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

TSB-A-94 (10) C
Corporation Tax
June 8, 1994

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. C940208B

On February 8, 1994, a Petition for Advisory Opinion was received from Dewey Ballantine, 1775 Pennsylvania Avenue, N.W., Washington, D.C. 20006.

The issue raised by Petitioner, Dewey Ballantine, is whether offshore investors, described in the set of facts herein, would be subject to New York State franchise tax under Article 9-A of the Tax Law or the New York City general corporation tax with respect to their investments in stocks and bonds of United States corporations.

Under the proposed investment structure, a parent corporation (hereinafter "Parent") organized in a foreign country (hereinafter "Country A") would establish a wholly-owned subsidiary (hereinafter "Subsidiary") under the laws of a third-country jurisdiction (hereinafter "Country B"). The Parent would cause a unit trust (hereinafter "Trust") to be established in Country B, and the Subsidiary would be the sole or principal unit holder in the Trust. The Subsidiary would invest primarily in widely traded stocks and bonds of large U.S. companies. The Trust would invest primarily in small capital stocks of U.S. corporations. Neither the Subsidiary nor the Trust would have U.S. source income other than with respect to these investments. No activities would be undertaken in the United States by or on behalf of either the Subsidiary or the Trust other than those described below in connection with these investments.

Under the proposed structure, a Country A subsidiary of the Parent would act as the principal investment advisor (hereinafter "Investment Advisor") for the Subsidiary. A wholly-owned U.S. subsidiary of the Parent located in New York (hereinafter "Sub Investment Manager") would provide investment advice to the Investment Advisor with respect to the Subsidiary's U.S. investments. The Investment Advisor, however, would have ultimate discretionary authority over the Subsidiary's securities investment and trading decisions, and these investment and trading decisions would be implemented by the Investment Advisor from its offices outside the United States.

The New York branch of an unrelated foreign bank (hereinafter "Custodian") would act as custodian for the Subsidiary's investments in New York and would provide portfolio statements regarding the Subsidiary's investments to the Subsidiary's administrative agent (hereinafter "Agent") located in Country B. The Agent would be responsible for performing the Subsidiary's accounting and bookkeeping functions and maintaining the Subsidiary's books in Country B. The Subsidiary's books would be audited by an auditor located in Country B. The Subsidiary would maintain a bank account in Country A from which all of its dividends and expenses would be paid.

In the case of U.S. investments made by the Trust, the Sub Investment Manager would provide investment advice directly to the Agent, which would be the trustee of the Trust and would have ultimate discretionary authority for approving such investment advice.

Upon the approval of the Agent, the Sub Investment Manager would implement these investment decisions on behalf of the Trust from its New York offices. (The Agent's discretionary authority on behalf of the Trust would derive froma declaration of trust by the Agent, as trustee for the unit holders. Thus, theAgent will be exercising that authority on behalf of the Subsidiary (the Trust's sole or principal unit holder), rather than the Sub Investment Manager, and that discretionary investment authority therefore will exist outside the United States (i.e., with the Subsidiary).)

The Custodian would act as custodian for the Trust's investments in New York and would provide portfolio statements regarding the Trust's investments to the Agent. The Agent would be responsible for performing the Trust's accounting and bookkeeping functions and maintaining the Trust's books in Country B. The Trust's books would be audited by an auditor located in Country B. The Agent, as trustee, would maintain a bank account in Country B from which all of the Trust's distributions and expenses would be paid.

Neither the Sub Investment Manager nor the Custodian will communicate directly with the Parent regarding the Subsidiary or the Trust. Moreover, neither the Sub Investment Manager nor the Custodian will communicate directly with the Subsidiary regarding the Trust; rather, all such communications will be made directly to the Agent, who will then incorporate any information received from the Sub Investment Manager or the Custodian in its communications with the Subsidiary. Thus, all communications to the shareholders of the Subsidiary and the unit holders of the Trust, oral or written, will be made from outside the United States.

Under the proposed structure, the Custodian will provide portfolio statements regarding the Subsidiary's and the Trust's investments to the Agent, which will then prepare the balance sheets and reports of their investments to be sent by the Agent to the Parent on behalf of the Subsidiary and the Trust. All other primary corporate records for the Subsidiary and similar records for the Trust will also be maintained outside the United States, either in Country A or Country B. Accordingly, both entities will be treated as maintaining their principal records and books of account outside the United States for Federal income tax purposes.

Under the proposed structure, an auditor located in Country B will audit the books of the Subsidiary and the Trust from Country B. Furthermore, all disbursements for the Subsidiary and the Trust will be made from bank accounts located outside the United States.

To the extent applicable to the Subsidiary or the Trust, the activities of communicating with the general public, soliciting sales of its own stock, accepting the subscriptions of new stockholders, and publishing or furnishing the offering and redemption price of the shares of stock issued by it will be performed outside of the United States. Moreover, all directors' and shareholders' (or unit holders') meetings for the Subsidiary and the Trust will be conducted outside the United States.

Country B does not have an income tax, therefore, it does not have an income tax treaty with the United States. Petitioner states that the proposed investment structure does not have a tax avoidance purpose because the income earned by the Subsidiary and the Trust will be currently taxable in full to the Parent by its home country whether or not that income is repatriated.

Petitioner contemplates that for Federal income tax purposes the Subsidiary and the Trust would be treated as associations taxable as corporations. Petitioner believes that the Subsidiary and the Trust will be treated as not engaged in a U.S. trade or business pursuant section 864(b)(2)(A) of the Internal Revenue Code and, therefore, will not be subject to tax for Federal income tax purposes.

Section 208.1 of the Tax Law provides that the term "corporation" includes an association, within the meaning of section 7701(a)(3) of the Internal Revenue

Section 209.1 of Article 9-A of the Tax Law imposes the business corporation franchise tax on every foreign corporation, unless specifically exempt, for the privilege of doing business, or of employing capital, or of owning or leasing property in New York State in a corporate or organized capacity, or of maintaining an office in New York State.

Section 1-3.2(b) of the Business Corporation Franchise Tax Regulations (hereinafter "Article 9-A Regulations) provides that:

> (1) The term doing business is used in a comprehensive sense and includes all activities which occupy the time or labor of men for profit. Regardless of the nature of its activities, every corporation organized for profit and carrying out any of the purposes of its orgranization is deemed to be doing business for the purposes of the tax. In determining whether a corporation is doing business, it is immaterial whether its activities actually result in a profit or a loss.
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> (2) Whether a corporation is doing business in New York State is determined by the facts in each case. Consideration is given to such factors as:
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> (i) the nature, continuity, frequency, and regularity of the activities of the corporation in New York State;
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> (ii) the purposes for which the corporation was organized;
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> (iii) the location of its offices and other places of business;
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> (iv) the employment in New York State of agents, officers and employees; and

(v) the location of the actual seat of management or control of the corporation.

Section 209.2 of the Tax Law provides that a foreign corporation shall not be deemed to be doing business, employing capital, owning or leasing property, or maintaining an office in New York State by reason of (a) the maintenance of cash balances with banks or trust companies in New York State, or (b) the ownership of shares of stock or securities kept in New York State, if kept in a safe deposit box, safe, vault or other receptacle rented for the purpose, or if pledged as collateral security, or if deposited with one or more banks or trust companies, or brokers who are members of a recognized security exchange, in safekeeping or custody accounts, or (c) the taking of any action by any such bank or trust company or broker, which is incidental to the rendering of safekeeping or custodian service to such corporation, or (d) the maintenance of an office in New York State by one or more officers or directors of the corporation who are not employees of the corporation, or (e) the keeping of books or records of a corporation in New York State or (f) any combination of the foregoing activities.

The conduct of business is more than the ownership of property and the collection and distribution of income derived from that property. (Smadbeck v St Tax Comm, 33 NY2d 930 (1973); People ex rel Nauss v Graves, 283 NY 383, 386 (1940)). The conducting of business to subject an investment corporation to the franchise tax is "more than the mere investment of funds and the collection of income therefrom, with the incidental replacement of securities and the reinvestment of funds that constitute the corpus, as in the case of an ordinary trust." Burrell v Lynch, 274 AD 347, 352 (1948). (See also, City Bank Farmers Trust Co. v Graves, 272 NY 1, 6 (1936)).

The State Tax Commission in Declaratory Ruling 79-02, TSB-H-80(2)C(Rev.), ruled that where the sole asset of a corporation is a portfolio of securities that is held in New York State and managed by a professional management corporation and that the purpose of the investments and reinvestments are made with a view of maintaining principal and protecting the same from "the vicissitudes of inflation", it would appear that the corporation would be doing business in New York State.

Section 1-3.2(f) of the Article 9-A Regulations, provides examples of foreign corporations which are subject to tax and example (1) states that:

> A foreign corporation operates or is organized for the purposes of buying and selling securities. It does not maintain a physical office anywhere, other than a statutory office in the state of its incorporation. Regular and continuous purchases of securities are directed by its officers or agents located in New York State. The corporation is subject to tax.

Under the structure presented herein, the only activities relating to the Subsidiary's and the Trust's United States investments that will be performed in New York State will be (i) the Custodian serving as custodian for the Subsidiary's and the Trust's investments in New York, (ii) the Sub

Investment Manager providing non-binding investment advice to the Investment Advisor or, in the case of the Trust, the Agent and (iii) upon approval of the Agent, the Sub Investment Manager implements the investment decisions on behalf of the Trust from its New York offices. All other activities of the Subsidiary and the Trust will be carried out outside of the United States.

For purposes of Article 9-A of the Tax Law, the Custodian's activities on behalf of the Subsidiary and the Trust would not constitute doing business in New York State under section 209.2 of the Tax Law. Although the Subsidiary and the Trust will receive investment advice from the Sub Investment Manager and the Sub Investment Manager would implement the investment decisions on behalf of the Trust, discretionary authority as to the Subsidiary's and Trust's investments will be exercisable only by the Investment Advisor and the Agent, as the case may be, outside of New York State.

Since the Subsidiary and the Trust would not transfer decision-making authority to persons located in New York State, and no other activities of either the Subsidiary or the Trust would be conducted in New York State, the Subsidiary and the Trust would not be considered to be doing business in New York State under section 209.1 of the Tax Law and section 1-3.2 of the Article 9-A Regulations. Accordingly, the Subsidiary and the Trust would not be subject to New York State franchise tax under Article 9-A of the Tax Law.

The New York City general corporation tax is not administered by the New York State Department of Taxation and Finance. Therefore, it is not within the scope of this Advisory Opinion to make any determinations with respect to such tax. Inquiries regarding the New York City general corporation tax should be submitted to the New York City Finance Department.

DATED: June 8, 1994

s/PAUL B. COBURN
Deputy Director
Taxpayer Services Division

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