

New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB-A-91(11)C
Corporation Tax
April 29, 1991

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. C900806A

On August 6, 1990, a Petition for Advisory Opinion was received from Mark S. Klein, Partner, Hodgson, Russ, Andrews, Woods & Goodyear, 1800 One M&T Plaza, Buffalo, New York 14203.

The issue raised by Petitioner, Mark S. Klein, is whether, under various situations described herein, a foreign corporation is subject to the franchise tax on utilities under section 186 of the Tax Law, the gross receipts tax under section 186-a of the Tax Law, and/or the franchise tax on business corporations under Article 9-A of the Tax Law, and if so, what receipts are subject to tax.

The underlying facts in each of the six situations described below are the same. A foreign (non-New York) corporation is engaged in the purchase and sale in bulk of natural gas. The foreign corporation negotiates for the purchase of natural gas from natural gas producers or wholesalers ("suppliers") under "requirements" contracts. Under a typical requirements contract the supplier makes available to the foreign corporation a maximum volume of gas. The foreign corporation takes title to as much of the natural gas as it can re-sell. The delivery point (the "point of sale") specified in the requirements contract with the supplier is the point at which the supplier's pipeline intersects the pipeline of an interstate distribution company.

The foreign corporation sells the natural gas to end-users. Generally an end-user is a business requiring large amounts of natural gas for heating and production. The agreement between the end-user and the foreign corporation is also a "requirements" contract. Under the terms of a typical requirements contract, the foreign corporation agrees to make available to the end-user a quantity of natural gas. The end-user takes title to all the gas it needs from the foreign corporation at the point of sale. The point of sale under the requirements contract with the end-user is also the point at which the supplier's pipeline intersects the interstate distribution company's pipeline.

The foreign corporation does not provide any transportation for the natural gas it purchases and sells. The supplier is required to "deliver" the natural gas to the point of sale (where the supplier's pipeline intersects the distribution company's pipeline). The end-user is required to separately contract with the interstate distribution company for transportation of the natural gas from the point of sale, through the interstate distribution company's pipeline and on to the end-user's facilities.

The foreign corporation is not related to the interstate distribution company. Nor is it related to any of the suppliers from which it purchases natural gas. The foreign corporation neither owns, leases nor has any contractual right to use the mains or pipes through which the natural gas flows.

The foreign corporation has title to the natural gas only for a moment, and only for the purpose of facilitating the transfer of title from the supplier to the user.

The foreign corporation is not subject to the supervision of the New York State Department of Public Service.

Unless otherwise stated below, the foreign corporation has no contact with New York State. Specifically, the foreign corporation does not maintain any office, any mail drop or any telephone listing within New York State.

SITUATION 1

Corporation A is a foreign corporation that purchases natural gas from suppliers and sells it to end-users.

Corporation A purchases all the natural gas from suppliers located outside of New York State. All negotiations for the purchase of natural gas occur outside of New York State.

Corporation A sells natural gas only to end-users located outside of New York State. All negotiations for the sale of the gas occur outside of New York State.

The points of sale with respect to the purchase and sale of natural gas by Corporation A are outside of New York State.

"Negotiations outside of New York State" include all negotiations and solicitations engaged in by employees or agents of the foreign corporations (corporations A-F, herein), where the employees or agents do not physically enter New York State for the purpose of soliciting or negotiating orders. Specifically included in "negotiations outside of New York" are negotiations and solicitations with suppliers or end-users located in New York State where the foreign corporations' employees and agents do not physically enter New York State, and where negotiations and solicitations with New York suppliers and/or end-users are engaged in via telecommunication or mail.

SITUATION 2

Corporation B purchases natural gas from suppliers located both inside and outside of New York State. All negotiations for the purchase of natural gas occur outside of New York State.

Corporation B sells the gas only to end-users located outside of New York State. All negotiations with end-users occur outside of New York State.

The points of sale with respect to both the purchase and sale of the natural gas by Corporation B are outside of New York State with respect to more than 50 percent of the natural gas Corporation B sells. However, the points of sale with respect to a significant (although not major) portion of the natural gas Corporation B purchases and sells are within New York State.

SITUATION 3

Corporation C purchases natural gas from suppliers located both inside and outside of New York State. All negotiations concerning the purchase of natural gas by Corporation C occur outside of New York State.

Corporation C sells to end-users located both inside and outside of New York. However, all negotiations concerning the sale of natural gas by Corporation C occur outside of New York State.

The points of sale with respect to the natural gas Corporation C purchases and sells are outside of New York more than 50 percent of the time.

SITUATION 4

Corporation D purchases natural gas from suppliers both inside and outside of New York. Negotiations between Corporation D and its suppliers occur both inside and outside of New York State, although Corporation D does not have an office or any employees permanently situated in New York State. When negotiations in New York State are necessary, Corporation D sends one of its employees to New York State. Corporation D's employees do not enter New York State for any purpose other than to negotiate the purchase of natural gas from suppliers.

Corporation D sells the natural gas to end-users located both inside and outside of New York. All negotiations concerning the sale of natural gas to the end-users occur outside New York State.

The points of sale with respect to the purchase and sale of the natural gas by Corporation D are outside of New York State more than 50 percent of the time.

SITUATION 5

Corporation E purchases natural gas from suppliers located both inside and outside of New York State. All negotiations with suppliers concerning the purchase of natural gas occur outside of New York State.

The natural gas is sold by Corporation E to end-users located both inside and outside of New York State. More than 50 percent of the end-users purchasing natural gas from Corporation E are located in New York State. Corporation E retains an unrelated New York corporation (the "broker") to solicit the sale of natural gas to end-users located in New York State. The broker does not perform services for any other business. The broker is located in New York State, and performs all negotiations and solicitations with end-users located in New York.

However, all orders solicited by the broker must be sent to Corporation E's office (located outside of New York) for acceptance. Corporation E's employees do not enter New York State.

The points of sale with respect to the natural gas purchased and sold by Corporation E are outside of New York State over 50 percent of the time.

SITUATION 6

Corporation F purchases natural gas from suppliers located both inside and outside of New York State. However, all negotiations concerning Corporation F's purchase of natural gas occur outside of New York State.

Corporation F sells natural gas to end-users located both inside and outside of New York State. All negotiations and solicitations with respect to the sale of natural gas to New York end-users is accomplished through an unrelated New York corporation (the "broker") that performs similar services for other businesses. More than 50 percent of the end-users that purchase natural gas from Corporation F are located within New York State.

The points of sale with respect to the natural gas purchased and sold by Corporation F are outside of New York State more than 50 percent of the time.

Section 209.1 of Article 9-A of the Tax Law imposes an annual franchise tax on domestic or foreign corporations for the privilege of exercising a corporate franchise, doing business, employing capital, owning or leasing property in a corporate or organized capacity, or maintaining an office, in New York State. Section 209.4 of the Tax Law, provides that a corporation liable to tax under section 186 of Article 9 of the Tax Law is not subject to tax under Article 9-A.

Section 186 of the Tax Law imposes a franchise tax, on a corporation, joint stock company or association formed for or principally engaged in the business of supplying water, steam or gas, when delivered through mains or pipes, or electricity, or principally engaged in two or more such businesses, for the privilege of exercising its corporate franchise or carrying on its business in such corporate or organized capacity in New York State. The tax is computed as the sum of a percentage of gross earnings from all sources within New York State and a percentage of certain dividends paid.

To determine the classification and proper taxability of a corporation under either Article 9 or Article 9-A, an examination of the nature of the corporation's activities is necessary, regardless of the purposes for which the corporation was organized. See McAllister Bros., Inc., v Bates, 272 App Div 511, 517.

The determination of whether Petitioner is subject to tax under Article 9-A or Article 9, depends on what activity the taxpayer is principally engaged in. Ordinarily, a corporation is deemed to be principally engaged in the activity from which more than 50% of its receipts are derived. See, e.g. Re Joseph Bucciero Contracting Inc., Adv Op St Comm, July 23, 1981, TSB-A-81(5)C.

In Boundary Gas, Inc., Adv Op St Tax Comm, April 9, 1981, TSB-H-81(24), the Tax Commission determined that Boundary was not engaged in the business of supplying gas (and, thus, was not subject to tax under section 186 of the Tax Law) because (1) Boundary had no connection with the gas being sold other than holding bare legal title thereto for an instant of time; (2) Boundary did not take physical, possession or have any control or supervision of the gas; (3) Boundary did not own or operate any facilities of any nature whatsoever and was prohibited by its certificate of incorporation from either owning or constructing any facility; (4) Boundary was prohibited by its certificate of incorporation from selling gas to any entity which was not a shareholder of Boundary; and (5) all expenses of Boundary were reimbursed dollar for dollar by shareholders.

Whereas Boundary was nothing more than a paper corporation without substantive existence, herein, the foreign corporation in all situations is actively engaged in the business of purchasing and selling natural gas. The foreign corporation in all situations negotiates its own requirements contracts with suppliers and actually purchases the contracted natural gas. For the period of time that the foreign corporation owns the natural gas, it has title to such gas. The foreign corporation separately negotiates its own requirements contracts with end-users and sells the contracted natural gas to such end-users.

Herein, in each situation the foreign corporation is principally engaged in the business of supplying natural gas to end-users. Accordingly, if the foreign corporation is subject to franchise tax in New York State it will be subject to tax under section 186 of Article 9.

Under Public Law 86-272, a state may not impose a net income tax on income derived within a state from interstate commerce if the corporation's only activity within the state during the year is the corporation's solicitation of orders for sales of tangible personal property within the state. However, Public Law 86-272 is not applicable to section 186 of the Tax Law because such section imposes a tax on gross earnings not a tax on net income.

A state tax on interstate commerce is not unconstitutional if the tax is applied to an activity with a substantial nexus with the taxing state, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the state. Complete Auto Transit, Inc. v Brady, 430 US 274. While Complete Auto dealt with Commerce Clause issues, a tax that meets the Complete Auto test will also satisfy the Due Process requirements "that there be a 'minimal connection' between the interstate activities and the taxing state and a rational relationship between the income attributed to the State and the intrastate values of the enterprise"Trinova Corporation v. Michigan Department of Treasury 498 US - ; 112 L Ed 2d 884.

The laws of New York State are presumed to be constitutional by the Commissioner of Taxation and Finance. There is no jurisdiction at the administrative level to declare such laws unconstitutional; therefore, it must be presumed that the relevant sections of the law are constitutional to the extent that they relate to the imposition of the tax liability on petitioner.

Accordingly, the foreign corporation is subject to franchise tax under section 186 of the Tax Law if it is carrying on its business in New York State. To determine if the foreign corporation is carrying on its business in New York State, its activities in New York State must be analyzed.

Herein, the foreign corporation's requirements contracts with its suppliers provide that the delivery point of the natural gas is the point of sale. At the point of sale, both legal possession and title pass to the foreign corporation. The foreign corporation sells its natural gas to end-users and that same point of sale (where the foreign corporation took possession and title) is the point the end-user takes possession and title. Accordingly, when the point of sale is in New York State, the foreign corporation is doing business in New York State.

Section 186 of the Tax Law provides that a corporation that carries on its business in New York State shall pay a tax of three-quarters of one percent on its gross earnings from all sources in New York State. Gross earnings, under section 186, means all receipts from the employment of capital without any deduction.

Herein, in Situations "2" through "6" the foreign corporation is subject to tax under section 186 of the Tax Law on its gross earnings from the sale of natural gas where the point of sale is located within New York State. However, if the foreign corporation sells natural gas to an end-user where the point of sale is in Louisiana, the gross earnings from such sale are not from a source in New York State. The end-user's subsequent contract with a pipeline company to transport the purchased natural gas to its destination, even if such destination is in New York State, is not relevant in determining the taxability of the foreign corporation selling the natural gas.

Section 186-a of the Tax Law imposes a tax on the furnishing of utility services. In the case of utilities not subject to the supervision of the New York State Department of Public Service, the tax is equal to three percent of the gross operating income of such a utility doing business in New York State which has annual gross operating income in excess of \$500.

A utility includes every person (whether or not subject to the supervision of the Department of Public Service) who sells gas, electricity, steam, water, refrigeration, telephony or telegraphy, delivered through mains, pipes or wires, or furnishes gas, electric, steam, water, refrigeration, telephone or telegraph service, by means of mains, pipes, or wires, regardless of whether such activities are the main business of such person or are only incidental thereto.

The term "gross operating income" includes receipts from sales of gas, electricity, steam, water, refrigeration, telephony or telegraphy, and from the furnishing of gas, electric, steam, water, refrigerator, telephone or telegraph service, for ultimate consumption or use within New York State.

The section 186-a tax is not levied as a sale or use tax on the purchaser, but is a tax on the seller with respect to its activities as a utility in New York State. Herein, the foreign corporation is doing business in New York when its point of sale of natural gas is in New York State. Therefore, in Situations "2" through "6", the foreign corporation is subject to tax under section 186-a of

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the Tax Law on its gross operating income. Further, the foreign corporation's gross operating income includes receipts from the sale of natural gas where the point of sale is located in New York State. Where the point of sale is outside New York, for example, in Louisiana, the receipts from such sale are not included in gross operating income for purposes of section 186-a of the Tax Law.

In conclusion, the foreign corporation in all situations is in the business of supplying natural gas. Therefore, it is not subject to franchise tax under Article 9-A of the Tax Law, but is subject to franchise tax under section 186 of the Tax Law in Situations "2" through "6" since it is doing business in New York State. Likewise it is subject to tax under section 186-a of the Tax Law. In Situation "1" the foreign corporation is not doing business in New York State and is not subject to tax in New York State.

DATED: April 29, 1991

s/PAUL B. COBURN
Deputy Director
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NOTE: The opinions expressed in Advisory Opinions
are limited to the facts set forth therein.