

New York State Department of Taxation and Finance
Office of Tax Policy Analysis
Technical Services Division

TSB-A-00(9)C
Corporation Tax
April 19, 2000

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. C000317A

On March 17, 2000, a Petition for Advisory Opinion was received from New York State Department of Economic Development, 30 South Pearl Street, Albany, New York 12245.

The issue raised by Petitioner, New York State Department of Economic Development, is whether the payment of an annual dividend out of current year and /or accumulated earnings to an investor in a For-Profit Zone Capital Corporation, within 36 months from the close of the taxable year with respect to which a zone capital tax credit was allowed for investment in the Zone Capital Corporation, constitutes a recovery of a portion of the qualified investment under sections 210.20 of Article 9-A, 1456(d) of Article 32 or 1511(h) of Article 33 of the Tax Law which would trigger a recapture of all or a portion of the credit allowed.

Petitioner submits the following facts as the basis for this Advisory Opinion.

The New York State Economic Development Zones Act, codified in Article 18-B of the New York General Municipal Law and selected provisions of the Tax Law (“EDZ Program”), was enacted in 1986 and modified in 1993, to promote new jobs and investment in the State’s most economically distressed communities. The EDZ Program targets small businesses located within designated economic development zones who are certified under the EDZ Program (“Zone Certified Business”). To encourage private investment in and /or contributions to or for the benefit of Zone Certified Businesses, the EDZ Program authorizes the issuance of an economic development zone capital tax credit (“Zone Capital Credit”). The EDZ Program authorizes Zone Capital Credit for business corporations under section 210.20 of the Tax Law, for banking corporations under section 1456(d) of the Tax Law, and for insurance corporations under section 1511(h) of the Tax Law.

There are three categories of activities identified under the EDZ Program for which Zone Capital Credit is available: (i) direct equity investments in Zone Certified Businesses; (ii) contributions to community development projects sponsored by a not-for-profit corporation which promote the goals of a Zone’s economic development plan; and (iii) investment in a “zone capital corporation” a separate entity which pools funds and serves as a source of community based financial assistance to Zone Certified Businesses in the form of loans and/or equity. In each instance, the availability of the Zone Capital Credit is the primary inducement to attract private capital which ultimately will fulfill the purposes of the EDZ Program.

To ensure that investor or contributor dollars remain with Zone Certified Businesses for at least three years, the EDZ Program imposes gradational recapture provisions if the investor or contributor who claims Zone Capital Credit recovers all or a portion of its contribution or

investment, or sells, transfers or otherwise disposes of the interest that was the basis for claiming the credit during the taxable year or within 36 months from the close of the taxable year with respect to which the credit is allowed.

Discussion

In this case, the provisions of sections 210.20, 1456(d) and 1511(h) of the Tax Law, respectively, are substantially identical and will be treated similarly.

Sections 210.20(d), 1456(d)(4) and 1511(h)(4) of the Tax Law, respectively, provide that where a taxpayer sells, transfers or otherwise disposes of corporate stock, a partnership interest or other ownership interest arising from the making of a qualified investment which was the basis, in whole or in part, for the allowance of the Zone Capital Credit provided for under sections 210.20, 1456(d) and 1511(h) of the Tax Law, respectively, or where a contribution or investment which was the basis for such allowance is in any manner, in whole or in part, recovered by such taxpayer, and such disposition or recovery occurs during the taxable year or within 36 months from the close of the taxable year with respect to which such Zone Capital Credit is allowed, the taxpayer shall add back, with respect to the taxable year in which the disposition or recovery occurred, a portion of the credit originally allowed. The portion that is to be added back, is computed pursuant to sections 210.20(d)(3) and (4), 1456(d)(4)(C) and (D), and 1511(h)(4)(C) and (D) of the Tax Law, respectively.

The Zone Capital Credit provisions do not discuss what constitutes a disposition of an investor's interest or a recovery of an investor's contribution or investment, that would trigger a recapture of a portion of the credit allowed. However, pursuant to section 1-2.1 of the Business Corporation Franchise Tax Regulations and section 16-2.1 of the Franchise Tax on Banking Corporations Regulations, terms presumably have the same meaning as when used in a comparable context for federal income tax purposes under the Internal Revenue Code ("IRC"). Since the provisions of Article 33 that are the same as or are substantially identical with those in Article 9-A of the Tax Law are regarded as being in *pari materia* (§ 12 Chapter 649 of the Laws of 1974), they are construed in a like manner. Accordingly, it is proper to look to the IRC for guidance in determining whether a dividend received by an investor, within 36 months from the taxable year in which Zone Capital Credit is allowed, will trigger a recapture of part of such credit under sections 210.20(d), 1456(d)(4) and 1511(h)(4) of the Tax Law, respectively.

The term "dividend" in the sense in which it is "generally understood and used, refers to the recurrent return upon stock paid to stockholders by a going corporation in the ordinary course of business which does not reduce their stock holdings and leaves them in a position to enjoy future returns upon the same stock. See Lynch v. Hornby, 247 U.S. 339, 344-346; and Langstaff v. Lucas (D.C.) 9F. (2d) 691, 694." (Hellnich v. Hellman, 276 U.S. 233). Distributions in complete or partial liquidation of corporations have not been construed to constitute the payment of dividends where they are in redemption for stock interests.

TSB-A-00(9)C
Corporation Tax
April 19, 2000

For federal income tax purposes, section 316(a) of the IRC defines the term “dividend” as any distribution of property made by a corporation to its shareholders out of its earnings and profits of the taxable year or out of its accumulated earnings and profits that were accumulated after February 28, 1913.

Section 301 of the IRC distinguishes a dividend from other distributions of property from a corporation to a shareholder. Section 301(a) and (c) of the IRC provide that a distribution of property made by a corporation to a shareholder with respect to its stock shall be treated as follows:

- (1) Amount constituting dividend – That portion of the distribution which is a dividend shall be included in gross income.
- (2) Amount applied against basis – That portion of the distribution which is not a dividend shall be applied against and reduce the adjusted basis of the stock.
- (3) Amount in excess of basis – Generally, that portion of the distribution which is not a dividend, to the extent that it exceeds the adjusted basis of the stock, shall be treated as gain from the sale or exchange of property.

Following Hellnich, supra, and sections 301 and 316 of the IRC, a dividend paid by a corporation out of current or accumulated earnings to a shareholder is a return on the shareholder’s investment in the corporation, and is not a distribution made to a shareholder that would reduce a shareholder’s interest in the corporation.

Accordingly, for purposes of the recapture provisions of the Zone Capital Credit described in sections 210.20(d), 1456(d)(4), and 1511(h)(4) of the Tax Law, respectively, an annual dividend paid out of current year and/or accumulated earnings of a For-Profit Zone Capital Corporation to an investor that was allowed a Zone Capital Credit under sections 210.20, 1456(d) and 1511(h) of the Tax Law, respectively, will not constitute the disposition of the corporate stock, a partnership interest or other ownership interest arising from the making of a qualified investment which was the basis for the allowance of the Zone Capital Credit, and will not constitute the recovery of a contribution or investment which was the basis for the allowance of the Zone Capital Credit.

DATED: April 19, 2000

/s/
John W. Bartlett
Deputy Director
Technical Services Division

NOTE: The opinions expressed in Advisory Opinions are limited to the facts set forth therein.