New York State Department of Taxation and Finance

Office of Counsel
Advisory Opinion Unit

TSB-A-11(3)C
Corporation Tax
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STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. C091113A

On November 13, 2009, the Department of Taxation and Finance received a Petition for Advisory Opinion from [redacted]. Petitioner asks whether a parent corporation (Parent) succeeds to an investment tax credit (ITC) carryover of its wholly owned subsidiary (Target), when Parent sells Target's stock to a third party purchaser (Purchaser) and makes a joint election with Purchaser under IRC § 338(h)(10) to treat the stock sale as a deemed asset sale.

We conclude that Parent may succeed to the ITC carryover of Target where Parent meets its burden of proof to substantiate the amount of the credit.

Facts

Parent files its federal income tax return on a consolidated basis with an affiliated group of corporations. Target is a wholly owned subsidiary of Parent and files its federal income tax return with Parent as a member of the consolidated group. Parent and Target also filed New York State general business corporation combined franchise tax returns with the members of the consolidated group.

Target, a manufacturing company with operations located in New York, became eligible to claim a New York ITC (Tax Law § 210.12) for equipment and other property used in its manufacturing business. Due to limitations that prevent a taxpayer from using an ITC to reduce its tax liability below certain minimum taxable amounts, Target was not able to use the credit against its tax liability in the year the credit was claimed but was allowed to carry forward its unused ITC to its succeeding fifteen taxable years. [Tax Law §§ 210.12(a) & (e)]. Prior to the expiration of Target's ITC carry forward period, but after the date of the ITC property's useful life, Parent sold all of its stock in Target to an unrelated corporation (Purchaser). Parent and Purchaser made a joint IRC § 338(h)(10) election to treat the stock sale as a deemed asset sale.

Analysis

Under IRC § 338, an election may be made by the purchaser in a qualified stock purchase, which generally is one involving the purchase of 80 percent or more of the stock of a corporation within a 12 month period. Pursuant to this election, the target corporation (old target) is treated as having sold all of its assets at the close of the acquisition date (the date of the qualified stock purchase) at fair market value in a single transaction and is then treated as a new corporation (new target) which purchased all of the assets as of the beginning of the day after the acquisition date. The result of the election is that the difference between the fair market value of the assets and the adjusted basis of the assets is recognized as gain or loss of old target, and the basis of the assets in the hands of new target is increased or decreased to recognize the gain or loss (stepped up or down), as the case may be.

Under IRC § 338(h)(10), the seller and purchaser of target stock may make a joint election under IRC § 338(h)(10) to treat the purchase and sale of stock of a target corporation as the purchase and sale of the assets of the target corporation, followed by a distribution of the proceeds of the deemed asset sale to the selling shareholder, after which the target corporation ceases to exist. This election may be made for the target corporation only under certain circumstances, one of which is that the target is a member of a selling consolidated group. The effect is that there will be only one level of federal income tax on the transaction, which will be imposed on the target corporation on the deemed sale of its assets while a member of the selling consolidated group. No gain or loss is recognized on the sale of target stock by members of the consolidated group. (See Treasury Regulation § 1.338(h)(10)-1). Where an election under IRC § 338(h)(10) is made for target, a section 338 election is deemed made for the target.

Treasury Regulation § 1.338(h)(10)-1(d)(3) provides the tax characterizations of the deemed sale of target's assets, stating that old target ("old T") is treated as transferring all of its assets to an unrelated person in exchange for consideration that includes the discharge of its liabilities, and realizes the tax consequences from the deemed asset sale before the close of the acquisition date (the date of the qualified stock purchase) while old T is a member of the selling consolidated group.

Section 1.338(h)(10)-1(d)(4) of the Treasury Regulations provides the tax characterization of the deemed liquidation of the old target and the selling consolidated group as follows:

> "(i) In general. Old T is treated as if, before the close of the acquisition date, after the deemed asset sale in paragraph (d)(3) of this section, and while old T is a member of the selling consolidated group…, it transferred all of its assets to members of the selling consolidated group,…and ceased to exist. The transfer from old T is characterized for Federal Income tax purposes in the same manner as if the parties had actually engaged in the transactions deemed to occur because of this section and taking into account other transactions that actually occurred or are deemed to occur. For example, the transfer may be treated as a distribution in pursuance of a plan of reorganization, a distribution in complete cancellation or redemption of all its stock, one of a series of distributions in complete cancellation or redemption of all its stock in accordance with a plan of liquidation, or part of a circular flow of cash. In most cases, the transfer will be treated as a distribution in complete liquidation to which section 336 or 337 applies."

Petitioner states that the transaction will satisfy all of the requirements of an IRC § 338(h)(10) election, and for federal tax purposes, the purchase of Target's stock will be treated as if it transferred its assets to an unrelated third party while it was a member of the selling consolidated group. After the asset sale, but before the close of the acquisition date, Target will be treated as if it had distributed the proceeds to Parent in a complete liquidation pursuant to IRC §§ 332 and 337.

IRC § 381(a)(1) provides that, in the case of a liquidation of a subsidiary corporation in accordance with IRC § 332, the acquiring corporation shall succeed to and take into account, as of the close of the day of distribution, the items of the distributor corporation described in IRC § 381(c), subject to certain limitations. Section 381(c)(24) provides that those items include the general business credit under IRC § 38. The general business credit includes many credits, including the former federal investment tax credit which has since been repealed. Therefore, for federal income tax purposes, as the result of Parent's joint election under IRC § 338(h)(10), Parent's sale of Target's stock will be treated as a deemed asset sale, and before the close of the acquisition date, Target will be

treated as if it distributed its proceeds to Parent in a complete liquidation pursuant to IRC § 332. Also, under IRC § 381(a)(1) Parent would have been able to succeed to any ITC carryover of Target on the day of distribution assuming the federal ITC was still allowed to be claimed for federal tax purposes. This Opinion reaches no conclusion with regard to the way Parent and Target will be treated for federal income tax purposes under IRC §§ 338 and 381. Assuming these transactions qualify under IRC § 338(h)(10) and that Parent would succeed to the carry over credit, if any, of Target pursuant to IRC § 381(a)(1), it must be decided whether any Parent will succeed to New York ITC carryover of Target under such circumstances.

For purposes of computing the entire net income base under Tax Law Article 9-A, where a parent corporation and a target file a consolidated return, the starting point for each corporation is its federal taxable income computed as if it had filed separately for federal income tax purposes. Section 208.9 of the Tax Law defines entire net income as "total net income from all sources, which shall be presumably the same as the entire taxable income…which the taxpayer is required to report to the United States treasury department…except as hereinafter provided…" After determining federal taxable income, it must be adjusted as required by section 208.9 and section 210.3(d) and (e) of the Tax Law to arrive at entire net income.

Therefore, when a parent corporation and a target corporation file a federal consolidated return, the starting point for each corporation to compute its entire net income is its federal taxable income computed as if it had filed separately for federal income tax purposes (pro forma federal return). For purposes of determining entire net income, the Federal taxable income of Target will reflect the IRC § 338(h)(10) election and any gain or loss on the deemed sale of its assets described in section 1-338(h)(10)-1 of the Treasury Regulations. Also, the federal taxable income of a member of the selling consolidated group that sold the stock of target corporation will not include any gain or loss on the sale or exchange of stock of the target corporation. The entire net income of the selling corporation will also not reflect any such gain or loss since there is no modification under sections 208.9 or section 210.3(d) and (e) of the Tax Law that would require the selling corporation to include the gain or loss in entire net income.

Tax Law section 210.12(a) provides that a taxpayer is allowed an ITC against its corporate franchise tax liability for investments in qualified tangible personal property and real property. The ITC cannot reduce the tax liability to less than the higher of the minimum tax on the minimum taxable income base or the fixed dollar minimum tax. Any ITC that cannot be used in the taxable year in which property is placed in service may be carried forward to the taxpayer's succeeding fifteen taxable years. Tax Law § 210.12(e). If property for which an ITC has been taken is disposed of or is not in qualified use before the end of its useful life, then the difference between the ITC taken and the ITC allowed, based on actual use of the property, must be recaptured in the year of disposition or where the property otherwise ceases to be in qualified use. Tax Law § 210.12(g).

In *Matter of the Petition of AIL Systems, Inc.*, (Tax Appeals Tribunal, October 21, 2002), the Tax Appeals Tribunal, relying on TSB-M-86(3)C, held that the sale of a corporation to a purchaser that elects to treat the transaction as a sale of assets under IRC § 338(h)(10) requires the target corporation to add back any New York ITC's claimed in prior years when it files its final return. The Tribunal noted that New York will follow the federal treatment under IRC § 338, and, accordingly, New York will require old target to recapture any unearned investment tax credit in such situations. Also, when the new target files reports as a new corporation, it would have a stepped up basis for the property and may claim a new ITC on such property if the property otherwise qualifies.

It is concluded that Parent will succeed to Target's ITC carryover when Parent can adequately produce the information substantiating the amount of that carryover. Parent will succeed only to Target's remaining years of the carry forward period relating to that carried forward amount.

DATED: February 18, 2011

/S/
DANIEL SMIRLOCK
Deputy Commissioner and Counsel

NOTE: An Advisory Opinion is issued at the request of a person or entity. It is limited to the facts set forth therein and is binding on the Department only with respect to the person or entity to whom it is issued and only if the person or entity fully and accurately describes all relevant facts. An Advisory Opinion is based on the law, regulations, and Department policies in effect as of the date the Opinion is issued or for the specific time period at issue in the Opinion.