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

TSB-A-98(3)C
Corporation Tax
TSB-A-98(1)R
Real Estate
Transfer Tax

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. Z971001B

On October 1, 1997, a Petition for Advisory Opinion was received from Long Island Lighting Company, 175 East Old Country Road, Hicksville, New York 11801.

The issues raised by Petitioner, Long Island Lighting Company, are:

1. Will LILCO's exchange of the Gas and Generation Assets for BL Holding common and preferred stock and the assumption by BL Holding of certain of LILCO's liabilities result in the imposition of gross earnings tax on LILCO under section 186 of the Tax Law?

2. Will the distribution by LILCO of the BL Holding common stock in the Redemption Distribution be treated as a dividend subject to the excess dividends tax imposed by section 186 of the Tax Law?

3. Will the distribution of cash in the LIPA Merger be treated as a dividend subject to the excess dividends tax imposed by section 186 of the Tax Law?

4. With respect to the Gas and Generation Assets Exchange, will LILCO realize taxable profits to the extent, if any, that the fair market value of the BL Holding common and preferred stock received by LILCO plus the amount of LILCO's liabilities assumed by BL Holding exceed the original cost of the Gas and Generation Assets, without deduction for depreciation, computed on an aggregate basis (i.e., treating the Gas and Generation Assets Exchange as a single "sale"), for purposes of the gross income tax imposed under section 186-a of the Tax Law?

5. With respect to the Redemption Distribution, will LILCO realize taxable profits to the extent, if any, that the fair market value of the LILCO stock deemed received by LILCO exceeds the original cost of the BL Holding common stock exchanged therefor, for purposes of the gross income tax imposed under section 186-a of the Tax Law?

6. Will the Transferee LLCs that, on a stand-alone basis, meet the definition of a "utility" under sections 186 and 186-a of the Tax Law be treated as separate taxable entities, distinct from each other and from BL Holdings, for purposes of the gross earnings and gross income taxes imposed under those provisions, such that the income and deductions of such Transferee LLCs are excluded from the income and deductions of BL Holding?

7. Will distributions to BL Holding from Transferee LLCs that are taxable as separate utility entities under section 186 of the Tax Law be subtracted from BL Holding's entire net income as income from subsidiary capital to the extent such distributions would constitute dividends if the Transferee LLCs had been organized as corporations?

8. If the Transferee LLCs are not treated as separate taxable entities under section 186 of the Tax Law, distinct from each other and from BL Holding, how are the receipts of BL Holding and the Transferee LLCs characterized for purposes of determining whether BL Holding is "principally engaged" in the business of supplying gas or electricity and thus taxable under section 186 of the Tax Law rather than Article 9-a of the Tax Law?

9. What receipts of the Transferee LLCs will be subject to tax under section 186-a of the Tax Law?

10. (a) Does the transfer of the Gas and Generation Assets from LILCO to BL Holdings and the Transferee LLCs constitute a mere change in the form of ownership such that the transfer is exempt from the New York State Real Estate Transfer Tax?

(b) Similarly, does the Brooklyn Union Merger fail to constitute a transfer of a controlling interest in BL Holding such that the New York State Real Estate Transfer Tax will not be imposed on the Gas and Generation Assets?

(c) Is the sale of the stock of LILCO to LIPA exempt from the New York State Real Estate Transfer Tax?

Facts:

Petitioner submits the following facts as the basis for this Advisory Opinion.

Long Island Lighting Company ("LILCO" or the "Company") is a publicly-held utility corporation subject to the supervision of the New York State (the "State") Department of Public Service (the "PSC"). As such, LILCO is required to pay taxes on its gross earnings and gross income pursuant to sections 186 and 186-a of the Tax Law, respectively.

This Advisory Opinion concerns two proposed transactions. The first transaction (the "LIPA Transaction") involves the acquisition of the stock of LILCO by the Long Island Power Authority ("LIPA") pursuant to an agreement dated as of June 26, 1997 (the "LIPA Agreement") and the transfer of certain of LILCO's assets to a new corporation ("BL Holding") that will (prior to the second

transaction described below) be owned by LILCO's former shareholders. LIPA is a corporate municipal instrumentality and political subdivision of the State of New York that was organized for the purpose of acquiring some or all of the stock or assets of LILCO.

The second transaction (the "Brooklyn Union Merger") involves a contemplated business combination between BL Holding and the Brooklyn Union Gas Company ("Brooklyn Union"), also a publicly-held utility corporation subject to the supervision of the PSC.[1] The Brooklyn Union Transaction is only relevant to the real estate transfer tax issues discussed below.

The LIPA transaction and the Brooklyn Union Merger are independent transactions. Since both transactions are subject to various contingencies and approvals, it is not possible at this time to determine with certainty the order of the transactions. However, it is presently anticipated that the LIPA Transaction will be consummated first and the Brooklyn Union Merger immediately thereafter, substantially as described below.

Shortly before the LIPA Transaction and the Brooklyn Union Merger are to be consummated, BL Holding will be formed. Although the initial ownership of BL Holding has not been finally determined, it is anticipated that BL Holding will initially have 100 shares of common stock outstanding, of which 66 will be owned by LILCO and 34 by Brooklyn Union. BL Holding will form one or more subsidiary entities that are presently expected to be limited liability companies (the "Transferee LLCs") for the purpose of holding and operating certain assets to be acquired from LILCO.[2]

The Transferee LLCs will be wholly owned by BL Holding. For federal income tax purposes, the Transferee LLCs will be ignored as separate entities and treated as operating branches or divisions of BL Holding. As such, their income, deductions, credits, etc., will be included on BL Holding's federal income tax returns. See Treas. Regs. §301.7701-3(b)(1)(ii). It is presently expected that at least three Transferee LLCs will be formed: (1) Serviceco, which will perform management services both for BL Holding and, under contract, LIPA; (2) Genco, which will receive and operate LILCO's non-nuclear generating plants; and (3) Gasco, which will receive and operate LILCO's gas business.

LILCO will transfer its non-nuclear electric generation, gas and common

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[1] It is expected that, prior to the Brooklyn Union Merger, Brooklyn Union will consummate an internal restructuring in which an unregulated Holding company, Keyspan Energy Corporation, would become the common parent of the Brooklyn Union consolidated group. Upon that event, references herein to Brooklyn Union should be read as referring to Keyspan Energy Corporation.

[2] If BL Holding instead forms corporate subsidiaries, the issues discussed below relating to the treatment of the Transferee LLCs will be moot. For example, for non-tax reasons, Gasco may need to be a corporation.

assets (the "Gas and Generation Assets") to the Transferee LLCs designated by BL Holding in exchange for approximately 53 million newly issued shares of BL Holding common stock, approximately $75 million of a class of newly issued nonvoting BL Holding preferred stock and the assumption by BL Holding of certain of LILCO's liabilities (the "Gas and Generation Assets Exchange").

LILCO will sell this nonvoting preferred stock in a pre-arranged sale to an unrelated third person and will retain the proceeds. LIPA will then acquire the balance of the LILCO common stock through a reverse subsidiary cash merger in which a wholly owned subsidiary of LIPA will merge with and into LILCO (the "LIPA Merger").[3]

The cash consideration to be paid by LIPA in the LIPA Merger will be remitted to an Agent for LILCO's public shareholders (the "LILCO Shareholder Agent"). The LILCO Shareholder Agent will use this cash to purchase approximately 53 million additional shares of BL Holding common stock. The LILCO Shareholder Agent will then distribute this stock to LILCO's former common stockholders, together with the approximately 53 million BL Holding common shares received by LILCO in exchange for the Gas and Generation Assets (i.e., a total of approximately 106 million BL Holding common shares). For federal income tax purposes, the distribution of the BL Holding common shares received in exchange for the Gas and Generation Assets will be treated as a distribution by LILCO in redemption of a portion of the LILCO common shares held by each shareholder (the "Redemption Distribution") and the distribution of the cash in the LIPA Merger will be treated as a purchase by LIPA of the balance of the LILCO common shares outstanding.

Immediately after the Gas and Generation Assets Exchange and before the LIPA Merger and the Brooklyn Union Merger, LILCO will hold all of the approximately 53 million then-outstanding shares of BL Holding common stock except for the 34 shares held by Brooklyn Union. Thus, immediately after the transfer of the Gas and Generation Assets from LILCO to BL Holding and/or the Transferee LLCs (which will be wholly-owned by BL Holding), LILCO will own approximately 99.99994% of BL Holding's voting stock.

Following the completion of the LIPA Transaction, it is expected that Brooklyn Union will merge with and into a newly-formed subsidiary of BL Holding in a tax-free reverse subsidiary merger (the "Brooklyn Union Merger"). In the Brooklyn Union Merger, Brooklyn Union's outstanding common shares will be converted one-for-one into BL Holding common shares and Brooklyn Union will become a wholly-owned subsidiary of BL Holding. Following the Brooklyn Union Merger, Brooklyn Union's former common shareholders will own approximately 32% of the common stock of BL Holding and LILCO's former commons shareholders will own the remaining 68% of such common stock.

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[3] Prior to or as part of the LIPA Merger, LILCO's existing preferred stock will either be redeemed or canceled.

In addition, in connection with the LIPA Merger, LIPA, BL Holding and the Transferee LLCs will enter into various agreements, including a Management Services Agreement, pursuant to which Serviceco will manage LIPA/LILCO's electric transmission and distribution system; a Power Supply Agreement, pursuant to which LILCO (now a wholly owned subsidiary of LIPA) will purchase electricity generated by LILCO's former non-nuclear power plants (now owned by Genco); and an Energy Management Agreement, pursuant to which BL Holding or a Transferee LLC will manage LILCO's fuel and power purchase requirements.

With respect to the LIPA Transaction for federal income tax purposes, Petitioner states that LILCO will recognize gain upon the exchange of the Gas and Generation Assets for BL Holding common and preferred stock and the assumption by BL Holding of LILCO's liabilities to the extent that the fair market value of the BL Holding stock plus the liabilities of LILCO assumed by BL Holding exceed LILCO's adjusted tax basis in the Gas and Generation Assets.[4]

In the LIPA Merger, the LILCO common stock held by LILCO's public shareholders will be canceled and converted into the right to receive cash, and the common stock of the LIPA acquisition subsidiary will be converted into LILCO common stock. Petitioner states that for federal income tax purposes, this transaction will be treated as a taxable sale of LILCO common stock from the public common shareholders to LIPA. See, Revenue Ruling 73-427, 1973-2 CB 301.

Petitioner states that it is anticipated that the distribution of the BL Holding common stock received in exchange for the Gas and Generation Assets to the LILCO Shareholder Agent in the Redemption Distribution, in conjunction with the sale of the balance of LILCO shares in the LIPA Merger, will constitute a redemption pursuant to section 302(b)(3) of the Internal Revenue Code (i.e., a complete termination of the shareholders' interests in LILCO). Consequently, for federal income tax purposes, the Redemption Distribution will not be taxed as a dividend but will instead be treated as payment for the LILCO shares that are deemed to have been redeemed. See, section 302(a) of the Internal Revenue Code and Zenz v Quinlivan, 213 F 2d 914. Petitioner states that accordingly, for federal income tax purposes, LILCO's common shareholders will realize a capital gain or loss as if they had sold their LILCO common shares and will not be treated as having received dividend income.[5]

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[4] The exchange will not qualify as a tax-free exchange with a controlled corporation under section 351 of the Internal Revenue Code because of the prearranged sale by LILCO of the BL Holding preferred stock. See, Intermountain Lumber Co v Commissioner, 65 TC 1025 (1976).

[5] Shareholders may be eligible to defer the recognition of such gain for federal income tax purposes on the ground that the sale of their LILCO stock is occurring under threat of condemnation, provided that such shareholders acquire qualifying replacement property and otherwise meet the requirements of section 1033 of the Internal Revenue Code.

Section 1020-f(e) of the New York Public Authorities Law (the "LIPA Act") authorized the formation of LIPA and specifically granted it the power to acquire the assets or securities of LILCO through the exercise of the power of eminent domain. Petitioner states that the LIPA Transaction is the result of extensive negotiations, and that during the course of the negotiations, LIPA indicated at various times that it would consider using its power of eminent domain to acquire LILCO if LIPA and LILCO could not reach an agreement. The LIPA Agreement itself states:

> WHEREAS, the [LIPA] Act confers upon [LIPA] the power to condemn the securities and/or assets of [LILCO], including the common stock of [LILCO] to be acquired in the proposed transaction, and [LIPA] has previously publicly announced its intention to consider exercising its condemnation power to acquire the common stock or assets of [LILCO] if a negotiated transaction cannot be achieved ....

Applicable Law -- sections 186 and 186-a

Section 186 of the Tax Law imposes a franchise tax upon every corporation, joint-stock company or association formed for or principally engaged in the business of supplying water, steam or gas, when delivered through mains or pipes, or electricity, "for the privilege of exercising its corporate franchise or carrying on its business in such corporate or organized capacity in this state". The tax is three-quarters of one percent on the taxpayer's gross earnings from all sources within New York State, and four and one-half percent on the amount of dividends paid during each year ending on the thirty-first day of December in excess of four percent on the actual amount of paid-in capital employed in New York State by the taxpayer.

When section 186 of the Tax Law was enacted in 1896, it provided for a franchise tax measured by "gross earnings from all sources within this state". In 1907, the Legislature amended section 186 by providing a statutory definition of gross earnings. Gross earnings is defined as "all receipts from the employment of capital without any deduction."

The definition of gross earnings was added to overcome the effect of a 1906 New York State Appellate Division decision holding that in order to arrive at taxable "gross earnings", the cost of raw materials used in producing the utility service had to be deducted from the company's gross receipts. (See People ex rel Brooklyn Union Gas Co. v Morgan, 114 App Div 266, affd 195 NY 616).

In 1969, the New York State Court of Appeals stated that "the 1907 amendment [of section 186] did not contemplate a substitution of 'capital' or 'gross receipts' for 'gross earnings' as the basis for taxation. It merely sought to include that portion of capital which the Brooklyn Union Gas Co. case [supra] required to be deducted from 'gross earnings' to arrive at the proper basis. This is only that portion of 'gross earnings' which represents the 'employment of capital' to manufacture, distribute and sell various public utility services." (Matter of Consolidated Edison Co. of NY v State Tax

Commission, 24 NY2d 114, 119). In the Con Ed case, the court determined that the proceeds received by the company for property damage and insurance claims and from the sale of capital assets no longer employed in its business, consisting of real property, scrap and used machinery, are amounts realized from the destruction or confiscation of capital, not from the employment of capital.

Section 2.5 of the Tax Law defines an LLC as a domestic limited liability company or a foreign limited liability company, as defined in section 102 of the Limited Liability Company Law.

It has been established that the classification of an LLC for New York State tax purposes will follow the classification accorded the LLC for federal income tax purposes under section 301.7701-3 of the Treasury Regulations. (See, FGIC CMRC Corp, Adv Op Comm T & F, April 1, 1996, TSB-A-96(11)C; and Department of Taxation and Finance Memorandum, TSB-M-94(6)I and (8)C, October 25, 1994.) Where a single member LLC does not make the election to be treated as an entity separate from its owner for federal income tax purposes, pursuant to section 301.7701-3 of the Treasury Regulations, it would not be classified as an entity separate from its owner for New York State tax purposes. If the owner is a corporation, the single member LLC would be considered a branch or division of the owner corporation. (See, McDermott, Will & Emery, Adv Op Comm T & F, July 24, 1996, TSB-A-96(19)C.)

For purposes of section 186 of the Tax Law, the term "corporation" includes an association, within the meaning of section 7701(a)(3) of the Internal Revenue Code. This includes an LLC that is treated as an association under the Internal Revenue Code. Where a single member LLC is treated as a branch or division of the owner corporation for federal income tax purposes, the LLC is not an association within the meaning of section 7701(a)(3) of the Internal Revenue Code and is not a taxpayer under section 186 of the Tax Law. However, if the owner corporation is principally engaged in the business of supplying gas and/or electricity, the corporation is subject to tax under section 186 of the Tax Law. The owner corporation is principally engaged in supplying gas and/or electricity if more than 50 percent of its gross receipts are derived from those activities. (See, e.g. Re Joseph Bucciero Contracting Inc., Adv Op St Tax Commn, July 23, 1981, TSB-A-81(5)C.) When making this determination, the economic activity of the LLC branch or division, including its gross receipts, are combined with the gross receipts of the other activities of the owner corporation in determining the total corporate gross receipts.

Section 186-a of the Tax Law imposes a tax on the furnishing of utility services that is equal to three and one-half percent of the gross income of a utility that is subject to the supervision of the PSC or the gross operating income of every other utility. For purposes of section 186-a of the Tax Law, a "utility" includes a person subject to the supervision of the PSC and every person (whether or not such person is subject to such supervision) who sells gas

or electricity, by means of mains, pipes, or wires; regardless of whether such activities are the main business of such person or are only incidental thereto. The word "person" is defined in section 186-a.2(b) of the Tax Law and includes corporations, companies, associations, joint-stock companies or associations, partnerships and LLCs.

Gross income, as defined in section 186-a.2(c) of the Tax Law, consists of the following elements:

1. receipts from any sale made or service rendered for ultimate consumption or use by the purchaser in New York State;

2. profits from the sale of securities;

3. profits from the sale of real property;

4. profits from the sale of personal property (other than inventory);

5. receipts from interest, dividends, and royalties, derived from sources within New York State; and

6. profits from any transaction (except sales for resale and rentals) within New York State whatsoever.

Gross operating income, as defined in section 186-a.2(d) of the Tax Law, means and includes receipts received in or by reason of any sale, conditional or otherwise, made for ultimate consumption or use by the purchaser of gas or electricity, or in or by reason of the furnishing for such consumption or use of gas or electric service in New York State, without any deductions.

Accordingly, under section 186-a of the Tax Law, a utility subject to the supervision of the New York State Department of Public Service includes in gross income the profits from the sale of real property and the profits from the sale of personal property, other than inventory. For purposes of section 186-a, the basis for computing the profit from the sale of real or personal property, other than inventory, is the original cost of the property, without the deduction for depreciation attributable to such property. If the sale of the real or personal property results in a loss, rather than a profit, such loss may not be deducted from the taxpayer’s other gross income.

In an Advisory Opinion of the Commissioner of Taxation and Finance to LILCO, dated May 19, 1995, TSB-A-95(9)C, it was determined that in the sale-leaseback transactions presented, the gain, rather than the entire proceeds, on the sale of equipment (machinery and equipment used in the production, transmission and distribution of electricity and natural gas, such as an undivided interest in one of LILCO's electricity generating plants, or certain diesel generators manufactured by Colt Industries, together with associated spare parts, accessories and related equipment and structures) is a receipt from the employment of capital and as such, the gain constitutes gross earnings under

section 186 of the Tax Law. When determining the gain or loss from the sale of the equipment for purposes of section 186, depreciation and other expenses attributable to the equipment are not deducted from the original cost. It was also determined that the profit from the sale of LILCO's equipment is required to be included in gross income for purposes of section 186-a of the Tax Law. When determining whether there is a profit or loss on the sale of the equipment, for purposes of section 186-a, depreciation attributable to the equipment is not deducted from the original cost. The profit is determined by subtracting from the receipts from the sale of the equipment, the original cost of the equipment along with the expenses incurred in making the sale. If the sale of such equipment results in a loss, such loss may not be deducted from LILCO's other gross income.

For purposes of section 186-a of the Tax Law, the word "person" includes an LLC. Accordingly, an LLC that is subject to the supervision of the PSC is subject to the tax imposed under section 186-a on its gross income and any other LLC is subject to the tax imposed under section 186-a on its gross operating income.

Conclusions:

Issue 1: The Gas and Generation Assets exchange is part of a series of transactions being entered into by LILCO under a threat of condemnation by LIPA in the LIPA Agreement. Like Con Ed, supra, LILCO does not employ its capital within the meaning of section 186 of the Tax Law for the purpose of being forced to dispose of such capital under threat of condemnation. Accordingly, the consideration received by LILCO for the Gas and Generation Assets does not constitute "receipts from the employment of capital" and is therefore not taxable under the gross earnings tax imposed by section 186 of the Tax Law.

Issues 2 and 3: The distribution by LILCO of the BL Holding common stock in the Redemption Distribution and the distribution of cash in the LIPA Merger are also part of a series of transactions being entered into by LILCO under a threat of condemnation by LIPA. LIPA is acquiring LILCO and these transactions are the means by which LIPA will purchase the balance of the LILCO common stock held by LILCO's public shareholders. These transactions constitute a complete termination of the shareholders' interests in LILCO and are considered as payment for the LILCO shares that are deemed to have been redeemed rather than treated as a dividend. Accordingly, these distributions are not treated as dividends subject to the excess dividends tax imposed by section 186 of the Tax Law.

Issue 4: With respect to the Gas and Generation Assets Exchange, LILCO will realize gross income taxable under section 186-a of the Tax Law to the extent that a profit is generated. The profit, if any, would equal the amount that the fair market value of the BL Holding common and preferred stock received by LILCO plus the amount of LILCO's liabilities assumed by BL Holding exceed the original

cost of the Gas and Generation Assets, without deduction for depreciation. Expenses of the sale are allowed to be deducted. It is appropriate in this situation to consider the distribution of the assets as one transaction or sale. Accordingly, the profit would be determined based on the sale of the aggregate of all the assets, not the sale of each asset separately.

Issue 5: With respect to the Redemption Distribution, LILCO will realize gross income taxable under section 186-a of the Tax Law to the extent that a profit is generated. The profit, if any, would equal the amount that the fair market value of the LILCO stock deemed received by LILCO exceeds the original cost of the BL Holding common stock exchanged therefor.

Issue 6: The Transferee LLCs that will be wholly owned by BL Holding will, for federal income tax purposes, be ignored as separate entities and treated as operating branches or divisions of BL Holding. Pursuant to FGIC CMRC, supra, and McDermott, supra, the classification of an LLC for New York State tax purposes follows the classification accorded the LLC for federal income tax purposes. Therefore, the Transferee LLCs will not be treated as separate taxable entities distinct from each other or from BL Holdings for purposes of the gross earnings tax imposed under section 186 of the Tax Law.

The Transferee LLCs are "persons" under section 186-a of the Tax Law and the Transferee LLCs will be subject to the tax imposed under section 186-a.

Issue 7: Since the Transferee LLCs will not be treated as entities separate from BL Holding for purposes of section 186 of the Tax Law, this question is moot.

Issue 8: Where the Transferee LLCs are not treated as entities separate from BL Holding, the Transferee LLCs' gross receipts will be included with the gross receipts of BL Holding's other activities in determining BL Holding's total corporate gross receipts. If more than 50 percent of BL Holding's total corporate gross receipts are from the business of supplying gas and/or electricity, BL Holding will be subject to the tax imposed under section 186 of the Tax Law; otherwise, it will be subject to tax under Article 9-A of the Tax Law. For purposes of this computation, the denominator of the fraction will include the gross receipts of BL Holding as well as the gross receipts of the Transferee LLCs. However, transactions between BL Holding and the Transferee LLCs would be disregarded. The numerator of the fraction will include only the gross receipts from the distribution and sale of gas and/or electricity. The gross receipts of BL Holding from its investments and the dividends from its corporate subsidiaries would not be included in the numerator of the fraction. The gross receipts of the Transferee LLCs will retain their character in the hands of BL Holding. Therefore, the gross receipts of Genco from the operation of the non-nuclear electric generating plants will be included in the numerator of the fraction, as well as the gross receipts of Gasco from the operation of the gas utility business. Other gross receipts of Genco and Gasco would not be included in the numerator of the fraction. With respect to a Serveco acting as an electric or gas marketer, the gross receipts from the sale of electricity or

gas would be included in the numerator of the fraction. However, the gross receipts of a Serveco from the provision of administrative and other services, including the management of the electric transmission and distribution system for LIPA/LILCO would not be included in the numerator of the fraction. The character of the gross receipts from the disposition of assets by either BL Holding or the Transferee LLCs would depend on the nature of the asset.

Issue 9: If a Transferee LLC is subject to the supervision of the PSC, for purposes of section 186-a of the Tax Law, the Transferee LLC will be subject to tax on it gross income as defined in section 186-a.2(c)of the Tax Law. The following would be included in gross income: receipts from any sale made or service rendered for ultimate consumption or use by the purchaser in New York State; profits from the sale of securities; profits from the sale of real property; profits from the sale of personal property (other than inventory); receipts from interest, dividends, and royalties, derived from sources within New York State; and profits from any transaction (except sales for resale and rentals) within New York State whatsoever. If a Transferee LLC is not subject to the supervision of the PSC, for purposes of section 186-a of the Tax Law, it will be subject to tax on its gross operating income as defined in section 186-a.2(d)of the Tax Law (that is, receipts received in or by reason of any sale, conditional or otherwise, made for ultimate consumption or use by the purchaser of gas or electricity, or in or by reason of the furnishing for such consumption or use of gas or electric service in New York State, without any deductions). Therefore, Servecos that are not regulated by the PSC but that sell gas or electricity in addition to providing services (e.g., a gas or electricity marketing company that also provides management or other services) will only include in gross operating income the receipts from the sales of gas or electricity for ultimate consumption, not the receipts from the provision of the management or other services.

Issue 10:

Additional Relevant Facts-Real Estate Transfer Tax

For purposes of the real estate transfer tax, Petitioner requests that the following scenarios be considered.

Scenario A (LIPA Transaction Precedes Brooklyn Merger)

Step 1: LILCO will transfer the Gas and Generation Assets to BL Holding in a taxable exchange for approximately 53 million BL Holding common shares and approximately $75 million of BL Holding preferred shares and the assumption by BL Holding of certain liabilities of LILCO. Immediately following the exchange, Brooklyn Union will own 34 common shares of BL Holding and LILCO will own approximately 53,000,066 common shares of BL Holding.

Step 2: In the LIPA Merger, LILCO will distribute the approximately 53 million BL Holding common shares received in exchange for the Gas and Generation Assets to the LILCO Shareholder Agent in a deemed redemption of a portion of the LILCO common shares held by LILCO's public shareholders. The cash paid by LIPA to acquire the remaining LILCO shares will also be distributed to the LILCO Shareholder Agent.

Step 3: The LILCO Shareholder Agent will use the cash received in the LIPA Merger to purchase an additional approximately 53 million common shares of BL Holding and will distribute those shares, together with the approximately 53 million BL Holding shares received by LILCO in exchange for the Gas and Generation Assets and distributed to the Shareholder Agent in the LIPA Merger, to LILCO's former common shareholders, each in proportion to the LILCO common shares previously owned by the respective former LILCO shareholders. At this point in time, BL Holding will own the Gas and Generation Assets formerly owned by LILCO, and the former shareholders of LILCO will own all but 34 of the approximately 106,000,100 outstanding common shares of BL Holding

Step 4: BL Holding will then acquire Brooklyn Union. In the Brooklyn Union Merger, Brooklyn Union will become a wholly-owned subsidiary of BL Holding in a tax-free merger pursuant to sections 368(a)(1)(A) and 368(a)(2)(E) of the Internal Revenue Code. Following this merger, Brooklyn Union's former common shareholders will own approximately 32%, and LILCO's former common shareholders will own approximately 68%, of the common stock of BL Holding.

Scenario B: (Brooklyn Union Merger Precedes LIPA Transaction)

Step 1: LILCO would become a subsidiary of BL Holding in a binding share exchange in which the common stockholders of LILCO would exchange their LILCO common stock for BL Holding common stock. At this time, Brooklyn Union would own 34 shares of BL Holding common stock and the former common shareholders of LILCO would own approximately 106,000,066 BL Holding common shares.

Step 2: The Brooklyn Union Merger would then occur, in which Brooklyn Union would become a wholly-owned subsidiary of BL Holding in a tax-free merger pursuant to sections 368(a)(1)(A) and 368(a)(2)(E) of the Internal Revenue Code. Following the Brooklyn Union Merger, the former common shareholders of Brooklyn Union would own approximately 34% of BL Holdings common stock, and LILCO's former common shareholders would own approximately 66% of BL Holding's common shares.

Step 3: LILCO would distribute the Gas and Generation Assets to BL Holding, or to the Transferee LLCs owned by BL Holding or to corporate subsidiaries wholly-owned by BL Holding.

Step 4: LIPA would acquire the common stock of LILCO from BL Holding in the LIPA Merger.

Step 5: Additional BL Holding common shares would be issued to LILCO's former common shareholders, increasing their ownership interest in BL Holding common stock from approximately 66% to approximately 68% and reducing the ownership interest of Brooklyn Union's former common shareholders from approximately 34% to approximately 32%.

Applicable Law

Section 1402 of the Tax Law imposes the real estate transfer tax on each conveyance of real property or interest therein when the consideration exceeds five hundred dollars. The term "Conveyance" is defined in section 1401(e) of the Tax Law. Included in the definition of conveyance is the transfer or transfers of any interest in real property by any method, including the transfer or acquisition of a controlling interest in any entity with an interest in real property.

Section 1401(b) of the Tax Law defines the term "controlling interest". This section provides, in the case of a corporation, that controlling interest means either fifty percent or more of the total combined voting power of all classes of stock or fifty percent or more of the capital, profits or beneficial interest in such voting stock.

Also, section 1405(b)(6) of the Tax Law sets forth that conveyances are exempt from the real estate transfer tax to the extent that they "effectuate a mere change of identity or form of ownership or organization where there is no change in beneficial ownership".

In addition, subdivision (1) of section 1020-c of the Public Authorities Law provides as follows:

> For the purpose of effectuating the policy declared in section one thousand twenty-a of this title, there is hereby created a corporate municipal instrumentality of the state to be known as the "Long Island Power Authority", which shall be a body corporate and politic and a political subdivision of the state, exercising essential governmental and public powers.

Also, section 1405(b)(1) of the Tax Law provides that the transfer tax shall not apply to "Conveyances to the United Nations, the United States of America, the state of New York, or any of their instrumentalities, agencies or political subdivisions (or any public corporation, including a public corporation created pursuant to agreement or compact with another state or the Dominion of Canada)."

Conclusion-If Scenario A Occurs:

The conveyance of the Gas and Generation Assets from LILCO to BL Holding as described in Step 1 of Scenario A and the purchase of the additional approximately 53 million common shares of BL Holding by the LILCO Shareholder Agent as described in Step 3 of Scenario A would result in a change in beneficial interest only to the extent of the 34 shares of BL Holding common stock owned by Brooklyn Union. Therefore, except as to the change in beneficial interest related to Brooklyn Union's acquisition of the 34 shares of BL Holding, this conveyance is exempt pursuant to the exemption provided by section 1405(b)(6) of the Tax Law as a conveyance which results in a mere change of identity or form of ownership or organization with no change in beneficial interest.

The conveyance which results because of the acquisition of a controlling interest in LILCO by LIPA as described in Step 2 of Scenario A is a conveyance which is exempt as a conveyance to an agency or an instrumentality of the State of New York pursuant to section 1020-c of the Public Authorities Law and section 1405(b)(1) of the Tax Law.

The Brooklyn Union Merger described in Step 4 of Scenario A will result, in part, in the former shareholders of Brooklyn Union acquiring 32% of the common shares of BL Holding. Thus, Step 4 does not result in a transfer or acquisition of a controlling interest in BL Holding and is not a conveyance subject to the transfer tax. It is noted that this Advisory Opinion does not address the application of the transfer tax to BL Holding's acquisition of Brooklyn Union.

Conclusion-If Scenario B Occurs:

The transaction pursuant to which LILCO becomes a subsidiary of BL Holding under the binding share exchange as described in Step 1 of Scenario B results in an acquisition of a controlling interest by BL Holding and is therefore a conveyance subject to transfer tax. This conveyance is exempt from the transfer tax pursuant to the mere change of identity exemption provided at section 1405(b)(6) of the Tax Law except as to the change in beneficial interest related to Brooklyn Union's acquisition of the 34 shares of BL Holding.

The Brooklyn Union Merger described in Step 2 of Scenario B does not result in an acquisition of a controlling interest in BL Holding by the former shareholders of Brooklyn Union and is therefore not a conveyance of real property subject to the transfer tax.

Any conveyance of real property that results from the distribution of the Gas and Generation Assets to BL Holding or to corporate subsidiaries or limited liability companies wholly owned by BL Holding as described in Step 3 of Scenario B would be exempt pursuant to the mere change of identity exemption provided by section 1405(b)(6) of the Tax Law.

TSB-A-98(3)C
Corporation Tax
TSB-A-98(1)R
Real Estate
Transfer Tax

The acquisition of LILCO common stock by LIPA as described in Step 4 of Scenario B is exempt from the transfer tax as a conveyance to an agency or instrumentality of the State of New York pursuant to section 1020-c of the Public Authorities Law and section 1405(b)(1) of the Tax Law.

The issuance of additional BL Holding common shares to LILCO's former shareholders as described in Step 5 of Scenario B does not result in the transfer or acquisition of a controlling interest in an entity with an interest in real property and therefore would not incur transfer tax.

/s/
DATED: February 27, 1998 John W. Bartlett
Deputy Director
Technical Services Bureau

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