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

TSB-A-91(6)C
Corporation Tax
March 7, 1991

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO.C900829A

On August 29, 1990, a Petition for Advisory Opinion was received from The Chase Manhattan Bank, N.A., c/o Tax Department, 33 Maiden Lane, 20th Floor, New York, New York 10038.

The issue raised by Petitioner, Chase Manhattan Bank, N.A., is whether a New York subsidiary of a national bank holding company, established 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 as a banking corporation under Article 32 where such subsidiary invests for its own account in a variety of equity and debt securities.

Chase Manhattan Corporation ("CMC"), a national bank holding company, is the parent company of Petitioner, The Chase Manhattan Bank, N.A. ("CMB") and a group of banking corporations filing combined New York State Franchise Tax returns under Article 32 of the Tax law. CMC proposes to locate in New York an investment company (the "Company"), organized pursuant to section 4(c)(7) of the Act, to engage in the sole business of purchasing a variety of equity and debt securities as principal for its own investment account. The Company's corporate charter authorizes broad investment powers with respect to the purchase and sale of securities of a number of different issuers, including banks and insurance companies, of which some may be considered to be predominately speculative and high risk investments. The Company may acquire these securities either directly (i.e., by direct purchase or by investing in certain leverage buy-out and venture capital funds), or from CMB. Any purchase of securities from CMB will be for, and recorded at, fair market value pursuant to section 23B of the Federal Reserve Act with any gain being recognized and any risk of loss transferred to, and assumed by the Company.

Among the types of securities which may be purchased are junk bonds and equity and debt securities that include equity kickers such as stock, warrants, options, or additional cash proceeds. These securities may or may not be in registered form or traded on an established securities exchange. It is also contemplated that the Company will, from time to time, purchase preferred stock and/or warrants from CMB which it had received in connection with various lending transactions. CMB will sell such securities because of certain regulatory restrictions, such as limitations on the time period which a bank may own securities, and prohibitions on the exercise of stock warrants received in lieu of interest or as additional consideration.

As part of the Company's investment strategies it may acquire securities of low credit grade or quality such as those issued as part of bankruptcy or workout restructurings.

Pursuant to section 4(c)(7) of the Act, a bank holding company may own "shares of an investment company which is not a banking holding company and which is not engaged

in any business other than investing in securities, which securities do not include more than 5 per centum of the outstanding voting shares of any company" (a "4(c)(7) Investment Company"). The Act does not require bank holding companies to obtain the prior approval of the Board of Governors of the Federal Reserve System ("Federal Reserve Board") to establish and acquire a 4(c)(7) Investment Company.

Under the terms of section 4(c)(7) of the Act, there are no limits on the dollar value of the securities which may be acquired by a 4(c)(7) Investment Company. Furthermore, there are no limits on the type of securities which may be acquired; they include, for example:

- equity and debt securities,
- both registered securities which are traded on a securities exchange, and registered and unregistered securities which are not traded on a securities exchange, and
- debt securities having restrictions on their transferability or having a very "thin" market.

A 4(c)(7) Investment Company is limited to owning five percent of any class of the voting shares of any one issuer. There are no statutory limits on the amount of nonvoting shares or debt securities that may be acquired by such a company. However, while there are examples to the contrary, the Federal Reserve Board has stated that an acquisition of more than 25 percent of the "total equity" of a company will generally not be permitted.

In summary, Petitioner states that a 4(c)(7) Investment Company has very broad investment powers regarding the purchase of securities as principal for its own account, whereas a national bank is generally prohibited from such investment activities.

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 fanchise, 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, the Company will be a banking corporation if 65 percent or more of the Company's voting stock is owned or controlled directly or indirectly by CMC and the Company is principally engaged in a business which (i) might be lawfully conducted by a corporation organized pursuant 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.

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 the Company is organized under section 4(c)(7) of the Act and it is immaterial what business the Company is authorized to do.

The Company's actual business activities must be analyzed at the end of the taxable year to determine if the Company meets the "principally engaged in a business" requirement of section 1452(a)(9) of the Tax Law. When analyzing the Company's business activities for the taxable year, it must be determined whether Company's business of investing for its own account in equity and debt securities 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 Company engages in during the taxable year must be analyzed. See, J.P. Morgan & Co. Incorporated, Adv Op, Comm T&F, January 31, 1991, TSB-A-91(4)C.

If more than 50 percent, in the aggregate, of the Company'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, the Company will meet the "principally engaged in a business" requirement of section 1452(a)(9) of the Tax Law for the taxable year. If the Company is 65 percent or more owned or controlled directly or indirectly by CMC and if the Company meets the "principally engaged in a business" requirement, the Company will be a banking corporation pursuant to section 1452(a)(9) of the Tax Law and will be subject to tax under Article 32 of the Tax Law.

If, in the aggregate, 50 percent or less of Company'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, Company will not meet, the "principally engaged in a business" requirement of section 1452(a)(9) of the Tax Law for the taxable year. If Company does not meet the "principally engaged in a business" requirement, Company will be subject to tax under Article 9-A of the Tax Law.

The determination of whether the Company 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 CMC will own or control directly or indirectly 65 percent or more of the Company's voting stock, the determination of whether the Company 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 will be based on what business the Company is principally engaged in during such taxable year.

It should be noted, that if it is determined that the Company is taxable under Article 9-A of the Tax Law and if any agreement, understanding or arrangement exists between CMC or CMB and the Company, whereby it appears to the Commissioner that the activity, business, income or assets

of CMC or CMB 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 CMC or CMB.

DATED: March 7, 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.