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State & Local Tax Advisory ■

**APRIL 9, 2020**

# NY Tribunal Disallows Broker-Dealer Sourcing for Receipts from a Disregarded LLC

In a case with sweeping ramifications and millions at stake for taxpayers, the New York Tax Appeals Tribunal issued an opinion on March 24, 2020 in *BTG Pactual NY Corporation* upholding the administrative law judge (ALJ) opinion and denying the taxpayer's refund request. Through its opinion, the Tribunal ruled that BTG, as the sole member of two limited liability companies, one of which is a registered broker-dealer, could not use the broker-dealer customer-based sourcing rule to source receipts from the other LLC. Unless this ruling is overturned on appeal, the Tribunal's decision will have a significant impact for many taxpayers that relied on the Division of Taxation's prior advisory opinions that concluded that "if a SMLLC that is treated for tax purposes as a disregarded entity is a registered broker-dealer, its single member should be treated for purposes of the allocation rules under Tax Law § 210.3(a)(9) as a registered broker-dealer."

## Special Broker-Dealer Sourcing

BTG is the sole member of BTG Pactual US Capital LLC (US BD), a registered broker-dealer, and BTG Pactual Asset Management US LLC (US AM), registered as an investment adviser with the SEC. BTG elected to treat both LLCs as disregarded entities for federal and New York tax purposes.

For the tax years at issue, 2012 and 2013, the general rule in New York required that receipts be sourced based on the traditional cost of performance method. However, registered brokers or dealers can use a rule to source receipts based on customer location. On its originally filed franchise tax returns, BTG sourced receipts from US BD using the customer-based rule for broker-dealers and receipts from US AM using cost of performance. BTG later filed amended franchise tax returns to also source receipts from US AM using the broker-dealer rule. BTG filed amended returns to reflect that US BD is disregarded and a registered broker-dealer such that BTG is treated as a registered broker-dealer for tax purposes, allowing it to use the broker-dealer sourcing rules for receipts from both LLCs. Based on the amended returns, BTG sought a refund of approximately $7.4 million.

In March 2019, the ALJ rejected BTG's argument that it should be treated as a broker-dealer because US BD is a disregarded entity for federal and New York tax purposes. The ALJ concluded that the statutory text

of the sourcing rules for broker-dealers was unambiguous and that the check-the-box regulations "do not dictate whether US AM's receipts are broker dealer receipts." The ALJ asserted that BTG had intentionally used two separate LLCs for its operations and thus it was bound by the tax consequences of the form chosen.

## The Tribunal Decision

The Tribunal endorsed the ALJ's analysis and concluded that the broker-dealer sourcing rule unambiguously states that it only applies to registered broker-dealers and that the check-the-box rules did not dictate the sourcing for receipts from BTG's non-broker-dealer LLC, US AM. The Tribunal ruled that because US AM was not itself a registered broker or dealer with the SEC, BTG Pactual was not entitled to source receipts from US AM under the broker-dealer sourcing rules of Tax Law former § 210(3)(a)(9) even though its disregarded SMLLC was a broker-dealer.

From our perspective, the Tribunal endorsed and adopted a significant flaw in the ALJ's reasoning. As BTG argued, by conforming to the federal check-the-box rules, New York views a single-member disregarded LLC as indistinguishable from its owner. As a result, the ALJ misconstrued the issue of whether US AM's receipts are broker-dealer receipts even though not registered as a broker-dealer with the SEC. The analysis should have focused on whether BTG, as the *taxpayer* and the single member of both US AM and US BD, is a registered broker-dealer and thus entitled to source receipts as a broker-dealer under the plain language of the law. If US BD is disregarded for New York tax purposes under the check-the-box regulations, then BTG is a registered broker-dealer for tax purposes and should be entitled to use customer sourcing for all receipts based on the unambiguous language of the sourcing rule.

## Past Advisories Many Taxpayers Relied On

The Division has previously endorsed the view that the single member of a disregarded LLC under the check-the-box rules should be treated as a broker-dealer if the LLC is registered as such with the SEC. In TSB-A-13(11)C (Dec. 20, 2013), the Division reasoned that because a single-member LLC "that is treated as an entity disregarded from its single member for federal tax purposes will be disregarded for State tax purposes," a corporation that was not itself a registered broker-dealer would be treated as such because several of the single-member LLCs that it owned were registered broker-dealers. The Division reached a similar conclusion in TSB-A-16(1)C (Jan. 11, 2016). The Division's position was later reversed through an Office of Counsel memorandum, NYT-G-17(2)C (Aug. 2, 2017), through which the prior interpretation was changed to reflect that only receipts from a disregarded LLC that is registered as broker-dealer are eligible for sourcing under the special sourcing rule.

These TSBs are not binding or precedential; however, they do reveal that the Division previously concurred with the arguments made on appeal by BTG. These TSBs also signal the magnitude of the issue decided by the Tribunal because many taxpayers relied on the position asserted by the Division in its TSBs—taxpayers that may have millions of tax dollars on the line now that the Division has argued and prevailed on the opposite view.

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If you have any questions or would like additional information, please contact your Alston & Bird attorney or any of the following:


Mary T. Benton
404.881.7255
mary.benton@alston.com

Clark R. Calhoun
404.881.7553
clark.calhoun@alston.com

John L. Coalson, Jr.
404.881.7482
john.coalson@alston.com

Kathleen Cornett
404.881.4445
kathleen.cornett@alston.com

Michael M. Giovannini
404.881.7957
michael.giovannini@alston.com

Zachry T. Gladney
212.210.9423
zach.gladney@alston.com

Matthew P. Hedstrom
212.210.9533
matt.hedstrom@alston.com

Kendall L. Houghton
202.239.3673
kendall.houghton@alston.com

Joshua Labat
212.210.9569
josh.labat@alston.com

Maryann Luongo
202.239.3675
maryann.luongo@alston.com

Ethan D. Millar
213.576.1025
ethan.millar@alston.com

Michael T. Petrik
404.881.7479
mike.petrik@alston.com

Andrew W. Yates
404.881.7677
andy.yates@alston.com


ALSTON & BIRD

WWW.ALSTON.COM