

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

TSB-A-91(4)C  
Corporation Tax  
January 31, 1991

STATE OF NEW YORK  
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. C900911B

On September 11, 1990, a Petition for Advisory Opinion was received from J.P. Morgan & Co. Incorporated, 60 Wall Street, New York, New York 10015.

The issued raised by Petitioner, J.P. Morgan & Co. Incorporated ("JPM") is whether its indirectly wholly-owned subsidiary organized pursuant to section 4(c)(7) of the Bank Holding Company Act of 1956, as amended (the "Act"), is subject to New York State franchise tax under Article 32 of the Tax Law where the subsidiary's sole business will be investing in securities.

JPM is a corporation organized under the Act. JPM owns 100 percent of the outstanding stock of Morgan Guaranty Trust Company of New York ("MGT"). JPM, MGT and certain affiliated corporations file combined returns under Article 32 of the Tax Law.

JPM intends to form an indirectly wholly-owned subsidiary ("Newco") which will be incorporated in either New York or Delaware and which will have its only office and place of business in New York. None of Newco's officers or employees will be officers or employees of JPM or MGT.

Newco's sole business will be investing in securities. All decisions regarding the making and disposition of investments will be made by the officers and employees of Newco independently. A portion of the securities held by Newco will be equity investments in corporations acquired in leveraged buy-out transactions. MGT will act as a lender to the acquired corporations in these transactions. The remaining securities held by Newco will constitute venture capital investments. The securities held by Newco will not include more than five percent of the outstanding voting shares of any corporation.

Subject to certain exceptions, section 4(a) of the Act prohibits a bank holding company from holding the shares of any corporation that is not a bank. Section 4(c)(7) of the Act provides an exemption for "shares of an investment company which is not a bank holding company and which is not engaged in any business other than investing in securities, which securities do not include more than 5 percent of the outstanding shares of any company." (12 U.S.C. 1843(c)(7).) Pursuant to this exception, JPM will not be prohibited from owning the stock of Newco. No regulatory approval is necessary to claim this exception nor will any such approval be sought by JPM or Newco.

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 during the taxable year. Section 209.4 of the Tax Law, provides that corporations liable to tax under Article 32 of the Tax Law are not subject to tax under Article 9-A.

Section 1451 of Article 32 of the Tax Law imposes an annual 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.

Section 1452(a) of the Tax Law defines "banking corporation" for purposes of Article 32 of the Tax Law. Section 1452(a)(9) of the Tax Law provides that a corporation 65 percent or more of whose voting stock is owned or controlled directly or indirectly by a corporation registered under the Act is a banking corporation provided that the corporation whose voting stock is so owned or controlled is principally engaged in a business, regardless of where conducted, which (i) might be lawfully conducted by a corporation subject to Article 3 of the Banking Law or by a national banking association or (ii) is so closely related to banking or managing or controlling banks as to be a proper incident thereto, as set forth in section 4(c)(8) of the Act.

Herein, Newco will be indirectly wholly owned by JPM, a corporation registered under the Act thereby meeting the "ownership" requirement contained in section 1452(a)(9) of the Tax Law. Therefore, when determining whether Newco is a banking corporation the question remaining is whether Newco will meet the "principally engaged in a business" requirement.

Section 16-2.5(j)(1)(ii) of the Franchise Tax on Banking Corporations Regulations provides that

. . .the phrase business which might be lawfully conducted means the nature of business, regardless of where such business is conducted, that a corporation organized pursuant to article 3 of the New York State Banking Law or a national banking association having its principal office in New York State may conduct:

- (a) without the need for a specific grant of authorization by the appropriate regulatory authorities; or
- (b) with a specific grant of authorization if such corporation or association has in fact received such authorization from the appropriate regulatory authority.

Section 16-2.5(j)(4) of the Franchise Tax on Banking Corporations Regulations provides that:

. . .the phrase principally engaged in a business means that a corporation derives more than 50 percent of its gross receipts from such business during its taxable year for Federal income tax purposes. Gross receipts from various aspects of a corporation's business may be aggregated to determine what business the corporation is principally engaged in. For example, corporation P derives 40 percent of its gross receipts from a business which might be lawfully conducted by a corporation subject to article 3 of the New York State Banking Law, 40 percent of its gross receipts from a business which is so closely related to banking or managing or controlling banks as to be a proper incident thereto, and 20 percent of its gross receipts from a business which may not be lawfully conducted by a corporation subject to article

3 of the New York State Banking Law and is not so closely related to banking or managing or controlling banks as to be a proper incident thereto. Since corporation P derives more than 50 percent of its total gross receipts from a business which might be lawfully conducted by a corporation subject to article 3 of the New York State Banking Law or is so closely related to banking or managing or controlling banks as to be a proper incident thereto, the "principally engaged in a business" requirement . . . is met.

Accordingly, it is immaterial that Newco will be organized under section 4(c)(7) of the Act and it is immaterial what business Newco is authorized to do. Newco's actual business activities must be analyzed at the end of the taxable year to determine if Newco meets the "principally engaged in a business" requirement of section 1452(a)(9) of the Tax Law. When analyzing Newco's business activities for the taxable year, it must be determined whether Newco's business of investing for its own account in securities that constitute equity investments in corporations acquired in leveraged buy-out transactions or venture capital investments constitute (1) a business which might be lawfully conducted by a corporation subject to Article 3 of the Banking Law, (2) a business which might be lawfully conducted by a national banking association or (3) a business which is so closely related to banking or managing or controlling banks as to be a proper incident thereto, as set forth in section 4(c)(8) of the Act. In addition, any other business activity that Newco engages in during the taxable year must be analyzed.

If more than 50 percent, in the aggregate, of Newco's gross receipts for the taxable year are from (1) a business which might be lawfully conducted by a corporation subject to Article 3 of the Banking Law, (2) a business which might be lawfully conducted by a national banking association and (3) a business which is so closely related to banking or managing or controlling banks as to be a proper incident thereto, as set forth in section 4(c)(8) of the Act, Newco will meet the "principally engaged in a business" requirement of section 1452(a)(9) of the Tax Law for the taxable year. If Newco meets the "principally engaged in a business" requirement, Newco will be subject to tax under Article 32 of the Tax Law.

If, in the aggregate, 50 percent or less of Newco's gross receipts for the taxable year are from (1) a business which might be lawfully conducted by a corporation subject to Article 3 of the Banking Law, (2) a business which might be lawfully conducted by a national banking association or (3) a business which is so closely related to banking or managing or controlling banks as to be a proper incident thereto, as set forth in section 4(c)(8) of the Act, Newco will not meet the "principally engaged in a business" requirement of section 1452(a)(9) of the Tax Law for the taxable year. If Newco does not meet the "principally engaged in a business" requirement, Newco will be subject to tax under Article 9-A of the Tax Law.

The determination of whether Newco will meet the requirements of section 1452(a)(9) of the Tax Law is a factual matter 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, subd. twenty-fourth; 20 NYCRR 901.1(a). Assuming Newco will meet the "ownership" requirement, the determination of

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whether Newco will be a banking corporation pursuant to such section 1452(a)(9) of the Tax Law must be made at the end of its taxable year and based on what business Newco is principally engaged in during such taxable year.

It should be noted, that if it is determined that Newco is taxable under Article 9-A of the Tax Law and if any agreement, understanding or arrangement exists between JPM or MGT and Newco, whereby it appears to the Commissioner that the activity, business, income or assets of JPM or MGT within New York State is improperly or inaccurately reflected, the Commissioner may exercise his discretion, pursuant to section 1462(g) of the Tax Law, by making adjustments he deems necessary in order to accurately reflect the tax liability of JPM or MGT.

DATED: January 31, 1991

s/PAUL B. COBURN  
Deputy Director  
Taxpayer Services Division

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