

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

TSB-A-94 (14) C
Corporation Tax
October 14, 1994

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. C940607A

On June 7, 1994, a Petition for Advisory Opinion was received from Diversified Futures Trust I, c/o Prudential Securities Futures Management, Inc., Financial Square, 6th Floor, New York, New York 10272.

The issue raised by Petitioner, Diversified Futures Trust I, is whether an entity organized as a Delaware Business Trust, which is classified as a partnership for Federal income tax purposes, will be treated as a partnership and not as an association taxable as a corporation for New York State franchise tax purposes.

Petitioner has been formed as a business trust under Chapter 38 of Title 12 of the Delaware Code. Petitioner will be operated in accordance with the terms of a trust agreement ("Trust Agreement"). Petitioner will receive an opinion of legal counsel admitted to practice in the State of Delaware confirming that the provisions of the Trust Agreement will be effective under Delaware law to establish the rights and obligations of the holders of interests in Petitioner ("Interestholders") among themselves and with the public at large.

The purpose of Petitioner is to trade, buy, sell, spread and otherwise acquire, hold and dispose of commodity futures, forward and option contracts for the account of the Interestholders. The trustee of Petitioner is a Delaware commercial bank, which may be replaced by the Manager (defined below) at any time. The trustee has no operational or managerial responsibilities with respect to Petitioner; no business will be conducted by the trustee. Instead, the duties of the trustee are solely ministerial.

The duty and authority of the trustee to manage the business and affairs of Petitioner has been delegated to, and the conduct of Petitioner's investment activities is controlled and conducted exclusively by, one of the Interestholders, Prudential Securities Futures Management Inc., as managing owner ("Manager"). The principal office of the Manager is located in New York, New York.

The Manager is liable for the obligations and expenses of Petitioner, to the extent that they exceed and are not satisfied out of the assets of Petitioner, to the same extent that the Manager would be so liable if Petitioner were a partnership formed under the Delaware Revised Uniform Limited Partnership Act and the Manager was the general partner of such partnership.

The Manager has substantial assets other than its interest in Petitioner. In addition, the Manager initially will have a net worth, consisting of assets other than its interest in Petitioner, of 10 Percent of the total capital contributions made by Interestholders to Petitioner, and is obligated not to take any affirmative action to reduce its net worth below an amount that is sufficient

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to satisfy the net worth requirements in section 4.07 of Rev Proc 89-12, 1989-1 CB 798. (Rev Proc 89-12 sets forth certain guidelines that are applied by the Internal Revenue Service in determining whether to issue a ruling concerning the Federal income tax classification of a limited partnership). Such safe harbor currently is that the net worth of the general partner must be at least 10 percent of the total contributions made to the limited partnership.

Petitioner has two classes of beneficial interests: General Interests and Limited Interests. No certificate evidencing an interest in Petitioner will be issued.

The holder of all the General Interests is the Manager. The Manager will have at all times at least a one percent interest in each material item of Petitioner's income, gain, loss and deduction. The Manager will contribute in cash to Petitioner an amount, which, when added to the total initial capital contributions made to Petitioner by all the Interestholders, will be not less than one percent of such total contributions. In addition, the Manager will contribute in cash to Petitioner an amount equal to 1.01 percent of any additional capital contributions made to Petitioner by Limited Interestholders.

Limited Interests will be sold to the public pursuant to a public offering registered with the Securities and Exchange Commission. The Limited Interestholders will have a 99 percent interest in Petitioner. The General and Limited Interestholders will have the same rights to receive distributions from Petitioner and to be allocated a share of Petitioner's income, gain, loss and deduction.

Limited Interestholders will have rights equivalent to those of limited partners in a limited partnership. With few exceptions, Limited Interestholders will have no right or authority to participate in management decisions and will not be liable under the terms and conditions of the Trust Agreement and Delaware law for the debts and obligations of Petitioner.

The Manager may transfer its General Interests. Limited Interestholders, who own substantially all the interests in Petitioner, can assign their interests in Petitioner to third parties but the assignee cannot become a substitute participant except with the consent of the Manager, which consent the Manager may grant or withhold in its sole discretion.

Petitioner will dissolve on December 31, 2014, unless dissolved at an earlier date. Petitioner will dissolve automatically upon the bankruptcy, insolvency, dissolution, retirement or resignation of the Manager, unless the Limited Interestholders consent to continue Petitioner. Neither the death, insanity or bankruptcy of a Limited Interestholder nor the admission, withdrawal or substitution of a Limited Interestholder will cause Petitioner to terminate.

Petitioner states that pursuant to sections 301.7701-1, 301.7701-2, 301.7701-3 and 301.7701-4 of the Treasury Regulations, it will be treated as a partnership rather than an association taxable as a corporation for Federal income tax purposes. See, Rev Rul 88-79, 1988-2 CB 361.

Section 209.1 of the Tax Law imposes the business corporation franchise tax on every foreign corporation, unless specifically exempt, for the privilege of doing business, or of employing capital, or of owning or leasing property in New York State in a corporate or organized capacity, or of maintaining an office in New York State.

Section 208.1 of the Tax Law provides that the term "corporation" includes an association, within the meaning of section 7701(a)(3) of the Internal Revenue Code ("IRC"), a joint-stock company or association, a publicly traded partnership treated as a corporation for purposes of the IRC pursuant to section 7704 thereof and any business conducted by a trustee or trustees wherein interest or ownership is evidenced by certificate or other written instrument.

Chapter 61 of the Laws of 1989 amended section 208.1 Tax Law to include as a corporation, an association within the meaning of section 7701(a)(3) of the IRC and a publicly traded partnership treated as a corporation pursuant to section 7704 of the IRC. In the memorandum in support of Chapter 61 of the Laws of 1989, the statement in support of the amendment of section 208.1 of Article 9-A of the Tax Law states in part:

Associations and Publicly Traded Partnerships. The intent of these provisions is to tax as corporations for State purposes certain non-stock associations and publicly traded partnerships which are taxed as corporations for federal purposes. These noncorporate entities engage in business activities traditionally conducted in corporate or quasi-corporate form and enjoy some of the benefits of corporate form, such as continuity of life, centralization of management, limited liability of owners of the entity and free transferability of ownership interests, often widely held, in the entity...

Associations. Associations and joint-stock companies are included within the definition of the term "corporation" under the Internal Revenue Code and are accordingly taxed as such... Article 9-A of the Tax Law imposes a franchise tax on "business corporations," including "a joint-stock company or association and any business conducted by a trustee or trustees wherein interest or ownership is evidenced by certificate or other written instrument" Tax Law section 208.1. Thus ... Article 9-A and the Internal Revenue Code overlap in taxing as corporations (1) true corporations and (2) joint-stock companies and joint-stock associations. In addition, the Code taxes as corporations entities included under the rubric of "associations." Associations are unincorporated organizations whose characteristics are substantially similar to those of corporations. The term association as used in the Code includes those business trusts which are subject to Article 9-A ... as businesses "conducted by a trustee or trustees wherein interest or ownership is evidenced by certificate or other written instrument." However, there are other business entities which are taxed under the Code as associations but which are not subject to tax under Article ... 9-A. This bill would bring such entities within the scope of Article ... 9-A by adding the term "association" to the list of entities encompassed within the Article

... 9-A definition of the term corporation.

The term "association" is not defined in the Code itself, but is thoroughly explicated in Federal regulations at 26 CFR section 301.7701-02 (Emphasis added.)

As shown in the memorandum in support of Chapter 61 of the Laws of 1989, the Legislature recognized that the IRC taxes joint-stock companies and joint-stock associations as corporations, and that the term "association" as used in the IRC includes those business trusts which are subject to Article 9-A as businesses "conducted by a trustee or trustees wherein interest or ownership is evidenced by certificate or other written instrument". The Legislative intent in amending section 208.1 of the Tax Law is to tax as corporations certain non-stock associations and publicly traded partnerships that were not subject to tax under Article 9-A of the Tax Law but that are taxed as corporations for Federal income tax purposes. Such amendment includes within the ambit of a "corporation" all entities that meet the definition of an "association" under section 7701(a)(3) of the IRC and publicly traded partnerships treated as corporations under section 7704 of the IRC.

Accordingly, where a business trust is treated as a partnership rather than an association taxable as a corporation for Federal income tax purposes, such business trust does not come within the ambit of a "corporation" for purposes of section 208.1 of the Tax Law and is not subject to tax under Article 9-A of the Tax Law.

Herein, if Petitioner is an entity that does not meet the definition of an "association" under section 7701(a)(3) of the IRC and is not treated as a corporation for Federal income tax purposes, Petitioner is not a "corporation" under section 208.1 of the Tax Law and Petitioner is not subject to tax under Article 9-A of the Tax Law.

DATED: October 14, 1994

s/PAUL B. COBURN
Deputy Director
Taxpayer Services Division

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