STATE OF NEW YORK
STATE TAX COMMISSION

ADVISORY OPINION PETITION NO. C801201A

On December l, 1980 a Petition for Advisory Opinion was received from Dickstein, Shapiro and Morin on behalf of Boundary Gas, Inc., 2101 L Street, N.W., Washington, D.C. 20037.

THE ISSUE

The issue raised by Petitioner is whether Boundary Gas, Inc., under the circumstances described below, is subject to the franchise tax on water-works companies, gas companies, electric or steam heating, lighting and power companies imposed under section 186 of the Tax Law, or the tax on the furnishing of utility services imposed under section 186-a of the Tax Law.

THE FACTS

The facts set forth by Petitioner, and upon which this Advisory Opinion will be based, are as follows. Boundary is a close corporation organized on July 7,1980 under the laws of the State of Delaware. Boundary was created in conjunction with the development of a project to import natural gas from Canada. The gas import project (hereinafter referred to as the "Project") is being undertaken by fourteen companies located in New York, New Jersey and New England. The fourteen Project companies are the sole stockholders of Boundary. Thirteen of the companies are natural gas distribution companies; one is an interstate natural gas pipeline company. The gas to be imported would enter the United State at a point on the border between Canada and New York.

The creation of Boundary was for a limited and specific purpose. Natural gas imports from Canada are regulated and controlled by the Government of Canada and the United States Government. In order to import Canadian natural gas, the Canadian exporter must obtain an export permit from the Canadian National Energy Board ("NEB"), and the United States importers must obtain import permits and other authorizations from the Economic Regulatory Administration ("ERA") and Federal Energy Regulatory Commission ("FERC") in the United States. Under ordinary circumstances, a company proposing to import gas from Canada would enter into a gas purchase contract with the exporter, which would then form the basis for regulatory applications to the NEB, ERA and FERC. In the case of the Boundary Project, however, that approach would result in fourteen separate gas purchase contracts and fourteen sets of filings at the NEB, ERA and FERC. There would, in other words, be forty-two separate regulatory applications and proceedings. The need for fortytwo filings would be repeated each time routine regulatory review became necessary during the term of the Project. In addition, there would be other burdens associated with administering fourteen separate gas purchase contracts. By way of example, routine reports submitted to government agencies must be filed for each supply contract. Inventory record keeping requirements also would be multiplied by a factor equal to the number of supply contracts.

In order to avoid the proliferation of regulatory proceedings and administrative burdens, the fourteen Project companies created Boundary as a consolidating "project entity." Under that concept,

Boundary (acting on behalf of its stockholders) would enter into one gas purchase contract with TransCanada (the Canadian exporter), and Boundary would file single applications with ERA and FERC for authority to import the gas purchased under that contract. Boundary would also enter into a single gas sales agreement with its fourteen stockholders to resell the imported gas to the stockholders, and would file a single application with FERC for authority to resell the gas in interstate commerce. Petitioner contends that although the transactions are structured in terms of sales, "it is clear that the contracts do not include 'sales' in the traditional tax sense."

Boundary's limited purpose is stated to be reflected in its Certificate of Incorporation and the contracts to which it has agreed in principle with the Canadian gas exporter. With regard to Boundary's Certificate of Incorporation, Article Eight specifies that Boundary is controlled exclusively and totally by its stockholders; it does not have a Board of Directors. In addition, Article Four, Section 6 of the Certificate of Incorporation bars Boundary from selling gas to any entity which is not a stockholder of Boundary. Thus, Boundary is permanently precluded from selling gas to any entity which has not agreed to be bound by the restrictive contracts and agreements required of all Boundary stockholders. This preclusion is reinforced by a stockholders' Memorandum of Agreement which specifies certain restrictions on the transfer of stock and certain requirements for Boundary's contractual relations with the Canadian gas exporter. One of these requirements is unanimous approval by the stockholders of all contracts and regulatory authorizations.

To satisfy regulatory requirements, the form of Gas Purchase Contract agreed to by Boundary specifies that Boundary will take title to the contract gas on the United States Canadian international border, thereby establishing Boundary as the importer. However, Boundary is simultaneously to transfer title to the gas to its fourteen stockholders. In other words, Boundary will hold title to the gas only for the instant required to establish it as the importer. Under the Gas Purchase Contract, Boundary will receive only bare legal title to the gas; Boundary will not take physical possession of the gas. This is so because Boundary will neither own nor operate any facilities of any nature whatsoever. The gas will physically be delivered to a United States interstate pipeline company ("Tennessee") with which each of the fourteen Boundary stockholders will have a transportation contract. This pipeline company is not itself a stockholder of Boundary, nor is it related to or affiliated with any of the stockholders. Boundary will itself have no contractual arrangements with the transporting pipeline company, other than a simple Operating Agreement authorizing direct communications between the United States transporting pipeline company and the Canadian exporter. Petitioner contends that aside from the fact that Boundary holds bare legal title to the gas for an instant, the arrangements for movement of the gas imported under the Gas Purchase Contract are essentially no different than if the fourteen Boundary stockholders had contracted directly with the Canadian exporter.

The form of Gas Sales Agreement agreed to by Boundary and its stockholders repeats the provisions outlined above regarding passage of title and the physical movement of the gas. The Gas Sales Agreement further specifies that all gas purchased by Boundary under the Gas Purchase Contract must be resold to the Boundary stockholders in proportion to their ownership interests in Boundary. Finally, the Gas Sales Agreement provides that Boundary's charges to the stockholders for the gas will be exactly equal to Boundary's cost of the gas. In other words, Boundary is merely to pass through any cost of gas and thus to show neither profit nor loss on the transactions.

Under the forms of Gas Purchase Contract and Gas Sales Agreement, payments for gas are to be deposited by the stockholders with an escrow agent pursuant to an Escrow Agreement. To the extent that Boundary incurs any administrative or operating expenses (such as regulatory costs and expenses, taxes and the like), those expenses are passed through on a dollar for dollar basis to the stockholders. Payments for these non-gas charges do not pass through the escrow agent. Disbursements of funds to TransCanada will be made by the escrow agent, based upon the invoice from TransCanada to Boundary. Consistent with this insulation of Boundary from the funds paid for the gas, the form of Gas Purchase Contract provides that TransCanada's claim in the event of any default by Boundary lies directly against the Boundary stockholder whose actions caused Boundary's default. While, for legal purposes, TransCanada may also proceed against Boundary, the Gas Purchase Contract effectively limits any recovery to Boundary's paid-in capital (which is $10,000). The Gas Purchase Contract, Gas Sales Agreement and the stockholders' Memorandum of Agreement among Boundary stockholders also specify that in no event shall any stockholder be liable for any obligations of another stockholder. In other words, Boundary is expressly precluded from being a legal vehicle by which joint liability can be imposed upon the stockholders. Thus, the arrangements for purchase and resale of gas are said by Petitioner to be legally equivalent to a situation wherein each Boundary stockholder contracted directly and separately with TransCanada.

THE LAW

Section 186 of the Tax Law, contained in Article 9 thereof, imposes a franchise tax on "Every 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.." The tax is computed as the sum of a percentage of gross earnings from all sources within the state and a percentage of certain dividends paid.

Section 186-a of the Tax Law, also contained in Article 9 thereof, imposes a tax on the furnishing of utility services. In the case of utilities not subject to the supervision of the Department of Public Service, as is the case with respect to Boundary, the tax is equal to three per cent of the "gross operating income" of every such utility doing business in New York which has an annual gross operating income in excess of five hundred dollars. The term "utility" includes every "person," including every corporation, "... who sells gas... delivered through mains, pipes ...." The term "gross operating income" means and includes"..... receipts received in or by reason of any sale, conditional or otherwise, made for ultimate consumption or use by the purchaser...of gas.

THE OPINION

Section 186 of the Tax Law imposes a franchise tax on gas companies "formed for or principally engaged in the business of supplying. . .gas, when delivered through mains or pipes ...." In determining whether Petitioner constitutes such a "gas company" reliance may be placed on Matter of McAllister Bros. v. Bates, 272 App. Div. 511. In McAllister a corporation was incorporated under a charter authorizing it to conduct virtually any legitimate business, including a marine transportation business. This corporation was in effect a successor to a partnership engaged in marine transportation, all of the assets of which,

> "including the fleet of vessels, were transferred to the new corporation. For the purpose of avoiding any possible tort claims for

> injuries arising out of petitioner's activities in marine corporations, the McAllister Lighterage Line, Inc., was formed, and then accepted the proposal and offer of the McAllister Brothers, Inc. to charter all of its vessels and operating equipment for a period of twenty years, the consideration being embodied in a resolution passed by the directors of the petitioner on November 13, 1937, which read as follows: 'Resolved, that this corporation enter into a contract with McAllister Lighterage Line, Inc. to charter each and every vessel owned by McAllister Brothers, Inc. on a bare boat basis for the sum equivalent to the net profits per annum accruing to the McAllister Lighterage Line, Inc. from said operation at a minimum of $5,000 per annum (net profits to be gross earnings, less overhead, salaries, taxes, operating expenses) for a period of twenty (20) years.'
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> "Since November, 1937, McAllister Brothers, Inc., has had but one employee on its payroll, namely, the president of its corporation. It has control of no equipment. The McAllister Lighterage Line, Inc. operates in excess of one hundred vessels of all types in the transportation business and employs from three hundred to four hundred men. It receives the gross income, and pays all expenses in connection with its business. The petitioner does not have control over the operation or use of this equipment. The petitioner's assets consist of title to such equipment, cash and stock of other corporations." Id. at 514.

The court held that the corporation was not a transportation company subject to tax under sections 183 and 184 of the Tax Law. The court pointed out that "petitioner had parted with all supervision and control of the vessels, holding only title." Id. at 516. In reality, the corporation had assumed the position of one who leased property to another "over which he has no control or supervision and no voice in the operating activity of" such a lessee. Id. at 516. The corporation, thus, as a merely passive holder of title, was held not to be in the transportation business.

Precisely similar considerations apply in the instant matter. Petitioner herein is not a corporation engaged in the business of selling gas through mains or pipes. Indeed, it neither owns nor leases mains or pipes, nor does it exercise any other manner of control over such property. As stated in the Operating Agreement between Petitioner and the pipeline companies which do deliver the gas in question, "Boundary owns and operates no facilities." (Exhibit 4). All that Petitioner ever owns is the gas, and that only instantaneously, for the mere purpose of facilitating the transfer from the Canadian exporter to Petitioner's stockholders (the "Repurchasers"). Thus, Article XVI of the Gas Sales Agreement between Petitioner and the Repurchasers (Exhibit 2, p. 22) provides as follows:

> "ARTICLE XVI - POSSESSION OF AND TITLE TO GAS
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> Upon delivery of the gas by Boundary to Repurchasers at the Point of Delivery, title to the gas shall pass from Boundary to Repurchasers and Repurchasers shall take possession of such gas and shall be deemed to be in control thereof. Boundary shall not be responsible for such gas thereafter, regardless of anything which may be done,

happen or arise with respect to such gas after delivery. Each Repurchaser understands that delivery of the gas by Boundary to Repurchasers shall occur simultaneously with Tennessee's receipt of such gas from TransCanada for Boundary's account, and that Boundary will neither own nor construct any facilities in connection with this Agreement. Notwithstanding the fact that Boundary will hold title to the gas for the instant necessary to transfer title to Repurchasers, delivery of the gas by TransCanada into Tennessee's facilities shall be deemed to be delivery of the gas by Boundary to Repurchasers for purposes of determining as between Boundary and Repurchasers when Repurchasers gain possession and control of the gas."

It is clear from the foregoing that Petitioner has no connection with the as being sold other than the holding of bare legal title thereto for an instant of time, and certainly no control or supervision over the gas. With regard to the issue of control, it should be noted that Petitioner is managed directly by its stockholders, the fourteen Repurchasers, rather than by a Board of Directors. Bylaws, Article III (Exhibit l).

Petitioner is in reality, thus, a special purpose administrative service organization, one designed to facilitate the development and administration of a natural gas import project. It is not engaged in the business of supplying gas, and is thus not subject to the franchise tax on gas companies imposed under section 186 of the Tax Law. Indeed, it is specifically provided that, as stated in the Gas Sales Agreement, "it is the intention of the parties that the gas sold by Boundary to the Repurchasers shall be sold at Boundary's cost including Boundary's expenses and shall not produce a profit or a loss to Boundary. . . ." The broad powers contained in the Petitioner's corporate charter do not defeat this analysis, because it is the nature of the business and not the chartered, rights that determine the classification of a corporation under the franchise tax law. McAllister, supra; People ex rel. Goodwin Sand & Gravel Co. v. Law, 207 App. Div. 567.

Section 186-a of the Tax Law imposes a tax on "utilities" which, as in the case of Petitioner, are not subject to the supervision of the Department of Public Service. The term "utility," as used in such context, refers to gas companies, inter alia, which sell gas to the ultimate consumer. Thus, assuming, arguendo, that Boundary is a "utility" within the meaning of section 186-a of the Tax Law, since it would be a utility not subject to the supervision of the Department of Public Service it would be subject to tax under section 186-a only if it had an annual gross operating income in excess of five hundred dollars. As used in the statutory provision, gross operating income means, insofar as the definition is here germane, receipts from sales of gas "for ultimate consumption or use by the purchaser." Applicable Regulations of the State Tax Commission provide as follows:

"Receipts from sales or services for ultimate consumption or use by the purchaser in this State are taxable, but receipts from sales for resale, as distinguished from sales for consumption, are not taxable.

"Question 37: The 'A' gas company in New York sells and delivers to the 'B' gas company in New York two million cubic feet of gas, which the 'B' company resells to consumers. Are the receipts from the sale of 'A' to 'B' taxable? Answer: No." 20 NYCRR 501.9(a). Inasmuch as

Boundary's sales are not to purchasers for their ultimate consumption or use, but to purchasers which purchase the gas for resale, none of Boundary's receipts would be includible in "gross operating income." Accordingly, since Boundary will in no event have an annual gross operating income in excess of five hundred dollars it will not be subject to the tax on the furnishing of utility services imposed under section 186-a of the Tax Law.

DATED: April 9,1981

s/LOUIS ETLINGER
Deputy Director
Technical Services Bureau