STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. C040506B

On May 6, 2004, a Petition for Advisory Opinion was received from Renaissance Technologies Corporation, 800 Third Avenue, New York, New York 10022, c/o Nicholas Nesi and Robert Zonenschein, BDO Seidman, LLP, 330 Madison Avenue, New York, NY 10017

The issue raised by Petitioner, Renaissance Technologies Corporation, is whether Petitioner's receipt of allocations from a limited partnership attributable to partnership profits (the "Allocations") should be categorized as investment income for New York State corporation franchise tax purposes under section 208.6 of the Tax Law for taxable years 2000 through 2002.

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

Petitioner is a Delaware S corporation and is an S corporation for federal and New York State tax purposes. Petitioner is an investment securities manager with its principal offices located at 800 Third Avenue, New York, New York. Petitioner is registered as an *investment advisor* with the Securities and Exchange Commission (SEC) pursuant to the Investment Advisors Act of 1940 (the Act), 15 USC §80a-1 *et. seq.* Petitioner also serves as the general partner in various limited partnerships operating as *hedge funds* formed under the Delaware Revised Uniform Limited Partnership Act (hereinafter a representative limited partnership is referred to as "LP".) Hedge funds are pooled investment vehicles, typically formed as limited partnerships, which employ active portfolio management to obtain above average capital gains for their own account. Hedge funds attempt to hedge against downturns in the markets through employing flexible investment strategies, such as short selling, leveraging and utilizing derivatives (e.g., puts, calls, options and futures.)

Petitioner's rights and obligations with respect to the LP are set forth in a Partnership Agreement. Petitioner is obligated to perform certain management activities for the LP, including making investment decisions on behalf of the hedge fund and various other duties. The partnership agreement provides that Petitioner will pay all of Petitioner's operating and overhead costs, including compensation of all employees responsible for management of the LP's investments. As compensation for these services, Petitioner is entitled to receive a management fee equal to 2.5 % of the value of the limited partners' respective capital accounts on a set date, without regard to the performance of the hedge fund (hereinafter this fee is referred to as the "Management Fee.") The Management Fee constitutes remuneration for services provided by Petitioner to the LP for the benefit of its partners. The LP deducts Management Fees paid to Petitioner each fiscal period as an expense necessary to generate income. Petitioner's right to receive a Management Fee from the LP is fixed and guaranteed regardless of the fund's performance.

The Partnership Agreement provides that Petitioner will receive its distributive share of the LP's income or loss, and may receive a special allocation called a performance allocation of up to 44 % of any positive performance change in the LP limited partners' capital accounts for a fiscal period. The positive performance change is, in essence, the increase in the net worth of the capital account of a limited partner determined for the fiscal period, and reflects the appreciated value of assets held by the fund as well as profits from transactions occurring during the period. The performance allocations are made by debiting the capital accounts of the limited partners and crediting the capital account of Petitioner. The Allocations that are at issue in this Advisory Opinion are that portion of the performance allocations attributable to the profits from transactions occurring during the period that are deemed to be passed-through from the LP to Petitioner. The amounts distributed as Allocations are not deducted by the LP regardless of whether the Allocations are passed-through to Petitioner. The Allocations are not fixed and guaranteed and are merely an allocation of profits generated from the LP's investment activities. A performance allocation is made only if there is a positive performance change in a limited partner's capital account for the fiscal period.

Petitioner states that the LP maintains the appropriate capital accounts in accordance with the requirements of Treasury Regulation section 1.704-1(b)(2)(ii) and (iv).

**Applicable law and regulations**

Section 208 of the Tax Law provides, in part:

> 1-A. The term "New York S corporation" means, with respect to any taxable year, a corporation subject to tax under this article for which an election is in effect pursuant to subsection (a) of section six hundred sixty of this chapter for such year, any such year shall be denominated a "New York S year", and such election shall be denominated a "New York S election". The term "New York C corporation" means, with respect to any taxable year, a corporation subject to tax under this article which is not a New York S corporation, and any such year shall be denominated a "New York C year"….
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> 5. The term "investment capital" means investments in stocks, bonds and other securities, corporate and governmental, not held for sale to customers in the regular course of business, exclusive of subsidiary capital and stock issued by the taxpayer, provided, however, that, in the discretion of the commissioner, there shall be deducted from investment capital any liabilities which are directly or indirectly attributable to investment capital ...;
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> 6. The term "investment income" means income, including capital gains in excess of capital losses, from investment capital, to the extent included in computing entire net income, less, (a) in the discretion of the commissioner, any deductions allowable in

computing entire net income which are directly or indirectly attributable to investment capital or investment income, and (b) such portion of any net operating loss deduction allowable in computing entire net income, as the investment income, before such deduction, bears to entire net income, before such deduction, provided, however, that in no case shall investment income exceed entire net income;

7. (a) The term "business capital" means all assets, other than subsidiary capital, investment capital and stock issued by the taxpayer, less liabilities not deducted from subsidiary or investment capital except that cash on hand and on deposit shall be treated as investment capital or as business capital as the taxpayer may elect.

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8. The term "business income" means entire net income minus investment income;

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9. The term "entire net income" means total net income from all sources, which shall be presumably the same as the entire taxable income (but not alternative minimum taxable income),

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(ii) which the taxpayer would have been required to report to the United States treasury department if it had not made an election under subchapter s of chapter one of the internal revenue code…

* * *

except as hereinafter provided, and subject to any modification required by paragraphs (d) and (e) of subdivision three of section two hundred ten of this article.

Section 1-2.1 of the Business Corporation Franchise Tax Regulations (Article 9-A Regulations) provides, in part:

Any term used in this Subchapter shall, unless a different meaning is clearly required, presumably have the same meaning as when used in a comparable context in:

(a) the laws of the United States relating to Federal income taxes and the Federal tax regulations promulgated thereunder;

Section 3-3.2 of the Regulations provides, in part:

(a)(1) The term *investment capital* means the taxpayer's investments in stocks, bonds and other securities issued by a corporation (except as provided in paragraph (2) of this subdivision) or by the United States, any state, territory or possession of the United States, the District of Columbia, or any foreign country, or any political subdivision or governmental instrumentality of any of the foregoing . . . At the election of the taxpayer, cash on hand and cash on deposit may be treated on any report as either investment capital or business capital . . . Any debt instrument, including a certificate of deposit, which is described in paragraph (2) or (3) of subdivision (c) of this section and is not described in paragraph (2) of this subdivision and which is payable by its terms on demand or within six months and one day from the date on which the debt was incurred is deemed to be cash on hand or on deposit. Any such debt instrument which is payable by its terms more than six months and one day from the date on which the debt was incurred is deemed to be cash on hand or on deposit on any day which is not more than six months and one day prior to its date of maturity. Cash also includes shares in a money market mutual fund. A money market mutual fund is a no-load, open-end investment company registered under the Federal Investment Company Act of 1940 which attempts to maintain a constant net asset value per share and holds itself out to be a "money market" fund. A taxpayer may not elect to treat part of its cash as investment capital and part as business capital. No election to treat cash as investment capital may be made where the taxpayer has no other investment capital.

* * *

(2) Investment capital does not include:

(i) stock issued by the taxpayer;

(ii) stocks, bonds or other securities constituting subsidiary capital;

(iii) securities of an individual, partnership, trust or other nongovernmental entity which is not a corporation within the definition contained in section 208.1 of the Tax Law (such as [FNMA and GNMA] pass-through certificates);

(iv) stocks, bonds and other securities of a DISC, or any indebtedness from a DISC;

(v) regular interests and residual interests in a real estate mortgage investment conduit (REMIC), as defined in section 860D of the Internal Revenue Code;

(vi) futures contracts and forward contracts; and

(vii) stocks, bonds and other securities held by the taxpayer for sale to customers in the regular course of its business.

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(c) For purposes of paragraph (1) of subdivision (a) of this section, the phrase *stocks, bonds and other securities* means:

(1) stocks and similar corporate equity instruments, such as business trust certificates, and units in a publicly traded partnership included in the definition of “corporation” contained in section 208.1 of the Tax Law;

(2) debt instruments issued by the United States, any state, territory or possession of the United States, the District of Columbia, or any foreign country, or any political subdivision or governmental instrumentality of any of the foregoing;

(3) qualifying corporate debt instruments (see subdivision (d) of this section);

(4) options on any item described in paragraph (1), (2) or (3) of this subdivision and not described in paragraph (2) of subdivision (a) of this section, or on a stock or bond index, or on a futures contract on such an index, unless the options are purchased primarily to diminish the taxpayer’s risk of loss from holding one or more positions in assets which constitute business or subsidiary capital; and

(5) stock rights and stock warrants not in the possession of the issuer thereof. Provided, however, debt instruments described in paragraph (2) or (3) of this subdivision which are deemed to be cash pursuant to paragraph (1) of subdivision (a) of this section do not constitute stocks, bonds or other securities.

(d) *Qualifying corporate debt instruments.* (1) The term *qualifying corporate debt instruments* means all debt instruments issued by a corporation other than the following:

(i) instruments issued by the taxpayer or a DISC;

(ii) instruments which constitute subsidiary capital in the hands of the taxpayer;

(iii) instruments acquired by the taxpayer for services rendered or for the sale, rental or other transfer of property, where the obligor is the recipient of the services or property; however, where a taxpayer sells or otherwise transfers property which is investment capital in the hands of such taxpayer (*e.g.*, stock) and receives in return a corporate obligation issued by the recipient of such property, such corporate obligation, if

it is not otherwise excluded from the category of investment capital, would constitute investment capital in the hands of the taxpayer;

(iv) instruments acquired for funds if:

(*a*) the obligor is the recipient of such funds;

(*b*) the taxpayer is principally engaged in the business of lending funds; and

(*c*) the obligation is acquired in the regular course of the taxpayer's business of lending funds;

(v) accepted drafts (such as banker's acceptances and trade acceptances) where the taxpayer is the drawer of the draft;

(vi) instruments issued by a corporation which is a member of an affiliated group which includes the taxpayer; and

(vii) accounts receivable, including those held by a factor.

Section 3-13.2 of the Regulations provides:

Each partnership item of income, capital, gain, loss or deduction has the same source and character in the hands of a partner for article 9-A purposes as it has in its hands for Federal income tax purposes. Where an item is not characterized for Federal income tax purposes or is not required to be taken into account for Federal income tax purposes, the source and character of the item shall be determined as if such item were realized by the partner directly from the source from which realized by the partnership, or incurred by the partner in the same manner as incurred by the partnership.

Internal Revenue Code (IRC) section 704(b) provides:

Determination of distributive share. – A partner's distributive share of income, gain, loss, deduction, or credit (or item thereof) shall be determined in accordance with the partner's interest in the partnership (determined by taking into account all facts and circumstances), if –

(1) the partnership agreement does not provide as to the partner's distributive share of income, gain, loss, deduction, or credit (or item thereof), or

(2) the allocation to a partner under the agreement of income, gain, loss, deduction, or credit (or item thereof) does not have substantial economic effect.

Treasury Regulation section 1.704-1(b)(2) provides, in part:

Substantial economic effect – (i) Two-part analysis. The determination of whether an allocation of income, gain, loss, or deduction (or item thereof) to a partner has substantial economic effect involves a two-part analysis that is made as of the end of the partnership taxable year to which the allocation relates. First, the allocation must have economic effect…. Second, the economic effect of the allocation must be substantial….

(ii) Economic effect – (a) Fundamental principles. In order for an allocation to have economic effect, it must be consistent with the underlying economic arrangement of the partners. This means that in the event there is an economic benefit or economic burden that corresponds to an allocation, the partner to whom the allocation is made must receive such economic benefit or bear such economic burden.

* * *

(iii) Substantiality – (a) General rules. Except as otherwise provided in this paragraph (b)(2)(iii), the economic effect of an allocation (or allocations) is substantial if there is a reasonable possibility that the allocation (or allocations) will affect substantially the dollar amounts to be received by the partners from the partnership, independent of tax consequences….

* * *

(iv) Maintenance of capital accounts – (a) In general. The economic effect test described in paragraph (b)(2)(ii) of this section requires an examination of the capital accounts of the partners of a partnership, as maintained under the partnership agreement. Except as otherwise provided in paragraph (b)(2)(ii)(*i*) of this section, an allocation of income, gain, loss, or deduction will not have economic effect under paragraph (b)(2)(ii) of this section, and will not be deemed to be in accordance with a partner's interest in the partnership under paragraph (b)(4) of this section, unless the capital accounts of the partners are determined and maintained throughout the full term of the partnership in accordance with the capital accounting rules of this paragraph (b)(2)(iv).

IRC section 707 provides, in part:

(a) Partner not acting in capacity as partner. –

(1) In general. – If a partner engages in a transaction with a partnership other than in his capacity as a member of such partnership, the transaction shall, except as otherwise provided in this section, be considered as occurring between the partnership and one who is not a partner.

(2) Treatment of payments to partners for property or services. – Under regulations prescribed by the Secretary –

(A) Treatment of certain services and transfers of property. – If –

(i) a partner performs services for a partnership ...,

(ii) there is a related direct or indirect allocation and distribution to such partner, and

(iii) the performance of such services ... and the allocation and distribution, when viewed together, are properly characterized as a transaction occurring between the partnership and a partner acting other than in his capacity as a member of the partnership,

such allocation and distribution shall be treated as a transaction described in paragraph (1).

*    *    *

(c) Guaranteed payments. – To the extent determined without regard to the income of the partnership, payments to a partner for services or the use of capital shall be considered as made to one who is not a member of the partnership, but only for the purposes of section 61(a) (relating to gross income) and, subject to section 263, for purposes of section 162(a) (relating to trade or business expenses).

The legislative history of IRC section 707(a)(2)(A) [1 Senate Comm of Finance, 98th Cong., 2d Sess., Deficit Reduction Act of 1984 (PL 98-369), S. Prt. No. 169, at 227 - 230] provides, in part:

The comittee does intend that the provision apply to allocations which are determined to be related to the performance of services for, or the transfer of property to, the partnership and which, when viewed together with distributions, have the substantive economic effect of direct payments for such property or services under the facts and circumstances of the case.

The bill authorizes the Treasury Department to prescribe such regulations as may be necessary or appropriate to carry out the purposes of the provision. In prescribing these regulations, the Treasury should be mindful that the committee is concerned with transactions that work to avoid capitalization requirements or other rules and restrictions governing direct payments and not with non-abusive allocations that reflect the various economic contributions of the partners. These regulations may apply the provision both

to one-time transactions and to continuing arrangements which utilize purported partnership allocations and distributions in place of direct payments....

These regulations will provide, when appropriate, that the purported partner performing services or transferring property is not a partner at all. Once it is determined that the service performer or property transferor is actually a partner, the committee believes the factors described below should be considered in determining whether the partner is receiving the putative allocation and distribution in his capacity as a partner.

The first, and generally the most important, factor is whether the payment is subject to an appreciable risk as to amount. Partners extract the profits of the partnership with reference to the business success of the venture while third parties generally receive payments which are not subject to this risk. An allocation and distribution provided for a service partner under the partnership agreement which subjects the partner to significant entrepreneurial risk as to both the amount and the fact of payment generally should be recognized as a distributive share and a partnership distribution, while an allocation and distribution provided for a service partner under the partnership agreement which involves limited risk as to amount and payment should generally be treated as a fee under sec. 707(a). For example, allocations that limit a partner's risk may be either "capped" allocations of partnership income (i.e., percentage or fixed dollar amount allocations subject to an annual maximum amount when the parties could reasonably expect the cap to apply in most years) or allocations for a fixed number of years under which the income that will go to the partner is reasonably certain. Similarly, continuing arrangements in which purported allocations and distributions (under a formula or otherwise) are fixed in amount or reasonably determinable under all the facts and circumstances and which arise in connection with services also shield the purported partner from entrepreneurial risk....

The second factor is whether the partner status of the recipient is transitory. Transitory partner status suggests that a payment is a fee or is in return for property. The fact that the partner status is continuing, however, is of no particular relevance.

The third factor is whether the distribution and allocation that are made to the partner are close in time to the partner's performance of services for or transfers of property to the partnership. In the case of continuing arrangements, the time at which income will be allocated to the partner may be a factor indicating that an allocation is, in fact, a disguised payment. For example, an allocation close in time to the performance of services, or the transfer of property, is more likely to be related to the services or property. Also, when the income subject to allocation arises over an extended period or is remote in time from the services or property contributed by a partner the risk of not receiving payment (the first factor described above) may increase.

The fourth factor is whether, under all the facts and circumstances, it appears that the recipient became a partner primarily to obtain tax benefits for himself or for the

partnership which would not have been available if he had rendered services to the partnership in a third party capacity. The fact that a partner has significant non-tax motivations in becoming a partner is of no particular relevance.

The fifth factor, which relates to purported allocations/distributions for services, is whether the value of the recipient's interest in general and continuing partnership profits is small in relation to the allocation in question. This is especially significant if the allocation for services is for a limited period of time. The fact that the recipient's interest in general and continuing partnership profits is substantial does not, however, suggest that the purported partnership allocation/distribution arrangement should be recognized.

The sixth factor ... relates to purported allocation /distributions for property....

The committee anticipates that the Secretary may describe other factors that are relevant in evaluating whether a purported allocation and distribution should be respected. In applying these various factors, the Treasury and courts should be careful not to be misled by possibly self-serving assertions in the partnership agreement as to the duties of a partner in his partner capacity but should instead seek the substance of the transaction.

* * *

The principles of this provision can be illustrated by the following examples.

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*Example 2*. – There may be instances in which allocation/distribution arrangements that are contingent in amount may nevertheless be recharacterized as fees. Generally, these situations should arise only when (1) the partner in question normally performs, has previously performed, or is capable of performing similar services for third parties; and (2) the partnership agreement provides for an allocation and distribution to such partner that effectively compensates him in a manner substantially similar to the manner in which the partner's compensation from third parties normally would be computed.

For example, suppose that a partnership is formed to invest in stock. The partnership admits a stock broker as a partner. The broker agrees to effect trades for the partnership without the normal brokerage commission. In exchange for his partnership interest, the broker contributes 51 percent of partnership capital and receives a 51 percent interest in residual partnership profits and losses. In addition, he receives an allocation of gross income that is computed in a manner which approximates his foregone commissions. It is expected that the partnership will have sufficient gross income to make this allocation. The agreement provides that the broker will receive a priority distribution of cash from operations up to the amount of the gross income allocation. In

this case, even though the broker/partner's special allocation appears contingent and not substantially fixed as to amount, it is computed by means of a formula like a normal brokerage fee and effectively varies with the value and amount of services rendered rather than with the income of the partnership. Thus, this contingent gross income allocation along with the equivalent priority distribution should be treated as a fee under sec. 707(a), rather than as a distributive share and partnership distribution.

**Opinion**

Petitioner is a registered investment advisor, and is the general partner of various LPs that operate as hedge funds. Petitioner is the service partner obligated to perform certain management activities for each LP, including making investment decisions on behalf of the LP and various other duties. In addition to its distributive share of items of LP income, capital, gain, loss and deduction, Petitioner receives, pursuant to the partnership agreement, a Management Fee. The Management Fee is paid for each fiscal period in consideration for the services that Petitioner provides for each LP, and is based on a fixed percentage and guaranteed regardless of the performance of the LP. The LP deducts Management Fees paid to Petitioner each fiscal period as an expense necessary to generate income.

Pursuant to the partnership agreement, Petitioner also receives special allocations called performance allocations. Such performance allocations are made only when there is a positive performance change in the LP limited partners' capital accounts for a fiscal period. The positive performance change is, in essence, the increase in the net worth of the capital account of a limited partner determined for the fiscal period, and reflects the appreciated value of assets held by the LP (unrealized gains) as well as profits from transactions occurring during the fiscal period (interest, dividends, capital gains, etc. from the activities of the hedge fund). The performance allocations are based on a percentage of the positive performance change in the LP limited partners' capital accounts and are made by debiting or decreasing the capital accounts of the limited partners and crediting or increasing the capital account of Petitioner. If there is a decrease in the net worth of the capital accounts of the limited partners, no performance allocation is made to Petitioner. The Allocations are the portion of the performance allocations reflecting the profits from transactions occurring during the fiscal period as provided by the Partnership Agreement.

Petitioner is a New York S corporation that is subject to tax under Article 9-A of the Tax Law. In determining its entire net income pursuant to section 208.9 of the Tax Law for taxable years 2000 through 2002, Petitioner's starting point, federal taxable income, will include its distributive share of the LP's items of income, capital, gain, loss and deduction, as well as the Management Fees and the performance allocations received by Petitioner from the LP. Pursuant to section 3-13.2 of the Regulations, the source and character of each LP item of income, capital, gain, loss or deduction is the same as for federal income tax purposes. If an item is not characterized for federal income tax purposes, the source and character of the item is determined as if such item were realized by Petitioner directly from the source from which realized by the

LP, or incurred by Petitioner in the same manner as incurred by the LP. Therefore, before it can be determined whether the income Petitioner receives from the LP is investment income or business income, the federal treatment of such income must be determined.

IRC section 707(a) applies to any payments made by each LP for services rendered by Petitioner other than in its capacity as a partner (i.e., for services rendered by Petitioner as a third party). If a payment to Petitioner is received in consideration of services provided in its capacity as a partner, and the payment is determined with regard to partnership income so that it is not a guaranteed payment under IRC section 707(c), such payment is treated as a distributive share of partnership income under IRC section 704.

To determine whether the Management Fees and Allocations received by Petitioner are in its capacity as a partner of the LP or as other than a partner (i.e., as a third party), guidance may be obtained from the legislative history with respect to IRC section 707(a)(2)(A). IRC section 707(a)(2)(A) applies to partners who perform services for a partnership and who receive a related allocation and distribution. Such payment would be treated as a payment to the partner other than in its capacity as a partner if the performance of the services and the related allocation and distribution "when viewed together, are properly characterized as a transaction occurring between the partnership and a partner acting other than in his capacity as a member of the partnership." The Senate Finance Committee Report discussing the provisions of section 707(a)(2)(A) lists six factors to be taken into account in making the distinction, and the most important factor is whether the payment is subject to an appreciable risk as to amount. Pursuant to such legislative history:

> Partners extract the profits of the partnership with reference to the business success of the venture while third parties generally receive payments which are not subject to this risk. An allocation and distribution provided for a service partner under the partnership agreement which subjects the partner to significant entrepreneurial risk as to both the amount and the fact of payment generally should be recognized as a distributive share and a partnership distribution, while an allocation and distribution provided for a service partner under the partnership agreement which involves limited risk as to amount and payment should generally be treated as a fee under section 707(a).

With respect to the Management Fees received by Petitioner as the service partner of each LP, such fees are paid by each LP in consideration for services rendered by Petitioner. Such Management Fees are fixed and guaranteed and are paid without regard to the income of the LP. It appears that pursuant to IRC section 707(a)(2)(A) the Management Fees are allocated and distributed each fiscal period to Petitioner in its capacity as other than a partner. These Management Fees are an expense of the LP, and constitute part of the operating income of Petitioner for services performed for the LP.

The performance allocations are allocated to Petitioner by crediting Petitioner's capital account, but it is not clear from the facts whether the portion of the performance allocations

attributable to the profits from the LP's transactions (the Allocations) are distributed to Petitioner. If there is no distribution, the Allocations cannot be treated under IRC section 707(a)(2)(A) as a payment to Petitioner in its capacity as other than a partner. However, under the facts presented (regardless of whether there is a distribution), it does not appear that such Allocations to Petitioner meet the requirements to be treated under IRC section 707(a)(2)(A). Since Petitioner will receive an Allocation from an LP only if there are profits from the LP's transactions, Petitioner is at risk not only as to the amount of the Allocation but as to whether there will even be an Allocation. Therefore, the Allocations made to Petitioner are in consideration for services performed by Petitioner in its capacity as a partner of LP. Since such Allocations are determined with regard to the LP's profits, they are not guaranteed payments under IRC section 707(c). Accordingly, it appears that the Allocations are treated as part of Petitioner's distributive share of partnership income under IRC section 704.

Pursuant to IRC section 704, where a partnership agreement provides for a special allocation to a partner, such allocation will be relied on to determine the partner's distributive share if it has substantial economic effect. If a special allocation does not have substantial economic effect pursuant to Treasury Regulation section 1.704-1(b)(2), such allocation will be determined in accordance with the partner's interest in the partnership. However, whether the Allocations made to Petitioner pursuant to each LP Partnership Agreement have substantial economic effect is a factual question 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 §171.Twenty-fourth; 20 NYCRR 2376.1(a).

For purposes of Article 9-A of the Tax Law, for taxable year 2000 through 2002, the Management Fees received by Petitioner that appear to be subject to IRC section 707(a) are compensation for services provided by Petitioner for each LP in the regular course of its business operations. As such, the Management Fees are not investment income under section 208.6 of the Tax Law because the Management Fees are not attributable to investment capital as defined in section 208.5 of the Tax Law. Therefore, the Management Fees received by Petitioner constitute business income under section 208.8 of the Tax Law.

The Allocations made to Petitioner by each LP are included in Petitioner's distributive share of the LP's items of income, gain, loss and deduction under IRC section 704. The performance allocations will be determined in accordance with the Partnership Agreement if the allocations meet the substantial economic effect provisions under Treasury Regulation section 1.704-1(b)(2). If the substantial economic effect provisions of such section 1.704.-1(b)(2) are not met, under IRC section 704(b) the performance allocations will be determined in accordance with Petitioner' interest in the LP. Where distributive share treatment is given to the performance allocations, including the Allocations, for federal income tax purposes, pursuant to section 3-13.2 of the Article 9-A Regulations, each item of income, capital, gain, loss and deduction reflected in the Allocation will retain the same source and character for purposes of Article 9-A as it has for federal income tax purposes. Where an item is not characterized or taken into account for federal income tax purposes, the source and character of such item for

purposes of Article 9-A is determined as if such item were realized by Petitioner directly from the source from which realized by the LP or incurred by Petitioner in the same manner as incurred by the LP. Therefore, where an LP has gain or loss from the sale of stock, Petitioner has such gain or loss.

Section 208.5 of the Tax Law provides, in part, that investment capital means investments in stocks, bonds and other securities, not held for sale to customers in the regular course of business. In the case of a corporate partner, stocks, bonds and other securities will not be investment capital if held for sale to customers in the regular course of business by the partnership of which it is a partner. Whether stocks, bonds or other securities are being held for sale to customers in the regular course of business is a factual question 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 §171.Twenty-fourth; 20 NYCRR 2376.1(a). However, stocks, bonds and other securities which qualify as capital assets pursuant to IRC section 1221 are presumably not being held for sale to customers in the regular course of business for purposes of section 208.5. Accordingly, such stocks, bonds and other securities will be investment capital, and the income from such stocks, bonds and other securities will be investment income, for purposes of section 208 of the Tax Law.

DATED: July 25, 2005

/s/
Jonathan Pessen
Tax Regulations Specialist IV
Technical Services Division

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