

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

TSB-A-94 (11) C
Corporation Tax
June 14, 1994

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. C940329A

On March 29, 1994, a Petition for Advisory Opinion was received from Bankers Trust New York Corporation, c/o Corporate Tax Division, 130 Liberty Street, 10th Floor, New York, New York 10006.

The issue raised by Petitioner, Bankers Trust New York Corporation, is whether a corporation organized pursuant to section 4(c)(7) of the Bank Holding Company Act of 1956, as amended, (hereinafter the "Act") is subject to franchise tax under Article 32 of the Tax Law when its sole business is investing in securities for its own account.

Petitioner, a New York corporation, is a bank holding company and owns 100 percent of the stock of Bankers Trust Company (hereinafter "BTCO"), a New York State chartered banking corporation. Petitioner, BTCO and certain affiliated corporations file combined New York State returns under Article 32 of the Tax Law.

BT Investment Partners, Inc. (hereinafter "BTIP") was incorporated in Delaware on September 10, 1993 pursuant to section 4(c)(7) of the Act, as a wholly owned subsidiary of BT Holdings (New York), Inc., a New York corporation, which is, in turn, a wholly owned subsidiary of Petitioner. BTIP has an office and a place of business in New York.

BTIP's sole business is investing in a variety of equity and debt securities as principal for its own account. All decisions regarding the acquisition and disposition of investments are made by the officers and employees of BTIP. BTIP's equity investments may include stock in corporations acquired in private equity transactions, in leveraged buyout transactions, in venture capital transactions and in other equity related transactions. In addition to equity securities, BTIP may acquire non-investment grade or speculative debt securities and debt securities that include equity kickers such a stock, warrants or options. The securities may or may not be in registered form or traded on an established securities exchange. The securities held by BTIP do not include more than five percent of the outstanding voting shares of any corporation. BTIP's investment in equities is in excess of 90 percent of its assets.

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 five percent of the outstanding shares of any company." Pursuant to this exception, Petitioner is not prohibited from owning the stock of BTIP. No regulatory approval is necessary to claim this exception, nor was any such approval sought by Petitioner or BTIP.

Section 97.5 of the Banking Law restricts a bank from purchasing any stock of any corporation except as provided pursuant to section 97 of the Banking Law. Sections 97.2, 97.3, 97.4 and 97.4-a permit ownership of stock of certain specified entities not relevant to the investment portfolio of BTIP.

Pursuant to section 97.4-b of the Banking Law, New York banks are permitted to invest in common or preferred stock registered (listed) on a national securities exchange subject to the following restrictions:

- (a) The aggregate amount of all investments in common and preferred stock permitted by section 97.4-b shall at no time exceed two percent of the assets or twenty percent of the capital, surplus and undivided profits of the bank, whichever is less.
- (b) The aggregate amount of all investments in the common and preferred stock of any one issuer pursuant to section 97.4-b together with the Aggregate amount of all investments in the bonds, debentures, notes or other obligations of such issuer made pursuant to section 103.1(i) of the Banking Law, shall at no time exceed one percent of the assets or fifteen percent of the capital, surplus and undivided profits of the bank, whichever is less.
- (c) No bank shall at any time hold, pursuant to section 97.4-b, more than two percent of the total issued and outstanding shares of stock of any one issuer.

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 property incident thereto, as set forth in section 4(c)(8) of the Act.

Herein, BTIP is indirectly wholly owned by Petitioner, 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 BTIP is a banking corporation,

the question remaining is whether BTIP meets the "principally engaged in a business" requirement.

Section 16-2.5(j)(1)(ii) of the Franchise Tax on Banking Corporations Regulations (hereinafter "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 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.

In both section 1452(a)(9) of the Tax Law and section 16-2.5(j) of the Regulations, when determining whether a corporation is principally engaged in a business which might be lawfully conducted by a corporation subject to, Article 3 of the Banking Law or by a national banking association, any activity permissible under Article 3 of the Banking Law without the need for a specific grant of authorization by the Banking Department is a "business which might be lawfully conducted". Neither the statute nor the regulations limit such activities to those activities that a particular bank might be restricted from engaging in because of its membership in the Federal Reserve System or because it is insured by the Federal Deposit Insurance Corporation.

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Section 97.4-b of the Banking Law provides that the aggregate amount of all investments in common and preferred stock shall not exceed two percent of assets or 20 percent of capital, whichever is less. Thus, under section 97.4-b of the Banking Law, a bank's power to invest in equity securities is an ancillary one and severely restricted. (See J. P. Morgan & Co. Incorporated, Adv Op Comm T & F, December 16, 1992, TSB-A-92(17)C.)

Since BTIP's investment in stock is in excess of 90 percent of its assets, it exceeds the limitations under section 97.4-b of the Banking Law and is not principally engaged in a business which might be lawfully conducted by a corporation subject to Article 3 of the Banking Law. In addition, BTIP is not principally engaged in a business which might be lawfully conducted by a national banking association, nor is it principally engaged in a business that is so closely related to banking or managing or controlling banks as to have been a proper incident to a banking business as set forth in section 4(c)(8) of the Act.

Accordingly, BTIP is not a banking corporation pursuant to section 1452(a)(9) of the Tax Law and is not subject to the franchise tax under Article 32 of the Tax Law.

DATED: June 14, 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.