REPORT #643

TAX SECTION

New York State Bar Association

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New York State Bar Association

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Dear Marilyn:

Further to our Report on New York Taxation of Foreign Corporate limited Partners, the Federal income tax law has treated all partners, whether corporations or individuals and whether general or limited partners, as engaged in trade or business in the United States if the partnership is so engaged. You may find that helpful in considering your position as to the taxation by New York State of non-New York corporate partners in partnerships doing business in New York.

Section 875(1) of the Internal Revenue Code of 1986 was originally enacted as part of the Revenue Act of 1936.* It applied only to individuals/ without regard to whether they were general or limited partners. The legislative

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* As originally enacted, the Section attributed to a nonresident individual partner any engaging in trade or business by the partnership and also any office of the partnership. At that time, either factor alone resulted in a foreign taxpayer being subjected to tax by the United States on a net income basis. In 1942, net income taxation on the basis of only an office was eliminated and the provision was amended accordingly.

history of the 1936 Act does not contain any specific comment on the provision, but the same conclusion had previously been reached with respect to a foreign corporation in the Board of Tax Appeals majority decision in Cantrell & Cockrane, Ltd., 19 B.T.A. 16 (1930). The facts in that case involved a "syndicate" or partnership in the United States and a foreign corporation that was actively involved in the conduct of the business carried on by the syndicate in the United States. But the Court's opinion focuses on the foreign corporation being a party to the conduct of the business by the syndicate "through which it established a place of business", citing the prior New York tax case of People v. Roberts, 152 N.Y. 59, 46 N.E. 161 (1897). The Roberts case held that New York could impose its franchise tax on a foreign corporation where the only basis for "doing business" in the state was the corporation being a special partner in a limited partnership carrying on business in the state.

In 1966, Section 875(1) was amended to refer specifically to corporations as well as individuals, and at the same time clause (2) was added to similarly "impute" to the beneficiaries of estates and trusts any engaged-in-trade-or-business status of the estate or trust. The fact that the addition of the words "or foreign corporation" in clause (1) in 1966 was not mentioned in the legislative history, even as a technical amendment, suggests that it is a reflection of what was already regarded to be the law.

Thus, for federal tax purposes, it has long been settled even without express statutory provision, and continues to be the case, that when a partnership is engaged in trade or business in the United States, then each foreign partner is so engaged. Moreover, the judicial-legislative history of Section 875(1) and the reference to "imputation" in the legislative history of Section 875(2) suggest that the basis for this conclusion does not rest upon some application of principal-agent theory but rather on what has come to be described as the "aggregate" theory of corporate taxation (under which the partners stand in the place of the partnership).

Sincerely,

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Wm. L. Burke
Chair

cc: William F. Collins, Esq.
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