

New York City – Issuer of publicly available financial information entitled to discretionary allocation method

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In brief

In a New York City Tax Appeals Tribunal Administrative Law Judge (ALJ) decision, a financial information publisher providing credit ratings to the public received discretionary authority to use an alternative allocation method calculated on an audience-based measure. Because First Amendment protections generally afforded to members of the press extend to providing certain financial information to the public, the taxpayer was entitled to use an allocation method similar to what the City allows other members of the press to use. [In the Matter of the Petition of *The McGraw-Hill Companies, Inc.*, New York City Tax Appeals Tribunal, ALJ Division, TAT (H) 10-19 (GC) et al., February 24, 2014]

In detail

Facts

During tax years 2003 to 2008, Standard & Poor's (S&P), a division of McGraw-Hill, operated as a credit rating agency, which provided ratings, indices, risk evaluation, and investment research and data. S&P employed approximately 1,200 analysts, located in various offices, who prepared the ratings recommendations.

S&P customers were generally issuers and obligors of debt that contracted with S&P to prepare company ratings. These ratings provide assessments regarding: (1) a company's capacity to meet its financial commitments and

(2) the creditworthiness of a company's specific financial instrument or specific financial program.

Although prepared for S&P customers, public ratings were published on S&P's website and available without charge to users worldwide.

Background - New York City General Corporation Tax allocation

Taxpayers subject to New York City's General Corporation Tax allocate their taxable income based on a business allocation percentage (BAP) composed of gross receipts, property, and payroll. The gross receipts factor computation varies depending

on what the taxpayer sells. Sales of tangible personal property are sourced on a 'destination' basis (i.e., where property is shipped) and sales of services and 'other business receipts' are sourced on an 'origin' basis (i.e., where the activity takes place).

Receipts may be allocated differently based on a taxpayer's business. For example, newspaper and periodical publishers are subject to the following rules:

- advertising revenue is allocated by a percentage reflecting the publication's delivery within the city

- service revenue arising from broadcasting is sourced according to the city audience
- subscription receipts are allocated to the proportionate number of city subscribers.

Initial allocation argument – Destination based

McGraw-Hill originally filed its 2002-2007 tax year returns using the 'origin' allocation method (i.e., based on where services are performed) to source S&P's receipts. McGraw-Hill filed amended returns (and its original 2008 tax year return) asserting that revenue from S&P's rating activities should be considered 'other business receipts' and sourced on a discretionary basis to the location of its customers (to the issuer/obligors based on 'destination').

Freedom of Press argument – Allocation should be similar to newspapers/periodicals

McGraw-Hill modified its position following its amended returns. Before the ALJ, McGraw-Hill asserted that, as a credit rating agency, S&P was a member of the press entitled to First Amendment protections. Accordingly, S&P's receipts should be allocated in a way that approximates the circulation methodology used by other members of the press. McGraw-Hill asserted that an 'audience-based' BAP factor allocation, measured by the geographic location of website viewers, was such a reasonable approximation.

S&P may allocate receipts based on geographic location of website viewers

The ALJ found that S&P was a financial information publisher that publicly provided the objective

viability of an investment in a given financial instrument. S&P's analysis was designed not just for the use of the rated companies, but for the benefit of all who might read S&P's publications. The ALJ reviewed US Supreme Court, New York State, and other state and federal decisions to conclude that financial information publishers are members of the press and public credit ratings are constitutionally protected expressions of opinion.

Since S&P was entitled to First Amendment protections when it published financial information to the general public, a tax that treats S&P differently from other members of the press would be 'presumptively unconstitutional.' Accordingly, the ALJ found that S&P, as a financial information publisher, should be taxed in the same manner as other publishers.

The ALJ found that S&P's audience-based allocation method was consistent in principle with the circulation/audience methods New York City provides to other publishing companies to allocate City receipts. Accordingly, McGraw-Hill was "entitled to 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 takeaway

Although ALJ decisions are not precedential, and *McGraw-Hill* is rooted in First Amendment principles, the decision should remind taxpayers that equitable apportionment is a power that is not reserved only for use by state revenue departments. Alternative apportionment is

generally available to taxpayers in many states by request; disparate treatment among similarly situated taxpayers could serve as a basis for requesting and receiving alternative apportionment. Taxpayers should evaluate the possibility of using alternative apportionment methodologies in any state when the statutory formula does not appropriately reflect their in-state activity. Taxpayers should recognize, however, that they could bear a heavy burden of proof in establishing the right to depart from the statutory formula.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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