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

TSB-A-94 (2) I
Income Tax
February 1, 1994

STATE OF NEW YORK

COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. I931108B

On November 8, 1993, a Petition for Advisory Opinion was received from Lee S. Richards, Receiver under Boesky/Siegal/Kidder-Peabody Disgorgement Funds, Richards Spears Kibbe & Orbe, 140 Broadway, New York 10005.

The issues raised by Petitioner, Lee S. Richards, Receiver under Boesky/Siegal/Kidder-Peabody Disgorgement Funds, are (1) whether the disgorgement funds are corporations under Article 9-A of the Tax Law and the earnings of each disgorgement fund taxable under Article 9-A of the Tax Law; (2) whether the disgorgement funds are trusts and subject to tax section 601 of Article 22 of the Tax Law and the earnings of each disgorgement fund taxable under Article 22 of the Tax Law and (3) whether the claimants or the defendants are separately subject to New York income tax on the earnings of the disgorgement funds.

Petitioner is the receiver of deposits in three settlement funds, Boesky Disgorgement Fund, Siegal Disgorgement Fund and Kidder, Peabody Disgorgement Fund (hereinafter "Disgorgement Funds") established by court order in final settlement of three separate actions brought by the Securities & Exchange Commission (hereinafter "SEC") against defendants alleging violations of the insider trading laws (each a "Court Order").Pursuant to each Court Order, the defendant deposited amounts with Petitioner,which amounts, together with any earnings thereon, are to be disbursedto persons allegedly injured by the particular defendant and certain related parties pursuant to a court-approved plan proposed by the SEC.

Each Court Order severely limits Petitioner's authority to invest the Disgorgement Funds by restricting the class of permissible investments to U.S. government securities entitled to the full faith and credit of the United States, and FDIC insured certificates of deposit or money market accounts at any domestic bank having a combined capital and surplus of at least $5,000,000,000. Petitioner has no discretion to make distributions to claimants, which are to be governed entirely by the SEC plan of distribution approved by court order. Pursuant to each Court Order, in no circumstance is any portion of the Disgorgement Fund to be returned to or otherwise made available to the defendant, his or its heirs or successors.

On March 15, 1993, Petitioner filed an election with the Internal Revenue Service (hereinafter "IRS") on behalf of each Disgorgement Fund to be treated as a "qualified settlement fund" in accordance with the newly finalized Treasury Regulations under section 468B(g) of the Internal Revenue Code (hereinafter "IRC"). But for Petitioner's election, approved by the SEC and the Court, the Disgorgement Funds are nottaxable entities and are not required to file annual Federal income tax returns.Since their inception, however, Petitioner has filed Federal Form 1041 annuallywith the IRS and Form IT-205 with the New York State Department of Taxation and Finance for each Disgorgement Fund solely to disclose the amount of income earned.

The income earned is continually added to the underlying deposits and the entire amount is reinvested for ultimate distribution to claimants. Because distributions relate solely to the underlying claim or injury, they do not reflect any separate accounting or allocation of the income earned by the Disgorgement Funds. Likewise, the taxation of a distribution in the hands of the claimant is based solely on the particular nature of the claim presented. Thus, the tax treatment of each distribution can vary considerably from claimant to claimant.

The class of claimants is widely-defined and dispersed. The situs of the funds themselves and the limited investment activity with respect thereto is determined entirely by the SEC and the Court Order. It is fortuitous that they are presently held within the State of New York. The claimants have no rights to "earnings" but, rather, to some aggregate sum payable pursuant to the court approved plan.

Section 209.1 of the Tax Law imposes, annually, a franchise tax on every corporation for the privilege of exercising its corporate franchise, or 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 for all or any part of each of its fiscal or calendar years.

Section 208.1 of the Tax Law provides that:

> The term "corporation" includes an association, within the meaning of paragraph three of subsection (a) of section seventy-seven hundred one of the internal revenue code, a joint-stock company or association, a publicly traded partnership treated as a corporation for purposes of the internal revenue code pursuant to section seventy-seven hundred four thereof and any business conducted by a trustee or trustees wherein interest or ownership is evidenced by certificate or other written instrument ...

The term "corporation" is defined in section 1-2.3 of the Business Corporation Franchise Tax Regulations, which provides, in part, that:

> (a) The term 'corporation' means an entity created as such under the laws of the United States, any state, territory or possession thereof, the District of Columbia, or any foreign country, or any political subdivision of any of the foregoing, which provides a medium for the conducting of business and the sharing of its gains.
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> (b) ... An entity conducted as a corporation is deemed to be a corporation.
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> (2) A business conducted by a trustee or trustees in which interest or ownership is evidenced by certificate or other written instrument includes, but is not limited to, an association commonly referred to as a business trust or Massachusetts trust. In determining whether a trustee or trustees are conducting a business, the form of the agreement is of significance but is not controlling. The actual activities of the trustee or trustees, not their purposes and powers, will be regarded as decisive factors in determining whether

> a trust is subject to tax under article 9-A of the Tax Law. The mere investment of funds and the collection of income therefrom, with incidental replacement of securities and reinvestment of funds, does not constitute the conduct of a business in the case of a business conducted by a trustee or trustees ....

For New York State franchise tax purposes, an unincorporated entity is not taxed as a corporation unless its activities are conducted in a manner whereby the entity presents itself as a corporation, in which case it is deemed to be a corporation.

The conduct of business is more than the ownership of property and the collection and distribution of income derived from that property. (Smadbeck v St Tax Comm, 33 NY2d 930 (1973); People ex rel Nauss v Graves, 283 NY 383, 386 (1940)). It is "more than the mere investment of funds and the collection of income therefrom, with the incidental replacement of securities and the reinvestment of funds that constitute the corpus, as in the case of an ordinary trust." (Burrell v Lynch, 274 AD 347, 352 (1948); see also, City Bank Farmers Trust Co. v Graves, 272 NY 1, 6 (1936)).

Herein, with respect to Petitioner's first issue, the activities of Petitioner, do not constitute the conduct of a business as contemplated by section 208.1 of the Tax Law and section 1-2.3 of the Business Corporation Franchise Tax Regulations. (See, Samuel R. Buxbaum, Administrator Buxbaum-Banco Popular Settlement Fund, Adv Op Comm T & F, April 30, 1993, TSB-A-93(10)C.) Accordingly, each Disgorgement Fund is not deemed to be a corporation for purposes of Article 9-A and is not subject to the tax imposed by such Article and the earnings of each Disgorgement Fund are not subject to tax under Article 9-A.

With respect to Petitioner's second issue, the New York State personal income tax under Article 22 of the Tax Law is imposed on resident and nonresident trusts.

Section 607(a) of the Tax Law provides, in pertinent part, that:

> Any term used in this article shall have the same meaning as when used in a comparable context in the laws of the United States relating to federal income taxes, unless a different meaning is clearly required ....

For Federal income tax purposes, each Disgorgement Fund has elected under section 1.468B-5(b)(2) of the Treasury Regulations to be treated as a qualified settlement fund for all taxable years since inception. Pursuant to section 1.468B-1(b) of the Treasury Regulations, a fund, account, or trust that is a qualified settlement fund that could be classified as a trust within the meaning of section 301.7701-4 of the Treasury Regulations, is classified as a qualified settlement fund for purposes of the IRC. Accordingly, since each Disgorgement

Fund is not treated as a trust for Federal income tax purposes, each Disgorgement Fund, pursuant to section 607(a) of the Tax Law, is not treated as a trust for purposes of Article 22 of the Tax Law; (See Samuel R. Buxbaum, Administrator Buxbaum-Banco Popular Settlement Fund, Adv Op Comm T & F, April 30, 1993, TSB-A-93(5)I.)

Further, section 601(g) of the Tax Law provides that an association, trust or other unincorporated organization which is taxable as a corporation for Federal income tax purposes shall not be subject to tax under Article 22 of the Tax Law. Herein, each Disgorgement Fund is a qualified settlement fund under section 468B of the IRC and pursuant to such section, each Disgorgement Fund is a person for Federal income tax purposes that is taxed on its modified gross income and the tax imposed is treated as a tax on corporations.

Accordingly, each Disgorgement Fund is not subject to the tax imposed under Article 22 of the Tax Law and the earnings of each Disgorement Fund are not taxable under Article 22.

With respect to Petitioner's third issue, section 611 of the Tax Law provides that New York taxable income of a resident individual is the individual's New York adjusted gross income less the individual's New York deduction and New York exemptions. Section 612 of the Tax Law provides that the New York adjusted gross income of a resident individual means the individual's Federal adjusted gross income as defined in the Laws of the United States for the taxable year, modified as required by such section. There is no modification in section 612 of the Tax Law with respect to income that is a distribution to a claimant from a qualified settlement fund. The income is treated the same for New York State personal income tax purposes as it is treated for Federal income tax purposes. Section 1.468B-4 of the Treasury Regulations states that whether a distribution to a claimant is includible in the claimant's gross income is generally determined by reference to the claim in respect of which the distribution is made and as if the distribution were made directly by the transferor.

Accordingly, the determination of whether the claimants or the defendants are separately subject to New York State personal income tax on the earnings of the Disgorgement Funds is a factual matter not susceptible of determination in 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, §l71.Twenty-fourth; 20 NYCRR 2376.1(a).

DATED: February 1, 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.