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

TSB-A-92 (17) C
Corporation Tax
December 16, 1992

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. C920318B

On March 18, 1992, a Petition for Advisory Opinion was received from J.P. Morgan & Co. Incorporated, 60 Wall Street, New York, New York 10260.

The issue raised by Petitioner, J.P. Morgan & Co. Incorporated ("JPM"), relates to an Advisory Opinion issued to Petitioner on January 31, 1991 (J.P. Morgan & Co. Incorporated, Adv Op Comm T&F, January 31, 1991, TSB-A-91(4)C) regarding the taxation of Newco, and questions as to whether certain activities are included in the gross receipts test for purposes of determining whether Newco, an indirectly wholly-owned subsidiary of Petitioner, organized pursuant to section 4(c)(7) of the Bank Holding Company Act of 1956, as amended, is subject to the franchise tax under Article 32 of the Tax Law.

Specifically, for purposes of the gross receipts test pursuant to section 16-2.5(j)(4) of the Franchise Tax on Banking Corporations Regulations (hereinafter "Regulations"), is the "business which might be lawfully conducted" limited to those activities that Morgan Guaranty Trust Company of New York ("MGT") is permitted to lawfully conduct as a state member bank of the Federal Reserve System subject to the Glass-Steagall Act of 1933. Also, for purposes of the gross receipts test, does gross receipts include all income and when computing gains net of losses, may net losses from a business that may not be lawfully conducted by a banking corporation offset net gains arising from a business that may be lawfully conducted and vice versa.

The previously issued Advisory Opinion holds that Newco, an indirectly wholly-owned subsidiary of JPM will be subject to the franchise tax on banking corporations if it is principally engaged in a business which (i) might be lawfully conducted by a corporation subject to Article 3 of the Banking Law or by a national banking association or (ii) is so closely related to banking or managing or controlling banks as to be a proper incident thereto, as set forth in section (4)(c)(8) of the Bank Holding Company Act of 1956, as amended. The Advisory Opinion also holds that Newco will be principally engaged in a banking business if more than 50 percent in the aggregate, of Newco's gross receipts for the taxable year are from a business described in either ii) or (ii) above.

JPM is a corporation organized under the Bank Holding Company Act. JPM owns 100 percent of the outstanding stock of MGT. MGT is a New York State chartered bank that is a member of the Federal Reserve System (state member bank). JPM, MGT and certain affiliated corporations file combined returns under Article 32 of the Tax Law.

On March 28, 1991, JPM formed the corporation, referred to as Newco in the previously issued Advisory Opinion, as an indirectly wholly-owned subsidiary named, J.P. Morgan Capital Corporation ("JPMCC"). JPMCC is incorporated in Delaware and has its only office and place of business in New York. None of JPMCC's officers or employees are officers or employees of JPM

or MGT. JPMCC's sole business is investing in securities. All decisions regarding the making and disposition of investments are made by the officers and employees of JPMCC. JPMCC invests in equity securities of privately held and publicly traded companies. It also invests in debt securities which are convertible into equity, stock warrants and equity options. JPMCC's investment activities in equity securities is its principal business activity. JPMCC's investment in stock is in excess of 90 percent of its assets. A portion of the securities held by JPMCC are equity investments in corporations acquired in leveraged buy-out transactions. MGT acts as a lender to the acquired corporations in many of these transactions. The remaining securities held by JPMCC constitute venture capital investments.

Section 97.5 of the Banking Law restricts a bank from purchasing any stock of any corporation except as provided pursuant to section 97. Sections 97.2, 97.3, 97.4 and 97.4-a permit ownership of stock of certain specified entities not relevant to the investment portfolio of JPMCC.

Pursuant to section 97.4-b of the Banking Law, New York banks are permitted to invest in common or preferred stock registered (listed) on a national securities exchange subject to the following restrictions:

> (a) The aggregate amount of all investments in common and preferred stock permitted by section 97.4-b shall at no time exceed two percent of the assets or twenty percent of the capital, surplus and undivided profits of the bank, whichever is less.
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> (b) The aggregate amount of all investments in the common and preferred stock of any one issuer pursuant to this subdivision, together with the aggregate amount of all investments in the bonds, debentures, notes or other obligations of such issuer made pursuant to section 103.1(i) shall at no time exceed one percent of the assets or fifteen percent of the capital, surplus and undivided profits of the bank, whichever is less.
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> (c) No bank shall at any time hold more than two percent of the total issued and outstanding shares of stock of any one issuer.

Section 1452(a) of the Tax Law defines "banking corporation" for purposes of Article 32 of the Tax Law. Section 1452(a)(9) of the Tax Law provides that a corporation 65 percent or more of whose voting stock is owned or controlled directly or indirectly by a corporation registered under the Bank Holding Company Act is a banking corporation provided that the corporation whose voting stock is so owned or controlled is principally engaged in a business, regardless of where conducted, which (i) might be lawfully conducted by a corporation subject to Article 3 of the Banking Law or by a national banking association or (ii) is so closely related to banking or managing or controlling banks as to be a proper incident thereto, as set forth in section 4(c)(8) of the Bank Holding Company Act.

Section 16-2.5(j)(1)(ii) of the Regulations provides that:

> the phrase business which might be lawfully conducted means the nature of business, regardless of where such business is conducted, that a corporation organized pursuant to article 3 of the New York State Banking Law or a national banking association having its principal office in New York State may conduct:
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> (a) without the need for a specific grant of authorization by the appropriate regulatory authorities; or
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> (b) with a specific grant of authorization if such corporation or association has in fact received such authorization from the appropriate regulatory authority.

Section 16-2.5(j)(4) of the Regulations provides that:

> the-phrase principally engaged in a business means that a corporation derives more than 50 percent of its gross receipts from such business during its taxable year for Federal income tax purposes. Gross receipts from various aspects of a corporation's business may be aggregated to determine what business the corporation is principally engaged in. For example, corporation P derives 40 percent of its gross receipts from a business which might be lawfully conducted by a corporation subject to article 3 of the New York State Banking Law, 40 percent of its gross receipts from a business which is so closely related to banking or managing or controlling banks as to be a proper incident thereto, and 20 percent of its gross receipts from a business which may not be lawfully conducted by a corporation subject to article 3 of the New York State Banking Law and is not so closely related to banking or managing or controlling banks as to be a proper incident thereto. Since corporation P derives more than 50 percent of its total gross receipts from a business which might be lawfully conducted by a corporation subject to article 3 of the New York State Banking Law or is so closely related to banking or managing or controlling banks as to be a proper incident thereto, the "principally engaged in a business" requirement ... is met.

In both section 1452(a)(9) of the Tax Law and section 16-2.5(j) of the Regulations, when determining whether a corporation is principally engaged in a business which might be lawfully conducted by a corporation subject to Article 3 of the Banking Law or by a national banking association, any activity permissible under Article 3 of the Banking Law without the needfor a specific grant of authorization by the Banking Department is a "businesswhich might be lawfully conducted". Neither the statute nor the regulationslimit such activities to those activities that a particular bank might be restricted from engaging in because of its membership in the Federal Reserve System or because it is insured by the Federal Deposit Insurance Corporation ("FDIC").

Herein, the gross receipts that JPMCC receives from activities permitted by Article 3 of the Banking Law are permissible activities for purposes of the gross receipts test under section 16-2.5(j)(4) of the Regulations even though HGT may not engage in such activities because of restrictions placed on it by its membership in the Federal Reserve System and by the FDIC. However, under section 97.4-b of the Banking Law, a bank's power to invest in equity securities is an ancillary one and severely restricted. Section 97.4-b provides that the aggregate amount of all investments in common and preferred stock shall not exceed two percent of assets or 20 percent of capital, whichever is less.

Since JPMCC investment in stock is in excess of 90 percent of its assets, it exceeds the limitations under section 97.4-b of the Banking Law and is not principally engaged in a business which might be lawfully conducted by a corporation subject to Article 3 of the Banking Law. In addition, JPMCC is not principally engaged in a business which might be lawfully conducted by a national banking association, nor is it principally engaged in a business that is so closely related to banking or managing or controlling banks as to have been a proper incident to a banking business as set forth in section(4)(c)(8) of the Bank Holding Company Act of 1956.

Accordingly, JPMCC is not a banking corporation pursuant to section 1452(a)(9) of the Tax Law and is not subject to the franchise tax under Article 32 of the Tax Law. Petitioner's other questions with respect to the gross receipts test are moot.

DATED: December 16, 1992

s/PAUL B. COBURN
Deputy Director
Taxpayer Services Division

NOTE: The opinions expressed in Advisory Opinions are limited to the facts set forth therein.