

August 1, 2006

Re: Request for Letter Ruling
General Corporation Tax
Unincorporated Business Tax
FLR-064854

Dear Mr.:

This letter responds to your request, dated May 22, 2006, on behalf of the (the "Fund") for a ruling regarding the application of the New York City General Corporation Tax (the "GCT") and the New York City Unincorporated Business Tax (the "UBT") to the Fund.

ISSUES:

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

CONCLUSION:

Based on the facts and representations submitted to the City, and on the condition that the Fund maintains its status as a qualified investment fund pursuant to Treasury Regulation 1.468B-1(c), we determine that: (i) the Fund is not a corporation under the GCT and therefore is not subject to that tax; and (ii) the Fund invests solely for its own account and, thus, is not engaged in an unincorporated business subject to the UBT.

FACTS:

The facts presented to the City are as follows:

On , 2006, the United States District Court for the created the Class Action Settlement Fund in the case of . It was the

result of a class action lawsuit brought by a large number of _____ dealers against (the “Company”) for an alleged breach of contract.

The parties reached a settlement where the Company would be released from all further claims in exchange for a payment of \$1.075 billion to the potential claimants. The Court approved this settlement and created the Fund for the purpose of paying the claims. By order dated _____, 2006, the Court established the Fund as a Qualified Settlement Fund in compliance with Treas. Reg. § 1.468B-1(c).

After formally approving the settlement, the Court ordered the _____ Group, Inc. to be the Claims Administrator. In another order signed the same day, the Court authorized the settlement’s Special Master and Claims Administrator to open various accounts (the “Depository Institution”) for accepting payment from the Company of \$1.075 billion, and for investing this money.

On _____, 2006, the Company transferred the monies to the Depository Institute. At that time the Company was released from further liability and participation in the claims process. Pursuant to the Court order, the moneys will be invested and re-invested for the benefit of the Fund. The investments are limited to instruments secured by the full faith and credit of the United States, including Treasury Bills, Treasury Notes and Treasury Bonds, and money market funds investing solely in those instruments. All earnings will be held for the benefit of the Fund.

The claims process continues before a Special Master appointed by and reporting to, the Court. Under this process individual dealers must establish their right to payments from the fund, and the Claims Administrator must process approved claims and distribute them.

The payments are made from the Fund’s assets, and the process will continue until all valid claims are adjudicated and paid. If there are any residual funds, they will revert to the states as abandoned property, and any class member who did not submit a proof of claim in a timely fashion may make a claim to the appropriate state government. The Fund’s assets will also be used to pay other persons involved in the case including class counsel. The Fund is subject to the continuing jurisdiction of the Court.

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, it must fit one of these categories in order to be considered a corporation for GCT purposes. Based on the facts submitted, the Fund is not one of these entities.

The Fund is not an association under I.R.C. section 7701(a)(3)

The Treasury Department promulgated regulations under I.R.C. section 7701(a)(3) that define the term “corporation”, and provide guidance for determining which associations are corporations. In doing so, they indicate that organizations receiving special treatment under the Internal Revenue Code will not be classified under I.R.C. section 7701(a)(3), and will not be considered corporations. The regulations state: “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) provides for special treatment of that organization.” Treas. Reg. section 301.7701-1(b).

I.R.C. section 468B provides for special federal income tax treatment for settlement funds, much like the way I.R.C. section 860A provides special treatment for REMICs. In its explanation of the regulations, the Treasury Department states expressly that a Qualified Settlement Fund receives special treatment that removes it from classification under I.R.C section 7701(a)(3): “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)).” T.D. 8697.

Thus, if the Fund qualifies under Treasury Regulation section 1.468B-1(c), as represented, its classification is not determined by the regulations issued under I.R.C. section 7701(a)(3).

There are three basic requirements for qualifying as a settlement fund under I.R.C. section 468B: (i) the Fund must be established pursuant to a federal court order and be subject to continuing jurisdiction of the court; (ii) it must be established to resolve or satisfy one or more contested claims resulting from an event giving rise to at least one

tort, breach of contract, or violation of law; and (iii) the Fund's assets must be segregated from the other assets of the transferor or related persons. Treas. Reg. §1.468B-1(c). Once qualified, the Fund is not taxed as corporation, even if it would otherwise be so classified. Treas. Reg. § 1468B-1(b). However, the Fund must file a return as a corporation, and pay tax on its income at the same rate as trusts. I.R.C. §468B(b)(5).

Based on the information submitted, it appears that the Fund meets these requirements, and would be subject to the federal tax law under I.R.C. section 468B. For that reason, it would not be subject to classification under Treas. Reg. sections 301.7701-2, or 301.7701-3, or 301.7701-4, and would not be considered an association under I.R.C. section 7701(a)(3). Because the Fund is not an association under I.R.C. section 7701(a)(3), it is not a corporation under Code section 11-602.1(a)(1).

The Fund is not a joint stock association or a publicly traded partnership.

The Fund is not a joint stock association or company because it has not issued stock. Similarly, the Fund is not a partnership with interests that are readily tradable on an established or secondary securities market. For that reason, it does not meet the definition of a publicly traded partnership under I.R.C. section 7704(b).

The Fund is not a business conducted by trustees.

Finally, the Fund does not fit within the fourth category of a corporation under section 11-602.1(a) of the Code. We conclude that the Fund's activities, which are the investment and re-investment of its assets in Treasury backed securities, do not constitute the conduct of a business by a trustee under Code section 11-602.1.

“Conduct of a business by a trustee” is not defined under the GCT, however, regulations promulgated under Tax Law section 208.1, the corresponding New York State Franchise Tax provision, provide that the “mere investment of funds and the collection of income there from, 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).

This Fund's investment in Treasury Securities falls within those parameters, and would not be considered the “conduct of a business” under the Franchise Tax. We conclude that the rationale underlying the State regulation applies to the GCT as well, and that the Fund's activities do not amount to the “conduct of a business” for GCT purposes.

Based upon the foregoing facts and analysis, we conclude that the Fund, as represented, is not subject to tax as a corporation under the GCT.

Unincorporated Business Tax

Under Code section 11-503(a), the UBT is imposed on the unincorporated business income of every unincorporated business carried on within New York City. 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, including a partnership, [or] a fiduciary.” However, under Code section 11-502(c)(2), an entity earning income solely by investing for its own account is not considered as conducting a business for UBT purposes.

The Code states that:

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 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) 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.

On the facts submitted, this Fund invests solely for its own account. By investing and re-investing in U.S. Treasury Securities, the Fund will earn income, but the transactions are made for the benefit of the Fund itself. As a result, Code section 11-502(c)(2) will apply, and the Fund will not be subject to tax under the UBT. However, it must meet the three basic conditions outlined in the Code, which are: (i) the Fund’s invests in “property”; (ii) the Fund is not a “dealer”; and (iii) the Fund is not taxable as a corporation for federal income tax purposes.

Securities are property.

Under Code section 11-502(c)(1), the term “property”, as used in 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 that do not apply here. The monies controlled by this Fund are invested, by Court order, in U.S. Treasury Securities and Money Market Funds that invest in U.S. Treasury Securities. These are investments in “notes, bonds, debentures or other evidences of indebtedness” and, thus, they qualify as property for this purpose.

The Fund is not a Dealer.

Under Code section 11-501(1) a “dealer” is defined as 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 business.

Based on the facts submitted, this Fund is not a dealer because it does not have property that it sells to customers in the ordinary course of a business. The Fund invests and re-invests moneys that it holds for the purpose of paying class action settlement claims. It will sell its property only as necessary to pay these claims. It does not have "customers" and, therefore, it is not a dealer.

The Fund is not taxable as a corporation for federal income tax purposes.

Code section 11-502(c)(2) does not exempt from the UBT unincorporated entities that are taxable as corporations for federal income tax purposes. However, as discussed above, the facts and representations submitted indicate the Fund is a qualified settlement fund under I.R.C. section 468B and Treas. Reg. section 1.468B-1(c). Pursuant to Treas. Reg. section 1.468B-1(b), if a fund qualifies under I.R.C. section 468B, it is not taxable as a corporation for federal income tax purposes.

Based upon the foregoing facts and analysis, we conclude the Fund as represented is not subject to tax under the UBT.

Our Ruling is based on the qualification of the Fund as a settlement fund under I.R.C. section 468B.

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

Sincerely,

Dara Jaffe
Assistant Commissioner
Office of Legal Affairs
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