SIFMA
Securities Industry and Financial Markets Association

TESTIMONY OF

SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION

BEFORE THE

NEW YORK STATE SENATE SELECT COMMITTEE ON BUDGET AND TAX REFORM

HEARING ON

EVALUATING THE EQUITABILITY OF NEW YORK STATE'S BUSINESS AND BANKING TAX STUCTURES AND THEIR EFFECTIVENESS TO FOSTER ECONOMIC GROWTH STATEWIDE.

May 21, 2009

Chair Krueger, and Senators of the Select Committee on Budget and Tax Reform, Committee, my name is Nancy Lancia, and I am testifying on behalf of the Securities Industry and Financial Markets Association[1] ("SIFMA"). We greatly appreciate the opportunity to testify today on this timely and important examination of the effectiveness of the current Corporate Franchise Tax and the Bank Tax statutes.

Throughout 2009, SIFMA will work with regulators, legislators and market participants around the world representing the interests of our 600 members in their efforts to stabilize the markets and pave the way for future economic growth and job creation. We continue to use our unique position at the center of the global financial markets to proactively provide leadership in addressing the enormous challenges posed by the financial crisis. SIFMA has a strong interest in many of the issues ranging from supporting state and city tax measures that encourage growth during these challenging economic times to preserving fair and constructive regulation.

The importance of the financial services industry in general, and the securities industry in particular, to New York and New York City is long-standing and well-recognized. Despite becoming more dispersed and increasingly globalized, the industry remains heavily concentrated in Manhattan, and New York still is the financial capital of the U.S., if not the world. The industry has a profound impact on and makes a significant

[1] SIFMA brings together the shared interests of more than 600 securities firms, banks, and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services, and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London. Its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

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contribution to personal income tax revenues and overall economic growth of the state and local economy. Even in these times of economic recession and financial market dislocation, the industry is still an important contributor. The following is a summary of the findings of SIFMA's "The Street, The City and The State" report, which our research team has updated for this hearing:

- As of the end of March 2009, the securities industry directly employed 188,500 individuals in New York, 89.8% of them in New York City. This represents 23.20% of securities industry jobs nationwide.

- Securities industry wages account for a much higher portion of New York and New York City total wages and adjusted income than the 2.2% and 4.7% of 2009 total employment in New York and New York City, respectively. In 2007, securities industry wages accounted for 15.5% and 25.0% of total wages paid in New York and New York City, respectively. Even considering the dramatic fall in total compensation experienced in 2009, the securities industry will likely remain a large contributor to wages and therefore personal income taxes around 15 percent of the total similar to earlier in the decade.

- The securities industry also accounts for a large share of the local, state and national economies. From 1997 to 2007, growth in the securities industry has outpaced activity in almost all other sectors of the New York economy. During this period, the securities industry's share of New York's Gross State Product rose to an estimated 8.5% from 7.4%, second only to the real estate and government sectors.

- The "tax effort" required of New York's workers and businesses are the second highest in the nation. New York City may be near its peak rate for sales tax and property tax, as well as income tax, given the overall tax rates in the surrounding areas.

In evaluating the Business Corporations Franchise Tax and Bank Franchise Tax, Articles 9-A & 32 of the Tax Law, we ask that you consider the following points:

- The securities and banking industry is concentrated in New York City and therefore, New York should view tax reform for the industry based on the combined State and City tax regimes. It is important that changes adopted by the State also be adopted by the City. SIFMA is encouraged by recent discussions at the City level to move towards conformity of the two tax laws by adopting many state rules including sourcing of industry receipts by customer location and single sales factor apportionment.

- The combined New York State and New York City tax rates are higher than any other state. Therefore, tax reform must include a reduction in both the State & City corporate income tax rates and regressive alternative tax bases. The combined State and New York City Tax rates create a significant burden on businesses that have a majority of their operations located in New York City create a statutory rate of tax over 17%. This added to the federal tax rate of 35% creates an effective tax rate of over 46%. Many firms are global and as such, these global businesses compare overall country tax burden in deciding where to locate facilities. Many industrialized, politically stable nations offer a 30% or lower statutory rate. This 16% difference is significant when evaluating expansion plans and long term capital commitments.

- The favorable taxation of investment income by New York and New York City makes it competitive with other states. If the taxation of investment income is modified or eliminated, it should be offset by a reduction in tax rates.

- The investment tax credit ("ITC") provided by the State has been a factor in companies retaining their presence in New York.

- Securities and banking firms should be taxed under the same Article of the tax code by New York State and New York City. Currently, they are two separate Articles which are very different. Most large financial institutions conduct businesses that even though the operations are related, are taxed under both 9A and Article 32, which leads to different tax results for the same activities.

- Banks are also subject to a considerable alternative tax based on gross assets with no "cap" even when operations result in a significant loss. Business corporations are subject to an alternative tax on net worth which is a truer measure of a company's ability to pay. At a minimum, consideration should be given to allowing banks to reduce their gross assets tax base for any Trouble Asset Relief Program ("TARP") funding received from the government.

- Net operating losses and tax credits that are currently allowed to be carried over from current periods under both Articles should be allowed in computing future corporate income tax liabilities if New York State and City changes the corporate income tax laws to establish a new or different article of taxation for the securities and banking industry.

- Several securities firms have established investment partnerships that include many individual investors. Based on the recent increase in New York State personal income tax rates and the reduction or elimination of the deduction of investment interest expense, it is not attractive to market these funds to New York residents. The new Term Asset-Backed Securities Loan Facility ("TALF") program sponsored by the US Treasury to allow companies and individuals to partner with the government to relieve banks of "toxic" assets is not an attractive investment for NYS residents since TALF is highly leveraged and individuals will not be allowed to deduct investment interest expense associated with such investments due to the recent changes in New York's personal income tax law. An amendment or technical correction to the law should be considered to eliminate this disincentive.

Industry Recommendations:

- **Make the Investment Tax Credit ("ITC") Permanent**

  The Investment Tax Credit (ITC) encourages businesses to expand office facilities and hire personnel for employment in New York State. The ITC has the effect of lowering the effective tax rate paid by businesses with significant operations in New York State. As noted in this statement, the State and City combined statutory tax rates create the highest effective tax rate in the United States. The ITC accomplishes the goal of reducing this rate for the taxpayer and the goal of creating a long term commitment by businesses to locate and expand within New York State. SIFMA appreciates the renewal of and technical changes made to the ITC signed into law last year. However, SIFMA urges the Legislature and Governor to make the ITC permanent and make one technical correction. This correction would clarify that the ITC definition of "investment advisory activity" should be expanded so that investment advisory services beyond those provided to Regulated Investment Companies (*i.e.,* mutual funds) will qualify for the ITC. This expansion is consistent with SIFMA's understanding of the original legislative intent to include all investment advisory activities. SIFMA has submitted suggested language to Senator Kruger's staff earlier this year.

- **Lower the liability cap of the business corporation franchise tax on capital.**

  Last year's initial Executive 2008-2009 New York State budget proposed amending the business corporation franchise tax by eliminating the cap on the capital tax base for non-manufacturers. Given that removing the old cap of $1 million on the capital base tax would have greatly increased the tax liability for the financial services industry, the Governor and Legislature agreed to reinstate a cap, but at the much higher rate of $10 million for non-manufacturers. SIFMA recommends lowering the $10 million cap or providing a credit for such alternative taxes paid by firms (both 9A and Article 32 taxpayers) against future year's net income taxes in this year's budget.

  A capital based tax at the current level of $10 million is a disincentive to being located in New York State because the tax is based on allocated and apportioned capital to New York State. Thus companies with a greater presence in the New York economy pay an increased tax a burden borne disproportionately by the New York based financial services industry precisely in years in which we are facing the greatest challenges to profit making in several generations.

- **Retain Investment Capital Incentive**

  The New York State and City tax systems provide different rates of tax on different types of income. This system was put in place to create an incentive for companies to locate headquarters operations within New York. This system acknowledges that the headquarters of a business receives multiple types of income from its investments, its subsidiaries and its regular business operations and it allows these types of income to be taxed at different effective rates. Income from investments and subsidiaries are taxed at significantly lower rates than the statutory rate for a reason. These rules are historical and have encouraged such companies to locate in New York. The investment income rules have allowed financial services companies to expand the proprietary trading areas of their business and reduce the overall tax burden on the firms. This effective tax rate reduction helps New York be more competitive globally. On December 26, 2007, the New York State Department of Taxation and Finance published regulations that eliminate the favorable tax treatment of income from all repurchase agreements (repos) held by securities brokers and dealers. Under the regulations, broker dealers are the only business corporations required to include all income and expenses from repos and securities lending in their computation of business income rather than as investment income when appropriate under the law. This change results in a significant effective tax increase on investment income and activities of the securities industry in New York State and will only serve as a disincentive to further expansion of such activities in the State. The rules took effect in January 2008.

- **New York City Adoption of the State's Customer Sourcing Rules**

SIFMA supports legislation such as last year's A.1382 (Farrell), which would amend the City's Administrative Code to conform to the State's Business Corporation Tax regarding the situs of receipts from services performed by regulated securities or commodities broker dealers. Further, amending the New York City tax code by bringing it into conformity with the New York State tax code would encourage firms to locate property and employees in New York City – a move directly in alignment with supporting New York City as a leading global financial center. SIFMA supports this proposal, because it eliminates some of the administrative burdens created by having two different systems of accounting for receipts and encourages the Senate to introduce and pass such legislation this session. We are also advocating for this tax change and have had ongoing discussions with New York City's Tax Commissioner.

Business Corporation Franchise Tax and Bank Tax Combination

SIFMA suggests that the committee carefully consider all aspects of the potential implications of combining Article 9A and Article 32 of the tax codes. SIFMA appreciates the state forming a task force to review this issue, but cautions that the state tax structure cannot be looked at in a vacuum. The New York City Tax structure runs parallel and in some instances, creates an even larger burden than the State Tax Structure. In response to the questions of what is successful in encouraging business development in the financial services industry and what sections act as disincentives, we offer the following:

- **New York City Bank Tax Net Operating Losses.**

  The City of New York does not allow for taxpayers under their Financial Corporation tax (Article 32 equivalent) to carryforward Net Operating Losses to reduce future profits. This is inconsistent with the treatment allowed by New York State and the Federal government. This disparate treatment also sends the message to taxpayers that the City Of New York will participate in sharing in the profits when taxpayers are successful, however, will not share the pain when taxpayers or the economy weaken. Any combined Article of tax must allow for the carryforward of losses at both the State and City level.

- **Alternative Tax on Assets under Article 32.**

  The Asset tax under Article 32 is assessed when it exceeds the tax on income. This tax is computed on gross assets rather than net worth and has no cap. In years when the taxpayer utilizes a loss carryforward to reduce the tax on income, the tax on assets will be greater. This effectively eliminates the benefits received by utilizing the loss carryforward to reduce income. In this situation the taxpayer never receives relief when economic circumstances are not favorable. Also, because there is no cap on this tax, the more the business increases its asset base and expands its business in New York, the greater the tax becomes. This effectively punishes a business for expanding in New York by increasing the tax burden upon the business.

- **Loss of attributes**.

  The combination of these Articles of the Tax Law will require the authors to consider attribute carryovers, such as net operating losses and tax credits. The group will need to address how carryovers generated under one article may be applied to taxpayers that were taxable under a different Article previously. Current Law would not allow such losses or credits to carry over when a company switches from one Article to the other due to a change in business operation or regulatory requirements. Such attributes must be allowed to carryover in any new unified Article.

Thank you for opportunity to comment on the Committee’s tax reform efforts. On behalf of SIFMA, I look forward to working together on this important endeavor. If you, other Senators serving on the committee or staff have questions or need additional information, please contact me.