NEW YORK CITY TAX APPEALS TRIBUNAL

In the Matter of SECURITIES INDUSTRY AUTOMATION CORP. Petitioner.	:	DECISION TAT (E) 12-9 (UT) TAT (E) 12-10 (UT)

Securities Industry Automation Corp. (Petitioner or SIAC) filed an exception to a Determination of an Administrative Law Judge (ALJ) dated June 17, 2014 (ALJ Determination), which sustained two Notices of Determination (Notices) issued by the New York City Department of Finance (Department) asserting Utility Tax (UT) deficiencies for the tax periods beginning November 1, 2003[1] and ending December 31, 2009 (Tax Periods) except to the extent that the Notices asserted negligence penalties for the Tax Periods November 1, 2003 through December 31, 2008.

Petitioner appeared by Irwin M. Slomka, Esq. and Kara M. Kraman, Esq. of Morrison & Foerster LLP. Respondent was represented by Martin Nussbaum, Esq., Assistant Corporation Counsel of the New York City Law Department.

Petitioner is a majority-owned subsidiary of the New York Stock Exchange, Inc. and, for Tax Periods after March 2006, a subsidiary of New York Stock Exchange, Inc.'s

[1]The ALJ Determination incorrectly described the Tax Periods as beginning on January 1, 2003.

indirect successor in interest, NYSE Group, Inc.[2]

During the Tax Periods, Petitioner operated and managed a private telecommunications network, called the Secure Financial Transactions Infrastructure (SFTI), which permits financial institutions and corporations to connect to the New York Stock Exchange and American Stock Exchange clearing and market data systems (Exchange Services). SFTI was created in response to a loss of connectivity to the New York Stock Exchange on September 11, 2001 resulting from a power outage at a single location. SFTI provides connectivity to Exchange Services through SFTI access centers located throughout the United States. Customers are required to maintain one primary and one backup connection to SFTI.

SFTI can be accessed in one of two ways. Direct customers of Petitioner (Direct Customers) can connect directly to SFTI access centers using their own circuits and equipment. Firms lacking the necessary technology, or unwilling to incur the costs to connect directly (Third-Party Users) can access SFTI through a third-party service provider (Service Provider).

There are two categories of Service Providers. A Third-Party User can connect to SFTI through an extranet provider (Extranet). Extranets provide connectivity and other telecommunications services over a managed aggregated network. During the Tax

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[2]Except where otherwise specified, the ALJ's Findings of Fact, although paraphrased and amplified herein, generally are adopted for purposes of this Decision. Certain Findings of Fact not necessary to this Decision have not been restated and can be found in the ALJ Determination.

Periods there were four Extranets that connected to SFTI: Sector, Inc. (Sector), BT Radianz, Savvis Communications Corp., and Transaction Network Services Inc. (Petitioner's Post Hearing Brief at 5-6.) Sector is Petitioner's subsidiary.

Third-Party Users also can connect to SFTI through a service bureau (Service Bureau). Service Bureaus provide transaction-processing services for their clients. As distinguished from Extranets, Service Bureaus serve more than an intermediary function in connecting Third-Party Users to SFTI. Service Bureaus connect Third-Party Users to SFTI in order to aggregate trades and provide trading order flow to the exchange floor for execution. (Tr at 33, 105; Stipulation of Facts (Stipulation), exhibit J, at A0055.)

Petitioner's Direct Customers can be divided between: (1) Direct Customers who connect to SFTI to obtain Exchange Services for their own use, such as securities broker-dealers; and (2) Direct Customers who, as Service Providers, connect Third-Party Users to SFTI.

All Direct Customers are charged for "access" - for connecting to SFTI ports to access SFTI. Robert Stauffer, a managing director at SIAC responsible for connecting customers to SFTI during the Tax Periods, testified that SFTI connection charges consist of one-time installation fees and monthly recurring charges for connectivity to SFTI. He stated that the charges are for SFTI access and are "also based on the size of [sic] connection requiring access." (Tr at 79.) Therefore, the amount of the access charge is related to the expected volume of access to SFTI.

Direct Customers connecting to SFTI must provide their own circuits conforming to Petitioner's circuit specifications. Petitioner requires a "multi-mode fiber" circuit to connect to the "SFTI edge router." (Tr at 90.) If the Direct Customer's telecommunications carrier does not supply the correct circuit type, the Direct Customer can locate its equipment at designated space in one of Petitioner's access centers. The Direct Customer then can connect to the SFTI edge router through the multi-mode fiber circuit supplied by Petitioner's telecommunications carrier at that location. (Tr at 88-91.) Petitioner refers to this service as "co-location." The sole purpose of Petitioner's co-location service, for which Petitioner charges a separate co-location fee, is to enable a Direct Customer to connect to SFTI. (Tr at 88-92.)

Charges for SFTI access, co-location and cross connect[3] are Petitioner's basic charges to Direct Customers for connecting to and accessing SFTI. Petitioner's contracts with its SFTI customers provide that the customer "shall not permit [SFTI] to be used by third-parties nor shall it resell [SFTI] without the prior written consent of SIAC." (Stipulation exhibit M[4] at A0148, ¶ 11.) If Petitioner consents, its customer must provide the names of all Third-Party Users accessing SFTI through the customer's connection.

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[3]Where a customer's telecommunications carrier supplies the correct "multi-mode fiber" circuit, a "cross connect" consists of cables to connect that circuit from the carrier's "space" to Petitioner's "space," from which Petitioner can, in turn, connect the customer to the SFTI edge router at a SFTI access center. (Tr at 94-96.)

[4] Exhibit M is a service order for SFTI between Belzberg Technologies Inc. (Belzberg) and SIAC that contains "terms and conditions of service". Mr. Stauffer testified that this document was representative of Petitioner's typical contract with its customers. (Tr 75-76.)

(Tr at 75-76; Stipulation, exhibit M at A0148, ¶ 11.) A Third-Party User that, in turn, grants SFTI access to another Third-Party User, is subject to the same consent and reporting requirements as the customer from whom it purchased SFTI access, and is required to incorporate those same requirements into its contract with that other Third-Party User. (Stipulation, exhibit M at A0148, ¶ 11.)

Petitioner's witness, Sharon Bendersky, Senior Tax Director of NYSE Euronext, Petitioner's ultimate parent, was unable to provide information as to whether UT was paid on the resale of SFTI access by Service Providers other than Sector. She testified that Petitioner does not know whether other Service Providers separately invoice their customers for SFTI, what categories of income they report as gross operating income on their UT returns, or whether they even file UT returns. (Tr at 178.) Ms. Bendersky was familiar with Sector's UT filings. She testified that Sector filed a Voluntary Disclosure Agreement for tax periods 1997-2005 and that Sector filed UT returns for subsequent tax periods.

Petitioner charges Service Providers a fee for connecting each Third-Party User to SFTI (Per End User Fee). The Per End User Fee is based on the number of Third-Party users the Service Provider connects to SFTI. (Tr at 78.) The amount of the Per End User Fee Petitioner charges is determined using a "tiered pricing structure". (Tr at 80.) The Service Provider is charged a monthly fee of $1,000 for each of the first 20 Third-Party Users, $750 for each of the next 20, $500 for each of the next 20, and $250 for each

additional Third-Party End User. (Stipulation, exhibit N at A0149; Tr at 80.)

The Department conducted a field audit of Petitioner's UT returns for the Tax Periods and determined that Petitioner had erroneously excluded Per End User Fees from the gross operating income Petitioner reported on its UT returns for each of the Tax Periods. The Department increased Petitioner's gross operating income for each of the Tax Periods by the amount of the excluded Per End User Fees.

The Department issued the Notices as follows:

Tax Periods	**Principal**	**Interest**	**Interest Calc. to**	**Penalties**	**Total Deficiency** [5]
11/01/03-12/31/05	$193,694.19	$118,583.60	9/30/10	$29,536.78	$341,814.57
1/1/06-12/31/09	$556,942.57	$163,687.11	3/31/11	$87,310.27	$787,939.95

The ALJ determined that the Per End User Fees were not exempt from UT as sales for resale and sustained the Notices except for the negligence penalties imposed for the Tax Periods November 1, 2003 through December 31, 2008. The ALJ reasoned that "[t]he Per End User Fee is not based on the actual consumption of telecommunications services." (ALJ Determination at 16.)

The ALJ also determined that Petitioner's receipts for co-location services were

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[5] The Department also increased Petitioner's gross operating income by the amounts of Metropolitan Commuter Transportation District charges and New York State excise tax. Petitioner does not dispute these audit adjustments. (Pet Post Hearing brief at 14, n 8.)

subject to UT because those services "are used for the express purpose of facilitating connectivity . . ." (ALJ Determination at 19) and, as such, qualified as a telecommunications service.

Petitioner contends the Per End User Fee is exempt from UT as a sale for resale. Petitioner argues that Service Providers purchased SFTI access from Petitioner and resold that SFTI access to Third-Party Users, and that Petitioner "charged the Per End User Fees to Third Party Providers for the privilege of reselling SFTI." (Brief for Petitioner (Pet brief) at 20.) Petitioner contends that subjecting the Per End User Fee to UT will tax those fees twice with a consequent "pyramiding" of the UT.

Petitioner also asserts that the sale-for-resale exclusion is an "imposition" provision not an "exemption." As such, Petitioner argues that the UT sale-for-resale exclusion must be "construed most strongly against the government."

Finally Petitioner contends that its co-location service involved the rental of designated space at its access centers, and was not a "telecommunications service" as defined in §11-1101(9) of the Administrative Code of the City of New York (Administrative Code). Petitioner argues that, if the Per End User Fees are not exempt sales for resale, the fees from providing co-location service are exempt from UT and should be eliminated from its gross operating income as a partial offset to the Department's Per End User Fee adjustment.

Respondent argues that the Per End User Fee is not a sale for resale of SFTI access

to a Third-Party User because the amount is based only on the number of Third-Party Users, not on their actual consumption of telecommunications services resold to them. (Brief for Respondent (Resp brief) at 20, 23.) Respondent argues that the Per End User Fee is a "user ID fee." Respondent urges that the purpose of the Per End User Fee is to compensate Petitioner for the administrative burden of tracking the various Third-Party Users who indirectly access SFTI through a Service Provider.

Respondent further contends that the sale of SFTI access by Service Providers is not a sale for resale because it does not "diminish the availability of SFTI access" to the Service Provider.

For the reasons below, we affirm the ALJ Determination in part, modify it in part and remand the matter to the ALJ Division for further proceedings consistent with this Decision.

Administrative Code §11-1102, in relevant part, imposes the UT on the gross operating income of a vendor of utility services. Administrative Code §11-1101(7) defines a "vendor of utility services" as:

> "Every person not subject to supervision of the department of public service, and not otherwise a utility . . . who furnishes or sells gas, electricity, steam, water or refrigeration, or furnishes or sells gas, electric, steam, water, refrigeration or *telecommunications services*. . . ." (Emphasis added.)

Under Administrative Code §11-1101(5) gross operating income:

> "Includes receipts received in or by reason of any sale made or service rendered, of the property and services specified in

subdivision seven of this section in the city. . . ."

Administrative Code §11-1101(9) defines "telecommunications services" as:

> "Telephony or telegraphy, or telephone or telegraph service, including, but not limited to, any transmission of voice image, data, information and paging, through the use of wire, cable, fiber-optic, laser, microwave, radio wave, satellite or similar media or any combination thereof *and shall include services that are ancillary to the provision of telephone service* (such as, but not limited to, dial tone, basic service, directory information, call forwarding, caller-identification, call waiting and the like) *and also include any equipment and services provided therewith*; provided, however, that the definition of telecommunication services shall not apply to separately stated charges for any service that alters the substantive content of the message received by the recipient from that sent. . . ." (Emphasis added.)

Petitioner does not dispute the treatment of SFTI access as a telecommunications service. The UT does not expressly exclude sales for resale from the gross operating income of a vendor of utility services. Sales for resale are excluded from the "gross income" of a "utility"[6] by Administrative Code §11-1102(b), which provides that "[s]o much of the gross income of a utility shall be excluded from the measure of the tax imposed by this chapter, as is derived from sales for resale to vendors of utility services validly subject to tax imposed by this chapter." The UT's enabling act effectively excludes sales for resale from the gross operating income of vendors of utility services as

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[6] The principal distinction between a "utility" and a "vendor of utility services" is that the former is "subject to supervision of the department of public service" and the latter is not. Compare Administrative Code §11-1101(6), (7).

well.[7]

This case involves two levels of SFTI access. Petitioner sells SFTI access to its Direct Customers, some of which are Service Providers. At this first level, Direct Customers pay for direct connections to SFTI. Direct Customers of Petitioner pay an initial charge and a monthly charge for accessing SFTI. The charge is based on the number of SFTI connections the Direct Customer purchases from Petitioner and the size or bandwidth of each connection. At the next level, Service Providers, with Petitioner's express permission, sell SFTI access to Third-Party Users, providing an indirect connection between those Third-Party Users and SFTI.[8] Service Providers pay a Per End User Fee for each Third-Party User they connect to SFTI. The Per End User Fee is a fixed per customer charge and does not bear any relationship to the number of SFTI access ports, size or bandwidth of the connection used by each Third-Party User.

We agree with the ALJ's conclusion that the Per End User Fees were not

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[7] General City Law §20-b provides: "Notwithstanding any other provisions of law to the contrary, any city of this state, acting through its local legislative body, is hereby authorized and empowered to adopt and amend local laws imposing in any such city a tax such as was imposed by section one hundred eighty-six-a of the tax law, in effect on January first, nineteen hundred fifty-nine. . . ." Tax Law §186-a in effect on that date, defined "gross operating income" to include only those sales made to persons "for ultimate consumption." Consequently sales for resale were excluded from the definition of "gross operating income" under the UT by reason of General City Law §20-b.

[8] We note that in some instances, Third Party Users also resold the SFTI access they purchased from Service Providers. For example, Belzberg, a Service Bureau providing transaction processing services, did not purchase its SFTI access from Petitioner but was, nevertheless, required to obtain Petitioner's consent to connect its customers to SFTI. (Tr at 75-77.)

excludible from gross operating income as sales for resale. The Per End User Fee qualifies as a sale for resale only if it is a charge for the SFTI access Direct Customers purchase and then resell. In affirming the ALJ on this issue, we agree with the ALJ that the Per End User Fee must, at a minimum, constitute a sale of SFTI access before it can qualify as a sale of SFTI access for resale. The ALJ correctly deduced from the Record that the Per End User Fee is not the sale of SFTI access because it "is not based on the actual consumption of telecommunications services" (ALJ Determination at 16.) Petitioner has no information as to the extent to which each Third-Party User accessed SFTI. Petitioner's information as to SFTI connectivity, access ports and volume of usage was limited to Petitioner's Direct Customers to whom Petitioner sold SFTI access. When asked why Petitioner charged Belzberg only a Per End User Fee but did not charge Belzberg for SFTI access, Mr. Stauffer testified that Belzberg purchases its SFTI access from a Service Provider, not from Petitioner.[9] (Tr at 76-77.)

Petitioner's witness, Vincent Lanzillo, Sector's Vice President for technical services during the Tax Periods, testified that "there was no real concept . . . of what that end user did beyond his environment in terms of sharing. From a SFTI standpoint it was one customer." (Tr at 67.) He further testified that "[t]he relationship between that . . . service provider and its end users was kind of separate and distinct of what SIAC was aware of." (Tr at 67.) Mr. Lanzillo described the business of Sector, an Extranet, as

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[9] Mr. Stauffer's later testimony refers to Belzberg as a "Service Bureau." (Tr at 105.)

reselling the access it purchased from Petitioner as a Direct Customer. He testified that "[Sector] would effectively buy SFTI . . . and then break that SFTI connection up and then resell it to customers." (Tr at 66.)

Sharon Bendersky testified that the purpose of the Per End User Fee was for Petitioner "to know who was accessing our private network." (Tr at 217.) Ms. Bendersky's testimony is consistent with ¶11 of Petitioner's terms and conditions of service with its customers (Stipulation, exhibit M at A0148), pursuant to which Petitioner would need to identify and track Third-Party Users connecting to SFTI to ascertain if they were authorized to do so. The ALJ rejected Respondent's contention that the Per End User Fee is a user identification fee, concluding that the Record did not establish user identification as the only purpose for the Per End User Fee. We agree.

In support of Petitioner's position that Per End User Fees are exempt sales for resales, Petitioner cites a Finance Letter Ruling[10] in which the Department ruled "that a long-distance telecommunications carrier that *sold access* to its switching and undersea cable to other carriers, who in turn *resold that access* to their own customers was permitted to exclude those receipts from gross operating income as sales for resale." (Emphasis added.) (Pet brief at 22.) The Finance Letter Ruling, however, does not support Petitioner's position. Petitioner asks us to apply the Finance Letter Ruling to its Per End User Fees on the basis that "Petitioner's Per End User Fees are directly tied to the

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[10] (Finance Letter Ruling 034815-011 [July 21, 2004].)

number of customers *to whom SFTI access is resold*." (Emphasis added.) (Pet brief at 22.) The testimony of Petitioner's witnesses establishes that the Per End User Fee is a payment to Petitioner to secure Petitioner's permission to indirectly connect one or more Third-Party Users to SFTI. Petitioner's brief asserts that it "charged Per End User Fees to Third Party Providers *for the privilege* of reselling SFTI." (Emphasis added.) (Pet brief at 20.) We agree. We find that Per End User Fees are not sales of SFTI access and are outside the scope of the Finance Letter Ruling.

Ms. Bendersky testified that in an audit of Petitioner's New York State Sales Tax (Sales Tax) returns for the period 9/1/2004 - 8/31/2009, the New York State Department of Taxation and Finance determined that Petitioner's Per End User Fees were not subject to Sales Tax. In support of Ms. Bendersky's testimony, Petitioner introduced an executed "Statement of Proposed Audit Change for Sales and Use Tax" signed by Ms. Bendersky on July 26, 2011. (Taxpayer's exhibit 17.) We reject the ALJ's Finding of Fact that Petitioner submitted a "Closing Agreement" supporting Ms. Bendersky's testimony that a Sales Tax audit "determined that the Per End User Fees were not taxable." A review of Taxpayer's exhibit 17 indicates that it does not support Ms. Bendersky's testimony nor does it have any relevance to the issue before us. The schedules in support of the audit findings indicate that all of the transactions reviewed were purchases made by Petitioner, to which the New York State Use Tax would apply. There is nothing in any of those schedules indicating that the audit involved the issue of whether the sales of SFTI access

reported by Petitioner on its Sales Tax returns were taxable or exempt sales for resale during that period. Consequently not only does Taxpayer's exhibit 17 not support Ms. Bendersky's testimony, it raises doubt as to the accuracy of her testimony.

Petitioner argues that the UT resale exclusion must be treated as an "imposition statute" and construed against the taxing authority, rather than as an exclusion provision, construed against the taxpayer. In support of that position, Petitioner cites *Brooklyn Union Gas Co. v McGoldrick,* (270 AD 186 [1st Dept 1945], *affd*, 298 NY 536 [1948]). The issue in that case was whether General City Law §20-b limited the City's authority to impose the UT to conform to the provisions of Tax Law §186-a. Tax Law §186-a imposed tax on "receipts received in or by reason of any sale . . . made or service rendered to persons *for ultimate consumption.*" (Emphasis added.) The First Department held that General City Law §20-b likewise restricts the scope of the City UT to sales "for ultimate consumption," and the UT, therefore, must exclude sales for resale. In concluding that the UT base excludes sales for resale in conformity with General City Law §20-b, the Appellate Division held that "[a] statute that levies a tax is to be construed most strongly against the government and in favor of the citizen." *(Brooklyn Union Gas,* 270 AD at 195.)

We do not agree with Petitioner's view that the sale for resale exclusion under the UT is an imposition provision. Unlike *Brooklyn Union Gas*, the present case does not concern the scope or structure of the UT statute, and does not address the question of

whether the UT contains a sale for resale exclusion in conformity with General City Law §20-b. We turn to the Sales Tax for guidance, which restricts the scope of the Sales Tax to a "retail sale" defined as a "sale . . . for any purpose, other than . . . for resale. . . ." (Tax Law §1101[a][4][I]; *see also* Tax Law §1105.) The Sales Tax, like the UT, also restricts the tax base to sales for ultimate consumption.[11] The Sales Tax presumes every sale to be taxable and places the burden on the taxpayer to establish that it is not. (Tax Law §1132[c].) The UT similarly presumes that all gross operating income is taxable. (Administrative Code §11-1102[c].) In *West Valley Nuclear Services Co. Inc. v Tax Appeals Tribunal of the State of N.Y.*, (264 AD2d 101 [3d Dept 2000], *lv denied*, 95 NY2d 760 [2000]) the Third Department held that "[a]s a party seeking the benefit of a statutory exemption to the imposition of sales tax, [the taxpayer] had the burden of establishing that its purchases fell within the meaning of the statutory resale exemption in that the items were purchased for the singular purpose of resale." (264 AD2d at 102-03 [citations omitted]); *See also Matter of Phone Programs, Inc.*, [DTA 815759 NYS Tax Appeals Tribunal (Aril 6, 2000)]Phone Programs) "The resale exclusion for utility services demands that the services *be resold as utility services*. . . ." [Emphasis added.]) Petitioner, therefore, has the burden to prove that a portion of its receipts for providing SFTI access were exempt as sales for resale.[12] We conclude that Petitioner has not met

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[11]*See* 20 NYCRR §525.2(a)(4): "The sales tax is generally a 'consumer tax'."

[12]We note that, unlike the Sales Tax, which requires vendors to produce a "resale certificate" as proof that goods or services were purchased for resale the UT has no such

that burden.

Petitioner makes an alternative argument that its gross operating income should be reduced by its co-location revenues because "they are not from the furnishing of a telecommunications service" within the meaning of Administrative Code §11-1101(9). (Pet brief at 30.) Petitioner claims that it "mistakenly included these amounts in its gross operating income, even though they are not from the furnishing of telecommunications service." (Pet brief at 31.)

Referring to the testimony of Mr. Stauffer (Tr at 91-92) Petitioner argues that customers who purchased its co-location service received nothing more than designated space at one or more of its co-location centers - "a rack with electrical outlets with multiple shelves to put the equipment into." (Tr at 91 as corrected.) Petitioner asks us to treat its co-location fee like rent, as a payment for designated space and, as such, not a telecommunications service or "ancillary" to a telecommunications service. (Pet brief at 33-34.)

In further support of its position, Petitioner argues that "[t]he purpose of co-locating equipment at Petitioner's access centers was to connect into the SFTI network." (Pet brief at 33.) Petitioner states that "[t]he small percentage (10 to 15 percent) of customers that did purchase co-location from Petitioner only did so in order to connect to

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requirement. This means that for UT purposes, a seller cannot satisfy its burden of proof simply by showing the timely receipt of a resale certificate "accepted in good faith" from a purchaser. (*See* 20 NYCRR §532.4[b][2].)

the SFTI network, not to enhance their SFTI access." (Pet brief at 34.)

The ALJ found that Petitioner's co-location services "are used for the express purpose of facilitating connectivity to SFTI by those Third Party Users that did not provide multi-mode handoffs." (ALJ Determination 19.) The ALJ, thus, concluded that the co-location services provided by Petitioner "are 'equipment and services provided' with Petitioner's SFTI telecommunication services and the receipts from the provision of such services are taxable" under Administrative Code §11-1102. (ALJ Determination at 19.)

We agree but conclude that the ALJ's finding that co-location services "are used for the express purpose of facilitating connectivity to SFTI" was sufficient to bring it within the scope of Administrative Code §11-1101(9) as "telecommunications services." Petitioner does not dispute that its sale of connectivity to Direct Customers constitutes telecommunications service, and that when a Direct Customer connects a Third-Party User to SFTI it is reselling telecommunications services. Petitioner also acknowledges that "the purpose of co-locating equipment at Petitioner's SFTI access centers was to connect into the SFTI network." (Pet brief at 33.) Therefore, when Petitioner provided its co-location service to customers, it was providing connectivity, i.e., telecommunications services.

Although we affirm the ALJ's determination that Per End User Fees are not exempt sales for resale, we conclude that some portion of Petitioner's receipts from the

sale of SFTI access to Service Providers should be excluded from Petitioner's gross operating income as sales for resale and we modify her determination to that extent. Petitioner did not request this adjustment.

Mr. Lanzillo's testimony that Spector would buy SFTI access from Petitioner "and then break that SFTI connection up and resell it to customers" (Tr at 66) is consistent with the business model of an Extranet - as an intermediary providing SFTI connectivity to Third-Party Users. The SFTI Customer Guide defines an Extranet as "an entity in the business of providing data connectivity between Customers and SFTI." (Stipulation, exhibit K at A0055.) When an Extranet connects a Third-Party User to SFTI, it is reselling a portion of the SFTI connection it purchased from Petitioner as a Direct Customer. We conclude that Petitioner sells SFTI access to Extranets for resale to Third-Party Users. The Record establishes that Service Providers that are Extranets purchased SFTI access for resale as utility services. (*Phone Programs*, *supra*.)

We do not believe that, under these facts, it is relevant whether Sector or other Extranets sustain a measurable decrease in their SFTI access when they resell it to Third-Party Users. The sole function of an Extranet's purchase of SFTI access is to connect Third-Party Users to SFTI. Extranets, therefore, do not "use" their SFTI connections except for resale to Third-Party Users. In Finance Letter Ruling 034815-011 (July 21, 2004) described above, the presence or absence of any diminution of service was not a factor in the conclusion that the sales of telecommunication services were excludible as

sales for resale.

We also find that the limited purposes for which the SFTI Customer Guide treats Third-Party Users as Customers of Petitioner does not change our conclusion that Petitioner sells SFTI access to Extranets for resale to Third-Party Users. Petitioner does not sell SFTI access to Third-Party Users. According to the SFTI Customer Guide, all SFTI Customers, both Direct Customers of Petitioner as well as Third-Party Users, are instructed to schedule a "Technical Implementation Meeting" with Petitioner's staff to assist that Customer in preparing a plan to connect to SFTI. (Stipulation, exhibit K at A0069.) However, the SFTI Customer Guide states that "the specification of the access between a Customer" and either a Service Bureau or Extranet "will not be covered in this document" and must be acquired from the individual Service Bureau or Extranet. (Stipulation, exhibit K at A0073-0074, ¶5.4.2; 5.4.3.) Apart from receiving certain useful basic information from Petitioner on how to proceed further, Third-Party Users connect to SFTI through their Service Providers and work out all connectivity details with them. The "Customer" nomenclature, therefore, is irrelevant to the result in this case.

While we conclude that Petitioner's sales of SFTI access to Extranets are exempt sales for resale, there is not sufficient evidence in the Record to conclude that Petitioner's sales of SFTI access to Service Bureaus are also exempt sales for resale. The Record shows that Service Bureaus do more than act as mere intermediaries in reselling SFTI access. Service Bureaus provide "transaction-processing services (e.g., submitting trades)

on behalf of member firms." (*Id.* at A0073, ¶5.4.2.) Although the Record shows that Service Bureaus, like Extranets, pay a Per End User Fee for each customer allowed SFTI access, nothing in the Record establishes whether Service Bureaus resell SFTI access as such or use SFTI access to provide customers "transaction-processing services."

Petitioner introduced into evidence a schedule entitled "SFTI Revenue for the Audit Period." (Taxp exhibit 13.) The schedule provides a breakdown of gross income for each calendar year, with one column listing the gross income Petitioner reported on its UT returns, a second column listing the Per End User Fees (identified as "Third Party Service Provider End User Charges") Petitioner omitted from its UT returns, and a third column listing the total "revenue." Respondent objected to the introduction of the schedule because it was prepared specifically for this litigation. The Parties were given the opportunity to stipulate that the amounts on Taxpayer's exhibit 13 are accurate, but they were unable to do so.

Petitioner also introduced into evidence a schedule entitled: "SFTI Revenue from Third Party Service Providers" (Taxpayer's exhibit 14), which lists the revenue from each Third Party Service Provider specified by name, for the years beginning in 2004 with totals for each year.[13] The yearly totals on Taxpayer's exhibit 14 agree with the yearly totals for Third Party Revenue on Taxpayer's exhibit 13.

Nevertheless, we find that the Record contains insufficient information to

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[13]Petitioner began selling SFTI access to Service Providers during 2003 and provided no breakdown for that year.

determine the amounts of Petitioner's receipts from the sale of SFTI access for resale. The detailed breakdown of Service Providers by name on Taxpayer's exhibit 14 contains the repeated use of certain names with slight variations, such that no accurate distinction can be made between the revenue from Extranets and the revenue from Service Bureaus. Therefore, we must remand this matter for further proceedings to determine Petitioner's sales of SFTI access to Extranets excludible from Petitioner's gross operating income as sales for resale for the Tax Periods.

Finally, Petitioner asks that we abate the remaining negligence penalty asserted by the Department pursuant to Administrative Code §11-1114(c) for the Tax Periods January 1, 2009 through December 31, 2009. The ALJ abated the negligence penalties for the Tax Periods November 1, 2003 through December 31, 2008 on the grounds that the Department had no procedure in place for Petitioner to obtain a "resale certificate" with respect to its Per End User Fees during those Tax Periods and based on her finding that Petitioner had been permitted to exclude those amounts for Sales Tax purposes.[14] With the exception of her abatement of the negligence penalties for Tax Periods through December 2008, the ALJ sustained the Notices "in all other respects."

Administrative Code §11-1114(c) imposes penalties of five percent of an

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[14] While we reject the ALJ's Finding of Fact that Petitioner was permitted to exclude Third Party User Fees for Sales Tax purposes, for the reasons below, we agree that Petitioner's exclusion of the Per End User Fees from its gross operating income during those Tax Periods was not negligent. Respondent did not file a cross-exception objecting to the ALJ's abatement of the negligence penalty for the Tax Periods through December 31, 2008 so we do not need to address the negligence penalties for those Tax Periods.

underpayment due to negligence and an additional penalty of 50% of the interest otherwise payable on that portion of an underpayment resulting from "negligence or intentional disregard" of the law. Administrative Code §11-1114(c) does not define "negligence" or "intentional disregard" for this purpose. However, analogous federal tax authority provides guidance. The accuracy-related penalty under Internal Revenue Code (26 USC) (IRC) §6662 is imposed when an underpayment is attributable to, among other things, "negligence or disregard of rules or regulations." IRC §6662(c) defines negligence as including "any failure to make a reasonable attempt to comply with the provisions of the [IRC] and disregard consists of any careless, reckless, or intentional disregard." The applicable federal regulation, further provides that a negligence penalty may be abated if there was reasonable cause for the understatement and the taxpayer acted in good faith. "Circumstances that may indicate reasonable cause and good faith include an honest misunderstanding of fact or law that is reasonable in light of all of the facts and circumstances, including the experience, knowledge, and education of the taxpayer." (26 CFR §1.6664-4[b][1].) Finally, the United States Tax Court has held that "[n]egligence connotes a lack of due care or a failure to do what a reasonable and prudent person would do under the circumstances." *Bunney v Commr. of Internal Revenue*, (114 TC 259, 266 [2000]).

With respect to the negligence penalty for the Tax Periods after 2008, we do not agree with the ALJ's conclusion that Petitioner's failure to obtain resale certificates from

its Service Providers constituted negligence. The ALJ did not abate the negligence penalty for the Tax Periods January 1, 2009 through December 31, 2009 because Petitioner did not obtain resale certificates during those periods although Tax Law §186-e, as in effect that year, did provide a procedure for obtaining resale certificates. The ALJ did not state whether obtaining a resale certificate under Tax Law §186-e would have been sufficient to support Petitioner's exclusion of Per End User Fees from its gross operating income after 2008, nor was it necessary for her to do so. Her discussion of the resale certificate after 2008 was limited to the issue of negligence. Ms. Fong, the Department's auditor, testified that the Department would not accept a resale certificate issued under the Sales Tax as proof that the sales were for resale. (Tr at 142.) She was not asked whether the Department would have accepted a resale certificate issued under Tax Law §186-e after 2008. As the Department lacked a resale certificate procedure at that time, we do not agree that it was negligent for Petitioner not to have obtained a resale certificate under Tax Law §186-e after 2008. We have concluded that Petitioner was entitled to a resale exclusion for some portion of its receipts from the sale of SFTI access. Although we conclude that the sale-for-resale exclusion applied to its sales of SFTI access to Extranets rather than its Per End User Fees, we believe that, under that totality of the situation in this case, Petitioner's exclusion of Per End User Fees from its gross operating income, while error, was not negligent. Therefore, we abate the negligence penalties asserted for the Tax Periods after 2008 under Administrative Code §11-1114(c).

In addition to the negligence penalties, the Notices also impose substantial understatement penalties pursuant to Administrative Code §11-1114(i) and failure to file and late filing penalties pursuant to Administrative Code §11-1114(b)(1). While the ALJ found that Petitioner acted reasonably and in good faith during the Tax Periods through December 31, 2008, she only abated the negligence penalties asserted under Administrative Code §11-1114(c).[15] With respect to the late-filing and non-filing penalties, Petitioner has offered no evidence nor argued in its briefs that those penalties were improperly imposed. Therefore, we sustain the late filing and non-filing penalties.

The substantial understatement penalty statute expressly provides that "[t]he commissioner of finance may waive all or any part of the [substantial understatement penalty] on a showing by the taxpayer that there was reasonable cause for the understatement (or part thereof) and the taxpayer acted in good faith." (Administrative Code §11-1114[i].) Our conclusion that Petitioner was entitled to a sale for resale exclusion with respect to Petitioner's sales of SFTI access to Extranets, which, the Record suggests, represents the majority of its sales of SFTI access to Service Providers, materially changes the amount of any understatement of UT asserted by the Department. Moreover, as we have concluded that Petitioner's exclusion of the Per End User Fees was erroneous but not negligent, we abate the substantial understatement penalty for all of the

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[15]We read the ALJ's abatement of the subdivision (c) penalties for Tax Periods through December 2008 to have implicitly abated both penalties imposed pursuant to that subdivision.

Tax Periods.[16]

Accordingly, the ALJ Determination is affirmed in part and modified in part and the matter is remanded to the ALJ Division for further proceedings consistent with this Decision.

Dated: October 27, 2015
New York, NY

Ellen E. Hoffman
Commissioner and President

Robert J. Firestone
Commissioner

[16] We have considered all of the other arguments of the Parties and find them unpersuasive.