistant Corporation Counsel. Petitioner and Respondent filed briefs in this matter, with the final sur-reply brief filed on May 24, 2013. On November

21, 2013, the undersigned informed the parties, pursuant to Tribunal Rules § 1-12 (e) (1), that the time to issue a determination was being extended and the determination would be issued on or before February 24, 2014.

ISSUES

Whether Petitioner The McGraw-Hill Companies, Inc. may compute City GCT for the period ended December 31, 2003 through the period ended December 31, 2008 (Tax Years) by application of a business allocation percentage (BAP) to entire net income, where the BAP receipts factor includes income from receipts for the provision of credit ratings earned by Petitioner's Standard & Poor's division allocated according to an audience-based method.

Whether for the 2006 Tax Year Petitioner is a manufacturer entitled to double-weigh the 2006 BAP receipts factor.

FINDINGS OF FACT

Standard and Poor's Division. Petitioner The McGraw-Hill Companies, Inc. (McGraw-Hill or Petitioner), a New York corporation with executive offices located in New York City (City), is engaged in the business of publishing and the provision of information services. During the Tax Years Standard & Poor's (S&P) was a division of Petitioner, with headquarters in the City, and offices and affiliates located throughout the United States and in twenty-seven countries. S&P operated through several business units; the largest was the credit ratings business. The S&P Division conducted most of McGraw-Hill's U.S. financial information business during the Tax Years.

On February 9, 2009, Petitioner transferred the US operations of S&P into S&P Financial Services LLC, a Delaware limited liability company and that company is presently a subsidiary of Petitioner.

The S&P Division operated as a credit rating agency (CRA) which provided ratings, indices, risk evaluation, and investment research and data for use by debt issuers, individual and institutional investors, brokerage firms, financial institutions and government agencies. S&P was hired by issuer/obligors to prepare credit ratings. S&P staff performed a detailed analysis before making a rating, and submitted the proposed rating to the client before it was issued. The rating represented a "forecast of a security's probability of default."[1] Finalized ratings took the form of letter grades assigned to the debt issue. In 2007 S&P's Ratings Services[2] registered with the U.S. Securities and Exchange Commission (SEC) as a Nationally Recognized Statistical Rating Organization (NRSRO) under the U.S. Credit Rating Agency Reform Act of 2006.[3]

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[1] Respondent's exhibit 21 at 255 "Meaning of Ratings."

[2] S&P Ratings Services is presently a "separately identifiable business unit" within S&P's Financial Services LLC, and includes the credit ratings businesses of other related McGraw-Hill subsidiaries. See, http://www.standardandpoors.com (last visited February 21, 2014), Standard & Poor's Ratings Services, Form NRSRO Exhibit 4 +and attachments.

[3] See, generally, http://www.sec.gov/rules/other/2007/34-56513 (last visited January 3, 2014). United States of America Before the Securities and Exchange Commission, Securities Exchange Act of 1934 Release No. 34-56513/September 24, 2007 Order Granting Registration of Standard and Poor's Rating Services As A Nationally Recognized Statistical Rating Organization. See, also, *In re Fitch, Inc. v UBS Paine Webber, Inc.* 330 F3d 104, [2d Cir 2003] (The Court of Appeals for the Second Circuit noted that an endorsement by an NRSRO "has regulatory significance, as many regulated institutional investors are limited in what types of securities they may invest based on the securities' NRSRO ratings" 330 F3d at 106); *In re Enron Corp. Sec., Derivative & "ERISA" Litig.*, 511 F Supp 2d 742, 817 [SD Tex 2005] n 77 (history of NRSROs and how their information is used); *King County, Washington v IKB Deutsche Industriebank AG, IKB et al*, 863 F Supp 2d 288, 293-4 [WD Wash 2012]) (discussion of NRSRO status).

S&P provided "issuer ratings" and "issue ratings." Issuer ratings assessed an identified obligor's capacity to meet its financial commitments on a long-term or a short-term basis. Issue ratings addressed the short-term and long-term creditworthiness of a specific financial obligation or class of obligations, or of a specific financial program. S&P rated corporate and public finance obligations, as well as structured finance vehicles.

S&P provided public ratings, private ratings and confidential ratings. Public ratings were prepared primarily for issuers/obligors, investors (*e.g.* individuals and funds), and intermediaries (*e.g.* banks and other financial institutions).[4] These ratings were published on the S&P website, www.standardandpoors.com (Website). Private ratings were prepared by S&P for a limited circulation, with specific distribution restrictions[5] and might have been published on a password-protected website. Confidential ratings were provided only for the internal use of the obligor. For private and confidential ratings, once S&P became aware that the obligor, or another entity, was making the rating information public, S&P publicized that rating as well. Pursuant to the standard agreement that S&P entered into with the obligor, S&P reserved the right to publish the rating and notified the issuer that unless the contract was for a private or public rating, S&P would publish the rating.[6]

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[4] Petitioner's exhibit E1, 02/06/2009 S&P First Supplemental Response, included in materials, Standard & Poor's, *Guide to Credit Rating Essentials,* 2009 at 5-7 "Why Credit Ratings are Useful." *See also* tr at 53.

[5] Respondent's exhibit 19, Sample Agreement ¶3, which provides that for private ratings the client agrees "not to disclose such rating to any third party [with specific exceptions] .. provided that [S&P] must agree to keep the information confidential and the private rating ... shall be identified only as a 'Standard & Poor's implied rating' ... ." Further, S&P placed certain internal limitations on providing private ratings, including monetary thresholds on debt size. Tr at 60.

[6] Respondent's exhibit 19, Sample Agreement ¶4

S&P based its ratings on information provided by the issuer and on other information it considered reliable. S&P employed approximately 1,200 analysts, located in various S&P offices, who prepared the ratings recommendations. A rating committee reviewed the recommendation, voting to approve or disapprove. After the committee vote, the rating was communicated to the issuer, and in the case of a public rating was then published on the S&P website.

S&P monitored ratings through a "surveillance" process, for the duration of the instrument and, the obligor paid S&P a charge for this service for the lifetime of the rating. Changes in ratings made by S&P followed a review similar to the initial rating process, and any withdrawals of ratings were also made public.

S&P ratings are not recommendations to purchase, sell, or hold a particular security, nor are they a comment on the suitability of a particular investment. Public ratings and surveillance information are presently disseminated on the Website, and the rationale behind each rating is published by press release. This information is republished in newspapers, on unrelated financial websites, and through other media outlets. Ratings and supporting data are compiled and stored in an electronic database.

S&P originally used a "subscriber pays" business model: S&P would perform credit research and prepare a credit report which it provided only to investors who subscribed to S&P's publications. Following the 1970s default by Penn Central[7], and attendant losses

[7] Tr at 31. *See, In the Matter of Penn Central Transp. Co*, 458 F Supp 1364 [ED Pa 1978](the action in bankruptcy). *See also Franklin Sav. Bank of New York v Levy*, 551 F2d 521 [2nd Cir 1977](related litigation); Respondent's exhibit 21: United States Senate Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, *Wall Street and the Financial Crisis: Anatomy of a Financial Collapse,* Majority and Minority Staff Report [April 13, 2011].

which were attributed in part to the unavailability of public credit information, S&P changed its business model to an "issuer pays" model. Under the issuer pays model the issuer/obligor contracts for the rating and for subsequent surveillance. The contract is generally between the issuer/obligor and the S&P office that has the relationship with the issuer. The initial fee charged the issuer/obligor is usually a percentage of the offering or the debt instrument, or in the case of a general rating, a set price. The fee includes payment for surveillance. The ratings are published on the Website at no charge to the issuer.

The Website is viewed by users worldwide. A Website user must register for an account in order to view ratings, must consent to Terms of Use which grant limited access to the information, and must acknowledge S&P's intellectual property rights. A user may also subscribe for a more detailed product which includes research information and supporting data considered to make a specific rating. Registration is free of charge, but the ratings are not in the public domain. Ratings and research are S&P proprietary intellectual property.

S&P sold other non-debt rating products such as investment indices, credit assessment databases, platforms, valuations, data feeds, software and data services products. These products were priced as subscription fees, licensing fees or data usage fees.

City GCT Reports, Audits and Refund Claims. For the Tax Years Petitioner was subject to the City GCT, and timely filed GCT returns (pursuant to valid extensions)[8] on a basis which included reporting the income and deductions attributable to the S&P

[8] Stipulation September 18, 2012 (Stip.), ¶¶ 14, 21, 28, 35, 45, 51.

division, and included the S&P receipts, property and wages in Petitioner's BAP factors.

Petitioner filed Forms NYC-3360, Report of Changes in Tax Base for the Tax Years 2003-2005, reporting adjustments made as a result of Internal Revenue Service audits, and paid the additional City GCT and interest due.[9]

On September 30, 2008, Respondent concluded an audit of Petitioner's 2003-2005 GCT returns. The auditor accepted Petitioner's reported allocation percentages for that period, recommended no changes and that the returns be accepted as filed.[10]

Petitioner filed amended City GCT returns requesting a refund of $8,916,788 for the Tax Years 2003 and 2004, on March 25, 2009, and requesting a refund of $26,078,315 for the Tax Years 2005, 2006 and 2007, on November 24, 2009. (Amended Returns).[11] The Amended Returns included the following statement:

> ". . . revenue from the performance of certain rating activities performed both within and without New York City was sourced to New York City, on an origin basis ... however, this revenue constitutes "other business receipts" to be sourced to the location of the customer in NYC on a destination basis."

Petitioner filed its 2008 GCT Return on December 14, 2009. The 2008 Return included a similar statement, explaining that the revenue from its Ratings Division constitutes "other business

[9] Stip. ¶¶ 15, 22, 29.

[10] Respondent's exhibit 4.

[11] Stip. ¶¶ 16,23, 30, 36, 46.

receipts" sourced to the location of the NYC customer on a destination basis.[12]

Respondent issued Notices of Disallowance of Petitioner's claims for refund for each of the Tax Years 2003 through 2007, on April 15, 2010. The Notices of Disallowance stated that the BAP receipts factor was "adjusted to allocate receipt [sic] based on where the service is performed per New York City Administrative Code § 11-604(3)(a)(2)(B)."[13] The refund amounts requested were disallowed in full.

In 2011, Respondent completed an audit of Petitioner's 2006-2008 GCT Returns and its 2006 and 2007 Amended Returns. A Notice of Determination was issued on August 17, 2011, asserting GCT due for 2006 and 2008, in the base tax amount of $5,006,140.77. The Notice of Determination stated that for 2006 and 2007, the reported calculation of the receipts factor was accepted as originally filed (on an origin basis before the Amended returns were filed) and for 2008 S&P receipts were adjusted to be allocated also on an origin basis "as in 2006 and 2007."[14] The additional tax due attributed to this adjustment is $3,220,718.33. The Notice of Determination also asserted additional GCT in the amount of $1,785,422.49 on the basis that Petitioner was not entitled to compute its BAP for the 2006 period by double-weighing the receipts factor.

The Website and Audience-Based Allocation. In the Amended Returns and in the 2008 Return, Petitioner requested a special BAP receipts factor allocation according to the location of its credit

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[12] Stip. ¶52.

[13] Stip. ¶¶ 17,24 31, 37, 47.

[14] Stip. ¶ 53.

rating customers, the issuer/obligors. Petitioner presently requests a special audience-based BAP factor allocation of S&P receipts, according to the geographic location of Website viewers.

Individuals who access the Website are identified through (1) registration information received directly by S&P when the individual logs on to the site, and (2) analytical data provided by HBX, a third-party company hired by S&P.[15]

HBX[16] identifies and analyzes demographic information for financial firms, marketing companies and other industries. The company adapted tools designed for advertising to the ratings business. It provided S&P with 'HBX Omniture,' a web analytics program which generates subscriber information including the location of the individuals accessing the site, the time of day, and the type of information viewed. HBX placed "cookies" on viewers' computers which allow S&P to identify "unique views" or "unique individuals," and to identify repeat visits.[17]

S&P separately collects address information for approximately 50% of Website visits. S&P-generated registration information and the information which the HBX cookies yield together eliminate most double-counting of Website viewers. In 2009 Petitioner provided

[15] Tr at 116-121; 124-5; 127; 134. Jenna Hutchins, Director Product Manager, Sales and Marketing Systems, S&P, testified generally to concepts of marketing analytics as they apply to the current operation of the Website. She discussed HBX's methodology for determining the geographic location of website visitors, but was unable to testify to any tracking systems used during the period before 2007. HBX is presently owned by Adobe Systems, Inc.

[16] Tr at 117.

[17] Tr at 127-129, 134-5.

Respondent Department with an Excel spreadsheet which conveyed statistics about the location of Website viewers.[18]

The New York State Allocation Agreements. Petitioner entered into two agreements with New York State Department of Taxation and Finance (State) for computing the State Corporation Franchise Tax BAP: (1) a 1997 Implementing Agreement applicable to the period when S&P was a McGraw-Hill division (Original Agreement) and, (2) a reformed Agreement which followed the 2009 restructuring (Reformed Agreement). Under the Original Agreement, to compute the State BAP receipts factor, S&P debt-rating sales were sourced on a destination basis; the numerator was then further adjusted by a 50% reduction. Under the Reformed Agreement debt-rating sales were allocated according to the location of the issuer, and the numerator was reduced by 50%. The agreements represented discretionary adjustments made pursuant to State Tax Law to "fairly reflect ... business activity in New York." Tax Law § 210 (8) (d).[19] The fifty percent reduction to the sales factor numerator was applied in order to reflect the user-audience for S&P's credit ratings.[20]

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[18] Tr at 123; 128-133; 137-8. A copy of the spreadsheet was not submitted into evidence. *See* petitioner's exhibit E3, e-mail correspondence between Jonathan Robin, Director, State and Local Tax Practice, PricewaterhouseCoopers LLP, and Michael Hyman, then Acting Commissioner of Finance, November 3, 2009. Mr. Robin stated that where "Uniques" represent "unique users accessing [the Website] on each day," the ratio of NYC Daily Uniques to Worldwide Daily Uniques was 6.76%. Similar calculations produced NYC Weekly Uniques of 6.29% and NYC Monthly Uniques of 5.90%.

[19] Petitioner's exhibit E1, 02/06/09 S&P First Supplemental Response, June 13, 1997 Implementing Agreement ¶I (Original Agreement); 04/28/2009 S&P Second Supplemental Response, draft Agreement In the Matter of The McGraw-Hill Companies, Inc. And Certain Affiliated Companies Regarding taxes to be computed under [sic] Article 9-A for the Periods beginning on or after January 1, 2009 through December 31, 2008, clause 2 (Reformed Agreement).

[20] Petitioner's exhibit E1, 05/19/2009 S&P Third Supplemental Response, point 1, ¶4. Petitioner's representative stated that sourcing receipts to a customer location "does not reflect the location of the true users of the debt

City BAP Factor Relief: Letter Ruling Request, City GCT Refunds Claimed, Notices Issued and the Petitions. Petitioner requested two Letter Rulings from Respondent Department of Finance on November 19, 2008 (Rulings Request), asking to (1)classify receipts from S&P's ratings business as "other business receipts" and (2)source the receipts from the ratings business to the "customer's location" as the situs where these receipts are earned. For purposes of the Rulings Request, while Petitioner considered both the issuer/obligor and the investing public as "customers," it asked that the receipts be sourced to the location of the issuer/obligor as an "efficient and satisfactory proxy."[21] Petitioner did not specifically ask Respondent for a further 50% reduction of S&P receipts as provided in the State agreements, although it indicated it would be amenable to such adjustment.[22]

At the time of the initial Rulings Request Respondent was not performing an audit of Petitioner, and no notices of determination or notices of disallowance of claims for credit or refund had been issued. The Rulings Request was not precluded. 19 RCNY 16-01 (C) (1).

During the following several months Petitioner's representatives and representatives of the Department exchanged e-mail and written correspondence, and held meetings with respect to the Rulings Request. At different times Respondent requested, and Petitioner supplied, additional information concerning S&P's

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ratings, i.e. the global investing public" and that the State's further sales factor reduction would compensate for that fact.

[21] Petitioner's exhibit C, Request for Letter Rulings, November 19, 2008, Attached Statement at 8.

[22] Petitioner's exhibit E1, 05/19/2009 Third Supplemental Response, Point 1, ¶4.

activities, its income from rating and non-rating activities, and the State Agreements.[23]

On March 25, 2009 and November 24, 2009, Petitioner filed the Amended Returns requesting GCT refunds for the Tax Years.[24] As noted, the position taken in these returns was based on the position first articulated in Petitioner's Rulings Request: revenue from S&P's ratings activities should be considered "other business receipts" and sourced to the location of the customer on a destination basis.

The Notices of Disallowance and the Notice of Determination (the Notices) incorporated Respondent's position that receipts should be sourced to the City on an origin basis "where the service is performed."[25] While the Department did not issue a ruling, its representatives consider the Notices of Disallowance to be an official response to Petitioner's Rulings Request.[26]

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[23] Letter Rulings Rule §16-06 provides that the request be answered by the Department within 90 days of receiving the "complete request." 19 RCNY 16-06(a). The Commissioner can extend issuing the ruling for 30 days on notice, and the parties can agree in writing to further extensions. 19 RCNY 16-06(a). In this case, based on correspondence and contacts, it appears there was a tacit agreement to extend the time for issuing the response, although ultimately a ruling was not issued.

[24] Tr at 89-90. Mr. Robin testified that he reviewed November 9, 2009 e-mail correspondence between himself, representatives of Petitioner and representatives of Respondent Department. The correspondence indicated that Petitioner was considering filing refund requests for 2005 through 2007 on November 28, 2009, the date the statute of limitations on a 2005 refund request would run. Petitioner previously filed refund requests for Tax Years 2003 and 2004, on March 25, 2009.

[25] Respondent's exhibits 1 and 2.

[26] Tr at 90. Mr. Robin testified that based on his review of e-mail correspondence on April 4, 2010, Peter Rabinowitz(then Chief of Audit Operations for Respondent Department) requested response to an offer allegedly made by Respondent to settle the matter. There is no documentary evidence in the record of an offer by Respondent.

Petitioner's position with respect to allocating S&P receipts according to Website audience is asserted for the first time in the Petitions.[27]

Expert Witness Testimony. Petitioner introduced the testimony of Floyd Abrams, an attorney with Cahill, Gordon & Reindel, LLP. He was accepted as an expert on First Amendment journalism issues. Mr. Abrams was asked to offer his opinion whether the credit rating which S&P issued was protected by the First Amendment. He stated that in his opinion a credit rating is a "predictive opinion about the future and it is fully protected by the First Amendment unless issued in bad faith." [28] In his testimony, Mr. Abrams opined that raters (or rating agencies) could be analogized to journalists.[29] Mr. Abrams supported his opinion by reference to state and federal caselaw. Petitioner did not offer any written report.

2006 Receipts Factor. The second issue raised in this proceeding is whether Petitioner McGraw-Hill is a manufacturer entitled to double-weigh the BAP receipts factor for the 2006 Tax Year pursuant to Administrative Code §§ 11-604 (3) (a) (4) and 11-604 (3) (a) (8). On audit of the 2006 Tax Year, Respondent concluded that Petitioner did not meet the statutory requirement that 50% or more of its receipts were from manufacturing activities in order to double weigh the receipts factor. Following the

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[27] Petitioner's exhibit E2. Memorandum from Petitioner to Commissioner Hyman, August 25, 2009. Petitioner did refer in a footnote to an audience-based allocation before it filed the Petitions, indicating that it could provide information which would "accurately track where its electronic information is viewed." However, the initial Rulings Request correspondence, as well as the Amended Returns and 2008 Return requested allocation according to the location of the customer.

[28] Tr at 175.

[29] Tr at 173.

hearing proceedings, the record was left open for the submission of an audit response to Petitioner's offer of additional materials with respect to this issue.[30] Based on audit review of that material, Respondent made an additional request for information which Petitioner did not provide.[31] On October 22, 2012, Respondent submitted correspondence and materials reflecting this post-hearing review, which indicated that Respondent was not prepared to accept Petitioner's position. These documents were admitted into evidence as Respondent's exhibit.

STATEMENT OF POSITIONS

Petitioner asserts that in computing its BAP receipts factor for the Tax Years, receipts earned by its S&P division from providing public credit ratings to issuer/obligors should be allocated according to an audience-based methodology. Petitioner requests a discretionary adjustment to the Tax Years BAP receipts factor, pursuant to Administrative Code § 11-604 (8), in order to properly reflect Petitioner's City activity, business and income. Petitioner argues that S&P, a credit rating agency, is a member of the press entitled to the protections of the First Amendment to the United States Constitution. It is Petitioner's position that S&P's receipts should be allocated based on the location of Website viewers, a circulation methodology which approximates the allocation method used for other members of the press pursuant to Administrative Code §§ 11-604 (3) and 11-604 (3) (a) (9).

Petitioner asserts that for the 2006 Tax Year, it received more than 50% of its income from manufacturing, and was therefore

[30] Respondent's exhibit 22.

[31] Respondent's exhibit 22, Audit Comment Addendum.

entitled to double weigh the receipts factor for that period pursuant to Administrative Code § 11-604 (3)(a) (8) (A), (C).

Respondent argues that receipts Petitioner receives from S&P credit ratings are to be allocated to the City on an origin basis in computing Petitioner's Tax Years BAP receipts factor pursuant to Administrative Code § 11-604 (3) (a) (2) (B). Respondent alleges that the credit rating receipts are receipts from services earned where the service is performed, primarily in the City. Respondent asserts that Petitioner is not entitled to a discretionary adjustment of its BAP receipts factor to allocate these receipts according to the location of Website visits, as such allocation would not reflect a proper reflection of Petitioner's City activity, business or income, pursuant to Administrative Code § 11-604 (8).

Respondent asserts that less than 50% of Petitioner's 2006 receipts are from manufacturing, and therefore Petitioner is not entitled to double-weigh its receipts in computing the 2006 BAP.

CONCLUSIONS OF LAW

Computing Petitioner's Tax Years BAP Receipts Factor. The Administrative Code imposes a general corporation tax on corporations doing business in the City. The tax is computed against the corporation's entire net income attributed to the City by application of a business allocation percentage. (Administrative Code §§ 11-603 [1], 11-604 [1]). The BAP is comprised of three factors: (1) real and tangible personal property; (2) receipts from sales of tangible personal property and services; and (3) wages and salaries. (Administrative Code § 11-604 [3] [a]). Each factor reflects the percentage which the City item (property,

receipts, wages) bears to the total of that item everywhere. (Administrative Code § 11-604 [3] [a]). This matter concerns the correct sourcing of receipts from S&P's public credit rating sales for the Tax Years in the computation of Petitioner's BAP receipts factor.

The BAP receipts factor includes a corporation's receipts from sales of tangible personal property, services, rental and royalty activities, and a general category, "all other business receipts." (Administrative Code § 11-604 [3] [a] [2]). Receipts from sales of tangible personal property are computed on a 'destination' basis, allocated according to where the property is shipped. (Administrative Code § 11-604 [3] [a] [2] [B]). Receipts from services, rentals and royalties, and "other business receipts," are attributed on an 'origin' basis allocated according to where the activity takes place or where the receipt is earned. (Administrative Code § 11-604 [3] [a] [2] [B] through [D]).

The Code also provides for allocating different types of receipts received by taxpayers engaged in specific businesses. For example, newspaper and periodical publishers allocate receipts from sales of advertising by a percentage reflecting the publication's delivery within the City. (Administrative Code §§ 11-604 [3] [a] [2] [B]; 11-604 [3] [a] [9]). Broadcasters allocate receipts from sales or charges for services arising from broadcasting according to the City audience. (Administrative Code § 11-604 [3] [a] [9] [B]). Newspaper and periodical publishers, and radio and television broadcasters, allocate receipts from subscriptions according to the proportionate number of City subscribers. (Administrative Code § 11-604 [3] [a] [9] [C]).

The credit rating business of S&P is not a specifically enumerated sub-category of publishing and broadcasting receipts

allocation, and there are no rules for attributing receipts of this type. S&P, a CRA, is not strictly an audience-based enterprise. S&P contracts with and is paid by individual issuer/obligors to produce individual credit ratings. Under the terms of its agreements with issuer/obligors, S&P does not earn separately denominated receipts for the publication of a particular rating. S&P does not earn receipts from advertising, and subscription to the Website is available without charge to users worldwide.

S&P, as a CRA, is a financial information publisher. One purpose of an S&P credit rating is to publicly establish the objective viability of an investment in a given obligation. *In re Scott Paper Co. Securities Litigation*, 145 F.R.D. 366 [ED Pa 1992]. The District Court noted in *Scott Paper*: ". . . S & P makes its own analysis, designed not merely for the personal use of the rated companies, but for the benefit of all who might read its publications." *Scott Paper* at 370. The essence of a public credit rating (in contrast to a private or confidential rating) is that it is made public. The fee which the issuer/obligor pays S&P arguably includes compensation to S&P for the agreed-upon dissemination of the rating information to a broad audience of potential investors.[32]

The Commissioner may adjust the BAP factors if the allocation percentage "does not properly reflect the activity, business, income or capital of a taxpayer within the city," (Administrative Code § 11-604 [8]). *Matter of Alumet Corp.,* TAT (E) 93-3 (GC) [NYC Tax Appeals Tribunal, Sept. 14, 1994]. A discretionary adjustment can involve exclusion of certain factors, inclusion of other factors, exclusion of assets, or by "any other similar or

[32] See generally Respondent's exhibit 19, Sample Agreement between S&P and issuer/obligor. The Agreement provides for a public rating, and states: ". . . once a rating is assigned, according to [S&P] policy, Standard and Poor's will publish that rating."

different method calculated to effect a fair and proper allocation of the activity, business, income ... reasonably attributable to the city ... ." (Administrative Code § 11-604 [8] [a] - [d]). Alternatively, a taxpayer may file a request for a letter ruling from Respondent Department asking for the discretionary adjustment (19 RCNY 16-01 [a]).[33] The request may be not be made after a "a notice of determination or a notice of disallowance of a claim for refund or credit has been issued to the taxpayer." 19 RCNY 16-01 (C) (1). The Tax Appeals Tribunal is authorized by Charter provision to adjust taxable items[34] and, a request for a discretionary adjustment may also be considered at this administrative level.

For the Tax years 2003 through 2007, Petitioner computed its City entire net income by application of a BAP which included S&P's public credit rating receipts allocated on a origin basis. Subsequently, Petitioner determined that due to the nature of S&P's business, filing on this basis did not accurately reflect its City activity, business or income.

Petitioner requested a ruling from Respondent in 2008, asking for a discretionary adjustment to its BAP sales factor to properly

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[33] See, generally, 19 RCNY 16-01. The request may

> "... relat[e] to any tax or charge administered by the Department of Finance. [It] may be sought with respect to a substantive question or a procedural one. Rulings may be requested with respect to questions arising in the course of an audit or examination of a tax return, or with respect to questions relating to a taxpayer's claim for refund or credit."

[34] NYC Charter § 168.a. The provision states that the Tribunal "shall have the same power and authority as the commissioner of finance to, impose, modify or waive any taxes within its jurisdiction." In *Alumet* the Tribunal noted that "the application of the discretionary power is generally to be exercised in the first instance by the Commissioner."

treat receipts from S&P as "other receipts" and allocate them on a destination basis according to the location of it customers, the issuers/obligors. The Rulings Request preceded any Department audit action on the adjustment. Respondent never formally answered the Request. Petitioner subsequently filed the Amended Returns and the 2008 Return which each incorporated the same application for discretionary adjustment expressed in the Rulings Request: that receipts from the credit ratings business be sourced according to the rating customer's location. Respondent denied the refund requests, asserting that allocation should be on an origin basis which would source the receipts to the S&P office where the credit rating activity takes place. Petitioner filed Petitions protesting the disallowances and the 2008 determination, effectively preserving its request for discretionary adjustment to the BAP receipts factor.

The First Amendment of the United States Constitution provides that "Congress shall make no law . . . abridging the freedom of ... the press." This prohibition applies equally to State and local governments. *(Grosjean v American Press Co.,* 297 US 233 [1936].) The category 'press' includes "every sort of publication which affords a vehicle of information and opinion." *(Lovell v City of Griffin, 303 US 444, 452* [1938].) Financial information publishers are included in the press category, and are afforded First Amendment protections. *(Lowe v S.E.C.,* 472 US 181, 205-6 [1985]; *Scott Paper* at 370.)

A public credit rating is a constitutionally protected expression of opinion. *(In re Pan Am Corp.*, 161 B.R. 577, 584 [SD NY 1993] (and cases cited therein). *See also Lowe,* 472 US 181*; Jefferson County School District No. R-1 v Moody's Investor's Services,* 175 F3d 848 [10th Cir 1999]*; Tolin v Standard & Poor's Financial Services LLC,* 950 F Supp 2d 714 [SD NY 2013].)

A CRA is a financial information publisher entitled to the same Constitutional protections afforded other members of the press provided the ratings are publicly disseminated protected speech. *(Pan Am* at 583-4, distinguishing *Dun & Bradstreet, Inc. v Greenmoss Builders, Inc. 472 US 749 [1985]*.) The safeguards of the First Amendment are not available to ratings which are prepared for, and distributed solely to, specific clients who contract for them (*i.e.* private or confidential ratings). *(In re Fitch, Inc. v UBS Paine Webber, Inc.* 330 F.3d 104 [2nd Cir 2003].)[35]

S&P disseminated corporate financial information, in the form of public credit ratings and supporting information, on the Website for the benefit of the general public. *Scott Paper* at 369. The division maintained editorial control over the form and content of the ratings and controlled the publication decision. It is not dispositive of the threshold Constitutional issue that S&P did not charge the obligor/client specifically for publishing the financial information on the Website. *Scott Paper at* 368-369. Further, the fact that S&P did not charge non-client Website subscribers for access to the ratings is not determinative. *Pan Am* at 583. S&P is entitled to the protections of the First Amendment when it publishes financial information to the general public.

Establishing that S & P's credit ratings are protected speech does not resolve this matter. The First Amendment does not

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[35] Fitch,Inc., a financial rating company, invoked the New York Press Shield Law (Civil Rights Law § 79-h) to avoid discovery requests. The Court of Appeals distinguished that financial rating agency from S&P, finding that Fitch rated only those financial transactions contracted for by a specific client, and was not entitled to a journalist's privilege with respect to discovery. *Fitch* at 110-111. The Court found the facts "reveal[ed] a level of involvement with the client's transactions that is not typical of the relationship between a journalist and the activities upon which the journalist reports." *Fitch* at 111. The Court, citing *Pan Am,* distinguished S&P which it noted "rated virtually all public debt financing and preferred stock issues whether they were done by S&P clients or not." *Fitch at* 109.

prohibit state taxation of the corporate income of publishers. (*See Stahlbrodt v Commissioner of Taxation & Fin of State of N.Y.,* 92 NY2d 646 [1998].)[36] A tax imposed on a publisher's income is not *per se* unconstitutional. *(Henry ex rel Chanry Communications v Wetzler,* 82 NY2d 859 cert denied 511 US 1126 [1993].*)* Where the imposition of the tax singles out the press for differential treatment, however, and there is no compelling state interest for the levy, the tax is "presumptively unconstitutional." *(McGraw-Hill, Inc. v State Tax Commission,* 146 AD2d 371, 375 [3rd Dept 1989] citing *Minneapolis Star and Tribune Co. v Minnesota Commr of Revenue,* 460 US 575 [1989]. *See also Leathers v Medlock,* 499 US 439 [1991]*; Arkansas Writers' Project v Ragland,* 481 US 221 [1987].)

The appropriate inquiry is whether some members of a class are subject to the tax while others are exempt: that is, if Petitioner is required to allocate receipts from S&P's public credit ratings on an origin basis will it be subject to a tax not similarly applied to other members of the press.[37] The Supreme Court has emphasized that "the fundamental question is not whether the tax singles out the press as a whole, but whether it targets a small group within the press." *Arkansas Writers'* at 229.

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[36] In *Stahlbrodt* the New York Court of Appeals, considered whether a sales tax levied on the purchase of printing services by a company which published a free "shopping paper" was unconstitutional as content-based discrimination. Tax Law § 1115 (i) (C) exempts shopping papers from the sales tax as long as 10% of their content is news of general and/or community interest. The Court noted that the exemption would have been available through a "minor adjustment" to the papers and found that the specific statutory provision was not unconstitutional. *Stahlbrodt* at 652.

[37] Respondent suggests that an appropriate First Amendment analysis is to consider how other CRAs compute the BAP receipts factor. This analogy fails. Respondent's argument does not acknowledge that the protections afforded a CRA derive from finding that the speech of CRAs – the public credit rating – is protected not because the corporation is a CRA, but because as a financial information publisher it is part of the press. *Scott Paper* at 370, discussing *Lowe.* Any tax levied against S&P's receipts must be asserted in the same manner as it is for other publishers. (*Minneapolis Star at 592-593; Arkansas Writers' at 230-232.)*

Receipts from S&P's provision of credit ratings do not fall within the enumerated statutory categories: they are neither receipts from the sale of tangible personal property, nor from services[38] performed in the City, nor from rents or royalties. (Administrative Code § 11.604 [3] [a] [2] [A] - [C].) They are therefore "other receipts" which are generally allocated on a destination basis where the receipts are earned. (Administrative Code § 11-604 [3] [a] [2] [D]).[39]

The Administrative Code provides specific allocation methods for publishers: they may (1) allocate receipts from sales of

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[38] S&P's receipts from the provision of public credit ratings are not receipts from services within the meaning and intent of Administrative Code § 11-604 (3) (a) (2) (B). (*Fitch at* 110. The Court of Appeals distinguished the credit rating practices of Fitch from those of S&P, stating that "Fitch's information-disseminating activity does not seem to be based on a judgment about newsworthiness, but rather on client needs"). *See also In re Lehman Bros. Mortgage-Backed Securities Litigation,* 650 F3d 167 [2d Cir 2011]; *In re Enron Corp. Securities, Derivative & ERISA Litigation,* 511 F Supp 2d 742 [SD Tex 2005]; *Scott Paper* at 369. In the preparation of the ratings, S&P acts as a professional journalist and not as an investment advisor (*Pan Am at* 581-2. The Court noted S&P was "functioning as a journalist ,*viz.,* with the intent to use the material to disseminate information to the public ...") or as an underwriter (*Lehman Bros.* at 185). S&P is distinguished from those rating agencies who perform private ratings. (*Greenmoss Builders at* 761-2. The Supreme Court found that a private credit rating involved "no public issue" and "was speech solely in the individual interest of the speaker and its specific business audience. ")

[39] State BAP receipts allocation provisions, Tax Law § 210 (3) (a), are substantially similar to the provisions of Administrative Code § 11-604 (3) (a), particularly with respect to the sourcing of various types of receipts. Each statute provides for the allocation category, "all other business receipts earned within [the specific jurisdiction]." (Tax Law § 210 [3] [a] [2] [D]; Administrative Code § 11-604 [3] [a] [2] [D]). State Advisory Opinions which consider computing the BAP receipts factor, although not binding, are instructive. *See e.g.* NY St Dept of Taxation and Fin Advisory Op No. TSB-A-99(16)C 1999 WL 285721(where subscription fees are considered 'other receipts' earned at the location of delivery of the information); NY St Dept of Taxation and Fin Advisory Op No. TSB-A-00(15)C (licensing fees for accessing copyrighted material are 'other receipts' earned at point of transmission); NY St Dept of Taxation and Fin Advisory Op No. TSB-A-11(1)C (receipts from sale of pre-paid debit cards and fulfillment fees are 'other receipts' allocated to situs where cards are sold or if sold over the internet, where the customer accessed the website); NY St Dept of Taxation and Fin Advisory Op No NYT-G-07(1)C (receipts from the sale of cable programming and video-on-demand are 'other receipts' sourced to the location of the subscriber).

advertising on a destination basis according to publication delivery site, (2) allocate receipts from sales of subscriptions on a destination basis according to the location of subscribers, and, by analogy to broadcasters, (3) allocate receipts from sales or charges to subscribers by audience location. (Administrative Code §§ 11-604 [3] [2] [B] [I], [iv]; 11-604 [3] [a] [9] [A], [C]). *See McGraw-Hill* at 375.

S&P does not sell advertising on its Website, and therefore a delivery-based allocation is not appropriate. Subscriptions to the Website are free; therefore S&P has no subscription revenue to source according to subscribers. S&P's receipts are not for charges or sales for services arising from broadcasting or publishing. The receipts which Petitioner earns from S&P's provision of credit ratings are properly classified as "other receipts." (Administrative Code § 11-604 [3] [a] [2] [D]).

The methodology which Petitioner requested in the Rulings Request and in the returns, to treat S&P receipts as "other receipts" allocated according to the situs of the issuer/obligor, as the location where the receipt is earned, offers an appealing resolution of this matter because it looks to the substance of the receipt (*i.e.* payment from the individual issuer upon the request by that issuer for a credit rating). However, on a First Amendment analysis allocation by customer situs fails as that methodology ultimately represents differential tax treatment between publishers. *McGraw-Hill* at 375. S&P, a financial information publisher, should be taxed in the same manner as other publishers. *McGraw-Hill.* The statutory provisions which apply to allocating a publisher's receipts require a method based generally on principles of circulation (*i.e.* receipts from advertising) or audience (*i.e.* receipts from subscriptions and receipts from services to subscribers). S&P credit rating receipts should be

allocated in the same manner permitted other publishers. *McGraw-Hill*.

Petitioner proposes allocation of S&P receipts by a hybrid method which takes into account the subscription information which S&P collects and the HBX audience metrics analysis.[40] The record contains only a rudimentary estimation of receipts allocated to the City, in the form of percentages of City "Unique" views.[41] While not precise, the methodology is consistent in principle with the circulation/audience methods which the Code provides be used by other publishing companies to allocate City receipts. It is also more exact than the State 50% receipts factor adjustment (which appears from the record to be an accommodation for circulation allocation issues).

Petitioner is entitled to this discretionary adjustment of its receipts factor to allocate S&P receipts according to an audience-based methodology, in order to properly reflect its City activity, business and income.

The 2006 BAP Receipts Factor. Petitioner asserts that for the 2006 Tax Year that it is a manufacturing company, pursuant to the Administrative Code. If a corporation is engaged in manufacturing, it can allocate its income by a BAP which double-weighs the receipts factor. Code § 11-604[3][a][8][A]. Petitioner used a double-weighted receipts factor in computing entire net income for the 2006 Tax Year. On audit, Respondent disallowed the

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[40] Tr at 126-128.

[41] Petitioner's exhibit E3. Petitioner did not offer the supporting schedules into the record, although it appears from the November 3, 2009 e-mail correspondence from Mr. Robin to Mr. Hyman that Respondent had an opportunity to review them. It is noted that apparently the schedules represented 2008 and 2009 Website users.

computation, using a single BAP receipts factor, and asserted a deficiency reflecting this adjustment.

A "manufacturing corporation" is a corporation "primarily engaged in the manufacturing and sale of ... tangible personal property." (Administrative Code §11-604.[3][a][8][C].) A corporation is primarily involved in manufacturing" where "more than fifty per cent of its gross receipts for the taxable year are attributable" to manufacturing activities. (Administrative Code § 11-604[3][a][8][C].)

The Hearing record was left open to permit Respondent ro reexamine this issue. Petitioner submitted schedules to Respondent which reflected that 50.45% of Petitioner's receipts for this period were from manufacturing, based on manufacturing QPAI[42] revenue of $2,401,111,264 and a total revenue of $4,759,634,751.[43] The manufacturing revenue included receipts from financial services and information and media sales. The total income figure offered was less than the reported Federal gross receipts of $4,868,847,145. The manufacturing revenues fell below the fifty percent required by the statute when applied to the Federal gross receipts amount.

Petitioner adjusted the Federal gross receipts totals by eliminating royalty income and a deferred gain, and increased the manufacturing receipts by other adjustments to $2,454,996,686, with the result that the manufacturing percentage was greater than 50%.

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[42] QPAI ("Qualified Production Activities Income") which is represented by the difference between the domestic production gross receipts (DPGR) divided by the sum of the costs of goods sold allocable to DPGR and other expenses, losses or deductions which are properly allocable to DPGR. See, generally, Internal Revenue Code (26 USC) § 199 (c) (1).

[43] Respondent's exhibit 22.

Respondent's auditor requested further documentation of the Financial Services and Information & Media divisions, to support the revised figures. Petitioner did not submit that information, and Respondent accordingly denied the request to double-weigh the receipts factor. Based on Respondent's review, Petitioner has not met its burden to establish that it is entitled to double-weigh the receipts factor of its 2006 BAP.

Expert Testimony. Expert testimony is admissible in administrative proceedings in the discretion of the trier of fact, when that testimony involves information or questions beyond the trier's ordinary knowledge which would be relevant to the matter, and which would assist the trier in reaching his or her determination. *(Matter of Bernstein,* 1992 WL 402671 [NY St Div of Tax Appeals DTA No. 807526, December 24, 1992].) Where an expert opinion amounts even in part to a conclusion of law, the trier is not bound to accept it. *(Matter of Clark,* 1992 WL 236065 [NY St Div Of Tax Appeals, DTA No. 807929, September 14, 1992].

Mr. Abrams' qualifications as an expert on issues involving the First Amendment are undisputed, and his experience in litigating these issues is unparalleled. However, his testimony in this matter primarily involved the application of relevant caselaw to the legal consideration of credit ratings. As such, the testimony was for the most part a conclusion of law which the trier of fact is not bound to accept. *(Bernstein; Clark.)*

ACCORDINGLY, IT IS CONCLUDED THAT Petitioner may allocate receipts from the public credit ratings of its S&P division according to an audience-based or circulation-based methodology which accounts for S&P's publication of public credit ratings and related information. S&P, a credit rating agency, is a financial

information publisher. Taxation of S&P's receipts must be consistent with the treatment of other publishers. The Notices of Disallowance for the Tax Years 2003 through 2007, dated April 15, 2010, are cancelled. Petitioner is entitled to refunds of GCT computed in accordance with this determination. The Notice of Determination for 2006 and 2008, dated August 17, 2011, is cancelled to the extent it reflects assessments based on application of a BAP which allocates S&P receipts from the provision of credit ratings according to an origin basis. For the 2006 Tax Year, less than fifty percent of Petitioner's income can be attributed to manufacturing activities. Therefore, for 2006, Petitioner may not double-weigh receipts in computing its BAP, and the portion of the August 17, 2011 Notice attributable to this adjustment is sustained.

Dated: February 24, 2014
New York, New York

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Anne W. Murphy
Chief Administrative Law Judge