

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

TSB-A-90 (24) C
Corporation Tax
TSB-A-90 (12) I
Income Tax
November 30, 1990

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. Z900216A

On February 16, 1990, a Petition for Advisory Opinion was received from Consolidated Edison Company of New York, Inc., and Con Edison Master Nuclear Decommissioning Trust, 4 Irving Place, New York, New York 10003.

The issue raised by Petitioners, Consolidated Edison Company of New York, Inc. (hereinafter "Con Edison") and Con Edison Master Nuclear Decommissioning Trust (hereinafter "Master Trust") is the application of the (1) New York State Corporation Franchise Tax, (2) New York State and New York City Personal Income Tax, and (3) Gross Receipts Taxes under sections 186, 186-a, 186-b and 186-c of the Tax Law, to the income as earned by the Master Trust and to the eventual distribution of the funds to Con Edison for the decommissioning of nuclear plants.

Con Edison is a corporation organized pursuant to the laws of the State of New York under the name of Consolidated Gas Company of New York by a consolidation agreement duly filed in the office of the Secretary of State of the State of New York on November 10, 1884. Con Edison supplies electric service in all of New York City (except a part of Queens) and in most of Westchester County. It owns two nuclear generating plants, Indian Point 1 and Indian Point 2 (hereinafter "nuclear plants") located in Buchanan, New York. It also supplies gas in Manhattan, the Bronx and parts of Queens and Westchester and steam in part of Manhattan.

Master Trust is a nuclear decommissioning reserve fund for federal income tax purposes, under section 468A of the Internal Revenue Code (hereinafter "IRC"), and was established under the terms of an Agreement and Declaration of Trust made as of December 30, 1988 between Con Edison and the Trustee, Harris Trust and Savings Bank (hereinafter "Harris").

The Trustee, Harris, is an Illinois banking corporation. The Master Trust and its assets are located in the State of Illinois. To date, the Master Trust has invested only in United States Treasury obligations, bank demand or time deposits and various state and local tax exempt municipal bonds. The Master Trust has not invested in any New York State or local bond, security or demand or time deposit accounts. Its income consists solely of interest from its investments and capital gains arising from the sale of the various bond holdings, all of which are from sources outside of New York State.

The Master Trust cannot distribute any of its earnings to Con Edison until the decommissioning of the plants has begun (presently estimated to occur in the year 2006).

The purpose of section 468A of the IRC is to provide a tax efficient vehicle for the accumulation of funds to facilitate the eventual decommissioning of the nuclear plants. Section 468A allows the establishment of a qualified fund

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to accept deductible contributions from the owners of nuclear plants. Investment choices are limited in order to provide safety and assurance that the funds will be available when needed.

Section 468A of the IRC provides that a public utility will be allowed a federal income tax deduction for payments it elects to make to a qualified nuclear decommissioning reserve fund (hereinafter "qualified fund") which is established exclusively to pay for the future decommissioning costs of a nuclear power plant. A qualified fund must be established for each nuclear plant owned by the utility, however, two or more qualified funds can be established and maintained pursuant to a single trust instrument with the assets pooled for investment purposes.

The qualified fund's assets must be used exclusively to satisfy, in the whole or in part, the utility's liability for decommissioning costs of the plant to which the fund relates and to pay administrative costs and other expenses of the fund, and to the extent the assets are not currently required for these purposes, to invest directly in public debt securities of the United States, obligations of a state or local government, or time or demand deposits. The fund can invest only in assets similar to those allowed to Black Lung Trust Funds.

The qualified fund is required to distribute its assets to the utility when needed. Section 1.468A-2 of the Treasury Regulations provides that any actual or deemed distribution from the fund shall be included in the gross income of the electing utility for the taxable year in which the distribution occurs. The utility will be able to offset the income to the extent decommissioning expenses are incurred. If the distribution matches the decommissioning expense, the effective federal tax treatment for the utility is a "wash" i.e., income matches deductible expense.

To obtain the deduction, the utility must request and receive a schedule of "ruling amounts" from the Internal Revenue Service to establish the maximum annual deduction that can be claimed. A ruling amount is the amount the Internal Revenue Service deems necessary: (1) to fund the future decommissioning costs and (2) to prevent excess funding or funding at a rate no more rapid than level funding. Contributions to the funds must be made within 2 1/2 months after the close of the utility's tax year.

Section 1.468A-4 of the Treasury Regulations provides that a qualified fund is subject to tax on all of its modified gross income for each taxable year and is treated as if it were a corporation. The tax imposed under section 468A is to be treated as a tax imposed by section 11 of the IRC.

Issue 1 - New York State Corporate Franchise Tax

The question presented is whether the Master Trust is a corporation subject to tax under Article 9-A of the Tax Law.

The Master Trust was established as a trust to conform to the provisions of section 468A of the IRC. Its sole purpose is to accumulate funds for the eventual decommissioning of the nuclear plants. The Master Trust is limited to investing in government debt securities and bank time or demand deposits.

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

Section 208.1 of the Tax Law provides that the term "corporation" includes any business conducted by a trustee or trustees wherein interest or ownership is evidenced by certificate or other written instrument.

Section 1-2.3(b) (2) of the Business Corporation Franchise Tax Regulations as amended on June 25, 1990 provides that:

a business conducted by a trustee or trustees in which interest or ownership is evidenced by certificate or other written instrument includes, but is not limited to, an association commonly referred to as a business trust or Massachusetts trust. In determining whether a trustee or trustees are conducting a business, the form of the agreement is of significance but is not controlling. The actual activities of the trustee or trustees, not their purposes and powers, will be regarded as decisive factors in determining whether a trust is subject to tax under article 9-A of the Tax Law. The mere investment of funds and the collection of income therefrom, with incidental replacement of securities and reinvestment of funds, does not constitute the conduct of a business in the case of a business conducted by a trustee or trustees.

Herein, the activities of the trustee of Master Trust do not constitute the conduct of a business as contemplated by section 208.1 of the Tax Law and section 1-2.3 of the Business Corporation Franchise Tax Regulations. Accordingly, Master Trust is not deemed to be a corporation for purposes of Article 9-A and is not subject to the tax imposed by such Article.

Issue 2 - New York State and New York City Personal Income Tax

The question presented is whether the Master Trust is a grantor trust and if it is, is it exempt from New York State Personal Income Tax under Article 22 of the Tax Law, and New York City Personal Income Tax authorized under Article 30 of the Tax Law.

Section 601(g) of the Tax Law provides that an association, trust or other unincorporated organization which is taxable as a corporation for federal income tax purposes shall not be subject to tax under Article 22 of the Tax Law.

Master Trust is not treated as a grantor trust for federal income tax purposes. Master Trust is a nuclear decommissioning reserve fund under section 468A of the IRC and pursuant to such section, Master Trust is treated as a corporation and is taxed at the highest corporate rate on its modified gross income.

Since section 601(g) of the Tax Law provides that a trust taxed as a corporation for federal income tax purposes is not subject to personal income tax, Master Trust is not subject to tax under Article 22 of the Tax Law and New York City Personal Income Tax authorized under Article 30 of the Tax Law.

Section 607(a) of the Tax Law provides that any term used in Article 22 of the Tax Law shall have the same meaning as used in a comparable context in the laws of the United States relating to federal income taxes, unless a different meaning is clearly required. Herein, Master Trust is not considered a grantor trust, for federal income tax purposes, therefore Master Trust is not a grantor trust for purposes of Article 22 of the Tax Law.

It should be noted that to the extent this Advisory Opinion differs from Kansas Gas and Electric Company, Adv Op Comm T&F, TSB-A-87(31)C, this Advisory Opinion is controlling.

Issue 3 - Gross Receipts Taxes

Petitioners questions regarding the gross receipts taxes are based on the assumption that Master Trust is a grantor trust and Con Edison is held to be the grantor. Since the Master Trust is not treated as a grantor trust, Petitioners questions are answered on the basis that Con Edison is not the grantor of a grantor trust.

Sections 186 and 186-b

Petitioners raise the following questions:

(a) Is Con Edison required to include currently the earnings of the Master Trust in its gross earnings for purposes of sections 186 and 186-b of the Tax Law?

No. Since the Master Trust is not treated as a grantor trust, the current earnings of the Master Trust are not gross earnings of Con Edison.

(b) Are such earnings includible currently in Con Edison's gross earnings even though they will not be distributed until the year 2006?

Since the answer in (a) is no, this question is not relevant.

(c) If the earnings of the Master Trust are derived from United States Treasury obligations, bank demand or time deposits and various state and local tax exempt municipal bonds, none of which represent any New York State or local

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investments, are such earnings considered to be from sources outside New York State and thus excludible currently from Con Edison's gross earnings?

Since the answer in (a) is no, this question is not relevant.

(d) If a portion of these earnings represents capital gains from the sales of non-New York State and local sources, are these capital gains includible currently in Con Edison's gross earnings?

Since the answer in (a) is no, this question is not relevant.

(e) Is the final distribution of earnings from the Master Trust to Con Edison includible in the gross earnings of Con Edison?

Yes. The distribution of earnings from the Master Trust is includible in gross earnings of Con Edison in the taxable year of distribution or deemed distribution.

(f) To the extent the final distribution represents a return of the original contributions made by Con Edison to the Master Trust, is such distribution subject to section 186 and 186-b taxes?

No. The return of the original contributions is the return of employed capital not the gross earnings from the employment of capital.

(g) To the extent such earnings were taxed to Con Edison when earned by the Master Trust, are such earnings subject to tax at the time of final distribution?

The earnings are not taxed to Con Edison when earned by the Master Trust; therefore, Con Edison includes in its gross earnings for the year of distribution, all earnings included in the distribution.

(h) To the extent such earnings were not subject to tax when earned by the Master Trust because the earnings were from sources outside New York State, the earnings were derived from obligations of the United States, or the earnings were not distributed to Con Edison as earned, will such earnings be subject to section 186 and 186-b taxes when they are finally distributed to Con Edison?

When section 186 was enacted, it provided for a franchise tax on various types of utility companies measured by their "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 that held 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). "The basis

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of the decision. . . was that, where the tax was limited by the statute to 'gross earnings', that limitation was too precise to permit the taxation of any receipts, which could not be classified as earnings, or profits, upon the capital invested." (People ex rel Westchester Lighting Co. v Gaus, 199 NY 147, 149)

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 Consolidated Edison Co. case, the court determined that (assuming there was no gain on the transactions) 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.

Based on legislation and the decisions of the courts, it is determined that the portion of the distribution from Master Trust that is in excess of Con Edison's contributions into the Master Trust is the gain or profit derived from Master Trust. Such gain or profit is a receipt from the employment of capital and as such, constitutes gross earnings under section 186. If the total distribution is less than Con Edison's contribution into the Master Trust, the loss may not be deducted from Con Edison's other earnings.

As previously stated, section 186 of Article 9 imposes a franchise tax based on gross earnings from all sources within New York State. In this regard, section 186 is akin to section 184 of Article 9 which imposes a franchise tax on transportation and transmission corporations based on gross earnings from sources within New York State.

In American Tel. & Tel. Co. v State Tax Commission, 93 AD2d 66; affd 61 NY 2d 393, it was held that, for purposes of section 183 of Article 9, where securities in a temporary cash investment account belonged to the parent telephone company and involved multitudinous purchases and sales, all of which incurred in New York, and required constant monitoring by the parent company's treasury department personnel in New York State and the parent telephone company earned substantial income from it, such account constituted taxable assets of the parent company employed in New York State. The court also determined that for purposes of section 184 of Article 9, the State Tax Commission incorrectly attempted to impose a tax based not on the source of income but on where assets giving rise to the income were employed. Therefore, the court held that interest income received by the parent telephone company from obligations of out-of-state obligors on such temporary investments were not earned from a "source" within New York State. However, such decision did not determine the source of the gains realized on the sale of such securities.

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It is apparent from the American Tel. & Tel. Co. case, (supra, that the crucial factor in determining the amount of gross earnings from all sources within New York State is the meaning of "source". The court stated "[c]ommon words are to be given their commonly understood meaning (Matter of Steinbeck v Gerosa, 4 NY2d 302, app dsmd 358 US 39).

For purposes of section 186, the gains on the sales of securities are sourced in New York State when the taxpayer exercises extensive management, control and utilization of such intangibles in New York State and when such activity is an integral and substantial part of the taxpayer's business conducted in New York State. (see People ex rel Manila Electric R.R. & Lighting Corporation v Knapp, 229 NY 502; People ex rel Tobacco & Allied Stocks, Inc. v Graves, 250 App Div 149, affd 277 NY 723; People ex rel Manhattan Silk Co. v Miller, 125 App Div 296; People ex rel North American Co. v Miller, 90 App Div 560; People ex rel Brooklyn Rapid Transit Co. v Miller, 85 App Div 178, affd 181 NY 582; People ex rel New England Loan Co. v Roberts, 25 App Div 16).

Herein, Con Edison's principal activity is that of a utility company and in furtherance of such business Con Edison conducts financial activities including the business of establishing the Master Trust to accumulate funds to facilitate the eventual decommissioning of its nuclear plants. The Master Trust is an integral part of Con Edison's total business activities because the sole purpose of Master Trust is to fund the decommissioning costs associated with Con Edison's nuclear plants in New York State. Within the confines of section 468A of the IRC, Con Edison is involved in the management of the assets of the Master Trust and controls when and to what extent disbursements are made from the Master Trust. Con Edison's activities with respect to the Master Trust are extensively conducted in New York State.

Accordingly, for purposes of sections 186 and 186-b of the Tax Law, Con Edison must include in its "gross earnings from all sources within this state", the gain or profit derived from Master Trust, that is, the portion of the distribution from Master Trust that is in excess of the contributions Con Edison has made into the Master Trust. If the total distribution is less than Con Edison's contribution, such loss is not deductible from Con Edison's other gross earnings.

Sections 186-a and 186-c

Petitioners raise the following questions:

(a) Is Con Edison required to include currently in its gross income for purposes of section 186-a and 186-c of the Tax Law the earnings of the Master Trust?

No. Since the Master Trust is not treated as a grantor trust, the current earnings of the Master Trust are not gross earnings of Con Edison.

(b) Are such earnings currently includible in gross income even though they will not be distributed until the year 2006?

Since the answer in (a) is no, this question is not relevant.

(c) If the earnings of the Master Trust are interest and dividends derived from United States Treasury obligations, bank demand or time deposits and various state and local tax exempt municipal bonds, none of which represent any New York State or local investments, are such earnings considered to be from sources outside New York State and thus excludible currently from gross income?

Since the answer in (a) is no, this question is not relevant.

(d) If the Master Trust sells United States Government obligations and non-New York State and local bonds and derives a profit from the sale, are such profits includible in the gross income of Con Edison even though the Master Trust can not distribute such profits currently to Con Edison?

Since the answer in (a) is no, this question is not relevant.

(e) Is the final distribution of earnings from the Master Trust to Con Edison includible in the gross income of Con Edison?

Yes. The distribution of earnings from the Master Trust is includible in the gross income of Con Edison in the taxable year of distribution or deemed distribution.

(f) To the extent the final distribution represents a return of the original contributions made by Con Edison to the Master Trust, is such distribution subject to section 186-a and 186-c taxes?

No. The final distribution is not a receipt from a sale made or service rendered, therefore, only the gain or profit is subject to tax. The return of the original contributions is not subject to tax.

(g) To the extent such earnings were taxed to Con Edison when earned by the Master Trust, are such earnings subject to section 186-a and 186-c taxes at the time of final distribution?

The earnings are not taxed to Con Edison when earned by the Master Trust, therefore, Con Edison includes in its gross income for the year of distribution the profit included in such distribution.

(h) To the extent such earnings were not subject to tax when earned by the Master Trust because the earnings were from sources outside New York State, the earnings were derived from obligations of United States, or the earnings were not distributed to Con Edison as earned, will such earnings be subject to section 186-a and 186-c taxes when they are finally distributed to Con Edison?

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Section 186-a provides a tax on the furnishing of utility services that is equal to three percent of the gross income of a utility that is subject to the supervision of the New York State Department of Public Service. Gross income, as defined in section 1S6-a2(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. profit 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.

The Master Trust is an integral part of Con Edison's total business activities because the sole purpose of Master Trust is to fund the decommissioning costs associated with Con Edison's nuclear plants in New York State. Within the confines of section 468A of the IRC, Con Edison is involved in the management of the assets of the Master Trust and controls when and to what extent disbursements are made from the Master Trust. Con Edison's activities with respect to the Master Trust are extensively conducted in New York State. Therefore, for purposes of section 186-a and 186-c of the Tax Law, the distribution that Con Edison received from Master Trust falls in the category of "profits from any transaction within New York State whatsoever". The amount of the distribution that constitutes gross income within New York State is the gain or profit derived from the Master Trust, that is, the portion of the distribution that is in excess of Con Edison's contributions into the Master Trust. If the total distribution is less than Con Edison's contributions, the loss may not be deducted from Con Edison's other gross income.

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s/PAUL B. COBURN
Deputy Director
Taxpayer Services Division

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