

**New York State Department of Taxation and Finance**  
**Office of Tax Policy Analysis**  
**Technical Services Division**

TSB-A-02(14)C  
Corporation Tax  
July 9, 2002

STATE OF NEW YORK  
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. C011219A

On December 19, 2001, a Petition for Advisory Opinion was received from Grant McCarthy Gagnon, LLC, 70 West Red Oak Lane, White Plains, New York 10604.

The issues raised by Petitioner, Grant McCarthy Gagnon, LLC, are:

1. Whether the limited liability company (“LLC”) described below (“NewCo LLC”) will be treated as a partnership for New York State tax purposes.
2. Whether NewCo LLC will be taxable under section 186-e of the Tax Law, and whether it will be subject to tax under Article 9-A or sections 183 and 184 of Article 9 of the Tax Law.
3. Whether NewCo LLC’s managing member (“Managing Member”) will be taxable under section 186-e of the Tax Law and whether it will be subject to tax under Article 9-A or sections 183 and 184 of Article 9 of the Tax Law.
4. Whether NewCo LLC’s non-managing member (“Non-managing Member”) will be taxable under section 186-e of the Tax Law and whether it will be subject to tax under Article 9-A or sections 183 and 184 of Article 9 of the Tax Law.
5. Whether the conclusions in the Issues above are dependent on whether Managing Member is owned directly by the corporate group’s parent (“Parent”) or by Non-managing Member.

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

TelCo, Inc. is a corporation doing business in New York, and is a member of an affiliated group of corporations. TelCo, Inc., plans to expand its operations to several states and intends for business and regulatory reasons to form separate entities to conduct its telephone operations in each state in which it anticipates doing business. Operations in other states may be established either as corporations or LLCs owned by Non-managing Member and/or Managing Member.

As part of this plan, TelCo, Inc. will cease to exist as an entity, and a newly formed LLC, NewCo, LLC, will hold and operate its New York State telephone business. NewCo, LLC will have two members: Managing Member will own a one percent membership interest and Non-managing Member will own a 99 percent membership interest. The group will be structured in one of the two

following ways: (1) Managing Member will be a wholly-owned subsidiary of Non-managing Member which will be a wholly-owned subsidiary of Parent, or (2) Managing Member and Non-managing Member will both be wholly-owned subsidiaries of Parent. NewCo LLC will be treated as a partnership for federal income tax purposes.

It is anticipated that NewCo LLC's business will include providing carrier access service to telecommunication vendors and a limited amount of intra-LATA and inter-LATA retail telephone service to end users. NewCo LLC will be responsible for all day-to-day business activities, and will make all ordinary operational business decisions related to the telephone business.

Managing Member will oversee the management and operations of NewCo LLC, and will be ultimately responsible for the successful design and execution of the LLC's New York State telephone business strategy. It is anticipated that Managing Member's only income/receipts will be derived from its membership interest in NewCo LLC.

Non-managing Member may conduct business activities unrelated to NewCo LLC. However, it is anticipated that the majority of Non-managing Member's assets will consist of its membership interest in NewCo LLC. Nonetheless, Non-managing Member's interest in NewCo LLC will be held solely for investment purposes. While Non-managing Member may share certain board members and executives with NewCo LLC and Managing Member, Non-managing Member will have no managerial responsibility or authority related to NewCo LLC, and will not participate in NewCo LLC's business operations.

### **Applicable Law and Regulations**

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 185 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)(5) of the Business Corporation Franchise Tax Regulations ("Article 9-A Regulations") provides that "[i]f a partnership is doing business, employing capital, owning or leasing property or maintaining an office in New York State, then all of its corporate general partners are subject to the tax imposed by article 9-A of the Tax Law."

Section 1-3.2(a)(6)(i) of the Article 9-A Regulations provides, in part:

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 ... exist during the taxable year or, except for clause (a) of this subparagraph, any previous taxable year:

(a) The foreign corporation has a one percent or more interest as a limited partner in a partnership and/or the basis of the foreign corporation's interest in the limited partnership, determined pursuant to section 705 of the Internal Revenue Code, is more than \$1,000,000. For purposes of determining whether the level of interest in the partnership or level of basis of the interest in the partnership is met, the percentage of interest in the partnership and basis of interest in the partnership of members of the foreign corporation's affiliated group, of officers or directors of the foreign corporation or of officers or directors of members of the foreign corporation's affiliated group are added to the foreign corporation's interest in the partnership or the basis of its interest in the partnership, respectively.

Section 183 of Article 9 of the Tax Law imposes a franchise tax on a domestic or foreign corporation formed for or principally engaged in the conduct of a telephone business, 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.

Section 184.1 of the Tax Law provides that a corporation subject to tax under section 183 of the Tax Law is subject to the additional franchise tax under section 184 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, if it is formed for or principally engaged in the conduct of local telephone business.

Section 186-e.2(a) of the Tax Law imposes an excise tax on "the sale of telecommunication services by any person which is a provider of telecommunication services ...." Section 186-e.1(c) of the Tax Law provides that the term "person" includes corporations, companies, partnerships and LLCs. Section 186-e.1(e) of the Tax Law defines "provider of telecommunication services" as "any person who furnishes or sells telecommunications services regardless of whether such activities are the main business of such person or are only incidental thereto...." Section 186-e.1(g) of the Tax Law defines "telecommunication services" as "telephony or telegraphy, or telephone or telegraph service, including, but not limited to, any transmission of voice, image, data, information and paging, through the use of wire, cable, fiber-optic, laser, microwave, radio wave, satellite or similar

media or any combination thereof and shall include services that are ancillary to the provision of telephone service ....”

## **Discussion**

### **Issue 1**

An LLC that is treated as a corporation for federal income tax purposes is treated as a corporation for New York State tax purposes. An LLC that is treated as a partnership for federal income tax purposes, is treated as a partnership for New York State tax purposes. (See, FGIC CMRC Corp, Adv Op Comm T & F, April 1, 1996, TSB-A-96(11)C; and Department of Taxation and Finance Memorandum, TSB-M-94(6)I and (8)C, October 25, 1994.)

In this case, NewCo LLC would be treated as a partnership for federal income tax purposes, and would be treated as a partnership for New York State tax purposes.

### **Issue 2**

As a partnership, NewCo LLC would not be subject to tax under Article 9-A or section 183 or 184 of Article 9 of the Tax Law. However, NewCo LLC would be a person pursuant to section 186-e.1(c) of the Tax Law, and as a provider of telecommunication services would be subject to the tax imposed under section 186-e of the Tax Law.

### **Issues 3 and 4**

NewCo LLC’s Managing Member and Non-managing Member would be treated as corporate partners of a partnership conducting business in New York and would be subject to tax under Article 9-A or sections 183 and 184 of the Tax Law.

If the activities of a corporate member of an LLC that is treated as a partnership for New York State tax purposes are similar to the activities of a general partner of a partnership, such corporate member will be treated like a general partner. However, if the activities of a corporate member of an LLC are similar to the activities of a limited partner of a partnership, such corporate member will be treated like a limited partner. See Stone Commodities Corp, Adv Op Comm T&F, December 4, 1997, TSB-A-97(26)C and FGIC CMRC Corp, *supra*.

To determine the classification and proper taxability of a corporate partner of a partnership 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

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are derived. See, e.g., Joseph Bucciero, Contracting Inc., Adv Op St Tax Commn, July 23, 1981, TSB-A-81(5)C.

For purposes of sections 183 and 184 of the Tax Law, where a partnership is engaged in the conduct of a telephone business, a corporate general partner is, generally, also engaged in the conduct of a telephone business. 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 general 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 partner of the partnership that was principally engaged in such telephone business was subject to tax under sections 183 and 184 of Article 9 of the Tax Law.

In GTE Spacenet Corp. v NYS Dept of Taxation and Finance, 224 AD2d 283 (1996), the Court held that while the partnership was arguably engaged in activities enumerated in sections 183 and 184 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 and 184 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 and 184 of the Tax Law.

Pursuant to section 1-3.2(a)(6) of the Article 9-A Regulations, a corporate partner would 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 if it meets the conditions of such section 1-3.2(a)(6). If the corporation does meet the conditions of section 1-3.2(a)(6), it would be doing business, employing capital, owning or leasing property or maintaining an office in New York State and would be subject to tax under Article 9-A unless it is subject to tax under section 183 of Article 9 of the Tax Law.

In this case, Petitioner states that the Managing Member would participate in the day-to-day management of NewCo LLC. Therefore, the Managing Member would be treated like a corporate general partner of a partnership, and following Partners of Buffalo Telephone, *supra*, would be considered to be engaged in the telephone business of NewCo LLC. If the Managing Member is principally engaged in such business, it would be subject to tax under section 183 of the Tax Law. Otherwise, it would be subject to tax under Article 9-A of the Tax Law.

If the Non-managing Member is a mere passive investor and does not participate in the day-to-day management or operations of NewCo LLC, then, pursuant to GTE Spacenet, *supra*, the

Non-managing Member would not be considered to be engaged in the telephone business of NewCo LLC and would not be subject to tax under section 183 of Article 9 of the Tax Law. The Non-managing Member would be treated like a corporate limited partner and would be subject to tax under Article 9-A of the Tax Law even if it were organized outside of New York, because it would hold a 99 percent interest in NewCo LLC and would meet the conditions of section 1-3.2(a)(6)(i)(a) of the Article 9-A Regulations.

However, if the Non-managing Member is not a mere passive investor or if it participates in the day-to-day management of the operations of NewCo LLC, the Non-managing Member would not come within the scope of GTE Spacenet, *supra*. Following Partners of Buffalo Telephone, *supra*, the Non-managing Member would be considered to be engaged in the business of NewCo LLC, and if the Non-managing Member is principally engaged in such business, it would be subject to tax under section 183 of the Tax Law. Otherwise, it would be subject to tax under Article 9-A of the Tax Law.

The determination of whether the Non-managing Member is a mere passive investor and whether it participates in the day-to-day management or operations of NewCo LLC 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, §171.20; 20 NYCRR 2376.1(a).

If either the Managing Member or the Non-managing Member is considered to be principally engaged in a telephone business taxable under section 183 of the Tax Law, and it is also principally engaged in local telephone business as defined in section 184 of the Tax Law, it would also be subject to the additional franchise tax imposed under section 184 of the Tax Law.

Since NewCo LLC would be subject to the tax imposed under section 186-e of the Tax Law, neither the Managing Member nor the Non-managing Member would be subject to section 186-e of the Tax Law on their share of NewCo LLC’s receipts for which NewCo LLC is taxable under section 186-e. However, the Managing Member or the Non-managing Member may be subject to the tax imposed under section 186-e of the Tax Law if it is otherwise providing telecommunication services taxable under section 186-e.

## **Issue 5**

The conclusions in Issues 3 and 4 above would not be dependent on whether Managing Member is owned directly by the Parent. However, if the Managing Member is a wholly owned subsidiary of the Non-managing Member, such structure may be considered in determining whether the Non-managing Member is a mere passive investor and not participating in the day-to-day management or operation of NewCo LLC so as to come within the scope of GTE Spacenet, *supra*.

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As stated above, such factual determination may not be made within the context of this Advisory Opinion.

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