NEW YORK CITY TAX APPEALS TRIBUNAL

In the Matter of	:	DECISION
THE MCGRAW-HILL COMPANIES, INC.	:	TAT (E) 10-19 (GC) et al.
Petitioner.	:	

The Commissioner of Finance of the City of New York (Respondent) filed an exception to a Determination of the Chief Administrative Law Judge (CALJ) dated February 24, 2014 (CALJ Determination), which cancelled Notices of Disallowance of refunds of New York City General Corporation Tax (GCT) issued by the New York City Department of Finance (Department) for The McGraw-Hill Companies, Inc. (Petitioner) for its tax years ending December 31, 2003 through December 31, 2007 (Notices of Disallowance). The CALJ Determination also cancelled a Notice of Determination issued by the Department (Notice of Determination) to the extent it asserted deficiencies of GCT for the tax years ending December 31, 2006 and December 31, 2008 based on using a place-of-performance method to allocate Petitioner's receipts from providing credit ratings.[1] The CALJ Determination sustained so much of the Notice of Determination as asserted a GCT deficiency based on the disallowance of Petitioner's use of a double-weighted receipts allocation factor for the 2006 tax year. Petitioner did not file a cross-exception to that portion of the CALJ Determination.[2]

Respondent appeared by Frances Henn, Esq., Senior Counsel of the New York City Law Department. Petitioner appeared by Peter L. Faber, Esq., and Maria P. Eberle, Esq., of McDermott Will & Emery LLP.

---

[1] The Notices of Disallowance and the Notice of Determination are referred to as the Notices.
[2] Brief for Petitioner (Pet brief) at 11, n 16.

Petitioner is a New York corporation having executive offices in New York City (City).[3] During the calendar years ending December 31, 2003 through December 31, 2008 (Tax Years), Standard & Poor's (S&P) was an unincorporated division of Petitioner.[4] S&P was headquartered in the City but conducted business throughout the world and had offices and affiliates in 27 countries. S&P is a leading supplier of information about financial markets and has several business units, the largest of which is a credit ratings business. S&P provides credit ratings, indices, risk evaluation and investment research and data that are used by individual and institutional investors, brokerage firms, the federal and state governments and by the debt issuers themselves. S&P is hired by debt issuers and intermediaries to prepare credit ratings. S&P provides public ratings, private ratings and confidential ratings. (Tr at 48.) Public ratings are prepared for the use of investors, intermediaries (e.g., investment banks) and the issuers. The United States Securities and Exchange Commission and other regulators require these ratings to be made public. (Tr at 46.) Confidential and private ratings are issued either for the issuer's own use or for limited distribution to qualified sophisticated investors. (Tr at 44-45; Respondent's exhibit [Resp exhibit] 19.) However, if S&P learns that the issuer or another party has made a private or confidential rating public, S&P will publish the rating as well. (Resp exhibit 19.) Confidential and private ratings represent a very small portion of S&P's ratings. (Tr at 48.)

S&P provides "issuer ratings" that address the issuer's overall ability to meet its financial commitments on a long and short term basis. S&P also provides "issue ratings" that address the issuer's creditworthiness with respect to a specific financial obligation, class of financial obligations or a specific financial program.

---

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

[4] Effective January 1, 2009, Petitioner transferred the United States operations of S&P into Standard & Poor's Financial Services LLC, a Delaware limited liability company that at the time of the CALJ Determination was a subsidiary of Petitioner. (Petitioner's Exhibit (Pet exhibit) E 1, S&P's First Supplemental Response to Question 1.) Except as otherwise specifically stated, all descriptions of S&P's activities and business applied during the Tax Years.

S&P's ratings are not recommendations to purchase, sell or hold a particular security nor do they comment on the suitability of an instrument for any particular investor. Generally a security with a higher rating is more marketable and more acceptable to an investor than a similar security with a lower rating. (Stipulation at ¶4.)

In deriving a rating, S&P's staff conducts a detailed analysis of information from the issuer as well as information from other sources deemed reliable by S&P. During the Tax Years, S&P had approximately 1,200 analysts in various offices who prepared the ratings. (Tr at 38.) A ratings committee reviews and approves a rating before it is communicated to the issuer. (Tr at 38.) The issuer can appeal the proposed rating and may provide additional information but the decision to issue or not issue the rating belonged to S&P alone. (Tr at 42-43.)

Petitioner's Vice President of Marketing Development, Bruce Schachne, testified that Petitioner's clients consist of investors, issuers and intermediaries (banks and other financial institutions that enable issuers to raise money in capital markets.) (Tr at 53-54.) He testified that about 85-90% of Petitioner's marketing budget and personnel is devoted to marketing to investors. (Tr at 54.) Marketing to investors includes personal meetings between analysts and investors and digital marketing using technologies such as videos, podcasts, websites and iPad applications. (Tr at 56.)

After a rating is made public, S&P conducts ongoing surveillance or monitoring of relevant information for the term of the rated instrument to determine if a rating should be modified. Any changes to a rating are reviewed, submitted to the issuer and made public in the same manner as the original rating. (Tr at 40-41.) S&P may withdraw a rating if sufficient information to continue the monitoring is unavailable. (Tr at 44; Resp exhibit 19.)

Originally S&P used a business model whereby its ratings were available only to subscribers who paid for S&P's various publications. (Tr at 34.) However, for over 30 years, S&P has used an "issuer pays" model under which the issuer pays S&P for preparing a rating and conducting ongoing monitoring. (Stipulation at ¶9.) The S&P office having the relationship with the issuer enters into an agreement under which the

issuer pays an initial fee, generally based on a percentage of the offering or a fixed fee, in the case of a general rating of the issuer. (Stipulation at ¶11.) A surveillance charge for ongoing monitoring is agreed upon for the term of the rating. If, after receiving the proposed rating, an issuer decides not to go forward with the rating, the contract requires the issuer client to pay for S&P's time and expenses of preparing the proposed rating. (Resp exhibit 19.)

Once a public rating is finalized, S&P makes the rating publicly available free of charge on its website, www.standardandpoors.com (S&P.com) and through a press release. (Tr at 35.) S&P also makes ratings available on its other websites available by subscription, through its other publications and through free "electronic newsletters, videocasts, and podcasts." (Pet exhibit C.) S&P's ratings are also available through third parties that obtained the press releases. Patrick Milano, Petitioner's Executive Vice President and Chief Financial Officer and Chief Administrative Officer of the McGraw-Hill Education Group, testified that "ratings are picked up almost by every sort of republisher of news that is around." (Tr at 35, 57.)

To view ratings on S&P.com, a user must register for an account and agree to the terms of use, including an acknowledgement that the ratings are the intellectual property of S&P. (Pet exhibit B.) However, there is no charge to use S&P.com. (Tr at 125-26; Stipulation at ¶8.)

For the Tax Years, Petitioner was subject to the GCT and timely filed its GCT returns.[5] Petitioner filed Forms NYC-3360 for the 2003 through 2005 Tax Years to report changes resulting from Internal Revenue Service audits and paid additional GCT. The Department audited Petitioner's GCT returns for the 2003 though 2005 Tax Years (Audit). On its original returns for the 2003 through 2007 Tax Years, Petitioner allocated receipts from its credit ratings business using a method based on the location of its employees who generated those ratings, i.e., a place-of-performance method. In a letter to the auditor dated February 6, 2008, Petitioner said:

[5] The returns were filed pursuant to properly filed requests for extension of the time to file the returns.

> S&P Ratings Services[6] are securities ratings services which are the review and analysis of debt instruments or other securities. . . .
>
> S&P Ratings Services are primarily headquartered in New York City. Since this is an *individualized service*, all revenue generated out of the NYC office has been reported . . . on an origin basis. (Emphasis added.) (Resp exhibit 7 at ¶6.)

The Department issued a Notice of Audit Result dated September 30, 2008 stating that no adjustment was necessary. (Resp exhibit 4.)

On its original returns for the 2003 through 2007 Tax Years, Petitioner allocated receipts from its credit ratings services using a method based on the location of its employees who generated those ratings, i.e., a place-of-performance method. However, Petitioner filed with the Department a request for a private letter ruling dated November 19, 2008 (Ruling Request) asking for a ruling that:

> "receipts derived from its Ratings Business constitute 'other business receipts' for allocation purposes under the GCT . . . [and] that such other business receipts are earned at the location of the debt issuers for allocation purposes under the GCT." (Pet exhibit C.)

In the Ruling Request, Petitioner asserted that:

> "While the value of an S&P credit rating accrues to the world-wide investing public, for the sake of administrative ease, [Petitioner] suggests that the location of the debt issuer, as opposed to the individual users of the ratings (i.e., investors and other lenders who are spread across the globe), is an efficient and satisfactory proxy." (Pet exhibit C, Attached Statement at 7-8.)

---

[6] Resp exhibit 7 does not identify S&P Ratings Services as an entity. That same letter contains the following statement: "Our Standard & Poor's Division, whose activities, which include Debt Rating (*see response to #6*), are heavily concentrated in NYC." (Emphasis added.) Resp exhibit 7, at ¶5. Thus, it appears that the reference in ¶6 is to the activities of S&P.

Although the Department exchanged substantial correspondence with Petitioner regarding the Ruling Request between November 2008 and May 2009, the Department did not issue a ruling.

In connection with the Audit, Petitioner signed waivers on July 12, 2007 and again on June 18, 2008 ultimately extending the limitations period for assessing additional tax for the 2003 and 2004 Tax Years to March 31, 2009. (Resp exhibit 7.) On amended GCT returns filed March 25, 2009 and November 24, 2009 (Amended Returns), Petitioner claimed refunds of GCT for the Tax Years 2003 through 2007 based on allocating receipts from S&P's ratings business as "other business receipts" sourced at the location of its customers. Petitioner filed its original GCT return for the 2008 Tax Year allocating receipts from S&P's credit ratings business based on the location of its customers (2008 Return).[7]

The Notices of Disallowance were dated April 15, 2010 and the Notice of Determination was dated August 17, 2011. (Resp exhibits 1 and 2.) Petitioner filed a separate petition in response to each of the Notices of Disallowance on July 28, 2010 and a petition in response to the Notice of Determination on October 12, 2011.

Before addressing the substantive issues raised in the case before us, we believe it is necessary to address the matter of the timeliness of a portion of the refunds claimed by Petitioner for the 2003 and 2004 Tax Years, although not addressed by the Parties or the CALJ.

Petitioner's petition protesting the Notice of Disallowance for the 2003 Tax Year claimed a refund of $5,429,321, described as a revised calculation of the refund claimed on the Amended Return of $4,351,693. Petitioner's petition protesting the Notice of Disallowance for the 2004 Tax Year claimed a refund of $5,948,868, described as a

---

[7] Stipulation at ¶¶16, 23, 30, 36 and 46. It is not entirely clear from the Record what Petitioner meant by "customers" for this purpose. The Ruling Request asserted that Petitioner proposed using the location of the issuers requesting ratings as a reasonable "proxy" for the location of customers. (Pet exhibit C at 7-8.) In the CALJ Determination, the CALJ stated that on the Amended Returns and the 2008 Return, receipts from credit ratings were allocated to the location of the issuers. (CALJ Determination at 8-9.)

revised calculation of the refund claimed on the Amended Return of $4,565,095.[8]

Section 11-678.1 of the Administrative Code of the City of New York (Administrative Code) provides that a taxpayer must file a claim for refund of GCT within the later of three years from the time the return was filed or two years from the time the tax was paid. Administrative Code §11-678.2 further provides that when a taxpayer files a waiver extending the period to assess additional GCT, the period for filing refund claims for that period is extended until six months after the end of the extended assessment period.[9] As a result, the period for claiming refunds of GCT paid by Petitioner for the 2003 and 2004 Tax Years expired on September 30, 2009, i.e., six months after the end of the extended period for asserting additional GCT for those Tax Years.[10] The Amended Returns for the 2003 and 2004 Tax Years were filed on March 25, 2009 and, therefore, were timely. Neither the Administrative Code nor the New York City Charter authorizes the Tribunal to determine an increased amount of overpayment of GCT after the expiration of the applicable limitations period. Consequently, the additional refunds for the 2003 and 2004 Tax Years claimed on the petitions filed July 28, 2010 were untimely. Therefore, the amounts in dispute for those Tax Years are limited to the amounts stated on the Notices of Disallowance for those Tax Years.

We turn now to the substantive issues. Administrative Code §11-604.3(a)(2) provides rules for determining the source of different types of receipts for purposes of allocating business income within or outside the City. Subparagraph 9 of Administrative Code §11-604.3(a) [11] provides:

> "(9) Special rules for publishers and broadcasters. (A) Notwithstanding anything in subparagraph two of this paragraph to the contrary and except as provided in clause (C)

---

[8] No explanation of the recalculation was included with either petition. No additional refunds were claimed on the petitions filed for the 2005, 2006 or 2007 Tax Years.

[9] The amount of any refund is limited to the tax paid after the waiver is signed plus the amount that could have been claimed on a refund claim filed on the date the waiver was signed.

[10] Petitioner also could have filed refund claims for any additional GCT paid with the Forms NYC 3360 for the 2003 and 2004 Tax Years within two years from the date of payment, i.e., on October 25, 2007 and December 7, 2009, respectively.

[11] Subclauses (i) and (iv) of Administrative Code §11-604.3(a)(2)(B) contain comparable provisions to clauses (A), (B) and (C) of Administrative Code §11-604.3(a)(9).

> of this subparagraph, in the case of a taxpayer engaged in the business of *publishing newspapers or periodicals*, there shall be allocated to the city, for purposes of subparagraph two of this paragraph, the gross sales or charges for *services arising from sales of advertising* contained in such newspapers or periodicals, to the extent that such newspapers or periodicals are delivered to points within the city.
>
> "(B) Notwithstanding anything in subparagraph two of this paragraph to the contrary and except as provided in clause (C) of this subparagraph, in the case of a taxpayer engaged in the business of *broadcasting radio or television programs*, whether through the public airwaves or by cable, direct or indirect satellite transmission, or any other means of transmission, there shall be allocated to the city, for purposes of subparagraph two of this paragraph, a portion of the gross sales or charges for *services arising from the broadcasting of such programs and of commercial messages* in connection therewith, such portion to be determined according to the number of listeners or viewers within and without the city.
>
> "(C) Notwithstanding anything in clause (A) or (B) of this subparagraph to the contrary, in the case of a taxpayer engaged in the business of *publishing newspapers or periodicals, or broadcasting radio or television programs*, whether through the public airwaves or by cable, direct or indirect satellite transmission, or any other means of transmission, there shall be allocated to the city, for purposes of subparagraph two of this paragraph, *the gross sales or charges to subscribers located in the city for subscriptions to such newspapers, periodicals, or program services*. For purposes of this clause, a subscriber shall be deemed located in the city if, in the case of newspapers and periodicals, the mailing address for the subscription is within the city and, in the case of program services, the billing address for the subscription is within the city. For purposes of this clause, 'subscriber' shall mean a member of the general public who receives such newspapers, periodicals or program services and does not further distribute them." (Emphasis added.)

The special allocation methods prescribed in subparagraph (9) apply to specific categories of receipts earned by publishers and broadcasters. Clause (A) requires

publishers to allocate *advertising* receipts according to where the publications are delivered. Clause (B) requires broadcasters to allocate receipts from the *broadcasting of programs and commercials* according to the location of their audience. Clause (C) requires publishers and broadcasters to allocate *subscription receipts* according to the location of the subscriber.

While Petitioner used a place-of-performance method on its original returns for Tax Years 2003 through 2007, on its Amended Returns and its 2008 Return, Petitioner apparently allocated receipts from providing credit ratings according to the location of the issuer that paid for the rating, a method similar to that provided in clause (C) for subscription receipts of publishers and broadcasters.[12] Now, however, Petitioner asserts that those receipts should be allocated using an audience methodology such as that provided in clause (B) for receipts from the broadcasting of programs and commercials, or that provided in clause (A) for advertising receipts of publishers.

Petitioner argues first, that the First Amendment to the United States Constitution (First Amendment) requires that it be allowed to use the same allocation method for its credit ratings receipts as is allowed for certain receipts of publishers and broadcasters, second, that its receipts from providing credit ratings are "other business receipts" and should be allocated where earned, which, Petitioner argues, is at the location of the audience for its free public website, and third, that the Tribunal should exercise the Respondent's discretion to permit Petitioner to use an audience allocation method because it more properly reflects Petitioner's "activity, business, income or capital . . . within the city." (Administrative Code §11-604.8.) We reject each of Petitioner's arguments for the following reasons.

First Amendment. Petitioner cites numerous cases in which the courts have held that credit ratings are speech entitling rating agencies to First Amendment protection from disclosure of their sources in a discovery proceeding (*Scott Paper Co. Sec. Litig.*, 145 FRD 366 [ED Pa 1992]), from compliance with subpoenas (*Pan Am Corp. v Delta Air Lines*, 161 BR 577 [SD NY 1993]), from defamation and breach of contract claims

---

[12] *See* n 6 *supra*.

(*Compuware Corp. v Moody's Inv. Serv., Inc.* 499 F3d 520 [6th Cir 2007]) and from claims of intentional interference with contract and publication of a falsehood (*Jefferson County Sch. Dist. No. R-1 v Moody's Inv. Serv. Inc.*, 175 F3d 848 [10th Cir 1999]). While no one disputes that these cases protect the content of Petitioner's ratings as speech under the First Amendment, none of these cases addresses the taxation of receipts of credit rating agencies or otherwise addresses the nature of the compensation Petitioner and other credit rating agencies receive for generating credit ratings.

The United States Supreme Court has addressed the First Amendment implications of state taxes, most recently in *Leathers v Medlock*, (499 US 439 [1991]) (*Leathers v Medlock)*. That case involved an Arkansas tax imposed on gross receipts from all sales of tangible personal property and certain services, which was applied to cable television sales in 1987. However, receipts from subscriptions and over-the-counter sales of newspapers and subscription sales of magazines were excluded from the tax. Cable operators subjected to the tax argued that the tax was an unconstitutional infringement on their First Amendment and Equal Protection rights.[13] The Court characterized its previous decisions as standing for the proposition that "a tax that discriminates among speakers is constitutionally suspect only in certain circumstances." (*Id.* at 444.)

The Court in *Leathers v Medlock* reviewed its earlier decisions in *Grosjean v American Press Co.*, (297 US 233 [1936]), *Minneapolis Star & Tribune Co. v Minnesota Commr. of Revenue*, (400 US 575 [1983]) and *Arkansas Writers' Project, Inc. v Ragland*, (481 US 221 [1987]) and summarized the applicable precedent as follows:

> "These cases demonstrate that differential taxation of First Amendment speakers is constitutionally suspect when it threatens to suppress the expression of particular ideas or viewpoints. Absent a compelling justification, the government may not exercise its taxing power to single out the press. The press plays a unique role as a check on government abuse, and a tax limited to the press raises concerns about censorship of critical information and opinion. A tax is also suspect if it targets a small group of speakers.

[13] Petitioner has not made an Equal Protection argument so we limit our discussion of Supreme Court precedent to the First Amendment issue.

> Again, the fear is censorship of particular ideas or viewpoints. Finally, for reasons that are obvious, a tax will trigger heightened scrutiny under the First Amendment if it discriminates on the basis of the content of taxpayer speech." *Leathers,* (499 US at 447.) (Citations omitted.)

The Court in *Leathers v Medlock* held that because the tax in question was not of the type found unconstitutional in the earlier cases, "cable petitioners can prevail only if the Arkansas tax scheme presents 'an additional basis' for concluding that the State has violated petitioners' First Amendment rights." (*Id.* at 449.) The Court held a tax was not unconstitutional solely because the tax discriminated among the media or even within a medium. The Court stated that its earlier decision in *Regan v Taxation with Representation of Washington*, (461 US 540 [1983]):

> "stands for the proposition that a tax scheme that discriminates among speakers does not implicate the First Amendment unless it discriminates on the basis of ideas. . . ." (499 US at 450.)

The Court in *Leathers v Medlock* then went on:

> "We conclude that the State's extension of its generally applicable sales tax to cable television services alone, or to cable and satellite services, while exempting the print media, does not violate the First Amendment." (499 US at 453.)

In the present case, the GCT is a tax of general application and Petitioner has not argued otherwise. The audience allocation method is an exception to the general allocation methods under the GCT, which include the place-of-performance method for service receipts that Petitioner used on its original 2003 through 2007 returns and that the Department applied to Petitioner's credit ratings receipts in issuing the Notices.

In arguing that because it is entitled to First Amendment protections it must be allowed to use the audience allocation method available to other First Amendment speakers, Petitioner ignores the fact that the audience allocation method under Administrative Code §11-604.3(a)(9) only is available for specific types of receipts, i.e., receipts from subscriptions, advertising and program broadcasting, which are nothing like

the amounts paid by issuers and intermediaries for Petitioner's credit ratings, which are the receipts at issue in the present case.

The CALJ concluded that Petitioner's receipts are not receipts from sales of subscriptions. (CALJ Determination at 17.) We agree. Petitioner argues that publication of its ratings on its website is akin to the broadcasting of commercials or newspaper advertising because the ratings have value only if they are made public. (Pet brief at 19.) It is notable that Petitioner reserves the right to publish a rating even over the objection of the issuer who is paying for it. In its brief, Petitioner notes "[w]hile a Debt Issuer may object to a proposed rating, it has no power to change it or to control its public dissemination – it cannot dictate what is done with the credit rating." (Pet brief at 6.) Thus the ratings also bear no resemblance to advertising. The CALJ also found that Petitioner did not sell advertising and that Petitioner's receipts were not receipts from broadcasting or publishing. (CALJ Determination at 23.) Therefore, we conclude that Petitioner has not proven that it is similarly situated to broadcasters and publishers such that the Department unconstitutionally discriminated against it in disallowing its use of the audience allocation method for its receipts from generating credit ratings.

Despite the fact that its receipts for credit ratings are not from subscriptions, advertising or broadcasting programs, Petitioner nevertheless asserts that:

> "Respondent's application of different sourcing methodologies for rating agencies and other financial publishers fails the *Leathers* test for two reasons: (1) the differential taxation discriminates against [Petitioner]'s unique viewpoint in the world of financial commentary; and (2) the differential taxation targets a small group of speakers. . . ." (Pet brief at 17.)

Both of Petitioner's arguments misconstrue the principles articulated by the Supreme Court in *Leathers v Medlock*. The place-of-performance allocation method for service receipts in Administrative Code §11-604.3(a)(2)(B) is not being applied solely to the press or even to a small subset of the press. Nor is it being applied to Petitioner based on the content of its ratings. While Petitioner argues that it has a "unique viewpoint"

among financial commentators and, therefore, its different tax treatment is unconstitutional, Petitioner has not offered any evidence that the Department's disallowance of the use of an audience method of allocation is related to, or based on, the content of Petitioner's speech in the form of ratings. Petitioner seeks to create a link where there is none between the nature of its credit ratings as opinion and the allocation method being applied by the Department.

Petitioner also argues that the Department has singled it out as a member of a small subset of First Amendment speakers, credit rating agencies, for discriminatory taxation by disallowing its use of an audience method of allocation. (Pet brief at 17.) However, Petitioner acknowledges that the fact that credit rating agencies make up a small subset of the press is a function of government regulation having nothing to do with taxation. (Pet brief at 19.) Federal securities regulation effectively requires credit rating agencies to qualify as Nationally Recognized Statistical Rating Organizations[14] and, thus, limits the number of such agencies. (*See* CALJ Determination, n 3.) Moreover, as noted above, the allocation method applied by the Department to Petitioner is a method of general application to all receipts from services under the GCT and is not being applied solely to Petitioner or solely to credit rating agencies.

Like the Supreme Court, the New York State Court of Appeals also has concluded that not every tax that results in differential treatment among members of the press is unconstitutional. In *Matter of Henry v Wetzler*, (82 NY2d 859 [1993]), a shopping paper distributed for free was found to be ineligible for a sales tax exemption on equipment used to produce property for sale. And in *Stahlbrodt v Commr. of Taxation and Fin. of the State of N.Y.*, (92 NY2d 646 [1998]), a weekly advertising paper was found to be ineligible for a sales tax exemption for printing services purchased by shopping papers because the weekly paper did not meet the requirement that 90% of its printed area be advertising copy.

Petitioner relies heavily on the decision in *Matter of McGraw-Hill Group, Inc.*, (146 AD2d 371 [3d Dept 1989] *affd* 75 NY2d 852 [1990]) (*McGraw-Hill*). In that case,

[14] Resp exhibit 21 at 244.

the petitioner[15] filed its New York State Franchise Tax (Franchise Tax) returns for the years 1976-1979 allocating receipts from the sale of advertising in its magazines according to the circulation of the magazines.[16] In 1984 on audit, the New York State Department of Taxation and Finance (State DTF) disallowed that method relying on *Matter of Condé Nast Publs. v State Tax Commn.* (51 AD2d 17 [3d Dept 1976]). After that decision was issued but before the audit of the petitioner, the State DTF amended its regulation to allow radio and television broadcasters to allocate receipts from broadcasting commercials according to audience location. In addition, a 1981 amendment to the Franchise Tax statute allowed publishers to use a circulation method for allocating advertising receipts, although the change was not retroactive to the years in question, 1976 through 1979. The petitioner argued that, in light of both the State DTF's amendment of its regulation and the statutory amendment, the petitioner should be allowed to allocate its advertising receipts using a circulation method and that it was a violation of the First Amendment to require otherwise. The Third Department agreed that the First Amendment required the petitioner to be allowed to allocate its magazine advertising receipts using a circulation method. (*McGraw-Hill,* 146 AD2d at 374.)

In the case before us, Petitioner argues that the *McGraw-Hill* decision requires the Department to allow Petitioner to use an audience allocation method for its receipts from generating credit ratings. Petitioner asserts that the *McGraw-Hill* decision did not depend on the similarity between magazine publishers' advertising receipts and broadcasters' receipts from broadcasting commercials because "the Third Department did not find or imply that, absent [the fact that the petitioner had introduced evidence of the similarity of content being taxed differently when received by publishers and broadcasters] differential taxation would have been permissible." (Pet brief at 20.) We disagree. The court in *McGraw-Hill* said:

> "We are persuaded that in this case, petitioner is correct in its contention that the difference in treatment between the print

[15] For purposes of the discussion of *McGraw-Hill*, the petitioner in that case is referred to as "the petitioner" rather than as "Petitioner".

[16] Receipts from generating credit ratings were not at issue in that case.

> and broadcast media under [the state regulation governing the allocation of advertising receipts of broadcasters] violates the 1st Amendment guarantee of freedom of the press." (*McGraw-Hill,* 146 AD2d at 374-75.)

This statement makes it clear that it was the specific regulation governing the allocation of advertising receipts of broadcasters that the court found to be unconstitutional. Moreover, as the case involved solely the petitioner's allocation of advertising receipts, which are not at issue in the present case, there was no need for the court to address any other set of circumstances. Thus we conclude that *McGraw-Hill* does not require us to find that the Department's denial of an audience allocation method for Petitioner's receipts from generating credit ratings violated its First Amendment rights.

Petitioner also argues that *McGraw-Hill* requires that it be allowed to use the same audience allocation method allowed for advertising and commercial receipts of publishers and broadcasters unless "the taxing authority can show that differential taxation is necessary to serve a compelling state interest." (Pet brief at 13.) *McGraw-Hill* cites *Minneapolis Star & Tribune Co. v Minnesota Commr. of Revenue*, (400 US 575 [1983]) (*Minneapolis Star*). In that case, the Supreme Court said:

> "[d]ifferential taxation of the press, then, places such a burden on the interests protected by the First Amendment that we cannot countenance such treatment unless the State asserts a counterbalancing interest of compelling importance that it cannot achieve without differential taxation." (*Id.* at 585.)

In *Minneapolis Star*, the state argued that a use tax imposed on ink and paper used by certain members of the press was a necessary substitute for the sales tax. The Court rejected that argument because the state offered no explanation as to why a sales tax was not applied nor did the state explain why the use tax in question was not imposed in the same manner as its general use tax. (*Id.* at 581-82.) The Court found:

> "The main interest asserted by Minnesota in this case is the raising of revenue. Of course that interest is critical to any government. Standing alone, however, it cannot justify the

> special treatment of the press, for an alternative means of achieving the same interest without raising concerns under the First Amendment is clearly available: the State could raise the revenue by taxing businesses generally, avoiding the censorial threat implicit in a tax that singles out the press." (*Id.* at 586.)

In the case before us, the GCT is a tax of broad application and the place-of-performance allocation method imposed by the Department, and originally used by Petitioner, is one generally applicable to all service receipts. The place-of-performance allocation method is not comparable to the special use tax on ink and paper at issue in *Minneapolis Star* nor is it comparable to the differential allocation of advertising receipts at issue in *McGraw-Hill.* Consequently, Respondent does not have to demonstrate a "compelling state interest" to justify applying it to Petitioner's credit ratings services receipts.

Petitioner argues that simply because it is a First Amendment speaker it is similarly situated to those First Amendment speakers that are entitled to use an audience method for allocating their receipts from advertising, program broadcasting and subscriptions, and that, as a result, it is unconstitutional to disallow Petitioner's use of that method for its receipts from generating credit ratings. Nothing in the case law in this area supports such a broad conclusion. Consequently, we find that Petitioner has failed to prove that in disallowing Petitioner's use of an audience method, the Department has violated Petitioner's First Amendment rights.

Credit Ratings Receipts as "Other Business Receipts." Next we turn to Petitioner's second argument. Administrative Code §11-604.3(a)(2) provides rules for determining the source of different types of receipts for purposes of allocating business income within and outside the City. Clause (A) of that subparagraph (2) applies to receipts from sales of tangible personal property, clause (B) applies to receipts from services, clause (C) applies to receipts from rentals and royalties and clause (D) applies to "all other business receipts." While the Department treated Petitioner's receipts from issuers for credit ratings as receipts from services sourced using the place-of-performance

method under clause (B), the method originally used by Petitioner on its 2003 through 2007 returns, Petitioner now argues that its receipts are "other business receipts" and should be sourced to where those receipts are earned as provided in clause (D) of Administrative Code §11-604.3(a)(2).

Petitioner argues that its receipts are not service receipts because they "are generated through the creation and communication of financial commentary to an audience." (Pet brief at 23.) Petitioner focusses on the communication element in arguing that its receipts are earned according to the location of the investing public because if the ratings were not made public they "would be worthless." (Pet brief at 23.)

Petitioner's argument disregards several facts. Primary among them is that by its own admission, Petitioner is compensated for its work in generating the ratings and that its ratings are made available on S&P.com *free of charge.* The Terms of Use of that website state: "The Standard & Poor's Ratings Services business *may receive compensation for its ratings and credit related analyses*, normally from issuers or underwriters of securities or from obligors. . . . [S&P's] public ratings and analyses are made available on its Web sites, [S&P.com] (*free of charge*). . . ." (Pet exhibit B.) (Emphasis added.) Similarly, Petitioner's *Guide to Credit Rating Essentials* submitted to the Department in connection with the Ruling Request, contains the following disclaimer: "Ratings Services receives compensation for its ratings. Such compensation is normally paid either by the issuers of such securities or third parties participating in marketing the securities. While [S&P] reserves the right to disseminate the rating, *it receives no payment for doing so* except subscriptions to its publications." (Emphasis added.)[17]

[17] (Pet exhibit E 1.) While the *Guide to Credit Rating Essentials* was published after the Tax Years, the quoted statement is consistent with other documents in the Record applicable to the Tax Years and is consistent with a statement from an S&P publication, *Creditweek*, quoted in *Scott Paper Co. Sec. Litig.*, (145 FRD 366 [ED Pa 1992] n 3): "The inside cover of *Creditweek* contains a disclaimer by S & P stating: 'S & P receives compensation for rating obligations. Such compensation is based on the time and effort to determine the rating and is normally paid either by the issuers of such securities or by the underwriters participating in the distribution thereof. . . . While S & P reserves the right to disseminate the rating, it receives no payment for doing so, except for subscriptions to its publications.'"

Petitioner's argument is contradicted by the substantial evidence of the personal effort behind each credit rating described at length in the Record and in Petitioner's own brief. In generating a rating, S&P's staff of credit analysts "investigate and analyze information about the issuer and propose a recommended rating" using information from the issuer as well as public information. (Pet brief at 5.) When an issuer retains Petitioner to provide continued surveillance, its staff monitors relevant developments to identify information that might require a modification of the rating. Most notably, if an issuer decides to discontinue the rating process, it will be billed a fee to cover the "time and expenses relating to the rating process." (Resp exhibit 19.) Thus, a rating is not "worthless" to Petitioner if it is not publicized although it may have no value to the investing public.

In its Ruling Request, Petitioner described the activities of S&P's personnel in deriving a rating as including "frequent cooperation between analysts and support staff" and "the services of a large staff of support personnel based in India." (Pet exhibit C, Attached Statement at 2.) S&P's own materials submitted with the Ruling Request describe its ratings as "based on analysis by experienced professionals who evaluate and interpret information received from issuers and other available sources to form a considered opinion." (Pet exhibit E 1, *Guide to Credit Rating Essentials* at 3.)

Petitioner cites two advisory opinions issued by the State DTF in support of its position.[18] In TSB-A-99(16)C (April 7, 1999), the taxpayer, a commodity futures exchange, licensed access to "market data" (the exact nature of the market data or how it was compiled or created is not described in the opinion) either directly to third party end users, defined as "Subscribers," or to vendors who sell access to the market data on the taxpayer's behalf. The State DTF concluded that the fees paid by vendors were "other business receipts" under the New York State equivalent to Administrative Code §11-604.3(a)(2)(D) earned at the location of the modems and other transmission equipment

[18] 20 NYCRR §2375.5 provides that advisory opinions have no "true precedential value" and are binding on the State DTF only with respect to the person requesting the opinion. However they reflect the view of the State DTF as to the application of the law to the facts presented.

that the vendor uses to access the taxpayer's market data. The advisory opinion did not address the treatment of receipts from Subscribers.

In TSB-A-00(15)C (September 6, 2000), the taxpayer supplied "statistical, actuarial, underwriting and claims information" to the insurance industry. As described in the advisory opinion, the taxpayer collects information and "compiles and aggregates" it into databases that it licenses to its customers who could access them through the Internet or direct access to the taxpayer's servers. The taxpayer's customers paid a fixed annual fee as well as a usage fee that varied based on the customer's use of the databases. The State DTF concluded that the receipts were "other business receipts" because they compensated the taxpayer "for the intangible right to access and obtain copyrighted data" and should be sourced based on the location of the modems and other transmission equipment used by the customer to access the taxpayer's databases. (TSB-A-00(15)C at 5.)

In each of those advisory opinions, the receipts in question were paid to the taxpayer by customers for access to the data, not by the companies whose information was incorporated into the data sold by the taxpayer. By contrast, in the present case, Petitioner's receipts are not from investors or others who use the ratings and can view them free of charge, but from the issuers of debt obligations who pay Petitioner to generate individualized ratings.[19] Therefore we find the advisory opinions are distinguishable from the case before us and have no bearing on the treatment of Petitioner's receipts from generating credit ratings, which we find to be receipts from services and not "other business receipts."

It is noteworthy that the special rules in Administrative Code §11-604.3(a)(9) for allocating receipts of publishers and broadcasters from advertising, commercials, programming and subscriptions, which Petitioner argues should apply to its receipts from generating credit ratings, repeatedly refer to the receipts in question as "gross sales or charges *for services*" (emphasis added). We note, also, that language corresponding to

---

[19] As stated earlier, Petitioner abandoned the subscriber pays model over 30 years ago.

that in paragraph (9) also appears in subclauses (i) and (iv) of Administrative Code §11-604.3(a)(2)(B), which generally governs the allocation of receipts from services.

Finally, it also is notable that in a letter to the auditor in connection with the Audit, Petitioner described S&P's credit ratings services as "the review and analysis of debt instruments or other securities. . . . *[A]n individualized service*". (Resp exhibit 7 at ¶6. [Emphasis added.])

Discretionary Adjustment. Petitioner's third argument is that the allocation method prescribed by clause (B) of Administrative Code §11-604.3(a)(2) as applied to its receipts from issuers for generating credit ratings "does not properly reflect [Petitioner's] activities within New York City." (Pet brief at 35.) Petitioner argues that, as a result, the Tribunal must exercise Respondent's discretion under Administrative Code §11-604.9 to allow Petitioner to use an audience-based method as a "method calculated to effect a fair and proper allocation" of those receipts.

Administrative Code §11-604.9 provides that:

> "If it shall appear to the commissioner of finance that any business allocation percentage determined as hereinabove provided does not properly reflect the activity, business, income or capital of a taxpayer within the city, the commissioner of finance shall be authorized in his or her discretion to adjust it by (a) excluding one or more of the factors therein, (b) including one or more other factors, . . . (c) excluding one or more assets in computing such allocation percentage, provided the income therefrom, is also excluded in determining entire net income, or (d) any other similar or different method calculated to effect a fair and proper allocation of the income and capital reasonably attributable to the city. . . ."

Petitioner has not proven that the allocation of its receipts from issuers for preparing credit ratings according to the location of the S&P employees who worked on them, i.e., the place-of-performance method, does not properly reflect its activities within and outside the City. Petitioner also has not proven that allocating those receipts according to the location of its audience, which it defines as the investing public

accessing S&P.com, results in "a fair and proper allocation of [Petitioner's] income and capital reasonably attributable to the city."

Petitioner's witness, Bruce Schachne, described his position as being in charge of "client marketing for the Americas as well as Asia Pacific, and also the global head of digital marketing." (Tr at 53.) He testified that Petitioner's clients were divided into three groups: investors, issuers and intermediaries. (*Id.*) Thus, the investing public is only one of three categories of identified clients. Petitioner acknowledges that, after it releases a rating, it is picked up and included in other financial publications including the New York Times and Wall Street Journal. (Pet brief at 6.) In its Ruling Request, Petitioner stated that it "disseminates its public ratings in three ways: via a press release, on its website, and directly to the issuer. Responding to modern technology, [Petitioner] now also disseminates many ratings to investors via complimentary electronic newsletters, videocasts, and podcasts." (Pet exhibit C, Attached Statement at 2.) The Terms of Use of S&P.com include the following statement: "[Petitioner's] public ratings and analyses are made available on its Web sites . . . and *may be distributed through other means, including via Standard and Poor's publications and third party redistributors*." (Emphasis added.) (Pet exhibit B.) Finally, Petitioner may license "the right to access, display or otherwise use its ratings" to third parties. (Pet brief at 6.)[20] Therefore, Petitioner's own evidence indicates that its free website, S&P.com, is only one of many sources whereby investors and others can obtain ratings.

In any event, Petitioner has not offered sufficient evidence to establish that the location of visitors to its free public website, S&P.com, as determined by a third party analytics firm, is a reasonable means of allocating receipts from issuers for creating public ratings. Petitioner offered the testimony of Jenna Hutchins to support its assertion. She testified that she joined Petitioner in 2007 and that she is "on the business side of managing the website." (Tr at 113-14.) Ms. Hutchins testified that Petitioner ascertains the location of visitors to that website by asking them to register, which provides

[20] Receipts from those license agreements are not at issue in this case.

Petitioner with their names, and by using a third party analytics vendor that identifies where visitors to the site are located, the time of day and the type of information sought. (Tr at 116.) Ms. Hutchins testified that the third party analytics vendor can tell Petitioner "this particular person was coming from this location and this is the piece of information that they wanted." (Tr at 120.) She testified that she uses the information to make decisions about the website infrastructure and that the information is used by the marketing, sales and finance staffs. (Tr at 120-22.) However, Ms. Hutchins testified that she did not have any personal knowledge of the way these analytics worked during the Tax Years. (Tr at 125.)

Moreover, Petitioner did not offer any testimony from the third party vendor nor did Petitioner introduce into evidence any of the reports or other information prepared by that third party. Petitioner's exhibit E 3 is an e-mail from Jonathan Robin of PricewaterhouseCoopers, who was involved in the Ruling Request,[21] to Michael Hyman and two other individuals identified only by their e-mail addresses, all at the Department. In that e-mail, Mr. Robin refers to three attached schedules that he described as showing, respectively, users worldwide broken down by country, users in the United States broken down by state, and users in New York State broken down by city. Mr. Robin described how the last schedule was used to compute the ratios of unique visitors to the public website within and outside the City. However, those schedules were not introduced into evidence nor included in the Record.

For the above reasons, we find that Petitioner has not established that the place-of-performance method of allocating income from services prescribed by Administrative Code §11-604.3(a)(2)(B) does not properly reflect its activities in the City in generating receipts from credit ratings services. Nor has Petitioner established that the location of visitors to its free website, S&P.com, only one of several sources available to the public for its credit ratings, is a method that results in a more proper or fairer allocation of Petitioner's receipts from generating credit ratings.

[21] (Tr at 74, 76.) Mr. Robin was not affiliated with the third party vendor or identified as having any expertise in data analytics.

Because we find that Petitioner has not persuaded this Tribunal to exercise Respondent's discretion under Administrative Code §11-604.9, we need not address Respondent's argument that Petitioner is precluded from requesting such an exercise for the first time on exception.

For the reasons stated above, the CALJ Determination is reversed, except to the extent it sustained the Notice of Determination for the 2006 Tax Year, and, to the extent cancelled by the ALJ Determination, the Notices are reinstated.[22]

Dated: October 28, 2015
New York, NY

Ellen E. Hoffman
Commissioner and President

Robert J. Firestone
Commissioner

---

[22] We have considered all of the other arguments of the Parties and find them unpersuasive. Petitioner asserts that the Department 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 discretion under the provision of the Tax Law corresponding to Administrative Code §11-604.9. 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.

Respondent has argued that the CALJ should not have admitted the testimony of Floyd Abrams because he has represented Petitioner on numerous occasions and at the time of the hearing in this case was representing Petitioner in New York State. (Tr at 178-79. Resp brief at 42.) Mr. Abrams testified as an expert on First Amendment law. We acknowledge that the New York City Tax Appeals Tribunal is an administrative body and that the rules of evidence are very loosely applied. We further acknowledge that the Tribunal is an administrative court of special expertise, i.e., taxation, and expert testimony outside of that field, even testimony as to the state of the law in a particular area, can be useful in a given case. Nevertheless, we question the necessity of Mr. Abrams' testimony in the present case. As the CALJ stated that she was not bound to accept his testimony and as we reverse her determination that the First Amendment requires Petitioner to be permitted to use an audience allocation method, we need not rule on Respondent's argument.