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

TSB-A-98(8)C
Corporation Tax

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. C980220A

On February 20, 1998, a Petition for Advisory Opinion was received from El Paso Energy Marketing Company, c/o Christopher L. Doyle, Hodgson Russ Andrews Woods & Goodyear LLP, 1800 One M&T Plaza, Buffalo, New York 14203.

The issues raised by Petitioner, El Paso Energy Marketing Company, are:

1. Whether a limited partnership whose principal business activity in New York is the sale of natural gas will be subject to franchise taxes in addition to the gross receipts tax imposed under section 186-a of the Tax Law.

2. Whether a limited partner having a 99 percent interest in the limited partnership will be subject to franchise tax under Article 9-A of the Tax Law based on its status as a passive investor in the limited partnership.

3. Whether a general partner having a one percent interest in the limited partnership will be subject to the gross earnings tax imposed under section 186 of the Tax Law based on its day to day activities of operating the limited partnership and on the management responsibility assigned to it as the result of New York's Partnership Law.

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

Petitioner is a foreign corporation that is currently principally engaged in the purchase and sale of natural gas in North America. Petitioner's principal business activity in New York State is also the sale of natural gas. Petitioner proposes to transfer all of the assets related to its New York business activities (including gas sales agreements, gas purchase agreements, customer lists, accounts receivable, etc.) to a newly formed wholly-owned subsidiary ("Newco"). Newco and Petitioner will immediately thereafter establish a limited partnership, El Paso Energy Marketing Limited Partnership ("Partnership") to engage in the New York business activities. Newco will be Partnership's sole limited partner, and will receive a 99 percent limited partnership interest in exchange for contributing all of its assets to Partnership. Petitioner will be Partnership's sole general partner, and will receive its one percent interest in exchange for cash or other valuable property that it will contribute to Partnership.

Subsequent to the restructuring, Partnership will engage in the purchase and sale of natural gas in New York, but will not be subject to the administrative oversight of the Public Service Commission with respect to the prices it charges for sales of natural gas to New York consumers. Some of the gas sold to New York purchasers will be consumed by such purchasers in New York. Partnership may engage in this activity through its own employees; however, it is more likely that it will contract with Petitioner to perform all the activities necessary to further its business objectives. In this latter case, Partnership will pay Petitioner a negotiated service fee.

As a general partner, Petitioner will be solely responsible for Partnership's management. Newco, however, will not have any management authority with respect to Partnership, and will hold its 99 percent interest in Partnership solely for investment purposes. Newco will not have any contact with New York State other than its ownership of a limited partnership interest in Partnership.

For purposes of this advisory opinion it is assumed that Petitioner's pro rata share of gross receipts from Partnership's sales of natural gas will constitute more than 50 percent of Petitioner's receipts from all New York activities.

Partnership will not be treated as an association taxable as a corporation under the Internal Revenue Code. Interests in Partnership will not be publicly-traded.

Applicable Law, Regulations and Case History

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 for tax under sections 183 through 186 of Article 9 of the Tax Law is not subject to tax under Article 9-A of the Tax Law.

Section 1-3.2(a)(6)(i) of the of the Business Corporation Franchise Tax Regulations (the "Article 9-A Regulations") provides that:

> [a] foreign corporation is doing business, employing capital, owning or leasing property or maintaining an office in New York State if it is a limited partner of a partnership, other than a portfolio investment partnership, which is doing business, employing capital, owning or leasing property or maintaining an office in New York State and if it is engaged, directly or indirectly, in the participation in or the domination or control of all or any portion of the business activities or affairs of the partnership. A foreign corporation is engaged in such manner in the business activities or affairs of the partnership if one or more of certain factual situations, including but not limited to the following, exist during the taxable year ...
>
> (*a*) The foreign corporation has a one percent or more interest as a limited partner in a partnership ...

Section 186 of Article 9 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 ... gas, when delivered through mains or pipes ...." The tax is imposed for the privilege of exercising its corporate franchise or carrying on its business in a corporate or organized capacity in New York State and is based, in part, upon gross earnings from all sources within New York State.

For purposes of section 186, where a partnership is in the business of supplying gas in New York, a corporate general partner is, generally, also engaged in the business of supplying gas in New York. In interpreting section 209.1 of the Tax Law, section 1-3.2(a)(5) of the Article 9-A Regulations sets forth a general rule which holds that if a partnership is exercising any of the privileges of section 209.1, then all of its corporate general partners are subject to the tax imposed by Article 9-A. The same interpretation was made for purposes of Article 9 of the Tax Law in The Partners of Buffalo Telephone Company, Adv Op Comm T & F, February 22, 1989, TSB-A-89(3)C. The Advisory Opinion held that where a partnership is engaged in a telephone business in New York State, each corporate partner is also engaged in a telephone business in New York State, and each corporate general partner of the partnership that is principally engaged in such telephone business is subject to tax under sections 183 and 184 of Article 9.

In GTE Spacenet Corp. v NYS Dept of Taxation and Finance, 224 AD2d 283, the Court held that while the partnership was arguably engaged in activities enumerated in sections 183, 183-a, 184 and 184-a of the Tax Law, the evidence demonstrated that the partners were engaged in the investment business and were not engaged in the conduct of any of the businesses enumerated in sections 183, 183-a, 184 and 184-a of the Tax Law because the partners were mere passive investors and did not participate in the day-to-day management or operations of the partnership. Therefore, the partners were subject to tax under Article 9-A and were not subject to the franchise taxes imposed pursuant to sections 183, 183-a, 184 and 184-a of the Tax Law.

For purposes of both Article 9-A and section 186 of Article 9 of the Tax Law, the term "corporation" includes an association within the meaning of section 7701(a)(3) of the Internal Revenue Code.

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 purpose for which the corporation was organized. See Matter of McAllister Bros., Inc. v Bates, 272 App Div 511, 517 (3rd Dept. 1947). Ordinarily, a corporation is deemed to be principally engaged in the activity from which more than 50 percent of its receipts are derived. See, e.g., Joseph Bucciero Contracting Inc., Adv Op St Tax Commn, July 23, 1981, TSB-A-81(5)C.

Section 186-a of the Tax Law imposes a tax on the furnishing of utility services. The tax is imposed on a utility which is not subject to the supervision of the New York State Department of Public Service, if it "sells gas ... delivered through mains [or] pipes ... or furnishes gas ... service, by means of mains [or] pipes ... regardless of whether such activities are the main business of such person or are only incidental thereto...." The tax is equal to three and one-half 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. The tax imposed under section 186-a of the Tax Law is imposed in addition to any and all other taxes and fees imposed by any other provision of law for the same period.

For purposes of section 186-a of the Tax Law, the word "utility" includes a person and the word "person" includes, among others, a person and a co-partnership. Thus, section 186-a imposes a tax upon incorporated and unincorporated entities alike, including a partnership (see, Partners of Buffalo Telephone Company, supra.)

Conclusions

Issue 1: Generally, partnerships are not subject to the franchise tax imposed under Article 9-A of the Tax Law or under section 186 of Article 9 of the Tax Law. However, under section 186-a of Article 9 of the Tax Law, a partnership, including a limited partnership, is a person that may be a taxable utility. Accordingly, in this case, Partnership will not be subject to tax under Article 9-A or section 186 of Article 9 of the Tax Law. For purposes of section 186-a of Article 9, Partnership will be a utility of the "second class" because Petitioner states that Partnership will not be subject to the supervision of the Public Service Commission, but will be engaged in the purchase and sale of natural gas in New York where some of the gas sold in New York will be consumed by purchasers in New York. Therefore, Partnership will be subject to the tax imposed under section 186-a of Article 9 on its "gross operating income".

Issue 2: In this case, Newco will be a limited partner in Partnership which is doing business, employing capital, owning or leasing property or maintaining an office in New York State. Pursuant to the section 1-3.2(a)(6) of the Article 9-A Regulations, Newco will be engaged, directly or indirectly, in the participation in or the domination or control of all or any portion of the business activities or affairs of the partnership because Newco will have more than a one percent interest in Partnership. Accordingly, Newco will be doing business, employing capital, owning or leasing property or maintaining an office in New York State and will be subject to tax under Article 9-A unless it is subject to tax under section 186 of Article 9. If Newco is a mere passive investor and does not participate in the day-to-day management or operations of Partnership, then, pursuant to GTE Spacenet, supra, Newco will not be subject to tax under section 186 of Article 9 of the Tax Law. However, if Newco is not a mere passive investor or if it participates in the day-to-day management or operations of Partnership, Newco will not come within the scope of GTE Spacenet, supra, and following Partners of Buffalo Telephone, supra, Newco will be considered to be engaged in the business of Partnership and will be subject to tax under section 186 of the Tax Law. The determination of whether Newco is a mere passive investor and whether it participates in the day-to-day management or operations of Partnership is a question of fact that is not susceptible of determination within the context of an advisory opinion. An advisory opinion merely sets forth the applicability of pertinent statutory and regulatory provisions to "a specified set of facts." Tax Law, §171.Twenty-fourth; 20 NYCRR 2376.1(a).

Issue 3: Petitioner states that it will be solely responsible for Partnership's management and will perform the day to day activities of operating Partnership, and, it is assumed, Petitioner's pro rata share of gross receipts from Partnership's sales of natural gas will constitute more than 50 percent of Petitioner's gross receipts. Accordingly, pursuant to Partners of Buffalo Telephone, supra, Petitioner will continue to be principally engaged in the business of supplying gas and will continue to be subject to tax under section

186 of the Tax Law. Petitioner is also subject to tax under section 186-a of Article 9 of the Tax Law on its gross operating income. Note that, under section 186-a, Petitioner is not subject to tax on its pro rata share of gross receipts from Partnership's sales of natural gas for which the partnership has already paid the tax imposed under section 186-a.

/s/
DATED: June 15, 1998 John W. Bartlett
Deputy Director
Technical Services Bureau

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