

**New York State Department of Taxation and Finance**  
**Office of Tax Policy Analysis**  
**Technical Services Division**

TSB-A-00(1)C  
Corporation Tax  
January 14, 2000

STATE OF NEW YORK  
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. C990922A

On September 22, 1999, a Petition for Advisory Opinion was received from The New York Independent System Operator, Inc., 3890 Carman Road, Schenectady, New York 12303.

The issues raised by Petitioner, The New York Independent System Operator, Inc., are:

1. Whether a not-for-profit corporation no part of the net proceeds of which inure to the benefit of shareholders or individuals or a not-for-profit corporation recognized as an exempt organization under section 501(c) of the Internal Revenue Code ("IRC") is exempt from (a) the gross receipts tax imposed on the furnishing of utility services under section 186-a of Article 9 of the Tax Law, (b) the franchise tax on electric or steam heating, lighting and power companies imposed under section 186 of Article 9 of the Tax Law, and (c) the franchise tax on business corporations imposed under Article 9-A of the Tax Law.
2. Whether a not-for-profit corporation organized to supervise the operation of New York State's bulk electric transmission system, administer competitive spot markets, maintain system reliability and compatibility standards, monitor market power and take actions to mitigate market power abuses is engaged in an activity subject to (a) the gross receipts tax imposed on the furnishing of utility services under section 186-a of Article 9 of the Tax Law, or (b) the franchise tax on electric or steam heating, lighting and power companies imposed under section 186 of Article 9 of the Tax Law.

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

Petitioner is a Type B not-for-profit corporation created in response to New York State and federal regulatory initiatives: (i) to promote competition in the supply of electric energy; (ii) to assure continued reliable, safe and secure operation of the New York State bulk electric transmission system in a competitive environment; (iii) to administer economically efficient spot markets for the wholesale trading of electric energy, capacity and related ancillary services; and (iv) to reduce the reliance upon government regulatory intervention to protect the interests of consumers and the general public.

Originally incorporated in 1997, Petitioner indicated that it anticipated taking up its responsibilities on or about October 12, 1999, after more than five years of collaborative industry, regulatory and public efforts, under the aegis of the New York State Public Service commission ("PSC") and the Federal Energy Regulatory Commission ("FERC"). Petitioner states that as an

independent and disinterested entity, it will aid in the transformation of the electric industry in New York from a monopoly – dominated by vertically integrated, investor owned utilities – to a competitive market for the benefit of the general public. In a fully competitive market, generators will compete to supply wholesale electric energy and capacity and energy service companies will compete to provide retail electric services to end users. Only transmission and distribution systems will remain as regulated monopolies, but their owners, operating through affiliates, will be free to compete in the generation and energy service sectors of the marketplace.

For the public to benefit fully from competition, the bulk electricity transmission system must be operated on an economically sound, nondiscriminatory basis, while remaining safe, reliable and secure. At the same time, spot markets for electric energy need to be operated efficiently and in a nondiscriminatory manner, both to facilitate the operation of a fully competitive market and to provide the proper economic signals for the dispatch of electric energy over the bulk electric transmission system. Petitioner states that by accepting responsibility for operational control of the bulk electric transmission system and administration of spot markets for electricity, it will help to assure that these functions are conducted in an independent, competitively neutral and fully responsible manner, thereby fostering a competitive market and reducing the regulatory burdens that would otherwise fall upon the PSC and the FERC.

### **Background presented by Petitioner**

Most retail electric service in New York State is provided by a group of investor owned utilities ("IOUs"), the Long Island Power Authority ("LIPA") and the Power Authority of the State of New York, collectively referred to as the New York Power Pool ("NYPP").<sup>1</sup> Hitherto, each of the IOUs was the exclusive provider of retail electric service of all kinds within its franchise area. Each of them remains the dominant retail seller of electric energy and the exclusive retail distribution company in its territory. Each of the IOUs is required, moreover, to provide retail electric service (that is, electric energy and related services other than distribution) to all members of the general public within its respective franchise area as the provider of last resort. In addition to being regulated by the PSC with respect to retail electric services, safety, reliability and security, the IOUs have been regulated at the wholesale level by the FERC. Generally, the FERC's jurisdiction extends to the wholesale sale and transmission of electric energy in interstate commerce.

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<sup>1</sup> The NYPP is composed of the eight major electric transmission and distribution companies in New York State, including six IOUs – Central Hudson Gas and Electric Corporation, Consolidated Edison Company of New York Incorporated, New York State Electric and Gas Corporation, Niagara Mohawk Power Corporation, Orange and Rockland Utilities Incorporated, and Rochester Electric and Gas Corporation – LIPA (in part successor to the Long Island Lighting Company which was once an IOU) and the Power Authority of the State of New York. Until recently, the six IOUs and the Long Island Lighting Company were the principal privately owned generators in New York.

The IOUs have historically discharged their retail electric service responsibilities by owning and operating vertically integrated systems, including facilities that provide: (i) generation capacity and energy; (ii) high voltage transmission service; (iii) lower voltage distribution service; and (iv) retail billing and collection services. The IOUs' right to be the sole provider of retail electric service within their respective geographic areas, together with the vertical integration of their generation, transmission, distribution and billing operations, created opportunities for the IOUs to protect their capital investment in generation facilities by closing their transmission and distribution systems to alternative suppliers of electricity. Recognizing the potential for competition in the electric industry and the burden that monopoly, even regulated monopoly, places upon the general economy, the PSC in New York and the FERC throughout the country have since the early 1990s moved aggressively to restructure the electric industry.<sup>2</sup>

The most significant aspects of the restructuring in New York include: (i) the breakup of monopoly control of generating capacity and energy as a result of mandatory divestiture by the IOUs of their generation facilities; (ii) the requirement, under FERC Order No. 888, that the IOUs provide open access to their transmission systems; and (iii) the creation of spot markets in which generators and end users will be able to sell and purchase competitively priced bulk electricity, capacity and ancillary services. To assure that access to the bulk transmission system will be fully open and nondiscriminatory and that the transmission system will continue to be operated on a safe, reliable and secure basis, however, the FERC and the PSC have insisted that an independent body be formed to be the operator. It was to fill this role that Petitioner was created.

Petitioner's functions in the reorganized market will be: (i) to assure maintenance of the reliability, safety and security of the entire New York State bulk electric transmission system; (ii) to assure open and non-discriminatory access to all eligible market participants desiring to use New York State's bulk electric transmission system; and (iii) to administer markets for electric capacity, energy and ancillary services in a non-discriminatory, economically efficient manner. Independent disinterested performance of these functions is needed to assure that the benefits of competition are realized by the public without diminution or impairment of safety, reliability and security. While Petitioner will have operational control over the power grid and will administer markets for energy, capacity and ancillary services, it will have no financial stake in either beyond the recovery of actual costs through rates promulgated under FERC approved tariffs.

Petitioner, a not-for-profit corporation governed by a self-perpetuating Board of Directors comprised of 10 individuals, unaffiliated with any transmission provider or other market participant. Board actions require the affirmative vote of six Board members. Board members, officers and

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<sup>2</sup> Since FERC Order No. 888 was issued in April 1994, independent systems operators have been formed to operate in at least 24 other states. Independent system operators include the California Independent System Operator, Midwest Independent System Operator, Independent System Operator New England and PJM Interconnection, LLC.

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employees are governed by a strict Code of Conduct precluding relationships with (including personal investments in) market participants. Petitioner states that this governance structure ensures that it will operate the New York transmission system in an independent and objective manner.

To facilitate open, non-discriminatory access to the New York bulk transmission grid, the owners of the bulk transmission system will cede to Petitioner complete and independent authority to direct transmission load over the bulk transmission grid. While the transmission owners will maintain ownership and physical control of power grid assets, Petitioner's operational control of them will prevent transmission owners that also own generation facilities and/or participate in the wholesale market as energy service companies, from using the transmission system in a manner that would favor their own affiliates. This arrangement will further preclude operation of the transmission grid by entities that have a financial interest in operation of the system or outcome of transactions that use the system. Thus, as an independent body with full operational control, Petitioner will provide all market participants with fair access to the New York transmission grid, thereby furthering open competition, while at the same time assuring that the transmission grid is operated in a manner that preserves safety, reliability and security of New York's electric energy supply system.

Because electric energy cannot be stored, but must be used as it is being generated, the operation of the market must be closely linked to the operation of the transmission system. Petitioner will provide a mechanism for the submission and selection of energy bids on a daily and hourly basis to supply New York State's electric energy requirements.

While Petitioner will facilitate the centralized market, it will neither receive a financial benefit nor bear any risk of financial loss from the transactions that it oversees. Petitioner will not trade energy, capacity or ancillary services for its own account. It will merely act as the administrator of a market for those services. In this capacity, Petitioner states that it will be providing market participants with a reliable mechanism to match buyers and sellers, thereby enhancing competition.

Petitioner will not, among other things: (i) own the power grid or transmission lines; (ii) transmit power; (iii) take title to power transferred over the grid; (iv) bear the risk of loss of energy on the power grid; (v) buy or sell bulk electricity for its own account; or (vi) set wholesale or retail prices.

Under the Federal Power Act ("FPA") FERC has exclusive jurisdiction over electricity that is either transmitted or sold at wholesale in interstate commerce. The FERC also has exclusive jurisdiction over "retail wheeling" in interstate commerce (i.e., rates, terms and conditions of unbundled transmission of electricity in interstate commerce from a public utility to end users). FERC has no jurisdiction, however, over: (i) facilities generating electricity; (ii) facilities used in local distribution or transmission of electricity in intrastate commerce; and (iii) retail sale of electricity; and (iv) facilities that consume all the electricity generated or transmitted.

FERC will have jurisdiction over Petitioner so long as: (i) Petitioner acts only in relation to operation of transmission facilities used to deliver electricity to or among wholesalers or from wholesalers to retailers; and (ii) electricity transmitted in New York originates in another state or is co-mingled with electricity from other states. Petitioner states that while the PSC was instrumental in the formation of Petitioner, and has a continuing interest in its operation, the PSC does not have direct supervisory authority, but does retain limited incidental supervisory authority consistent with the FPA. For example, while the FPA requires that utilities obtain FERC approval prior to incurring short term indebtedness (defined as indebtedness that matures in less than twelve months), the FPA authorizes states to enact legislation that requires utilities to obtain approval from appropriate state agencies prior to incurring long term indebtedness. Consistent with the FPA, section 69 of the New York State Public Service Law requires electric companies to obtain approval from the PSC prior to incurring long term indebtedness. In accord with this provision, Petitioner on August 26, 1999, requested the PSC to approve its long term credit facilities.

Petitioner states that it is a Type B not-for-profit corporation, without stock or shares, performing functions that will reduce the burdens of government and, pursuant to its organizational documents (*i.e.*, Certificate of Incorporation and By-Laws) and relevant provisions of the Not-For-Profit Corporation Law, no part of its net earnings, if any, may inure to the benefit of private shareholders or individuals.

Petitioner has applied for recognition as an exempt organization under section 501(c)(3) of the Internal Revenue Code ("IRC").<sup>3</sup> In order to be recognized as an exempt organization, Petitioner

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<sup>3</sup> In its application to the Internal Revenue Service for recognition as an exempt organization under section 501(c)(3) of the IRC, Petitioner emphasized that it, as well as independent system operators collectively, lessen the burden on the FERC and other state regulatory agencies, like the PSC. Examples cited by Petitioner include:

- Petitioner's responsibility to administer the spot market and maintain open and nondiscriminatory access to the grid, thus permitting the competitive market to function and the PSC to reduce substantially its rate regulation in favor of reliance upon the market to protect the consuming public.
- Petitioner's role in identifying and mitigating abuses of market power and sanctioning market participants who use their market power to exert a discriminatory influence over electric service.
- ISOs' drafting, approving and implementation of intrastate, interstate, and international transmission grid reliability standards.
- ISOs' implementation of FERC promulgated transmission grid compatibility regulations.

must demonstrate that "no part of the net earnings of the corporation inure to the benefit of any private shareholder or individual" and that it will be operated for a charitable purpose, in this case, Petitioner believes that it is lessening the burden of government. If the Internal Revenue Service denies Petitioner's application for such exemption, Petitioner will immediately file an application for recognition as an exempt organization under section 501(c)(4) of the IRC. The case for exemption under such section 501(c)(4) would be premised on the somewhat less rigorous standard that not-for-profit organizations "organized and operated exclusively for the promotion of social welfare are exempt." An organization is "organized and operated exclusively for the promotion of social welfare, if it is primarily engaged in promoting in some way, the common good and general welfare of the people of the community." Treas. Reg. 1.501(c)(4)-1 (a)(2). Petitioner states that the Internal Revenue Service has held that organizations are entitled to recognition under section 501(c)(4) where the organization is operated for the benefit of the community and the organization's primary activity is not a business activity conducted by for-profit entities.

### **Discussion**

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. Section 209.4 of the Tax Law, provides that a corporation liable for tax under section 186 of Article 9 of the Tax Law is not subject to tax under Article 9-A of the Tax Law.

To determine the classification and proper taxability of a corporation under either Article 9-A or section 186 of Article 9, an examination of the nature of the corporation's activities is necessary, regardless of the purposes for which the corporation was organized. See Matter of McAllister Bros., Inc. v Bates, 272 AD 511, 517. Ordinarily, a corporation is deemed to be principally engaged in the activity from which more than 50 percent of its receipts are derived. See, e.g., Re Joseph Bucciero Contracting Inc., Adv Op St Tax Commn, July 23, 1981, TSB-A-81(5)C.

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 electricity, for the privilege of exercising its corporate franchise or carrying on its business in such corporate or organized capacity in this state.

Section 186-a of the Tax Law imposes an excise tax on the furnishing of utility services that is equal to three and one-quarter percent from October 1, 1998 through December 31, 1999 (three

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- ISOs' facilitation of wheeling of bulk electricity pursuant to the OATT Tariff without applications to the FERC.



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and one-half percent prior to October 1, 1998 and two and one-half percent on and after January 1, 2000) 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 doing business in New York State. For purposes of section 186-a, 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 electricity or furnishes electric service, 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. The tax imposed under section 186-a of the Tax Law is imposed in addition to the franchise tax imposed under Article 9-A or under section 186 of Article 9 of the Tax Law.

In this case, Petitioner will have operational control of the bulk electric transmission system, be responsible for the administration of markets for electric energy, capacity and ancillary services, implement system reliability and compatibility standards, and monitor and mitigate market power and sanctioning of market power abuses. However, Petitioner will not: (1) own the power grid or transmission lines, (2) transmit power, (3) take title to power transferred over the grid, (4) bear the risk of loss of energy on the power grid, (5) buy or sell bulk electricity for its own account, or (6) set wholesale or retail prices. Under these circumstances, Petitioner is not supplying electricity pursuant to section 186 of the Tax Law, and is not subject to the tax imposed under such section 186. Further, Petitioner is not selling electricity or furnishing electric service pursuant to section 186-a of the Tax Law, and is not subject to the tax imposed under such section 186-a.

Since Petitioner is not subject to the franchise tax imposed under section 186 of the Tax Law, Petitioner would be subject to the franchise tax imposed on general business corporations under Article 9-A of the Tax Law, unless it is exempt pursuant to section 1-3.4(b)(6) of the Business Corporation Franchise Tax Regulations ("Article 9-A Regulations") which provides an exemption for

corporations organized other than for profit which do not have stock or shares or certificates for stock or for shares and which are operated on a nonprofit basis no part of the net earnings of which inures to the benefit of any officer, director, or member, including Not-for -Profit Corporations and Religious Corporations.

(i) A corporation organized other than for profit, as described in this paragraph, which is exempt from Federal income taxation pursuant to subsection (a) of section 501 of the Internal Revenue Code, will be presumed to be exempt from tax under article 9-A.

(ii) The determination of the Internal Revenue Service, denying or revoking exemption from Federal taxation under the Internal Revenue Code, will ordinarily be followed.

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Accordingly, if the Internal Revenue Service determines that Petitioner is a corporation that is exempt from federal income taxation pursuant to section 501(a) of the IRC, under either section 501(c)(3) or (4) of the IRC, Petitioner would be presumed to be exempt from taxation under Article 9-A of the Tax Law pursuant to section 1-3.4(b)(6) of the Article 9-A Regulations. However, if the Internal Revenue Service determines that Petitioner is not exempt from federal taxation under the IRC, Petitioner, may be exempt from the franchise tax imposed under Article 9-A of the Tax Law. Based on the facts presented herein, Petitioner is a not-for-profit corporation which does not have stock or shares or certificates for stock or for shares, and it is assumed that, pursuant to its organizational documents, it is operated on a nonprofit basis no part of the net earnings of which inures to the benefit of any officer, director, or member. Therefore, Petitioner will meet the requirements of section 1-3.4(b)(6) of the Article 9-A Regulations, in which case, Petitioner will be exempt from the franchise tax imposed under Article 9-A of the Tax Law.

### **Summary**

Issue 1. Petitioner's operations, as described herein, will not constitute a business that is taxable under sections 186 and 186-a of Article 9 of the Tax Law, regardless of whether it is recognized as an exempt organization under section 501(c) of the IRC. Further, based on the facts presented, Petitioner, pursuant to section 1-3.4(b)(6) of the Article 9-A Regulations, will not be subject to the tax imposed under Article 9-A of the Tax Law.

Issue 2. As stated above, Petitioner's operations, as described herein, will not constitute a business that is taxable under section 186 and 186-a of Article 9 of the Tax Law.

DATED: January 14, 2000

/s/  
John W. Bartlett  
Deputy Director  
Technical Services Division

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