

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

TSB-A-97(11)C  
Corporation Tax

STATE OF NEW YORK  
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. C970220B

On February 20, 1997, a Petition for Advisory Opinion was received from BT Capital Partners, Inc., c/o Corporate Tax Division - Mail Stop 2103, 130 Liberty Street - 10th Floor, New York, New York 10006.

The issues raised by Petitioner, BT Capital Partners, Inc., are (1) whether it will maintain its Article 9-A tax status, pursuant to the grandfather provision of section 16-2.5(j)(3) of the Franchise Tax on Banking Corporations Regulations ("Article 32 Regulations"), when it contributes substantially all of its assets to a new partnership in exchange for a partnership interest; and (2) whether it will be permitted to include in investment income its distributive share of partnership interest, dividends and capital gains, and include in investment capital its proportionate share of stock, bonds, and other securities of the partnership based on the status of the partnership assets.

Petitioner submits the following facts as the basis for this Advisory Opinion.

Bankers Trust New York Corporation ("BTNY"), a New York corporation, is a bank holding company and owns 100 percent of the stock of Bankers Trust Company ("BTCO"), a New York State chartered banking corporation. BTNY, BTCO and certain affiliated corporations file a combined New York State tax return under Article 32 of the Tax Law.

Petitioner was incorporated in Delaware on May 24, 1972, and is licensed to do business under the Federal Small Business Investment Company Act of 1958, as amended ("the Act"). Petitioner provides small business companies with financial assistance by granting loans and investing in long term notes and capital stock of qualified companies. Petitioner is a wholly owned subsidiary of BT Holdings (NY), Inc. ("BTH"), which is a wholly owned subsidiary of BTNY.

On March 17, 1982, Petitioner (under its former name, BT Capital Corporation) received an Advisory Opinion of the State Tax Commission, TSB-A-82(3)C, concluding that Petitioner was not principally engaged in business which might be lawfully conducted by a corporation subject to Article 3 of the Banking Law. For the taxable year at issue, less than one third of Petitioner's invested capital was devoted to business of a type permitted to banks organized under Article 3 of the Tax Law. The opinion stated that it was not a banking corporation, as defined under section 1452 of the Tax Law, and was not taxable under Article 32 of the Tax Law. It was classified as an Article 9-A corporation. Since receiving that opinion, Petitioner states that it has continued to file under Article 9-A of the Tax Law pursuant to the grandfather provision contained in section 16-2.5(j)(3) of the Article 32 Regulations.

In conducting its business, Petitioner competes with various venture capital and buyout funds in the hiring and retention of experienced management. In general, these independent venture capital and buyout funds are structured in

partnership form to afford their management the opportunity to participate directly in the investments they are managing. To retain and recruit experienced management, Petitioner plans to adopt a similar structure to provide similar incentives to its management. A new Delaware limited partnership BT Capital Partners, L.P. (the "Master Partnership") will be formed, of which Petitioner will be the general partner, and Petitioner's current management will be the limited partners. The Master Partnership will be the general partner of a second tier partnership called SBIC Partnership, L.P. ("SBIC L.P.") and Petitioner will be the limited partner. This two tier structure is required under the Act.

Petitioner will contribute substantially all of its assets and its license to operate as a Small Business Investment Company ("SBIC") to the Master Partnership in exchange for an interest in the Partnership. Each member of management will contribute cash to the Partnership in exchange for his or her limited partnership interest. The Master Partnership will then contribute all of its assets and its license to the SBIC L.P. The SBIC L.P. will then operate as an SBIC and make all future investments in assets eligible for investment by an SBIC that are originated by management. Management will continue to be employees of Petitioner and participate in all benefit plans they currently participate in. They will render services both to the partnerships and to Petitioner. Petitioner may make investments in assets that are not permissible investments for the SBIC. In addition, Petitioner will collect any fees for consulting services rendered by management. The partnership agreements provide that Petitioner will render the services of management to both partnerships.

Section 1452(a) of Article 32 of the Tax Law defines a "banking corporation". Chapter 298 of the Laws of 1985 amended section 1452(a)(9) of the Tax Law by expanding the definition of a banking corporation to include additional entities. However, to be a banking corporation, a corporation must still be 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 or which 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 Federal Bank Holding Company Act of 1956, as amended.

Section 1452(d) of the Tax Law was added by Chapter 298 of the Laws of 1985, and provides that, notwithstanding the provisions of Article 32, all corporations of classes now or heretofore taxable under Article 9-A shall continue to be taxable under Article 9-A except, among other entities, banking corporations described in section 1452(a)(9) of the Tax Law. However, section 1452(d) provides further that a corporation described in section 1452(a)(9) of the Tax Law which was subject to the tax imposed by Article 9-A for its taxable year ending during 1984 may make a one-time election to continue to be taxable under Article 9-A. The election is made by the corporation on or before the due date for filing its return (determined with regard to extensions) for its taxable year ending during 1985. The election shall continue to be in effect until revoked by the taxpayer. In no event shall the election or revocation be for a part of a taxable year.

Section 16-2.5(j)(3) of the Franchise Tax on Banking Corporations Regulations provides that the election is made by the filing of a tax return pursuant to Article 9-A of the Tax Law and the revocation is made by the filing of a tax return pursuant to Article 32 of the Tax Law.

In this case, Petitioner received an Advisory Opinion of the State Tax Commission stating that for taxable year 1980 and subsequent taxable years during which its activities were substantially similar to those in 1980, it was not a banking corporation pursuant to section 1452(a)(9) of the Tax Law. Accordingly, Petitioner was properly classified as an Article 9-A taxpayer. Assuming that Petitioner's activities have not changed and that its activities are not activities described in section 4(c)(8) of the Federal Bank Holding Company Act of 1956, as amended, Petitioner did not qualify as a banking corporation under section 1452(a)(9) of the Tax Law either before or after that section was amended in 1985. Therefore, if Petitioner's activities did not change and its activities are not described in section 4(c)(8) of the Federal Bank Holding Company Act of 1956, as amended, the election pursuant to section 1452(d) of the Tax Law to continue to be taxable under Article 9-A of the Tax Law would not be applicable to Petitioner.

Since Petitioner states that it is still operating as a Small Business Investment Company, it is assumed that it has never met the conditions of section 1452(a)(9) of the Tax Law. Based on that assumption, Petitioner is still classified as an Article 9-A taxpayer and the election contained in section 1452(d) of the Tax Law is not applicable to Petitioner.

In the event that Petitioner properly made the election contained in section 1452(d) of the Tax Law to be "grandfathered" under Article 9-A of the Tax Law, the fact that Petitioner contributes substantially all of its assets and its license to operate as a SBIC to Master Partnership in exchange for an interest in the Partnership, and the contribution of all of Master Partnership's assets and its license to SBIC L.P. will not revoke the election made by Petitioner pursuant to section 1452(d) of the Tax Law to continue to be taxable under Article 9-A of the Tax Law.

With respect to Petitioner's second question, section 3-13.2 of the Business Corporation Franchise Tax Regulations ("Article 9-A Regulations") provides that each partnership item of income, capital, gain, loss or deduction has the same source and character in the hands of a partner for Article 9-A purposes as it has in its hands for federal income tax purposes. Where an item is not characterized for federal income tax purposes or is not required to be taken into account for federal income tax purposes, the source and character of the item shall be determined as if such item were realized by the partner directly from the source from which realized by the partnership, or incurred by the partner in the same manner as incurred by the partnership.

Section 3-13.3 of the Article 9-A Regulations provides that where a partner is a member in a partnership, and such partnership (the "upper tier partnership") is a partner in another partnership (the "lower tier partnership"), the source and character of such member's distributive share of each partnership item of income, capital, gain, loss or deduction of the upper tier partnership which is attributable to the lower tier partnership retains the source and character

determined at the level of the lower tier partnership using the provisions of section 3-13.2 of the Article 9-A Regulations. Such source and character are not changed by reason of the fact that such item flows through the upper tier partnership to such member.

Section 4-6.5(a) of the Article 9-A Regulations provides that a taxpayer which is a partner of a partnership, other than a taxpayer which makes the election pursuant to section 3-13.1 of the Article 9-A Regulations (relating to foreign corporate limited partners), must include its proportionate part of the partnership's property, receipts and payroll within and without New York State in computing its business allocation percentage and alternative business allocation percentage and must include its proportionate part of the assets and liabilities of the partnership which are used in the computation of investment capital in computing its investment allocation percentage. The term *proportionate part* as used in this section means the percentage which the partnership used to distribute to the partner, its distributive share of partnership ordinary income in an income year, or partnership ordinary loss in a loss year.

Accordingly, the income, capital, gain, loss or deduction of SBIC L.P. will retain its source and character when it flows through the Master Partnership to Petitioner. Therefore, Petitioner may include in its investment capital, its proportionate share of stock, bonds, and other securities of SBIC L. P. that qualify as investment capital. Further, Petitioner's distributive share of partnership interest, dividends and capital gains attributable to its investment capital is included in Petitioner's investment income.

DATED: May 19, 1997

/s/  
John W. Bartlett  
Deputy Director  
Technical Services Bureau

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