

November 26, 2001

Re:  
Unincorporated Business Tax  
FLR-014777-006

Dear \_\_\_\_\_ :

This letter responds to your request, dated \_\_\_\_\_ 2001, on behalf of \_\_\_\_\_ (the "Reserve Escrow Agent") under \_\_\_\_\_, for a ruling regarding the application of the New York City General Corporation Tax (the "GCT") and New York City Unincorporated Business Tax (the "UBT") to the \_\_\_\_\_ (the "Fund"). This office received additional information relating to this request on \_\_\_\_\_, 2001.

#### FACTS

The facts presented are as follows:

The \_\_\_\_\_, and related entities, (the "Debtors") engaged in the purported business of financing office equipment through sales or pledges of leases and financial instruments to investors and to banking institutions. On \_\_\_\_\_, the Securities and Exchange Commission filed suit against the Debtors. Certain Debtors applied for bankruptcy protection in the Bankruptcy Court, and that Court appointed a trustee for the Debtors (the "Trustee"). Starting in \_\_\_\_\_, various class action lawsuits were filed against the Debtors and other parties, including \_\_\_\_\_ (the "Accounting Firm").

Many \_\_\_\_\_ of \_\_\_\_\_ the \_\_\_\_\_ cases \_\_\_\_\_ were \_\_\_\_\_ eventually \_\_\_\_\_ consolidated \_\_\_\_\_ in \_\_\_\_\_ in the United States District Court for the \_\_\_\_\_ District of \_\_\_\_\_. As certified by the court, the plaintiff class in that litigation is composed of persons who bought or invested in securities marketed by the Debtors (the "Class").

On \_\_\_\_\_, 2000, the court approved a settlement of all claims against the Accounting Firm raised in the consolidated cases. Both the Class and the Trustee agreed to the settlement.

The settlement agreement provided that a specified amount of money be set aside for distribution to the members of the Class and to creditors represented by the Trustee. To do that, the court established the Fund to receive and invest the settlement proceeds pending disbursement to the plaintiff class members.

Two separate escrow accounts were set up within the Fund. One account (the "Reserve Claims

Account") was established to provide funds to be used in connection with other claims against the Accounting Firm that might arise in connection with that firm's relationship with the Debtors (the "Reserve Claims"). The funds in the Reserve Claims Account could also be used to pay additional litigation and costs. The court appointed the Reserve Claims Escrow Agent to manage the Reserve Claims Account.

The remaining funds went into an account for distribution to the class members and creditors (the "Proceeds Account"). The court appointed the \_\_\_\_\_ as the Proceeds Escrow Agent (the "Proceeds Escrow Agent").

Both Escrow Agents must invest the funds solely in instruments, or in money market funds investing solely in instruments, secured by the full faith and credit of the United States, including Treasury Bills, Treasury Notes, and Treasury Bonds, or in instruments constituting obligations issued or guaranteed by agencies or instrumentalities of the United States. The Escrow Agents may sell those investments when funds need to be distributed in accordance with the requirements of the accounts. The income or losses realized on the investments will be credited to each of the Escrow Accounts.

The funds in the Proceeds Account will be distributed to another account controlled by co-counsel for the Class and the Trustee, when the conditions in the Settlement agreement have been met. Those funds will thereafter be distributed to the parties entitled to receive the funds in accordance with the Settlement Agreement.

The funds in the Reserve Claims Account will be used to pay Reserve Claims and litigation expenses upon presentation of acceptable requests for payment. The Reserve Claims Agent will notify co-counsel for the Class and the Trustee of its intention to make payments. Funds also will be periodically transferred to the Proceeds Account. At such time as there are no Reserve Claims pending, the remaining balance will be transferred to the Proceeds Account in three equal installments over a three-year period.

You have represented that in your opinion the Fund qualifies for federal income tax purposes as a settlement fund under Section 468B of the Internal Revenue Code (the "IRC"). Consistent with that position, a Form 1120-SF, U.S. Income Tax Return for Settlement Funds was filed for the Fund for the calendar year 2000. You have not requested a ruling from the Internal Revenue Service (the "IRS") that the Fund qualifies under IRC section 468B.

## ISSUES

You have requested rulings that the Fund is not subject to the GCT or UBT.

## CONCLUSIONS

Based upon the facts presented and the representations submitted, and on the condition that the Fund is and continues to be qualified under IRC section 468B, we have determined that (i) the Fund is not a

corporation under the GCT and, therefore, is not subject to that tax; and (ii) the Fund invests for its own account and thus is not engaged in an unincorporated business subject to the UBT.

## DISCUSSION

### General Corporation Tax.

The GCT is imposed on corporations that do business, employ capital, own or lease property, or maintain an office in New York City. Section 11-602.1(a) of the New York City Administrative Code (the "Code") provides that, for purposes of the GCT, a corporation includes:

- (1) an association within the meaning of paragraph three of subsection (a) of section seventy-seven hundred one of the internal revenue code (including a limited liability company),
- (2) a joint-stock company or association,
- (3) a publicly traded partnership treated as a corporation for purposes of the internal revenue code pursuant to section seventy-seven hundred four thereof and
- (4) any business conducted by a trustee or trustees wherein interest or ownership is evidenced by certificate or other written instrument.

Because the Fund was not expressly formed as a corporation, imposition of the GCT would require that it qualify as one of the above four types of entities. With respect to item (2) above, the Fund has not issued stock so it is not a "joint-stock company" or "joint stock association." The Fund is not a publicly traded partnership treated as a corporation for purposes of IRC section 7704, so it is not a corporation under item (3).

With respect to item (4), the Fund is not a business conducted by a trustee having ownership interests evidenced by written instruments. First, no certificates or other written instruments evidence ownership in the Fund. Second, we conclude that the Fund's activities, the investment and reinvestment of funds, do not constitute the conduct of a business by a trustee under Code section 11-602.1. While conduct of a business by a trustee is not defined under the GCT, regulations promulgated under Tax Law section 208.1, the corresponding provision of the New York State Franchise Tax, provide that 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." 20 NYCRR § 1-2.5(b)(2). Because the Fund's activities fall within those set out in that regulation, those activities would not amount to the "conduct of a business" under the Franchise Tax. We conclude that the Fund's activities do not amount to the "conduct of a business" for purposes of the GCT.

To be a corporation under item (1), an entity must be an association within the meaning of IRC section 7701(a)(3). IRC section 7701(a)(3) provides that "term 'corporation' includes associations, joint-stock companies, and insurance companies."

In 1996, the Internal Revenue Service promulgated regulations under IRC section 7701 that

substantially modified the classification of entities under IRC section 7701(a)(3). See T.D. 8697 (December 17, 1996). As modified, Treasury regulation section 301.7701-2(b) provides that a corporation includes an "association (as determined under §301.7701-3)." However, Treasury regulation section 301.7701-1(b), addressing classification of organizations, provides that the:

classification of organizations that are recognized as separate entities is determined under §§301.7701-2, 301.7701-3, and 301.7701-4 unless a provision of the Internal Revenue Code (such as section 860A addressing Real Estate Mortgage Investment Conduits (REMICs)) provides for special treatment of that organization.

As a result, where an IRC provision provides for special treatment of an organization, such as IRC section 860A addressing REMICs, the classification rules set out in Treasury regulation section 301.7701 do not apply.

IRC 468B provides for special federal income tax treatment for settlement funds, much like the way IRC section 860A provides special treatment for REMICs. T.D. 8697 makes clear that the exception in Treasury regulation section 301.7701-1(b) applies to settlement funds subject to tax under IRC section 468B:

An organization that is recognized as a separate entity for federal tax purposes is either a trust or a business entity (unless a provision of the Code expressly provides for special treatment, such as the Qualified Settlement Fund rules (section 1.468B) or the Real Estate Mortgage Investment Conduit (REMIC) rules, see section 860A(a)).

To qualify under IRC 468B: (i) a fund must be established pursuant to a federal court order and be subject to continuing jurisdiction of the court; (ii) a fund must be established to resolve or satisfy one or more contested or uncontested claims resulting from an event giving rise to at least one tort claim; and (iii) the fund must be segregated from other assets of the transferor and related persons. Treasury regulation section 1.468B-1(c). When a settlement fund qualifies, the fund is not taxable as a corporation for federal income tax purposes even if would otherwise so qualify. Treasury regulation section 1.468B-1(b).<sup>1</sup>

Based on the information and representations submitted, it appears that: (i) the Fund was established pursuant to a federal court order and is subject to continuing jurisdiction of the court; (ii) the Fund was established to resolve or satisfy one or more contested or uncontested claims resulting from an event giving rise to at least one tort claim; and (iii) the Fund's assets are segregated from other assets of the transferor and related persons. A Form 1120-SF, U.S. Income Tax Return for Settlement Funds was filed for the Fund for the calendar year 2000.

Based on the foregoing and your legal opinion the Fund is taxable under IRC section 468B, it would not

---

<sup>1</sup> While a designated settlement is not taxable as a corporation, it is treated as a corporation for administrative and procedural purposes, such as filing of returns and assessment and collection procedures. IRC section 468B(b)(5).

be subject to classification under the section 301.7701 Treasury regulations, and therefore is not an association under IRC section 7701(a)(3). Because the Fund is not an association under IRC §7701(a)(3), it is not a corporation under Code Section 11-602.1(a)(1). Therefore, the Fund is not subject to the GCT.

#### Unincorporated Business Tax.

The UBT is imposed on the unincorporated business income of every unincorporated business carried on within New York City. Code § 11-503(a). Code section 11-502(a) defines an unincorporated business as including "any trade, business, profession, or occupation conducted, engaged in or being liquidated by ... an unincorporated entity...."

Under Code section 11-502(c)(2), an entity earning income solely by investing for its own account is not considered to be conducting a business for purposes of the UBT. That section provides:

An individual or other unincorporated entity, except a dealer as defined in subdivision (1) of section 11-501 of this chapter, shall not be deemed engaged in an unincorporated business solely by reason of (A) the purchase, holding and sale for his, her or its own account of property, as defined in paragraph one of this subdivision, or the entry into, assumption, offset, assignment, or other termination of a position in any property so defined, or both, (B) the acquisition, holding or disposition, other than in the ordinary course of a trade or business, of interests in unincorporated entities engaged solely in activities described in subparagraph (A), (B) or (C) of this paragraph, or (C) any combination of the activities described in subparagraphs (A) and (B) of this paragraph and any other activity not otherwise constituting the conduct of an unincorporated business subject to the tax imposed by this chapter, but this paragraph shall not apply if the unincorporated entity is taxable as a corporation for federal income tax purposes.

In this case, the Fund earns income solely by reason of investments by the Escrow Agents. As a result, Code section 11-502(c)(2) will apply, and the Fund will not be subject to the UBT, if (i) the Fund's investments are in "property"; (ii) the Fund is not a dealer; and (iii) the Fund is not taxable as a corporation for federal income tax purposes.

Property: Under Code section 11-502(c)(1), property for purposes of Code section 11-502(c)(2) includes "property qualifying as investment capital within the meaning of subdivision (h) of section 11-501 of this chapter, other stocks, notes, bonds, debentures, or other evidences of indebtedness," with certain exceptions, not applicable here.

Both Escrow Agents invest for the Fund solely in instruments, or in money market funds investing solely in instruments, secured by the full faith and credit of the United States, including Treasury Bills, Treasury Notes, and Treasury Bonds, or in instruments constituting obligations issued or guaranteed by agencies or instrumentalities of the United States. Those investments constitute "notes, bonds, debentures, or other evidences of indebtedness." As a result, the Fund's investments qualify as "property" for purposes of Code section 11-502(c)(1) and (2).

Dealer: Code section 11-501(l) defines "dealer" as follows:

“Dealer” when used in this chapter shall mean an individual or unincorporated entity that

(A) holds or disposes of property that is stock in trade of the taxpayer, inventory or is otherwise held for sale to customers in the ordinary course of the taxpayer's trade or business, or

(B) regularly offers to enter into, assume, offset, assign or otherwise terminate positions in property with customers in the ordinary course of the taxpayer's trade or business, provided, however, an individual or unincorporated entity shall not be treated as dealer based solely on such individual's or entity's ownership of an interest in an entity that is a dealer, and provided, further, that an unincorporated entity shall not be treated as a dealer based solely on the ownership by a dealer of an interest in that unincorporated entity.

The Fund does not have customers. Thus, it is not a dealer for purposes of Code section 11-502(c).

Taxable as a corporation: Code section 11-502(c)(2) does not exempt from the UBT an unincorporated entity that is taxable as a corporation for federal income tax purposes. As discussed above, the facts presented and representations submitted indicate that the Fund qualifies under IRC section 468B. Treasury regulation section 1.468B-1(b) provides if an entity qualifies under IRC section 468B, then it is not taxable as a corporation for federal income tax purposes even if it would otherwise so qualify.

Based upon the foregoing, we have determined that the Fund is not engaged in an unincorporated business and, as a result, is not subject to the UBT.

Condition for rulings.

Our rulings under both the UBT and GCT are based on the qualification of the Fund as a settlement fund under IRC section 468B. You have represented that you have not requested a ruling from the IRS that the Fund qualifies as a settlement fund under IRC section 468B. While this Department agrees that, based on the information and representations submitted, the Fund appears to so qualify, in the event that the IRS concludes that the Fund does not qualify as a settlement fund under IRC section 468B and is taxable as a corporation for federal income tax purposes, this letter ruling is no longer valid or binding on the Department.

\* \* \*

The Department of Finance reserves the right to verify the information submitted.

Sincerely,

Devora B. Cohn  
Associate Commissioner  
for Legal Affairs

LED:ld