STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petitions	:	
of	:	
SHELL GAS GATHERING CORP. #2	:	
AND	:	DETERMINATION
		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, filed petitions 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, by their representatives, Shell U.S. Tax Organization (Paul K. Lester, Esq., Peter Lowy, Esq., and Alan Gutierrez, Esq.) and Oreck, Crighton, Adams & Chase, LLC (Jesse R. Adams, III, Esq.) and the Division of Taxation, by Daniel Smirlock, Esq. (Jennifer L. Baldwin, Esq., of counsel), waived a hearing and agreed to submit the matter for a determination based on documents and briefs to be submitted by December 19, 2008, which commenced the six-month period for the issuance of this determination. After review of the evidence and arguments presented, Arthur S. Bray, Administrative Law Judge, renders the following determination.

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 Clauses of the United States Constitution.

FINDINGS OF FACT

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 determination in this matter, the stipulated facts are set forth below. Additional findings of fact were also made. Unless otherwise stated, all facts pertain to the years in issue.

1. 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.

2. 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."

3. 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.

4. 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.

5. 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.

6. 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.

7. 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.

8. 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.

9. 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:

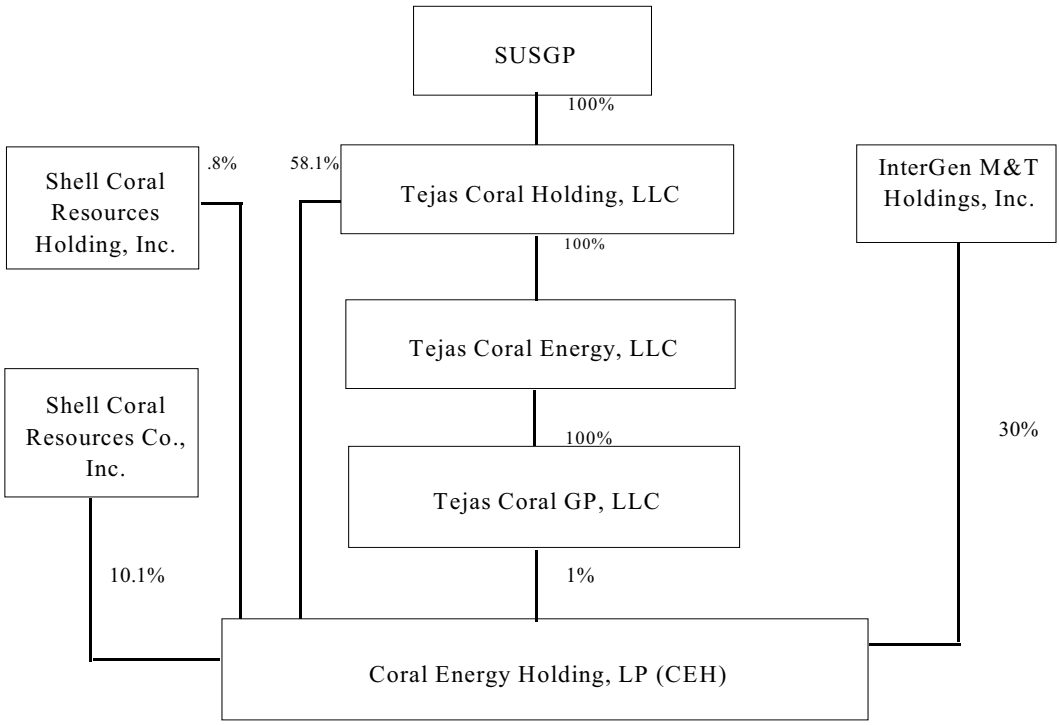
(a) Conduct any business in New York,
(b) Employ anyone in New York, including independent contractors or agents,
(c) Own or lease any real property within the State,
(d) Own or lease any personal property within the State,
(e) Solicit or sell anything in New York,
(f) Enter into any contracts with any 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.

10. 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."

11. 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.

12. 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.

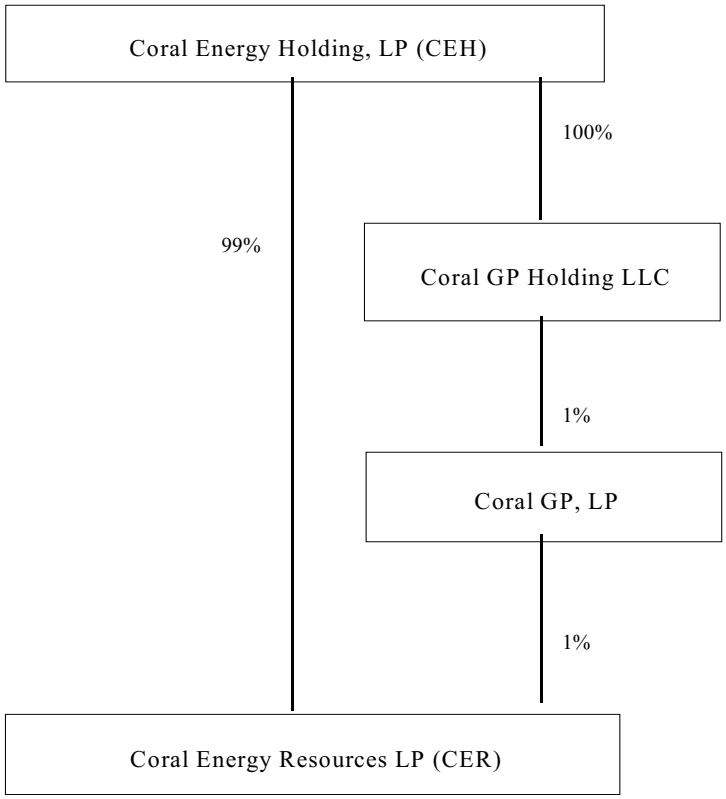
13. SUSGP owned the sole membership interest in Tejas Coral Holding, LLC. That entity held a 58.130539% limited partnership interest in Coral Energy Holding, LP (CEH). Shell Coral Resources Company, LLC, held a 10.1% limited partnership interest in CEH. Shell Coral Resources Holding, Inc., held a .8% 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:



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

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

16. 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 (1percent 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:



17. 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.

18. 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.

19. 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 plus interest 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

20. 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

CONCLUSIONS OF LAW

A. Petitioners maintain that neither SGG nor SGP are subject to tax under Article 9-A of the Tax Law. As this argument is premised upon several theories, an examination of the legal relationship of the entities to each other and to New York State is instructive.

B. 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 5 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 6 which defined a "partnership and partner" as 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 which 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.

The Operating Agreement of SUSGP provided that it was a limited liability company which would be treated as a partnership for both federal and state income tax purposes. In accordance with this agreement, SUSGP filed partnership returns in New York during the years in issue. SGG and SGP were foreign corporations that were members of SUSGP. As corporate members, they are properly regarded as corporate partners (Tax Law § 2[6]).

C. 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 (20 NYCRR 1-3.4[a]; ***see Matter of Hugo Bosca Company***, Tax Appeals Tribunal, October 17, 1991).

D. 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 (20 NYCRR 1-3.2[a][5]). As the Division pointed out in its brief, it is undisputed that CER did business in New York. CEH held a 1% general partnership interest in CER through its indirect ownership of Coral GP, LP. SUSGP held a 1 % general partnership interest in CEH through its 100 % ownership of Tejas Coral Holding, LLC and that firm's indirect 100% ownership of Tejas Coral GP, LLC. During the years in issue, SGG and SGP were members of SUSGP which held a general partnership interest in CER. In accordance with 20 NYCRR 1-3.2(a)(5), as members of the corporate general partner, SGG and SGP were properly found to be liable for franchise tax pursuant to Article 9-A of the Tax Law.

E. Petitioners challenge the constitutionality of imposing tax upon SGG and SGP. As set forth by the Court of Appeals, a substantial burden is placed upon a taxpayer seeking to limit the operation of a statute on the grounds that it is unconstitutional:

> 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 *(see, Container Corp. v Franchise Tax Bd.,* 463 U.S. 159, 164; *Woolworth Co. v Taxation & Revenue Dept., supra,* at 363; *ASARCO Inc. v Idaho State Tax Commn., supra,* at 315; *Mobil Oil Corp. v Commissioner of Taxes,* 445 U.S. 425, 436437). 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., supra,* 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). ***(Allied-Signal Inc. v. Commr. of Finance*** (79 NY2d 73, 79 [1991]).

F. The leading case in New York on the issue of whether New York may tax a portion of the dividend or capital gain income that a foreign corporation receives through its investment in

another corporation doing business in New York without the presence of a unitary business relationship is ***Allied-Signal v. Commissioner of Finance*** (79 NY2d 73, 580 NYS2d 696 [1991]). (***Allied-Signal, NYC***). Since this case is determinative of many of the issues presented, a detailed review is warranted.

In the ***Allied-Signal NYC*** case, The Bendix Corporation (Bendix)[1] acquired approximately 20.6% of the common stock of ASARCO, Inc. (ASARCO). ASARCO was a New Jersey mining firm with its commercial domicile in New York City. Bendix managed this investment from its offices in Michigan. Bendix's only activities in New York City consisted of the development of business abroad. During the period in issue, Bendix received dividends from its ASARCO investment and later a capital gain from the sale of its ASARCO stock. Bendix did not include any of the dividend or capital gain on its New York City corporate tax return. As the result of an audit, the New York City Department of Taxation and Finance restored the excluded income and asserted a deficiency of tax.

Bendix challenged the deficiency on the basis that New York City could not tax any of the income in the absence of a unitary business relationship between the two corporations. In support of its position, Bendix raised two arguments: (1) New York City may not tax the income that a nondomiciliary corporation derives from its investment in another corporation in the absence of a unitary relationship and, (2) the tax imposed in this instance is unconstitutional because it does not reflect the taxpayer's own presence and activities within the taxing jurisdiction.

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[1] Allied-Signal, Inc., was Bendix's successor-in-interest.

The Court began its analysis by noting that the Due Process and Commerce Clauses prevent a State from taxing the income that a nondomiciliary corporation earns unless there is a "minimal connection" or "nexus" between the income and the taxing jurisdiction (***Allied-Signal NYC, citing Container Corp. v. Franchise Tax Bd.,*** 463 US 159 and ***Exxon Corp. v. Wisconsin Dept. of Revenue,*** 447 US 207). The Court concluded that a sufficient nexus existed for the imposition of tax for the following reason:

> In determining whether a sufficient nexus exists between a taxing jurisdiction and the income it seeks to tax, the Supreme Court has emphasized that the inquiry should focus upon whether "the taxing power exerted . . . bears fiscal relation to protection, opportunities and benefits given by the state. The simple but controlling question is whether the state has given anything for which it can ask return" ***(Wisconsin v Penney Co.,*** 311 U.S. 435, 444; ***see, Norfolk & W. Ry. Co. v Tax Commn.,*** 390 U.S. 317, 325, n 5). Here, it is undisputed that New York City has afforded privileges and opportunities to ASARCO. That these privileges and opportunities have contributed to ASARCO's capital appreciation and thus also inured to the benefit of all its shareholders, including Bendix, is also beyond question. Thus, we agree with the City that it has given Bendix something "for which it can ask return," and that consequently a sufficient nexus existed to support the City's tax.(***Allied-Signal NYC***, at 82-83).

The Court then turned its attention to the remaining argument which is that the tax was unconstitutional because it did not reflect Bendix's own activities in the taxing jurisdiction. The Court concluded that this argument also lacked merit with the following language:

> If a tax is properly premised on the presence in the taxing jurisdiction of an entity other than the taxpayer (as we have concluded that the tax at issue here was), common sense would seem to dictate that the tax must be fairly related to that entity's activities within the taxing jurisdiction — not the taxpayer's. Indeed, the Supreme Court has indicated that such a focus is constitutionally required ***(Trinova Corp. v Michigan Dept. of Treasury,*** 498 US ___, ___, 111 S Ct 818, 832 [the tax imposed "`must actually reflect a reasonable sense of how [the] income is generated'"], quoting ***Container Corp. v Franchise Tax Bd.,*** 463 US, at 169, ***supra; see also, Goldberg v Page*** **85** ***Sweet,*** 488 US 252, 262 [the tax imposed must "reasonably reflect the in-state component of the activity being taxed"]; ***Woolworth Co. v Taxation & Revenue*** *Dept.,* 458 US, at 363, *supra* ["`the income attributed to [a] State for tax purposes must be rationally related to

"values connected with the taxing State""]). (***Matter of Allied-Signal NYC,*** at 84-85.)

G. Initially, petitioners maintain that neither SGG nor SGP possessed the requisite minimum contacts with the State of New York in order to impose tax on the income in issue. Petitioners posit that their only connection to New York is their passive ownership interest in SUSGP. It is submitted that the lack of activities by SGG and SGP in New York does not satisfy the four-part test set forth in ***Complete Auto Transit, Inc. v. Brady*** (430 US 274 [1977]) in determining 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 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 capital appreciation 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 for something in return. The same consideration permits the imposition of tax here.

H. Petitioners have cited to a series of cases involving personal jurisdiction for the proposition that the ownership of a membership interest in a limited liability company does not provide a sound basis to assert personal jurisdiction over a nonresident member. This argument is unpersuasive because the Court of Appeals in ***Varrington v. New York City Dept. of Finance***

(85 NY2d 28, 34, 623 NYS2d 534 [1995]) clearly stated that cases involving personal jurisdiction were not precedent in tax matters.

I. Petitioners maintain that the assertion of tax upon SGG and SGP violates the Commerce Clause of the United States Constitution. Again, under the principle of stare decisis, it is concluded that the ***Allied-Signal*** decision is determinative of the outcome. Following facts and a statutory scheme which are clearly analogous to those presented here, the Court expressly stated that it was addressing both Due Process and Commerce Clause issues when it found that the New York City method of taxing the income of foreign corporations that had interests in New York businesses did not violate the constitution. It is noteworthy that in reaching this conclusion, the ***Allied-Signal*** Court did not find it necessary to refer to the four-prong analysis in ***Complete Auto Transit, Inc. v. Brady***. Similarly, petitioners' attempt to address these points is rejected.[2]

J. Relying upon ***Moran Towing Corp. v. Urbach*** (99 NY2d 443 [2003]) and ***Orvis v. Tax Appeals Tribunal*** (86 NY2d 165 [1995]), petitioner argues that physical presence is required to satisfy the substantial nexus criterion of the ***Complete Auto Transit, Inc.*** test. According to petitioners, since neither SGG nor SGP has a physical presence in New York, neither SGG nor SGP has a substantial nexus with the state.

Neither of the cases cited by petitioner is apposite. ***Moran*** involved a facial challenge to certain provisions of the Petroleum Business Tax (Article 13-A). In ***Moran***, New York sought to impose tax on vessels engaged in interstate commerce while operating in New York waters. The Court found that the nexus test in ***Complete Auto*** was satisfied because there was a physical

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[2] The decision not to refer to the ***Complete Auto*** analysis follows from the rationale that it is not the taxpayer's relationship to the taxing jurisdiction which provides the necessary nexus. Rather, the critical relationship is between the source of the income being taxed and the taxing jurisdiction.

presence of the business in the state. In reaching its conclusion, the Court noted that those cases involving a tax on that type of interstate travel were inapposite because it was the privilege of doing business, measured by the consumption of fuel, that was being taxed. Thus, the Court found it unnecessary "to address whether the tax would be constitutional as applied to a foreign business whose only connection with the State is its consumption of fuel as its ships pass through New York in the course of interstate commerce." (***Moran*** at 451). Thus, as pointed out by the Division, the Court of Appeals did not concern itself with an issue which was similar or related to the issue presented here - whether New York may tax the income earned in New York which is passed through to foreign corporations that are not directly conducting business in New York.

Petitioners also rely upon ***Orvis Co. v. Tax Appeals Tribunal*** (86 NY2d 176, ***cert denied*** 516 US 989 [1995]) to support the argument that physical presence is required to satisfy the substantial nexus requirement of the Complete Auto Transit, Inc. test. In ***Orvis***, the Court reviewed the evolution of Supreme Court doctrine limiting the authority of a state to collect or impose taxes on the business activity of a foreign firm involved in interstate commerce. Upon completing the historical survey, the Court of Appeals concluded that the substantial nexus prong of the ***Complete Auto*** test required the physical presence of the interstate vendor in the taxing state. It defined the degree of physical presence required as follows:

> While a physical presence of the vendor is required, it need not be substantial. Rather, it must be demonstrably more than a 'slightest presence' (***see***, ***National Geographic v. California Equalization Bd.***, 430 US 551, 556 97 S Ct 1386, 1390, ***supra***). And it may be manifested by the presence in the taxing State of the vendor's property or the conduct of economic activities in the taxing State performed by the vendor's personnel or on its behalf. (***Matter of Orvis Co. v. Tax Appeals Tribunal*** 630 NYS2d at 687; emphasis added).

Petitioners' argument confuses the issues presented. Unlike the situation in ***Orvis***, the tax at issue herein was imposed on the income generated by the activities of a firm doing business in New York. Thus, the ***Orvis*** case has no bearing on the issues in this matter.

K. Petitioners assert that the tax is not fairly apportioned and discriminates against interstate commerce. This argument is unpersuasive because the methodology that New York State employs to impose tax on corporations is very similar to the New York City plan, which was reviewed and sustained in ***Allied-Signal NYC***. Furthermore, the same New York State methodology as was reviewed and sustained in the ***Matter of Alliedsignal, Inc. as Successor-in-Interest to the Bendix Corporation,*** (Tax Appeals Tribunal, August 31, 1995, ***confirmed*** 229 AD2d 759***, appeal dismissed*** 89 NY2d 859 [1996]) (***Allied-Signal NYS***).

L. Petitioners maintain that all of their business activities are conducted outside of New York. In response, the Division has correctly noted that petitioners are holding companies whose *only* business activity consists of holding interests in SUSGP. Furthermore, petitioners' assertion that the tax is not fairly related to the services provided by the state fails to recognize that it is *not* the services provided to SGG and SGP which are determinative of the legality of the tax. In accordance with the analysis utilized in ***Allied-Signal NYC***, the determinative consideration is that New York provided services to CER. The services allowed CER to derive substantial income from New York which inured to the benefit of SGG and SGP. It follows that the tax was fairly related to services provided by New York and does not violate the Commerce Clause.

M. Petitioners argue that their rights under the Equal Protection clause were violated because a taxpayer with a 1% interest is treated differently than a taxpayer with a 2% interest. The Division has correctly noted that the true standard is not whether all taxpayers are treated the same but whether those taxpayers who are similarly situated are treated uniformly (***Matter of***

Brockman, Tax Appeals Tribunal, April 4, 1996, ***confirmed*** 238 AD2d 693 [1997]). Petitioners have not shown that the correct standard was violated. Furthermore, petitioners' assertion that 20 NYCRR 1-3.2(a)(6)(i)(a) is arbitrary is rejected. As the Division has correctly pointed out, this provision "was necessary to prevent avoidance of taxation through the splitting of interests in a limited partnership" and "intended to insure that foreign corporations do not escape taxation merely because such corporations are limited partners in New York partnerships." (New York Register, July 11, 1990, at 36.) Consequently, this section balances the need to prevent a tax avoidance scheme with administrative concerns.

N. In their reply brief, petitioners continue to offer many of the same arguments that were presented in their opening brief. However, there are some additional points which require attention. Petitioners contend that the Division's position must be rejected because their subsidiaries are not petitioners' agents. According to petitioners, the Division has expended much of its energy attempting to infer an agency relationship between petitioners and SUSGP. Petitioners' also posit that the Division's reliance upon the outmoded agency relationship is exemplified in the opinion of the Attorney General at 1954 Opns Atty Gen 221. Petitioners further submit that the Division erred by only considering the Tax Law and not the substantive law regarding limited liability companies to determine what is taxable. In this regard, petitioners posit that the type of tax returns they filed does not change the classification of the business relationship and that the Division's argument that petitioners chose to organize their affairs in a manner that would subject them to tax is without merit. Petitioners further posit that under current law a member of a limited liability company is separate and distinct from the limited liability company.

O. Petitioners' argument regarding an agency relationship misstates the Division's position regarding the source of petitioners' liability. 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 (20 NYCRR 1-3.2[a][5]). As previously stated, the imposition of the tax is justified by the fact that New York provided services to CER thereby allowing CER to generate income, from which SGG and SGP benefitted. Further, it is clear from the opinion in ***Varrington*** that the cited opinion of the Attorney General does not require consideration as it was considered an aberration because of its failure to follow the tenets of established New York precedents. Therefore, an agency theory is not required to support the Division position. Contrary to petitioners' argument, the Division has not claimed that petitioners hold a general partnership interest in SUSGP. Rather, SUSGP was a limited liability company which was treated as a partnership under the Internal Revenue Code and the New York State tax law.

P. Relying upon ***International Shoe v. Washington*** (326 US 310 [1945]), petitioners submit that the Court of Appeals erred when it dismissed Varrington Corporation's reliance upon ***Lynn*** which is a case involving in personam jurisdiction. This position is rejected because under the principle of stare decisis it is incumbent upon the Division of Tax Appeals to follow the most direct precedent and leave it to the Court of Appeals to determine if it wishes to reconsider its own decision (***see generally Matter of Alliedsignal NYC***). Petitioners' remaining objection to ***Varrington Corp.,*** regarding the decision of the New York City Department of Finance to reverse a policy regarding the taxation of out-of-state firms, should also be left to the Court of Appeals to address.

Q. Petitioners submit that their own apportionment factors were not used with respect to the Article 9-A tax imposed on capital because it is based on the location of the issuer of the securities. This argument is also rejected. The tax on capital reflects "the presence of the issuers of the securities *in which the taxpayer has invested*." (***Allied-Signal NYS***, 229 AD2d 759, 761 - 762; emphasis added). Having chosen to indirectly invest in a company which conducted business in New York, the imposition of the tax on capital is properly imposed (***Allied-Signal NYS***).

R. Petitioners cited a series of cases, including ***International Harvester***, which were relied upon by the Division, and presented an argument for why these cases should be distinguished from the matter at hand. Notwithstanding petitioners' arguments to the contrary ***International Harvester***, as applied by the Court of Appeals in ***Allied-Signal NYC*** is the controlling precedent on the taxation of a foreign firm because it discusses the power of the state to tax income where the state has provided benefits and privileges to the corporation that generated the income (***Matter of Alliedsignal NYC***). Petitioners' repeated claim that they did not have a nexus with New York must fail because of the holding in ***Allied-Signal, NYC***.

S. Petitioners contend that the Division's reliance upon both the Tax Law's definition of a partnership to include limited liability companies and the Commissioner's regulations is inconsistent with Article 9-A of the Tax Law. Clearly Article 1 of the Tax Law defines a "partnership" to include a limited liability company and the members thereof. Petitioners assert that this definition is inconsistent with Tax Law § 208(1) which defines a corporation to include limited liability companies. According to petitioners, Tax Law § 208(1) must control because it is the language of a specific statutory section.

Petitioners' analysis fails to recognize that the provisions cited are in pari materia. As such, they should be construed as forming part of the same statute (McKinney's Cons Laws of NY, Book 1, Statutes § 252[b]). A limited liability company is a hybrid entity with characteristics of both a partnership and a corporation, and it is this composite form which is reflected in the provisions of the Tax Law. In sum, it is concluded that the conflict suggested by petitioners is illusory and the Division's interpretation of the Tax Law is reasonable and consistent with the law as a whole.

T. Petitioners contend that a ruling in the Division's favor would conflict with the decisions of other states. It is acknowledged that petitioners have raised a serious concern. The difference in the analysis of the constitutional issues was recently mentioned by the Supreme Court in ***Meadwestvaco Corp. v. Il. Dept. of Revenue*** (128 S Ct 1498, 170 L Ed 2d 404 [2008]). However, the Court declined to rule on the issue because the issue of the constitutionality of the New York approach was not presented in a manner permitting a proper judicial resolution. The principle of stare decisis precludes consideration of the issue here.

U. The petitions of Shell Gas Gathering Corp. #2 and Shell Gas Pipeline Corp. #2 are denied and the notices of deficiency dated, November 17, 2004, are sustained together with such penalty and interest as are lawfully due.

DATED: Troy, New York
June 11, 2009

/s/ Arthur S. Bray
ADMINISTRATIVE LAW JUDGE