STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petitions	:	
of	:	
MOODY'S CORPORATION & SUBSIDIARIES	:	DETERMINATION DTA NOS. 828094 AND 828203
for Redetermination of Deficiencies or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Periods Ended December 31, 2011 through December 31, 2014.	:	

Petitioner, Moody's Corporation & Subsidiaries, filed petitions for redetermination of deficiencies or for refund of corporation franchise tax under article 9-A of the Tax Law for the periods ended December 31, 2011 through December 31, 2014.

A consolidated hearing was commenced before Dennis M. Galliher, Administrative Law Judge, in New York, New York, on August 9, 2018, at 10:30 a.m., and was continued to conclusion at the same location on August 10, 2018, with all briefs to be submitted by January 26, 2019, which date commenced the six-month period for issuance of this determination. By a letter dated July 24, 2019, this six-month period was extended for an additional three months (***see*** Tax Law § 2010 [3]). Petitioner appeared by Pillsbury Winthrop Shaw Pittman LLP (Marc A. Simonetti, Esq., Evan M. Hamme, Esq., and Aruna Chittiappa, Esq., of counsel). The Division of Taxation appeared by Amanda Hiller, Esq. (Jennifer L. Baldwin, Esq., of counsel).

ISSUES

I. Whether, for all of the years at issue, petitioner may be permitted to source credit rating receipts earned by Moody's Investors Services, Inc., on a destination basis, to wit, via

audience-based sourcing, premised upon the position that Moody's Corporation is a publisher and the location of Moody's Corporation's audience is the global investing public, or alternatively, based on the commercial domicile location of debt issuer customers of Moody's Investors Services, Inc., as opposed to an origination basis, premised upon the location where Moody's Investors Services, Inc., performs its credit rating activities.

II. Whether, for the years 2011 and 2012, Moody's Corporation properly excluded royalty income received from its alien affiliates, pursuant to the royalty income exclusion provision under Tax Law § 208 (9) (o) (3), as in effect through the end of the 2012 calendar year.

III. Whether, for the years 2012, 2013 and 2014, Moody's Corporation was required to include Moody's Assurance Company, Inc., its New York licensed captive insurance company, in its New York State combined filing group, under Tax Law article 9-A, § 2 (11), as an overcapitalized captive insurance company.

IV. Whether Moody's Corporation has established sufficient bases to support reduction or cancellation of penalties assessed for substantial underpayment of its tax liabilities.

FINDINGS OF FACT[1]

Stipulated Facts

1. The Division of Taxation (Division) conducted audits of petitioner, Moody's Corporation & Subsidiaries (Moody's), New York State corporation franchise tax returns for each of the three years ended December 31, 2011 through December 31, 2013, and for the year ended December 31, 2014, respectively.

2. Moody's filed combined New York State corporation franchise tax returns and federal consolidated income tax returns for the years 2011 through 2014.

3. Moody's Assurance Company, Inc., (MAC), is not included in Moody's combined New York State corporation franchise tax returns for 2011 through 2014, but is included in Moody's federal consolidated income tax returns for such years.

4. The payor companies identified in Moody's workpapers (***see*** Exhibit A, pp. 215 - 217, and 219 - 221), are not members of Moody's combined New York State corporation franchise tax returns, and shall hereafter be referred to as Alien Affiliates.

5. On its combined franchise tax returns for the years 2011 through 2014, Moody's sourced 6.28% of the credit rating receipts received by Moody's Investors Service, Inc., (MIS), to

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[1] The parties executed, submitted and agreed to the admissibility of a stipulation of facts setting forth 39 separately numbered stipulated facts, together with exhibits A through CC in support thereof (contained within eight, separately labeled, binders). The stipulated facts are set forth herein as findings of fact 1 through 35, noting however that: a) references to the annexed exhibits are not set forth unless contextually or otherwise necessary and, b) stipulated fact 36 has been renumbered 34, and stipulated facts 34, 35, and 37 through 39, concerning undisputed procedural matters, have been combined and renumbered 35. Further, the record includes additional exhibits 1, 3 through 17, 19, and 24 through 27. Proposed exhibits numbered 2, 18, and 20 through 23, were offered at hearing, but were withdrawn before admission, and their exclusion is intentional. An affidavit of authenticity regarding exhibit 9, made by Evan M. Hamme, Esq., and dated August 15, 2018, is appended to and made a part of exhibit 9.

Each of the parties submitted post-hearing errata sheets, listing proposed corrections or modifications to the transcripts of proceedings held herein. Most of the proposed corrections and modifications are not in dispute and are adopted as set forth on the errata sheets, which have been appended to the transcripts of proceedings. To the extent the proposed corrections and modifications differ, or are in dispute, they are addressed and resolved, as set forth in Addendum I at the end of this determination, so as to settle the record (***see*** 20 NYCRR 3000.15 [d] [7]).

New York State using the population of New York State compared to the population of the United States, based on 2010 United States census data.

6. If it is determined that MIS's credit rating receipts are properly sourced using the population of New York State compared to the population of the United States based on 2010 census data, the parties agree that 6.28% of MIS's credit rating receipts would be sourced to New York State each year for 2011, 2012, 2013 and 2014.

7. For 2014, the Division sourced 15.1195% of MIS's credit rating receipts to New York State based on the location of the commercial domicile of the issuers who contracted with MIS for credit ratings (Debt Issuers).

8. If it is determined that MIS's credit rating receipts are properly sourced to the location of the Debt Issuers for 2011, 2012, 2013 and 2014, the parties agree that the following percentages of MIS's credit rating receipts would be sourced to New York State:

2011-----14.2352%
2012-----13.7894%
2013-----14.4981%
2014-----15.1195%

9. For 2011 through 2013, the Division sourced 57% of MIS's credit rating receipts to New York State based on where MIS performed its credit rating activities.

10. If it is determined that MIS's credit rating receipts are properly sourced based on where MIS performed its credit rating activities, the parties agree the 57% of MIS's credit rating receipts would be sourced to New York State each year for 2011, 2012 and 2013.

11. On its combined franchise tax returns for 2011 and 2012, Moody's subtracted payments received from the Alien Affiliates on Line 15, Other subtractions, of its New York State forms CT-3-A, in the following amounts:

2011-----$112,484,988.00
2012-----$126,564,533.00

12. MIS Quality Management Corp., (MISQM), licenses certain Moody's trademarks, trade names and domain names to various Alien Affiliates to use in connection with their businesses for 4% of the Alien Affiliates gross revenues or, with respect to certain Alien Affiliates, $10,000.00. Whether the payments from the Alien Affiliates to MISQM under the MISQM License Agreements are royalty payments for purposes of Tax Law § 208 (9) (o) is not in dispute in this matter.

13. Of the total amount Moody's subtracted on Line 15 of its 2011 New York State form CT-3-A, $31,007,170.00 represents royalty payments received by MISQM pursuant to the MISQM License Agreements. Of the total amount Moody's subtracted on Line 15 of its 2012 New York State form CT-3-A, $36,506,603.00 represents royalty payments received by MISQM pursuant to the MISQM License Agreements. The dollar amounts of these royalty payments are not in dispute in this matter.

14. MIS licenses certain processes and databases of Moody's (Rating Processes) to the Alien Affiliates to use in their respective territories for 8% or 10% of their gross revenues or, with respect to certain Alien Affiliates, $10,000.00. Whether the payments from the Alien Affiliates to MIS under the MIS License Agreements are royalty payments for purposes of Tax Law § 208 (9) (o) is not in dispute in this matter.

15. Of the total amount Moody's subtracted on Line 15 of its 2011 New York State form CT-3-A, $46,915,187.00 represents royalty payments received by MIS pursuant to the MIS License Agreements. Of the total amount Moody's subtracted on Line 15 of its 2012 New York State form CT-3-A, $52,704,886.00 represents royalty payments received by MIS pursuant to the

MIS License Agreements. The dollar amounts of these royalty payments amounts are not in dispute in this matter.

16. Of the total amount Moody's subtracted on Line 15 of its 2011 New York State form CT-3-A, $34,562,631.00 represents payments received by Moody's Analytics, Inc., (MA) from Moody's Analytics UK Ltd. (MA UK), pursuant to a Revenue Allocation Agreement & Sublicense (MA - MA UK Agreement).[2] Of the total amount Moody's subtracted on Line 15 of its 2012 New York State form CT-3-A, $37,353,044.00 represents payments received by MA pursuant to the MA - MA UK Agreement.

17. Whether the Alien Affiliates are Moody's related members for purposes of Tax Law § 208 (9) (o) is not in dispute in this matter.

18. The Alien Affiliates did not file tax returns in New York State.

19. The Division determined that Moody's could not subtract the payments MISQM, MIS, and MA received from the Alien Affiliates in computing its combined entire net income in 2011 and 2012.

20. If it is determined that Moody's cannot subtract the payments MISQM, MIS, and MA received from the Alien Affiliates, Moody's agrees to the Division's adjustments related to such payments to Moody's combined entire net income and business allocation percentage as reflected on the Division's schedules (***see*** Exhibit A, pp. 14, 24).

21. For 2011 through 2014, MAC filed New York State captive insurance company franchise tax returns (form CT-33-C).

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[2] Within the filings submitted by the parties, Moody's Analytics, Inc., is sometimes referred to as "MA," sometimes referred to as "MA US," and sometimes referred to as "Analytics," without any apparent distinguishing differences. For consistency and clarity, and unless otherwise specified, Moody's Analytics, Inc., and MA US will be referred to herein as MA.

22. MAC paid premiums taxes, under Tax Law article 33, in the following amounts:

2012-----$197,469.00
2013-----$199,222.00
2014-----$200,889.00

23. MAC is a New York State captive insurance company licensed by the New York State Department of Financial Services (DFS).

24. MAC is wholly-owned by Moody's Assureco Inc., which is wholly-owned by MIS, which is wholly-owned by Moody's Corporation.

25. MAC receives payments from Moody's Corporation to provide coverage to the Moody's group for professional liability, director and officer liability, property liability, workers' compensation liability, and Terrorism Risk Insurance Act (TRIA) coverage.

26. More than 50% of MAC's gross receipts were payments from petitioner, for coverage provided to the Moody's group under policies relating to the foregoing potential liability areas.

27. MAC does not provide coverage to third parties.

28. The Division included, as an audit adjustment, MAC in Moody's combined New York State corporation franchise tax returns for 2012, 2013 and 2014.

29. Because the statute of limitation to assess MAC for 2011 had expired, the Division did not include MAC in Moody's combined corporation franchise tax return in 2011.

30. If it is determined that MAC is required to file combined corporation franchise tax returns with Moody's for any of the years 2012, 2013 or 2014, Moody's agrees to the Division's adjustments to Moody's combined entire net income as reflected in the Division's schedules (***see*** Exhibit A, pp. 14, 16, and Exhibit B, pp. 13, 15).

31. If it is determined that MAC is required to file combined corporation franchise tax returns with Moody's for any of the years 2012, 2013 or 2014, the Division agrees to credit or refund MAC's premium taxes paid for that year in the amounts referred to in stipulated fact 22.

32. The Division imposed substantial understatement penalties under Tax Law § 1085 (k) for 2011, 2012, 2013, and 2014.

33. On November 28, 2016, the Division issued to Moody's a notice of deficiency (Notice No. L-045770242-8) in the amount of $63,266,706.11, consisting of $45,861,844.00 in additional corporation franchise tax and MTA Surcharge, $4,586,181.00 in penalties, and $12,818,681.11 in interest for 2011 through 2013.

34. On March 7, 2017, the Division issued to Moody's a notice of deficiency (Notice No. L-046108057-1) in the amount of $4,637,230.18, consisting of $3,678,428.00 in additional corporation franchise tax and MTA Surcharge, $367,842.00 in penalties, and $590,960.18 in interest for 2014.

35. Moody's filed petitions protesting and challenging the foregoing notices of deficiency, and the Division filed answers to the petitions. The parties received notices of hearing, and a consolidated hearing with respect to the foregoing notices of deficiency was held on August 9 and 10, 2018.

***Additional Facts*[3]**

Background

36. Moody's is a group of U.S. corporations that conducts financial analyses of businesses. Its analyses inure to the benefit of such businesses, as well as to the benefit of investors and to other market participants.

37. Moody's operates two business segments: (1) MIS, a credit rating agency; and (2) MA, an analytics business. MIS operates petitioner's credit rating business, providing credit ratings on debt obligations and the entities that issue such debt obligations, including corporate and governmental obligations, structured finance securities and commercial paper. MA operates the rest of petitioner's business, developing products and services that support financial analysis and risk management activities of institutional participants.

38. Petitioner creates, and owns, significant intellectual property (IP) through its business operations, including its credit rating business operation. Moody's affiliates MIS, MA, and MISQM, are members included in Moody's combined New York State corporation franchise tax returns for the Audit Period.

39. MIS, MA, and MISQM hold Moody's combined New York State corporation franchise tax group's IP.

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[3] Pursuant to State Administrative Procedure Act (SAPA) § 307 (1), petitioner submitted with its brief 230 separately numbered proposed findings of fact. Proposed findings of fact numbered 1 through 11, 13 through 16, 19 through 22, 24 through 35, 40 through 42, 49 through 52, 54 through 99, 101 through 121, 125 through 129, 131 through 151, 153 through 159, 161 through 165, 167, 168, 170 through 174, 177 through 187, 194 through 196, 199 through 204, 208 through 210, 212 through 216, and 218 through 220 are supported by the record, and have been consolidated, condensed, combined, renumbered and substantially incorporated herein. Proposed findings of fact numbered 12, 17, 18, 23, 36 through 39, 43 through 47, 53, 100, 122, 123, 130, 152, 166, 169, 175, and 176, have been modified or expanded to more accurately or fully reflect the record, remove conclusory information, or delete irrelevant or immaterial portions thereof, and as so modified or expanded, have been accepted, renumbered and set forth herein. Proposed findings of fact 124, 188 - 193, 197, 198, 205 through 207, 211, and 221 through 230 have been eliminated as repeating other facts, including facts set forth as stipulated to by the parties. Proposed findings of fact 48, 160, and 217 have been rejected as setting forth conclusions of law and not proper findings of fact.

40. MIS, MA, and MISQM license the IP to Moody's Alien Affiliates, who in exchange and as consideration for the licenses pay MIS, MA, and MISQM royalties.

41. Moody's routinely analyzes its risk profile and ensures adequate insurance coverage, including through MAC, its New York licensed captive insurance company.

Credit Ratings Operations

42. MIS is a credit rating agency. It is headquartered in, and operates its credit rating business from, New York State. A credit rating is MIS's "current opinion regarding the relative future creditworthiness of a credit commitment, a debt or debt-like security, or an issuer of such obligations."

43. MIS conducts research and evaluates the creditworthiness of domestic and international Debt Issuers.

44. Debt Issuers are companies or sovereign entities, including financial institutions, insurance companies, corporate issuers, asset-backed securities issuers, and government issuers, that have issued, or plan to issue, debt instruments generally to the public at large.

45. Based on its contracts with Debt Issuers (Application and Fee Schedule) MIS is engaged and paid by Debt Issuers to research, evaluate and arrive at its opinion rating the credit worthiness of such Debt Issuers and the debt they propose to issue, i.e., credit ratings. In addition, MIS is paid a separate annual fee by the Debt Issuers for surveillance of the credit ratings it develops (***see*** findings of fact 61 through 71). MIS owns the credit ratings it creates (***see*** finding of fact 51).

46. MIS's ratings assist and are of benefit to investors (i.e., the market) by providing information and analysis not readily available without MIS's research and expert analysis.

47. MIS's ratings inform the global investing public about Debt Issuers and debt instruments, and assist the global investing public to understand the quantitative and qualitative aspects of potential debt issuances.

48. Dissemination of credit ratings is essential to Moody's overall business and to the proper functioning of financial markets. Debt Issuers expect their credit ratings, as developed by MIS, will be publically disseminated. Under the contracts with MIS, there is provision (addendum) allowing such Debt Issuers to post a link on their own websites to the Moodys.com website, where their rating is available to be viewed free of charge.

49. Historically, Moody's published MIS's ratings and analytical reports in hard-bound volumes, which it distributed to the public, upon request, by mail.

50. More recently, MIS's ratings have been published on MA's website, Moodys.com., to facilitate easy and broad public access to such ratings and to other publications. The Moodys.com website is owned and operated by MA.

51. MIS creates its own content by analyzing the creditworthiness of Debt Issuers and debt instruments. MIS owns the ratings that are published on the Moodys.com website. Although MIS owns the credit ratings that appear on the Moodys.com website, MIS does not publish its own credit ratings. Rather, and although debt issuers pay MIS for the credit ratings it develops, MA pays MIS for the right to disseminate such ratings (***see*** finding of fact 55). As noted, MA places such ratings on its website, Moodys.com, where they may be viewed by the general public free of charge.

52. If Moody's believes that its opinion on a particular debt issuer or debt instrument is critically important to the global investing public, MIS might conduct an analysis of the

creditworthiness of the debt issuer or debt instrument without the debt issuer soliciting or engaging MIS (Unsolicited Rating).

53. In limited circumstances, MIS provides private ratings to specific investors who engage MIS to obtain more information about a private company's debt issuance or a debt-instrument that is not offered to the public-at-large (Private Rating).

54. Private Ratings are not published on the Moodys.com website, represent MIS's assessment of the debt issuer at a single point in time, are not monitored, and account for less than 1% of MIS's annual revenue.

55. MA creates software, quantitative tools, and data subscriptions, which incorporate MIS's detailed analytical reports and analysis. MA pays MIS a license fee for its ratings, which MA then disseminates on the website, and for MIS's research reports, and other IP associated with MIS's ratings.

56. MA sells subscriptions to its customers that wish to use software and quantitative tools, and access thorough and detailed financial reports and analysis regarding particular Debt Issuers or debt instruments. MA's subscription services aid customers' analysis of financial conditions and financial decision-making.

Credit Rating Activities

57. MIS, and S&P Global Ratings, Inc. (S&P), the credit rating division of S&P Global, Inc. (f/k/a McGraw-Hill Financial, Inc., The McGraw-Hill Companies, Inc. [McGraw-Hill]), are the two predominant credit rating agencies in the U.S., having a combined market share of approximately 82.3%. During the Audit Period, in annual reports to the Senate Committee on Banking, Housing, and Urban Affairs, and to the House of Representatives Committee on Financial Services, the SEC identified MIS and S&P as the two largest Statistical Ratings

Organizations in the U.S.

58. The SEC regulates credit rating agencies, i.e., Nationally Recognized Statistical Rating Organizations (Statistical Rating Organizations), in the U.S. The SEC granted MIS's application for registration as a Statistical Ratings Organization on September 24, 2007.

59. The SEC reports establish that MIS and S&P serve the vast majority of the credit ratings market, and are the most dominant market players.

60. MIS's primary competitor was S&P during the Audit Period.

MIS's Credit Rating Process and Methodologies

61. MIS's credit rating process consists of nine steps: (1) pre-engagement (i.e., Debt Issuer rating request); (2) assigning an analytical team; (3) collecting information; (4) interacting with Debt Issuers; (5) analyzing the Debt Issuer or debt instrument; (6) rating committee review; (7) notifying the Debt Issuer; (8) rating dissemination (i.e., publication); and (9) rating surveillance.

62. Pre-Engagement: Debt Issuers have an initial meeting or teleconference with MIS to request a rating on a debt instrument, discuss the credit rating process and products, discuss the initial fee, and negotiate the terms upon which the rating will occur. When a Debt Issuer is ready to move forward, it requests the appropriate ratings application form (Application and Fee Schedule) from MIS, completes, signs and returns the same, at which point MIS will begin the rating process.

63. Analytical Team Assigned: the lead analyst or analysts (Lead Analyst), who is primarily responsible for the rating, is assigned and begins collecting relevant information on the Debt Issuer or obligation from publicly available sources.

64. Collecting Information: The Debt Issuer is asked to provide relevant financial and non-financial information, and relevant information from other non-public sources and public

sources. The information requested will vary according to the particular sector and/or market information.

65. Interaction With Debt Issuers: MIS's analysts engage in discussions with Debt Issuers, or their agents or representatives, about the information collected, and their ratings, including credit strengths and weaknesses and trends in their industries.

66. Analysis: the Lead Analyst will conduct the initial analysis of the Debt Issuer or debt instrument, by applying MIS's credit rating methodologies, which includes consideration of both quantitative and qualitative factors, to formulate a recommendation. MIS relies on a broad range of business, financial, and non-financial information, including key performance indicators, economic, regulatory, and geopolitical influences, management and corporate government (governance) attributes, competitive position, and changes within the Debt Issuer when evaluating the creditworthiness of the Debt Issuer or debt instrument. For its methodology, MIS uses an "expected loss" standard, which analyzes primarily whether a Debt Issuer will eventually pay creditors in full, regardless of whether payment is timely under the applicable debt instrument.

67. Rating Committee: the Lead Analyst will formulate his or her proposed rating, and will submit the same for consideration by a rating committee (Rating Committee). MIS's credit ratings are determined only through a majority vote of the Rating Committee members, and not by individual analysts. The Rating Committee decides whether to assign the proposed rating. This manner of assigning credit ratings is a critical mechanism in promoting the quality, consistency and integrity of MIS's rating process.

68. Rating Notification: the Lead Analyst informs the Debt Issuer of the Rating Committee's decision, and drafts a proposed press release for dissemination.

69. Rating Dissemination: credit ratings, and related research reports generated during the course of the team's analysis, are communicated to the general public free of charge through credit rating announcements published on the Moodys.com website, and are distributed to traditional major financial newswires and news outlets.

70. Rating Surveillance: MIS conducts surveillance of the credit ratings on the debt it has rated on an ongoing basis, monitoring and reviewing the same, at least once every year depending on the type of rating, to ensure the rating remains accurate.[4] MIS will modify a credit rating, if necessary, in response to changes in its opinion of the creditworthiness of the Debt Issuer or the debt.

71. MIS uses an issuer-pay model, and charges Debt Issuers an initial fee for the rating and an additional, separately stated, annual fee to monitor the rating for the life of the debt. The surveillance fee is not part of the initial fee paid to provide the credit rating.

72. MA earns additional revenue by converting MIS's proprietary information and analysis into more comprehensive and functional products, and selling subscriptions thereto to the global investing public who wish to access more thorough and detailed financial reports and analysis regarding a particular Debt Issuer or debt instrument evaluated by MIS (***see*** finding of fact 56).

73. MIS's fees are not contingent upon public dissemination of the ratings, and a Debt Issuer is required to pay MIS even if the rating does not become public. In the event a Debt Issuer terminates its relationship with MIS, MIS may collect liquidated damages.

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[4] This ongoing surveillance and monitoring does not apply with respect to point-in-time ratings (***see*** finding of fact 54).

74. Even if a debt issuer never approaches MIS, or seeks to withdraw a rating, MIS may rate a debt-issuance or instrument if it determines the issuance is of sufficient importance to the global investing public (i.e. , the market), and adequate information is available to generate an accurate rating (***see*** finding of fact 52).

75. Petitioner sourced MIS's credit ratings receipts based on an audience methodology upon the premise that it was a "publisher of financial data" and its audience was the "global investing public." Petitioner's sourcing methodology used the population of New York compared to the population of the United States, based on 2010 United States census data, as a proxy for the global investing public.

S&P's Credit Rating Process and Methodologies

76. Like MIS, S&P analyzes the creditworthiness of debt issuers, including financial institutions, insurance companies, corporate issuers, asset-backed securities issuers, and government issuers. The SEC granted S&P's application for registration as a Statistical Ratings Organization on September 24, 2007.

77. S&P's credit rating process consists of eight steps, which mirror MIS's nine-step ratings process: (1) Debt Issuer ratings request (i.e., pre-engagement); (2) the analytical team assignment and initial evaluation; (3) meeting with the Debt Issuer to collect information; (4) analyzing the Debt Issuer or debt instrument; (5) rating committee review and vote; (6) notifying the Debt Issuer; (7) rating publication and dissemination; and (8) rating surveillance.

78. S&P's credit rating process, as condensed, is set forth hereinafter.

79. The first step in S&P's credit rating process is when Debt Issuers have an initial meeting with S&P to request a rating on a debt instrument, discuss S&P's credit rating process, discuss the initial fee, and negotiate the terms upon which the rating will occur.

80. The second step in S&P's credit rating process is S&P's assignment of an analytical team, led by a lead analyst primarily responsible for the rating, and the conduct of an initial evaluation.

81. The third step in S&P's credit rating process is meeting with the Debt Issuer to collect all relevant financial and non-financial information from the Debt Issuer, and relevant information from other non-public sources and public sources, and interact with debt issuers to discuss the information collected.

82. The fourth step in S&P's credit rating process is analyzing the Debt Issuer or debt instrument to formulate a recommendation by applying the S&P's credit rating methodologies, which includes consideration of both quantitative and qualitative factors. S&P relies on a broad range of business, financial, and non-financial information, including key performance indicators, economic, regulatory, and geopolitical influences, management and corporate government (governance) attributes, competitive position, and changes within the Debt Issuer in evaluating the creditworthiness of the Debt Issuer or debt instrument. S&P differs from MIS in that S&P uses a "chance of default" standard, which analyzes primarily the possibility that debt issuers may miss making a payment on time, as required by the debt instrument, regardless of whether such debt issuer would be likely to eventually pay creditors in full (compare finding of fact 66 [MIS's expected loss standard] versus S&P's chance of default standard).

83. The fifth step in S&P's credit rating process is to submit the proposed rating to a rating committee, which evaluates the proposed rating, and through a majority vote, decides whether to assign the rating.

84. The sixth step in S&P's credit rating process is S&P's Lead Analyst will inform the Debt Issuer of its rating committee's decision and draft a proposed press release for dissemination.

85. The seventh step in S&P's credit rating process is when the S&P analytical team publishes a press release, the rating, and related research reports generated during the course of the team's analysis, on the S&P website, and disseminates the same through traditional financial newswires and news outlets.

86. The eighth step in S&P's credit rating process is that S&P conducts surveillance of the rating on an ongoing basis, which S&P reviews at least once every year depending on the type of rating, to ensure the rating remains accurate.

87. S&P owns the ratings that it publishes on the S&P website. S&P also earns revenue from selling subscriptions to the global investing public who wish to access more thorough and detailed financial reports and analysis regarding a particular Debt Issuer or debt instrument evaluated by S&P.

88. Even if a Debt Issuer never approaches S&P, or seeks to withdraw a rating, S&P may rate a debt-issuance or instrument if it determines the issuance is of sufficient importance to the market, and adequate information is available to generate an accurate rating.

Alien Affiliates' Royalty Payments

89. MIS created significant IP through its credit rating operations, including proprietary processes, procedures, methodologies, and know-how regarding assigning ratings.

90. MIS licensed the IP to MA, and to the Alien Affiliates listed in the Royalty Payors column in Stipulation Exhibit A, pages 215 through 217 and 219 through 221.

91. MISQM owned IP, including trademarks, service marks, trade names, domain names, and rating symbols.

92. MISQM licensed the IP to the Alien Affiliates listed in the Royalty Payors column in Stipulation Exhibit A, pages 215 through 217 and 219 through 221.

93. MA owned IP, including certain financial data, software, and quantitative tools.

94. MA licensed MIS's IP to the Alien Affiliates listed in the Royalty Payors column in Stipulation Exhibit A, pages 215 through 217 and 219 through 221.

95. During the Audit Period, all the Alien Affiliates were organized under the laws of foreign countries. During the Audit Period, all the Alien Affiliates were regarded non-U.S. entities, or were owned by regarded non-U.S. entities for federal income tax purposes.

96. Moody's owned at least 30%, directly or indirectly, of the capital, profits, or beneficial interest in each of the Alien Affiliates during the Audit Period.

Licensing Agreements

97. During the Audit Period, MIS, MISQM and MA licensed IP to the Alien Affiliates pursuant to licensing agreements.

98. The Alien Affiliates identified in Stipulation Ex. A, pages 214 through 221, paid MIS, MISQM, and MA for the right to use the licensed IP.

99. MIS and MISQM's licensing agreements granted the Alien Affiliates the right to exploit MIS's and MISQM's IP in specified non-U.S. territories for specified periods of time for a certain percentage of the Alien Affiliates' gross revenue, or for certain Alien Affiliates, $10.000.00.

100. During the Audit Period, MA entered into a revenue allocation and sublicensing agreement, the MA - MA UK Agreement, with MA UK, an Alien Affiliate (***see*** finding of fact 16).

Royalty Receipts

101. All of the royalty payments listed in Stipulation Ex. A, pages 214 through 221 were paid pursuant to license agreements that were in effect during the entire Audit Period.

102. All the license agreements were respected as IP license agreements for federal IP law purposes.

103. MIS, MISQM, and MA reported as received (in the aggregate) $112,484,988.00 in royalties from Alien Affiliates in 2011.

104. MIS, MISQM, and MA reported as received (in the aggregate) $126,564,533.00 in royalties from Alien Affiliates in 2012.

105. Moody's treated all the Alien Affiliates' payments as royalties for financial reporting and income tax purposes.

106. Petitioner included the Alien Affiliates' royalties received by MIS, MISQM, and MA in the calculation of Federal Taxable Income (FTI) on its federal consolidated income tax returns during the Audit Period.

107. The federal informational returns (IRS forms 5471 and 8858) reported the payments by Alien Affiliates to MIS, MISQM, and MA as royalties.

108. The IRS has always respected the characterization of the Alien Affiliates' payments as royalties in Moody's federal income tax audits.

109. Moody's did not license from an unrelated third party the IP that MIS, MISQM, and MA licensed to the Alien Affiliates.

110. Neither MIS, MISQM, nor MA pay to an unrelated third party the royalties it receives from the Alien Affiliates.

111. Neither MIS, MISQM, nor MA pay royalties to related non-U.S. entities.

112. The Alien Affiliates are not members of petitioner's combined corporation franchise tax returns, and they do not file tax returns in New York State. There is no evidence that the Alien Affiliates added back deductions for royalty payments made to petitioner on their home countries' tax returns.

Revenue Allocation and Sublicensing Agreement with MA UK

113. The terms of the MA - MA UK Agreement (i) allocated a specific percentage of MA UK's gross revenue to MA; and (ii) granted MA UK the right to exploit certain of MIS's IP that MA licensed from MIS, and in turn sublicensed to MA UK, for a specific percentage of MA UK's retained (i.e., post-allocation) revenue.

114. MIS's IP that MA sublicensed to MA UK included credit research and opinion content, credit rating data, certain software, data models and other analytical tools related to assigning credit ratings, financial information, data, MIS's analysis, and access to MIS's rating analyst's time.

115. The revenue allocation provision prescribes that MA UK retains 90% of its gross revenue and remits 10% of its gross revenue to MA. This revenue allocation provision in the agreement notes that MA UK's business activities in its particular territory (Europe, Middle East and Africa) have "exhibited sufficient entrepreneurial innovation and risk-taking in the local market, *e.g.*, developing localized analytical tools and independently establishing local client relationships, [so as to be] eligible for participation in a Revenue Allocation Agreement . . . ."

116. Under the same Agreement, MA UK also paid MA for the sublicensed right to exploit the sublicensed IP in specified non-U.S. territories in exchange for 20% of MA UK's retained gross revenue (i.e., 90% of gross revenue), which equates to 18% of MA UK's gross revenue (i.e., 20% of 90%).

117. MA UK thus paid MA 28% of its gross revenues (delineated 10% as revenue allocation, and 18% as a sublicense fee) during the Audit Period.

118. For 2011, MA UK's gross revenues were $182,561,211.00.

119. For 2011, MA UK paid $34,562,631.00 in royalties to MA.

120. For 2012, MA UK's gross revenues were $197,698,104.00.

121. For 2012, MA UK paid $37,353,044.00 in royalties to MA.

122. For 2011 and 2012, the MA UK royalties constituted approximately 18% of MA UK's gross receipts, consistent with the sublicense portion of the MA - MA UK Agreement.

123. For the 2011 and 2012 tax years, MA received, and recorded as royalties, the 18% payments from MA UK, in the amounts of $34,562,631.00 and $37,353,044.00, for the sublicense.

124. The royalty amounts received by MA from MA UK were included in the total amounts MIS, MISQM, and MA excluded from entire net income pursuant to N.Y. Tax Law § 208 (9) (o) (Royalty Income Exclusion).

Moody's Captive Insurance Company

125. Moody's operates MAC, a wholly-owned New York licensed captive insurance company.

126. MAC's directors and officers are responsible for the day-to-day operations and business decisions related to MAC.

127. MAC holds regular meetings with its board of directors, an annual shareholders' meeting, and documents such meetings in accordance with its bylaws.

Initial Formation and DFS Captive License

128. In December 2001, Moody's finalized a business plan for MAC to provide Moody's with liability coverage as permitted under article 70 of the New York State Insurance Law.

129. MAC was to be used as an insurance mechanism to provide coverage to Moody's that may not be available, either commercially or economically, in the marketplace. One of the primary reasons Moody's formed MAC was to be able to obtain federal TRIA coverage.

130. On May 24, 2002, Moody's formed MAC as a New York State corporation, and capitalized MAC with a contribution of $250,000.00 in cash, intercompany notes with an initial cash value of $49,470,000.00, and certain intangible assets.

131. MAC applied for and, on June 14, 2002, received a New York State captive license from DFS (f/k/a New York State Insurance Department).

132. On June 14, 2002, DFS reviewed and approved MAC's capitalization, liability coverage, policy issuance, intellectual property licensing, and affiliated company lending.

133. On June 18, 2002, DFS released a statement applauding Moody's creation of MAC.

134. DFS annually reviewed and approved MAC's liability coverage policy issuance, intellectual property licensing, and affiliated company lending, including during the Audit Period.

Audit Period

135. DFS conducted audits of MAC's insurance program, insurance policies, and capitalization in 2006 and 2011, i.e., once every five years (***see*** Insurance Law § 7007).

136. MAC was audited annually by independent financial auditors, KPMG, LLP, who

examined MAC's financial condition.

MAC's Insurance Program

137. MAC maintained policies covering professional liability, director and officer liability, medical stop loss, integrated risk, employment practices, errors and omissions and workers' compensation liability.

138. MAC's policies provide supplemental coverage to Moody's comparable to coverage available in the open market, and on terms substantially similar to third-party commercial insurance policies. MAC primarily provides coverage above and beyond the coverage Moody's otherwise obtains from third-party insurers. For example, MAC reimburses deductible amounts owed under Moody's third-party policies, including medical stop loss policy deductible amounts, workers compensation deductible amounts (up to $250,000.00), employment practices liability, errors and omissions liability and directors and officers liability. MAC also provides integrated risk insurance, including umbrella coverage for property and reputational damage, as well as excess liability coverage above such amounts.[5]

139. Moody's obtained TRIA coverage from MAC, and MAC participated in the United States government's TRIA program. MAC is responsible, under its policy, to report a terrorism claim and to seek reimbursement from the United States government under the TRIA, as subject to TRIA rules limiting such reimbursement to: (i) 85% of losses in excess of a statutorily established deductible, and (ii) a requirement that the insurance industry aggregate of all insured losses resulting from a Certified Act of Terrorism exceeds the TRIA program trigger of $100 million.

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[5] Moody's does not have third-party insurance coverage for reputational damages.

140. The covered policy holders under MAC's insurance policies were Moody's Corporation and any of its subsidiaries and affiliates covered by the related Moody's third-party policies, to the extent necessary.[6] The TRIA related policy covered Moody's and its affiliated, subsidiary and associated companies, among others.

141. The policy holders under MAC's insurance policies included the members of Moody's New York State combined corporation franchise tax returns for the Audit Period, which encompassed 14 to 15 separate insureds, and their affiliates and subsidiaries, during the Audit Period.

142. During the Audit Period, MAC agreed to reimburse Moody's for covered losses pursuant to the terms of MAC's policies for professional liability, director and officer liability, medical stop loss, integrated risk, and workers' compensation liability. MAC maintains reserves against claims. Reserve amounts are generally based upon prior years' claims. MAC's largest net amount insured in any one risk is $2 billion, and it is unlimited in the aggregate for the policy period.

143. During the Audit Period, MAC did not provide coverage to third parties, and did not cede or assume any reinsurance from any affiliate or third party.

MAC's Premiums

144. The DFS does not set premium rates for MAC. Moody's contracted with Marsh Management Services, Inc. (Marsh), to conduct independent actuarial studies to determine its premium expenses to MAC.

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[6] Under the medical stop loss insurance policy, coverage applied to employees and dependents of employees of Moody's under the Moody's self-funded employee welfare benefits program provided for eligible employees and their eligible dependents.

145. MAC is not qualified as an insurance company for federal income tax purposes. MAC's Board of Directors reviewed its operations "to determine how to maximize the insurance-related benefits of the companies and whether [MAC] can qualify as an insurance company for US federal income tax purposes." MAC's Directors discussed "two options to meet certain risk distribution requirements: (1) insure brother/sister companies with reasonable distribution of risk among entities; or (2) insure unrelated third parties." The Board later discussed "the insurance-related benefits associated with the proposed changes," and the "potential tax benefits" of "accelerated tax deduction in certain circumstances" and "state tax benefits related to treatment of an insurance company for federal income tax purposes." MAC's Board decided not to pursue such changes.

146. During the Audit Period, Moody's made periodic payments to MAC in consideration for MAC's obligations under the policies. The total annual payments by Moody's to MAC in the audit years ranged from $80 million to $85 million per year, as based upon the evaluations provided by Marsh. Petitioner included MAC in its consolidated federal income tax returns for the years in issue, and included its payments to MAC as part of its "other deductions." Likewise, petitioner reported such amounts as intercompany eliminations, thereby resulting in a net zero effect on its consolidated returns. Consequently, the inclusion of such premium payments among its federal other deductions does not, in fact, result in a deduction for such payments to MAC on petitioner's consolidated federal returns.

147. For tax years 2012 through 2014, the parties agree that over 50% of MAC's gross receipts were payments from Moody's to MAC for coverage under MAC's policies.

The Division's (Alleged) Discrimination

Moody's Early Alternative Allocation Requests

148. Since 2008, Moody's has consistently requested that the Division confirm that Moody's properly sourced MIS's credit rating receipts on a destination basis, reflecting its alternative allocation requests.

149. On October 3, 2008, Moody's requested that the Division issue an advisory opinion regarding the proper sourcing treatment of MIS's credit rating receipts (2008 Advisory Opinion Request).

150. The Division did not formally respond to Moody's 2008 Advisory Opinion Request.

151. On April 23, 2009, Moody's requested that the Division grant it alternative allocation to source credit rating receipts on a destination basis (April 2009 Alternative Allocation Request).

152. The Division did not formally respond to Moody's April 2009 Alternative Allocation Request.

153. On June 30, 2009, Moody's again requested that the Division grant it alternative allocation to source credit rating receipts on a destination basis (June 2009 Alternative Allocation Request).

154. The Division did not formally respond to Moody's June 2009 Alternative Allocation Request.

155. On May 3, 2013, Moody's submitted a position paper to the Division's representatives that requested certainty regarding the proper sourcing treatment of credit rating receipts.

156. On May 3, 2013, Moody’s personnel, Thomas Fezza and William Tice, and Moody’s representatives, met with Division representatives, including Nonie Manion and Joseph Carzo, to discuss Moody’s New York State tax treatment (2013 Meeting).

157. At the 2013 Meeting, Moody’s addressed three issues with the Division, including: (1) the proper sourcing of credit rating receipts; (2) Moody’s excluding from entire net income royalty payments received from Alien Affiliates; and (3) Moody’s excluding its New York State captive insurance company, MAC, from its article 9-A combined group.

158. During the 2013 Meeting, Moody’s representatives and counsel asked the Division to permit Moody’s to source its credit rating receipts on a destination basis.

159. During the 2013 Meeting, Moody’s representatives and counsel asked the Division whether it permitted any credit rating agencies to source credit rating receipts on a destination basis.

160. During the 2013 Meeting, Moody’s representatives and counsel requested that the Division ensure consistent sourcing treatment of all credit rating receipts.

161. During the 2013 Meeting, the Division expressed to Moody’s that the Division shared Moody’s interest in consistent New York State tax treatment of all credit rating agencies.

162. On May 23, 2013, Moody’s sent a letter to the Division representatives from the 2013 Meeting requesting consistent treatment (May 23, 2013 Letter).

163. The May 23, 2013 Letter provided materials illustrating that S&P’s New York State effective tax rate was lower than Moody’s New York State effective tax rate, even though the two taxpayers had very similar business operations.

164. The Division did not formally respond to Moody’s May 23, 2013 Letter.

Discovery of the Division's (Alleged) Discrimination

165. On February 24, 2014, the New York City Tax Appeals Tribunal Chief Administrative Law Judge released a determination (NYC ALJ Determination) concerning S&P's New York City business allocation percentage (BAP) (***see Matter of McGraw-Hill Cos.***, TAT [H] 10-19 [GC] et al. [NYC Admin. Law Div. Feb. 24, 2014]).

166. The NYC ALJ's determination stated as follows:

> "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) 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 [of McGraw-Hill] (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) was applied in order to reflect the user-audience for S&P's credit ratings."
>
> An accompanying footnote provided as follows:
>
> > ". . . [p]etitioner's representative stated that sourcing receipts to a customer location 'does not reflect the location of the true users of the debt ratings, i.e., the global investing public' and that the State's further sales factor reduction would compensate for that fact."

167. On February 12, 2015, a New York State Divison of Tax Appeals administrative law judge entered an order (NYS ALJ Order) concerning S&P's New York State BAP (***see Matter of McGraw-Hill Cos.***, DTA No. 825598 [NYS Div. Tax App. Feb. 12, 2015]).[7]

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[7] It is noted that while determinations issued by administrative law judges "shall not be considered as precedent" (***see*** Tax Law 2010; compare Tax Law 2016), the foregoing cases are referenced herein not as precedent, but for the facts set forth therein. Official notice can be taken of all facts of which judicial notice could be taken. Since a court may take judicial notice of its own records (***Matter of Ordway***, 196 NY 95 [1909]), the Division of Tax Appeals may take official notice of its record of proceedings (***see Bracken v Axelrod***, 93 AD2d 913 [3d Dept 1983]; ***see also Matter of Piscopo***, Tax Appeals Tribunal, April 29, 2019; ***Matter of Kolovinas***, Tax Appeals Tribunal, December 28, 1990; CPLR 4511).

168. The NYS ALJ's order confirmed the Division's grant of alternative allocation to S&P.

169. On November 16, 2017, the New York State administrative law judge issued a determination (NYS ALJ Determination) concerning S&P's New York State BAP (***see Matter of S&P Global Inc., f/k/a The McGraw-Hill Companies, Inc.***, DTA No. 825598 [NYS Div. Tax App. Nov. 16, 2017]).

170. The NYS ALJ's Determination again confirmed the Department's grant of alternative allocation to S&P.

171. The NYC ALJ Determination, NYS ALJ Order, and NYS ALJ Determination revealed that the Department entered into an Implementing Agreement with S&P dated June 13, 1997 (1997 Agreement).

172. The 1997 Agreement permitted S&P to calculate its BAP by including credit rating receipts in the New York State receipts factor numerator on a destination basis using, in part, a proxy for the location where investors view the ratings (i.e., an audience proxy).

173. Specifically, the 1997 Agreement permitted S&P to source credit rating receipts into New York State in the same ratio that S&P's "non-debt destination sales" were sourced into New York State.

174. S&P's non-debt destination sales consist of sales of software, quantitative and analytical tools, and database subscriptions, similar to MA's sales during the Audit Period.

175. The NYC ALJ Determination, NYS ALJ Order, and NYS ALJ Determination establish that the Division further granted S&P a 50% reduction to its sales factor numerator to better account for S&P's non-New York audience, and thus more clearly reflect S&P's income attributable to New York.

176. In 2009, the Division proposed reforming the 1997 Agreement by changing the sourcing method S&P could use for credit rating receipts. The Division proposed that S&P source its credit rating receipts to the location of the debt issuer and reduce its BAP numerator, which included credit rating and other receipts, by 50% (***see*** finding of fact 166).

177. The NYS ALJ Determination revealed that the Division applied the 1997 Agreement, or a successor agreement, to grant alternative allocation and permit destination sourcing for S&P's credit rating receipts through December 31, 2015. Although the 1997 Agreement purports to be effective through 2018, the NYS ALJ Determination revealed that the Division sought to rescind the 1997 Agreement beginning in 2015 due to structural changes in the Tax Law and S&P's corporate organization. The Division asserted that these changes rendered alternative allocation unnecessary to properly reflect S&P's income in New York State.[8]

178. A 2009 Draft Agreement, made public in a court filing, included terms permitting S&P to source its credit rating receipts to the debt issuer's location (***see*** finding of fact 166; exhibit 10).

Post-Moody's Discovery Alternative Allocation Requests

179. On December 5, 2014, Moody's sent a letter to the Division again requesting alternative allocation for 2011 through 2014 to use a destination sourcing method (2014 Request). Moody's requested to source its receipts to New York State using a population proxy for its audience, the global investing public.

180. On April 8, 2015, the Division issued a letter in response to petitioner's request for alternative allocation based on destination sourcing. By this letter, the Division granted Moody's

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[8] ***See Matter of S&P Global Inc.***, (DTA No. 825598 [NYS Div. Tax App. Nov. 16, 2017], at finding of fact 20, n. 8).

request for alternative allocation for 2014, based upon destination sourcing (2014 Approval Letter). The Division specified that Moody's sourcing of credit rating receipts for 2014 was to be based on the location of the Debt Issuer MIS evaluated.

181. The Division's 2014 Approval Letter denied Moody's request for alternative allocation for 2011 through 2013, upon the specific assertion that Moody's was required to request alternative allocation prior to filing its returns for these years, and had not done so. The final paragraph of the April 2014 Approval Letter provides as follows:

> "Upon review of your request, we have determined that, for the 2014 tax year, a fair and proper allocation of Moody's business income is best achieved by allowing Moody's to source its credit rating receipts based on the location of its customers, that is, the commercial domicile of the issuers who contract with Moody's for credit ratings. This determination does not apply to Moody's 2011 - 2013 tax years as, according to [20 NYCRR 4-6.1 (c)], if the taxpayer has not made a request for an adjustment of its business allocation percentage prior to the time it files its report, the taxpayer must file its report and compute its tax in accordance with the statutory formulas."

182. On April 4, 2016, during the Division's audit of Moody's for the Audit Period, Moody's counsel sent a letter to Amanda Hiller, the Division's General Counsel, requesting alternative allocation for 2011 through 2013, which recounted Moody's prior requests and asserted that the Division must grant alternative allocation to Mood's for 2011 through 2013 (April 2016 Alternative Allocation Request). Moody's counsel sent a copy of the letter to the Division's primary auditor in the ongoing Moody's audit, Halina Dzedavets.

183. The Division did not formally respond to Moody's counsel's April 2016 Alternative Allocation Request.

184. On August 9, 2016, during the Division's audit of Moody's for the Audit Period, Moody's sent a letter to Amanda Hiller, the Division's General Counsel (and again copying the primary auditor), requesting a written response to Moody's April 2016 Alternative Allocation

Request, reiterating Moody's prior alternative allocation requests submitted to the Division, and asserting that the Division must grant alternative allocation to Moody's for 2011 through 2013 per the August 2016 Alternative Allocation Request.

185. The Division did not formally respond to Moody's counsel's August 2016 Alternative Allocation Request.

Moody's Tax Filings

186. Moody's filed federal consolidated income tax returns for the 2011, 2012, 2013, and 2014 Tax Years. The federal returns for 2011, 2012 and 2013 are dated as signed on September 5, 2012, September 6, 2013, and September 8, 2014, respectively. The record does not specify a date of signing or filing for the 2014 federal return.

187. Moody's filed New York State combined corporation franchise tax returns for the 2011, 2012, 2013, and 2014 Tax Years. The state returns for 2011, 2012, 2013 and 2014 were E-filed on March 12, 2013, December 13, 2013, December 9, 2014, and December 9, 2015, respectively (***see*** Exhibit A, page 40).

188. MIS, MISQM, and MA were U.S. corporations included in Moody's New York State combined corporation franchise tax returns during the Audit Period.

189. The Alien Affiliates were non-U.S. entities, and were not included in Moody's federal consolidated tax returns, or in Moody's New York State combined corporation franchise tax returns during the Audit Period. The Alien Affiliates did not otherwise file New York State tax returns.

190. Moody's included in its New York State combined corporation franchise tax returns all subsidiaries included in its federal consolidated income tax returns, except MAC. Petitioner excluded MAC because it believed that MAC was not an overcapitalized captive insurance

company, and hence was not subject to inclusion as part of petitioner's New York State combined filing group.

Credit Rating Receipts Sourcing

191. On its New York State combined corporation franchise tax returns for the Audit Period, Moody's sourced MIS's credit rating receipts under the assertion that it was a publisher, and that sourcing should be based upon the location where the the credit ratings were viewed, with the viewing audience denominated as the global investing public. Sourcing was based on the portion of that audience located in New York State. Sourcing was accomplished by the use of 2010 United States census data to determine the ratio of the New York State population to the U.S. population, and the resulting 6.28 percentage was applied as a proxy for where investors viewed ratings. Hence, petitioner sourced 6.28% of MIS's credit rating receipts to New York State by including that portion of total credit rating receipts in the BAP numerator.

192. On its 2011 New York State combined corporation franchise tax return, Moody's reported $151,227,373.00 in its New York State receipts factor numerator ($59,175,894.00 of credit rating receipts), and Moody's reported total (everywhere) receipts of $1,339,841,334.00 ($942,831,918.00 of credit rating receipts).

193. On its 2012 New York State combined corporation franchise tax return, Moody's reported $175,908,484.00 in its New York State receipts factor numerator ($73,948,996.00 of credit rating receipts), and Moody's reported total (everywhere) receipts of $1,630,073,203.00 ($1,178,207,361.00 of credit rating receipts).

194. On its 2013 New York State combined corporation franchise tax return, Moody's reported $204,009,162.00 in its New York State receipts factor numerator ($81,396,870.00 of

credit rating receipts), and Moody's reported total (everywhere) receipts of $1,907,564,837.00 ($1,296,872,124.00 of credit rating receipts).

195. On its 2014 New York State combined corporation franchise tax return, Moody's reported $206,353,042.00 in its New York State receipts factor numerator ($88,130,429.00 of credit rating receipts), and Moody's reported total (everywhere) receipts of $2,080,620,592.00 ($1,404,155,919.00 of credit rating receipts).

Foreign Royalty Exclusion

196. For 2011 and 2012, on its New York State combined corporation franchise tax returns, Moody's computed its New York State combined entire net income by excluding, at line 15 (other subtractions), the Alien Affiliates' royalty payments to MIS, MISQM, and MA pursuant to the Royalty Income Exclusion under Tax Law former § 208 (9) (o) (3).

Captive Insurance

197. During the Audit Period, Moody's excluded MAC from its New York State combined corporation franchise tax returns.

The Division's 2011 through 2013, and 2014 Audits

198. On June 4, 2015, the Division initiated an audit of Moody's New York State combined corporation franchise tax returns for the Audit Period. The three main issues examined during the course of the audit were: (1) MIS's credit rating receipts sourcing; (2) the foreign royalty exclusion applied in computing ENI; and (3) the treatment of Moody's captive insurance company, MAC.

Credit Rating Receipts Sourcing

199. During the audit, for tax years 2011 through 2014, the Division adjusted Moody's BAP to increase the credit rating receipts sourced to New York State.

200. The Division asserted that Moody's must source credit rating receipts to the location where MIS's Lead Analyst analyzed the Debt Issuer, i.e., origination or cost of performance sourcing.

201. The Division asserted, on audit, that taxpayers are not publishers unless they prove that they publish real, physical illustrations and materials.

202. During the 2011 Tax Year, the Division added $478,238,300.00 to Moody's receipts factor numerator, increasing Moody's New York State receipts from $151,227,373.00 to $629,465,672.00.

203. For the 2012 Tax Year, the Division added $597,629,200.00 to Moody's receipts factor numerator, increasing Moody's New York State receipts from $175,908,484.00 to $773,537,684.00.

204. For the 2013 Tax Year, the Division added $657,820,241.00 to Moody's receipts factor numerator, increasing Moody's New York State receipts from $204,009,162.00 $861,829,403.00.

205. For the 2014 Tax Year, the Division applied the 2014 Approval Letter, which included credit rating receipts in Moody's receipts factor numerator if the Debt Issuer evaluated was located in New York State. For the 2014 Tax Year, the Division sourced MIS's credit rating receipts to New York State based on the location of the commercial domicile of the debt issuers who contracted with MIS for ratings.

206. For the 2014 Tax Year, the Division sourced $124,171,219.00 of additional credit rating receipts to New York State, reflecting 15.1195% of Moody's credit rating receipts sourced to New York State, which increased Moody's New York State receipts from $206,353,042.00 to $330,524,261.00.

207. For 2011, Moody's would have included a total of $226,265,107.00 in its receipts factor numerator, reflecting 14.2352% of Moody's credit rating receipts sourced to New York State, if Moody's included credit rating receipts in its receipts factor numerator based on whether the issuer Moody's evaluated was located in New York State.

208. For 2012, Moody's would have included a total of $264,426,909.00 in its receipts factor numerator, reflecting 13.7894% of Moody's credit rating receipts sourced to New York State, if Moody's included credit rating receipts in its receipts factor numerator based on whether the debt issuer Moody's evaluated was located in New York State.

209. For 2013, Moody's would have included a total of $310,634,615.00 in its receipts factor numerator, reflecting 14.4981% of Moody's credit rating receipts sourced to New York State, if Moody's included credit rating receipts in its receipts factor numerator based on whether the debt issuer Moody's evaluated was located in New York State.

Foreign Royalty Exclusion

210. The Division determined that Moody's did not qualify for the Royalty Income Exclusion based on its review of the home country tax returns of Moody's Alien Affiliates MA UK, and Moody's Investors Service, Ltd.

211. For the 2011 Tax Year, the Division added back to Moody's combined ENI base $112,484,988.00 of royalties it reported as received from Alien Affiliates. For the 2012 Tax Year, the Division added back to Moody's combined ENI base $126,564,533.00 of royalties it reported as received from Alien Affiliates.

212. For 2011 and 2012 Tax Years, the amounts Moody's excluded as royalties are accurate if Moody's qualifies to apply the Royalty Income Exclusion for MIS's, MISQM's, and MA's payments from the Alien Affiliates.

213. For the 2011 and 2012 Tax Years, the Division's adjustments relating to such payments were properly calculated if it is determined that Moody's cannot deduct (i.e., subtract) the payments to MIS, MISQM, and MA from the Alien Affiliates.

Captive Insurance

214. The Division forcibly combined MAC in Moody's New York State combined corporation franchise tax returns for 2012, 2013, and 2014, because the Division believed MAC met the definition of an overcapitalized captive insurance company, since less the 50% of its gross receipts consisted of premiums paid as consideration for bona fide insurance.

Penalties

215. In addition to the foregoing substantive issues, the Division imposed a penalty for substantial understatement of tax liability, pursuant to Tax Law § 1085 (k), for each of the years at issue. Petitioner challenges the imposition of such penalties.

CONCLUSIONS OF LAW

Background

A. Tax Law article 9-A imposes a franchise tax on all domestic and foreign corporations doing business, employing capital, owning or leasing property, or maintaining an office in New York State (***see*** Tax Law § 209 [1] [a]).[9] During the years at issue, New York corporate taxpayers reported their tax liability as the greatest amount due as computed by four different methods or bases, one of which was their ENI base (***see*** Tax Law former § 201 [1] [a - d]).[10] ENI

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[9] Tax Law former § 209-B imposes an additional surcharge franchise tax upon corporations located, doing business, owning or leasing property, or maintaining an office within the Metropolitan Commuter Transportation District (MCTD). For purposes of resolving the issues presented in this matter, it is unnecessary to specifically address the calculation of such additional tax.

[10] Corporate tax reform, effective for taxable years commencing on or after January 1, 2015, made significant changes to the computation of liability under article 9-A (***see*** L 2014, ch 59).

is generally the same as the taxpayer's entire federal taxable income (FTI) with certain, statutorily specified, modifications:

> "the term 'entire net income' means total net income from all sources, which shall be presumably the same as the entire taxable income (but not alternative minimum taxable income), (i) which the taxpayer is required to report to the United States treasury department . . . . " (Tax Law former § 208 [9]).

Tax Law § 208 (9) (a) - (q), in turn, provides numerous adjustments and modifications that are to be made to FTI in arriving at ENI for purposes of the article 9-A franchise tax.

B. As is most often the case, the franchise tax to which Moody's is subject is based upon ENI. Generally, affiliated corporations with substantial intercorporate transactions are required to file combined returns and pay New York business corporation franchise tax on all of their allocated ENI (***see*** Tax Law §§ 209 [4], 211 [4]). During the years in issue, allocated ENI was computed based upon investment income (Tax Law former § 208 [6]), and business income (Tax Law former § 208 [8]; ***see*** Tax Law former §§ 210 [1] [a]; [3]; 208 [9]; 209 [1]). Allocation to New York is accomplished via the formulary apportionment of a corporation's investment income, resulting in its investment allocation percentage (IAC) (Tax Law former § 210 [3] [b]), and its business income, resulting in its business allocation percentage (BAP) (Tax Law former § 210] [3] [a]), with the resulting amounts totaled to arrive at the corporation's entire allocated ENI base, which was then subjected to tax at the applicable rate (***compare*** conclusion of law JJ, n. 26 [tax rates under article 9-A versus article 33]). Such formulary allocation is intended to fairly reflect the taxpayer's activity in New York (***see*** 20 NYCRR 4-6.1 [a]).[11]

C. This matter presents four distinct issues: (1) the proper sourcing, and hence allocation, of petitioner's credit rating receipts during the years at issue; (2) the propriety of petitioner's

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[11] This matter most specifically involves the sourcing of petitioner's business income. Consequently, it is not necessary to further address investment income or its allocation.

subtraction of royalty income received from its alien affiliates, pursuant to the deduction afforded under Tax Law § 208 (9) (o) (3), in computing its entire net income for the years 2011 and 2012; (3) the forced inclusion of petitioner's captive insurance company, MAC, in petitioner's combined corporation franchise tax reports for the years 2012, 2013 and 2014; and (4) the imposition of penalties for substantial understatement of petitioner's tax liabilities for each of the years at issue. Each issue will be addressed separately.

Sourcing (Allocation) of Credit Rating Receipts

D. The first issue involves determining the amount of petitioner's business income from MIS's credit rating activities that may be properly sourced to, and consequently subjected to tax by, New York. During the years at issue, a taxpayer's BAP was calculated based upon a single receipts factor (***see*** Tax Law former § 210 [3] [a] [10] [A] [ii]). To calculate its receipts factor, and hence its BAP, a taxpayer totaled its receipts from: (1) sales of tangible personal property shipped to points within the state; (2) services performed within the state; (3) rentals from properties situated, and royalties from the use of patents or copyrights, within the state; and (4) all other business receipts earned within the state (***see*** Tax Law former § 210 (3) [a] [2] [A - D]; 20 NYCRR 4-4.1 [b] [1] - [5]). That sum was then divided by the taxpayer's total of such receipts from both within and without the state (***id.***).

E. The first determination to be made is the proper classification of the credit rating receipts earned by MIS, from which the proper sourcing of such receipts, as so classified, may then be determined. Tax Law former § 210 (3) (a) (2) (B) provided that receipts that were compensation derived from the performance of services were to be sourced on an origin basis, and were to be allocated according to the location where the performance of the service by which the receipt was earned took place. Tax Law former § 210 (3) (a) (2) (D) provided that "other

business receipts" (OBR), as distinguished from receipts purely resulting from the performance of services, were also to be sourced on an origin basis, but were to be allocated upon the basis of the location where the receipts were earned (***see*** 20 NYCRR 4-4.6 [a]). In either case, where the issue is the classification of a corporation's receipts for BAP purposes, the focus is properly on the transactions that resulted in those receipts (***see Matter of Catalyst Repository Systems, Inc.***, Tax Appeals Tribunal, July 24, 2019). In the case of OBR, sourcing based on the location of where the receipts are earned means the location of the work that resulted in the receipt (***id.*** citing ***Matter of Siemens Corp. v Tax Appeals Trib.***, 89 NY2d 1020, 1022 [1997], ***rearg denied***, 90 NY2d 845 [1997]).

F. Moody's tax returns for the years at issue were filed upon the position that the credit rating receipts earned by MIS resulted from the dissemination of such ratings by publication, that Moody's is a publisher, and as such, the credit rating receipts are subject to apportionment by sourcing pursuant to the special sourcing rules applicable to broadcasters and publishers (***see*** 20 NYCRR 4-4.3 [d] [2], [3]). Under a specifically spelled out sub-category of sourcing rules (Media Exceptions), receipts from the broadcasting of radio and television programs and commercial messages, and from the publishing of advertisements in newspapers and periodicals, respectively, are deemed to be receipts from services, and are allocable based on the number of listeners or viewers in New York as compared to those in other states (***see*** 20 NYCRR 4-4.3 [d] [2]), or upon the New York circulation of the newspaper or periodical (***see*** 20 NYCRR 4-4.3 [d] [3]). The credit ratings business and receipts of MIS are not a specifically enumerated sub-category of publishing and broadcasting receipts subject to the Media Exceptions sourcing and allocation rules, and there are no specific rules set forth for sourcing and allocation of receipts of the type at issue herein. Moody's maintains its audience is the global investing public, and it

filed its returns using a sourcing method it believes to be akin to those described above (for publishers and broadcasters), but presumably better aligned with the nature of its business in general and the actual basis upon which MIS's credit ratings receipts were earned. Thus, petitioner sourced its credit ratings receipts using a population proxy (the portion of the United States population located in New York compared to the United States population), based on 2010 United States census data, to determine a percentage reflecting the portion of the global investing public that was its New York audience, and thereby arrive at the portion of its credit ratings receipts that were allocable to New York. In order to accept petitioner's argument, it is necessary, at the outset, to conclude that MIS is, in fact, a publisher, and that its customers (Debt Issuers) engage and pay MIS for the primary purpose of disseminating credit ratings to the public. Moody's further argues that even if MIS is not deemed to be a publisher earning receipts from the service of publishing, then the receipts in question must thus be OBR, per Tax Law former § 210 (3) [a] [2] [D]).[12] As such, according to Moody's, the receipts in question must be sourced to the location where earned. Moody's maintains, in essentially the same manner as above, that the receipts at issue are in fact earned where the consumers access the ratings, such that sourcing is properly based on viewership again using the "population as proxy" method described above.

G. Moody's also maintains, in the alternative, that even if it is concluded that the receipts in question are from the performance of services, but do not fall within the publishing regulations, as above, and are not categorized as OBR, the Division must nonetheless adjust the sourcing of such receipts to correct the distortion allegedly resulting from origination (or cost of performance) sourcing, i.e., sourcing the receipts to New York to the extent the services required to produce the ratings are performed in New York. Under this position, Moody's seeks

[12] The other two receipts categories under Tax Law former § 210 (3) (a) (2), sales of tangible personal property, and property rentals and royalties, are not relevant in this matter.

alternative allocation of MIS's credit ratings receipts based on destination sourcing, by application of a statutorily permissible deviation, or discretionary adjustment, using "any . . . method . . . to effect a fair and proper allocation of . . . income . . . attributable to the state." Such a deviation is proper if the statutory method of allocation "[d]id not properly reflect the . . . income . . . [of the taxpayer] within the state" (Tax Law former § 210 [8]). Under this argument, petitioner would seek destination-based allocation, as allowed by the Division for the year 2014, based upon the commercial domicile of the Debt Issuers who contracted with MIS for ratings, for all of the years at issue. Finally, petitioner maintains that it is, in any event, entitled to be treated in a manner like its prime competitor, S& P Global, Inc. Here, petitioner argues that the Division afforded its competitor sourcing adjustments that effectively allowed destination sourcing, in a manner that discriminated against petitioner so as to result in petitioner being placed at a significant competitive disadvantage.

H. The Division's position, by contrast, is that the receipts in question were derived from the performance of services, and were earned directly from the service of analysis resulting in the generation of credit ratings by MIS (***see*** findings of fact 61 through 71 [describing the process of generating credit ratings]). The Division allocated such receipts to New York, on audit, to the extent MIS's services were performed in New York. More specifically, the Division based such allocation on the location of the lead analyst tasked with determining the rating, and asserts that such sourcing was correct under the then-applicable statute and regulations.[13] Notwithstanding the foregoing conclusion as to the nature and sourcing of the receipts, the Division did allow an adjustment to such origination-based sourcing for the year 2014, only, so as to destination-source

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[13] The fact that this was the Division's prevailing interpretation of sourcing and allocation of credit ratings receipts is born out by the very fact that petitioner made requests seeking variance therefrom (i.e., requests for alternative sourcing and allocation).

MIS's credit ratings receipts based upon the commercial domicile of the various Debt Issuers being rated. The Division argues that petitioner is not entitled to a discretionary adjustment for the years 2011 through 2013, based upon destination sourcing to the commercial domicile of the Debt Issuers, because petitioner failed to make a request for such an adjustment prior to the filing of its returns for the years 2011 through 2013, in accordance with 20 NYCRR 4-6.1 (c). In this regard, the Division also points out that none of petitioner's returns for the years at issue, including its return for 2014, were filed in accordance with any of the sourcing or allocation rules available under the then-applicable law.

I. As noted above, the first determination to be made is whether the credit rating receipts earned by MIS were properly classified as compensation from the performance of services. If so, then the receipts are to be sourced to New York to the extent the services giving rise thereto were performed in New York (***see*** Tax Law former § 210 [a] [2] [B]; 20 NYCRR 4-4.3). The Tax Appeals Tribunal recently provided guidance in making such a determination. In ***Matter of Catalyst Repository Systems***, the Tribunal stated:

> "The word 'services' is not defined in Tax Law former § 210 (3) (a) (2) (B). Accordingly, we must construe this word 'according to "its ordinary and accepted meaning at the time [of enactment]"' (***Gevorkyan v Judelson***, 29 NY3d 452,459 [2017] citing ***People v Eulo***, 63 NY2d 341, 354 [1984]). . . ."

In an accompanying footnote, the Tribunal stated:

> "We rely on the following definition of service in Black's Law Dictionary 1491 (9th Ed 2009): 'The act of doing something useful for a person or a company, usu. for a fee.' We believe that this definition is consistent with the common understanding of a service at the time of the enactment of article 9-A (***see*** L 1944, c 415)."

The Tribunal went on to state:

> "the issue is the classification of a corporation's receipts for BAP purposes and our focus is properly on the transactions that resulted in those receipts and not on the corporation's principal business activity." (***id;*** [thereby distinguishing ***Matter***

> ***of Capital Cablevision Sys., Inc.***, Tax Appeals Tribunal, June 9, 1988, and the question of classification for corporation tax filing purposes, as was at issue in that case, versus classification of receipts, as is at issue herein]).

J. Applying this analysis to the present matter, the transactions that gave rise to the credit ratings receipts at issue created a discrete and clearly identifiable stream of revenue resulting directly from MIS's activities of gathering relevant information, and analyzing and synthesizing the same, so as to arrive at a credit worthiness assessment and the generation of a credit rating reflecting that assessment. The record details the multi-step process MIS carries out in generating a credit rating, and establishes that a substantial amount of personal involvement, interaction and effort is expended in carrying out that process. This is supported by the terms of the contracts between MIS and the Debt Issuers by whom MIS is engaged. The terms of MIS's agreements with Debt Issuers reflect that MIS is being paid for providing analysis and review that culminates in the creation of a credit rating. The contract application for a rating is on MIS's letterhead, and payment of the fee is in exchange for MIS's service of generating a credit rating for a Debt Issuer customer. Payment of the fee is not contingent upon public dissemination of the rating (***see*** Exhibit A, pp. 531, et seq.; ***S&P Global, Inc. v New York City Tax Appeals Tribunal***, 147 AD 3d 640 (1ST Dept. 2017]). It is noted that MIS's invoices for payment from the Debt Issuers under the parties' contracts are "For Professional Services" (***see*** Exhibit A, page 588). Further, MIS is also paid a separate and additional annual surveillance fee with respect to continued review and maintenance of the rating (***see*** finding of fact 71). Moreover, even if a rating is not issued, or a Debt Issuer terminates its relationship with MIS, MIS remains contractually entitled to compensation for its time and effort expended (***see*** finding of fact 73). Ultimately, these facts bear out that MIS's credit rating process and results constitute the

performance of a service for its customers within the contemplation of Tax Law former § 210 (3) (a) (2) (B).

K. The facts that MIS receives additional payment from MA for its use of the ratings, and that MA, in turn, places the ratings on its website, where the same are accessible to and may be viewed by the public, without charge, does not convert the ratings receipts earned directly by MIS into receipts from publishing. It is a fact that Moody's, and more specifically MA, is able to combine and package the methods, information and results of MIS's credit rating activities so as to further monetize the same in a number of different ways (e.g., subscription sales, IP licensing, and the like), and thereby realize receipts in addition to those initially earned by MIS for the credit rating services it performs. While a testament to Moody's sophisticated overall business model and activities, this fact lends no support for a conclusion that MIS's receipts earned from its credit rating business were earned by MIS for publication of such ratings, or that MIS was a publisher. In this respect, it remains that the credit ratings were not disseminated by MIS but by MA, and they were disseminated without charge. In sum, the discrete stream of revenue at issue, receipts earned by MIS from the generation of credit rating reports, were receipts derived from the performance of services, and as such were allocable based on the location where those services were performed, pursuant to Tax Law former § 210 (3) (a) (2) (B).

L. Petitioner's arguments that it should be allowed to classify MIS's credit rating receipts either as: (a) receipts from the service of publishing, with allocation via audience based sourcing under a proxy method allegedly like the Media Exceptions methods available to broadcasters and publishers or, (b) as OBR derived from the service of providing access to proprietary content, with allocation also via audience based sourcing, are rejected. MIS's receipts directly result from

its analysis and generation of creditworthiness ratings. As detailed above, no part of the stream of MIS's credit rating receipts is derived from

public dissemination, because the ratings are not disseminated by MIS, but by MA, on its website, as well as via various financial newswires, to the public "free of charge." Given that MIS did not generate its receipts from public dissemination, it follows that the same are not subject to audience sourcing based on the rules applicable to broadcasters and publishers, or under audience-based sourcing using census data as a proxy method, as chosen and utilized by petitioner in the filing of its returns.[14] Notwithstanding any expectation that the credit ratings would be disseminated, the specific receipts here were paid to MIS, per contract, in exchange for the service of providing a credit rating, and not for dissemination thereof. Petitioner's claim that the dissemination of ratings is for the benefit of investors, Debt Issuers and the financial markets, in general, must be balanced against the fact that Debt Issuers engage MIS to provide analysis and a rating concerning proposed debt. Dissemination is clearly a practical, expected and beneficial consequence of obtaining such a rating. However, it remains that dissemination and access is provided without charge. While dissemination assists petitioner in further monetizing such credit ratings, so as to create a different and additional revenue stream for itself, the initial receipts, earned by MIS, are receipts earned from its performance of services. Indeed, the fact that MIS is paid a "break up" fee in the event of a cancelled rating request, or a failure to close on a debt issuance, thereby compensating MIS for its time, effort and lost revenue, is consistent with the fact that MIS is engaged and compensated by Debt Issuers for the purpose of generating a credit rating. MIS's primary contractual obligation is to independently and accurately assess the

[14] Petitioner's allocation method, United States census data comparisons as a proxy for petitioner's viewing audience, as denominated the "global investing public," has apparently never been sanctioned by the Division, and the accuracy, and hence appropriateness of such a method, at best, remains open to debate.

proposed debt issuance, and issuer, for the contracting Debt Issuer. An MIS credit rating is an independent evaluation and assessment of the creditworthiness of a Debt Issuer and debt instrument, but it is not an endorsement of a Debt Issuer or debt instrument, or a solicitation to purchase a debt instrument. Though creation and dissemination of a credit rating may be said to be complementary (or even symbiotic) actions, they are not the same. Dissemination, though an expected and subsequent consequence of creation, is not an obligation undertaken or performed by MIS. MIS is a sophisticated service provider and not a publisher, notwithstanding that the results of MIS's services are disseminated by MA (and others), and thereby become publically available. In conclusion, MIS's receipts are not from investors or others who view, and may rely upon, MIS's credit rating, but are from issuers of debt obligations who pay MIS to generate individualized credit ratings.

M. Having concluded that the receipts at issue were properly classified as compensation earned from services, the question devolves to the portion thereof allocable to New York. Tax Law former § 210 (3) (a) (2) (B) provided that such receipts were to be sourced to New York to the extent the services giving rise thereto were performed in New York (***see*** conclusion of law E; 20 NYCRR 4-4.3). The question of such allocation has been answered here by the parties' stipulation that 57% of MIS's fees for credit ratings were properly sourced to New York for the years at issue, subject only to the discretionary adjustment for the year 2014, whereunder 15.1195% of such receipts are to be sourced to New York based upon the commercial domicile location of the debt issuers (***see*** findings of fact 7 and 10).[15]

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[15] The sourcing method granted to petitioner for 2014 reflects a material change to the sourcing of service receipts, and is consistent with legislative changes to the sourcing rules for such receipts effective as of the year 2015. As part of the reform legislation enacted in 2014, and made effective as of January 1, 2015 (***see*** conclusion of law A, n. 10), the Legislature changed the method of sourcing receipts derived from services from where the services are performed (origination sourcing) to the location of the service provider's customers (destination sourcing). The (continued...)

N. Notwithstanding the foregoing, two additional sourcing issues have been raised by petitioner. First, there is the question of the Division's alleged discrimination against petitioner regarding the sourcing of credit ratings receipts as allowed by the Division to petitioner's main competitor, S&P Global, via a discretionary adjustment under an agreement (Implementing Agreement) with S&P Global. Petitioner argues that it, too, is entitled to such an adjustment to rectify the difference in tax treatment and impact between it and S&P resulting from such alleged discrimination.[16] Second, there is petitioner's assertion that it is entitled to a discretionary adjustment for the years 2011 through 2013, so as to allow destination sourcing for those years in the same manner as was allowed to petitioner via discretionary adjustment for 2014 (sourcing based on the commercial domicile location of the Debt Issuers), and as was specifically adopted by the Legislature effective as of January 1, 2015. These arguments are intertwined to a degree, given that both would necessarily involve the allowance of a discretionary adjustment, albeit on different grounds, representing a departure from the then-applicable manner of sourcing credit rating receipts (***see*** conclusions of law E through L).

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[15](...continued)
memorandum in support of this legislation states:

> "New York's current sourcing rules fail to acknowledge the shift to a service-based economy. Companies that generate significant receipts from services can incur greater tax liability if they increase their activity in New York. This reform proposal would source a business's receipts to the location of its customers. This assigns income to various states based on where the customers are located and eliminates factors that would increase tax if a company increased its activity in New York. This removes a previous disincentive to locating in New York" (***see*** New York State Executive Budget, Revenue Article VII Legislation, Memorandum in Support, Part A).

The legislative enactment of such a material change supports the conclusion that prior to 2015, receipts from the performance of services, such as those performed by MIS, were properly sourced to where such services were performed.

[16] Alternative allocation by discretionary adjustment under the Implementing Agreement was allowed in favor of McGraw-Hill. That entity is now known as S&P Global Ratings, Inc. Those entity names are sometimes used interchangeably herein.

O. Tax Law former § 210 (8) granted very broad authority and discretion to the Commissioner of Taxation allowing for adjustment of the BAP formula provided under Tax Law former § 210 (3) (a) (2), when it appeared that formula did not properly reflect the activity, business, income or capital of a taxpayer within New York State.[17] Under such authority, the Commissioner was allowed to make adjustments that: a) included one or more other BAP formula factors, such as expenses, purchases, or contract values; b) excluded one or more assets in computing the BAP; or c) utilized any other similar or different method calculated to effect a fair and proper allocation of the income and capital reasonably attributable to New York State. Companion regulations recognized that, due to the nature of certain businesses, the formula used to compute the BAP under Tax Law former § 210 (3) (a) (2) could, in some cases work hardship and not do justice to either the taxpayer or the State. The regulations provide that if a different method is used to compute the BAP, it must be calculated to effect a fair and proper allocation of the business income reasonably attributable to the State (***see*** 20 NYCRR 4-6.1).

P. First, and as to the issue of alleged discrimination, it is a matter of public record that the Division did afford a discretionary adjustment allowing McGraw-Hill to effectively source its credit rating receipts on a destination basis. At the same time, it is also a matter of public record that such discretionary treatment was not based simply on the issue of destination versus origination (place of performance) sourcing of credit rating receipts. Rather such treatment was pursuant to an agreement arrived at in specific response to McGraw-Hill's stated intent to remove its operations from New York to New Jersey (***see*** Exhibits 7 through 9; ***Matter of S&P Global, Inc., f/k/a The McGraw-Hill Companies, Inc.***; ***Matter of The McGraw-Hill Companies, Inc.***, TAT [E] 10-19 [GC] et al. [NYC Tax Appeals Tribunal, Oct. 28, 2015] [***see*** p. 23, n. 12], ***rev'g***

[17] The Commissioner's statutory discretionary authority, formerly set forth at Tax Law § 210 (8), is now set forth at Tax Law § 210-A.

Matter of The McGraw-Hill Companies, Inc., TAT [H] 10-19 [GC] et al. [NYC Admin. Law Div., Feb. 24, 2014], ***confirmed S&P Global, Inc., f/k/a McGraw Hill Financial, Inc., v New York City Tax Appeals Tribunal, et al.***, 147 Ad3D 620 [1ST Dept 2017]).[18]

From the foregoing, it is clear that the reason for the allowance of a discretionary adjustment based upon destination sourcing for McGraw-Hill, was specifically to prevent the removal of McGraw-Hill's operations and over 3,000 jobs from New York State (***id.***). There is no evidence that the sourcing adjustment allowed to McGraw-Hill was allowed for the purpose of assisting McGraw-Hill to the detriment or at the expense of Moody's, so as to be considered directly discriminatory. It was allowed, in fact, for the specific purpose of preventing massive New York State (and City) job losses. The McGraw-Hill agreement was driven by and structured to achieve savings commensurate with the savings identified as necessary to forestall McGraw-Hill's move out of New York and into New Jersey, and was not an instance of different treatment allowed to one party in favor of another, with no stated or discernible rationale for departure from the norm, or in support of the consequent differential result in tax impact between the two taxpayers. The circumstances in support of the Commissioner's determination to allow a discretionary adjustment to McGraw-Hill provide a rational basis for such an adjustment, and show the same to have been clearly within the discretion of the Commissioner (***see Matter of Balan***, Tax Appeals Tribunal, April 17, 1991). Accordingly, petitioner's assertion of purposeful

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[18] Note 12 from the City Tribunal's Decision reads, in relevant part:

"Petitioner [McGraw-Hill] asserts that the [NYC Dept. Of Finance] should follow an agreement between Petitioner and the State DTF dated August 13, 1997, under which the New York State Commissioner of Taxation and Finance exercised his [discretionary authority per former Tax Law § 210 (8)]. However, that agreement states that it was entered into 'to induce [Petitioner] to maintain its existing presence and headquarters, and the existing presence and headquarters of [S&P] in New York State.' Thus the agreement is not based on an objective determination that the general rule for allocating income from services should not apply. Moreover, the allocation method agreed to is not the method being requested by Petitioner for the Tax Years in the present case."

discriminatory treatment is rejected, as is its request, based thereon, for a discretionary adjustment allowing sourcing on terms like those allowed for McGraw-Hill.

Q. Finally, there remains the question of whether petitioner should have been afforded a discretionary adjustment for 2011 through 2013, allowing it to source MIS's credit rating receipts for those years in the same manner as was discretionarily allowed for 2014, i.e., on the basis of the commercial domicile location of the Debt Issuers (***see*** findings of fact 7, 8 and 207 through 209). The discretionary adjustment for 2014 was memorialized in the 2014 Approval Letter, dated April 8, 2015, from the Division's Deputy Commissioner and Counsel to petitioner's counsel. That letter indicates that it is in response to petitioner's counsel's December 5, 2014 letter, requesting confirmation that petitioner had properly sourced its credit rating receipts on a destination basis for 2011 through 2013, and should continue to source such receipts on a destination basis for 2014. After describing the basis and authority for granting a discretionary adjustment, the final paragraph of the Division's counsel's letter grants such an adjustment, but only for 2014 (***see*** finding of fact 181).

R. The only reason offered by the Division in support of allowing the foregoing discretionary adjustment only for 2014, rather than for the other years at issue, is that petitioner had not made a request for the earlier years (2011 through 2013) prior to the filing of its franchise reports for such earlier years. However, the record bears out that petitioner had been pursuing the BAP adjustments based on destination sourcing, on a consistent basis and in an ongoing manner for many years, during the course of its essentially continuous status of being audited (a fact of life for most large and complex entities). Those requests commenced, as a practical matter, in October 2008, and continued consistently thereafter, nomenclature aside, including in April 2009, June 2009, and May 2013 (***see*** findings of fact 148 through 162), and thereafter on

December 5, 2014, April 14, 2016, and August 9, 2016 (***see*** findings of fact 179, 182 and 184). Such requests, including the December 5, 2014 letter request giving rise to the adjustment granted for the year 2014, essentially mirror each other, and with the exception of petitioner's initial October 2008 request for an advisory opinion regarding the proper sourcing of credit rating receipts (***see*** finding of fact 149), none of the requests were ever withdrawn. Moreover, the Division never formally responded to any of petitioner's requests until its 2014 Approval Letter. It is therefore disingenuous for the Division to maintain that petitioner failed to request an adjustment to its BAP based on destination sourcing, whether denominated a request for alternative allocation or a request for a discretionary adjustment, prior to the filing of its franchise tax reports for the years 2011 through 2013. The fact is that petitioner has established a continuum of requests for alternative allocation based on destination sourcing of credit rating receipts.[19]

S. There is no question that an adjustment, such as that allowed by the Division for 2014, clearly falls within the broad authority of the Commissioner of Taxation under Tax Law former § 210 (8). The Division's 2014 Approval Letter granting that adjustment specifically admits and agrees that a "fair and proper allocation" of MIS's credit rating receipts for 2014 "is best achieved" by sourcing such receipts to the commercial domicile of the Debt Issuers who contract with MIS for such credit ratings (***see*** finding of fact 181). This admission is not in conflict with the conclusion, in accordance with the Division's then-prevailing interpretation concerning the sourcing of credit rating receipts, that such receipts were, in the first instance, receipts from services to be sourced and allocated based on where the services giving rise to the receipts were

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[19] Petitioner's 2013 franchise tax report appears to have been filed on December 9, 2014 (***see*** finding of fact 187). Petitioner's counsel's letter seeking alternative allocation based on destination sourcing is dated December 5, 2014 (***see*** finding of fact 179). It would therefore appear, at least for the year 2013, that petitioner's request for alternative allocation was in fact made prior to the filing of its report for that year.

performed (***see*** conclusions of law I through M), but rather only acknowledges that discretionary departure therefrom may be warranted in some circumstances. The record includes no evidence or indication of any differences in petitioner's operations regarding the credit rating process, as described in detail herein, nor any significant year-to-year variances between the percentages of such receipts as sourced based upon the commercial domicile of the Debt Issuers (***see*** finding of fact 8). The consistency in the apportionment percentages derived from sourcing based upon customer location, for the years 2011 through and including 2014, supports applying the 2014 adjustment in a likewise consistent manner for the years 2011 through 2013. Further, and as noted, the method of sourcing granted for 2014 by discretionary adjustment became the law as of 2015.[20] Again, the Division's only stated reason for not allowing adjustment for the earlier years was the alleged absence of a request for the same. That allegation has been rejected based on the evidence in the record. In sum, the foregoing all support applying the 2014 discretionary sourcing adjustment to MIS's credit rating receipts, in the same manner, to the years 2011 through 2013. Not granting such an adjustment for the earlier years, under the particular circumstances presented here, is at best inconsistent, and is in fact arbitrary. Accordingly, the 2014 sourcing adjustment is hereby granted for such earlier years, and the Division is directed to recalculate petitioner's liability for such years (***see*** findings of fact 7, 8, 207 through 209).

Exclusion of Royalty Payments from Alien Affiliates

T. The second issue concerns the propriety of petitioner's treatment of royalty payments received from its related member Alien Affiliates in 2011 and 2012. As above, ENI is presumably the same as FTI, as increased or reduced by any of the applicable modifications and

[20] Though unstated, it may well be that such sourcing was, in part, allowed for 2014, in recognition and as an acknowledgment reflecting that while the legislation allowing destination sourcing became effective January 1, 2015, the same was passed in 2014.

adjustments set forth under Tax Law § 208 (9) (a) - (q). Payments received by petitioner from its Alien Affiliates, denominated as royalties, were included as part of petitioner's FTI on its consolidated federal returns. In calculating its New York ENI, however, petitioner deducted such payments from FTI, pursuant to Tax Law former § 208 (9) (o) (3).

U. The exclusion modification under Tax Law § 208 (9) (o) (3) allowed a taxpayer to deduct "royalty payments" received from a "related member" during the taxable year, subject however to the companion add-back requirements of Tax Law § 208 (9) (o) (2). The primary issue presented is whether any of the amounts petitioner received from its Alien Affiliates, that were properly denominated as royalty payments, may be deducted by petitioner in calculating ENI. With the exception of the portion of the payments petitioner received from MA UK that were denominated royalty payments, the Division does not dispute that the receipts at issue were royalty payments received from related members, including MA UK (***see*** Tax Law § 208 [9] [o] [1] [A], [C]), or the dollar amounts of such payments received.[21] Rather, the Division maintains only that petitioner is not entitled to deduct the same in its calculation of ENI in any event, because the amounts would not be required to be added back by the related member payors.

V. Tax Law § 208 (9) (o) (1) (A) defines a related member as:

> "a person, corporation or other entity, including an entity that is treated as a partnership or other pass through vehicle for purposes of federal taxation, *whether such person, corporation or entity is a taxpayer or not*, where one such person, corporation, entity or set of related persons, corporations or entities, directly or indirectly owns or controls a controlling interest in another entity. Such entities *may* include all taxpayers under articles nine, nine-A thirteen, twenty-two, thirty-two, thirty-three or thirty-three-A of this chapter." (emphasis added)

[21] The sub-issue concerning whether the portion of the payments received from petitioner's Alien Affiliate MA UK, that were booked and denominated as royalty payments were, in fact, royalty payments as opposed to receipts from sales, is dealt with in conclusions of law W and X. If such payments are not royalty payments, then the same would not be deductible under Tax Law former § 208 (9) (o) (3), even assuming petitioner's royalty payments received from its other Alien Affiliate related members may be deducted thereunder.

Tax Law § 208 (9) (o) (1) (c) defines royalty payments as:

> "payments directly connected to the acquisition, use, maintenance or management, ownership, sale, exchange, or any other disposition of licenses, trademarks, copyrights, trade names, trade dress, service marks, mask works, trade secrets, patents and any other similar types of intangible assets as determined by the commissioner, and includes amounts allowable as interest deductions ... to the extent such amounts are directly or indirectly for, related to or in connection with the acquisition, use, maintenance or management, ownership, sale, exchange or disposition of such intangible assets" (Tax Law § 208 [9] [o] [1] [C]).

W. Preliminarily, and as to the MA UK payments to MA, the Division asserts that all of the amounts that MA received from MA UK, including specifically the amounts denominated royalties, were simply payments of a percentage of MA UK's gross revenues from its sales, and that no portion of such payments constituted royalty payments under Tax Law § 208 (9) (o) (1) (c). The evidence does not support this assertion.

X. The payments at issue constituted royalties because such payments were made specifically in connection with the licensing of intangible assets. The disputed payments were calculated, and made, pursuant to a Revenue Allocation and Sublicensing Agreement between MA UK and MA. This agreement differs from the IP licensing agreements between petitioner and its other Alien Affiliates, which simply specified that the Alien Affiliates were allowed to exploit the licensed IP in specific territories for specific periods of time in exchange for a specified percentage of the particular Alien Affiliate's gross revenues, or in certain cases, for a specified dollar amount. By contrast, the MA UK agreement with MA specifically divided the payments from MA UK to MA, denominating a portion thereof (10% of MA UK's gross revenues), as sales revenues, and a separate portion thereof (20% of MA UK's net [or retained] revenues), as the sublicense fee MA UK was required to pay for the right to exploit, by

sublicense, the IP that MA itself licensed from MIS.[22] This distinction in payments by MA UK to MA, wherein a certain portion of MA UK's payment was simply a portion of its revenues, was justified upon the specific recognition that MA UK's business activities in its particular territory (Europe, Middle East and Africa) had "exhibited sufficient entrepreneurial innovation and risk-taking in the local market, *e.g.*, developing localized analytical tools and independently establishing local client relationships, [to be] eligible for participation in a Revenue Allocation Agreement . . . ." (***see*** finding of fact 115). MA UK's exploitation and use of the sublicensed IP in its territory merited such a "split payment" agreement, as based upon its own entrepreneurial accomplishments, and supported allowing MA UK to retain the lion's share of its own revenues. Consistently, this split payment appears as a total 28% payment of MA UK's gross revenue, booked as an 18% royalty payment for the sublicense of MIS's IP (a sublicense fee calculated as 20% of MA UK's allocated [or retained] gross revenue [which is 90% of MA UK's gross revenue]), plus 10% of MA UK's gross revenue. For the years in question (2011 and 2012), the federally reported, and New York state excluded, sublicense royalty portion of MA UK's total amounts paid to MA was $34,562,631.00 and $37,363,044.00, respectively. Such amounts, as reported on federal information reports (IRS forms 5471 and 8858), and on petitioner's federal consolidated income tax returns for the period at issue, were respected by the IRS as reported, i.e., as royalty payments, and there is no argument raised nor is it otherwise apparent that the royalty payment percentage or resulting dollar amounts were excessive or were otherwise

[22] The IP that MIS licensed to MA, that was in turn sublicensed by MA to MA UK, included credit research and opinion content, credit rating data, certain software, data models and other analytical tools related to assigning credit ratings, financial information data, MIS's analysis, and access to MIS's rating analyst's time.

unreasonable. In sum, petitioner's royalty receipts from its Alien Affiliates properly included the amounts reported as royalties received from MA- UK.[23]

Y. Having concluded that all of the payments received by petitioner from its related member Alien Affiliates were, as claimed, royalties, the remaining (and primary) issue is whether such amounts were properly deducted by petitioner from FTI in calculating its ENI. In 2003, the Legislature enacted essentially reciprocal exclusion/add back provisions concerning royalty payments made to, or received from, related members (***see*** L. 2003, ch. 62). For the years at issue, the modification under Tax Law former § 208 (9) (o) (3), known as the royalty income exclusion, provided as follows:

> "Royalty income exclusions. For the purpose of computing entire net income or other taxable basis, a taxpayer shall be allowed to deduct royalty payments directly or indirectly received from a related member during the taxable year to the extent included in the taxpayer's federal taxable income unless such royalty payments would not be required to be added back under subparagraph two of this paragraph or other similar provision in this chapter."

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[23] The total amounts reported by petitioner as royalties from Alien Affiliates (that were excluded under Tax Law § 208 [9] [o] [3]) totaled $112,484,988.00 (for 2011) and $126,564,533.00 (for 2012). Reducing such totals by the portion of such total royalty amounts attributable to MISQM and MIS for each year ($77,922,357.00 for 2011 and $89,211,489.00 for 2012), results in the amounts reported as royalty payments from MA UK (i.e., $34,562,631.00 for 2011 and $37,353,044.00 for 2012) to MA.

By contrast, calculating the royalty portion of the payment from MA UK to MA under the terms of the Revenue Allocation and Sublicense Agreement results in somewhat different (lower) royalty amounts ($1,701,613.00 for 2011 and $1,767,385.00 for 2012), as follows:

Year	2011	2012
MA UK gross revenue	$182,561,211.00	$197,698,104.00
less: 10% = allocated gross revenue	164,305,090.00	177,928,294.00
times 20% = royalty amounts	32,861,018.00	35,585,659.00
MA UK royalty as reported	$ 34,562,631.00	$ 37,353,044.00
MA UK royalty per Agreement	32,861,018.00	35,585,659.00
Difference	$ 1,701,613.00	$ 1,767,385.00

This difference in dollar amounts, as calculated above, is not further specifically explained in, or discernable from, the record.

In turn, the complementary reciprocal provision under Tax Law former § 208 (9) (o) (2), known as the royalty income addback, applicable to royalty payors, such as petitioner's related member Alien Affiliates, provided as follows:

> "(A) [F]or the purpose of computing entire net income or other applicable taxable basis, a taxpayer must add back royalty payments to a related member during the taxable year to the extent deductible in calculating federal taxable income."

Z. The addback provision initially included two exceptions, the Conduit Exception (Tax Law § 208 [9] [o] [2] [B] [i]), and the Treaty Exception (Tax Law § 208 [9] [o] [2] [B] [ii]), to the foregoing addback requirement, as follows:

> "(B) The add back of royalty payments shall not be required if and to the extent that such payments meet either of the following conditions:
>
> (i) the related member during the same taxable year directly or indirectly paid or incurred the amount to a person or entity that is not a related member, and such transaction was done for a valid business purpose and the payments are made at arm's length;
>
> (ii) the royalty payments are paid or incurred to a related member organized under the laws of a country other than the United States, are subject to a comprehensive income tax treaty between such country and the United States, and are taxed in such country at a tax rate at least equal to that imposed by this state;"

The statute was amended in 2007 to add another addback exception, the Combined Filing Exception, under Tax Law § 208 (9) (o) (2) (A), as follows:

> "Except where a taxpayer is included in a combined report with a related member pursuant to subdivision four of section two hundred eleven of this article, for the purpose of computing entire net income or other applicable taxable basis, a taxpayer must add back royalty payments to a related member during the taxable year to the extent deductible in calculating federal taxable income."

AA. Under Tax Law § 208 (9) (o) (3), in order to deduct the payments received from its Alien Affiliates petitioner must establish that the payments were royalty payments, were received from related members, and that the related members were required to add back the payments

under Tax Law § 208 (9) (o) (2). As concluded earlier, the payments in question were royalty payments (***see*** Tax Law § 208 [9] [o] [1] [C]); conclusion of law Y), and there is no dispute that the Alien Affiliates were petitioner's related members (***see*** Tax Law § 208 [9] [o] [1] [A]). Thus, the only question is whether the Alien Affiliates were required to add back the royalty payments.

BB. Under Tax Law § 208 (9) (o) (3), a taxpayer is allowed to deduct royalty payments from related members "unless such royalty payments would not be required to be added back under [Tax Law § 208 (9) (o) (2)] or other similar provision in this chapter." The royalty payments at issue here may not be deducted by petitioner because the Alien Affiliates were not federal taxpayers and were not New York taxpayers, and therefore were not subject to Tax Law § 208 (9) (o) (2). Thus they would not, and could not be required to add back the royalty payments they made to petitioner.[24]

CC. Petitioner maintains that if the Alien Affiliates were New York taxpayers, they would have been subject to the add back provision. In turn, and if none of the add back exceptions thereto, as specified at Tax Law § 208 (9) (o) (2) (A), (B) (i - ii) applied, the Alien Affiliates would have been required to add back their royalty payments, such that petitioner would then have been entitled to deduct such payments from FTI in computing its ENI. As the Division points out, to accept this position requires adding words that are not present in the statute, i.e., "if the Alien Affiliate royalty payors were New York taxpayers," so as to arrive at facts that are not present in this case, under which the Alien Affiliates would therefore be required to add back the

[24] Under Tax Law § 208 (9) (o) (2), "a taxpayer must add back royalty payments to a related member during the taxable year to the extent [such payments are] deductible in calculating [FTI]." Federal informational returns (IRS forms 5471 and 8858) were filed by petitioner reporting the royalty payments by the Alien Affiliates (***see*** finding of fact 107). However, there is no claim raised or evidence to show that the Alien Affiliates filed their own federal income tax returns reporting any income from U.S. sources, or were required to do so. Consequently, the payments the Alien Affiliates made to petitioner could not have been deducted (or deductible) in the calculation of FTI for such Alien Affiliates because they had no such income, thus leaving petitioner ineligible to deduct such payments in computing its ENI.

royalty payments. A royalty recipient, such as petitioner, cannot deduct royalty payments in computing ENI if those payments are not also required to be added back by the royalty payor under Tax Law § 208 (9) (o) (2).[25]

DD. Under the foregoing provisions, the Legislature established a symmetrical addback/ exclusion system, whereby royalty transactions between related members do not escape taxation altogether, but at the same time are subjected to tax only once. This system thus addresses the questions of where, and upon whom, i.e., payor or payee, the incidence of New York tax on the income will fall. If both the royalty payor and the royalty recipient are New York taxpayers, then the royalty payor is required to add back the otherwise deductible payments (**see** Tax Law § 208 [9] [o] [2]), while the royalty recipient is entitled, in turn, to exclude the payment from FTI in calculating its ENI (Tax Law § 208 [9] [o] [3]). The addback provision, without the complementing exclusion provision, would result in both the payor and the recipient being subjected to New York tax on the same income. As stated above, since the Alien Affiliates were not New York taxpayers, and they were therefore not subject to the add back provision, they could never be required to add back the royalty payments at issue. It follows, therefore, that petitioner was not entitled to deduct such payments under Tax Law § 208 (9) (o) (3).

EE. Petitioner also argues that the Division's interpretation of Tax Law § 208 (9) (o) violates the dormant Commerce Clause of the United States Constitution. Article I, Section 8, clause 3 of the United States Constitution gives Congress the power "to regulate commerce with foreign Nations, and among the several States. . . ." In addition to this express power to regulate

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[25] A New York royalty payor is not required to add back royalty payments if one of the exceptions under Tax Law § 208 (9) (0) (2) (A), (B) (i - ii) applies. If a New York royalty payor would not be required to add back its payments because such an exception applied, the New York royalty recipient would not be entitled to subtract the royalty payment in computing its ENI.

commerce, authority to "protect the free flow of commerce, and thereby safeguard Congress's latent power from encroachment by the several States" is available, under the dormant or negative Commerce Clause, when Congress has not affirmatively exercised its express Commerce Clause power (***Merrion v Jicarilla Apache Indian Tribe***, 455 US 130, 154 [1982]). The dormant Commerce Clause prohibits states from imposing taxes that "benefit in-state economic interests by burdening out-of-state competitors" (***Fulton Corp. v Faulkner***, 516 US 325, 330 [1996]). In ***Complete Auto Transit, Inc. v Brady***, 430 US 274, 279 (1977), the Supreme Court set forth a four-pronged test to determine whether a state tax violates the Commerce Clause. Pursuant to this test, a state tax will withstand a Commerce Clause challenge if the tax: (1) is applied to an activity having a substantial nexus with the taxing state; (2) is fairly apportioned; (3) does not discriminate against interstate commerce; and (4) is fairly related to the services provided by the state. Heightened scrutiny is required if foreign commerce is implicated (***see Japan Line, Ltd. v County of Los Angeles***, 441 US 434, 451 [1979]). Petitioner argues that the dormant Commerce Clause is violated here under the third prong of the ***Complete Auto*** test, the anti-discrimination requirement.

FF. A tax violates the Commerce Clause anti-discrimination requirement if it is "facially discriminatory, has a discriminatory intent, or has the effect of unduly burdening interstate commerce" (***Amerada Hess Corp. v Director, Div. of Taxation, NJ Dept of the Treasury***, 490 US 66, 75 [1989]). According to petitioner, providing the royalty income exclusion to the taxpayer only if the royalty payor is a New York taxpayer is facially discriminatory, and is per se invalid. At the administrative level, as here, statutes are presumed to be constitutional, and the Division of Tax Appeals' jurisdiction, as prescribed by its enabling legislation, does not encompass the authority to address a challenge that a statute is unconstitutional on its face

(***Matter of Fourth Day Enterprises***, Tax Appeals Tribunal, October 27, 1988; ***Matter of Unger***, Tax Appeals Tribunal March 24, 1994). However, the Division of Tax Appeals can determine whether the manner of the Division's application of a statute to the specific facts of a given case is constitutional (***Matter of David Hazan, Inc.***, Tax Appeals Tribunal, April 21, 1987, ***confirmed sub nom Matter of David Hazan, Inc. v Tax Appeals Trib. of State of N.Y.***, 152 AD2d 765 [3dDept 1989], ***affirmed*** 75 NY2d 989 [1990]; ***Matter of Waste Conversion***, Tax Appeals Tribunal, August 25, 1994). In such cases, petitioner bears the burden of proving such application to be unconstitutional (***see Matter of Brussel***, Tax Appeals Tribunal, June 25, 1992).

GG. To the extent petitioner asserts that, since the statute here allows the royalty exclusion to a taxpayer only if the royalty payor is a New York taxpayer, the same is invalid per se as discriminatory on its face, is a challenge beyond the jurisdiction of the Division of Tax Appeals (***see*** conclusion of law FF). Assuming, however, that petitioner's dormant Commerce Clause constitutional challenge is an as applied challenge, it is determined that petitioner has not sustained its burden of the proving a constitutional violation. "'[D]iscrimination' simply means differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter" (***Oregon Waste Sys., Inc. v Department of Envtl. Quality of Oregon***, 511 US 93, 99 [1994]). Tax Law former § 208 (9) (o) does not impose a heavier burden on the royalty transaction on the basis of where the royalty payor is located, and under the add back and exclusion provisions, the income in question is subjected to tax only once, regardless of whether the royalty payor is, or is not, a New York taxpayer. That is, where the royalty transaction occurs within New York, the New York royalty payor is required to add back the payment to its ENI, while the New York recipient is entitled to deduct the payment in calculating its ENI. Likewise, where the royalty transaction crosses state lines, the non-New York royalty payor is not required

to add back the payment to its ENI (because it is not a New York taxpayer), and (because the royalty payment is not required to be added back), the New York royalty recipient is not entitled to deduct the payment in calculating its ENI. Thus, the royalty payment is taxed to the same extent, only once, regardless of whether the transaction crosses state lines, and New York, therefore, does not favor intrastate commerce at the expense of interstate commerce. The addback and exclusion provisions work in symmetry to tax royalty transactions between related members once, but not twice. In fact, the addback and exclusion provisions of Tax Law former § 208 (9) (o) are only applicable if the payor and payee are related parties (***see*** Tax Law former § 208 [9] [o] [1] [A]). If the payor is not a related party, the royalty payment is included in the payee's FTI, and thus in its ENI, regardless of whether the payor is, or is not, a New York taxpayer, and the non-related royalty payor is not denied a deduction for the royalty payment expense. The Legislature established a system where royalty payments are taxed only once, but not a system where royalty payments escape taxation altogether. In sum, petitioner has failed to establish that in-state economic interests are benefitted to the detriment of out-of-state interests, and therefore has not established an as applied violation of the dormant commerce clause.

Inclusion of Captive Insurance Company in Combined Reporting Group

HH. The third issue concerns MAC, petitioner's wholly-owned subsidiary captive insurance company. The Division seeks to include MAC as part of petitioner's New York combined filing group, upon the premise that less than 50 percent of MAC's gross receipts for each of the years 2012, 2013 and 2014 consisted of premiums paid for providing bona fide insurance. Specifically, the Division asserts that risk shifting and risk distribution were not present in the relationship between and among MAC and the Moody's group, such that MAC did not provide bona fide insurance in exchange for the premiums it received, solely, from Moody's.

According to the Division, MAC was therefore an overcapitalized captive insurance company (OCCIC), as defined by Tax Law § 2 (11), and as such, was required to be included in the combined reports filed by Moody's, pursuant to Tax Law § 211 (4) (a) (7) (ii). The Division states that as an OCCIC, MAC was excluded by statute from the definition of an insurance corporation subject to tax under Tax Law article 33, and its tax filing as such was incorrect.

II. Petitioner counters that insurance corporations, including captive insurance corporations, are subject to tax under Tax Law article 33 (***see*** Tax Law § 1502-b [a]; Insurance Law § 7012), and are not subject to tax under Tax Law article 9-A. Petitioner acknowledges the above-noted exception, whereby a captive insurance corporation must be included in a combined report and subjected to tax under Tax Law article 9-A (or Tax Law former article 32) if it is an OCCIC. Petitioner asserts, however, that MAC was not an OCCIC. Petitioner points out that premiums are defined to include "all amounts received as consideration for insurance contracts," pursuant to Tax Law §§ 1502-b (c) and 1501 (c) (1), and argues that the Division's position that MAC did not provide bona-fide insurance relies incorrectly on an inapplicable and outdated definition of insurance for federal income tax purposes, rather than upon the specific definitions of insurance and premiums provided under New York's insurance law. Petitioner further maintains that even if the federal definition of insurance relied upon by the Division is applicable, MAC satisfies that definition because MAC's arrangement with Moody's did, in fact, provide risk shifting and risk distribution.

JJ. Insurance Law article 70, enacted in 1997, provides for the formation, licensing and operation of captive insurance companies within New York State (***see*** Insurance Law § 7001, *et seq*). In contrast to business corporations subject to tax under article 9-A, licensed captive insurance corporations, like other insurance corporations, are subject, in the first instance, to tax

under Tax Law article 33, and not under Tax Law article 9-A (***see*** Tax Law §§ 209 [4]; 1502-b). Thus, MAC may be permitted to file a tax return that is separate from its parent company Moody's return, and pay the special, and comparatively much lower, franchise tax on its premium income only, rather than the higher tax paid by most corporations under article 9-A (***id.; see also*** Insurance Law § 7012), so long as it does not fall within the definition of an OCCIC, under Tax Law § 2 (11).[26] MAC filed a separate New York return, and paid tax under article 33, based on its reported premium income, and argues that this was both legally required and factually appropriate.

KK. In 2009, the Legislature amended the tax law to provide that an OCCIC is excluded from the definition of an insurance corporation subject to tax under article 33, and is instead required to file a combined return under article 9-A. This amendment, and the rationale for its enactment, has been summarized as follows:

> "In 2009, responding to concerns that captives were depriving New York State of tax revenue on their nonpremium income by overloading their wholly owned insurance subsidiaries with property bearing no economic relationship to the writing of legitimate captive insurance policies, the legislature amended the law governing the taxation of captives (***see*** L 2009, ch 57, part E-1, § 1, adding subd [11] to then Tax Law § 2). For a captive to qualify for favorable tax status under the new law, the majority of the captive's revenue has to consist of "bona-fide" insurance premiums; a captive that does not satisfy that requirement is deemed an 'overcapitalized captive insurance company' (OCCIC). An OCCIC is required to file a combined return with its parent, paying taxes on all of its income at the corporate rate" (***Anonymous v Anonymous***, 165 AD3d 19, 23 [1ST Dept 2018]).

LL. As added, subdivision 11 of Tax Law § 2 defined an OCCIC to mean an entity that is treated as an association taxable as a corporation under the internal revenue code (IRC) and that meets the following requirements:

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[26] The article 33 franchise tax rate on premium income only, commences at 0.4% on the first twenty million dollars in direct premiums, and decreases thereafter as the dollar amount of direct premiums increases until the rate is reduced to 0.075% on direct premiums in excess of sixty million dollars. By contrast, the article 9-A, ENI-based, franchise tax rate was 0.71% (***see*** Tax Law §§ 1502-b; 210).

> "(1) more than 50 percent of its voting stock is owned or controlled directly or indirectly by a single entity that is treated as an association taxable as a corporation under the ITC and not exempt from federal income tax;
>
> (2) that is licensed as a captive insurance company in New York State or another jurisdiction;
>
> (3) its business includes providing insurance or reinsurance covering the risks of its parent or members of its affiliated group; and
>
> (4) 50 percent or less of its gross receipts for the taxable year consist of premiums."

MM. Tax Law § 2 (11) provided that "'premiums' [shall have] the same meaning as that term is given in [Tax Law § 1510 (C) (1)], i.e., "any amount received by a captive insurance company as consideration for insurance provided . . . to its parents and affiliated companies" (***see*** Tax Law §§ 1502-b [c], 1510 [c] [1]), "*except that it includes consideration for annuity contracts and excludes any part of the consideration for insurance, reinsurance or annuity contracts that do not provide bona fide insurance, reinsurance or annuity benefits;*" (***see*** Tax Law § 2 [11] [emphasis added]). Further, Tax Law § 2 (11) (4) (a) (7) was added to require a captive insurance company to be included in an article 9-A combined return, as follows:

> "[a]n [OCCIC] must be included in a combined report with the corporation that directly owns or controls over fifty percent of the voting stock of the [OCCIC] if that corporation is subject to tax or required to be included in a combined report under [article 9-A]" (***see*** Tax Law § 211 [4] [a] [7] [ii]).

NN. The parties do not dispute that MAC meets the first three requirements of Tax Law § 2 (11), and thus the only question presented is whether Moody's payments to MAC are "premiums" for "bona-fide" insurance, reinsurance, or annuity benefits. If so, then MAC was not an OCCIC, and properly filed its returns and paid franchise tax on its premium income under article 33. If not, then MAC was required to be included in Moody's combined filing group and subjected to tax under article 9-A.

OO. The Division notes, and petitioner does not dispute, that the premiums paid by Moody's to MAC did not qualify as a deductible business expense for federal income tax purposes under the IRC and related regulations (***see*** IRC § 162 (a); 26 CFR 1.162-1 [a]). In fact, petitioner considered, but did not pursue, qualifying MAC as an insurance company for federal income tax purposes. The consequences of that decision admittedly included the loss of potential federal and state tax benefits (***see*** finding of fact 145). The fact that Tax Law article 9-A includes no modification or adjustment among those specified in Tax Law § 208 (9) (a - q) allowing subtraction of insurance premiums in calculating ENI supports the intent and conclusion that any reduction for such premiums is only available at the federal level. That is, if an insurance company, including a captive insurance company, qualifies as such under the IRC, and is thus entitled to the benefit of the deduction of premiums at the federal level in arriving at FTI (the starting point for determining ENI), then that reduced FTI amount simply travels down to become the starting point from which ENI is determined. The absence of any modification under Tax Law § 208 (9) strengthens the conclusion that the federal income tax standard as to premium deductibility, available to federally qualified insurance companies, is the appropriate standard for determining whether bona fide insurance is being provided, as relevant here for purposes of determining whether a captive insurance company, like MAC, is overcapitalized and thus subject to inclusion in a combined group return, pursuant to Tax Law § 2 (11) (***see Matter of Stewart's Shops Corporation v Tax Appeals Tribunal, et al.***, 172 AD3d 1789 [3d Dept, May 23, 2019]; ***see also Anonymous v Anonymous***).[27]

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[27] MAC is part of petitioner's federal consolidated tax reporting and filing group, and the premiums petitioner pays to MAC are restored at the federal level by virtue of intercompany elimination (***see*** finding of fact 146). Such nondeductible premium amounts are included in petitioner's FTI, and are not allowable as a modification reducing petitioner's FTI in arriving at its New York ENI for lack of such a subtraction modification among those set forth in Tax Law § 208 (9) (a) - (q) (***see Matter of Stewart's Shops Corp.***). The absence of such a subtraction

(continued...)

PP. Petitioner's first argument is that MAC was a captive insurance company licensed by DFS, that carried on a captive insurance business as such, and therefore met the definition of an insurance company under Insurance Law § 1500 (a), so as to be properly and only subject to the captive premiums tax based on gross direct premiums under Tax Law § 1502-b. Petitioner's argument fails to reconcile with the impact of Tax Law § 2 (11) on the definition of premiums, under Tax Law § 1510 (c), and in conjunction with Tax Law § 211 (4) (A) (7) (ii), its potential direct impact of changing the manner in which captives are otherwise subjected to tax, i.e., on premiums under Tax Law § 1502-b. A comparison of the relevant statutory language makes clear that a *captive* insurance company licensed as such under the Insurance Law, can at the same time, be an *overcapitalized captive* insurance company, under Tax Law § 2 (11), and that differing tax consequences, as here, follow therefrom. In ***Anonymous v Anonymous***, the First Department rejected the petitioner's argument on the law, stating clearly as follows:

> "We similarly reject [the] argument that DFS's licensure or oversight . . . should be construed as an endorsement of [a captive's] tax filings . . . . In order to be licensed, a captive must meet the requirements set forth in article 70 of the Insurance Law. The requirement that insurance be bona fide is contained in the Tax Law, not article 70 of the Insurance Law (Tax Law § 2 [11]). A review by [DFS] would not concern itself with determining the bona fide status of insurance, nor with determining if a captive insurer is combinable under section 1502-b of the Tax Law.
>
> It is true that upon initial application [DFS] must evaluate the captive's assets and liquidity 'relative to the risks assumed,' as well as the 'overall soundness of the plan' (Insurance Law § 7003 [c] [2] [A], [C]). However, license renewals do not entail the substantive review suggested by defendants. [DFS] is not obligated to revoke a captive's license for not providing bona fide insurance, nor is revocation required when the conditions under section 7008 are met. Similarly, the five-year examinations contemplated under section

[27](...continued)
modification under Tax Law § 208 (9) also lends support not only to the conclusion that the federal income tax standard was the correct standard for determining the bona-fides of insurance arrangements during the years in issue, but also that the 2014 amendment to Tax Law § 2 (11) [replacing the term OCCIC with "combinable captive insurance company," and specifying that to avoid classification as combinable at least 50% of a captive's premiums must be from arrangements that constitute insurance for federal income tax purposes] was, as the Division argues, essentially a clarifying amendment.

> 7007 do not entail review of factors relevant to a captive's tax status" (***Anonymous v Anonymous***, 165 AD3d at 29).[28]

Thus, the Court recognized that while DFS regulates the insurance business of a captive, the Division regulates the taxation of a captive.

QQ. Petitioner's other main assertion is that federal case law concerning the definition of "insurance," for purposes of the deductibility of premium expense in calculating federal taxable income, is not applicable here to determine the bona-fides of the insurance provided by MAC. In order to be considered premiums for purposes of the Tax Law, payments must be received in exchange for arrangements that constitute the provision of insurance coverage, the hallmark of which is the existence of risk shifting (viewed from the perspective of the insured) and risk distribution (viewed from the perspective of the insurer). In ***Matter of Stewart's Shops***, the Third Department confirmed the Tribunal's decision that a parent company's payments to its wholly-owned captive insurance company were not deductible for federal income tax purposes, and in turn, were not otherwise allowable as a modification reducing FTI in calculating ENI for purposes of the franchise tax under Tax Law article 9-A (***id.***; ***see*** conclusion of law A [ENI is presumptively FTI, prior to statutorily enumerated modifications under Tax Law former § 208 (9) (a - q)]). The Tribunal's holding, based on federal tax law, was that risk shifting and risk distribution are necessary elements of bona fide insurance (***see Matter of Stewart's Shops Corporation***, Tax Appeals Tribunal, July 27, 2017). On this issue, the Tribunal stated:

> "Premium payments for insurance may be deducted from gross income in the calculation of FTI as an ordinary and necessary business expense pursuant to Internal Revenue Code

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[28] Petitioner asserts that ***Anonymous v Anonymous***, an opinion affirming the New York State Supreme Court's refusal to dismiss a qui tam False Claim Act complaint against petitioner, is irrelevant to this matter, specifically with respect to the Court's conclusions that (i) reference to federal case law to determine whether insurance coverage offered by a captive is "bona-fide," and (ii) DFS licensure alone is insufficient to serve as an endorsement of a captive's tax filings. The First Department's conclusions on applicable law, as set forth herein, are clearly relevant, and petitioner's contention to the contrary is rejected.

> (26 USCA) § 162 (a) (***see also*** Treas Reg [26 CFR] §1.162-1 [a]). Such a payment is not deductible per se, however, as the existence of insurance for federal tax purposes and the consequent deductibility of a premium payment is contingent on, among other things, the presence of risk-shifting and risk distribution in the insurance arrangement (***see e.g. Helvering v Le Gierse***, 312 US 531 [1941]; ***Securitas Holdings, Inc. v Commr***., TC Memo 2014-225 [2014]). These two factors are typically present when insurance is provided by a third-party commercial insurer. Such traditional insurance shifts the risk of loss from the insured to the insurer, who, in turn, distributes the risk among the insurer's many policy holders. These factors are not present when a captive insurance company accepts premium payments only from its parent, as in the present matter. Under such circumstances, there is no shift in the risk of loss, as it remains, in economic reality, with the parent, and there is no distribution of the risk among other insureds, as there are no other insureds (***see e.g. Stearns-Roger Corp. v US*** 774 F2d 414 [10th Cir 1985]; ***Humana Inc. v Commr***., 881 F2d 247 [6th Cir 1989]).[29]

Other than circling back to the broad concept of insurance, petitioner's argument both fails to provide any "alternative state formulation of 'insurance' or otherwise demonstrate that the definition of 'insurance' in this state differs from the federal one" (***see Matter of Stewart's Shops Corporation; see also Anonymous v Anonymous*** at 28).

RR. Petitioner also maintains that even if the federal definition of insurance, and specifically its reliance upon the need to show risk shifting and risk distribution for purposes of determining the bona fides of such insurance applies, more recent federal case law has clarified how to determine whether risk shifting and risk distribution are present in a captive insurance company situation by focusing on: a) an analysis of the assets of the insureds (***see Humana Inc. v Comm'r***), and b) upon the number of "statistically independent risk exposures" covered rather than simply upon the number of insureds (***id.***; ***see Securitas Hldgs. v Comm'r***, T.C. Memo 2014 - 225 [U.S. Tax Ct. Oct. 29, 2014]; ***Rent-A-Center, Inc. v C.I.R.***, 142 TC 1 [US TC 2014]). Under these cases, the courts focused upon premiums paid by affiliated subsidiary corporations to

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[29] The risk-shifting and risk distribution requirements remain even where, as in the present matter, the captive insurer is authorized to operate as such under state law (***see e.g. Clougherty Packing Co. v Commissioner*** (811 F2d 1297 [9th Cir 1987]; ***Humana Inc. v Commr.***). Hence, insurance for state licensing and regulatory purposes is not necessarily insurance for federal tax purposes.

the captive (***see Securitas Hldgs. v Comm'r; Rent-A-Center v C.I.R.)***, or by the parent to the captive but allocated to (and thereby presumably recognized as an expense by) the subsidiary corporations (***see Humana, Inc., v Commr***). These situations were held to involve risk shifting and risk distribution, and were thus payments of premiums for bona fide insurance, and hence were deductible for federal income tax purposes. The courts focused on the reality of the subsidiaries' separate corporate existence for tax purposes, rather than upon treating the parent, the subsidiaries, and the captive as one economic unit. The courts reasoned that by their payments of premiums, the subsidiaries divested themselves (i.e., their own assets) of the otherwise adverse consequences of a claim covered by the insurance policies obtained (***see Securitas Holdings, Inc.***). Accordingly, the courts found that risk shifting was present because, unlike premium payments made by the parent corporation to the captive, payment on a claim from the captive to a subsidiary did not reduce the net worth of the subsidiaries, since, unlike the parent, the subsidiaries owned no stock in the captive (***see Rent-A-Center***; ***Securitas Holdings, Inc.***). The courts also found risk distribution based on the fact that the captive insurer's undertaking of the risks of numerous subsidiaries resulted in a pool of risks spread among the various subsidiaries in the pool (***id.***). Essentially, under the facts, the subsidiaries were treated as though they purchased insurance from a third-party insurer, notwithstanding that the insurer was, in fact, a captive. As noted earlier, petitioner considered these very same options, likewise recognized by the Appellate Division in ***Stewart's***, i.e., insuring brother and sister companies with reasonable risk distribution among such entities, and/or insuring unrelated third parties, so

as to qualify for federal income tax purposes, but chose not to pursue such options. Presumably, petitioner's choice in this regard was made based upon other valid, not-tax business reasons.[30]

SS. Here, Moody's alone paid premiums to MAC. Such premiums were not allocated out to any of the subsidiary entities, and Moody's was the policy holder in all instances. As such, any policy payment on a covered risk by MAC to Moody's, or to any other covered subsidiary, ultimately impacts Moody's balance sheet and net worth, as a restoration of value to Moody's with a concomitant reduction in the value of MAC. The facts thus reveal a lack of risk shifting and risk distribution. Therefore, petitioner's payments of premiums to MAC were not premiums paid for bona fide insurance. Accordingly, the Division properly determined that MAC was an OCCIC, and was required to be included in Moody's combined returns for the years 2012 through 2014.

Penalties

TT. The fourth and final issue is whether petitioner has established any bases upon which penalties imposed by the Division for substantial understatement of tax under Tax Law § 1085 (k) should be reduced or cancelled. A "substantial understatement of tax" exists if the amount the understatement for any taxable year exceeds the greater of ten percent of the tax required to be shown on the return for the taxable year or five thousand dollars" (Tax Law § 1085 [k] [1]). The penalty may be waived, in full or in part, if the taxpayer establishes that there was reasonable cause for the understatement and that the taxpayer acted in good faith (***id.***). In addition, the amount of understatement may be reduced by the portion thereof attributable to the tax treatment

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[30] In ***Stewart's***, the Appellate Division specifically stated that "[u]nder federal law, petitioner could have structured its arrangement with [its captive] in such a way that the requisite risk shifting and risk distribution were present such that petitioner's payments to [its captive] would have, in fact, met the criteria for bona fide insurance payments and been tax deductible under federal law - [the captive] could have, among other things, insured affiliated companies, formed a group captive insurance company or reinsured its risk with a third-party insurer (***see e.g. Rent-A-Center, Inc. v C.I.R.***, 142 TC 1, 13 [US TC 2014])."

of any item for which there was substantial authority, or if the relevant facts were adequately disclosed on the taxpayer's return (Tax Law § 1085 [k] [2]).

UU. In this matter, petitioner has not established that the foregoing factors allowing for penalty reduction or cancellation apply. To the contrary, petitioner's filing position regarding its sourcing of credit ratings receipts was not in accord with any of the then-recognized methods for such sourcing. Further, petitioner's filing positions regarding its exclusion of MAC from its combined filing group, and its exclusion of the royalty payments received from its Alien Affiliates, have been rejected herein. A statutory interpretation and filing position that disregards a portion of a statute (as to the former), and the lack of authority for deducting royalty payments (as to the latter), does not constitute substantial authority. Furthermore, misinterpretation of a statute, or petitioner's reliance on its own interpretation, without more, does not constitute reasonable cause for abatement (***see Matter of Barker***, Tax Appeals Tribunal, January 26, 2012 [good faith in an incorrect legal interpretation does not constitute reasonable cause]). In this case, there were no statements set forth on petitioner's returns regarding any of these matters that, in conjunction with the dollar amounts reported on such returns, might be considered adequate disclosure. Finally, and notwithstanding the liability reduction resulting from the discretionary adjustment as to sourcing, granted upon the reasons set forth in this determination, there remains a significant understatement of liability.[31] Accordingly, the Division's imposition of penalties based on the existence of a substantial understatement of tax liability for each of the years at issue is sustained.

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[31] Even as adjusted by the Division for 2014, and herein for 2011 through 2013, the resulting percentages of credit ratings receipts allocable to New York for such years, and hence the amounts of tax due thereon, were still more than twice the 6.28 percent of such receipts allocated to New York by petitioner, and the amounts of tax due thereon, as reported by petitioner on its franchise tax reports as filed (***see*** findings of fact 6 through 8).

VV. The petitions of Moody's Corporation & Subsidiaries are hereby granted to the extent provided under conclusion of law S (adjustment of petitioner's BAP computation for the years 2011 through 2013 based upon destination sourcing of credit ratings receipts), but are otherwise denied; the notice of determination dated November 28, 2016 (pertaining to the years 2011 through 2013) is to be adjusted and reduced in accordance with the foregoing (***see*** findings of fact 8, 33, 207 through 209); and that notice, as so adjusted, together with the notice of determination dated March 7, 2017, are hereby sustained.

DATED: Albany, New York
October 24, 2019

/s/ Dennis M. Galliher
ADMINISTRATIVE LAW JUDGE

ADDENDUM I

tr. page 38/line 10:
--insert “perspective” after “tax”--(see quote at ex A, page 1437).

tr. page 129/lines 6/7:
--delete “risk shift and redistribution” and replace with “risk shifting and risk distribution”--contextually consistent with subsequent testimony: (see transcript page 129/lines 12/13; 140/lines 8, 14/15).

tr. page 136/line 5:
--delete “15.10(c)1” and replace with “”1510 (c) (1)”--(to reflect correct statutory citation).

tr. page140/line 18:
--delete “two entities captive” and replace with “two entities, [the] captive, and”–(corrects context).

tr. page 153/line 24:
--delete “pint” and replace with “point”–(corrects misspelling).

tr. page 166/line 21:
--delete “for” and replace with “or”–(corrects misspelling and context).

tr. page 291/line 5:
--delete “Investors” and replace with “investing”–(corrects context).

tr. page 314/line 19:
--delete “publish” and replace with “publishing”–(corrects context).

tr. page 316/line 24:
--delete “that think” and replace with “think that”–(corrects word transposition).

tr. page 354/line 4:
--delete “income” and replace with “annual”–(see ex. AA, form title).

tr. page 357/line 15:
--delete “ examines” and replace with “examine”–(corrects context).

tr. page 366/lines 17/19-22/24, and tr. page 367/lines 2/4-14/16-17:
-- replace quote, as transcribed from testimony, so as to conform same to quoted language from document–(see ex A, vol. II, p. 1158, § 1.22).

tr. page 331/line 9:
--testimony correctly transcribed--re: title of addendum referenced in testimony–(see ex. 15, page 133).

tr. page 338/line 14:
--delete “issuer fee” and replace with “issuer-pay”–(corrects transcription of quoted material: see ex 15, page 134).