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

TSB-A-02(4)C
Corporation Tax
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STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. C010117B

On January 17, 2001, a Petition for Advisory Opinion was received from Fort Drum Cogenco, Inc., 422 S. Church Street, P.O. Box 1244, PB05B, Charlotte, North Carolina 28201-1244.

The issues raised by Petitioner, Fort Drum Cogenco, Inc., are:

1. Whether Petitioner is subject to tax pursuant to Article 9-A of the Tax Law for taxable years ending on or after December 31, 2000.

2. Whether Petitioner is subject to tax pursuant to section 186 of Article 9 of the Tax Law for years ended on or before December 31, 1999.

3. If Petitioner is subject to tax under section 186 of the Tax Law pursuant to Issue 2, whether termination payments derived from a contract restructuring, as described below, are included in Petitioner's gross earnings for purposes of section 186 of the Tax Law.

4. If Petitioner is subject to tax under section 186 of the Tax Law pursuant to Issue 2, whether it is required to file tax returns pursuant to such section beyond the three-year limitation period set forth in section 1083(a) of the Tax Law, when it has mistakenly filed its tax returns pursuant to Article 9-A of the Tax Law for previous tax years.

5. Whether Petitioner is subject to tax pursuant to section 186-a of Article 9 of the Tax Law.

6. If Petitioner is subject to tax under section 186-a of the Tax Law pursuant to Issue 5, whether termination payments derived from a contract restructuring, described below, are included in the partnership's taxable gross operating income for purposes of section 186-a of the Tax Law.

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

Petitioner owns a 10 percent general partnership interest in Black River Limited Partnership ("Partnership"). The Partnership has been principally engaged in providing electricity and high temperature water generating services in New York State since 1988. From 1988 through 1999, Partnership provided electricity to Niagara Mohawk Power Corporation ("NMPC"), and beginning in 2000, has provided high temperature water to an unrelated third party, under a separate purchase agreement. Partnership is not subject to the supervision of the Public Service Commission ("PSC").

Since 1988, the Partnership has been a qualifying small power producer or qualifying cogenerator that is referred to as an independent power producer ("IPP"). As an IPP, the Partnership operates in the service area of NMPC, an investor-owned public utility company subject to the regulation of the PSC. From 1988 through 1999, NMPC was required to purchase all electricity generated by IPPs operating within its service area. The Partnership had an IPP Agreement with NMPC for such years, and all of the revenues received from NMPC were derived from wholesale sales of electricity for "resale". No sales of electricity were made to ultimate consumers.

NMPC, in order to mitigate the economic burdens related to the favorable IPP agreements, and consistent with NMPC's PowerChoice filing for NMPC's restructuring as part of the mandated restructuring of the electric industry in New York State under the PSC's order (Opinion No. 96-12), NMPC and certain IPPs, including the Partnership, executed the Master Restructuring Agreement ("MRA") on July 27, 1997 to terminate or restructure NMPC's IPP agreements. Petitioner states that the Partnership, to a great extent, was compelled to participate in such MRA in light of certain public statements by NMPC (including statements in its 1995 PowerChoice filing with the PSC) that it was empowered to take the IPP projects under the eminent domain powers afforded to it under section 11(3-a) of the New York Transportation Corporation Law. The MRA was approved by the PSC as a key element of its Opinion 98-8, Opinion and Order Adopting Terms of Settlement Agreement Subject to Modifications and Conditions (Case 94-E-0098 and Case 94-E-0099) issued March 20, 1998 by the PSC to NMPC, which *inter alia*, approved PowerChoice. (See Niagara Mohawk Power Corporation, Adv Op Comm T&F, January 26, 1999, TSB-A-99(3)C.) Under the MRA, the Partnership terminated its agreement with NMPC, and it received certain contract termination payments from NMPC that were used by the Partnership to retire debt and to make cash distributions to its partners.

Petitioner states that from 1988 through 1999, through its ownership interest in the Partnership, it has provided electricity to NMPC pursuant to the Partnership's IPP Agreement with NMPC. Since the beginning of 2000, Petitioner states that through its ownership interest in the Partnership it has provided high water temperature water to an unrelated third party, under a separate purchase agreement. Petitioner has never been subject to the supervision of the PSC. Petitioner's pro rata share of gross receipts from the Partnership's sales of electricity and water constitute more than 50 percent of Petitioner's gross receipts. Petitioner states that it secures engineering services for the Partnership on an as needed basis and that it is actively involved in all major operating decisions of the Partnership.

Discussion

Issue 1

Section 209.1 of Article 9-A of the Tax Law imposes an annual franchise tax on domestic and 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. Generally, partnerships are not subject to the franchise tax imposed under Article 9-A of the Tax Law. Section 1-3.2(a)(5) of the Business Corporation Franchise Tax Regulations ("Article 9-A Regulations") provides that if a partnership is exercising any of the privileges of section 209.1 of the Tax Law, then all of its general corporate partners are subject to the tax imposed under Article 9-A of the Tax Law. However, section 209.4 of the Tax Law, prior to the repeal of section 186 by Chapter 63 of the Laws of 2000, provided that a corporation liable for tax under section 186 of Article 9 of the Tax Law was not subject to tax under Article 9-A of the Tax Law. Beginning on and after January 1, 2000, corporations previously subject to tax under section 186 are now subject to tax under Article 9-A of the Tax Law.

In this case, Petitioner is a general corporate partner in the Partnership which is doing business in New York State. Accordingly, pursuant to section 1-3.2(a)(5) of the Article 9-A Regulations, Petitioner is subject to tax under Article 9-A for taxable years beginning on and after January 1, 2000.

Issue 2

Section 186 of Article 9 of the Tax Law, prior to its repeal by Chapter 63 of the Laws of 2000, imposed a franchise tax on a corporation, joint stock company or association "formed for or principally engaged in the business of supplying water ... when delivered through mains or pipes, or electricity, or principally engaged in two or more of such businesses ...." The tax was imposed for the privilege of exercising a corporate franchise or carrying on business in a corporate or organized capacity in New York State and was based, in part, upon gross earnings from all sources within New York State.

For purposes of section 186, where a partnership was in the business of supplying water and electricity in New York, a corporate general partner was, generally, also engaged in the business of supplying water and electricity in New York. In interpreting section 209.1 of the Tax Law, section 1-3.2(a)(5) of the Article 9-A Regulations sets forth a general rule which holds that if a partnership is exercising any of the privileges of section 209.1, then all of its corporate general partners are subject to the tax imposed by Article 9-A. The same interpretation was made for purposes of Article 9 of the Tax Law in The Partners of Buffalo Telephone Company, Adv Op Comm T & F, February 22, 1989, TSB-A-89(3)C. The Advisory Opinion held that where a partnership is engaged in a telephone business in New York State, each corporate partner is also engaged in a telephone business in New York State, and each corporate general partner of the partnership that is principally engaged in such telephone business is subject to tax under sections 183 and 184 of Article 9.

In GTE Spacenet Corp. v NYS Dept of Taxation and Finance, 224 AD2d 283, the Court held that while the partnership was arguably engaged in activities enumerated in sections 183, 183-a, 184 and 184-a of the Tax Law, the evidence demonstrated that the partners were engaged in the investment business and were not engaged in the conduct of any of the businesses enumerated in sections 183, 183-a, 184 and 184-a of the Tax Law because the partners were mere passive investors

and did not participate in the day-to-day management or operations of the partnership. Therefore, the partners were subject to tax under Article 9-A and were not subject to the franchise taxes imposed pursuant to sections 183, 183-a, 184 and 184-a of the Tax Law.

To determine the classification and proper taxability of a corporation under either Article 9 or Article 9-A, an examination of the nature of the corporation's activities is necessary, regardless of the purpose for which the corporation was organized. See Matter of McAllister Bros., Inc. v Bates, 272 App Div 511, 517 (3rd Dept. 1947). 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., Joseph Bucciero Contracting Inc., Adv Op St Tax Commn, July 23, 1981, TSB-A-81(5)C.

Generally, partnerships were not subject to the franchise tax imposed under section 186 of Article 9 of the Tax Law, prior to its repeal. Accordingly, in this case, Partnership was not subject to tax under section 186 of Article 9 of the Tax Law, prior to its repeal.

Petitioner states that it is a general partner in the Partnership, and that it secures engineering services for the Partnership on an as needed basis and is actively involved in all major operating decisions of the Partnership. As explained in Issue 1, Petitioner, as a general partner in the Partnership which is doing business in New York State, is subject to tax under Article 9-A of the Tax Law for all taxable years, unless Petitioner is subject to tax under section 186 of Article 9 of the Tax Law, prior to its repeal. If Petitioner is a mere passive investor and does not participate in the day-to-day management or operations of the Partnership, then, pursuant to GTE Spacenet, supra, Petitioner will not be subject to tax under section 186 of the Tax Law, prior to its repeal. However, if Petitioner is not a mere passive investor or if it participates in the day-to-day management or operations of the Partnership, Petitioner will not come within the scope of GTE Spacenet, supra, and following Partners of Buffalo Telephone, supra, Petitioner will be considered to be engaged in the business of the Partnership and will be subject to tax under section 186 of the Tax Law, prior to its repeal. The determination of whether Petitioner is a mere passive investor or whether it participates in the day-to-day management or operations of Partnership is a question of fact that is 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.Twenty-fourth; 20 NYCRR 2376.1(a).

However, based on the facts presented, it appears that Petitioner may be more than a mere passive investor in the Partnership. If it is determined that Petitioner's circumstances are not distinguishable from GTE Spacenet, supra, then Petitioner will be subject to tax under Article 9-A of the Tax Law for all taxable years. If Petitioner's circumstances are distinguishable from GTE Spacenet, id, then following Partners of Buffalo Telephone, supra, Petitioner will be considered to be principally engaged in the business of supplying electricity and water because Petitioner's pro rata share of the Partnership's gross receipts from sales of electricity and water account for more than 50 percent of the Petitioner's gross receipts. In such case, Petitioner will be subject to tax under

section 186 of the Tax Law, prior to its repeal. In any event, for taxable years beginning on and after January 1, 2000, Petitioner is subject to tax under Article 9-A of the Tax Law.

Issue 3

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 of the Tax Law 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 address 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 was 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.

Several utilities in New York State are being compelled by the PSC to reorganize their corporate structure and possibly sell off some of their business to unrelated third parties pursuant to the PSC's Competitive Opportunities Proceeding and the PSC's policy objectives set forth in Opinion No. 96-12. With respect to such mandated restructuring, the Commissioner of Taxation and Finance has issued an advisory opinion to Central Hudson Gas & Electric Corporation, Adv Op Comm T&F, July 29, 1998, TSB-A-98(12)C. (See also, Long Island Lighting Company, Adv Op Comm T&F, February 27, 1998, TSB-A-98(3)C and New York State Electric & Gas Corporation, Adv Op Comm T&F, July 29, 1998, TSB-A-98(11)C.) The Central Hudson advisory opinion concluded that the sale of electric generation assets pursuant to the auction process, implementing the petitioner's restructuring agreement that was confirmed by a PSC order, does not represent the employment of capital, and that the consideration received by the petitioner for the generation assets does not constitute "gross earnings" taxable under section 186 of the Tax Law.

In KPMG LLP, Adv Op Comm T&F, October 11, 2000, TSB-A-00(17)C, the fact pattern was substantially similar to Petitioner's facts. In that opinion, the taxpayer was a partner in a general partnership that was an IPP that had an IPP Agreement with NMPC that was terminated

pursuant to the MRA. In that case, the partnership was one of several IPPs and utilities in New York State being mandated by the PSC, pursuant to the Competitive Opportunities Proceeding and the PSC's policy objectives set forth in Opinion No. 96-12, to restructure IPP contracts by such means as a buyout or renegotiation of the contracts that would mitigate the impact of such contracts on rates to benefit ratepayers, so as to align them more closely with a competitive framework. Such mandated restructuring was implemented by NMPC under the restructuring plan described in the PowerChoice Filing and approved in PSC Opinion No. 98-8. Pursuant to the MRA, the partnership terminated its contract with NMPC in 1998. The opinion held, in part, that the partnership did not employ its capital within the meaning of section 186 of the Tax Law, prior to its repeal, for the purpose of being forced to restructure its IPP contract with NMPC. The taxpayer's pro rata share of the termination payments received by the partnership pursuant to the MRA did not represent the employment of capital and did not constitute "gross earnings" of the taxpayer under section 186 of the Tax Law.

Similarly, in this case, the Partnership is one of the IPPs and utilities in New York State being mandated by the PSC, pursuant to the Competitive Opportunities Proceeding and the PSC's policy objectives set forth in Opinion No. 96-12, to restructure IPP contracts by such means as a buyout or renegotiation of the contracts that would mitigate the impact of such contracts on rates to benefit ratepayers, so as to align them more closely with a competitive framework. Such mandated restructuring was implemented by NMPC under the restructuring plan described in its PowerChoice filing. Pursuant to the MRA, the Partnership terminated its contract with NMPC in 1999.

Like KPMG, supra, Con Ed, supra, and Central Hudson, supra, the Partnership did not employ its capital within the meaning of section 186 of the Tax Law, prior to its repeal, for the purpose of being forced to restructure its IPP contract with NMPC. If pursuant to Issue 2, Petitioner is subject to tax under section 186 of the Tax Law, prior to its repeal, Petitioner's pro rata share of the termination payments received by the Partnership pursuant to the MRA does not represent the employment of capital, and Petitioner's pro rata share of the termination payments received by the Partnership for the termination of its IPP contract with NMPC would not constitute "gross earnings" of Petitioner taxable under section 186 of the Tax Law. See KPMG, supra.

Issue 4

Section 192.3 of Article 9 of the Tax Law, prior to its repeal by Chapter 63 of the Laws of 2000, provided that every corporation liable to pay a tax under section 186 of Article 9, shall on or before March fifteenth of each year, make a written report to the Commissioner of Taxation and Finance of its condition at the close of its business on the preceding December thirty-first.

Article 27 of the Tax Law applies to the administration of and the procedures with respect to the taxes imposed by both Articles 9 and 9-A of the Tax Law. Section 1083(a) of Article 27 provides that, except as otherwise provided, any tax under Articles 9 and 9-A shall be assessed within three years after the return is filed. Section 1083(c)(1) of Article 27 provides, in pertinent

part, that the tax may be assessed at any time if (A) no return is filed, or (B) a false or fraudulent return is filed with intent to evade tax.

In this case, Petitioner states that it has been filing its franchise tax returns pursuant to Article 9-A of the Tax Law. If pursuant to Issue 2, Petitioner was subject to tax under section 186 of Article 9 of the Tax Law, prior to its repeal, Petitioner should have been filing its tax returns pursuant to such section 186 of the Tax Law. Pursuant to section 1083 of the Tax Law, the tax imposed under section 186 of Article 9 for a taxable year may be assessed within three years after the tax return was filed for such taxable year. The fact that Petitioner may have erroneously filed returns under Article 9-A rather than Article 9 does not prevent the three year limitation period from running for the periods covered by those returns, unless such tax returns are determined to be false or fraudulent with intent to evade tax, in which case the tax imposed pursuant to section 186 of Article 9 may be assessed at any time.

Issue 5

Section 186-a of the Tax Law imposes a tax on the furnishing of utility services. With respect to a utility which is not subject to the supervision of the PSC, the tax is imposed if it "sells ... electricity [or] water ... delivered through mains, pipes or wires, or furnishes ... electric [or] water ... service, 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 tax, for such utilities, is equal to two and one-tenth percent from January 1, 2000 through December 31, 2000, of the gross operating income of such a utility doing business in New York State which has annual gross operating income in excess of $500. The tax imposed under section 186-a of the Tax Law is imposed in addition to any and all other taxes and fees imposed by any other provision of law for the same period.

For purposes of section 186-a of the Tax Law, the word "utility" includes a person and the word "person" includes, among others, a partnership. Thus, section 186-a imposes a tax upon incorporated and unincorporated entities alike, including a partnership (see, Partners of Buffalo Telephone Company, supra.). The Partnership is not subject to the supervision of the PSC. Therefore, the Partnership would be subject to the tax imposed under section 186-a of Article 9 on its gross operating income from the sale of electricity or water and from the furnishing of electric or water service, for ultimate consumption or use within New York State.

Since the Partnership is a utility subject to the tax imposed under section 186-a of the Tax Law on its gross operating income, Petitioner is not subject to tax under section 186-a on its pro rata share of such gross operating income. However, Petitioner may be subject to tax under section 186-a of the Tax Law if it has gross operating income that is attributable to an activity subject to tax under section 186-a, other than Petitioner's pro rata share of the Partnership's gross operating income.

Issue 6

As stated in Issue 5, the Partnership, not Petitioner is subject to the tax imposed under section 186-a of the Tax Law on its gross operating income. However, in KPMG, supra, it was also held, in part, that the termination payments received by the partnership from the termination of its IPP contract with NMPC, pursuant to mandate by the PSC and pursuant to the Competitive Opportunities Proceeding and the PSC's policy objectives set forth in Opinion No. 96-12, and implemented under the restructuring plan described in the PowerChoice filing and approved in PSC Opinion No. 98-8 to restructure IPP contracts by such means as a buyout or renegotiation of the contracts, did not constitute receipts from the sale of electricity or electric services. Therefore, such payments did not constitute gross operating income of the partnership taxable under section 186-a of the Tax Law.

Likewise, in this case the termination payments received by the Partnership from the termination of its IPP Agreement with NMPC, pursuant to the MRA, do not constitute receipts from the sale of electricity or electric services, and such payments do not constitute gross operating income of the Partnership taxable under section 186-a of the Tax Law.

DATED: April 24, 2002

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