STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. C960718C

On July 18, 1996, a Petition for Advisory Opinion was received from Morrison & Foerster LLP, 1290 Avenue of the Americas, New York, New York 10104.

The issue raised by Petitioner, Morrison & Foerster LLP, is whether recapture of investment tax credit claimed under section 210.12 of the Tax Law is required by reason of a proposed restructuring brought about by the tax-free mergers of the corporate partners of a partnership owning qualified property.

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

Partnership

Partner I, owns a 51 percent general partnership interest in Partnership, a limited partnership. The other 49 percent interest in Partnership is owned by Partner II, a limited partner. Partner I and Partner II are wholly-owned subsidiaries of Corporation I, a corporation subject to taxation under Article 9-A of the Tax Law.

In 1993, Partnership purchased and placed in service certain property that was eligible for investment tax credit under section 210.12 of the Tax Law. Partner I and Partner II claimed 51 percent and 49 percent of the credit, respectively, based on their proportionate interests in Partnership. Most of the property for which the investment tax credit was claimed is seven-year property being depreciated pursuant to section 168 of the Internal Revenue Code ("IRC") over a seven-year period.

Proposed Restructuring

Partner I and Partner II are contemplating a restructuring which will consist of the following steps:

1. Partner I will form a new wholly-owned subsidiary ("Newco").

2. Partner I will transfer a one percent interest in Partnership to Newco.

3. Partner I and Partner II will merge into their parent, Corporation I. Pursuant to this merger, all assets owned by Partner I and Partner II (the Partnership interests and Newco stock) will be transferred to Corporation I.

At the conclusion of the restructuring, Corporation I will own 99 percent of Partnership, and it will own 100 percent of the stock of Newco which will own the remaining one percent of Partnership.

At all times, Partnership will have at least two partners, and for purposes of the New York State Partnership Law it will continue as a partnership. The property for which the investment tax credit was claimed will not be transferred. The property will continue in qualified use and will remain in Partnership's hands both before and after the contemplated restructuring. Partnership interests in Partnership will be transferred when Newco is formed and when Partner I and Partner II merge into Corporation I.

Petitioner states that this restructuring will be tax-free for federal income tax and New York State franchise tax purposes. The formation of Newco and transfer to it of the one percent Partnership interest will be tax-free under section 351 of the IRC, and the mergers of Partner I and Partner II into Corporation I will be tax-free reorganizations described in section 368(a)(1)(A) of the IRC.

Section 210.12 of the Tax Law allows an investment tax credit against the tax imposed under Article 9-A of the Tax Law. For taxable years beginning after 1990, section 210.12 allows an investment tax credit equal to five percent with respect to the first $350 million of the investment credit base and four percent with respect to the investment credit base in excess of $350 million. The investment credit base is the cost or other basis for federal income tax purposes of qualified tangible personal property and other tangible property, including buildings and structural components of buildings.

Under section 210.12(b) of the Tax Law and section 5-2.2 of the Business Corporation Franchise Tax Regulations ("Article 9-A Regulations"), the term "qualified property" means tangible personal property and other tangible property, including buildings and structural components of buildings, which:

(1) is acquired, constructed, reconstructed or erected by the taxpayer after December 31, 1968;

(2) is depreciable pursuant to section 167 of the Internal Revenue Code;

(3) has a useful life of four years or more;

(4) is acquired by the taxpayer by purchase as defined in section 179(d) of the Internal Revenue Code;

(5) has a situs in New York State; and

(6) is principally used by the taxpayer in the production of goods by manufacturing, processing, assembling, refining, mining, extracting, farming, agriculture, horticulture, floriculture, viticulture or commercial fishing.

Section 210.12(g) of the Tax Law and section 5-2.8(a) of the Article 9-A Regulations provide that if property on which investment tax credit has been claimed is disposed of or ceases to be in qualified use prior to the end of its useful life, the difference between the credit taken and the credit allowed for actual use must be added back to the tax otherwise due in the year of disposition or disqualification.

Section 5-2.8(c) of the Article 9-A Regulations provides that a disposition of qualified property includes:

(1) a sale of the property;

(2) a liquidation other than as part of a statutory merger or consolidation;

(3) a legal dissolution of the taxpayer;

(4) a trade-in of the property;

(5) a gift of the property;

(6) transfer upon foreclosure of a security interest in the property;

(7) retirement of the property before expiration of its useful life;

(8) condemnation of the property;

(9) loss of the property due to fire, theft, storm or other casualty; and

(10) transfer of the property to a corporation not taxable under article 9-A.

Section 5-2.8(e) of the Article 9-A Regulations provides that

> [f]or purposes of this section, a disposition does not occur where property is transferred from a corporation as part of a transaction to which section 381(a) of the Internal Revenue Code applies; *e.g.,* ... a reorganization under ... section 368(a)(1)(A) (statutory merger or consolidation) ... As there is no disposition in these cases, an add back is not required provided that the property continues in qualified use and is acquired by a corporation subject to tax under article 9-A. Generally, in these cases, the acquiring or surviving corporation cannot claim an investment tax credit because it takes over such property at the adjusted basis of the transferor and the transfer therefore does not qualify as a purchase pursuant to Internal Revenue Code, section 179(d)(2). If the property in the hands of the acquiring corporation is not in qualified use for its entire life or for more than 12 consecutive years, a recovery from the acquiring corporation is required. In measuring the period of qualified use, the period during which the property was held by the transferor corporation and the acquiring corporation are to be taken into account.

However, the term "disposition" is not defined for purposes of section 210.12(g) of the Tax Law or section 5-2.8 of the Article 9-A Regulations.

Section 1-2.1 of the Article 9-A Regulations provides that, unless a different meaning is clearly required, any term used in the Article 9-A Regulations shall presumably have the same meaning as when used in a comparable context in the IRC and the corresponding regulations. The language of section 210.12(g) of the Tax Law is parallel to that contained in section 47 of the IRC prior to the enactment of the Revenue Reconciliation Act of 1990. Therefore, when determining whether a transaction is a disposition requiring recapture of investment tax credit for purposes of section 212.12(g) of the Tax Law and section 5-2.8 of the Article 9-A Regulations, it is appropriate to apply precedent set under the IRC for federal income tax purposes.

Section 47 of the IRC, (prior to the enactment of the Revenue Reconciliation Act of 1990 applicable to property placed in service after December 31, 1990), provides for a recomputation of the investment credit allowed by section 38 of the IRC when qualified property is disposed of or ceases to be section 38 property. In general, property will be considered disposed of whenever it is sold, exchanged, transferred, distributed, involuntarily converted, or disposed of by gift. (See, S Rep No 1881, 87th Cong, 2nd Sess 149 (1962), 1962-3 CB 707, 852-853.) However, not all dispositions result in recapture for federal income tax purposes.

Section 1.47-3(f)(1) of the federal Income Tax Regulations provides that the provisions of section 47 of the IRC relating to disposition do not apply to "section 38 property which is disposed of, or otherwise ceases to be section 38 property with respect to the taxpayer, before the close of the estimated useful life which was taken into account in computing the taxpayer's qualified investment by reason of a mere change in the form of conducting the trade or business in which such section 38 property is used provided that [certain] conditions ... are satisfied." The conditions are as follows:

(1) the section 38 property is retained as section 38 property in the same trade or business;

(2) the transferor of the section 38 property retains a substantial interest in such trade or business;

(3) substantially all the assets (whether or not section 38 property) necessary to operate the trade or business are transferred to the transferee to whom the section 38 property is transferred; and

(4) the basis of the section 38 property in the hands of the transferee is determined in whole or in part by reference to the basis of the section 38 property in the hands of the transferor.

It has been determined that where the conditions set forth in section 1.473(f)(1) of the federal Income Tax Regulations are met, a transaction qualifying for nonrecognition treatment under section

351 of the IRC constitutes a mere change in the form of conducting the trade or business and recapture of investment credit under section 47 of the IRC is not required. (See, Rev Rul 77361, 1977-2 CB 6.)

A tax-free transfer pursuant to section 351 of the IRC, that for federal income tax purposes does not require the recapture of the investment tax credit taken on section 38 of the IRC property, does not constitute a "disposition" as contemplated in section 210.12(g) of the Tax Law. See Coats & Clark Inc., Adv Op Comm T & F, August 11, 1988, TSB-A-88(16)C, and Milton Roy Company, Adv Op Comm T F, February 10, 1993, TSB-A-93(7)C.

In John J. Eagan. Norris. McLaughlin & Marcus, Adv Op St Tax Comm, April 29, 1987, TSB-A-87(9)C, it was held that where a partnership purchases tangible personal property that is principally used by the partnership, the property is deemed to be purchased by each partner to the extent of the partners's allocable or pro rata share of the partnership's property. Therefore, where the property meets all of the requirements for qualifying for the investment tax credit, a corporate partner of the partnership is allowed an investment tax credit, pursuant to section 210.12(a) of the Tax Law, for its allocable share of the cost or other basis of such qualifying tangible personal property.

In this case, Partnership purchased and placed in service property that was eligible for investment tax credit under section 210.12 of the Tax Law. Pursuant to John Eagan, supra, Partner I and Partner II, as corporate partners, were deemed to have purchased the property. The property met all of the requirements for qualifying for the investment tax credit, and Partner I and Partner II were each allowed an investment tax credit, pursuant to section 210.12 of the Tax Law, for their allocable share of the cost or other basis of the qualifying property. Since Partner I and Partner II have claimed the investment tax credit, it must be determined whether a disposition of the qualifying property was made by Partner I and Partner II.

Petitioner states that the formation of Newco by Partner I and the transfer to Newco by Partner I of the one percent Partnership interest will be tax-free under section 351 of the IRC. It appears that all of the conditions set forth in section 1.47-.3(f)(1) of the federal Income Tax Regulations will be met. Accordingly, pursuant to section 5-2.8 of the Article 9-A Regulations and Coats & Clark, supra, and Milton Roy, supra, it appears that this transaction is not considered a "disposition" by Partner I as contemplated in section 210.12(g) of the Tax Law.

Petitioner also states that the mergers of Partner I and Partner II will be tax-free reorganizations described in section 368(a)(1)(A) of the IRC. Pursuant to section 5-2.8(c)(2) and (e) of the Article 9-A of the Regulations, a "disposition", as contemplated in section 210.12(g) of the Tax Law, does not occur as a result of a reorganization that constitutes a statutory merger or consolidation under section 368(a)(1)(A) of the IRC. Accordingly, it appears that Partner I and Partner II will not dispose of the qualifying property when they are merged into their parent, Corporation I under reorganizations that qualify as tax-free reorganizations described in section 368(a)(1)(A) of the IRC.

Where there is no disposition of qualified property, a recapture of investment tax credit is not required provided that the property continues in qualified use for its entire life or for more than 12 consecutive years. Therefore, it appears that the restructuring proposed in the facts of this case will not require the recapture of a portion of the investment tax credit claimed by Partner I and Partner II.

/s/

DATED: December 19, 1996

John W. Bartlett
Deputy Director
Technical Services Bureau

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