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

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Corporation Tax
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STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. C871013B

On October 13, 1987, a Petition for Advisory Opinion was received from Weightwatchers of Chicago, Inc., 611 Enterprise Drive, Oakbrook, Illinois 60521.

The issue raised is whether a foreign corporation which is not otherwise subject to the corporate franchise tax imposed under Article 9-A of the Tax Law becomes subject to such tax solely by virtue of its purchase, through a private placement, of a limited partnership interest in a limited partnership which is doing business in New York.

FACTS:

Petitioner is a foreign corporation, not otherwise subject to New York franchise tax, which has purchased, through private placements, interests in limited partnerships doing business in New York State but which are not subject to the Federal Securities Act of 1933.

APPLICABLE LAW:

Section 209.1 of Article 9-A of the New York 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. In interpreting this section, Franchise Tax Regulation 20 NYCRR § 1-3.2(a)(5) sets forth a genera] rule which holds that if a partnership is exercising any of the privileges of section 209.1, then all of its corporate partners are subject to the tax imposed by Article 9-A.

ANALYSIS:

The broad issue presented here is whether Petitioner is subject to the Article 9-A franchise tax. But the pivotal issue is whether, as a matter of law, a limited partner is doing business if the limited partnership is. Within the context of the Article 9-A franchise tax, the New York Attorney General, in a December 28, 1954 Opinion, answered both of those questions in the affirmative. See, 1954 Opinions of the Attorney General 221. However, since 1954, limited partnerships have multiplied, resulting in a much more refined judicial philosophy concerning the status of the limited partner. In light of these developments, it is now clear that the rationale employed by the Attorney General has not withstood the test of time and that the 1954 Opinion itself should no longer be followed insofar as it relates to corporate limited partners.

The heart of the 1954 Opinion is the belief that the common law doctrine of agency is at all times mutually inherent, as a matter of law, in the relationship between limited partners and general partners. The soundness of the agency rationale is essential for the validity of the 1954 Opinion.

As authority for this assertion, the 1954 Opinion relied chiefly on two New York cases: People ex rel Badische Anilin & Soda Fabrik v. Roberts, 152 NY 59 (1897)(1 dissent); and Matter of Chapman v. Browne, 268 AD 806 (3d Dept 1944), mot lv app den, 293 NY 933 (1944).

Were it applicable, the agency doctrine would lead to the conclusion that limited partners inevitably are doing business wherever the general partners are doing business. However, the agency doctrine simply has no place in analyzing the status of the typical limited partner who remains passive in the business:

> "As the Official Comment to § 1 of the Uniform [Limited Partnership] Act makes clear, a limited partner, though so called by custom, is not 'in any sense' either a partner or a principal in the business or transactions of the partnership .... See 6 Uniform Laws Annotated, Uniform Limited Partnership Act § 1 .... Succinctly put, a limited partnership interest in a business is in the nature of an investment .... He is an investor in the partnership venture, without authority to participate in the management of the business .... Hence, the general rule would appear to be that the principal-agent relationship which exists between the parties of an ordinary partnership is not per se present between general and limited partners in a limited partnership."

Klein v. Weiss, 284 Md 36, 395 A. 2d 126, 136 (1978), citing Riviera Congress Assoc. v. Yassky, 25 AD 2d 291 (lst Dept. 1966), aff'd 18 NY 2d 540 (1966); Ruzicka v. Rager, 305 NY 191 (1953); Lynn v. Cohen, 359 F. Supp. 565 (SDNY 1973); Freedman v. Tax Review Board of Philadelphia, 212 Pa Super 442 (1968) (unanimous 7/0 opinion), aff'd by an equally divided court (3/3)(dissent not grounded in agency law), 434 Pa 282 (1969); and 60 Am. Jur. 2d Partnership § 379 (1972).

The Lynn case, a diversity action, focused on the territorial power of New York to attain in personam civil jurisdiction over a nonresident limited partner via the New York long-arm statute as limited by the Due Process Clause of the Fourteenth Amendment to the Federal Constitution. The district court held that the limited partner's investment in partnerships producing movies in New York did not, of itself, constitute the "transacting of any business" in New York, through an agent, within the meaning of the long-arm statute. On this point, Lynn said:

> "Plaintiffs argue that by investing in the partnerships, both of which were producing movies in New York, the defendant transacted business in New York. In making this argument, plaintiffs assume that a general partner engaged in the business of a limited partnership acts as the 'agent' of the limited partners within the meaning of CPLR § 307(a). This assumption is unfounded. Being strictly a creature of statute, a limited partnership resembles a corporation more closely than it does an ordinary partnership. Ruzicka v. Rager, 305 NY 191

> (1953); NY Partnership Law, Art 8 (McKinney's Consol. Laws, c. 39, 1948). The principal-agent relationship which exists between the partners of an ordinary partnership is not present between the limited and general partners of a limited partnership. Moreover, the actual relationship between plaintiffs and defendant created by the partnership agreement does not meet the standards of agency established by the courts of New York in construing the long-arm statute. Under the standards, the defendant principal must exercise 'domination and control' over the activities of the plaintiff agent in order to come within the statute. Hodom v. Stearns, 32 AD 2d 234, appeal dismissed, 25 NY 2d 722 (1969). The cases make clear that the amount of 'domination and control' required is considerably more than defendant Cohen exercised over the plaintiffs under the partnership agreements."

359 F. Supp. at 567.

Lynn has been cited with approval by several courts, including those in New York. See, e.g., Oncology Associates v. McGraw-Hill Corp., 109 AD 2d 616 (lst Dept 1985).

Moreover, the "passive investor/no agency" rationale of Lynn has been subscribed to by other courts nationwide when faced with the identical civil jurisdiction issue. See, Oriental Imports & Exports v. Maduro & Curiel's, 701F. 2d 889 (llth Cir 1982) (applying Florida]aw); Klein v. Mega Trading Ltd., 416 So. 2d 866 (Fla 3d DCA 1983); Ga-Pak Lumber Co., Inc. v. Nalley, 337 So. 2d 1270 (Mississippi 1976); and Norman v. Kal, 88 Ill App 3d 81 (lst District 1980).

In addition, the instant agency issue appears in contexts besides civil jurisdiction, with the same result.

For example, the analogous issue has arisen several times in the area of Federal diversity jurisdiction. Will a limited partner's state of citizenship impede diversity? The Federal circuits are sharply split on this question, with some courts holding that diversity is destroyed solely because such a bright-line rule of jurisdiction regarding unincorporated associations is perceived to be the intent of Congress. See, 13B C. Wright, A. Miller and E. Cooper, Federal Practice and Procedure: Jurisdiction 2d, § 3630 (collecting cases). However, the cases which disagree with the bright-line approach are usually then forced to confront an additional argument: it is asserted that a limited partner's citizenship in the same state as an adverse party will destroy diversity whenever the partnership is suing or is being sued, for it is claimed that general partners are inherently general agents for the limited partners and vice versa. Ail of the courts which have faced this anti-diversity argument have rejected it. See, e.g., Colonial Realty Corp. v. Bache & Co., 358 F. 2d 178 (2d Cir 1966), cert den, 385 US 817 (1966). As one Federal court said in this regard, at times quoting the Official Comments to the ULPA:

> "Though a general partner has general agency authority to bind partnership assets and other general partners he cannot bind limited partners .... [A general partner] is not in any sense a general agent for the limited partners. [The Official Comments say, in part:] 'First, in the draft the person who contributes the capital, though in accordance with custom called a limited partner, is not in any sense a partner. [However, he] may become a partner.' Thus, a limited partnership such as the one involved herein, which has only one general partner, is not a true partnership under California law, and the label 'partnership' is less descriptive of its legal relations than 'sole proprietorship' would be."

Wroblewski v. Brucher, 550 F. Supp. 742, 747 (WD Okla 1982). Compare the observation of the First Department in Skolny v. Richter (139 AD 534, 537 /1910)), wherein the court, in ruling that a limited partner, unlike a general partner, owes no fiduciary duty to fellow partners, permitted limited partners to invest in a competing partnership. The court stated: "Similarity of terminology does not always establish identity in meaning or in the rules of law affecting the subjects similarly named".

In fact, in the face of the modern trend summarized above, only one case could be found which, like the Third Department's 1944 Chapman case (supra), held general partners to be inherent general agents of the limited partners: Donroy, Ltd. v. United States, 301F. 2d 200 (9th Cir 1962). And that case has been sharply criticized by other courts, including the court in Wroblewski v. Brucher, supra, 550 F. Supp. at 746 n. 6, as well as the California Supreme Court which, in declining to follow Donroy, held that the Ninth Circuit had badly misconstrued California law on the subject of limited partners. See, Evans v. Galardi, 16 Cal 3d 300 (1976)(citing Skolny v. Richter, supra). Even the Ninth Circuit itself has, apparently, abandoned the partnership/agency rationale of Donroy. See, Estate of Meyer v. Commissioner, 58 TC 311 (1972), nonacq., 1975-1C. B. 3, aff'd per curiam, 503 F. 2d 556 (9th Cir 1974).

It is obvious that the overwhelming weight of the modern authorities in a variety of areas of law has crippled the foundation on which the 1954 Opinion of the Attorney General rests. The 1944 Chapman case, which explicitly held that agency principles apply so as to taint limited partners as being engaged in business wherever the partnership is so engaged, was an extremely succinct opinion, completely devoid of cited authority. Its agency-based rationale stands virtually alone and quite weak viewed against the more recent decisions discussed above.

Therefore, in the instant case, it cannot be said that Petitioner is doing business in New York for purposes of section 209.1 of the franchise tax. The 1954 Opinion should no longer be followed. In this regard, note that "an opinion of the Attorney General is an element to be considered but is not binding on the courts". Matter of AT&T v. State Tax Commission, 61 NY 2d 393, 404 (1984).

The remaining bases for potential jurisdiction under section 209.1 are easily disposed of.

Even if the limited partnership owns property in New York, it cannot be said, for purposes of jurisdiction, that Petitioner thereby owns property in New York. General partners do not own direct pro rata shares of each partnership asset. Matter of Havemeyer, 17 NY 7d 216 (1966). The same is true for limited partners. Matter of Ausbrooks v. Chu, 66 NY 2d 281, 288 (1985)(partnership A which is a limited partner in partnership B has no direct ownership interest in partnership B's assets). (That is not to say, though, that computational matters, such as the factors used in computing the business allocation percentage, may not employ a pass-through approach -- assuming jurisdiction is otherwise established. See, Tax Law section 210.3(a); 20 NYCRR 4-6.5.)

For like reasons, Petitioner is not "maintaining an office" in New York even though the limited partnership is.

Nor is Petitioner "employing capital" in New York. In general, employing capital refers to the use of assets in maintaining or aiding the corporate enterprise or activity in New York (20 NYCRR 1-3.2(c)). There are circumstances where the investment of corporate monies in a New York State enterprise will constitute "employing capital" in the state (see, Matter of AT&T v. State Tax Commission, supra, 61 NY2d at 402). However, an investment which is strictly passive is not sufficient (see , People ex rel Union Ferry Co. v. Roberts, 66 AD 157, 160 (3d Dept. 1901)). As has been clearly demonstrated, Petitioner is merely a passive investor. As such, it is not employing capital in New York State.

Petitioner's status is akin to that of a preferred shareholder. If Petitioner were employing capital for purposes of the jurisdictional bases of section 209.1, then the same would have to be said for a nonresident shareholder of a corporation which resembles the limited partnership in its New York operations. Yet the Court of Appeals has held that to subject a nonresident shareholder to the franchise tax upon the basis of the corporation's activities within New York "would be an unreasonable exercise of the power of taxation". People v. American Bell Telephone Co., 117 NY 241, 255 (1889). There is no indication that the 1969 legislation which expanded the nexus standards of Article 9-A of the Tax Law to include "employing capital" was intended to cover purely passive investments such as in the present case.

It should be emphasized that this opinion is restricted to a partnership interest, in the circumstances described above, which is owned by a foreign corporation in the capacity of a limited partner. That is to say, this opinion does not extend to a foreign corporate general partner in the above circumstances. Moreover, limited partners in name only, i.e., limited partners who shed their passive role and who in fact take an active part in the partnership should be treated as the general partners they really are, for purposes of the franchise tax. Cf., New York Partnership Law section 96; Micheli Contracting Corp. v. Fairwood Associates, 68 AD 2d 460 (3d Dept 1979); Estate of Meyer, supra, 58 TC at 314. Similarly, if a foreign corporation acquires a limited partnership interest

under circumstances whereby the business carried on by the partnership in New York is integrally related to the regular business of the foreign corporation or whereby the foreign corporate limited partner obtains a controlling interest in the limited partnership, such foreign corporate limited partner should be considered to be both doing business and employing capital in New York. See, People ex rel Badische Anilin & Soda Fabrik v. Roberts, supra, 152 NY 59. See also, People ex rel Union Ferry Co. v. Roberts, supra, 66 AD at 160; Matter of AT&T v. State Tax Commission, supra, 61 NY2d at 402. The key to nontaxability is that the limited partnership holding be a passive, disinterested investment.

CONCLUSION:

Petitioner's ownership of a limited partnership interest in a limited partnership which is doing business in New York, when Petitioner is not otherwise subject to the New York Article 9-A corporate franchise tax, will not in itself cause Petitioner, as a foreign corporate limited partner, to be doing business, employing capital, owning or leasing property or maintaining an office in New York and, thus, Petitioner, as a foreign corporate limited partner, is not subject to the Article 9-A franchise tax.

DATED: April 19, 1988

s/FRANK J. PUCCIA
Director
Technical Services Bureau

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