STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petitions	:	
of	:	
SHELL GAS GATHERING CORP. #2	:	
AND	:	DECISION DTA NOS. 821569
SHELL GAS PIPELINE CORP. #2	:	AND 821570
for Redetermination of Deficiencies or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Fiscal Years 2001 through 2004.	:	

Petitioners, Shell Gas Gathering Corp. #2 and Shell Gas Pipeline Corp. #2, each filed an exception to the determination of the Administrative Law Judge issued on June 11, 2009. Petitioners appeared by Shell U.S. Tax Organization (Peter Lowy, Esq., of counsel) and Jones, Walker, Waechter, Poitevent, Carrere & Denegre, LLP (Jesse R. Adams, III, Esq., of counsel). The Division of Taxation appeared by Daniel Smirlock, Esq. (Jennifer L. Baldwin, Esq., of counsel).

Petitioners each filed a brief in support of its exception. The Division of Taxation filed a brief in opposition. Petitioners each filed a reply brief. Oral argument, at petitioners' request, was heard on March 24, 2010 in New York, New York.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUES

I. Whether it was proper for the Division of Taxation to impose corporation franchise tax pursuant to Article 9-A of the Tax Law on petitioners, who are foreign corporations.

II. Whether imposition of the tax violates the Commerce Clause or Due Process Clause of the United States Constitution.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

In the course of the submission, petitioners, Shell Gas Gathering Corp. #2 (SGG) and Shell Gas Pipeline Corp. #2 (SGP), and the Division of Taxation (Division) entered into joint stipulations of fact. To the extent relevant to the decision in this matter, the stipulated facts are set forth below. Additional findings of fact were also made by the Administrative Law Judge below. Unless otherwise stated, all facts pertain to the years in issue.

In 1998, Shell Oil Company acquired Tejas Gas, which owned numerous entities involved in the processing and transportation of oil and gas products (midstream oil and gas business). The entities that held midstream assets, SGG, SGP, Shell Seahorse Company and SWEPI LP contributed assets to the firm that became SUSGP in exchange for a membership interest. Those entities did not manage SUSGP or any of the entities in which SUSGP held an interest.

SUSGP was a limited liability company organized under the Delaware Limited Liability Company Act. Prior to February 9, 2001, SUSGP was known as Coral Energy, LLC. SUSGP conducted its business under the terms of the First Amended and Restated Operating Agreement (Operating Agreement). Although the percentage of ownership of SUSGP may have changed over time, the members of SUSGP possessed ownership interests approximately as follows: SGG

- 21.88%, SWEPI LP - 16.98%, SGP - 57.91% and Shell Oil Company - 3.23%. SUSGP filed partnership returns in New York, which reported that SUSGP had "income, gain, loss, or deduction derived from New York sources."

Under the terms of the Operating Agreement, a membership interest in SUSGP is personal property for all purposes. The members of SUSGP further agreed that they have no ownership interest in any of the property owned by SUSGP and that they are not partners or joint venturers. The Operating Agreement permits the members of SUSGP to compete for business opportunities with SUSGP, and each other, and they do not owe each other any fiduciary obligations. SUSGP has never acted as an agent of any of its members.

The Operating Agreement grants SUSGP's board all authority and powers necessary to manage and control the business of SUSGP including but not limited to the following:

a) To buy, sell, construct, maintain, operate, mortgage, finance, rent or lease real or personal property on behalf of SUSGP,
b) To incur debt or liabilities for SUSGP,
c) To purchase insurance for SUSGP,
d) To invest SUSGP's funds,
e) To sell, or otherwise dispose of the assets of SUSGP,
f) To execute all financial instruments on behalf of SUSGP,
g) To employ accountants, legal counsel, managing agents or other experts to perform services for SUSGP,
h) To bring or defend litigation on behalf of SUSGP,
i) To issue membership interests, and
j) To declare and make distributions to the members in accordance with the Operating Agreement.

The members of SUSGP do not possess the authority to act on behalf of SUSGP or to bind SUSGP. They do not have the right to participate in the management of SUSGP.

The members of SUSGP had limited liability with regard to the operations of SUSGP. Members of SUSGP were not liable for any indebtedness or obligations of SUSGP or required to make additional capital contributions to SUSGP. SUSGP could borrow funds in its own name

and on its own behalf if it needed funds or capital. The members of SUSGP were not responsible for the loans or debts incurred by SUSGP.

During the years in issue, SGG and SGP were holding companies organized under the laws of the State of Delaware. All of SGG's and SPG's corporate records were maintained in Texas or Delaware.

SGG and SGP were not licensed to do business in New York. They did not appoint an agent for service of process in New York and none of SGG's or SGP's officers or directors resided in New York.

SUSGP has never been a general partner in any general or limited partnership that conducted any business in New York. Some of the firms in which SUSGP held an interest, or entities in which they held an interest, did business in the State of New York. During the years in issue, other than own a membership interest in SUSGP, SGG and SGP did not:

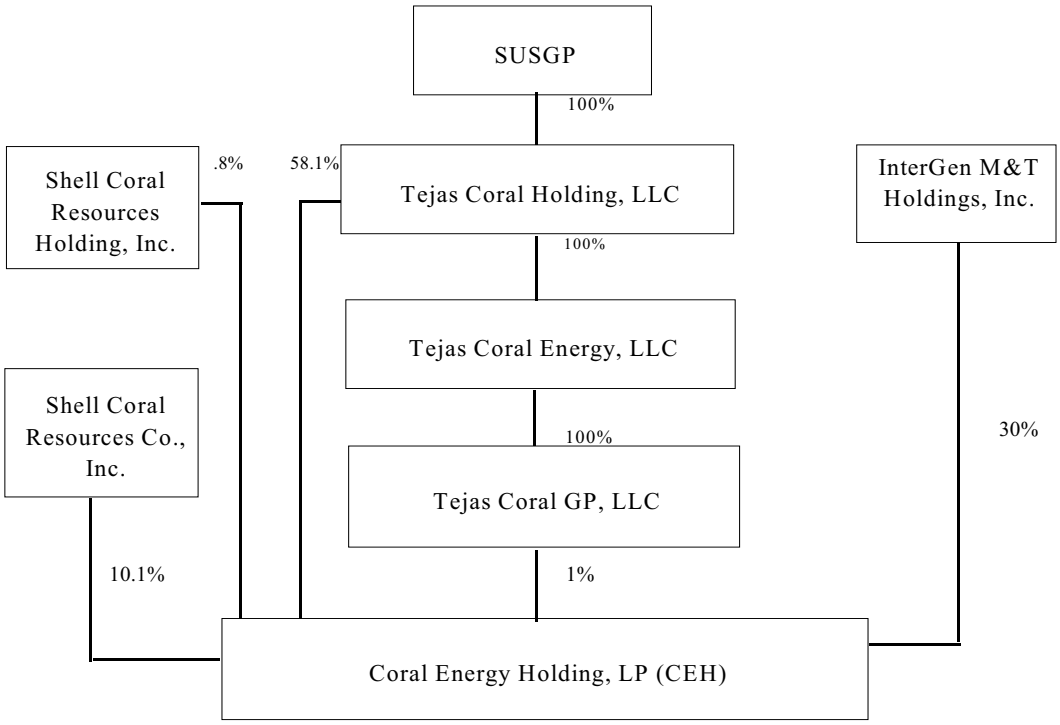
(a) Conduct any business in New York,
(b) Employ anyone in New York, including independent contractors or agents,
(c) Own or lease any real property within the State,
(d) Own or lease any personal property within the State,
(e) Solicit or sell anything in New York,
(f) Enter into any contracts with any New York residents,
(g) Provide any services in the State,
(h) Maintain any bank accounts in the State,
(i) Have a listed telephone number in New York,
(j) Make any management decisions in New York,
(k) Utilize New York's court system to enforce or defend any rights or obligations.

SGG and SGP filed forms CT-245 wherein they each disclaimed tax liability to New York. On these forms, SGG and SGP each indicated that it "participate[d] in a partnership, limited liability company/partnership, or joint venture doing business in New York State."

SGG's membership interest in SUSGP was approximately 21.88 percent, though this may have varied from year to year. SGG's basis in SUSGP was more than $1,000,000.00 and it owned more than a 1 percent interest in SUSGP.

SGP's membership interest in SUSGP was approximately 57.91 percent, though this may have varied from year to year. SGP's basis in SUSGP was more than $1,000.000.00 and it owned more than a 1 percent interest in SUSGP.

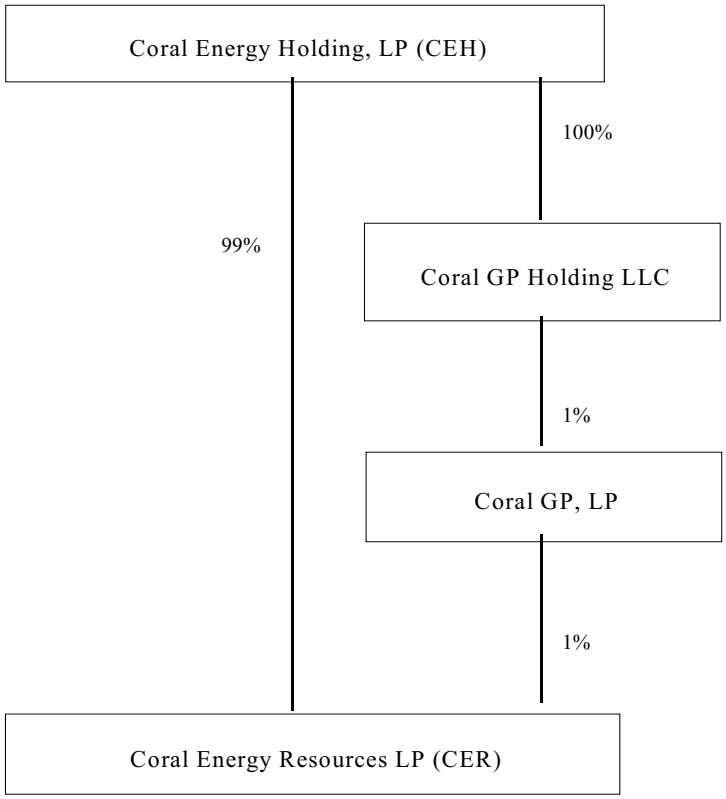
SUSGP owned the sole membership interest in Tejas Coral Holding, LLC. That entity held a 58.130539% limited partnership interest in Coral Energy Holding, LP (CEH). Shell Coral Resources Company, LLC, held a 10.1% limited partnership interest in CEH. Shell Coral Resources Holding, Inc., held a .8% percent limited partnership interest in CEH. The remaining limited partnership interest was owned by an unrelated entity, InterGen M&T Holdings, Inc. Tejas Coral GP, LLC, held a 1% general partnership interest in CEH. Tejas Coral GP, LLC, was owned indirectly by Tejas Coral Holding, LLC. For certain federal and state income tax purposes, Tejas Coral Holding, LLC, Tejas Coral Energy, LLC, and Tejas Coral GP, LLC, are disregarded entities. SUSGP reports Tejas Coral Holding, LLC's and TEJAS Coral GP, LLC's distributive shares of CEH's income and expenses on its informational returns. This structure may be depicted as follows:



Neither SGG nor SGP held any direct ownership in any of the entities in which SUSGP held an ownership interest.

CEH filed partnership returns in New York during the period in issue.

CEH held a 99 percent limited partnership interest in Coral Energy Resources, L.P. (CER). Coral GP, LP held a 1 percent general partnership interest in CER. Coral GP, LP was owned by CEH (99 percent limited partnership interest) and Coral GP Holding LLC (1 percent general partnership interest). CEH owned the sole membership interest of Coral GP Holding LLC. For certain federal and state income tax purposes, Coral GP, LP and Coral GP Holding LLC are disregarded entities. The ownership of CER may be diagramed as follows:



CER is a seller and marketer of natural resources. CER conducts business, owns property and makes sales in New York. CER filed utility services tax returns in New York during the tax period. For certain federal income tax purposes, CER is a disregarded entity. CEH reports 100 percent of CER's income and expenses in its informational returns. No tax is imposed on the income of CER until it passed through to the corporate members of SUSGP.

Although it indirectly held an ownership interest in CER, SUSGP was not involved in the management of CEH or CER. SUSGP was not a general partner of either CEH or CER. Neither CEH nor CER has ever been authorized to act as SUSGP's agent in New York or elsewhere. SUSGP did not share officers, directors, managers or employees with either CEH or CER. SUSGP possesses limited liability with respect to, and is not responsible for, the liabilities and obligations of either CEH or CER.

The Division conducted an audit of SGG for the years 2001 through 2004. As a result of the audit, the Division issued a Notice of Deficiency to SGG, dated November 17, 2006, which asserted a deficiency of tax, penalty and interest in the amount of $109,529.49 as set forth below:

Period	Tax	Interest	Penalty	Total
2001	$8,662.00	$3,514.28	$1,077.00	$13,253.28
2002	$3,447.00	$1,116.80	$133.00	$4,696.80
2003	$3,402.00	$818.15	$124.00	$4,344.15
2004	$66,966.00	$10,725.26	$9,544.00	$87,235.26
Total				$109,529.49

The Division also conducted an audit of SGP for the years 2001 through 2004. As a result of the audit, the Division issued a notice of deficiency to SGP, dated November 17, 2004, which asserted a deficiency of tax, penalty and interest in the amount of $29,974.08 as follows:

Period	Tax	Interest	Penalty	Total
2001	$2,596.00	$1,053.81	$103.00	$3,752.81
2002	$662.00	$215.06	$100.00	$977.06
2003	$5,313.00	$1,277.79	$180.00	$6,770.79
2004	$14,406.00	$2,307.42	$1,760.00	$18,473.42
Total				$29,974.08

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge determined that SGG and SGP were properly assessed tax, penalty and interest for the years 2001 through 2004 under the provisions of Article 9-A of the New York State Tax Law, regulations thereunder and the controlling authority of the New York State Court of Appeals.

SGG and SGP were corporate members of SUSGP, a limited liability company. SGG and SGP filed form CT-245 with the state of New York wherein each disclaimed tax liability to New York. On those forms, SGG and SGP indicated that it "participate[d] in a partnership, limited liability company/partnership, or joint venture doing business in New York State." SGG and SGP participated in the partnership, SUSGP, which directly and indirectly controlled Coral Energy Holding LP (CEH), which filed partnership returns in New York during the period at issue and which held a 99% interest in Coral Energy Resources, LP (CER), which conducts business, owns property and makes sales in New York. CEH reports 100% of CER's income and expenses in informational returns and no taxes are imposed on the income of CER until it is passed through to the corporate members of SUSGP, the ultimate recipients of New York income.

The Administrative Law Judge determined that as indirect recipients of New York income, petitioners were liable for the proper apportionment of New York State taxes in accordance with New York partnership and tax laws then in effect. Regulations expressly provide that if a partnership is doing business in New York State then all general corporate partners are subject to tax under Article 9-A of the Tax Law (***see,*** 20 NYCRR 1-3.2[a][5]). It is undisputable that CER did business in New York and that the ultimate recipients of the income of such business were responsible for New York taxes on such income. The Administrative Law Judge further found that petitioners had not met the required substantial burden seeking to limit the operation of the statute on grounds that it is unconstitutional.

The Administrative Law Judge rejected the argument that petitioners had no physical presence in New York State and, thus, were not responsible for taxes on their New York income. The Administrative Law Judge determined that the required presence was not that of petitioners

herein, but rather the New York State activity of CER in which entity petitioners had an ultimate interest and from whose activities petitioners received income. The Administrative Law Judge also rejected petitioners argument that the membership interest in the limited liability company does not provide a sound basis to assert personal jurisdiction over a non-resident member. The Administrative Law Judge rejected that argument citing the case of ***Varrington Corp. v. New York Dept. of Fin.*** (85 NY2d 28 [1995]).

ARGUMENTS ON EXCEPTION

Petitioners argue that the Administrative Law Judge made an error of fact. Petitioners, in their briefs, state the alleged error, as follows:

> **I. ERRORS OF FACT**
>
> In his Determination, the Administrative Law Judge makes the following conclusion:
>
> > Simply stated, Petitioners, as members of the corporate general partner, SUSGP, which ultimately held a general partnership interest in CER, a firm which did business in New York, are required to pay Article 9-A franchise tax in 20 N.Y.C. RR 1-3.2(a)(5) (Petitioners' briefs in support, p. 13).

Petitioners state that this conclusion contradicts not only the evidence, including the joint stipulations, but also is inconsistent with the Administrative Law Judge's own finding of fact that SUSGP was not a general partner of either CEH or CER.

Petitioners state that the Administrative Law Judge also made an alleged error of law. Petitioners argue that in ***Matter of Allied-Signal, Inc. v. Commissioner of Fin.***, 79 NY2d 73 (1991) (hereinafter "Allied-Signal NYC"), allegedly controlling in this matter, does not extend New York taxing jurisdiction to the point that a non-resident need not have a minimum connection and a substantial nexus with the taxing jurisdiction before a tax can be imposed,

stating that: "no jurisprudence has ever concluded that a passive investment in another entity provides a sound basis for imposing tax on a non-resident" (Petitioners' briefs in support, p. 14).

Petitioners state that, regardless of how New York State attempts to define a limited liability company and the decision on how to treat corporate members of a limited liability company, the statute, regulations and decisions do not alter a non-residents rights under the United States Constitution.

Petitioners argue that the Division's efforts in this matter contravene the due process and commerce clauses of the United States Constitution as enunciated in ***Quill Corp. v. North Dakota***, 504 US 298 (1992). Further, petitioners contend that it is contrary to the four part test articulated by the United States Supreme Court in ***Complete Auto Transit v. Brady***, 430 US 274 (1977).

In short, petitioners argue that they did not have such contacts with the state of New York as to allow the taxes assessed herein. Further, petitioners state that members of an LLC are not subject to a personal jurisdiction based on the activities of the LLC.

OPINION

Limited liability companies were not authorized or recognized in New York until 1994. The formation of limited liability companies in New York and the recognition of foreign limited liability companies was authorized by chapter 576 of the Laws of 1994, which enacted the New York Limited Liability Company Law. This chapter added a new subdivision five to Tax Law § 2, which defined a "limited liability company" as a domestic limited liability company or a foreign limited liability company as defined in Limited Liability Company Law § 172. It also added a new subdivision six, which provided that the definition of "partnership and partner" shall include a limited liability company. The chapter also amended Tax Law § 601(f) to include

a subchapter K limited liability company as a limited liability company that is classified as a partnership for Federal income tax purposes. Tax Law § 208(1) was amended to define a corporation as an association (including a limited liability company) within the meaning of IRC § 7701(a)(3). As a consequence of this legislation, limited liability companies that are treated as partnerships under the Internal Revenue Code are treated as partnerships under the New York State Tax Law.

In 1969, the Legislature amended Tax Law § 209(1) to expand the criteria that would subject a corporation to tax in New York. As amended, a corporation is subject to Article 9-A franchise tax if it does business in the state, employs capital in the state, owns or leases property in the state or maintains an office in the State (***see,*** 20 NYCRR 1-3.4[a]; ***see also, Matter of Hugo Bosca Co.***, Tax Appeals Tribunal, October 17, 1991).

The Division's regulations expressly provide that if a partnership is doing business in the state, then all of the corporate general partners are subject to tax under Article 9-A of the Tax Law (***see,*** 20 NYCRR 1-3.2[a][5]). The burden is on the petitioners to show that they have been unconstitutionally assessed.

> When a State or municipality seeks to impose an income-based tax upon a multijurisdictional corporation the strictures of the Due Process and Commerce Clauses compel it to confine its taxing powers to income fairly attributable to activities carried on within its borders (citations omitted). A taxpayer who contends that a taxing jurisdiction has transgressed this fundamental limitation bears "the ' "distinct burden of showing by 'clear and cogent evidence' that [the challenged tax] result[ed] in extra-territorial values being taxed" ' " *(Container Corp. v Franchise Tax Bd.,* [463 US 159], at 164, quoting *Exxon Corp. v Wisconsin Dept. of Revenue,* 447 U.S. 207, 221, in turn quoting *Butler Bros. v McColgan,* 315 U.S. 501, 507, in turn quoting *Norfolk & W. Ry. Co. v North Carolina,* 297 U.S. 682, 688) (***Matter of Allied-Signal, Inc. v. Commissioner of Fin., supra***, at 79).

We affirm the determination of the Administrative Law Judge. The petitioners maintain that neither possessed the requisite minimum contacts with the state of New York in order to impose tax on the income at issue. Petitioners posit that their only connection to New York is their passive ownership interest in SUSGP. They submit that due to the lack of activities by SGG and SGP in New York, they do not satisfy the four part test set forth in ***Complete Auto Transit v. Brady*** (***supra***) to determine whether a state can tax activities taking place in interstate commerce under the Commerce Clause.

This argument is without merit because it focuses upon the lack of direct nexus between petitioners and New York. The ***Allied-Signal NYC*** case stands for the principle that the State's power to tax need not be based on the taxpayer's own activities in the State. In order to justify the imposition of tax, the relevant inquiry is whether New York has given something for which it may impose a tax in return. Here, New York has satisfied this standard because it has accorded privileges and immunities that led to CER's income, which inured to the benefit of its shareholders, including petitioners. Similarly, petitioners' argument that ***Allied-Signal NYC*** is distinguishable because Bendix was doing business in its own right in New York City overlooks the rationale of the decision. As set forth above, the case was premised upon the theory that New York City was providing an environment for which it could ask something in return. The same consideration permits the imposition of tax here.

Petitioners also cited cases involving personal jurisdiction for the proposition that ownership of a membership interest in a limited liability company does not provide a sound basis to assert personal jurisdiction over a non-resident member. The Court of Appeals in ***Varrington Corp. v. New York Dept. of Fin.*** (***supra***) clearly stated that cases involving personal jurisdiction were not precedent in tax matters.

Petitioners argue that the determination herein is contrary to the jurisprudence that has developed regarding the ability of states to tax non-residents. Although the ***Allied-Signal NYC*** decision is determinative of the outcome herein, as the court expressly stated that it was addressing both due process and commerce clause issues when it found the New York City method of taxing the income of foreign corporations with an interest in New York businesses did not violate the constitution, it is worthwhile to discuss the issue.

The issue at hand is not the activity of petitioners' holding companies, the recipients of the New York income, that do not have any activities in New York State. Rather, the issue involves the activities of CER, which is wholly owned, directly or indirectly by CEH, in which SUSGP has a substantial interest. The petitioners filed form CT-245 wherein they disclaimed the tax liabilities to New York, but on those forms each indicated that it "participate[d] in a partnership, limited liability company/partnership, or joint venture doing business in New York State." It is unquestioned that CER, a disregarded entity for federal income tax purposes, did business in New York State and that CEH reports 100% of CER's income and expenses on its informational return. The activities being taxed are the activities of CER. Obviously, CER meets the four-prong test established in ***Complete Auto Transit,*** the physical presence required by ***Matter of Orvis Co. v. Tax Appeals Tribunal*** (86 NY2d 165 [1995]) and the presence required to satisfy the requirements of due process as described in ***Quill Corp. v. North Dakota*** (***supra***).

In their argument, petitioners state that the Administrative Law Judge's conclusion that SUSGP "ultimately held a general partnership interest in CER, a firm which did business in New York" is contrary to the Administrative Law Judge's own findings of fact therein (Determination, conclusion of law "O"). Such exception is rejected. SUSGP, through disregarded entities, held a 1% general partnership interest and a 58.1% membership interest in CEH. In turn, CEH directly

held a 99% membership interest and through disregarded entities a 1% general membership interest in CER. Thus, according to the agreed upon facts, SUSGP ultimately held a general partnership interest in CER.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exceptions of Shell Gas Gathering Corp. #2 and Shell Gas Pipeline Corp. #2 are denied;

2. The determination of the Administrative Law Judge is affirmed;

3. The petitions of Shell Gas Gathering Corp. #2 and Shell Gas Pipeline Corp. #2 are denied; and

4. The Notices of Deficiency dated November 17, 2006 are sustained together with such penalty and interest as are lawfully due.

DATED: Troy, New York
September 23, 2010

/s/ James H. Tully, Jr.
James H. Tully, Jr.
President

/s/ Carroll R. Jenkins
Carroll R. Jenkins
Commissioner

/s/ Charles H. Nesbitt
Charles H. Nesbitt
Commissioner