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Corporation Tax
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STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. C091102A

A petition was received from [redacted] . (the "Petitioner" or "ABC") asking whether it and several affiliated entities are required to file returns as banking corporations under Article 32 of the Tax Law. Petitioner also asks whether the deposits, if any, received by a limited partnership that are attributable to a limited liability trust company treated as a disregarded entity by the limited partnership would be included in the deposits factors of the limited partners that are Article 32 taxpayers.

We conclude that neither Petitioner nor any of its affiliated entities is considered a "banking corporation" subject to the filing requirements of Article 32. We also conclude that deposits received by the limited partnership, if any, would not be included in the respective deposits factors of the limited partners that are banking corporations.

Facts

Petitioner is a corporation organized under the laws of Delaware and is the parent corporation of the ABC affiliated group. Petitioner directly owns a 79.7 % limited partnership interest in ABC Holding Company LP ("ABC Holding"), a foreign limited partnership treated as a partnership for federal income tax purposes. Petitioner also owns a 100% interest in DEF, a Delaware limited liability company, which in turns owns a 0.08% general partnership interest in ABC Holding. Petitioner also owns a 100% interest in GHI, a United Kingdom entity disregarded for federal income tax purposes. GHI owns 100% of JKL, a corporation organized under the laws of Delaware, which in turn owns a 0.61% limited partnership interest in ABC Holding. The remaining 19.61% limited partnership interest in ABC Holding is held by several unrelated partners, which are mostly banks.

ABC Holding does not conduct any activities or operations on its own, but it holds a 100% membership interest in MNO Trust, a New York limited liability trust company disregarded for federal income tax purposes. ABC Holding also owns 100% of PQR, which developed the credit default swaps ("CDS") risk management framework, operational processes, and infrastructure used by MNO Trust's clearing operations described below. PQR files a return under Article 9-A of the Tax Law.

Petitioner operates over the counter (OTC) markets for commodities and derivative products. Headquartered in [redacted], Petitioner also has offices in New York City and several other cities in the U.S. and other countries. Through widely-distributed electronic marketplaces, Petitioner brings together buyers and sellers of derivatives and commodities, and offers a range of services to support participant's risk management and trading activities. Petitioner also offers a variety of market data services and products for OTC market participants. Petitioner's revenues are comprised of trading fees, trade confirmation fees, access fees for Petitioner's online information databases, market data fees, and other revenues. The other revenues include Petitioner's share of revenues from its limited partnership interest in ABC Holding. Petitioner's revenues and receipts from ABC Holding, including the revenue and receipts attributable to MNO Trust, are less than 50% of Petitioner's total receipts.

MNO Trust is a New York limited purpose limited liability trust company formed in 2008 to act as a clearinghouse for the clearing of CDS transactions. MNO Trust's activities as a clearinghouse and central counterparty for CDS transactions are subject to regulation by multiple regulators including the New York State Banking Department and the Board of Governors of the Federal Reserve System. Although it operates pursuant to exemptive relief from the Securities and Exchange Commission and the U.S. Treasury Department, it is required to comply with certain requirements to satisfy the conditions of exemptive relief. Specifically, MNO Trust cannot accept deposits from the general public and may only act as a fiduciary for its participants. MNO Trust is open to all qualifying buy-side and sell-side institutions. Membership is available to institutions that meet the financial and eligibility standards set forth in the clearinghouse rules. Initial MNO Trust members include several large scale financial institutions. MNO Trust began processing CDS transactions in 2009.

Under MNO Trust's clearing rules, a bilateral CDS contract between members that is submitted to MNO Trust for clearing will be "novated." As part of this process, the submitted contract is replaced by two superseding CDS contracts between each of the original parties to the submitted contract and MNO Trust. Under these new contracts, MNO Trust will act as "protection buyer" to the original "protection seller" and as the "protection seller" to the original "protection buyer."

MNO Trust will collect an initial margin deposit and perform a daily "marked-to-market" to ensure that each participant's positions are properly valued and collateralized, further reducing credit risk. MNO Trust also has established a guaranty fund to provide protection covering losses that may occur when unwinding a defaulting participant's positions. All participants are required to make ongoing contributions to the guaranty fund in proportion to their share of the overall market risk. MNO Trust does not make loans, approve loans or accept any repayments of loans.

In the event of a default, MNO Trust will use the defaulting participant's margin collateral and guaranty fund contributions to cover the loss. If the loss is greater than the amount on deposit, the remaining participants agree to share the losses of the defaulting participant by using the guaranty fund to cover the loss. Because the losses are spread across MNO Trust and the non-defaulting participants, rather than being concentrated on a smaller number of parties, the risk of additional defaults is decreased.

Questions Presented

1. Whether Petitioner meets the definition of a "banking corporation" under Tax Law § 1452(a) without regard to Petitioner's ownership of ABC Holding or Petitioner's receipt of pass-through income from ABC Holding.
2. Assuming Petitioner is not a banking corporation and is properly filing under Article 9-A of the Tax Law, whether receipt of pass-through income from ABC Holding requires Petitioner to file a tax return under Article 32.
3. Whether ABC Holding is required to file under Article 32 of the Tax Law.
4. Whether MNO Trust is required to file under Article 32 of the Tax Law.
5. Whether the deposits, if any, received by ABC Holding that are attributable to MNO Trust would, for allocation purposes, be included in the deposits factors of the limited partners of ABC Holding that are Article 32 taxpayers.

Analysis

Section 209.1 of Article 9-A of the Tax Law imposes an annual franchise tax on a corporation for the privilege of exercising its corporate franchise, doing business, employing capital, owning or leasing

property in a corporate or organized capacity, or maintaining an office, in New York State during the taxable year. Section 209.4 of the Tax Law provides that a corporation liable for tax under Article 32 of the Tax Law is not subject to tax under Article 9-A.

Section 1451 of Article 32 of the Tax Law imposes a franchise tax on every banking corporation for the privilege of exercising its franchise or doing business in New York State in a corporate or organized capacity during the taxable year.

Issue 1.

Section 1452(a)(2) provides that every corporation or association organized under the laws of another state (i.e., a foreign corporation) that is doing a banking business is considered a "banking corporation." A "banking business" for purposes of section 1452(a) includes such business as a foreign corporation has authority to do which is substantially similar to the business which a corporation may be created to do under Articles three, three-B, five, five-A, five-C, six or ten of the Banking Law, or any business which a corporation is authorized by any such article to do. Tax Law § 1452(b). Petitioner is a foreign corporation that operates OTC markets for commodities and derivative products through electronic market platform(s). It also offers various market data services. Petitioner's revenues consist generally of trading fees, trade confirmation fees and access fees for online services. These activities are not the business activities described in the Banking Law that constitute doing a "banking business." Therefore, Petitioner does not come within the definition of a banking corporation in Article 32.

Issue 2.

MNO Trust is a limited liability trust company that is treated as a disregarded entity for federal income tax purposes. That is, MNO Trust is not considered separate from its owner, ABC Holding. New York follows the federal income tax classification of entities for purposes of Articles 9-A and 32 of the Tax Law. See, *Comptroller of the State of New York*, Adv Op Comm T & F, October 7, 1998, TSB-A-98(19)C. Therefore, MNO Trust will be treated as a disregarded entity that is part of ABC Holding for purposes of Articles 9-A and 32 of the Tax Law. ABC Holding is treated as a partnership for federal income tax purposes (see Issue 3 below), and each partner of ABC Holding is required to report its share of income, gain, loss, deduction and credit passed through from the partnership in computing its federal taxable income. Internal Revenue Code ("IRC" or "Code") §§ 702, 704.

Petitioner asks whether its receipt of pass-through income from ABC Holding, which will include the income, gain, loss, deduction, etc. of MNO Trust, will cause it to be classified as a banking corporation that is required to file a return under Article 32 of the Tax Law. *Clariden Asset Management (New York) Inc.*, Adv Op Comm T & F, December 13, 1995, TSB-A-95(20)C provides the relevant analysis of this question. There the petitioner's parent corporation, Clariden Bank, provided investment management and advisory services to clients and was required by Swiss authorities to be licensed as a bank. The question presented was whether the parent was doing a banking business. If it was, then the parent would be considered a "banking corporation," as would petitioner since its business activities and portion of stock owned by a bank satisfied the definition of a banking corporation in Tax Law § 1452(a)(9). The opinion noted that the carrying on of a banking business does not mean the performance of a single disconnected banking business act. It is only when the banking-like engagements become a principal activity of a business corporation that the corporation becomes engaged in banking. *Id.* (citing *Phillips v. Investors' Syndicate*, 145 Misc 361(1932)). The opinion went on to state that, for a corporation to be engaged in banking, it must be principally engaged in the core activities that make a corporation subject to the Banking Law (such as the lending or borrowing of money, buying or selling of

exchange, receipt of deposits, and other activities set out in Section 96 of the Banking Law). Clariden Bank was not principally engaged in those core activities, so neither it nor the petitioner, its wholly-owned subsidiary, were banking corporations under Article 32.

In this matter, Petitioner is not principally engaged in the core activities of a bank under the Banking Law; rather, its business is the operation of electronic marketplaces or exchanges that enable the purchase and sale of commodities and derivative products. Moreover, Petitioner's receipt of income from ABC Holding, which includes income from MNO Trust, does not change this conclusion. A corporation is "principally engaged" in the activity from which more than 50% of its receipts are derived. *S & S Westchester Shipping Co., Ltd.*, Adv Op Comm T & F, July 22, 1994, TSB-A-94(12)C; *Bucciero Contracting, Inc,* Adv Op Comm T & F, July 23, 1981, TSB-A-81(5)C. Here, less than 50% of Petitioner's receipts are attributable to ABC Holding. Accordingly, the flow through of income and other items from that limited partnership to Petitioner does not make Petitioner a banking corporation within the meaning of Tax Law Article 32.

Issue 3.

Petitioner asks whether ABC Holding will be subject to the filing requirements of Article 32. Tax Law Article 32 imposes a franchise tax on all "banking corporations" exercising their franchise or doing business in New York State in a corporate or organized capacity. Tax Law § 1451(a). Generally, a "banking corporation" for purposes of Article 32 of the Tax Law is a corporation which is doing a banking business or a corporation which is principally engaged in a business that is substantially similar to a banking business and is 65% or more beneficially owned by a banking corporation. Tax Law § 1452(a). A corporation for purposes of Article 32 includes "associations" and "joint stock companies." 0 NYCRR § 16-2.3. The terms used in the regulations pertaining to the Article 32 have the same meaning, when used in a comparable context, as those terms have under the Internal Revenue Code and the regulations promulgated thereunder. 20 NYCRR § 16-2.1. A corporation under the Code includes an association and a joint stock company. IRC § 7701(a)(3). Accordingly, an entity treated as an association, and thus a corporation, for federal income tax purposes is treated as a corporation for purposes of Article 32.

A partnership under the Internal Revenue Code includes an unincorporated organization that is carrying on business and is not a corporation. IRC § 761(a). A partnership for purposes of IRC § 761 means a partnership determined under Treas. Reg. §§ 301.7701-1 through 3. Treas. Reg. § 1.761-1(a).

ABC Holding is a foreign limited partnership that elected to be treated as a partnership for federal income tax purposes under Treas. Reg. §§ 301.7701- 3. Since ABC Holding is treated as a partnership for federal income tax purposes, it cannot be an association or a "corporation" under the Code. IRC § 761(a). Because it is not a corporation for federal income tax purposes, ABC Holding is considered neither a corporation nor a "banking corporation" for purposes of Article 32. Therefore, ABC Holding is not subject to tax under Tax Law Article 32 and is not required to file a return thereunder. See generally, *Comptroller of the State of New York*, *supra*.

Issue 4.

As discussed under Issue 2 above, MNO Trust will be treated as a disregarded entity, that is, an entity that is not separate from its owner. Since MNO Trust is not a corporation for federal income tax purposes it is not a banking corporation within the definition of Article 32 of the Tax Law, and it is not required to file a return under that article.

Issue 5.

For purposes of this question, it is assumed that the unrelated limited partners of ABC Holding that are banking corporations include their respective distributive shares of income, gain, loss, and deduction from the partnership in the computation of their entire net income (or alternative entire net income) for purposes of Tax Law Article 32. It is also assumed that these limited partners, consistent with the aggregate theory of partnerships, include in the computation of their income allocation percentages under Tax Law § 1454 any payroll, receipts, and deposits attributable to ABC Holding.

A banking corporation doing business within and without New York allocates its entire net income, alternative entire net income and taxable assets pursuant to an allocation percentage composed of payroll, receipts and deposits factors. Tax Law §1454(a). The deposits factor is the ratio of deposits maintained at branches within New York to the deposits maintained at branches within and without the State. Tax Law § 1454(a)(3). A "branch" for allocation purposes is a bona fide office used by the taxpayer to approve loans, accept loan repayments, disburse funds, and conduct one or more other functions of a banking business. Tax Law § 1454(a)(5)(B).

Under the facts presented, ABC Holding (including its disregarded entity, MNO Trust) is not a branch within the definition of Tax Law § 1454(a)(5)(B) since ABC Holding does not make loans, approve loans or accept repayments of loans. Therefore, the deposits factors of these unrelated limited partners are not affected by the operations of ABC Holding.

DATED: February 10, 2011

/S/
Daniel Smirlock
Deputy Commissioner & Counsel

NOTE: An Advisory Opinion is issued at the request of a person or entity. It is limited to the facts set forth therein and is binding on the Department only with respect to the person or entity to whom it is issued and only if the person or entity fully and accurately describes all relevant facts. An Advisory Opinion is based on the law, regulations, and Department policies in effect as of the date the Opinion is issued or for the specific time period at issue in the Opinion.